FINANCIAL EXECUTIVES INSTITUTE

October 12, 2000

Mr. Timothy S. Lucas
Director of Research and Technical Activities
Financial Accounting Standards Board
401 Merritt 7
P. O. Box 5116
Norwalk, CT 06856-5116

Re: Exposure Draft of the Proposed Statement of Financial Accounting Standards – ***Accounting for the Impairment or Disposal of Long-Lived Assets and for Obligations Associated with Disposal Activities*** **(File Reference No. 210-D).**

Dear Mr. Lucas:

The Committee on Corporate Reporting (CCR) of the Financial Executives Institute wishes to express its views on the Exposure Draft (ED) of the Proposed Statement of Financial Accounting Standards – *Accounting for the Impairment or Disposal of Long-Lived Assets and for Obligations Associated with Disposal Activities*.

We support the Board's decision to address the implementation issues that have arisen since the adoption of Statement No. 121, *Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of* (FAS 121). However, we are concerned that the ED is proposing a significantly different underlying approach to the issue of impairment than that on which FAS 121 is based. FAS 121 is consistent with the best estimate approach of FAS 5. It also recognizes that the question of impairment is a business issue and places a great deal of emphasis on management's plans and objectives, whereas the ED proposes a standard that is essentially a numbers exercise. This will create a disconnect between the information that is reported to the public and how the company is managed. We concur with the ED's conclusions that would result in consistency in the reporting of discontinued operations as well as the clarification of how to report changes in the plan of sale.

The section in the ED that addresses obligations associated with disposal activities is proposing significant changes to current practice for reporting those obligations. We believe that because of those changes, this section of the ED should be omitted and current practice, primarily as required by EITF 94-3, should continue until the Board is prepared to undertake a complete reconsideration on the subject of past events necessary for recognition of liabilities.

Our comments on the specific issues, as well as other comments are attached.

Very truly yours,

Philip D. Ameen
Chair, Committee on Corporate Reporting

Accounting for the Impairment or Disposal of Long-Lived Assets
And for Obligations Associated with Disposal Activities
Attachment to CCR Letter of October 12, 2000

Issue 1 – Is the expected cash flow approach appropriate in developing estimates of future cash flows used to test an asset (group) for recoverability? Is there sufficient guidance for implementing this approach and if not, what additional guidance would be helpful?

CCR has been consistent in its opposition to mandating the use of probability weighted expected cash flow techniques. In its letter commenting on the exposure draft for Concepts Statement No. 7 – *Using Cash Flow Information and Present Value in Accounting Measurements* (CON 7), CCR observed that the mechanical use of expected cash flows are not useful if they yield results that are not representative of the amounts that will be realized. This is particularly evident where the cash flows are not normally distributed. In those situations using a best estimate based on management judgment will result in a more relevant answer and is consistent with the underlying premise of Statement No. 5 – *Accounting for Contingencies* (FAS 5). CCR recognizes that as management undertakes its analysis of determining the best estimate of cash flows for purposes of recognizing impairment, it quite often will use informally implied probabilities but normally it will not use the mechanical approach required by the ED. Assessing impairment requires significant judgment and CCR believes that the accounting model should reflect the underlying decision making processes.

Asset recoverability is more of a business issue than an accounting issue. Line management has the responsibility to develop and implement business plans and capital asset management programs that will yield acceptable returns on capital employed. Determinations of impairment for assets held and used should be based on the cash flows underlying these plans. By mandating the use of probability weighted expected cash flow techniques to determine recoverability, the ED is creating an environment where the financial statements may not faithfully represent how the entities are managed. CCR believes this outcome is inappropriate and is an unintended consequence of applying CON 7 to an inapplicable situation. Moreover, it will be costly to implement because those entities that do not use expected cash flows in the capital asset management process (which CCR believes to be the vast majority) would be required to perform two different analyses. The FAS 121 method of determining asset recoverability, which allows but does not mandate the use of probability weighted expected cash flows, should not be changed.

While Issue 1 does not ask for views on the criteria for measurement of impairment, CCR would like to comment. Example 2 in Appendix A provides guidance on measuring the fair value of the impaired asset discussed in Example 1. Example 2 adjusts the Example 1 cash flows for market conditions and then discounts those cash flows using an expected present value technique. CCR has the following observations on these Examples:

- CCR notes that the market adjustments to the Example 1 cash flows are for contractual labor and material price differences compared to “market price”. CCR believes that

these adjustments, which are eliminating the impact of the contracts, would only be appropriate for estimating fair value of the asset if it were to be sold without the contracts and the contracts could be unwound. It is more likely that the contracts would transfer with the asset or they could not be unwound. In either case the entity will bear their economic consequences. Certainly, if the asset is held and used the economic impact of the contracts would not be eliminated. Eliminating the impact of these contracts would be inconsistent with the ED basis of conclusion that fair value of impaired assets reflects the capital investment decision alternative of holding the asset for use or selling it and investing the proceeds. When making the capital investment decision, few, if any, entities would ignore the economic impact of the contracts.

- The ED should indicate that Example 2 illustrates the preferable method of calculating discounted cash flows to estimate fair value, but the traditional approach of discounting reasonable and supportable best estimates of cash flows using the rate commensurate with the risk is not precluded. CCR expects that very few entities would use the approach illustrated in Example 2.

Issue 2 – Will the definition of primary asset enable entities to consistently identify the primary asset of an asset group? If not what additional guidance is needed?

CCR believes that the definition of "primary asset" is reasonable. However, since "asset group" is related to the definition of primary asset, CCR recommends that its definition should be removed from footnote 2 to paragraph 7 and included in the glossary.

Issue 3 – Will the criteria for a qualifying plan of sale in paragraph 30 enable entities to consistently classify assets (groups) as held for sale? If not, what additional guidance is needed?

In general, the guidance in paragraph 30 appears reasonable. CCR notes the following observations for the Board's consideration:

- *Paragraph 30b* – CCR would interpret this paragraph to mean that an asset held for sale can be delivered to the buyer within a reasonable timeframe that it normally takes for similar assets to be delivered and there would be no disruption to the operations of the selling entity. We raise this issue because the language in paragraph 30b is slightly different than the language in the SEC's Staff Accounting Bulletin 100 (SAB 100). CCR understands that the SEC is applying SAB 100 in a way that makes it very difficult to classify an asset as held for sale much earlier than when the sale is ready to close.
- *Paragraph 30e* – CCR recommends that the last sentence of this paragraph be deleted. It is apparent from reading paragraph 187 that this sentence is attempting to prevent a perceived abuse. However, CCR believes there can be market factors other than simply higher net proceeds that may cause entities to market assets as a group. For example, an entity may decide to withdraw from a marketing region and place all of its retail outlets up for sale. It is possible that selling those assets individually might yield higher prices, but the entity may consider the timing of implementing its new

marketing strategy more valuable than realizing slightly higher proceeds on the sale of the outlets. This entity should not be prevented from accounting for the sale of the marketing region assets as a group.

Issue 4 – Do you agree with the Board's decision to broaden the reporting of discontinued operations? Will entities be able to consistently identify and report in discontinued operations the disposal of all significant components of an entity? If not what additional guidance is needed?

CCR is supportive of broadening the reporting of discontinued operations and thus eliminating the inconsistencies that now exist in current accounting standards. CCR expects that many entities will initially struggle to determine what qualifies as a significant component of an entity, but eventually practice will determine how the requirements should be applied. Perhaps after a period of time, the Board or EITF can provide some interpretative guidelines based on experiences found in practice. CCR would discourage the Board from attempting to establish bright lines as most preparers and their auditors will best be able to apply the concept of significance to their individual circumstances.

The Board may wish to add clarifying language to paragraphs 45 and 46. CCR assumes that Paragraph 45 requires that disposal gains or losses should be shown on a separate line in the discontinued operations section. The ED should make that clear. Paragraph 46 should clarify that all assets and all liabilities from discontinued operations can be grouped on one line each in the assets and liabilities sections of the balance sheet respectively.

Issue 5 – Do you agree with the recognition requirements of this proposed Statement for obligations associated with a disposal activity? If not, why not?

CCR disagrees with the conclusions in the ED for obligations associated with disposal activities. In the opinion of CCR, the ED would significantly change the accounting for disposal related obligations and would result in material inconsistencies with how liabilities are accounted for in other areas, as discussed below. Because of these significant differences, current accounting should be left in place until the Board is willing to undertake a full conceptual reconsideration of the subject of past events necessary for recognition of a liability.

Employee Termination Benefits –

CCR is opposed to the ED's conclusions on the method to accrue employee termination benefits that are related to prior services. The fact that employees cannot receive those benefits until after they stay for a short wind down period is irrelevant. The guidance in EITF 94-3 should continue to apply. When an entity commits itself to a plan and meets the EITF 94-3 requirements, it is clear that there is a liability. The method proposed by the ED of attributing the cost over the period between the announcement date and the termination date does not faithfully represent compensation for services during that period, which is usually nominal compared to most employees' length of service.

FASB Statement No. 106 – *Employers' Accounting for Postretirement Benefits Other Than Pensions* (FAS 106) addressed this issue of nominal attribution periods. Paragraph 44 of FAS 106 requires that the attribution period is generally the credited service period unless that period is nominal in relation to employees' total years of service prior to full eligibility dates. Paragraph 410 illustrates that when that is the case, the attribution period begins at the date of hire. In effect FAS 106 ignores nominal attribution periods because it recognizes that postretirement benefit obligations relate to services rendered by employees over their total years of service. CCR believes that the EITF 94-3 guidance for when to record a liability is analogous to the conclusion reached in FAS 106 for nominal attribution periods. While one time termination benefits obviously cannot be accrued over the entire employee service period, the EITF 94-3 guidance recognizes that when an entity commits to a substantive plan, it has an obligation that should be recorded at the time the plan is committed to. Requiring employees to remain with the entity for a nominal period in order to get paid for termination benefits based on length of service should not result in an unrealistically short attribution period.

The provisions of EITF 94-3 have significant hurdles that must be overcome before liabilities can be recorded. When those hurdles are met there is little doubt by anyone, including employees, shareholders and analysts, that the entity has a liability for employee termination benefits. It would be misleading to publish financial statements without recording that liability, as it is unlikely that more than a very small number of employees will leave the company before receiving the payment. Employees view those benefits as rewards for being valued employees for the years of service on which the benefit formula is based. They do not consider their services rendered subsequent to a plan announcement as being multiple times more valuable after the announcement date as before. It is not logical for the same work done by two employees for exactly the same salary the day before the announcement to result in twice the compensation expense of one employee over the other the day after the announcement simply because the service period for that employee is twice as long as the service period for the second employee.

Lease Termination Costs to Be Incurred under an Existing Operating Lease –

CCR believes that liabilities for penalties to terminate operating leases should be recorded at the time a plan of disposal is committed to. This is consistent with the view expressed above for employee termination benefits and is also consistent with EITF 94-3. The conclusion reached by the ED for lease termination costs is somewhat more reasonable than the conclusion reached for employee termination benefits, however, the ED does not adequately explain why this difference exists.

Example 12 provides a useful illustration of how the provisions of the ED would be applied. CCR believes that this example highlights the inconsistency with both the ED conclusions on employee benefit plans and how most entities would record the lease termination benefits under current accounting standards. In order to illustrate these inconsistencies, the following table uses the amounts pertaining to leases to compare the accounting as set forth in Example 12 with the method that would be used if the ED requirement for leases were consistent with the ED requirements for employee benefit

plans. The table also shows how most entities using the current accounting model would account for the facts in Example 12.

	ED Example 12	Consistent w/ Employee Benefits in ED	Current Accounting
At plan commitment	$150,420	0	$180,500
Plan date to vacate date	$130,080	$280,500	$100,000
Total	$280,500	$280,500	$280,500

The above table uses the same amounts as in Example 12 but does not purport to express CCR's opinion on whether fair value ($180,500) is appropriate. CCR assumes that the fair value amount is the discounted present value of the future $200,000 cash flows in years six through ten and that this would be a different amount if it was recorded at the plan commitment date (year five). In any case, the above comparison shows that current accounting would record a liability for the cost of exiting the facility at the time the plan is committed to ($180,500). The cost of using the facility during the period between the plan date and vacate date would be at the same normal rent expense as in other periods ($100,000). In CCR's view, this reflects the underlying economics. The ED method has the disadvantage of not fully reflecting the impact of the commitment when it is made. The employee benefit plan method applied to leases is shown only to illustrate the inconsistency in the accounting for employee termination benefits and lease termination costs proposed by the ED.

Issue 6 – Any respondent who would desire to participate in a public hearing, if one is held, should so indicate.

CCR believes that the ED is addressing important issues and would participate in a public hearing.

Other Comments Not Specifically Addressed by the Issues.

Paragraph 12 –
It is not practical to reduce total entity cash flows for those applicable to specific assets for which cash flows can be identified or those not covered by the ED when testing assets for impairment at the entity level. The FAS 121 approach for these assets should not be changed.

Paragraph 17 –
Certain industries have assets that begin operating independently, but their profitability is based on the integration with other processes and assets that are still being developed. CCR is unsure whether these operating assets would qualify as an asset (group) under development in accordance with paragraph 17. If not, paragraph 16 would seem to require

the recognition test be performed solely on the operating asset without consideration of the cash flows and capital expenditures of the future development plans. This could cause the premature write-down of the one operating asset whose profitability is dependent on future development. The Board should clarify paragraph 17 so that it applies to both assets under development and assets that are already operating but were constructed under a larger development plan, the completion of which is necessary for the operating assets to achieve their intended profitability.

Paragraph 29 –
Assets to be exchanged for similar productive assets in accordance with APB No. 29 are appropriately included in the section of assets held and used. Therefore, impairments should only be recorded if the recognition test of undiscounted cash flows is failed. Consistent with that view there can be no disposal gain or loss and the reference to paragraph 29 in paragraph 45 should be removed.