



Association for Investment Management and Research

Date: August 29, 1997
To: Sir Bryan Carsberg
IASC
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If there is a problem with this transmission, please call Teri Smith at (804) 980 3613.

MESSAGE:

Sir Bryan:

Attached please find our comment letter on E55, *Impairment of Assets*. I apologize for the lateness of our response. If you or your staff have any questions, please contact me.

| Sincerely,



ASSOCIATION FOR INVESTMENT MANAGEMENT AND RESEARCH

August 29, 1997

Sir Bryan Carsberg
The Secretary-General
International Accounting Standards Committee
167 Fleet Street
London, EC4A 2ES
ENGLAND

Re: Proposed International Accounting Standard, *Impairment of Assets* (E55)

Dear Sir:

The Financial Accounting Policy Committee (FAPC) of the Association for Investment Management and Research (AIMR)¹ is pleased to comment on the Proposed International Accounting Standard, *Impairment of Assets* (E55). The FAPC is a standing committee of AIMR charged with maintaining liaison with and responding to initiatives of bodies that set financial accounting standards and regulate financial reporting disclosures. The FAPC also maintains contact with professional, academic, and other organizations interested in financial reporting.

General Comments

The FAPC is evenly split between two approaches to impairment recognition. One group of FAPC members believes that loss recognition should be a two-step process separating recognition and measurement. First, recognition should be required only when (i) when one or more specified indicators of impairment are present, and (ii) the gross, undiscounted cash flows from the use of the asset (or the cash generating unit to which the asset belongs) and its disposal are lower than the carrying amount. Second, when required, the loss would be measured as the difference between the recoverable amount of the asset and its carrying amount. This group believes that the two-step process will prevent early or premature loss recognition, decrease the incidence of reversals, and be more cost effective.

¹AIMR is a global not-for-profit membership organization of more than 70,000 members and candidates comprising investment analysts, portfolio managers, and other investment decision-makers employed by investment management firms, banks, broker-dealers, investment company complexes, and insurance companies. AIMR members and candidates manage, directly and through their firms, over six trillion dollars in assets. The Association's mission is to serve investors through its membership by providing global leadership in education on investment knowledge, sustaining high standards of professional conduct, and administering the Chartered Financial Analyst (CFA[®]) designation program.

The second group would not separate the recognition and measurement phases. It believes that an impairment loss should be recognized (i) when one or more specified indicators of impairment are present, (ii) whenever the recoverable amount of the asset is less than its carrying amount, and (iii) only if the cash generating unit to which the asset belongs is impaired. This group contends that the decision to continue to use an impaired asset must be made by reference to the recoverable cost rather than the gross cash flows. The use of the latter increases the probability of delayed recognition of losses.

Specific Issues

Question 1: Which of the following approaches do you support:

- (a) *the recoverable amount of an asset should be measured as the higher of its net selling price and its value in use?*
- (b) *the recoverable amount of an asset should be measured as the fair value of the asset, that is the amount obtainable for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction? Fair value would be primarily based on the asset's market price, if one exists, regardless of the value in use of that asset. If no market value exists, fair value would be estimated as its value in use.*
- (c) *other?*

The FAPC believes that an asset's recoverable amount should be the fair value (adjusted for costs of disposal) of the asset based on its market price. In the absence of an active market, the enterprise may use an estimate based on the market for similar assets or its value in use. Disclosure of an estimated selling price and the reason for not using it should be required when the enterprise uses a higher value in use.

We believe that the ED's proposed approach may lead to abuses by allowing an enterprise's overall profitability to be used to avoid recognizing impairment losses on certain operating assets. Page 82 of the ED provides an example of a headquarters building with a market value below its carrying amount. Since the building does not generate independent cash flows, under the provisions of the ED no value in use can be calculated. In effect, in that example enterprise profitability is used to avoid recognition of a real impairment loss because the example is based on enterprise rather than operating assets. It may often prove difficult or impossible to calculate the value in use of certain operating assets and reliance on overall enterprise profitability may often prevent or delay loss recognition.

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The FAPC believes that an *operating* asset is impaired when its fair value (adjusted for costs of disposal) based on market price is less than its carrying amount. Although it may be possible to establish a recoverable amount based on value-in-use for operating assets, the cash flows generated by these assets are generally measurable only at some level of aggregation and, hence, will incorporate some amount of internally generated goodwill. If the IASC continues to support non-recognition of operating asset impairments when the value-in-use is higher than net selling price, additional disclosures beyond what is currently proposed are crucial for effective financial analysis.

Furthermore, we are confused by the Board's belief that the requirement to use reasonable and supportable assumptions for cash flow projections, to give greater weight to verifiable evidence, and to disclose the fact that value in use *significantly* [emphasis supplied] exceeds net selling price will prevent abuses. Under the proposed standard if the value in use exceeds the carrying amount, there is no need for an enterprise to estimate the net selling amount. We also wonder how the Board anticipates that companies will comply with the additional disclosure requirement when the proposed standard does not provide a definition of *significantly*.

Question 2: Do you agree that present value techniques should be used to measure the recoverable amount of an asset, implicitly (net selling price) or explicitly (value in use)?

The FAPC agrees with the use of present value techniques to measure the recoverable amount.

Question 3: Do you agree that the definition of recoverable amount in paragraph 5 of the ED is just as applicable to an asset held for disposal as to an asset held for continuing use?

The FAPC believes that the same definition should apply to all assets regardless of the enterprise's intention with respect to those assets.

Question 4: Do you agree that an impairment loss should be recognized for an asset:

- (a) whenever the recoverable amount of the asset is less than its carrying amount; and
- (b) only if the cash-generating unit to which the asset belongs is impaired?

If you disagree with these proposals, please indicate criteria you would prefer for the recognition of an impairment loss in the financial statements?

The FAPC agrees with this proposal.

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Question 5: Do you agree that an impairment loss recognized in prior years for an asset carried on a historical cost basis should be reversed up to the depreciated historical cost of the asset, if and only if, there has been a change in the estimates used to determine the impaired asset's recoverable amount since the last impairment loss was recognized?

The FAPC disagrees with the proposal to allow reversals of impairment losses. As we stated in our letter on the exposure draft to the IAS, *Inventories*, if the benchmark treatment for intangible assets is used and the historical cost model is followed, it should be applied consistently. Asset impairments should be viewed as a transfer of historical cost from the balance sheet to the income statement. We see little logic or consistency in allowing a firm to recognize an increase in an asset value simply because it had previously recognized a decrease. We believe that the arguments presented in our previous letter remain valid:

A firm purchasing that same [asset] after its value decrease but prior to its value increase would not be allowed [under the benchmark treatment] to record the increase, even though the wealth of both firms would have changed by the same amount over the same period of time. We can phrase it as a question: Why is a value increase good enough to record only when it was preceded by a value decrease? If it is good enough to record, so be it; if it isn't then it isn't. Previous losses should be neither a sufficient nor necessary condition for recording holding gains. (AIMR Comment Letter, November 7, 1991)

Question 6: Do you agree that an impairment loss recognized for goodwill and other intangible assets for which no active market exists should be reversed in a subsequent period if, and only if, the external event that caused the recognition of the impairment loss has reversed?

If the IASC fails to see the logic of our arguments regarding reversals of impairments and continues to permit such reversals, the FAPC certainly prefers that reversals on goodwill and other intangible assets for which no active market exists be prohibited. However, it may be adequate to allow a reversal if the enterprise can demonstrate that the impairment was caused by an external event, that that causal event has been reversed and such reversal can be independently verified, and that the assets that were lost, have indeed been returned to the enterprise at their value at the time of impairment.

Question 7: Do you agree that the Standard should apply to all assets except those listed in Paragraph 1 of the ED?

The FAPC agrees with the scope of the ED.

Question 8: Do you agree that:

- (a) the recoverable amount of an asset should be estimated if, and only if, there is an indication that the asset is impaired; and*
- (b) the list of indicators of impairment included in Paragraph 8 of the ED will require an enterprise to estimate the recoverable amount whenever there is significant risk that the asset is impaired?*

The FAPC agrees that the recoverable amount needs to be estimated only if there is an indication of impairment. We believe that the listed impairment indicators will require estimation of the recoverable amount whenever there is a significant risk that the asset is impaired. Because of our concern that assets carried at value in use amounts may be misstated, disclosures required in Paragraph 85 are integral and critical to the substance of the proposed standard. Without them, we would find it unacceptable.

Question 9: Do you agree that net selling price should be determined:

- (a) based on "the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties" and that it is not necessary to determine net selling price by reference to an active market; and*
- (b) after deducting from the amount obtainable from the sale of an asset the incremental costs that are directly attributable to the disposal of the asset (excluding finance costs and income tax expense)?*

We agree with the E55 definition of the net selling price as the current net amount (that is, after the costs of disposal) that can be obtained from the sale of the asset. E55 also states that it is not necessary to determine net selling price by reference to an active market. The costs of disposal should exclude those costs recognized as liabilities from restructuring and/or reorganization, even when they have been incurred as a consequence of asset disposals.

Question 10: Do you agree with the proposed requirements and guidance in the ED for:

- (a) the basis for estimates of future cash flows;*
- (b) the composition of estimates of future cash flows; and*
- (c) selecting the discount rate?*

The FAPC agrees with the proposed requirements and guidance. However, we believe that the use of increasing growth rates in the development of long-term cash flow projections should be an infrequent and unusual occurrence and emphasize the need for the proposed disclosure. This

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disclosure requirement should not be costly for preparers to implement since it is expected to be rare.

Question 11: Do you agree that, if an asset does not generate cash inflows that are largely independent of those from other assets, an enterprise should determine the recoverable amount of the asset's cash-generating unit?

Question 12: Do you agree with the requirement and guidance for determining the items that are included in a cash-generating unit?

See General Comments.

Question 13: Do you agree with the requirement (and related guidance) to recognize and measure an impairment loss if there exists goodwill or other corporate assets (such as head office assets) that relate to a cash-generating unit?

We believe that the proposed approach ignores certain off-balance sheet obligations. For example, environmental, closure, and similar asset-related obligations may be not recognized in the financial statements, but are significant factors in the estimation of net selling price or value in use.

Question 14: Do you agree with the procedures for allocating an impairment loss of a cash-generating unit between the assets of that unit?

The FAPC agrees with the proposed allocation procedures.

Question 15: Do you agree with the disclosure requirements in paragraphs 79-81 of the ED and that an enterprise should not be required to disclose more information, such as the amount of impairment losses that can be reversed in subsequent periods?

The FAPC agrees with the disclosure requirements in these paragraphs. The amount of impairment losses than can be reversed in subsequent periods needs to be disclosed.

Question 16: Do you agree with the disclosure requirements in paragraph 82 of the ED and that an enterprise should not be required to disclose for each individual asset (or cash-generating unit) for which significant impairment losses have been recognized or reversed during the period:

- (a) the value in use of the asset (cash-generating unit) if the recoverable amount is based on the net selling price of the asset (cash-generating unit);*
- (b) the net selling price of the asset (cash-generating unit) if the recoverable amount is based on the value in use of the asset (cash-generating unit);*
- (c) if the recoverable amount is based on the value in use of the asset (cash-generating unit): (i) the discount rate(s) used in the calculation; and (ii) the assumed long-term average growth rate for the products, industries, and country or countries in which the enterprise operates or for the market in which the asset (cash-generating unit) is used; and*
- (d) other key assumptions used to determine the recoverable amount of an asset.*

The FAPC concurs with the specified disclosures. However, the value in use or the net selling price of the asset or cash-generating unit should also be disclosed when the recoverable amount is based on the other measure. This disclosure should be required even if the IASC accepts our contention that the recoverable amount of an asset (cash-generating unit) should be its fair value.

With respect to discount rates, firms should be required to disclose assumed long-term average growth rates, particularly when increasing growth rates are used.

Question 17: Do you agree with the disclosure requirements in paragraphs 83-84 of the ED and that an enterprise should not be required to disclose information similar to that proposed in question 16 above for each individual asset (cash-generating unit) for which:

- (a) recoverable amount has been determined during the period;*
- (b) no impairment loss was recognized or reversed during the period;*
- (c) a small change in key assumptions could lead to the recognition or reversal of a significant impairment loss?*

The FAPC agrees with these disclosures.

Question 18: Do you agree with the disclosure requirements in paragraph 85 of the ED?

The FAPC strongly supports these disclosure requirements. Also, see our response to Question 8.

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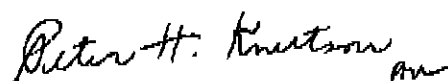
Question 19: Do you agree that an enterprise should not be required to give information on how cash-generating units are determined? If you believe such information should be required, please indicate which details should be required.

The FAPC disagrees with this proposal. Information on the composition of cash generating units would be particularly useful when (i) one or more indicators of impairment are present, (ii) recoverable amount has been estimated using the value in use approach, and (iii) no impairment was recognized. In keeping with the disclosure requirement specified in Paragraph 85, disclosure of any modifications in a specified cash generating unit since the last estimate of recoverable amount would be very useful.

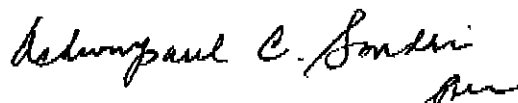
Conclusion

The FAPC appreciates the opportunity to comment on the Proposed International Accounting Standard, *Impairment of Assets* (E55). If the Steering Committee or IASC staff have questions or seek amplification of our view, we would be pleased to provide any additional information you might request.

Respectfully yours,



Peter H. Knutson, CPA
Chair
Financial Accounting Policy Committee



Ashwinpaul C. Sondhi
Subcommittee Chair
Intangibles & Impairments

cc: Distribution List

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