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Will steep declines in economic activity trigger testing for impairment…

… and how do I reflect this in the valuation?

Historically, economic activity declines often trigger impairment testing of assets, including goodwill and other intangible assets. Other factors that may accompany declines, such as the triggering events below, are typically examined as well.

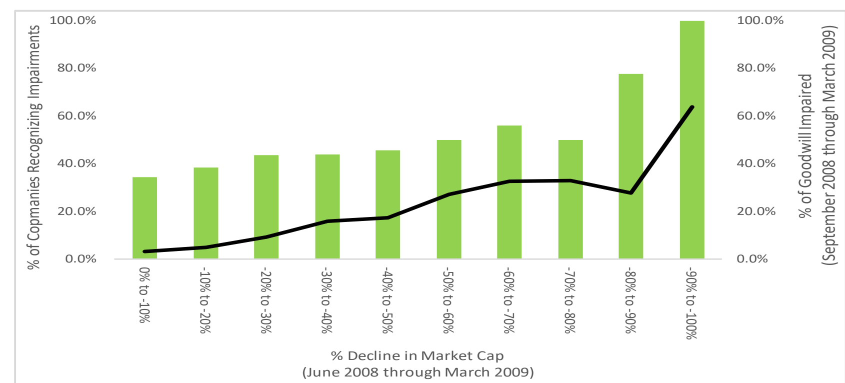
A study of the Financial Crisis of 2008–2009 provides a guidepost to how companies viewed impairment testing during periods of market volatility. Our analysis shows that the impairments recognised by companies in our sample tracked closely with decreases in their stock price. For us here in the Caribbean, that impairment is likely better tracked against our economic activity.

Market cap declines correlate with goodwill impairment

Source: S&P Capital IQ.

Population: Current S&P 500 companies publicly—traded as of January 2008.

Greater market cap declines correlate with greater impairments



Source: S&P Capital IQ.

Population: Current S&P 500 companies publicly—traded as of January 2008.

Types of Triggering Events[1]:

Financial	Operational	Strategic and reputational	Geopolitical and regulatory	Extended enterprise
Trends and events related to financial markets or corporate financial risk	Risks relating to products, services, and operational activities	Emerging issues impacting your strategy and brand reputation	Disruptions relating to trade, global markets, and regulatory change	Emerging risks and opportunities related to your third-party ecosystem
Market volatility	Store or facility closures	Competitive shifts	Health pandemic	Supply chain interruptions
Credit risk	Declining customer traffic	Technology innovation	Trade disruptions	Distribution delays
Commodity risk	Reduced human capital	Industry convergence	Sustainability risks	Reliance on third parties

(1) IAS 36 and FASB ASC 350 both require annual impairment tests for goodwill and assets with an indefinite useful life as well as interim tests for most all long-lived assets, including goodwill, when there is an indication of impairment.

Key Testing Questions:

- How do I define a cash generating unit or reporting unit?
- How do I identify the lowest level of cash flows?
- Do I need to estimate both value in use and fair value under IFRS and how do cash flows differ for each? How do cash flows under US GAAP differ for the ASC 360 and the ASC 350 test?
- How do I model alternative scenarios in a time of unprecedented uncertainty?

Key Valuation Considerations:

- Is intrinsic value as measured by the income approach weighted more than the market approach in current conditions?
- With depressed current multiples, should forward multiples be used to reflect updated market earnings measures?
- In this environment, should I focus on fair value less costs of disposal or value in use for my recoverable amount?
- Are my estimates of discount rate inputs aligned with current market volatility? If impacts to forecast are uncertain, how should I reflect this in the discount rate?
- Should average historical metrics be used to smooth the impact of market volatility?
- In the current environment, should I consider a longer projection period than previously?

Other considerations

Disclosure and reporting:

Consider whether there is a need to update the risk factor to provide more specificity about the potential impact of significant events and current and potential future impact on their operations, financial condition, or liquidity.

Reforecasting and modeling:

Given the immense uncertainty in the near and medium term, consider alternative scenarios in your forecasting process and performing enhanced modeling.

Liquidity and cash management:

Evaluate liquidity needed to sustain operations as well as meet obligations under alternative scenarios. Monitor debt obligations and need for waivers or refinancing.

Asset sales and divestitures

Examine potential options to increase liquidity and financial flexibility through asset sales, sales leasebacks, and divestitures.

Impairment test summary

IAS 36 vs ASC 360

- Unlike IFRS, under US GAAP for **long-lived assets** and **finite lived intangibles** held for use, a two-step approach is required.
- Under US GAAP, the recoverability test is performed based on a comparison of undiscounted expected future cash flows and carrying amount.
- Under IFRS, recoverability is based on a comparison of carrying amount and the recoverable amount (that is, the greater of fair value less costs of disposal (FVLCD) or value in use (VIU)).
- Differences may result in recognition of impairment losses at an earlier period under IFRS compared to US GAAP.

IAS 36 vs ASC 350

- Consistent with the requirements of IAS 36, ASC 350 requires **goodwill and indefinite-lived intangible assets** to be tested for impairment annually, or more frequently if indicators exist.
- **Goodwill and indefinite-lived intangible assets** are subject to a one-step assessment that reduces the carrying amount to fair value under US GAAP, and to the recoverable amount (i.e. the greater of FVLCD or VIU) under IFRS.

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Your team:

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Raymond has conducted and led financial reporting valuation reviews for impairment reviews of goodwill, separately identified intangibles, and investments in subsidiaries, associates and JVs (**IAS 36**), business combinations and purchase price allocations (**IFRS 3**), modelling and reviews of financial instruments (**IFRS 9**), and other financial reporting value considerations and advice. Industries and sectors covers financial services, oil & gas, wholesale/retail, utilities, and telecoms, amongst others.

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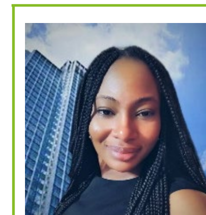

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Akiesha specialises in valuation and modeling, transaction services, restructuring consultancy and other advisory services. She is also experienced in the provision of auditing and assurance services.

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