

Price Waterhouse



August 4, 1997

The Secretary-General
International Accounting Standards Committee
167 Fleet Street
London EC4A 2ES
England

Dear Sir:

**Exposure Draft
Impairment of Assets**

We appreciate the opportunity to comment on the Exposure Draft, "Impairment of Assets" (the ED). We support the need for a standard in this area and, for the most part, we agree with the conclusions expressed in the ED. Subjectivity and judgment are, of necessity, permanent bedfellows in this area of accounting; in our view, the ED strikes an appropriate balance between specificity and the need to allow for judgments. Our comments on the specific issues raised in the Invitation to Comment follow.

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 or (c) other?

We support (a) - the approach taken in the ED. Most assets subject to impairment review under the ED will be assets held for continuing use in the business, not held for sale. Therefore, it only seems reasonable that the approach to impairment consider the current use of the asset and the intended future use. Even in the U.S. standard on impairment, which uses fair value as the measurement objective for impaired assets, important consideration is given to the asset's current and intended use in determining whether an impairment exists. Furthermore, as noted in the Invitation to Comment, we would expect the situations to be rare in which value in use is significantly higher than net selling price and disclosure of these situations is required by paragraphs 82 and 83 of the ED.



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)?

Yes.

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

Yes.

Question 4: Do you agree that an impairment loss should be recognised 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?

Yes. The U.S. standard on impairment takes a different view from the ED with respect to (a), as it uses undiscounted cash flows as the trigger for recognition of impairment. The main problem with such an approach is that it is possible that a small change in estimated cash flows can result in a very large difference in accounting effect. The approach in the ED avoids this problem. As to cash-generating units, when an asset must be considered as part of a larger group for assessing impairment, that group essentially becomes a single asset (for impairment purposes). As such, impairment either exists for the group of assets or it does not; it is not meaningful to recognise impairment for an individual asset if there is no impairment for the group.

Question 5: Do you agree that an impairment loss recognised in prior years for an asset carried on an 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 recognised?

Our view is that an impairment writedown should be considered to create a new cost basis for the asset and that subsequent increases in the carrying value only be permitted if the enterprise follows the practice of revaluation. We are persuaded by the following advantages of such an approach.

- **Information content.** Although there is worthwhile information value in an impairment writedown, there is not the same degree of information value in a subsequent write-up. This is because the writedown is necessarily to a meaningful



amount - either the net selling price or the value in use. However, a subsequent write-up is limited to the amortised cost of the asset, which is not necessarily a particularly meaningful amount.

- **Similarity to revaluations.** The conceptual difference between a restoration of a previous impairment writedown and a revaluation is quite tenuous. Generally, the recoverable amount used in an impairment situation would be value in use. A subsequent increase in the value in use would represent an increase in the estimated future cash flows or earnings potential of that asset. While recognition of such increase prior to its realisation may be supportable under a revaluation approach, its conceptual justification in a historical cost model is questionable.
- **Burden of calculation.** Calculating value in use can be burdensome for an enterprise. For this reason, the ED includes triggers (indicators), whereby the detailed calculation need be made only if these triggers are present. In theory, if reversals are allowed, an impaired asset's carrying value should be increased whenever its value in use has increased from the impaired amount. Even with the use of impairment reversal triggers similar to those for impairment writedowns, the requirement to restore impairment writedowns will impose an additional burden on enterprises.

If the IASC decides, in the final standard, that an impairment loss recognised in prior years can be reversed, then we suggest that reversals be permitted whenever an asset's recoverable amount exceeds its carrying amount, for whatever reason. Reversals should not be restricted to situations in which there has been a change in the estimates used to determine the asset's recoverable amount. The ED confuses the measurement technique (discounting future cash flows) with the concept (value in use). If the value in use of an asset increases over time, then it simply has increased over time; it is not important whether that increase results from changes in estimates of cash flows or from the unwinding of the discounting process. The accounting principle is clear - assets should be carried at the lower of their amortised historical cost or recoverable amount. Any exception to that principle makes the concept less clear and the standard more difficult to understand and apply.

Question 6: Do you agree that an impairment loss recognised 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?

Almost invariably, goodwill will need to be evaluated for impairment as part of a larger cash-generating unit. When an asset is considered as part of a larger group for



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 conclusions in the ED.

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?

Yes.

We believe additional guidance may need to be given in respect of the phrase in paragraph 28 (b) of the ED: "... projections of cash outflows necessarily incurred to generate the cash inflows from continuing use of the asset...." It has been suggested, for example, that cash outflows relating to restructuring or reorganization might be included in the estimates of future cash flows to determine value in use. Clearly, this would not be consistent with the Board's thinking in, for example, paragraph 20 (b).

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?

Yes, provided of course that there is an indicator of impairment for the asset, other assets in the cash-generating unit, or the cash-generating unit as a whole. In fact, we believe that the wording used in the ED may understate the frequency with which the use of a cash-generating unit will be required in assessing impairment.

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

Yes. However, additional guidance may be needed regarding the term "largely independent," as used in paragraphs 47 and 48 of the ED. Specifically, we have in mind a situation in which two groups of assets each have identifiable cash flows. However, one of the groups of assets is operated at a loss because management considers it important to engage in that business activity to support or complement the other group of assets which is operated profitably. This "support" is based on subjective analysis and cannot be reliably quantified. The issue is whether each of the groups of assets



constitutes its own cash-generating unit or whether they should be viewed together as one cash-generating unit.

Question 13: Do you agree with the requirement (and related guidance) to recognise 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?

Yes. The impairment test generally is applied on a "bottom-up" basis, whereby individual assets may need to be aggregated into a cash-generating unit to perform a meaningful impairment test. Goodwill, on the other hand, may not be so easily allocated to those cash-generating units determined on a bottom-up basis. Rather than force an arbitrary allocation of goodwill to those cash-generating units, we agree with the proposal in the ED that cash-generating units including goodwill be determined on a "top-down" basis where necessary.

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

Yes. However, the procedures described in paragraphs 62 and 65 (especially paragraph 65) are rather difficult to follow without a comprehensive example. The example given does not illustrate the procedures to be followed in paragraphs 65 (a) and (b), which are the most confusing. In fact, the description in paragraph 65 (b) is not all that clear as to whether the "excess impairment loss" of 30 in the example should indeed be allocated in some manner; it is not allocated in the example.

Questions 15, 16 and 17: Do you agree with the disclosure requirements in paragraphs 79 - 84 of the ED?

Not entirely. We do not agree with the disclosures proposed by paragraph 82 (d) as these seem designed to present information by which users of the accounts can "audit" management's adherence to the requirements of the standard, rather than useful accounting information.

We also do not agree with the disclosures required by paragraph 83. Such information is superfluous to users' needs and is analogous to disclosing why management have not made additional provisions for doubtful receivables having reviewed their bad debt provisions and concluded that they are adequate.

We agree that the other information described in questions 15, 16 and 17 should not be required disclosures.



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

Definitely not. As a general principle, disclosure of something should be required on the basis that the particular information is likely to be meaningful and useful to the users of financial statements. Otherwise, it is mere clutter and can serve to detract from the ability to use other, more relevant information. The disclosures required by paragraph 85 seem designed, for the most part, to influence the way in which management exercises judgment in estimating value in use, rather than to convey useful information to users of the financial statements. Accordingly, we strongly oppose these disclosure requirements, because of the lack of relevant information content and, perhaps even more importantly, because of the disturbing precedent they create in deciding what disclosures to require.

Question 19: Do you agree that an enterprise should not be required to give information on how cash-generating units are determined?

Yes, we agree.

Question 20: Should an enterprise be required to disclose any information other than that discussed in questions 15 - 19 to this Invitation to Comment?

We are satisfied with the disclosure requirements in the ED, except for paragraphs 82 (d), 83 and 85 as previously noted.

Question 21: Should any material in Appendix 1 be amended or deleted? Should any further guidance be added to the appendix?

We have one suggestion, which might be considered a drafting point. The second full paragraph on page 48 states "The Country A cash-generating unit's net selling price is not available and is assumed to be zero, as it is unlikely that a ready buyer exists for all the assets of that unit." It is not appropriate, in our view, to assume that the net selling price of an asset is zero simply because a net selling price is not available. Although this nuance will not have any effect on the actual impairment calculation, it does have disclosure implications because paragraphs 82 and 83 require the disclosure of certain situations in which value in use significantly exceeds net selling price.

Question 22: Do you agree with the consequential changes to IAS 16, Property, Plant and Equipment?

Yes.



Question 23: Do you have any other comments on the proposed International Accounting Standard?

We have two drafting suggestions.

- Paragraph 53, last sentence. Replace the words "is not adjusted" with the words "effectively does not include the liability." Otherwise, the words "is not adjusted" could be taken to mean that the carrying amount of the cash-generating unit is not adjusted to recoverable amount.
- Paragraph 76, Insert "(calculated as if no impairment loss had been recognised in prior years)" after the words "historical cost of the asset."

* * * * *

We would be pleased to discuss further the matters raised in this letter. Should you wish to do so, please contact Barry Robbins in San Francisco at (415) 393-8838.

Very truly yours,

Pricewaterhouse