



FINANCIAL EXECUTIVES
INSTITUTE

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

Subject: Proposed IAS, Impairment of Assets, Exposure Draft E55

Dear Sir Bryan:

The Committee on Corporate Reporting (CCR) of the Financial Executives Institute is pleased to comment on the proposed International Accounting Standard (IAS), Impairment of Assets.

In its deliberations on this subject, the IASC Board determined that an impairment loss should be recognized whenever the recoverable amount of an asset is below its carrying amount (economic criterion); CCR strongly opposes this position for a number of reasons.

The greatest concern is the potentially volatile effect this accounting model would have on earnings. The ED links very subjective measures with a very rigid recognition process which could result in frequent impairments being recognized and/or reversed based upon temporary circumstances, flawed estimates or revised estimates.

It could occur that a number of small impairments might be recognized over time for the same asset(s) as conditions or assumptions gradually deteriorate. Alternatively, market or economic conditions may reverse, resulting in a restoration or, again, a series of restorations being recorded. The user of the financial reports is not well served by this earnings pattern. Worse, there may be the inference that previously recognized impairments were erroneous, causing a lack of confidence in the reported information.

Value-in-use measurements and many net selling price determinations are difficult to substantiate. Value-in-use is a compounding of estimates and assumptions. There needs to be some mechanism for factoring in management's judgment regarding the degree of permanence of the indicated impairment before a write-off is actually recorded. One approach to this, a practical approach, is to only recognize impairment losses when the

projected undiscounted cash flows of the asset or cash-generating unit are less than the asset's carrying amount.

It appears the Board recognized the deficiencies of the model it is advocating and has proposed measures designed to compensate for them. We find these additional measures also to be objectionable in that they exacerbate the volatility issue, take us further away from the historical cost model and add significantly to disclosure overload. For example, the principal reasons for permitting reversals of previously recognized impairments are the immediate recognition aspect coupled with the fact that estimates are subject to change. Rather than improve the reporting of results of operations, we feel that the reversal mechanism would lead to increased volatility and possible manipulation.

The majority of the disclosures called for in the ED are designed to either limit the potential for abuses or enable the reader to project the next earnings impact (either positive or negative). None of this would be needed if a more practical approach to impairment loss recognition were adopted. The disclosures proposed in paragraphs 79(b), 82(d), 83(a), (b) and (c), and 85(a), (b) and (c) are, in our view, all unnecessary or excessive.

There are several aspects of the ED that we support as meaningful contributions to the body to international standards. We agree with an approach that is triggered by the existence of impairment indicators. We support the option to use the higher of the two recoverable cost measures as means of limiting the frequency and amount of impairment losses. We concur with the definition and use of cash-generating units and we agree with the proposed handling of assets held for disposal.

We are particularly impressed with the interspersing of examples throughout the standard and the Basis for Conclusions. We recommend that the Board retain Appendix 3 - Basis for Conclusions in the final pronouncement. It is a very useful aid in understanding the intent of the standard's provisions.

We trust that the Board will give full consideration to the comments contained in this letter despite the fact that the comment deadline of August 15 has passed. We find it difficult to properly develop a consensus view of our committee in the limited three-month exposure period set by IASC. We have responded in the attachment to this letter to each of the twenty-three questions specifically raised in the proposed IAS. We would be pleased to discuss our comments further with you or your staff. This response was developed by Mark Ogden of Pharmacia & Upjohn, Inc. Should you have any questions, please contact him at (616) 833-5623.

Sincerely,



Susan Koski-Grafer

Attachment

Measurement of Recoverable Amount

1. *Measurement approach - higher of net selling price and value in use (the ED approach), or fair value?*

As a general statement, CCR has long advocated adherence to the historical cost model. As such, we do not feel that long-lived productive assets of an enterprise should be "marked to market". We oppose the volatility in earnings that would result from temporal market influences over which the business has no control. Consistent with this view, we advocate provisions that minimize the frequency of adjustments to carrying value (either up or down) of assets to be held in use. It is for this reason that we endorse an approach that incorporates a probability consideration. The "two-step" approach embraced in the U.S. Statement of Financial Accounting Standards No. 121, Accounting for the Impairment of Long-Lived Assets employs this criterion. Under this method, if undiscounted future cash flows equal or exceed the carrying value of the asset, there is no need to measure fair value (or market value or net selling price) and no impairment loss is recognized.

For these reasons, we reject the measurement approach proposed in the ED for assets to be retained and used in the business. CCR believes the measure of an impairment for assets to be held in use should be based upon the undiscounted cash flow stream and not follow a discounted cash flow approach (discussed more fully below).

Of the two options presented in the ED question, though, we prefer the alternative put forth in the draft, i.e. higher of net selling price and value in use (the ED approach). As a practical matter, the difference in results between these two alternatives most often will be relatively small as selling price or market value will generally be difficult to ascertain, in which case the two methods converge to the value-in-use approach. The reason we favor the use of the ED approach (again of the two choices presented) is that it better reflects the financial realities, it allows greater exercise of management judgment and it eliminates the possibility of impairment write-downs in those instances when a market value is determinable but that value is exceeded by the asset's value in use. We also recognize that by having the option to use the higher of the two measures, there will be some "screening" effect that would preclude the recognition of some impairments where the indicated cause may be of a temporary nature.

2. *Do you agree that present value techniques should be used to measure the recoverable amount of an asset, implicitly or explicitly?*

CCR is concerned about the use of discounting in connection with non-financial assets and liabilities. The measurement techniques are subjective, prone to manipulation and are not verifiable. Moreover, the result is an artificial distortion of year-to-year earnings in that the enterprise recognizes an impairment charge in the current period and assures a "profit" element in succeeding periods. Then, if restoration is permitted, some amount of this built-in profit is brought back into income in the year that restoration occurs. The Board acknowledges this problem in paragraphs 70-73 and attempts to limit the extent to which reversals may be recognized. Even with the imposed restrictions, however, the interest

element inherent in the discounting process will be reflected in subsequent reversals and in ongoing depreciation charges.

Assets Held for Disposal

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, we agree that the definition of recoverable amount should apply to assets held for disposal, and that additional requirements or guidance is not necessary unless the Board were to accept our recommendation that undiscounted cash flows be used to measure the recoverable amount for assets to be retained in the business. In that case, of course, distinctions would be required for assets held for disposal.

Recognition of Impairment Losses

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?*

As indicated in response to question 1 above, CCR favors a "two-step" approach that effectively "buffers" the frequency of impairment recognition. IASC has characterized this as employing the "probability criterion".

- b) *only if the cash-generating unit to which the asset belongs is impaired?*

CCR supports the conclusion of the IASC Board that limits the recognition of an impairment loss only if the cash-generating unit, as a whole, is impaired.

Reversals of Impairment Losses

5. *Do you agree that an impairment loss recognized 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 recognized?*

We are strongly opposed to the concept of reversing previously recognized impairments. As indicated previously, we do not believe long-lived productive assets should be "marked to market". To permit the restoration of impaired assets, even as limited by paragraph 71, is to effectively allow such non-financial assets to fluctuate in value, often based upon extraneous market factors.

Impairment of Assets

Reversal of previous impairment losses can lead to manipulation of earnings because the assumptions necessary for the reversal are just as subjective as the original impairment assumptions. The Board supports its position on reversals by acknowledging the subjectivity of estimates and that they are subject to future changes. If the two-step approach to recognition of impairments were accepted, the potential effects of erroneous estimates to affect earnings would be mitigated.

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 was reversed?*

As above, CCR opposes any reversal of previously recognized impairment losses. In this particular area, we are concerned that this will be a difficult provision of the standard to implement. The recognition of an impairment loss related to goodwill may occur for any of the indicated reasons cited in paragraph 8 of the ED. Moreover, goodwill is written down (or off) before the tangible assets of the cash-generating unit are written down. There is a predisposition to eliminating goodwill without requiring any particular rationale.

Indications of potential decrease in an impairment loss (paragraph 68) are, as indicated in paragraph 69, simply the mirror of those in paragraph 8. Why, then should there be any distinction made with regard to reversal of impairment of goodwill and, more importantly, how can the practitioner determine such distinctions?

While we are not opposed to the outcome (we would prefer to limit the occasions when goodwill, once written off, is reinstated), we fail to understand the conceptual basis upon which the Board is basing disparate treatment of goodwill from other long-lived assets. We recommend the Board retain the position in IAS 22 that prohibits any reversal of an impairment loss recognized in prior periods in respect of goodwill.

Scope

7. *Do you agree that the Standard should apply to all assets except those listed in paragraph 1 of the Exposure Draft?*

In addition to the assets listed in paragraph 1, it would seem reasonable that investments in equity investees and subsidiaries should be excluded from the scope of the ED. Impairment tests of the assets of these entities will be made at the entity level, and the investor's accounting is covered by other Standards.

Identifying a Potentially Impaired Asset

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?*

Yes, we firmly support testing for impairment only when there is an indication that an impairment may have occurred. Our views on this subject apply equally to subsequent review of impaired assets. That is, we object to the need to make such subsequent reviews. Consistent with our positions opposing mark-to-market accounting and reversals of previously recognized impairments, we do not support the costly and burdensome need to periodically review all previous impairments.

- b) *The list of indicators of impairment included in paragraph 8 of the Exposure Draft will require an enterprise to estimate the recoverable amount whenever there is a significant risk that the asset is impaired?*

Yes, the list of indicators in paragraph 8 appears to encompass all of the most likely situations that might cause a significant impairment to occur.

Net Selling Price

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?*

CCR supports the conclusion of the ED in looking first to active market information to determine net selling price and then, in the absence of an active market, to base it on the "arm's length" concept.

- 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 believe the deduction of costs of disposal is consistent with the Board's concept of rational management behavior. That is, management would likely sell the asset (net of costs of sale) if it could not yield a better outcome through continued use of the asset.

Value in Use

10. *Do you agree with the proposed requirements and guidance in the Exposure Draft for:*
- a) *the basis for estimates of future cash flows?*
 - b) *the composition of estimates of future cash flows?*
 - c) *selecting the discount rate?*

We agree with the proposed requirements and guidance.

Cash-Generating Units

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, if independent cash flows are not possible, impairment should be measured at the lowest level of asset groupings for which cash flows can be identified.

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

Yes. Only those assets which can be specifically identified and quantified should be included in the grouping. Assets such as goodwill should be excluded if a reasonable method of allocation cannot be applied.

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?*

Yes. Since goodwill and administrative assets are generally difficult to allocate to smaller cash-generating units, the "top-down" approach is a good method by which to determine whether impairment exists.

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

Yes, although we wonder if it is necessary to make the statement in paragraph 65 that the carrying amount of an asset should not be reduced below zero. It seems obvious that a fixed asset should not have a negative value.

Disclosure

15. *Do you agree with the disclosure requirements in paragraphs 79-81 of the Exposure Draft 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?*

Yes, we agree with the disclosure requirements of paragraphs 79-81, and that it is not necessary to disclose more information.

We are strongly opposed to disclosing the amount of impairment losses that are available to be reversed. Aside from the fact that we object to the entire notion of reversals, we believe impairment write-downs should be unique, one-time events and that there should be no expectation that they might reverse. To disclose available amounts implies an expectation that there may be a reversal. We feel this undermines the quality of the reported data. This is one of the problems with the economic approach.

16. *Do you agree with the disclosure requirements in paragraph 82 of the Exposure Draft 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.*

We agree with the disclosure requirements (a), (b), and (c) of paragraph 82, but the amount of disclosure required by paragraph (d) is excessive. While it is important to present the reader with a good understanding of the impairment loss, it is just as important to avoid information overload. We feel that there is no value added in discussing and justifying the period or the rate used for future cash flow projections. Whether the write-down was based on net selling price or value in use should be of no relevance to the reader.

As is likely clear from the preceding comments, we wholeheartedly support the Board's conclusion not to require disclosure of the information referred to in question 16 of the Invitation to Comment. This information, particularly providing the lesser of net selling price or value in use, is clearly unnecessary.

17. *Do you agree with the disclosure requirements in paragraphs 83-84 of the Exposure Draft 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; and*
 - c) a small change in key assumptions could lead to the recognition or reversal of a significant impairment loss?*

We strenuously oppose the disclosure requirements of paragraphs 83-84. We see no value in disclosing information on assets which have been tested for impairment when the impairment tests conclude that the assets are not impaired. A statement that the company is in compliance with the accounting standard is all that is needed to assure that there are no materially impaired asset values in the financial statements. We believe part (c) of paragraph 83 illustrates our contention of disclosure overload. If the carrying amount is significantly in excess of net selling price, the risk of an impending future write-off should be minimal and no disclosure is appropriate.

Naturally, we oppose the addition of items (a) - (c) in question 17 and agree with the Board's decision not to require this information be disclosed.

18. *Do you agree with the disclosure requirements in paragraph 85 of the Exposure Draft?*

No, once an asset is written down as impaired, the impairment should be considered permanent. No purpose is served in second-guessing past actions and disclosing what "might have been" had cash flow estimates been closer to actual. In fact, such disclosures might have the undesirable effect of stimulating questions about the reliability of previous estimates. It is a fundamental truth that estimates will never exactly reflect the future. Paragraphs 8 (g) and 68 (f) require that value-in-use calculations be performed if cash flows vary materially from previous estimates. Therefore, any needed further impairment write-down will be recognized.

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

Yes.

20. *Should an enterprise be required to disclose any information other than that discussed in question 15-19 to this Invitation to Comment?*

No.

Appendices

21. *Should any material in Appendix 1 be amended or deleted? Should any further guidance be added to the appendix? (Note: the Board does not intend to publish appendix 3, Basis for Conclusions, with the final Standard.)*

The examples provided in Appendix 1 are very helpful, as are the various examples provided throughout the ED. In addition, we recommend that Appendix 3, Basis for Conclusions, also be published with the final Standard. The concepts and rationale provided in the Basis for Conclusions provide valuable insight which will be most helpful when applying the Standard to business situations.

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

While we have not studied the proposed amendments to IAS 16 in depth, nothing came to our attention that warrants comment.

23. *Do you have any other comments on the proposed International Accounting Standard?*

No.