



Impairment considerations due to Covid-19

**Key considerations related to the
impairment of non-financial assets**

August 2020

KPMG Lower Gulf



Introduction

The outbreak of Covid-19 has caused a significant deterioration in economic conditions for some companies and an increase in economic uncertainty for others. It is expected that this pandemic will significantly affect extant social behaviors, spending patterns, travel habits, supply-chains, country-interdependence, and service delivery models, with a consequential impact on lifestyles, markets and the global economy.

Many companies are facing low demand for their products or services. As a result, there is a likelihood that a triggering event to test impairment has occurred in 2020. As the companies approach their interim financial reporting deadlines, there is an urgent need to evaluate the impact of the outbreak on their accounting and financial reporting.

Entities may need to assess whether the impact of Covid-19 has led to asset impairment. Their financial performance, including estimates of future cash flows and earnings, may be significantly affected, directly or indirectly, by recent and ongoing events. Estimating the fair value, discount rate, estimation of cash flows and computation of value in use requires significant informed judgement in the best of times. The Covid-19 pandemic calls for enhanced consideration of individual facts and circumstances with a rapidly changing macroeconomic overlay.

This document highlights some of the key considerations in relation to the calculation of impairment provision on non-financial assets.

Impairment of non-financial assets

The following are the key considerations and challenges for an entity calculating its impairment provision on non-financial assets (e.g. fixed assets, intangible assets, goodwill, investment properties) as per IAS 36 Impairment of Assets.



1. Determination of CGU

In most cases, impairment testing is performed at the independent Cash Generating Unit (CGU) level - i.e. assets are tested in groups, rather than on a stand-alone basis. The key test is the identification of independent cash inflows. Two considerations are particularly useful in identifying groups of assets that have independent cash inflows:

- **Revenue separation:** Are the streams of revenue derived from these groups of assets independent of one another?
- **Asset separation:** Are the assets operated together to such an extent that they do not generate independent revenue streams?



2. Forecasting cash flows

'Value in use' is the present value of future cash flows expected to be derived from an asset or CGU. Forecasting cash flows is likely to be a challenging exercise due to increased economic uncertainty.

Cash flow projections should reflect the impact of Covid-19, both its severity and duration.

The following are factors which an entity needs to consider when projecting cash flows:

- Updates required regarding past budgeted cash flows on the product and services pricing, operating margins, etc.

- Impact of potential disruption to distribution and production, for example, due to supply chain issues or government imposed shutdowns and trade restrictions
- Impact of the latest view from sector experts and other international organizations on exchange rates, growth rates, etc.
- Impact of periods of suspended operations and production on sales quantities and contract duration.
- Impact of the time frame and speed over which the business is expected to recover from Covid-19.



3. Calculation of the discount rate

In determining value in use, projected future cash flows are discounted using a pre-tax discount rate that reflects both current market assessments of the time value of money and the risks specific to the asset or CGU.

The discount rate should not double count forecasting and market risks if they are already included in the cash flow forecasts. It would generally be expected that the discount rate will be higher than past rates to reflect higher risk and uncertainty.

The following are some factors which an entity needs to consider in calculation of the discount rate in light of the pandemic:

- Impact of changing risk free-rates and gearing ratios

- Updates required to various risk parameters to reflect the risk environment at the reporting date
- Assessment of additional risk premiums to reflect the overall greater uncertainty in forecasting inputs



4. Disclosure requirements

Entities should pay close attention to disclosures and provide useful information to the financial statements' primary users.

Management should consider disclosing key assumptions and sensitivities, and the amounts by which values may change after incorporating certain consequential effects of change on the other variables used to measure recoverable amounts.

The following are some factors which an entity needs to bear in mind when considering disclosures under IAS 36, in light of the pandemic:

- Enhancing sensitivity disclosures and disclosures about key assumptions and major sources of estimation uncertainty in interim and annual reports.
- Determining what scenario information and sensitivities' details should be disclosed with respect to the impact from Covid-19 on businesses' operations and the potential impairment of assets.
- Determining if there are any CGU specific risks that need to be disclosed (e.g. components of the discount rate, operational and other sector specific-issues, and potential functional/economic obsolescence).

The impairment tool

This is a simple Excel-based tool which can assist you in understanding the impact of impairment provisions under IAS 36. The impairment calculator helps calculate the impairment based on input provided and enables the user to understand the sensitivity of various types of input on the impairment provision.

Analytical dashboard

Key features of the tool:

The tool provides a built-in analytical dashboard to understand the impact of impairments on assets balance, equity balance, debt-equity ratio, future savings in depreciation, available headroom etc.

The tool provides multivariable sensitivity analysis on the following:



Revenue inflows



Operating cost outflows



Growth rate used in calculating the terminal value



Fair value of the CGU



Discount rate

Here is an extract of the impairment dashboard:

Analytical dashboard

Value in use



515,003,812

Fare value



440,006,000

Impairment/headroom



123,288,511

Sensitivity options

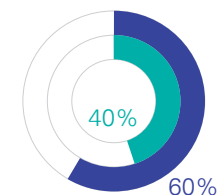
1. Revenue inflows
No change
2. Operating cost outflows
Increase by 5%
3. Terminal value growth rate
No change
4. Fair value of the CGU
Increase by 10%
5. Levered beta used in discount rate
No change
6. Weight of debt in WACC used in discount rate
30%

Discount rate



WACC 7.18%

Debt-enquiry ratio



● total enquiry
● total debt

Savings in depreciation



123,288,511

How can KPMG Lower Gulf assist?

Estimating impairment provision requires significant informed judgement in the best of times. The current environment requires enhanced consideration of individual facts and circumstances with a rapidly changing macroeconomic overlay. We would be happy to discuss with you and share our views and experience to help you navigate these complex circumstances.



Contact us

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