

TEL: +353-1 668 0400
FAX: +353-1 668 0842
e-mail: ca@icai.ie



THE INSTITUTE OF
Chartered Accountants
IN IRELAND

Ref: 32/52/DB/PM

1st September 1997

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

Dear Sir

IASC E55

I am enclosing for your consideration the comments of our Accounting Committee on E55. If any information is required on the attached please feel free to contact me.

Due to the scheduling of our Committee meetings I regret the attached has missed the IASC deadline but I trust our comments will be considered.

Yours sincerely

Declan Bourke
Technical Director

Encl

pm/ac/general/101097secr



THE INSTITUTE OF
Chartered Accountants
IN IRELAND

ACCOUNTING COMMITTEE

COMMENTS ON

INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE

EXPOSURE DRAFT E55

IMPAIRMENT OF FIXED ASSETS

CONTENTS

	<u>Paragraphs</u>
1. Introduction and General Comments	1.1 - 1.2
2. Response to Invitation to Comment	2.1 - 2.23

Technical Department
1st September 1997

pm/ac/general/n01097fron

E55 "IMPAIRMENT OF ASSETS"

Response from the Accounting Committee of the Institute of Chartered Accountants in Ireland to the IASC Exposure Draft.

1.0 Introduction and General Comments

- 1.1 This paper presents the comments of the Accounting Committee (AC) of the Institute of Chartered Accountants in Ireland on the IASC Exposure Draft E55 "Impairment of Assets".
- 1.2 AC welcomes E55 and supports its objective to prescribe the accounting treatment for an asset that is impaired and the consequences of such an impairment.

2.0 Response to Invitation to Comment

Measurement of Recoverable Amount

2.1 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 (paragraphs 5 and 12-40 of the Exposure Draft and paragraphs 7-30 of the Basis for Conclusions)?***
- (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. 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 (paragraphs 13-19 of the Basis for Conclusions)?***
- (c) other (please specify)?***

Response:

AC favours the IASC's preferred approach "(a)", higher of net selling price and value in use. In cases where the Going Concern concept is applicable, AC concurs with Appendix 3 paragraph 16(a) that a rational enterprise will not dispose of an asset with a service potential that is greater than its net selling price. Where the Going Concern concept is not applicable, the recoverable amount would be the same under both approaches, i.e. net selling price/fair value.

- 2.2** *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) (paragraphs 7-9 and 11-12 of the Basis for Conclusions). 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)?*

Response:

AC agrees that present value techniques must be used to measure the recoverable amount of an asset. AC believes that additional generic guidance from IASC on the topic of the application of present value techniques in financial statements would be valuable, and should in time be incorporated in a separate and specific IAS. This would reduce the potential for divergent practices both as between national standard setters, and also as between individual IASC pronouncements.

Assets Held for Disposal

- 2.3** *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 (paragraph 26 of the Basis for Conclusions)?*

Response:

Agree. AC concurs with Appendix 3 paragraph 26 that net selling price and value in use will be approximately equal in the case of assets held for disposal.

Recognition of Impairment Losses

- 2.4** *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 (paragraph 41 of the Exposure Draft and paragraphs 59-67 of the Basis for Conclusions); and*
 - (b) only if the cash-generating unit to which the asset belongs is impaired (paragraphs 55-58 of the Exposure Draft and paragraphs 74-75 of the Basis for Conclusions)?*

If you disagree with these proposals, please indicate criteria you would prefer for the recognition of an impairment loss in the financial statements.

Response:

- (a) Agree. AC concurs with the points included in Appendix 3 paragraph 61 supporting rejection of the alternative of recognising an impairment loss based on a "permanent" criterion. In addition, AC concurs with the view that the use of present value techniques, as referred to at 2.2 above, effectively removes the need for a permanence test to avoid having to recognise temporary changes. AC also agrees that the "probability" criterion would be too difficult to apply in practice in many cases.
- (b) Agree.

Reversals of Impairment Losses

- 2.5** *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 (paragraphs 70-76 of the Exposure Draft and paragraphs 83-87 of the Basis for Conclusions)?*

Response:

Disagree. AC is unclear why IASC proposes a different prerequisite for reversal of an impairment loss in E55 from that provided for in IAS 16. Specifically, E55 proposes a reversal "if, and only if, there has been a change in the estimates" whereas IAS 16 requires a reversal when "the circumstances and events that led to the recognition of the impairment loss have changed". In most practical cases it may be expected that a prudent preparer of financial statements will react to a change in "circumstances and events" by restating estimates, in which case both methods will yield the same result. However the wording of E55 may permit abuses whereby an entity changes its estimates in circumstances where it is less certain that "circumstances and events" have changed significantly, and by means of the changed estimates justifies a reversal of past impairment losses. AC recommends that E55 adopt the "circumstances and events" wording from IAS 16.

- 2.6** *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 (paragraphs 77-78 of the Exposure Draft)?*

cont.../

(4)

Response:

Agree. There should be a requirement that the preparer of the financial statements can demonstrate that the external event has reversed.

Scope

2.7 *Do you agree that the Standard should apply to all assets except those listed in paragraph 1 of the Exposure Draft (paragraphs 1-4 of the Exposure Draft and paragraphs 106-110 of the Basis for Conclusions)?*

Response:

Agree. However AC recommends that IASC decide whether IAS 11 and IAS 12, which determine recoverable amount on an undiscounted basis, will ultimately require revision to incorporate discounting. If so, it would be helpful if a statement were made indicating when the revisions should be expected.

Identifying a Potentially Impaired Asset

2.8 *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?

(paragraphs 6-12 of the Exposure Draft)

Response:

(a) AC agrees that the recoverable amount of an asset should be estimated if there is an indication that the asset is impaired. AC does not agree that the recoverable amount should be estimated only if there is such an indication. AC notes that the "...and only if" qualifier in question 8 is not included in paragraph 6 of E55, and would not support its inclusion. Preparers should be left the option of performing an estimate of recoverable amount even in the absence of the one of the indications, should they see fit to do so.

(b) AC recommends that the following "internal sources of information" be added to the indicators of impairment included in paragraph 8:

cont.../

(5)

- A net cash outflow from operating activities or an operating loss in the current period.
- A commitment by management to undertake a significant reorganisation.
- A major loss of key employees.
- A significant adverse change in any "indicator of value" (for example multiples of turnover) used to measure the fair value of a fixed asset on acquisition.
- The Going Concern concept has not been applied to the entity, or to a separately identifiable part thereof.
- The entity has failed to meet a forecast on which a previous present value calculation for impairment assessment had been based.

Net Selling Price

2.9 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 (paragraphs 5 and 17-18 of the Exposure Draft and paragraphs 31-38 of the Basis for Conclusions); 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) (paragraphs 5 and 19-21 of the Exposure Draft and paragraph 35 of the Basis for Conclusions)?***

Response:

- (a) Agree.** However further guidance on how a net selling price should be determined in the absence of an active market would be helpful.
- (b) AC concurs** that net selling price should be determined after deducting directly attributable costs of disposal. Paragraph 20 of E55 should specifically state that finance costs are not to be included in costs of disposal.

However, as indicated in the response to Question 2.10 (b) below, AC believes that impairments should be measured on a post tax basis. AC therefore proposes that the tax consequences of disposal be allowable as a directly attributable cost in arriving at net selling price.

Value in Use

2.10 Do you agree with the proposed requirements and guidance in the Exposure Draft for:

- (a) the basis for estimates of future cash flows (paragraphs 23-27 of the Exposure Draft and paragraphs 24 and 40-42 of the Basis for Conclusions);**
- (b) the composition of estimates of future cash flows (paragraphs 28-35 of the Exposure Draft and paragraphs 43-46 and 50-58 of the Basis for Conclusions); and**
- (c) selecting the discount rate (paragraphs 36-40 of the Exposure Draft and paragraphs 47-49 of the Basis for Conclusions)?**

Response:

- (a) Agree.
- (b) AC believes that impairments should be measured on a post-tax basis, and not on a pre-tax basis as proposed by E55. In particular AC believes that goodwill and similar tax-disallowed items should be grossed up for impairment testing purposes, as detailed in Appendix 3, paragraph 57. Cases such as that described in the example are only likely to arise, and be material, in the largest and most complex of entities, which should have the resources to perform the grossing up calculations.
- (c) AC concurs in principle that a market-determined rate should be used and that the riskiness of the venture must be taken into account. If this were done by applying a risk based discount rate to risk-free cashflows, the objective would be achieved.

However a substantial minority of AC believes that in the early stages of implementation of present value and discounting techniques a simpler approach may be preferable, i.e. reflect risk in the cashflows and use a risk-free discount rate. A further case for the use of risk-free rates generally is that risk would normally be reflected in the assumptions underlying the preparation of the cashflow forecasts, and that therefore using a market-determined rate incorporating risk would double-count at least part of the inherent risk and lead to overly conservative forecasts. These persons believe that there is greater experience in companies of incorporating risk into cashflows than there is of adjusting a discount rate to take account of risk. This approach also ensures that the discount rates used by entities will be more comparable and can be objectively assessed. The members of AC holding this view therefore concluded that the IAS should require use of an objectively measured risk-free discount rate, and that

cont.../

(7)

subsequently, when some years' practical experience of the use of present values and discontinuing in these circumstances has been gained, IASC may wish to revisit the topic of discount rates in more complex situations. AC would be interested to hear whether IASC has done any research on this topic to date, with details of the reasons for their current preference.

In certain cases specific borrowings may be clearly matched with specific activities. In such cases the most appropriate discount rate may be linked to the interest rate applying to the borrowings. An example would be a special purpose company which has funded its main asset (say an aircraft) with specific borrowings, and which must therefore earn a return in excess of the cost of those borrowings in order to generate a profit.

Cash-Generating Units

- 2.11** *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 (paragraphs 46-47 of the Exposure Draft)?*

Response:

Agree.

- 2.12** *Do you agree with the requirements and guidance for determining the items that are included in a cash-generating unit (paragraphs 5 and 48-53 of the Exposure Draft)?*

Response:

Agree in principle. AC concurs with the concept, as set out in paragraph 48, that a cash-generating unit is the "smallest group of assets" that generate an independently identifiable cash flow. However AC fears that this definition may be interpreted too restrictively in the case of small and medium sized entities. AC recommends that IASC add the following wording to paragraph 48 either immediately before or after the example:

"Although there are different ways in which a cash-generating unit might be identified, in order to perform impairment reviews as accurately as possible the groups of assets that are considered together should reflect economic linkages and be as small as is feasible given the size and structure of the entity. In the case of small entities the cash-generating unit may be the entity itself".

2.13 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 (paragraphs 59-61 of the Exposure Draft and paragraphs 79-81 of the Basis for Conclusions)?

Response:

Agree. AC concurs with the proposed approach as:

- (a) Frequently only the "bottom-up" test will be required; and
- (b) Where the "top-down" test is also required, the entity will often test the recoverable amount of a whole business.

Accordingly AC does not believe that requiring the two tests to be applied in certain cases is overly burdensome.

2.14 Do you agree with the procedures for allocating an impairment loss of a cash-generating unit between the assets of that unit (paragraphs 62-65 of the Exposure Draft and paragraphs 77-78 of the Basis for Conclusions)?

Response:

AC would prefer an impairment loss to be allocated between assets of the cash-generating unit in the following order:

- (a) first, to goodwill
- (b) second, to any intangible asset for which no active market exists
- (c) third, to other intangible assets
- (d) last, to tangible assets on a pro rata basis.

Alternatively, items (b) and (c) could be combined. AC believes that the distinction drawn in E55 between "assets whose net selling price is less than their carrying amount" and other assets is artificial, and would prefer to allocate impairment losses between these assets, as a single group, on a pro-rata basis.

Disclosure

2.15 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

cont.../

(9)

information, such as the amount of impairment losses that can be reversed in subsequent periods (paragraphs 88-92 of the Basis for Conclusions)?

Response:

Agree. Where an impairment loss is very significant to the results of the entity, additional disclosures will be required by paragraph 82 of E55.

2.16 *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 recognised 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.

(paragraphs 24, 93-95 and 98-99 of the Basis for Conclusions)?

Response:

Agree. However, guidance should be provided to determine when impairment losses are "significant" and therefore trigger these disclosures. AC would prefer these disclosures to be restricted to "exceptional" or "unusual" items.

AC concurs with the additional disclosure at (c)(i) above, i.e. the discount rate.

A requirement to include the other suggested additional disclosures could be counter-productive, as a mass of data regarding individual assets could obscure the "big picture".

cont.../

(10)

2.17 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 recognised 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?**

(paragraphs 24 and 96-97 of the Basis for Conclusions)?

Response:

AC does not agree with the disclosure requirements in paragraphs 83-84 and would not support any additional disclosures in this area. E55 requires recoverable amount (and hence value in use) to be calculated whenever there is an "indication that an asset may be impaired". This may occur in relation to a number of assets but after performing the recoverable amount calculation an impairment loss may only require to be recognised in a limited number of cases. Paragraphs 83-84 would result in excess disclosure without adding any value particularly if the accounting policy for the relevant asset caption explains the steps the Directors have followed once an indication of impairment has been identified. The user of the financial statements would then have all the information required.

2.18 Do you agree with the disclosure requirements in paragraph 85 of the Exposure Draft (paragraphs 24 and 100-101 of the Basis for Conclusions)?

Response:

AC agrees with paragraph 85 up to the first line of page 45 ending ".....but leaving all the other assumptions unchanged". The rest of the requirement would again lead to excessive disclosure. The disclosures which E55 proposes are similar to those for a change in accounting policy. The scenario described results from actual differing from original estimates. Where this occurs the recoverable amount should be recalculated in light of possible reductions in future cash flows and an impairment decision made in the normal way.

2.19 Do you agree that an enterprise should not be required to give information on how cash-generating units are determined (paragraphs 102-105 of the Basis for Conclusions)? If you believe that such information should be required, please indicate which details should be required.

cont.../

(11)

Response:

Agree.

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

Response:

No further disclosures should be required.

Appendices

2.21 *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.)*

Response:

Appendix 1 should be included in the IAS without amendment. AC also concurs that Appendix 3, whilst useful in explaining the rationale for the approach taken in E55, should be excluded from the IAS.

2.22 *Do you agree with the consequential changes to IAS 16, Property, Plant and Equipment (Appendix 2, Proposed Amendments to Other International Accounting Standards)?*

Response:

Subject to any consequences arising from paragraph 2.5 above, AC agrees with the proposed changes to IAS 16.

Other Comments

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

Response:

AC has the following additional comments:

- (a) E55 does not address a case where diverse activities, some profitable and others unprofitable, share common facilities. The allocation of assets between

cash-generating units in such a case becomes problematical. For example, is it permissible in such a case to take account of the benefit of transferring such facilities to other profitable uses within the entity? This issue should be addressed.

- (b) The second sentence of paragraph 6 should refer to "Paragraphs 8 to 12".
- (c) The last sentence of the example in paragraph 52 is confusing. AC recommends that it be replaced with the following:

"The carrying amount of the cash-generating unit is 500, which is..."