



BRITISH BANKERS' ASSOCIATION

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

Dear Sir

IASC Exposure Draft on the Impairment of Assets

Thank you for inviting the British Bankers' Association to comment on E55. We generally support the proposals of the IASC exposure draft and agree with most of the questions raised in the invitation to comment section. However we would like to draw your attention to the following aspects of the draft:

Approach to Impairment

We support the approach outlined in 1(a) to measure the recoverable amount of an asset as the higher of its net selling price and its value in use. Using fair value in option (b) does not take into account the fact that enterprises usually retain and use assets rather than sell them.

Value in Use

We would suggest that more practical guidance needs to be given on the determination of the discount rate to be used. This guidance should be included in the Appendices of the proposed International Accounting Standard.

Disclosure Requirements

We do not agree with the disclosures in paragraph 82 since the disclosure of an asset by asset basis is too onerous and at most any disclosures should be by class of asset. In addition we feel that disclosures concerned with how management have arrived at the impairments (such as the rate used for extrapolation and why) is not useful and may not be commercially sensitive.

We also disagree with the disclosure requirements of paragraph 83. We do not see the need for disclosure requirements unless there has been an impairment loss on an asset.

With respect to paragraph 85 we believe that the subsequent monitoring of actual cash flows should be carried out and adjustments to current year figures made accordingly, but that there should not be a requirement to disclose impairment losses that would have been recognised in prior years.

We recently responded to the ASB's equivalent Discussion Paper on the Impairment of Tangible Fixed Assets and have enclosed a copy of the BBA's response to this paper for your reference. In this paper we expressed our concerns over the proposals to regard everything as impaired since we felt that this was unnecessarily strict.

I would be happy to discuss these comments further with you.

Yours faithfully


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ASB DISCUSSION PAPER ON THE IMPAIRMENT OF TANGIBLE FIXED ASSETS

Comments by the British Bankers' Association

The British Bankers' Association welcomes the opportunity to comment on the ASB discussion paper on the impairment of tangible fixed assets.

It is difficult to know how to respond to the discussion paper without knowing the conclusions that the ASB will conclude on other topical issues, notably:

1. The basis for the valuation of fixed assets
2. Discounting
3. The use of the statement of recognised gains and losses
4. Provisions
5. Goodwill

In addition, we have presumed that the proposals do not apply to financial fixed assets, including investments in subsidiaries.

Our comments provided below respond to the questions raised in the discussion paper and follow the sequential order of the chapters of the draft.

1. When impairment reviews are required

Paragraph 1.2 states that an impairment test is only necessary where there is a specific indication of impairment. We are happy with most of these indicators. However we feel that it should be made clear that the "significant adverse change" referred to in (b) would not include normal cyclical downturns anticipated by management or any other changes that were reasonably expected to be temporary. We feel that test (d) should only refer to falls in market value below the current net book value of the asset. We do not see a need for test (h) since not all reorganisations are related to falling profitability in existing markets. This could possibly result in reorganisations which are preparing for entry into new markets being recognised in the impairment test. We suggest that tests (a) and (b) should suffice for the identification of all "significant adverse changes".

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2. The measurement and recognition of impairment

Chapter 2 of the draft statement regards an asset as being impaired when its recoverable amount falls below its carrying value. The recoverable amount is regarded as being the higher of the net realisable value (NRV), ie selling price less disposal costs, and value in use, defined as the net present value of future cash flows obtainable (PV). Therefore the measurement of impairment, as outlined in paragraph 2.7, is based on a comparison between the NRV and PV of the asset in question.

We appreciate the benefits of the pragmatic approach of the proposals but would like further guidance on how the recoverable amounts should be calculated. We are especially concerned about the possible consequences of assets being written down below their recoverable amounts. Our other concerns are discussed below:

1. We consider that the computations involved in the calculation of PV will be unnecessarily time-consuming and could be misleading in some industry sectors. For example in the case of assets used by the retail and service industries cash flows can only be determined for the business as a whole because of the existence of centralised business functions. Also we question the need for long-term cash flow projections to establish the value of assets with a relatively short depreciable life.
2. The discussion paper does not distinguish between permanent and temporary impairments in value. We feel that this introduces an unacceptable degree of volatility which could distort the underlying trading performance. We would therefore like to see a clearer definition of what constitutes a permanent (or temporary) impairment.
3. We do not agree with the proposal that NRV should be measured after tax since we believe that any tax implications should be accounted for as part of the deferred tax provision and not as part of the carrying amount of the asset. The ASB's proposed treatment could give rise to an anomalous pre-tax profit and an offsetting tax charge if the asset were subsequently disposed of at its net realisable value.

3. Comparison with present value

Our concerns with the proposals are as follows:

1. There are considerable practical difficulties associated with the proposals concerning the identification of income generating units, as outlined in paragraph 3.3. This is likely to be a particular problem in a retail banking context where, arguably, the whole of the branch network would be one income generating unit. This could potentially result in impairments not being recognised.

2. We think the suggestion in paragraph 3.4, that the assets of a business unit held below market values should be increased for the purposes of the comparison between net asset value and PV, is both impractical and illogical. The need to calculate PV for the business unit as a whole arises because it is impossible to attribute cash flows, and thus recoverable amounts, to individual assets. The last sentence of the paragraph is thus misguided, as the purpose of the impairment test can only be to ensure that the recoverable amount of the business unit as a whole exceeds its carrying value.

3. We do not agree with the proposal to compare cash flow estimates with subsequent actual cash flows and to recognise any impairment which originally existed but was not reported at the time. This could be misleading especially in situations where there are variations in the timing of cash flows which could possibly result in false impairments being identified and thus reported.

4. Discounting

We do not support the proposal that the discount rate to be used in the calculation of PV should be the market rate for an equally risky investment since this would result in all assets producing a below-average return being impaired, which does not seem a fair and consistent accounting system. As an alternative method we would suggest that the entity's borrowing rate or a Government bond rate would be more appropriate.

We also think it needs to be made clear that for a business for which interest cost is deducted in arriving at operating profit, the discounting process set out in the Discussion Paper should be applied to the forecast cash flows from operations after deducting interest outflows.

5. Presentation of impairment in the statements of financial performance

Paragraphs 5.3, 5.7 and 5.10 outline where in a set of financial statements impairment values should be recognised. Whilst we would accept these proposals as a matter of practicality, we are concerned that the ASB has not established a clear difference in purpose between the profit and loss account and statement of total recognised gains and losses. Consequently a relatively minor difference in the circumstances in which an impairment arises can result in a significant difference in presentation.

6. Restoration of past impairment losses

We agree that impairment provisions should be reversed when the circumstances leading to the provision have ceased to apply, as stated in paragraph 6.5. This appears to be required by the Companies Act.

We agree with the proposals in paragraph 6.9 that a reversal of an impairment provision should be accounted for in the same way as the provision itself.