

Christian Dior

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October 31, 1997.

Sir Bryan CARSBURG
Secretary- General
International Accounting Standards Committee
167, Fleet Street
LONDON EC4A 2ES, England
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Dear Mr. Carsberg,

In response to your July 24, 1997 letter and following our meeting with Mrs. Laurence Rivat on October 14, 1997, please find below our response to the « Field Test » in which you invited us to participate.

This letter deals only with proposed Standard E 55 (Impairment of Assets). With regard to the proposed Standard E 60 (Intangible Assets), we will send you a separate correspondence at a later date.

Our overall opinion of the proposed Standard E 55 is positive. The project's philosophy is in line with the approach our Group has followed for several years, i.e. to monitor the value of our brands on an ongoing basis and adjusting it if it falls below book. Moreover, Standard E 55's use of

future cash flows provides a more dynamic approach than our own, which was based on historical performance.

The Christian Dior Group with its LVMH subsidiary, is the world's largest luxury products group. Many of the Group's brands are over a century old - Moët & Chandon was created 254 years ago, Hennessy 232 years ago, and Louis Vuitton 143 years ago - and are our major asset, representing FRF 40 billion out of totals assets of FRF 112 billion at 1996 year end. Our comments on proposed Standard E 55 therefore focus mainly on the application of the impairment test to brands.

We will confine our comments to five main points :

- cash generating units
- interest rates and impairment tests
- accounting for provisions for depreciation of intangible assets
- reversal of provisions
- notes to the financial statements

1. Cash generating units

Determining cash generating units from an operating standpoint should not be a problem for our Group. A legal entity, with its own balance sheet and income statement, is associated to each of our brands. As a result, for each specific brand, we are able to accurately define :

- . the cash flows it generates
- . the assets directly attributed or allocated to the specific brand

2. Interest rates and impairment tests

For the purpose of proposed project E [55], a list of criteria liable to result in an impairment test was established. This includes both external and internal sources of information and, as part of the former, interest rates. We believe interest rates should be excluded from this list as assets subjected to the impairment test are in most cases fixed assets, held as part of a long-term strategy. We feel that only 'operating' factors likely to have a **lasting** negative effect on the value of the assets under consideration should be taken into account. This seems in line with your references to technological change, competition, etc.

If interest rates were taken into account, this would add a factor of volatility to the valuation of assets bearing no relationship to the underlying operating evolution of the relevant assets. Under such circumstances, it would be very difficult to explain to the head of a company having acquired a business whose revenues and profitability have improved steadily over the previous 12 months, and whose activities clearly complement those of other companies in his group, that the value of this business should be depreciated because long-term interest rates have increased significantly. Furthermore, an increase in long-term interest rates may have no consequence on short-term rates, and the company's profitability will therefore not be affected.

To sum up, it seems to us that the interest rate criterion as potential trigger of an « impairment test » should not be considered because :

- 1) interest rate fluctuations result in instability in the valuation of assets, unrelated to the assets' useful value to the company ;
- 2) changes in the valuation of assets - for some, virtually on a yearly basis - will make it difficult to understand financial statements over a long period. Disparities will emerge between assets whose valuation was originally set at a time of high interest rates, and others whose value was established when interest rates were low.
- 3) in a worst case scenario, the criterion could be used as an ingenious device to « smooth out » a company's results.

3. accounting for depreciation of intangible assets

Beyond the question of whether interest rates should be used as a criterion triggering an impairment test, there remains the question of defining the accounting treatment of interest rate fluctuations when provisions need to be written following an impairment test.

We believe that a provision following an impairment test can result from two different types of causes, which should result in different accounting treatments :

- purely operating causes : lower sales and profitability, etc. that generally occur over time and need to be reflected in the income statement ;

- . purely circumstantial causes, such as interest rate fluctuations, which are short-term elements and therefore should result in adjustments to shareholders' equity. From this standpoint, there is a similarity with translation adjustments.
- . The point of such a solution would be to distinguish between what is part of the company's long-term management from what represents the appreciation of a company at a specific moment in view of highly unstable factors, such as interest rates.

You will note that this distinction seems in line with the Steering Committee's analysis in its discussion paper on financial instruments (chapter 7, paragraph 2 - Framework for analysis).

4. reversal of provisions

A provision measures the loss of value of assets resulting from **causes** that are not deemed **irreversible**.

If, however, their effects are deemed irreversible, a provision for depreciation - or even accelerated depreciation - is by definition irrevocable and represents the appropriate way to measure the asset's loss of value.

The novelty of proposed Standard E 55 is the creation of a new, hybrid form of provision, midway between provision and amortization. As quoted :

« A provision for amortization of goodwill and for all intangible assets, for which there exists no active market, must be reversed if, and only if, the external factor responsible for the allocation to provisions has been reversed.

Standard E 55 thus introduces new restrictions to reversals of provisions depending :

- . on whether or not there exists an **active** market for the assets under consideration ;
- . on the factor that has caused the reversal of the provision. Only a factor of **opposite direction** to the cause of the initial provision may lead to a reversal of provisions.

Reference to an active market is no justified

When the valuation of assets has been established, reference was made to an accounting value in use, not to a market value.

It is unclear why the approach needs to be changed along the way when reversals of provisions are involved, and why it is no longer possible to rely on the value in use of the asset as the determining criterion.

This lack of coherence is objectionable, and the reference to an active market should therefore be eliminated.

According to E 55, the source of the reversal of a provision should come from a phenomenon rigorously opposite to that which led to the establishment of the provision

Economic realities cannot be reduced to mere plus (+) and minus (-) signs.

It is unclear why the asset's value cannot be that resulting from a discounted cash flow analysis, just because the legal environment, for instance, has become more difficult - the reason for the initial provision - while market evolutions have subsequently become more favorable than initially forecast.

Overly constraining regulations based on a simplistic vision of economic realities will not result in an accurate picture of economic phenomena.

As a consequence, the criterion for reversal of provisions for the purpose of impairment tests should be based exclusively on a comparison of net book value to discounted cash flow and the « opposite outside event » criterion should therefore be left out.

5. Notes to the financial statements

We approve the suggestion of proposed Standard E 55 to include in the notes to the financial statements a breakdown of :

allocation of provisions and reversals of provisions by category of asset for the period under consideration.

At this point, the financial information included in proposed Standard E 55 is compatible with what has already been done for all tangible assets.

However, proposed Standard E 55 introduces additional requirements specific to intangible assets, with no relation to what is done in the case of other assets. In particular, detailed information is requested regarding **each asset** (or cash generating unit) : book value, allocation to provision or reversal of provision for the period under consideration, factors having resulted in the provision or reversal in terms of valuation criterion (net selling price or value in use), time period over which future cash flows are calculated and justification of the choice of this, rate of increase and justification of the choice of this, etc.

These additional demands reflect misplaced distrust of intangible assets and should be eliminated for the following reasons :

- the information levels requested should remain coherent across asset categories.

The **sector of activity** is recognized by existing accounting standards as the most pertinent level for aggregate financial information. What is true for the income statement (revenues, operating income) is also true for the balance sheet :

- too much information hinders good information.

Information has to be concise and relevant. The sector of activity is, and justifiably so, considered the last level for which information is relevant. Beyond that level, information becomes fragmented and difficult to read.

- a brand is an asset much easier to understand than many tangible assets for which such information is not required.

For example, the risks associated with a high-technology factory becoming obsolete and, in which case, requiring accelerated amortization, are much higher and difficult to understand

than risks related to a brand. However, the former being a tangible asset, no information is requested, while the latter being an intangible asset, all sorts of justifications must be supplied. Such an imbalance in the level of information requested, based on the **nature** of the asset rather than on the **risk** associated, is no justified.

- confusion between financial information and audit

The purpose of the annual report is to provide relevant and accurate financial information that has been reviewed by Statutory Auditors. This does not require as much detail as a management control and reporting system, which, moreover, would be inconsistent with the need to protect competitively sensitive information. To indicate each asset, the period for which future cash flows are calculated, the choice of this period, the rate of increase in total revenues, etc., is not relevant, and the excess information only contributes to making the annual report unreadable.

We therefore ask that §82, 83, 84 and 85 be eliminated.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'D. Dalibot', with a horizontal line drawn underneath it.

Denis DALIBOT
Director of Finance