



**FINANCIAL EXECUTIVES INSTITUTE CANADA
L'INSTITUT DES DIRIGEANTS FINANCIERS DU CANADA**

August 21, 1997

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

Dear Sir:

Financial Executives Institute Canada is a professional organization of over 1400 senior financial executives representing more than 900 organizations. The Committee on Corporate Reporting (CCR) has reviewed the proposed International Accounting Standard on Impairment of Assets. CCR disagrees with the proposal to determine and measure impairment using discounted cash flows for the following reasons:

a) Conceptual

The current accounting model is based on historical cost. In this model, impairment occurs when future cash flows will be insufficient to recover the remaining book value, resulting in future book losses. The impairment write down brings these book losses into the current period, rather than burdening future periods. An alternative accounting model would use current values. The proposals in E55 result in a hybrid, with some assets recorded at current value and others at historical cost -- hardly the model of comparability espoused in the ED. No conceptual model is given in the ED for this hybrid approach.

The key test should be the benefit to the financial statement user. The ED does not demonstrate how users will be able to make better decisions based on a discounted approach to impairment. The practical problems discussed below suggest that users will not benefit by this methodology.

b) Practical

1. Identifying the appropriate discount rate to use will often be difficult and subjective. The risks associated with non-financial assets are not known with certainty. Different companies will likely evaluate these risks differently. This is why, in the marketplace, businesses (cash generating units) are bought and sold -- because the buyer and seller have different views of the risks. Identical assets owned by different companies will be valued differently for impairment. This will happen even if future cash flows are not discounted, as there will be different views on these future cash flows. However, the impact becomes more significant with discounting as the lower impairment threshold will result in more assets being impaired.
2. Discounting will increase the number of asset impairments. This, coupled with the proposals to allow subsequent asset write-ups, will introduce a non-operating volatile element into the income statement. The income statement remains the financial statement most used by financial statement readers. Bottom line earnings and earnings per share are the pieces of data of most interest to investors as measures of the enterprise's performance. Adding a volatile impairment amount into these will make it harder for users to understand the operating results of the enterprise.
3. The requirement to use a current interest rate in the discount calculation will exacerbate this issue. Changes in interest rates, with no changes in expected cash flows, will result in impairment losses and write-ups.

This entry in the income statement will not be meaningful to financial statement users -- the asset has the same cash generating outlook yet the accountants require a change in the book value and a resulting charge or credit to earnings.

4. Investment decisions are usually made using the enterprise's (after tax) cost of capital. It is quite feasible that the proposed rules would require an immediate write down of a new asset, even though all projections and assumptions in the investment decision remain fully valid.
5. The ED states, "When an asset is impaired, an enterprise will either keep the asset or dispose of it. The Board believes that if an enterprise behaves rationally, the resulting decision is in substance, an investment decision." For many assets there is no ready market. The decision to hold the asset is not an investment decision -- it is a lack of realistic alternatives. To analogize that the enterprise has made an investment decision by deciding not to divest is, in these (not uncommon) circumstances, invalid.
6. The IASC is proposing a new methodology that is different to SFAS 121, which underwent the rigorous due diligence process in the United States. Experience indicates that SFAS 121 is working satisfactorily. CCR strongly supports the trend towards harmonization of accounting standards. In the current effort to create commonality in accounting standards, we are concerned that this ED proposes a new method of accounting for impairments that represents a significant GAAP difference between the IASC and FASB. This difference will create substantial additional accounting effort in the areas of fixed assets and depreciation for companies who wish to comply with both IASC and FASB.

Comments on the specific questions raised at the beginning of E55 are on the attachment to this letter.

Yours very truly,



Mark Walsh
Chairman, Committee on Corporate Reporting
Financial Executives Institute Canada

.cc S.M. Smith, CICA
Attach.
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ATTACHMENT

COMMENTS ON SPECIFIC QUESTIONS

1. Recoverable value should be measured at the undiscounted future cash flows expected from use of the asset. If management has determined to sell the asset, anticipated proceeds (net of selling costs) plus interim cash flows for use of the asset should be used.
2. Present value techniques should not be used in measuring the recoverable amount of an asset.
3. The definition of recoverable value is valid for assets held for disposal.
4. Impairment losses should be recognized when the recoverable amount (undiscounted) is less than the carrying amount.
5. CCR does not agree with the reversal of impairment losses. The impairment write down establishes a new basis of accounting for the asset. There is no more basis for writing up impaired assets than there is for writing up other (non impaired) assets. The information benefit of these selective write-ups to financial statement users is not described in the ED.
6. Consistent with the above, impairments of goodwill and other intangible assets should not be reversed.
7. The scope of E55 is appropriate. However, since E55 is consistent with IA52, there seems no reason to exclude inventories.

8. From a practical perspective, it is important not to require impairment tests of all assets as the work involved would be very large. It would also be inconsistent with the going concern assumption. E55's requirement to estimate recoverable amount only if there is an indication the asset is impaired is appropriate.

The list of indicators of impairment are generally consistent with those in U.S. and Canadian GAAP. For consistency's sake, and to avoid unnecessary differences, the wording from one of these existing criteria should be used.

9. The ability to determine a net selling price will vary. An active market should not be a pre-requisite. However, as noted in paragraph 14 of the ED, "sometimes it will not be possible to determine net selling price". If there is not a reasonable basis to determine net selling price, then this should not be part of the recoverable value computation.
Incremental costs directly attributable to the disposal of the asset should be deducted in arriving at net selling price.

10. The ED's proposals for estimating future cash flows are generally appropriate. However, management's short-term cash flow projections may not be based on their best estimates. For example, companies in commodity businesses may base their plans on deliberately conservative assumptions, given the volatility and unpredictability of commodity prices.
As already noted, cash flows should not be discounted.

- 11.14 The proposals concerning cash generating units are appropriate. We caution that this is a very complex area and will lead to diversity in practice unless more detailed guidance and examples are provided.

- 15.20 Disclosure of impairment losses and reversals recognized is appropriate, together with some details of the asset involved. However, the disclosures proposed are excessive, leading to disclosure overload. Disclosures should only be required if they provide additional value to the financial statement user. It is not clear what the value of the following proposed disclosures would be:

1. Whether recoverable amount is not selling price or value in use.
2. Methodology of cash flow projections.
3. Whether value in use significantly exceeds net selling price
(What is significant?)
4. Details of impairment reviews which do not lead to impairment losses or reversals being recorded.
5. The result of hindsight -- what would have been booked as an impairment loss or reversal had subsequent period's actual cash flows been used instead of estimates. Management is expected to use best estimates. Auditors ensure they are reasonable. Actuality will (almost) always be different. In no other area of accounting is a company required to report in detail on the differences between estimates and what actually occurs. A material difference may trigger a new computation of recoverable amount and thus lead to recording an impairment or a reversal.

The above disclosures should not be required.