KHILJI & CO. Chartered Accountants

KCO BLOGS 2020

This blog is written by **Mr. Ahmed Yar Khan.** Please read this blog and provide your valued comments

Consideration for Impairment Assessment Under COVID-19 Circumstances

The magnitude of disruption from the Covid-19 pandemic has significantly impacted organizations of all sizes, across all industry sectors. Management and those charged with governance are having to make difficult decisions daily about operational, financial, and strategic matters.

The consequences on financial statement reporting and audit engagements are complex. There is an unprecedented level of uncertainty about the economy, future earnings and many other inputs that represent fundamental elements of financial reporting. There will be multiple financial reporting implications to be considered by preparers of financial statements for the purposes of reporting in the short and potentially medium term.

Businesses are dealing with lost revenue and disrupted supply chains. The disruption to global supply chains due to factory shutdowns has already exposed the vulnerabilities of many organizations. The outbreak has also resulted in significant volatility in the financial and commodities markets worldwide. There are already signs that the virus has significantly impacted the world economy. Various governments have announced measures to provide both financial and non-financial assistance to the disrupted industry sectors and the affected business organizations.

The blog provides a reminder for the existence of conditions/indications that should be considered when assessing an asset for impairment. The financial effects of the coronavirus outbreak with respect to impairment of assets greatly coincides with the indications identified in para 12 "External source of information" sub para (b) of IAS-36.

Impairment Assessment

The standard requires an entity to assess, at each reporting date, whether there are any indicators that assets may be impaired. An asset is impaired when an entity is not able to recover its carrying value, either by using it or selling it. An entity estimates the recoverable amount of the asset for impairment testing. The recoverable amount of an asset is the greater of its 'fair value less costs to sell' and its 'value in use'. To measure impairment, the asset's carrying amount is compared with its recoverable amount. Value in use (VIU) is the present value of the future cash flows expected to be derived from an asset or a cash generating unit (CGU). The calculation of an asset's value in use incorporates an estimate of expected future cash flows and expectations about possible variations of such cash flows.

IAS 36 Impairment of Assets requires an entity to assess, at the end of each reporting period, whether there is any impairment for an entity's non-financial assets. For goodwill and intangible assets with indefinite useful lives, the standard requires an annual impairment test and when indicators of impairment exist. For other classes of assets within the scope of the standard, an entity is required to assess at each reporting date whether there are any indications of impairment. The impairment test only has to be carried out if there are such indications.

Events after the reporting period and information received after the reporting period should be considered in the impairment indicator assessment only if they provide additional evidence of conditions that existed at the end of the reporting period. Similarly, the determination of the recoverable amounts of an asset should only consider the

information obtained after the reporting date if such information relates to conditions existing as of the reporting period end. Judgement of all facts and circumstances is required to make this assessment.

Existence of impairment indicators

As mentioned above, an entity is required to assess at the reporting date whether there are any indicators of impairment. With the recent developments of the outbreak, there are both external and internal sources of information, such as the fall of stock and commodity prices, decrease of market interest rates, manufacturing plant shutdowns, shop closures, reduced demand and selling prices for goods and services, etc. indicating an asset may be impaired.

Measurement

When assessing impairment, entities are required to determine the recoverable amounts of the assets. Recoverable amount is the higher of an asset or CGU's fair value less costs to sell (FVLCS) and its value in use. The estimation of the VIU involves estimating the future cash inflows and outflows that will be derived from the use of the asset and from its ultimate disposal and discounting the cash flows at an appropriate rate.

In cases where the recoverable amount is estimated based on value in use, the considerations on accounting estimates apply. The forecasted cash flows should reflect management's best estimate at the end of the reporting period of the economic conditions that will exist over the remaining useful life of the asset. With the current uncertain situation, significant challenges are expected to prepare the forecast of or budgets for future cash flows. In these circumstances, an expected cash-flow approach based on probability-weighted scenarios may be more appropriate to reflect the current uncertainty than a single best estimate when estimating value in use.

Since the remaining useful life for many assets, such as goodwill, is long term, entities should consider not just the short-term effects, but especially the long term effects.

Disclosure

The more the current environment is uncertain, the more important it is for the entity to provide detailed disclosure of the assumptions taken, the evidence they are based on and the impact of a change in the key assumptions.

Given the inherent level of uncertainty and the sensitivity of judgements and estimates, disclosures of the key assumptions used and judgements made in estimating recoverable amount will be particularly important. This is especially the case as they will have likely been materially updated compared to the key assumptions, judgements and estimates applied in the latest annual financial statements. These would include, for example, the values of the key assumptions and the probability weights of multiple scenarios when using an expected outcome approach.

Ahmed Yar Khan
September 2, 2020