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**The Secretary General
International Accounting
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DIRECT DIALING:

YOUR REF.

OUR REF.

VEVEY, 13 August 1997

FC/GAR/GNB/UI/PFG/ibg

Dear Sir,

INVITATION TO COMMENT ON E 55 - IMPAIRMENT OF ASSETS

Please find enclosed our comments on the above mentioned Exposure Draft.

General comments

Overall we agree with the measurement and recognition principles of the Exposure Draft and with the measurement of the recoverable amount on the basis of the higher of its selling price and value in use. However, we have some concerns about the complexity of the exposure draft in general and we also consider that many disclosure requirements are excessive.

In particular, we consider that the ED should not give too detailed guidance about the determination of the value in use. Enterprises know how to prepare discounted cash flow calculations. An accounting standard concerning impairment should not state in details how these calculations are to be prepared. Also, we find that the ED should not prevent the enterprises from addressing certain issues in a pragmatic way, for example when allocating the impairment loss to the components of a cash generating-unit.

As far as the disclosure requirements are concerned, we consider that their purposes are to be informative and to reflect the economic substance but not to show theoretical "as if" situations. It is not the purpose of the disclosures to enable the users to verify the assumptions used in preparing the accounts. This is the role of the auditors.

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Specific questions

Measurement of the recoverable amount

1. We agree that the recoverable amount be measured as the higher of net selling price and the value in use because this reflects the economic reality. For example, certain enterprises may have assets that are located in rural areas or in depressed areas and that could hardly be sold to anybody. Nevertheless these assets generate sufficient - and often very good - returns to recover their carrying amounts. If a fair value measurement basis (as defined in question 1 b) were adopted, an impairment might have to be recognised for these assets, which is not economically justified.
2. We agree that the consequence of the measurement basis defined under point 1 above is that present value techniques should be used to determine the recoverable amount.
3. We agree that the definition of the recoverable amount as stated in § 5 is applicable to both an asset held for disposal and to an asset held for continuing use.

Recognition of impairment losses

4. We agree that an impairment loss should be recognised for an asset when its recoverable amount is lower than its carrying amount. We also agree that an impairment loss should be recognised if the cash-generating unit to which the asset belongs is impaired. This should, however, not be the only criterion. Despite this reservation, the stated principles reflect well the economic reality of the enterprises and will avoid volatility in recognising impairment losses when the market value of specific assets decreases, but when the carrying amount of the cash generating-unit is still recoverable from profitable returns.

Nevertheless, it seems to us that the standard should not explicitly or implicitly forbid the recognition of an impairment loss for an asset whose recoverable amount cannot be identified separately. For example, this is the case of obsolete or underutilised assets of profitable cash-generating units. In these circumstances, we consider that the recognition of an impairment loss should be allowed on the basis of prudence. As § 56 currently does not allow such recognition of an impairment loss, we recommend that the final standard be modified in this respect.

Reversal of Impairment Losses

5. The reversal of impairment losses is a controversial issue where merits can be found in favour or against the reversal. We nevertheless share the concerns of the opponents to the reversal on grounds of abuses and “smoothing” behaviour practices but we have to acknowledge that prohibiting the reversal is probably too extreme and that there may be rare circumstances where an impairment loss has to be reversed.



However, we do not agree with paragraph 67 that makes a review of the carrying amount of an impaired asset compulsory nor with the “reverse impairment indicators” of § 68. The criteria of §§ 72 and 73 are also rather strict. We are thus *concerned about the quasi obligation of reversing an impairment loss* and the consecutive volatility of the results. We also believe that the principle of prudence should also be taken into consideration. This is particularly important in case of increasing the value of an asset. Therefore the decision should be left up to the enterprises.

We thus propose to replace §§ 66, 67 and 68 by a general statement mentioning that an enterprise may re-estimate the recoverable amount of an asset when there are reasonable and supportable evidence that an impairment loss recognised in prior years no longer exists or has decreased. Paragraph 70 should also be modified by stating: “The carrying amount of an asset for which an impairment loss has been recognised in prior years *may* be increased to its recoverable amount [...]”.

6. We fully agree with stricter criteria for the reversal of impairment losses recognised for goodwill and other intangible assets. However, in line with our comments concerning point 5 above, we recommend to amend § 77 as follows: “[...] an impairment loss recognised for goodwill and other intangible assets *may* be reversed [...]”.

Scope

7. We agree that the Standard applies to all assets except those listed in paragraph 1 of the ED.

Identifying a Potentially Impaired Asset

- 8 a. We agree that the recoverable amount be estimated only if there is an indication that an asset is impaired.
- 8 b. We generally agree with the impairment indicators. However we feel that the indicator 8 (g) “actual cash flows are materially less than those previously estimated [...]” is not necessary. We consider that this situation is already covered by the impairment indicator 8 (f) concerning the worsening of the economic performance.

Net Selling Price

- 9 a. We agree that the net selling price be based on “the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable willing parties” because this is how the price would be fixed should the asset be sold. We consider that the reference to an active market is too restrictive because a great number of assets that might be subject to impairment are not traded in active markets. For example, this is the case of most industrial equipment.
- 9 b. We agree with the definition of the costs of disposal.



Value in use

- 10 a. We agree with the concept of value in use and we agree with the bases for estimates of future cash flows. Nevertheless we consider that guidance is generally too detailed (as stated under general comments). In particular, the last sentence of § 23 (c) and the explanations of § 27 are not necessary because, if a higher rate than that of short term projections can be justified, it goes without saying that it can exceed average growth rate of a market, etc.. We also disagree with the related disclosures (see under point 16 below).

In addition, we consider that it is excessive to require budget/financial forecasts that are “formally approved by management with an appropriate degree of authority” because this would mean that the forecasts would have to follow all the formal procedures of the enterprise, that is to be ultimately approved by the Board of Directors. The level of approval should be left up to the enterprises and the expression “with an appropriate degree of authority” should be deleted.

- 10 b. We agree with the composition of the estimates and we believe it is important to emphasize that, when it is impossible to identify the cash flows from the initially recognised asset, cash flows from the asset in its current condition are to be used. This provision is important to allow the enterprise to make meaningful calculations.
- 10 c. In general, we agree with the determination of the discount rate. Nevertheless we are not totally in agreement with the provision that the discount rate should be independent from the way in which the enterprise finances the asset. This provision implies that the asset is entirely financed by equity, which is not necessarily the case. We also consider that, if a specific financing is taken for an asset or a cash generating unit, the enterprise should be allowed to take this into account when determining the discount rate.
11. We generally agree that if an asset does not independently generate cash inflows, an enterprise should determine the recoverable amount of the asset’s cash generating unit. We, however, have certain reservations in this respect (see under point 4 above).
12. We agree with the requirements and guidance for determining the items included in a cash-generating unit.
13. We agree with the requirements to recognise and measure an impairment loss if there exists goodwill or other corporate assets. We would nevertheless draw your attention to the fact that, in practice, when goodwill or intangibles are involved, a great number of impairment losses will probably be recognised on the basis of the top down test. This is inherent to the fact that it is very difficult to find reasonable and consistent bases to allocate goodwill and intangibles to a specified cash-generating unit.
14. While we agree that an impairment loss should be allocated in priority to the assets that have the most subjective values, we do not totally agree with the procedures defined in § 62 and 65 because they are based on somewhat questionable assumptions.



When the recoverable amount is determined on the basis of the value in use, it seems inconsistent to reduce the value of certain assets on the basis of the net selling price and the value of others to zero. For example, if a cash generating unit consists of land, buildings, machinery and equipment and, if only land and building could be sold, machinery and equipment might be reduced to zero while they still generate future cash flows. This is not logical in a going concern concept environment.

We also question making an exception for intangibles traded in an active market because this could occur in very rare circumstances.

We recommend that the impairment loss be allocated as follows:

- a) first to goodwill,
- b) second to intangible assets,
- c) then to other assets on a pro rata basis if the impairment loss is determined on the basis of the value in use. If the impairment loss is determined on the basis of the net selling price and if the net selling price of certain assets can be identified separately, then the value of these assets should not be reduced below their selling price. In all cases the value of the assets should not be reduced below zero.

Disclosures

15. We agree with the disclosure requirements in §§ 79-81 of the ED. We do not recommend to require additional disclosures such as the movement of impaired assets as stated in §§ 88 to 90 of the basis for conclusions. We support the Board's arguments that the relevant information about impairment is the impairment losses recognised (or reversed) during the period and that the proposed disclosures would compel the enterprises in maintaining separate records for impaired assets without additional benefits.

We also reject the disclosure of impairment losses by business segments as stated in §§ 91 and 92 of the basis for conclusions and we support the Board's arguments that this information is already covered by the disclosure of § 82 of the ED.

16. We partly agree with the disclosure requirements of 82. We consider that these types of disclosures are more important for individual companies than for large groups of companies, although a material impairment of e.g. a important cash-generating unit might also occur in these groups. In establishing these disclosure requirements, the IASC should distinguish those that are illustrative and explicative from those whose purposes are to show the bases of calculation. We agree with the first ones, that is § 82 items (a) and (b) but we disagree with the second ones, that is items (c) and (d) (i) to (d) (iii). In particular, we consider that the disclosure of the basis for the determination of the recoverable amount (net selling price or value in use) as well as that of projection periods, extrapolation of short-term projections, etc. are exaggerated. It is not the role of the users of the accounts to assess whether the assumptions used when preparing value in use calculations are correct. This is the role of the auditors. In this context, we also agree that an enterprise should not disclose the items (a) to (b) listed in question 16 for the reasons stated previously.



17. We disagree with the disclosure requirements of § 83. The competitors would be the primary users of information about assets that had been tested for impairment but for which no impairment has been recognised. As far as the other users are concerned, the future economic benefits of these assets still enable to recover their carrying amount and these assets are similar to any others. The disclosure is therefore irrelevant. We also obviously agree that enterprises should not be required to disclose the items (a) to (c) listed in question 17.
18. We totally disagree with § 85. This paragraph is a mix of measurement and of disclosure requirements. It leads to the disclosure of data under measurement principles that are not those of the ED and requires explanations of the differences. This is not acceptable because the role of the financial statements is to explain the situation of an enterprise under stated methods and not disclose and explain hypothetical situations.
19. We agree that an enterprise should not be required to disclose information on how the cash generating units are determined and we also agree with the reasons for rejecting these disclosure requirements, which could also result in unveiling proprietary information.
20. We consider that no additional disclosure requirements are necessary.

Appendices

21. We consider that the examples are very good from a didactical point of view although they do not reflect real cases. We nevertheless believe that the purpose of these examples is to enable the preparers to rapidly understand how the standard should be applied without going into the complexity of the real business life.
22. We agree with the consequential changes to IAS 16. We consider it is important to include impairment information in the tables of movement of the related assets as also stated in E 55 § 81.
23. We do not have additional comments.

We thank you for your attention to the above.

Yours very truly,

NESTEC Ltd.

F. Ulrich

Head of Group Consolidation Services