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The Secretary-General
International Accounting Standards Committee
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Zentralbereich

Rechnungswesen und Steuern

Wk

Essen, 22 July 1997

Comments on the IAS exposure draft E 55 Impairment of Assets

Dear Sir:

In reply to your request we comment on E 55 Impairment of Assets, being aware of the usefulness of vivacious discussion and thanking for the possibility to participate in it. Please allow us to pronounce some general statements to the way an impairment of assets is to be dealt within E 55, in order to make you understand better our detailed answers:

In our view the aim of E 55 is to unify the treatment of impairment losses, being the amount by which the carrying amount is reduced to its recoverable amount. We must admit that taking a theoretical approach for to judge about the "real" recoverable amount, taking account of an asset's value in use is charming and theoretically the right way. Nevertheless, this approach cannot be applied in practice, because the value in use is typically not determinable for each class of assets in an individual way. E 55, itself, treats the case, where an individual determination of an asset's value in use seems not possible, proposing to determine the recoverable amount of the asset's cash-generating unit. By forming a cash-generating unit as well as by valuing the formed cash-generating unit as well as by allocating the impairment loss between the assets of the unit, sufficient scope is given to manipulate. Therefore we are convinced that the trade-off of objectivity and measuring the real value of an asset should be solved in favour of objectivity, particularly because the necessity of IAS-rules arose with the wish to make financial statements comparable around the

world. Our suggestion is the following treatment, though recognition on a permanent criterion has been rejected by the Board (we concentrate only on fixed assets, understanding that mainly fixed assets are concerned in the context of E 55):

Financial assets, belonging to fixed assets, such as investments in subsidiaries and associates, interests in joint ventures and participations should be valued at their value in use to assess their recoverable amount. To value each individual investment with its value in use seems to be not only appropriate, but as well applicable, because cash-in and cash-out can be classed to each single asset, with each investment being a separately independently valuable unit generating profitability and as a consequence ensuring objectivity. Should the value in use of these financial assets be below their carrying value, enterprises should have the option to value these financial assets at their value in use in the accounts, if the impairment was not expected to be for long. If a durable impairment was expected, recognising an impairment loss should be compulsory.

Other fixed assets, generating independently profitability, should be measured at their value in use and an impairment loss should only be allowed to be recognised, if the impairment was a permanent one, but then compulsory to be recognised.

If a disposal of the fixed assets, generating independently profitability, is planned, a reduction to their net selling price, if higher than their value in use or even lower, seems appropriate, but these assets intrinsically do not belong anymore to the category of fixed ones.

Fixed assets, generating profitability only in co-operation with further assets, should be measured at their net selling price, whereby the arm's length transaction is assumed to take place in a going-concern scenario, i.e. the enterprise is not forced to sell the asset, so that a fair value can be realised. Recognising an impairment loss should only be allowed, under the condition that the enterprise expected the impairment to be a long-lasting reduction in value, but then compulsory to be recognised.

Insofar as technical machines are concerned, it seems to be clear that typically the value in use of such a machine cannot be determined. According to our proposed treatment it is only justified to recognise an impairment loss attributable to a machine either when the machine is to be shut down or the product line in a whole does not lead to any profit. The example on page 33 shows that as a result our proposal does not differ from yours. Consequently we claim that forming cash-generating units to estimate values in use may only be the exe-

cution of a right approach, when detailed procedures are outlined for to give the users a hint, how to proceed in each individual case, as done in the example on page 33. Therefore should the approach of the value in use be retained for all fixed assets, detailed description for the treatment of each individual asset would become necessary to ensure that financial statements were set in an objective manner. Nevertheless, it should not be forgotten that detailed description, even if indispensable, does not simplify the matter, therefore we deem our proposal worth to be considered.

We stress that recognising impairment losses referring to fixed assets should be an exception in the normal course of business, therefore we strictly recommend to reduce fixed assets, except financial assets within the fixed assets, to their recoverable value only when the impairment is expected to be durable. Otherwise the impression might arise that a balance sheet with a liquidation aim has been set up.

Please find in the following our answers in concrete:

1. We favour a distinction between those assets, whose value in use can be measured independently (recoverable value = value in use or = net selling price, if the assets are intended to be sold), and those, whose cannot (recoverable value = net selling price) (see above). If approach a) is insisted on, we request further instructions for the treatment of value-generating units. In any case recognising an impairment should be restricted to permanent value reductions for fixed assets, except when financial assets are concerned. We strongly disagree with approach b), leading to a balance sheet similar to one set up with the aim of a liquidation.
2. We agree.
3. The recoverable value of an asset for disposal is its net selling price and should only be measured in this way.
4. See our argumentation above about the difficulties to measure the value of use of each single asset and on the other hand the opportunities to manipulate when cash-generating units are formed, as well as our proposal to take the expected duration of the impairment into account.
5. We agree.

6. We agree, but recommend that if a new event takes place, having the same effect on the economic situation as the reversal of the event that caused the impairment loss would have, a reversal of the former impairment shall be allowed.
7. Depends. If the fair value concept outlined in the IAS discussion paper Accounting for Financial Assets and Financial Liabilities is not modified, we will support to apply E 55 for financial instruments, too, whereby it should be compulsory to reduce financial assets to net selling price, when impaired, but strictly forbidden to increase them to a higher amount than their acquisition costs, when improved, with the IAS discussion paper Accounting for Financial Assets and Liabilities losing importance. If the fair value concept is replaced by the lower-of-cost-or-market rule in the IAS discussion paper Accounting for Financial Assets and Financial Liabilities, we will agree.
8. We agree to a) and b).
9. We agree to a) and b), but recommend to add that a going-concern scenario is assumed.
10. We agree to a), b) and c).
11. We agree only if detailed instructions for each imaginable class of assets, having to be treated as a cash-generating unit, are given, but please take into account how complicated E 55 would become.
12. Though we agree with the requirements and guidance for determining the items that are included in a cash-generating unit, we deny that when implementing them practically, objectivity is ensured.
13. see our remarks to question 12.
14. To be honest, the proposed procedures show, how arbitrary the allocation of impairment losses of a cash-generating unit between the assets of that unit might be.
15. We agree.

16. We agree. We, however, are convinced that the disclosure requirements of 82 c) and d) should be renounced, being much too excessive.

17. We disagree completely with the disclosure requirements of § 83, not being able to imagine any use of such a disclosure and fearing high costs. As already explained, we consider recognising impairment losses as an exception, when a deterioration of fixed assets has occurred and is assumed to be of permanency. Therefore the disclosure requirements under § 83 will take excessive extent.

18. No, these requirements are too excessive, too.

19. We agree.

20. No.

21. We will suggest to enlarge the instructions, how to treat value in use, whenever cash-generating units are concerned, if the concept is retained, with these instructions being part of E 55.

22. We agree.

23. No.

Hoping our arguments were persuasive, we remain with our best regard.

Yours sincerely

Fried. Krupp AG Hoesch-Krupp



- Jonas -



- Pfeiffer -