

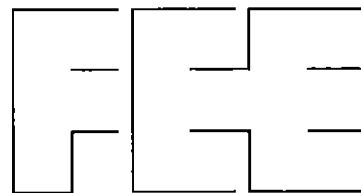
Date  
17 September 1997

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Sir Bryan Carsberg  
Secretary General  
IASC  
167 Fleet Street  
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Dear Sir Bryan,

FEE (Fédération des Experts Comptables Européens) has considered Exposure Draft E 55 - Impairment of assets - and is pleased to submit answers to the questions raised on pages 5 to 10 of the document.

### **1. Approach for determining the recoverable amount**

Provided our following remarks are considered, we agree with approach (a) to measure the recoverable amount as the higher of its net selling price and its value in use, which is the approach adopted by E 55. Two problems should be taken into account in the future discussions within IASC:

1. Basis for the conclusion of the Exposure Draft is the assumption that an enterprise, that behaves rationally, will decide the continuing use of an asset, if the value in use is higher than its net selling price, or decide the disposal of an asset, if the value in use is lower than the net selling price.

The assumption of the draft may only be retained under the following both conditions:

- a. There are no legal or effective obstacles to sell the asset; i.e. the management must have the possibility to take an investment decision as assumed. Otherwise the net selling price has no relevance for the measurement of the recoverable amount, which is in this case finally determined by the (lower) value in use.
- b. Often the disposal of an asset or a group of assets will result in further expenditures for example for restructuring and social plans. If these costs exceed the difference between the (higher) net selling price and the value in use management will decide to continue the use of the asset. Only under the condition that there will result no costs (including for example restructuring costs) or costs less the difference between the (higher) net selling price and the value in use it may be assumed that the company will dispose of the asset.

Furthermore it has to be considered that the recoverable amount from selling the asset is reduced by the costs described. If it is assumed that the company will sell the asset all the consequences related to this assumption must be reflected in the financial statements. As long as no provision is recognised for these costs they must be considered in determining the net selling price. Otherwise, that means if only parts of the assumption are considered in the financial statements, the financial statements will contradict the real situation. For this reason, not to include restructuring or reorganisation costs, as proposed under para. 20(b) is a contradiction to the assumption of rational economic behaviour and therefore para. 20(b) should be deleted.

2. Determining the value in use is a very demanding task (see our response to questions 10 and 11). If it should not be possible to develop a set of indisputable criteria to define the value in use and cash generating units the suggested solution of the Exposure Draft for measuring the recoverable amount will lead to a contradiction to the requested reliability of financial statements (see IASC - Framework, para. 31-38). In this case the alternatively suggested solution (measuring the recoverable amount normally as the fair value of an asset, see question 1.(b)) might gain importance. For this alternative it should be considered whether the fair value is equal to the net selling price.

The problems set out arise again in the context of question 14, concerning para. 65 of the Exposure Draft.

## **2. Use of present value**

Yes, we agree with the use of present value to measure the recoverable amount of assets. However, we regret that this technique of present value is implemented without any reference to the use of discounting and without any in-depth discussion of the historical cost model, which remains the benchmark treatment in IAS 16 on property, plant and equipment and in the draft standard on intangible assets. It seems that two different valuation models - fair valuing and historical cost accounting - are mixed and have potentially to be applied at the same time to the same assets. The question is how to align the cost model with present value as the approach will give rise to conceptual inconsistencies.

## **3. Assets held for disposal**

Yes, we accept a common approach to determine the recoverable amount of assets held for continuing use and of assets held for disposal. However, see answer to question 1.

**4. Recognition of impairment losses**

Yes, we agree that an impairment should be recognized for an asset for which the recoverable amount is less than its carrying amount and only if the cash-generating unit to which the asset belongs is impaired.

This answer should be read in the light of our answer to question 12, where we stress the fact that additional guidance is necessary with respect to the determination of the cash-generating unit.

**5. Reversals of impairment losses**

Yes, we agree that reversals should take place only if there has been a change in the estimates used to determine the impaired asset/recoverable amount. An example to illustrate paragraph 73 could be useful.

**6. Reversals of impairment losses on goodwill**

Yes, we agree that a reversal of an impairment loss on goodwill should be limited to cases where the external event that causes the recognition of the loss has reversed.

However, we would like the standards to be more specific on the external events referred to. For instance, paragraph 77 could refer explicitly to the external sources of information listed in paragraph 8.

**7. Scope**

Yes, we agree with the proposed scope.

**8. Identifying a potentially impaired asset**

- a) Yes, we agree that the recoverable amount of an asset should be estimated only if there is an indication that the asset is impaired.
- b) Yes, we agree with the list of indicators in question 8.

## 9. Net selling price

- a) Yes, we agree with the definition of the net selling price.
- b) Yes, we agree that the incremental costs attributable to the disposal should be deducted from the selling price. See also our response to question 1.

We suggest that the words "*income tax expense*" in the definition of costs of disposal in paragraph 5 should be replaced by "*income tax effect*" as in the case of an impairment loss, the income tax effect might be a benefit, not an expense.

In addition, we did not find any explanation in the document on the "*finance costs*" which are excluded from the definition of costs of disposal.

## 10. Value in use

- a) Yes, we agree with the basis for estimates of future cash flows.
- b) Yes, we agree with the composition of estimates of future cash flows.
- c) With respect to the discount rate selection, we are not sure that the current wording of paragraph 38 ensures that no risk factor has already been taken into consideration when estimating future cash flows. This point could be explicitly mentioned in paragraph 23.

In addition, in paragraph 36, it seems contradictory to determine the value in use of an asset, which is determined in the context of the situation of the asset's owner, on the basis of a discount rate which includes a risk component.

See also our response to question 1.

## 11. Cash generating unit

Yes, we agree that an asset with no independent cash flows should be attached to its cash-generating unit.

See also our response to question 1.

**12. Guidance to determine the cash-generating unit**

The determination of cash-generating units is a central point in the proposed standard. If cash-generating units are selected at a high level in the company, the likelihood of having impairment losses is remote.

**13. Allocation of goodwill to cash-generating units**

Yes, we agree with the guidance in paragraph 59 to allocate goodwill to cash-generating units.

**14. Allocation of the impairment loss to the components of a cash-generating unit**

No, we do not agree with the procedure for allocating an impairment loss of a cash-generating unit, in paragraph 62 c), whereby the impairment loss is allocated to assets whose net selling price is less than their carrying amount. We do not see the relevance of this allocation rule as the cash-generating units concept implies a global approach of the recoverable amount and not an individual asset approach. The (c) rule could be deleted.

Similarly, the impairment loss determined in the second part of the example in pages 37 and 38 represents the sum of the net selling price of the components of a cash-generating unit (530 in the example). In our opinion, the solution which would have stemmed from the cash-generating unit approach would have been to determine the impairment loss on the basis of the global recoverable amount of the cash-generating unit (500 in the example). The additional impairment loss would have been allocated to intangible assets and equipment on a pro-rata basis.

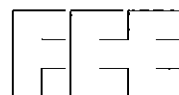
See also our response to question 1.

**15. Disclosure of impairment losses and reversals recognised during the period**

Yes, we agree with the disclosures required in paragraph 79.

**16. Disclosure in respect of each asset for which an impairment loss has been recognised or reversed during the period**

Yes, we agree with the type of disclosures required in paragraph 82, but not for each individual asset or cash-generating unit, as these could be very onerous and are likely to involve commercially sensitive information. We believe the disclosures should be made by class of assets.



**17. Disclosures in respect of assets for which the recoverable amount has been estimated but was above the carrying value**

No, we do not agree with the disclosures required in paragraph 83. We find it unrealistic and misleading to make this disclosure in a context where the necessary information may not be sufficiently reliable and involves subjectivity.

**18. Disclosure of differences between past estimates and actual cash flows**

Yes, we agree with the disclosures in paragraph 85, which are designed to avoid systematic over-estimations of cash-flows.

**19. Identification of cash-generating units**

Yes, we agree not to provide any information on how cash-generating units are determined.

**20. Additional disclosure**

No, we do not think that an enterprise should be required to disclose information other than those discussed in questions 15 to 19.

**21. Appendix 1**

No, we do not feel it necessary to amend or delete any part of appendix 1, other than the example requested to illustrate paragraph 73 (see question 5)

**22. Changes in IAS 16**

Yes, we agree with the changes in IAS 16 proposed in appendix 2.

**23. Other comments**

We have the two following additional comments:

*Paragraph 42*

Paragraph 42 states that the impairment loss should not be greater than the carrying amount of the impaired asset, unless an IAS requires to recognise a liability. No further explanation is provided to support this rule. We would suggest to add an explanatory paragraph linking the rule in paragraph 42 with standards such as the future standard on provisions.

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*Paragraph 70*

Paragraph 70 states that if a change in estimates has a favourable impact on the recoverable amount of an impaired asset, the impairment loss should be reversed in order to increase the carrying amount of the impaired asset to its recoverable amount. In cases where the impairment loss was allocated to the components of a cash-generating unit, paragraph 70 does not provide any guidance on how to allocate the reversal to these components. We suggest that this guidance should be provided, referring to paragraph 62.

In the appendix attached to this letter we would like to draw your attention to some environmental aspects of impairment of assets which have not been considered by E 55. Whilst the general principles of reviewing asset values for possible impairment should apply equally to environmental impairment, this type of impairment often carries unique uncertainties regarding timescale and amount. We realise however that these comments by nature are more detailed.

Should you have any queries about our response, please do not hesitate to contact me or my staff.

Yours sincerely,

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

David Darbyshire  
President

Encl.

## Appendix

### Environmental aspects of impairment of assets

1. E 55 does not address the impact on asset values due to environmental factors, where the uncertainty of timing and measurement may cause particular difficulty. Impairment is not unique to assets affected by environmental factors. However, whilst the general principles of reviewing asset values for possible impairment should apply equally to environmental impairment, this type of impairment often carries unique uncertainties regarding timescale and amount. Guidance in this area should be developed.
2. As long as an asset's value in use is greater than its carrying amount, there is no impairment. Thus pollution of a site may be known to exist but may not represent an existing obligation although it will have to be cleared up at some future date, such as when the site is closed or sold. However, while the enterprise continues to use the site profitably and there is no immediate requirement or commitment to rectify the damage, the enterprise has no obligation and no impairment is recognised. Whilst counter-intuitive, such an approach is technically correct and should therefore, if followed, be accompanied by additional disclosure. However, we believe that in this case there would normally be a constructive obligation to remove the pollution at some future time which should be reflected in recognising impairment of the asset.
3. Measurement of an environmentally impaired asset may be affected by:
  - a) delayed disposal, due to the need to deal with contamination, resulting in increased interest charges;
  - b) direct costs of overcoming the problems of contamination;
  - c) uncertainties due to the possibility of improvements in related technology or changes in legislation; and
  - d) 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, whether treated or not, which exceeds the costs attributable to:
  - a) the remediation of the asset;
  - b) the prevention of future contamination;
  - c) any known penalties or civil liabilities;
  - d) insurance; and
  - e) future monitoring.

The element of environmental impairment due to stigma is thus a negative intangible, i.e. a balancing figure equivalent to "badwill". 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, or at least the effect should be disclosed.
5. Where the purchase price of an impaired asset already allows for the cost of remedial work, it would be logical for the purchaser to include the asset at an unimpaired amount and to set up a provision for the expected remedial costs. However, this treatment would appear to be precluded by the IASC's exposure draft on provisions, contingent liabilities and contingent assets (E59), as these would not necessarily be an obligation at the time of purchase to incur such costs. This issue needs to be clarified.
6. Paragraphs 28 and 32 of E 55 refer to certain cash flows that should be included, or should not be included, in measuring value in use. It would be helpful for the proposed standard to clarify whether future restoration costs should be included or not.



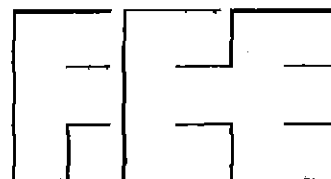
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#### **1. Approach for determining the recoverable amount**

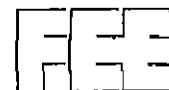
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FEE

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**FEE**

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Should you have any queries about our response, please do not hesitate to contact me or my staff.

Yours sincerely,

David Darbyshire  
President

Encl.

## Appendix

### Environmental aspects of impairment of assets

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