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MANAGEMENT
ACCOUNTANTS**
CERTIFIED MANAGEMENT ACCOUNTANT PROGRAM
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August 21, 1997

The Secretary-General
International Accounting Standards Committee
167 Fleet Street
London, EC4A 2ES
United Kingdom

Dear Sir:

The Financial Reporting Committee (FRC) of the Institute of Management Accountants appreciates the opportunity to comment on the IASC Exposure Draft (ED), *Impairment of Assets*. The FRC regrets that it is unable to support the proposed standard. As discussed in detail below, we fundamentally disagree with an impairment test based on discounted cash flows and question whether the benefits associated with the ED's radical approach will exceed the costs.

The FRC believes that impairment, in the context of the present historical cost accounting model for long-lived assets, means the inability to recover the carrying amount of an asset. It does not mean inability to recover the asset's carrying amount and interest at a risk-adjusted rate of return. While the fact that an asset may not be able to provide cash flows sufficient to cover such "imputed" interest costs would be disappointing, that fact alone certainly does not represent a condition that requires accounting recognition. Moreover, as discussed later in this response, there are a number of serious consequences associated with the Board's approach. The FRC therefore recommends that the IASC adopt a definition that recognizes an impairment condition in circumstances in which the carrying amount of an asset exceeds the sum of the undiscounted cash flows from the asset.

The FRC does agree with the IASC that when an asset is impaired (in accordance with our definition, not the ED's), the amount of the write-off should be sufficient to reduce the carrying amount of the asset to its estimated fair value. This conclusion is based on the view that the impairment event gives rise to the need for a new cost basis for the asset and that the most appropriate measurement of that basis is its estimated fair value on the new measurement date.

The FRC also believes that the new cost basis should not be subsequently adjusted, except where further impairment losses must be recognized and we would expect those instances to be rare. Thus the new carrying amount would be depreciated over the asset's remaining useful life. The FRC believes that the ED's requirement for subsequent reversals of impairment write-downs is fundamentally inconsistent with the notion of a new cost basis for the asset and we therefore strongly oppose that conclusion.

Overall, the FRC views the IASC's proposed accounting framework for impaired assets with the grave concern as it perpetuates and expands application of the allowed alternative treatment under IAS 16, namely requiring spontaneous revaluations of such assets when their fair value and carrying amounts differ significantly. Stated more specifically, when the fair value of an impaired asset is below its original carrying amount, the proposed standard would require the entity to revalue the asset by reversing previously recognized impairment losses. The FRC does not support the allowed alternative treatment under IAS 16 and strongly objects to its mandatory application, under the previously stated conditions, to impaired assets.

Implications of the IASC Approach

In addition to our disagreement with the conceptual basis underlying the ED's principles, the FRC has serious concerns about the practical implications of that approach.

- The implementation and ongoing financial reporting costs, particularly those related to forecasting future cash flows for impaired assets, will be significant and far in excess of the expected benefits.
- Occurrence of a series of impairment write-downs of the same asset will become commonplace, since many impairment situations occur gradually and over longer periods of time.
- Recognition of "temporary" impairments will occur routinely in cyclical, capital-intensive industries during periods of economic recession and reversals during subsequent periods of economic expansion.

These consequences result directly from the key decision to define an asset as "impaired" when its carrying amount exceeds the present value of its future cash flows. As discussed in more detail below, these are consequences the IASC should seek to avoid.

Cost/Benefit Considerations

It can be argued persuasively that the ED will be significantly more costly to implement and maintain than the alternative approach proposed by the FRC. There can be no doubt that the number of assets considered to be impaired under the ED's approach will be much larger than an undiscounted impairment criterion would produce. Moreover, for each of those impaired assets, significant effort and expense will be required to forecast and remeasure for purposes of determining subsequent changes in the present value so that subsequent impairment losses or reversals of impairment losses can be recognized. We find it unrealistic to assume, as the ED implicitly does, that impairments are always sudden and catastrophic in measure. While such assumptions simplify the IASC's cost benefit analysis, the simple fact remains that declines in the utility of assets often occur gradually and over long periods of time with uneven results period to period. This reality, coupled with the onerous consequences of the ED's principles, will create a significant resource drain devoted to the accounting for impaired assets – with no improvement in financial reporting to show for it.

Recurring Impairments

As discussed in the previous paragraph, impairment situations are seldom sudden and catastrophic. Thus, application of the ED's principles will likely produce a series of "mini-impairments" with a few "mini-impairment reversals" before the impaired asset finally reaches rock-bottom. From a

financial statement user's standpoint we would assume that routine, recurring write-downs will distort the analysis of an enterprise's underlying operating results. As the recurring pattern of recognizing impairment losses for the same asset becomes commonplace and thereby more apparent to financial statement users over time, we suspect that the information content implicit in the impairment loss will continue to decline until it is finally wholly irrelevant.

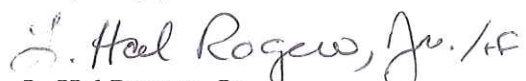
Temporary Impairments

It is unclear whether the IASC has fully considered the consequences associated with recognizing "temporary" impairments. That is, an impairment that occurs because of declines in near term cash flows during a recession, only to be reversed during periods of economic expansion. Without a doubt, this is where use of a present value based impairment trigger does the most damage. Specifically, we note that under a discounted cash flow approach the nearest three or four years of cash outflows are much more influential on the outcome of the test for potential impairment than are the five or six years of cash flows that follow. Thus, for an enterprise in a highly cyclical industry that stands on the brink of a severe recession, the diminishing series of cash flows that are expected until the trough of the recession is reached will have a pronounced negative effect on the impairment test. Three or four years later, when the recession is over, the steadily climbing cash flows expected over the near term will have a pronounced positive effect on the impairment test, causing wholesale reversals of previously recognized impairment losses. All of which leaves the financial statement users to ponder the true status of assets in question: are they impaired in some way as the financial reporting for the past three years had suggested or are they "suddenly" ordinary and productive, as the subsequent reporting would have them believe? Perhaps users in this circumstance will conclude, and we would agree, that these assets never really were impaired and that the accounting required by the proposed standard had misled them. We believe that consequences such as these will not be uncommon under the new standard and we are concerned that the Board's approach will ultimately weaken investor confidence in the relevance of today's financial reporting model.

We therefore believe that the IASC should proceed cautiously in considering such an onerous and radical standard for impairment recognition. Because of its fundamental flaws, we believe that the ED's approach is unlikely to gain general acceptance among preparers and therefore recommend that the Board abandon its approach and adopt the alternative impairment definition proposed in this letter.

Our views on each of the issues covered in the invitation to comment are provided in Attachment A. We would be pleased to discuss our comments with you at your convenience.

Very truly yours,


L. Hal Rogero, Jr.
Chair, Financial Reporting Committee

Attachment A
Responses to Specific Issues Raised in the ED

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 an asset, that is the amount obtainable for which the 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 a market exists for that asset regardless of the value in use of the asset. If no market exists for the asset, fair value would be estimated in a similar way to value in use as defined in the exposure draft?**
- c) other (please specify)?**

As discussed in the cover letter, we strongly disagree with the basic framework for identifying and recognizing asset impairment. However, if the Board decides to proceed to a final standard based on its present conclusions, the FRC would prefer approach (a).

2. One consequence of the approach adopted in this Exposure Draft (or the alternative definition of recoverable amount based on fair value) is that present value techniques should be used to measure the recoverable amount of an asset, implicitly (net selling price) or explicitly (value in use). 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)?

We fundamentally disagree with the use of discounted cash flows as the basis for determining when an asset is impaired. Notwithstanding our views on that issue, we agree that once an asset is considered to be impaired, the carrying amount of the asset should be written down to a new cost basis. We also agree that the new basis should be measured based on fair value, determined by higher of the asset's net selling price or value in use.

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.

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.

As discussed in our cover letter, we believe the document should define an impairment condition to exist when the undiscounted cash flows expected from an asset do not exceed its carrying amount. For reasons stated previously, we strongly disagree with the Board's conclusions.

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 strongly disagree with the reversal of previous write-downs. We believe that the event of an impairment should create a new cost basis that remains unchanged absent subsequent impairments. Further, we question the operationality of the criteria for determining when subsequent reversals are appropriate.

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 has reversed?

We do not believe that this is an operational condition for determining when to reverse an impairment. The difficulty of this determination provides further evidence that the principle permitting subsequent reversals is fundamentally flawed.

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

Yes.

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 Exposure Draft will require an enterprise to estimate the recoverable amount whenever there is a significant risk that the asset is impaired?

Yes. However, we believe that the ED does not go far enough to ameliorate the costs that will be borne by companies in implementing the principles. We believe that under the ED's conclusions the number of impairments, including those we would classify as temporary, will be far greater than is warranted and reasonable. Further, we believe that once impaired, the ongoing cost to monitor and measure fair values of impaired assets, either for future write-downs or future reversals of previously recognized impairment losses, will be significant.

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?
- 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)?

Yes.

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**
- c) selecting the discount rate**

We do not disagree with the Board's conclusions. However, we observe that in performing the proposed impairment test, the discount rate is a key factor affecting changes in the recoverable amount. Given that the discount rate is based on market rates that can be quite volatile at times, we would not be surprised if a majority of the changes in the recoverable amount are attributable to discount rate changes alone.

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.

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

Yes.

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?

No. We question whether the guidance provided can be made operational.

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

Yes.

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?

We do not object to the disclosures called for in paragraph 79. However, we would strongly oppose disclosure of impairment losses that can be reversed since such disclosure inevitably creates a presumption that such losses will be reversed.

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.**

On balance, we find that the disclosures called for in the ED far exceed the needs of financial statement users. We caution the Board against requiring disclosures that seek to provide users with measurement assumptions such as those proposed in (c) and (d) in the question above and to a lesser extent, in the paragraph 82 (d) of the Exposure Draft. In our experience, such data are seldom, if ever, used by analysts to perform alternative valuations or for assessing reasonability.

In addition, we urge the Board not to require the disclosures proposed in (a) and (b) on grounds that such disclosures will further increase the compliance costs associated with the proposed standard. It is reasonable to assume that there will be many cases for concluding that value in use is significantly higher than net selling price. In those instances, requirement (b) would force the company to incur additional expense to determine net selling price – solely for purposes complying with the proposed disclosure requirement.

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?**

We disagree with the proposed disclosures in paragraph 83. In brief, that paragraph requires an enterprise to disclose key facts and assumptions surrounding the estimation of value in use if no impairment loss is recognized. The Board appears to presume that when an enterprise recomputes the value in use, this exercise must result in a change in estimate and that the onerous disclosures called for in paragraph 83 will provide sufficient disincentive to ensure that such amounts are recognized during the period. We think such safeguards are unnecessary and recommend that the disclosure be dropped.

Further, we do not support the addition of the disclosure proposed above to an already exhaustive list of disclosures.

18. Do you agree with the disclosure requirements in paragraph 85 of the exposure draft?

We have a saying that hindsight is 20-20. The disclosure proposed in paragraph 85 does nothing more than prove that estimates are just that... approximations derived from small amounts of reliable information coupled with management intuition and assumptions. Actual cash flows for these kinds of assets will almost always be different from estimates, and the proposed disclosures accomplish nothing substantive other than placing corporate management in the awkward situation of having to explain why, year after year. The FRC strongly objects to these requirements and recommends that they be dropped.

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 questions 15-19 to this Invitation to Comment?

No. Rather, we think the Board should make a good faith effort to reduce the excessive amount of data that would be required to be disclosed under the proposed standard.

21. Should any material in Appendix A be amended or deleted? Should any further guidance be added?

No.

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

We do not disagree with the proposed consequential changes.

23. Do you have any other comments on the proposed IAS?

No.