

The Consultative Committee of Accountancy Bodies

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The Institute of Chartered Accountants of Scotland
The Institute of Chartered Accountants in Ireland
The Association of Chartered Certified Accountants
The Chartered Institute of Management Accountants
The Chartered Institute of Public Finance and Accountancy

Our ref

AC/jas/sbc4 Your ref

Date 4 September 1997

Dear Sir Bryan

IMPAIRMENT OF ASSETS

General remarks

I have pleasure in submitting the views of CCAB on the above exposure draft. We welcome the exposure draft and are generally supportive of the recommendations in it.

Measurement of impaired assets

We consider that an impaired asset should be measured at the higher of its net selling price and its value in use. We agree that present value techniques should be used to measure its recoverable amount. The criteria in the exposure draft to be applied in deciding when an impairment loss should be recognised also have our support.

Relationship with depreciation

We believe that the inter-relationship between depreciation and impairment should be more clearly explained.

Discounting

The proposed standard involves the use of discounting which again highlights the need for IASC to undertake a project on this subject to ensure that its requirements in various different standards are consistent.

Reversal of impairment losses

In overall terms, we support the proposals for the reversal of impairment losses. It would, however, be helpful if it were made clear that such reversals will only rarely occur. We also suggest that consideration should be given to only permitting a reversal where the *circumstances* that gave rise to the impairment have changed. This is a more rigorous requirement than that proposed which discusses a change of *estimates*. In addition, it may be helpful to restrict changes giving rise to reversals to those specific to the asset excluding, for example, changes in discount rate.

Identification of impaired assets and their measurement

We endorse the proposals for identifying a potentially impaired asset and those for determining its net realisable value. With regard to estimating value in use we agree with the proposals composing the basis on which future cash flows should be estimated. One member of CCAB would prefer post-tax cash flows to be used in the calculation. More guidance is needed on the determination of the discount rate to be applied.

Cash generating units

We agree with the proposals dealing with cash generating units.

Disclosure

One of the members of CCAB has certain reservations about the necessity of the disclosures in paragraphs 83-85 of the exposure draft.

Appendices

There would be merit in expanding the examples in the Appendix to explore the effects of the accounting treatment in subsequent years.

Detailed comments

A copy of the detailed letters of comments received from the ACCA, ICAEW and ICAS are attached.

Yours sincerely



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Our ref:

1 August 1997

Dear Anthony,

E55 Impairment of assets

ACCA's Financial Reporting Committee considered the above exposure draft (ED) from the International Accounting Standards Committee (IASC) at a recent meeting. I am writing now to give you their views for incorporation into the CCAB's response to IASC.

General points

There are two general points that we would make before turning to the questions that IASC have raised for specific comment.

The first concern is that the ED does not really cover adequately the inter-relationship between impairment and depreciation. The position for tangible fixed assets in this respect may be rather different from goodwill or other intangibles. A clear statement that impairment should not be a substitute for depreciation would be welcome. Impairment should be an addition to systematic depreciation over prudently estimated expected useful lives. It would also be helpful for a standard to stress that impairments should be viewed as unusual circumstances, as depreciation should be set to adequately reduce asset values in most circumstances. If impairments should be rare events, then the reversal of those impairments should be rarer still.

The second general point that we would make is that this proposed standard would be a further example of the introduction of discounting into financial reporting, when the IASC has produced no general justification for this in historical cost accounts, or set out in a



comprehensive way when it would be right for discounting to be used, or how discount rates should be calculated and accounted for in theory and practice.

IASC's specific questions

Q1. Which of the following approaches do you support: (a) recoverable amount as the higher of net selling price and value in use? (b) recoverable amount as the fair value of the asset? (c) other?

We support method (a).

Q2. Do you agree that present value techniques should be used to measure the recoverable amount of an asset?

As noted above we would have preferred that discounting had been introduced into financial reporting by IASC on a reasoned and fully worked-out basis, and not piecemeal.

Q3. Do you agree that the definition of recoverable amount is just as applicable to an asset held for disposal as to an asset held for continuing use?

Yes.

Q4. Do you agree that an impairment loss should be recognised whenever the recoverable amount of an asset is less than its carrying amount, and only if the cash generating unit to which the asset belongs is impaired?

We have some problems with the wording of this question, specifically the "and only if..." condition which is laid down. However we do think that in cases where recoverable amount can be worked out for an individual asset, if that is below carrying amount the impairment loss should be recognised, without consideration of any larger cash generating unit (CGU) to which the asset might belong. If recoverable amount can only be calculated for a CGU, impairment should be provided only where this falls below carrying amount, and then allocated to the unit's assets.

Q5. Do you agree that an impairment loss recognised in prior years should be reversed if, and only if, there has been a change in the estimates used to determine the recoverable amount?

As stated above we consider that the need for impairment provisions should only arise in unusual circumstances, and that the reversals of such provisions should be rarer still. Impairment provisions will often be very subjective, with little hard external evidence for the estimated future cash flows selected. Combining this subjectivity with the ability to reverse an impairment provision, might seem reasonable grounds for treating impairments as permanent changes to an asset's cost. This would have the effect of not allowing a provision for impairment to be made one year and then reversed the next, almost at the discretion of management.

However, on balance we consider that significant changes in key assumptions must be reflected in accounts and reversals permitted. We would, however, like to see more restrictions on the reversal of impairments, perhaps adopting the rules proposed for goodwill. We suggest that the changes should be specific to the asset and should not include, for example, reductions in discount rates. We support the proposed exclusion of the unwinding of the discount in this respect.

Q6. Do you agree that an impairment loss recognised for goodwill and other intangible assets should be reversed in a subsequent period if, and only if, the external event that caused the recognition of the impairment loss has reversed?

Yes. We would, however, appreciate some further guidance on what might or might not be appropriate external events. Could loss of market share be an example of an external event? If so its reversal would be difficult to disentangle from internally generated goodwill. The ED makes no reference as to whether the effects of general price inflation might be grounds for reversals of impairments. We would favour the conditions for any reversals of impairments being more restricted rather than less.

Q7. Do you agree that the Standard should apply to all assets except those listed in paragraph 1?

Yes.

Q8. 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 included will require an enterprise to estimate recoverable amount whenever there is a significant risk that the asset is impaired?

Yes to both parts of this question. It will not however be realistically possible to prevent an impairment review where management are determined to have one, because for example the indicators are a minimum list and not exclusive of others. This may be of importance when considering reversals of impairments.

Q9. Do you agree that net selling price should be determined (a) based on the sale of an asset in an arm's length transaction between knowledgeable willing parties, and that it is not necessary to have an active market; and (b) after deducting the incremental costs directly attributable to the disposal of the asset (excluding finance cost and income tax)?

(a) Yes, though clearly caution needs to be exercised in relation to selling prices where no active market exists to support them.

(b) Yes.

Q10. Do you agree in determining value in use with the proposed requirements and guidance for (a) the basis for future cash flows (b) the composition of estimates of future cash flows; and (c) selecting the discount rate?

(a) Yes, these seem reasonable restrictions to try to ensure that unrealistic cash flow projections are not used to avoid impairments.

(b) No. We consider that post tax cash flows would be better than pre-tax, because otherwise all relevant cash flows would be discounted with the one exception of tax cash flows. This is an example of a matter that should be dealt with in a comprehensive consideration of the role of discounting in financial reporting.

(c) No. The ED makes no mention of how to deal with general price inflation, which seems unsatisfactory. Also while risk-adjusted market rates would be right for estimating market values or selling prices, we favour risk-free discount rates for value in use calculations. We do so on three grounds:

- risk-adjusted market rates carry within them the premium that any third party would demand on purchasing the asset, representing their lesser knowledge of the cash flows
- we are not clear that in principle it is right for value in use to reflect risk
- the determination of a risk-free rate is generally less subjective than for a risk-adjusted one.

Q11. Do you agree that if an asset does not generate cash inflows that are largely independent, an enterprise should determine the recoverable amount of the asset's CGU?
Yes.

Q12. Do you agree with the requirements and guidance for determining the items that are included in a CGU?
Yes.

Q13. Do you agree with the requirement to recognise an impairment loss if there exists goodwill or other corporate assets that relate to a CGU?
Yes.

Q14. Do you agree with the procedures for allocating an impairment loss between the assets of a CGU?
Yes.

Q15. Do you agree with the disclosure requirements in paragraphs 79-81 of the ED?

Q16. Do you agree with the disclosure requirements in paragraph 82 of the ED?

Yes, and in both cases we do not consider further information should be required.

Q17. Do you agree with the disclosure requirement in paragraph 83 of the ED?

No. This seems both an unrealistic requirement and one that is inconsistent with other areas of the financial statements, for example where there might be potential provisions against debtors or inventories.

Q18. Do you agree with the disclosure requirements in paragraph 85 of the ED?

Yes. We recognise that this might be a difficult and potentially onerous disclosure to meet, and to check that it has been met. It may in some circumstances, however, be an important hindrance to the use of increasingly optimistic cash flow assumptions in order to avoid impairment.

Q19. Do you agree that an enterprise should not be required to give information on how cash generating units are determined?

Yes. In many cases disclosure would simply adopt the general wording from the Standard. The disclosure of the unit itself under paragraph 82 is likely to be more illuminating.

Q20. Should an enterprise be required to disclose any other information?

Not in relation to impairments.

Q21. Should any material in Appendix 1 be amended or deleted?
No.

Q22. Do you agree with the consequential amendments to IAS16?
Yes.

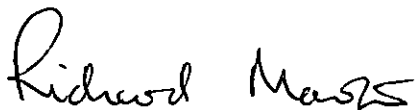
Q23. Do you have any other comments on the proposed International Accounting Standard?
No.

General

If there are any matters arising from the above on which you require further clarification or information, please be in touch with me.

Please send me a copy of CCAB's submission when it has been finalised.

Yours sincerely



Richard Martin
Secretary to the Financial Reporting Committee

20 August 1997

REL/RNC/JP/IASCE55

**MEMORANDUM OF COMMENT
ON THE PROPOSED INTERNATIONAL ACCOUNTING STANDARD
IMPAIRMENT OF ASSETS**

Introduction

1. We have reviewed the exposure draft on impairment of assets (E55) issued for comment by the IASC and our comments are set out in this memorandum. We deal first with a number of general points. We then comment on the specific issues on which views are invited. Finally, we refer to some other matters that will need to be addressed before the proposals are issued as an international accounting standard.
2. In view of the possibility that the proposals may have an effect on the development of a future standard on accounting for impairment in the UK, we are sending a copy of this memorandum to the Accounting Standards Board.

GENERAL

3. We welcome the exposure draft as a thought-provoking contribution to a continuing debate. We agree that impairment of assets is important and that it should be communicated to users of financial statements, notwithstanding the subjectivity that will often be involved in the measurement of impairment.
4. Our principal concerns are that:
 - The proposed standard would involve departures from historical cost accounting that have not been fully debated and are likely to cause conceptual difficulties. We question the effectiveness of a standard on impairment before resolution of such issues as the use of valuations within the historical cost model, the purpose and basis of depreciation and the role of discounting. (Paragraphs 6, 12 and 16)
 - The measurement of impairment is unavoidably subjective, particularly in respect of the determination of cash-generating units, the allocation of goodwill and central cashflows, and the choice of an appropriate discount rate. (Paragraphs 15, 16 and 17)

- Unless the subjectivity involved is properly acknowledged, there may be a gap between the degree of comfort that users will expect to draw from information about impaired values and the work that preparers and auditors will be able to perform to support that information. (Paragraphs 16 and 17)
- Providing the information required for the proposed disclosures will often be onerous for preparers and may involve the release of commercially sensitive information. Disclosures should be by class of asset rather than by individual asset or cash generating unit and are unnecessary when no impairment loss is recognised. (Paragraphs 19 to 22)
- E55 does not address the impact on asset values that may occur due to environmental factors, where uncertainty of timing and measurement and the relationships with provisions may cause particular difficulties. Guidance in this area should be developed (see Appendix).

SPECIFIC ISSUES

Measurement of recoverable amount

Q1. 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)*

5. We support the approach in option (a).

Q2. 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)?

6. Yes. As *net selling price* is implicitly a present value, a comparable *value in use* must also be measured on a discounted cashflow basis. However, as neither historical cost, nor depreciation, which is an allocation of historical cost, recognise the time value of money, this approach gives rise to conceptual inconsistencies.

Assets held for disposal

- Q3 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)?
7. Yes. Paragraph 26 explains the situation succinctly and should be included in the proposed international accounting standard.

Recognition of impairment losses

- Q4. 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.

8. We find the question is not sufficiently clear for us to provide a response. It appears that both conditions need to be satisfied for impairment to be recognised, in which case the words "only if" in sub-paragraph (b) should be deleted. Their inclusion is otherwise in conflict with use of the word "whenever" in sub-paragraph (a).

Reversals of impairment losses

- Q5. 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 estimate 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)?
9. We consider that an impairment loss recognised in prior years in respect of an asset carried on an historical cost basis should be reversed, not on a change of *estimates*, which might result in excessive volatility, but only on a change of *circumstances* which gave rise to the impairment. We therefore prefer the wording in IAS16, as described in paragraph 83 of Appendix 3. The proposed standard should also include one set of criteria that would apply, not only to goodwill and intangibles, but to all tangible fixed assets and fixed asset investments.

Q6. *Do you agree that an impairment loss recognised for goodwill and other intangibles 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)?*

10. Yes. See our answer to Question 5 above.

Scope

Q7. *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)?*

11. Yes.

Identifying a potentially impaired asset

Q8. *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 that recoverable amount whenever there is a significant risk that the asset is impaired?*

12. Yes. However, paragraph 8(a) should refer to declines as a result of *normal business use* (wear and tear) rather than *depreciation* (allocation of cost). We also note that, when discussing internal sources of information, paragraph 8(e) mentions *changes expected to take place*. This appears to be a clear reference to management intent which, in most other areas, the IASC considers irrelevant.

13. It would be helpful for the proposed standard to provide a definition for the term *impairment*, if only to distinguish *impairment* from *depreciation*. We suggest the following definition:

‘An asset has suffered an impairment when its recoverable value is less than its carrying value’.

Net selling price

Q9. *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) (paragraph 5 and 19-21 of the exposure draft and paragraph 35 of the basis for conclusions)?*

14. Yes. However, it should be stated that the recoverable amount should take into account any proper marketing necessary to dispose of the asset. In this connection, we draw your attention to the explanation in the Appraisal and Valuation Manual issued in the UK by the Royal Institution of Chartered Surveyors:

‘after proper marketing’ means that the asset would be exposed to the market in the most appropriate manner to effect its disposal at the best price reasonably obtainable in accordance with the market value definition. The length of exposure time may vary with market conditions, but must be sufficient to allow the asset to be brought to the attention of an adequate number of potential purchasers. The exposure period occurs prior to the valuation date.

Value in use

Q10. *Do you agree with the proposed requirements and guidance in the exposure draft for:*

- (a) *the basis for estimates of future cash flows (paragraph 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)?*

15. Yes, as regards Questions 10(a) and (b). However, the example in paragraph 29 illustrates the difficulty of applying these rules in practice and we doubt whether they will be as robust as the IASC appears to believe.
16. No, as regards Question 10(c). Guidance should be provided as to the principle involved. Selection of the discount rate is probably the single most important and subjective area of the proposed standard. A small change in the discount rate adopted can very significantly affect the *value in use* derived for the asset. We consider that the proposed guidance is insufficiently helpful to preparers in deciding how to select the appropriate discount rate. For example, practical difficulties may arise in determining the *risks specific to the asset* and what is *an investment of equal risk*.

Cash-generating units

Q11. *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)?*

- Q12. *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)?*
- Q13. *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 cash-generating unit (paragraphs 59-61 of the exposure draft and paragraphs 79-81 of the basis for conclusions)?*
- Q14. *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)?*
17. Yes, although we are concerned about the subjectivity involved. The *bottom-up* and *top down* approach may make it easier for enterprises to avoid recognising impairment losses for purchased goodwill. Nevertheless, we do foresee situations where it may reasonably be claimed that:
- (a) the whole business is a cash-generating unit; or
 - (b) the generation of income depends on the interdependence of the overall asset network.

The proposed standard should acknowledge that such situations might arise.

Disclosure

- Q15. *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 information, such as the amount of impairment losses that can be reversed in subsequent periods (paragraphs 88-92 of the basis for conclusions)?*
18. Yes.
- Q16. *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 amounts is based on 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 in 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)

19. We do not agree with the disclosure requirements in paragraph 82 for each *individual* asset or cash-generating unit, as these could be very onerous and are likely to involve commercially sensitive information. We do, however, support the disclosures proposed in paragraphs 82(a) and (b) if made by *class* of asset.

20. We do not support the disclosures in paragraphs 82(c) and (d) in any circumstances.

21. We agree that enterprises should not be required to provide the additional disclosures set out in Question 16(a) to (d)

Q17. *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 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)?

22. We do not agree with the disclosure requirements proposed in paragraphs 83-84. For example, if both management and auditors are satisfied that no impairment loss should be recognised, it is very unclear what message the information in paragraph 83 is supposed to give to the capital markets.

23. We agree that an enterprise should not be required to disclose the information specified in Questions 17(a) to (c).

Q18. *Do you agree with the disclosure requirements in paragraph 85 of the exposure draft (paragraphs 24 and 100-101 of the basis for conclusions)?*

24. No. The first part of paragraph 85 is concerned with measurement rather than disclosure. The second part seems to be designed purely as an anti-avoidance measure and should not be necessary.

Q19. *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.*

25. No. We consider that the way in which an entity defines its cash-generating units may have a significant effect on measurement and should accordingly be disclosed as an accounting policy in the form of a general description of the basis used.

Q20. Should an enterprise be required to disclose any information other than that discussed in questions 15-19 to the invitation to comment?

26. No.

Appendices

Q21. Should any material in Appendix 1 be amended or deleted? Should any further guidance be added to the appendix?

27. Yes. We suggest an expansion of the examples as they do not explore the effect of the accounting treatments in subsequent years. We are also concerned about the effect of unwinding the discount. The IASC's proposed approach leads to a mismatch between depreciation and the unwinding of the discount which may result in profits being recorded in future years. We consider that the inherent potential for distortion in future years needs to be addressed.

Q22. Do you agree with the consequential changes to IAS16, Property, plant and equipment (Appendix 2)?

28. Yes.

Other comments

Q23. Do you have any other comments on the proposed international accounting standard?

29. Yes. The IASC should consider the impact of its current proposals on other standards. For example, paragraph 36 of IAS 11 on Construction contracts makes no mention of discounting in recognising losses.

ISSUES RELATING TO ENVIRONMENTAL IMPAIRMENT

Introduction

1. Whilst the general principles of reviewing asset values for possible impairment should apply equally to assets affected by environmental factors, this type of impairment often carries particular uncertainties regarding timescale and amount and E55 does not address problems involved in measuring the related impact on asset values. Guidance in this area should be developed. For example, it would be helpful to illustrate the points made in paragraphs 32 and 33 about the interplay of provisions and asset impairment using an environmental example.

Management intent

2. The exposure draft attaches little importance to the relevance of management intent in determining the appropriate accounting treatment. A bias against such factors is difficult to justify in the case of environmental impairment, where an enterprise's plans for repair or abandonment are likely to be a key consideration.

The 'stigma' effect

3. Measurement of an environmentally impaired asset may be affected by:
 - delayed disposal, due to the need to deal with contamination, resulting in increased interest charges;
 - direct costs of overcoming the problems of contamination;
 - uncertainties due to the possibility of improvement in related technology or changes in legislation; and
 - risks arising from the stigma effect, deterring potential purchasers and resulting in a more restricted market.
4. Stigma is an aspect of asset contamination resulting from various intangible factors ranging from possible public liability and fear of additional health hazards to fear of the unknown. It might be defined as that part of any diminution in value attributable to the existence of contamination which exceeds the costs attributable to:
 - remediation of the asset;
 - the prevention of future contamination;
 - any known penalties or civil liabilities;
 - insurance; and
 - future monitoring.

In practice, the stigma effect may be recognised by applying a further discount to the value of an asset after allowing for all expected remediation costs.



ACCOUNTING STANDARDS COMMITTEE

IASC EXPOSURE DRAFT 55 "IMPAIRMENT OF ASSETS"

The Institute's Accounting Standards Committee has reviewed the IASC Exposure Draft 55 "Impairment of Assets" (E55) and wishes to comment on this as follows.

The Committee sees the proposals within E55 as being similar to those it has seen before in the ASB's Discussion Paper "Impairment of Tangible Fixed Assets", and it is supportive of the IASC's proposals. The Committee believes that as the ASB has extended the scope of its own impairment document (FRED 15) to encompass intangible assets and goodwill, the IASC should similarly extend the scope of its exposure draft, given that the process of the impairment review should be similar for all fixed assets and goodwill.

The Committee wishes to respond to the specific questions asked as follows:

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 amounts 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?

The Committee strongly supports (a) as giving the clearest guidance for the calculation of the recoverable amount. It does not support (b) as there may be an element of "current cost" within this guidance and because the guidance could be confused with acquisition accounting.



The Mark of Quality

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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)?

The Committee agrees in principle with the use of present value techniques to measure the recoverable amount of an asset. However, the Committee is concerned about the practicality of these proposals, especially in new businesses where there will be no previous cash flows on which to base these measurements. It believes that such techniques, where used, may also prove difficult to review from an audit point of view.

The Committee is also concerned regarding the possible costs of compliance of the proposals for smaller entities. It notes that the IASC has indicated that it will begin reviewing later in 1998 the application of IAS's to smaller entities. The Committee recommends that the standard, based on E55, is specifically included in that review.

Assets Held for Disposal

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 Basis for Conclusions)?

The Committee does not agree with this proposal, but accepts that there may be an element of semantics in this. The Committee considers that the IASC could give clearer guidance on which basis to use, i.e. the net selling price. An entity may be selling an asset to generate cash for the business, even though its value in use to the entity is higher than the net selling price.

Recognition of Impairment Losses

4. Do you agree that an impairment loss should be recognised for an asset:
- (a) whenever the recoverable amount of an asset is less than its carrying amount (paragraph 41 of the Exposure Draft and paragraphs 59-67 of the Basis for Conclusions); and
 - (b) 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.

The Committee agrees with both (a) and (b).

Reversal of Impairment Losses

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)?

The Committee agrees with this proposal, but believes that the tests used to assess whether an impairment loss should be reversed should be very stringent.

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)?**

The Committee agrees with this proposal. However, it believes that it is relatively artificial to distinguish between tangible assets and certain intangible assets, but accepts that it is useful to start with this stringent test for intangibles. In due course, practical experience may suggest that these could be relaxed.

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)?**

The Committee agrees with this proposal, as a practical way to move forward. However, there should be a consistent application of the principles underlying E55 to all assets. Accordingly the Committee recommends that this matter is considered by the IASC in due course.

Identifying a Potentially Impaired Asset

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)

The Committee agrees with this "two step" approach, as this will avoid unnecessary calculations (and costs) being imposed on businesses where there is no indication that an asset has been impaired.

The Committee questions the need for these indicators to be in black type. The principle, in paragraph 7, should be black lettered (as it is) but the detailed indicators in paragraph 8 should be "light type", as examples.

Net Selling Price

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)?

The Committee agrees with both of these proposals. In particular, the Committee welcomes that calculations should be made gross of tax, with the tax being calculated on a reporting entity basis.

Value in Use

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)?

The Committee agrees with both these proposals. It strongly supports the exclusion of tax from the estimates as this is a consequence of doing business, not a cost. However, the Committee is not comfortable with the example given in paragraph 29 as this uses cash flows from new business to support a valuation of "old" business.

Cash-Generating Units

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)?

The Committee agrees with this proposal.

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)?

The Committee agrees with this proposal.

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)?

The Committee agrees with this proposal, especially the approach taken to the allocation of head office assets.

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)?

The Committee agrees with this proposal.

Disclosure, Questions 15 - 20

The Committee has no comments to make on questions 15-20 on Disclosure.

Appendices

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.)

As noted earlier, the Committee believes that the guidance could be expanded to incorporate goodwill in merged businesses (similar to the expansion of the ASB's FRED 15 from the Discussion Paper).

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

The Committee has no comment on this matter.

Other Comments

23. Do you have any other comments on the proposed International Accounting Standard?

The Committee has no further comments to make on E55.