

25 August 1997

The Secretary General
International Accounting Standards Committee
167 Fleet Street
LONDON EC4A 2ES
United Kingdom

Dear Sir

RE: E 55 "Impairment of Assets"

The Institute of Chartered Accountants in Australia welcomes the opportunity to make a submission on E 55 "Impairment of Assets". The issue of asset impairment and the recognition of impairment losses is a controversial one and we agree that there is a great need to progress towards international harmonisation of accounting standards in this contentious area.

The ICAA does not have the resources to research and comment in detail on exposure drafts. However we have endeavoured to raise awareness of E 55 among our members and the attached comments are based on feedback we have received.

While the proposals appear to have been soundly researched, there remains a considerable level of concern within this country concerning the appropriateness of introducing "fair values" into the accounting framework without the resolution, by way of a Concept Statement, of the broader Issue of "Measurement" in financial statements. We believe this issue needs to be of a higher priority in order to ensure all the valuation bases being applied to assets produce a set of financial statements that is consistent and meaningful to users.

If you require any further information please do not hesitate to contact the ICAA's Technical Director, Mr. Keith Reilly or the writer.

We reiterate that we support the IASC, subject to the "measurement" issue referred to above and our detailed comments are attached.

Yours faithfully

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Technical Standards Consultant

IASC Exposure draft E 55

Impairment of Assets

Questions raised by the ED

1. Definition of recoverable amount

We agree that the definition of "recoverable amount" proposed in the ED is preferable to "fair value" on the basis that it allows management's intentions with respect to the asset to be reflected in the calculation. This ensures that the value truly attempts to reflect the service potential of the asset, consistent with the definition of an asset as contained within Statements of Accounting Concepts. It also allows for the fact that many of the types of assets held by an entity would not be "exchanged" as it is on this basis that management make decisions,

This definition is consistent with the feedback obtained from the invitation to Comment on Recoverable Amount issued by the Australian Accounting Standards Board in 1993. However considerable reservation was expressed on the practicalities of working with this definition hence the need for detailed guidance. We consider that the current ED does provide a good level of practical guidance for the assessment of this issue.

Notwithstanding the above there is a considerable body of our members who consider that the use of a valuation technique necessitated by "recoverable amount" is introducing into the reporting process new bases of measurement which depart from historical cost accounting. Given that the whole issue of "measurement" in financial reports is still very contentious they do not support the introduction of "market" or "value in use" concepts into the reporting framework, preferring that the broader topic of "measurement" be addressed first. In particular these members express considerable reservation about the use of present value techniques, seeing this as an even greater departure from historical cost principles and additionally introducing an unacceptable level of uncertainty into the reporting process.

We recommend that the IASC address the issue of "measurement" in financial statements as a matter of priority and that the appropriateness of these new requirements be reconsidered in light of the results of these deliberations.

2. Appropriate use of present value techniques

We agree with the use of present value techniques as the most appropriate way of determining the current value of future cash flows in order that they may be compared with current selling prices and carrying values.

However many of our constituents feel that making the discounting calculations mandatory is not appropriate since it presupposes valuation bases on the balance sheet that are not currently in use (i.e. are not part of modified historical cost accounting) as well as introducing an unacceptable level of subjectivity into the asset calculations and the reporting process as a whole.

Given that the broader issue of the appropriate valuation bases for assets is still subject to debate we would prefer that mandatory use of discounting was not required. Instead entities should be required to disclose whether or not they have adopted a discounted approach (current practice in Australia).

3. Assets held for disposal - should the rules be the same?

We agree with the Board's arguments that since "recoverable amount" deals with intentions in relation to the assets there is no need for different rules in relation to assets held for disposal.

4. Recognition of impairment losses

We agree that an Impairment loss should be immediately recognised on assessment of an asset's recoverable amount being below its carrying value

We also agree that where recoverable amounts cannot be determined for individual assets, impairment losses should only be recognised if there is an impairment to the asset's relevant cash generating unit

5 and 6. Reversals of impairment losses

We agree with the ED's proposals that it is only appropriate to reverse impairment losses when there has been a change in the underlying factors influencing the original impairment assessment

7. Scope

We agree that the ED should apply to all assets except inventories, construction contracts, deferred tax, financial instruments and employee benefits as these types of assets and liabilities are specialised and are subject to their own impairment rules.

We also believe it is appropriate to apply this test to all physical assets and investments as it is consistent with the way management would assess the service potential of these assets and their continued role in the organisation.

However many of our constituents argue that it is unnecessary to apply these rules to current assets due to their short term nature, effectively meaning that they are almost always carried at what would constitute "recoverable amount".

We recommend that the Board consider and specifically address the issue of application of the test to "current assets" in the final standard. This is particularly significant in view of the IASC's recently issued discussion paper on financial assets and liabilities which proposes the introduction of "fair value" concepts for the valuation of these assets.

We also recommend that the Board give consideration to excluding the assets of "not for profit" and other similar entities where the service potential for assets is not measured on the basis of ability to provide future cash flows. This would be consistent with the current exclusion for these entities contained in Australian Standard AASB 1010 "Accounting for the Revaluation of Non Current Assets".

8 Identification of impaired assets

We agree with the ED's proposal that all assets should be reviewed at each balance date and that the recoverable amount test only be done for those assets where there is an indication of impairment. We consider this is the most practical means of ensuring that this often difficult exercise is not performed unless necessary.

We agree that the list of indicators of impairment set out in the ED including market values, obsolescence, cash flows generated and rates of return should ensure that all significantly impaired assets are readily identified.

9 Definition of net selling price

We agree with the definition of "net selling price" as the "amount obtained between willing buyer and seller, net of directly attributable disposal costs". In most cases it would be quite impractical to obtain a price from an active market and therefore this definition is more practical to work with. However given the significance of this definition to "recoverable amount" we feel there should be greater guidance given on what constitutes "best available information" of this value.

10 Value in use

- - basis of estimating future cash flows

We agree with the ED's proposals that cash flows used should be based on reasonable, supportable assumptions, objectively verifiable where at all possible. We also agree that the short term projections should be based on 5 year periods and be appropriately approved, and that longer term projections should be based on steady or declining growth rates (unless higher rates can be justified,)

- - composition of estimates of future cash flows

We agree that cash inflows should include flows generated from the asset's use, as well as outflows directly attributable to those inflows i.e. necessary to ensure the inflows are achieved. The flows should also be net of any disposal in or outflows at the end of the asset's useful life.

- - selecting the discount rate

We agree that the appropriate discount rate is a market determined risk adjusted rate appropriate to the circumstances of the asset. This is consistent with current Australian requirements in AASB 1010

11-14 Cash generating units

We agree that where an asset's cash flows cannot be separately identifiable it is appropriate to assess recoverable amount on the smallest separately identifiable cash generating unit. This is consistent with current Australian requirements as set out in AASB 1010 and should provide sufficient guidance to prevent a level of aggregation that effectively avoids the requirements.

We agree that a cash generating unit should consist of all assets (and if appropriate liabilities) that can be reasonably be attributed to it.

We also agree that the allocation of goodwill and overheads should be made to cash generating units if there is a reasonable basis for doing so although in practical terms our members indicate that this will often be difficult to do.

We agree that the order of allocation of an impairment loss to assets of a cash generating unit i.e. goodwill, intangibles not actively traded, asset's with net selling prices below their carrying values and other is an appropriate basis fairly reflecting the likely contributors to an impairment.

15-20 Disclosure

We consider that the disclosure requirements contained in the ED are quite sufficient to enable users to make informed judgements on the status of an enterprise's assets.

We believe that disclosures based on class of asset is sufficiently informative and that there is no need to disclose details of how the assessments were performed or on how cash generating units were determined - the existence of this ED should be sufficient to indicate to users the bases that have been applied rather than necessitating disclosure of the detailed procedures undertaken.

On this basis we also consider that it is only appropriate to require detailed disclosure where impairment losses have actually been recognised unless unusual circumstances, such as those in paragraph 83, exist.

In addition to the current disclosures we consider that it would be appropriate to require disclosure of significant impairment circumstances and management response in the "management discussion and analysis" section of the financial statements.

21 Appendices-illustrative examples

We consider that Appendix 1 provides adequate detail and explanation of the major issues identified within the ED as do the examples contained within the standard and would support their inclusion in the standard.

22 Appendices - consequential changes to IAS 16

We agree with all the consequential changes proposed to IAS 16.

23 Other

References to IAS 16

In paragraphs 41 and 70 the effect of the operation of IAS 16 on these requirements is referred to in a footnote.

We consider that the impact of another standard on these provisions is of sufficient significance that it should be explicitly referred to in the body of the standard.