AcSB
Accounting Standards Board

COVID-19 Resource

Discount Rates

What you need to know (April 2020)

What is the issue?

1. The risks and uncertainties arising from COVID-19 and the move by central banks to cut their overnight rates may affect discount rates used in asset and liability measurements.
2. This resource focuses on the potential implications that COVID-19 may have on the discount rates companies use in the various valuation techniques under IFRS® Standards.
3. Present value measurement techniques are often used to measure assets or liabilities under IFRS Standards. These techniques require two main sets of input estimates:
    - the amount and timing of future cash flows; and
    - the discount rates to translate those cash flows.
4. Management should ensure that all applicable COVID-19 risks are reflected either as adjustments to the future cash flows or as an adjustment to the discount rate used in the present value calculation. (IAS 36.32, A15, and IAS 37.47)

Do the recent interest rate changes affect my discount rate?

5. It depends. Not all IFRS Standards have the same requirements when determining discount rates, since each may have its own separate measurement technique. These techniques may identify the types of risks to consider or may go as far as indicate the types of rates to be used.

6. A move by central banks to cut their overnight rate may not always result in a decline in a company's discount rate used due to increases in the risks specific to the assets or the liabilities being measured. (IAS 36.A18; IFRS 13.22, and IAS 37.47)

7. As a result of COVID-19, the assessment of the risks specific to the assets and liabilities may require significant assumptions about the future and may be subject to other major sources of estimation uncertainty. The assumptions about the expected duration of the pandemic and other sources of estimation uncertainty may evolve over time and require revisiting in future reporting periods.

8. The discount rate used in measuring an asset's or liability's fair value, or an asset's recoverable amount should be market based and consider risks associated with the asset or liability's estimated cash flows. In addition to company-specific risks (i.e., industry risk, product risk, etc.), market risks, including country risk, currency risk, and price risk, should also be considered. (IAS 36.A18, IFRS 13.22)

9. The same applies to measuring provisions. For example, the discount rate used to measure the present value of an asset retirement obligation may also need to consider the risks specific to the liability, such as the risk of extended service disruptions. (IAS.37.47)

10. A change in the interest rates may also not affect a company's effective interest rate[1] provided there are no changes to the amount or timing of the future cash flows. However, a drop in interest rates may impact a company's incremental borrowing rate (IBR),[2] increasing the amount of a lessee's right of use assets and its lease liabilities. With that said, this will only affect a lessee's new leases or modifications of its existing leases.[3] (IFRS 16.42-43)

11. The rate used to discount post-employment benefit obligations should reflect the market yields at the end of the reporting period on high-quality corporate bonds. This discount rate does not need to reflect the company's credit risk or the risk that future events may differ from actuarial assumptions. (IAS 19.83-84)

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[1] The rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial asset or financial liability to the gross carrying amount of a financial asset or to the amortised cost of a financial liability. (IFRS 9 Appendix A)

[2] The rate of interest that a lessee would have to pay to borrow over a similar term, and with a similar security, the funds necessary to obtain an asset of a similar value to the right-of-use asset in a similar economic environment. (IFRS 16 Appendix A)

[3] The IASB is planning to publish an Exposure Draft of a proposed amendment to IFRS 16 by April 27, 2020. The proposed amendment will provide lessees with an optional exemption to account for COVID-19 related rent concessions as if they were not lease modifications.

12. When deriving the discount rate to be used in a non-financial asset's impairment test, management may consider the company's weighted average cost of capital,[4] the company's IBR and other market borrowing rates, which may have been significantly affected by COVID-19. (IAS 36.A17)

What if the recent interest rate changes only affect short-term interest rates?

13. A decrease in short-term interest rates may not have a material effect on the discount rate used for an asset or group of assets that has a long remaining useful life. Discount rates usually consider the time value of money, represented by a risk-free interest rate that has the same or similar duration as the cash flows of the asset or liability being measured. (IAS 36.16(a) and IFRS 13.B13(c))

14. For example, the discount rate on an asset retirement obligation considers the time value of money by referencing a risk-free rate on a government bond with a term similar to the remaining useful life of the mineral resource asset.

15. The discount rate applicable to post-employment benefit obligations reflects the estimated timing of the benefit payments, which can be achieved by applying a single weighted average discount rate. (IAS 19.85)

Am I required to update my discount rates if I expect the circumstance presented by COVID-19 to be temporary?

16. It depends. If you are required to remeasure your assets or liabilities at reporting date, the fair value at measurement date should reflect current market conditions. (IFRS 13.62)

17. Management will need to make judgments on the current market conditions presented by COVID-19, which may result in major sources of estimation uncertainty. In assessing the current market conditions, management may need to make assumptions on the expected duration of the COVID-19 disruption on its business operations. Furthermore, management's assumptions and major sources of estimation uncertainty may be more pronounced during the early stages of the pandemic. Therefore, management may need to revisit these assumptions in future reporting periods as the situation evolves and becomes subject to fewer assumptions and less estimation uncertainty.

How will COVID-19 affect my financial statement disclosures?

18. For each class of provision, a company will need to disclose the effect of any change in the discount rate. (IAS 37.84(e))

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[4] A firm's weighted average cost of capital represents its blended cost of capital across all sources, including common shares, preferred shares, and debt. (Source: Corporate Finance Institute "Definition of WACC.")

19. Companies will need to disclose information about the key assumptions affecting the discount rates used to measure the recoverable amount of a cash-generating unit[5] when goodwill or an intangible asset with an indefinite useful life is included in that unit's carrying amount. (IAS 36.134(d)(i))

20. Management should also consider the need to disclose key assumptions about any major sources of estimation uncertainty in determining the discount rates, that could result in material adjustment to an asset's or liability's carrying amount. (IAS 1.125)

21. For post-employment benefit obligations – defined benefit plans, the company will need to disclose:

- the discount rate used to determine the present value of the defined benefit obligation; (IAS 19.145)
- a sensitivity analysis for the discount rate assumption as of the end of the reporting period, showing how the defined benefit obligation would have been affected by changes in the discount rate that were reasonably possible at that date. (IAS 19.145(a))

Has the IFRS® Discussion Group talked about this topic?

22. The Group has had several conversations about discount rates. The discussions below may be helpful as you think about how COVID-19 affects discount rates used in asset and liability measurements.

Meeting Date	Topic	Meeting Report
October 16, 2018	Lessee's Discount Rate	View Document
January 10, 2018	Lessee's Discount Rate	View Document
May 14, 2015	Discount Rates	View Document
May 14, 2015	Recoverable Amount	View Document
September 16, 2010	Discount Rate	View Document

[5] A cash-generation unit is the smallest identifiable group of assets that generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets (IAS 36.6)

Extracts from Relevant IFRS® Standards

Standard	IFRS Guidance
IFRS 13	22 An entity shall measure the fair value of an asset or a liability using the assumptions that market participants would use when pricing the asset or liability, assuming that market participants act in their economic best interest. 62 The objective of using a valuation technique is to estimate the price at which an orderly transaction to sell the asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. Three widely used valuation techniques are the market approach, the cost approach and the income approach. The main aspects of those approaches are summarised in paragraphs B5–B11. An entity shall use valuation techniques consistent with one or more of those approaches to measure fair value. B13 Present value (ie an application of the income approach) is a tool used to link future amounts (eg cash flows or values) to a present amount using a discount rate. A fair value measurement of an asset or a liability using a present value technique captures all the following elements from the perspective of market participants at the measurement date: (a) an estimate of future cash flows for the asset or liability being measured. (b) expectations about possible variations in the amount and timing of the cash flows representing the uncertainty inherent in the cash flows. (c) the time value of money, represented by the rate on risk-free monetary assets that have maturity dates or durations that coincide with the period covered by the cash flows and pose neither uncertainty in timing nor risk of default to the holder (ie a risk-free interest rate). (d) the price for bearing the uncertainty inherent in the cash flows (ie a risk premium). (e) other factors that market participants would take into account in the circumstances. (f) for a liability, the non-performance risk relating to that liability, including the entity's (ie the obligor's) own credit risk.
IFRS 16	42 A lessee shall remeasure the lease liability by discounting the revised lease payments, if either: (a) there is a change in the amounts expected to be payable under a residual value guarantee. A lessee shall determine the revised lease payments to reflect the change in amounts expected to be payable under the residual value guarantee. (b) there is a change in future lease payments resulting from a change in an index or a rate used to determine those payments, including for example a change to reflect changes in market rental rates following a

Standard	IFRS Guidance
	market rent review. The lessee shall remeasure the lease liability to reflect those revised lease payments only when there is a change in the cash flows (ie when the adjustment to the lease payments takes effect). A lessee shall determine the revised lease payments for the remainder of the lease term based on the revised contractual payments. 43 In applying paragraph 42, a lessee shall use an unchanged discount rate, unless the change in lease payments results from a change in floating interest rates. In that case, the lessee shall use a revised discount rate that reflects changes in the interest rate.
IAS 1	125 An entity shall disclose information about the assumptions it makes about the future, and other major sources of estimation uncertainty at the end of the reporting period, that have a significant risk of resulting in a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of: (a) their nature, and (b) their carrying amount as at the end of the reporting period
IAS 19	83 The rate used to discount post-employment benefit obligations (both funded and unfunded) shall be determined by reference to market yields at the end of the reporting period on high quality corporate bonds. For currencies for which there is no deep market in such high quality corporate bonds, the market yields (at the end of the reporting period) on government bonds denominated in that currency shall be used. The currency and term of the corporate bonds or government bonds shall be consistent with the currency and estimated term of the post-employment benefit obligations. 84 One actuarial assumption that has a material effect is the discount rate. The discount rate reflects the time value of money but not the actuarial or investment risk. Furthermore, the discount rate does not reflect the entity-specific credit risk borne by the entity's creditors, nor does it reflect the risk that future experience may differ from actuarial assumptions. 85 The discount rate reflects the estimated timing of benefit payments. In practice, an entity often achieves this by applying a single weighted average discount rate that reflects the estimated timing and amount of benefit payments and the currency in which the benefits are to be paid. 144 An entity shall disclose the significant actuarial assumptions used to determine the present value of the defined benefit obligation (see paragraph 76). Such disclosure shall be in absolute terms (eg as an absolute percentage, and not just as a margin between different percentages and other variables). When an entity provides disclosures in total for a grouping of plans, it shall provide such disclosures in the form of weighted averages or relatively narrow ranges.

Standard	IFRS Guidance
	145 An entity shall disclose: (a) a sensitivity analysis for each significant actuarial assumption (as disclosed under paragraph 144) as of the end of the reporting period, showing how the defined benefit obligation would have been affected by changes in the relevant actuarial assumption that were reasonably possible at that date. (b) the methods and assumptions used in preparing the sensitivity analyses required by (a) and the limitations of those methods. (c) changes from the previous period in the methods and assumptions used in preparing the sensitivity analyses, and the reasons for such changes.
IAS 36	16 As an illustration of paragraph 15, if market interest rates or other market rates of return on investments have increased during the period, an entity is not required to make a formal estimate of an asset's recoverable amount in the following cases: (a) if the discount rate used in calculating the asset's value in use is unlikely to be affected by the increase in these market rates. For example, increases in short-term interest rates may not have a material effect on the discount rate used for an asset that has a long remaining useful life. 32 The elements identified in paragraph 30(b), (d) and (e) can be reflected either as adjustments to the future cash flows or as adjustments to the discount rate. Whichever approach an entity adopts to reflect expectations about possible variations in the amount or timing of future cash flows, the result shall be to reflect the expected present value of the future cash flows, ie the weighted average of all possible outcomes. Appendix A provides additional guidance on the use of present value techniques in measuring an asset's value in use. 134 An entity shall disclose the information required by (a)–(f) for each cash-generating unit (group of units) for which the carrying amount of goodwill or intangible assets with indefinite useful lives allocated to that unit (group of units) is significant in comparison with the entity's total carrying amount of goodwill or intangible assets with indefinite useful lives: (d) if the unit's (group of units') recoverable amount is based on value in use: (i) each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts. Key assumptions are those to which the unit's (group of units') recoverable amount is most sensitive. A15 Whichever approach an entity adopts for measuring the value in use of an asset, interest rates used to discount cash flows should not reflect risks for

Standard	IFRS Guidance
	which the estimated cash flows have been adjusted. Otherwise, the effect of some assumptions will be double-counted. A17 As a starting point in making such an estimate, the entity might take into account the following rates: (a) the entity's weighted average cost of capital determined using techniques such as the Capital Asset Pricing Model; (b) the entity's incremental borrowing rate; and (c) other market borrowing rates. A18 However, these rates must be adjusted: (a) to reflect the way that the market would assess the specific risks associated with the asset's estimated cash flows; and (b) to exclude risks that are not relevant to the asset's estimated cash flows or for which the estimated cash flows have been adjusted. Consideration should be given to risks such as country risk, currency risk and price risk.
IAS 37	47 The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and the risks specific to the liability. The discount rate(s) shall not reflect risks for which future cash flow estimates have been adjusted. 84 For each class of provision, an entity shall disclose: (a) the carrying amount at the beginning and end of the period; (b) additional provisions made in the period, including increases to existing provisions; (c) amounts used (ie incurred and charged against the provision) during the period; (d) unused amounts reversed during the period; and (e) the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.