

HSBC Holdings plc

Registered Office and Group Head Office:

10 Lower Thames Street, London EC3R 6AE, United Kingdom

D J Flint

Group Finance Director

GHQ FIN 971239

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

8 August 1997

Dear Sir Bryan

Exposure Draft E55 'Impairment of assets'

Please find enclosed our comments on Exposure Draft E55, 'Impairment of assets'.

If you have any queries regarding any of the issues raised in our response, please let me know.

Yours sincerely



Douglas Flint
Group Finance Director

Encl

Response to IASC E55 'Impairment of assets'

1. Which of the following approaches do you support:
 - (a) the recoverable amount of an asset should be measured as the higher of its net selling price and its value in use (paragraphs 5 and 12-40 of the Exposure Draft and paragraphs 7-30 of the Basis for Conclusions)?
 - (b) the recoverable amount of an asset should be measured as the fair value of the asset, that is, the amount obtainable for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction. Fair value would be primarily based on the asset's market price if a market exists for that asset regardless of the value in use of the asset. If no market exists for the asset, fair value would be estimated in a similar way to value in use as defined in the Exposure Draft (paragraphs 13-19 of the Basis for Conclusions)?
 - (c) other (please specify)?

We support (a). Using fair value in option (b) does not take into account the fact that enterprises usually retain and use assets rather than sell them.

2. One consequence of the approach adopted in this Exposure Draft (or the alternative definition of recoverable amount based on fair value) is that present value techniques should be used to measure the recoverable amount of an asset, implicitly (net selling price) or explicitly (value in use) (paragraphs 7-9 and 11-12 of the Basis for Conclusions). Do you agree that present value techniques should be used to measure the recoverable amount of an asset, implicitly (net selling price) or explicitly (value in use)?

We agree that in principle present value techniques give the truest reflection of recoverable amount to be compared with carrying value.

We are concerned, however, that the subjectivity involved in calculating value in use leaves the calculation of impairment losses open to abuse. In particular, we believe there is a lack of practical guidance given in selecting an appropriate discount rate (see response to question 10).

Assets held for disposal

3. Do you agree that the definition of recoverable amount in paragraph 5 of the Exposure Draft is just as applicable to an asset held for disposal as to an asset held for continuing use (paragraph 26 of the Basis for Conclusions)?

Yes, as value in use will essentially be net selling price.

Recognition of impairment losses

4. Do you agree that an impairment loss should be recognised for an asset:
- (a) whenever the recoverable amount of the asset is less than its carrying amount (paragraph 41 of the Exposure Draft and paragraphs 59-67 of the Basis for Conclusions); and
 - (b) only if the cash-generating unit to which the asset belongs is impaired (paragraphs 55-58 of the Exposure Draft and paragraphs 74-75 of the Basis for Conclusions)?

If you disagree with these proposals, please indicate criteria you would prefer for the recognition of an impairment loss in the financial statements.

We concur with (a) for assets where value in use can be calculated for the individual asset and (b) for assets where value in use can be calculated only for the asset's cash generating unit. We do not feel that both (a) and (b) must be satisfied as the question suggests.

Reversals of impairment losses

5. Do you agree that an impairment loss recognised in prior years for an asset carried on an historical cost basis should be reversed up to the depreciated historical cost of the asset, if, and only if, there has been a change in the estimates used to determine the impaired asset's recoverable amount since the last impairment loss was recognised (paragraphs 70-76 of the Exposure Draft and paragraphs 83-87 of the Basis for Conclusions)?

Yes. We concur with the explanation that, if there is no change in estimates, the excess of value in use over carrying value represents the unwinding of the discount and not a change in the service potential of the asset.

6. Do you agree that an impairment loss recognised for goodwill and other intangible assets for which no active market exists should be reversed in a subsequent period if, and only if, the external event that caused the recognition of the impairment loss has reversed (paragraphs 77-78 of the Exposure Draft)?

Yes. This represents a more prudent approach to a more subjective area and will ensure that any increase is not due to internally generated goodwill which should not be recognised.

The Board also welcomes answers to the following questions, with reasons for those answers.

Scope

7. Do you agree that the Standard should apply to all assets except those listed in paragraph 1 of the Exposure Draft (paragraphs 1-4 of the Exposure Draft and paragraphs 106-110 of the Basis for Conclusions)?

Yes.

Identifying a potentially impaired asset

8. Do you agree that:
- (a) the recoverable amount of an asset should be estimated if, and only if, there is an indication that the asset is impaired; and

Yes. This should save time, effort and unnecessary expense in assessing impairment losses as detailed calculations are only required if impairment is suspected.

- (b) the list of indicators of impairment included in paragraph 8 of the Exposure Draft will require an enterprise to estimate the recoverable amount whenever there is a significant risk that the asset is impaired?

(paragraphs 6-12 of the Exposure Draft).

Yes. The list of indicators should require an enterprise to calculate recoverable amount whenever there is a risk that an asset is impaired. However, the degree of subjectivity, particularly with regard to the triggers from internal sources could result in the decision not to recognise potentially significant impairments.

Net selling price

9. Do you agree that net selling price should be determined:
- (a) based on "the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties" and that it is not necessary to determine net selling price by reference to an active market (paragraphs 5 and 17-18 of the Exposure Draft and paragraphs 31-38 of the Basis for Conclusions); and

Yes. Without the benefit of an active market, however, the determination of net selling price becomes more subjective.

- (b) after deducting from the amount obtainable from the sale of an asset the incremental costs that are directly attributable to the disposal of the asset (excluding finance costs and income tax expense) (paragraphs 5 and 19-21 of the Exposure Draft and paragraph 35 of the Basis for Conclusions)?

Yes. We note that a strong case can be put for deducting any tax expense in deriving net selling price, but feel it is better excluded on the grounds that it is a consequential expense of any decision to sell. We also note that if full provisioning for deferred tax is used, the resulting balance sheet effect is the same in both instances.

Value in use

10. Do you agree with the proposed requirements and guidance in the Exposure Draft for:

- (a) the basis for estimates of future cash flows (paragraphs 23-27 of the Exposure Draft and paragraphs 24 and 40-42 of the Basis for Conclusions);

Yes. The provisions for using short-term and long-term forecasting provides a clear base for approaching the measurement of value in use.

- (b) the composition of estimates of future cash flows (paragraphs 28-35 of the Exposure Draft and paragraphs 43-46 and 50-58 of the Basis for Conclusions); and

Yes.

- (c) selecting the discount rate (paragraphs 36-40 of the Exposure Draft and paragraphs 47-49 of the Basis for Conclusions)?

We agree, that in theory, a market determined rate that reflects the risks specific to the asset is conceptually viable. However, in practice we feel this is an arduous concept to implement for enterprises not used to discounting techniques of this nature.

Practical guidance on how to determine the discount rate needs to be given. The exposure draft says that a surrogate rate may be used for example 'the enterprise's weighted average cost of capital ... may provide a useful starting point before adjustment for the particular risk associated with the asset'. However this offers no help unless entities are given **practical** guidance on how to evaluate such an adjustment.

Cash-generating units

11. Do you agree that, if an asset does not generate cash inflows that are largely independent of those from other assets, an enterprise should determine the recoverable amount of the asset's cash-generating unit (paragraphs 46-47 of the Exposure Draft)?

Yes.

12. Do you agree with the requirements and guidance for determining the items that are included in a cash-generating unit (paragraphs 5 and 48-53 of the Exposure Draft)?

Grouping assets into cash generating units and allocating part of other assets to that unit is likely to prove too subjective unless more detailed guidance is given on the allocation of assets that are used in more than one potential cash generating unit.

Without this extra effort to allocate assets to small enough units, impaired assets will not be written down as the cash-generating unit they have been assigned to may be a larger profitable unit of the business that is not impaired in aggregate.

13. Do you agree with the requirement (and related guidance) to recognise and measure an impairment loss if there exists goodwill or other corporate assets (such as head office assets) that relate to a cash-generating unit (paragraphs 59-61 of the Exposure Draft and paragraphs 79-81 of the Basis for Conclusions)?

No. It is considered unlikely that an enterprise cannot find a sensible way of allocating central assets, thus there is no need for two tests.

14. Do you agree with the procedures for allocating an impairment loss of a cash-generating unit between the assets of that unit (paragraphs 62-65 of the Exposure Draft and paragraphs 77-78 of the Basis for Conclusions)?

Yes. This method of allocation is reasonable.

Disclosure

15. Do you agree with the disclosure requirements in paragraph 79-81 of the Exposure Draft and that an enterprise should not be required to disclose more information, such as the amount of impairment losses that can be reversed in subsequent periods (paragraphs 88-92 of the Basis for Conclusions)?

Yes.

16. Do you agree with the disclosure requirements in paragraph 82 of the Exposure Draft and that an enterprise should not be required to disclose for each individual asset (or cash-generating unit) for which significant impairment losses have been recognised or reversed during the period:

- (a) the value in use of the asset (cash-generating unit) if the recoverable amount is based on the net selling price of the asset (cash-generating unit);
- (b) the net selling price of the asset (cash-generating unit) if the recoverable amount is based on the value in use of the asset (cash-generating unit);
- (c) if the recoverable amount is based on the value in use of the asset (cash-generating unit);
 - (i) the discount rate(s) used in the calculation; and

- (ii) the assumed long-term average growth rate for the products, industries, and country or countries in which the enterprise operates or for the market in which the asset (cash-generating unit) is used; and
- (d) other key assumptions used to determine the recoverable amount of an asset.

(paragraphs 24, 93-95 and 98-99 of the Basis for Conclusions)?

We agree with the above non disclosures except for item c(i). Without clearer practical guidance on arriving at a discount rate (see answer 10 c) the discount rate used by a firm is likely to be highly subjective and users of accounts should be made aware of the discount rate used.

We do not agree with the disclosures in paragraph 82 for the reasons below.

- disclosure on an asset by asset basis is too onerous. At most any disclosures should be by class of asset; and
- disclosures about how management have arrived at the impairments (such as the rate used for extrapolation and why) is not useful and may be commercially sensitive.

17. Do you agree with the disclosure requirements in paragraphs 83-84 of the Exposure Draft and that an enterprise should not be required to disclose information similar to that proposed in question 16 above for each individual asset (cash-generating unit) for which:

- (a) recoverable amount has been determined during the period;
- (b) no impairment loss was recognised or reversed during the period; and
- (c) a small change in key assumptions could lead to the recognition or reversal of a significant impairment loss?

(paragraphs 24 and 96-97 of the Basis for Conclusions)?

We agree that the disclosures not required should not be given.

We disagree with the disclosure requirements of paragraph 83. If there has been no impairment loss on an asset there should be no disclosure requirements. The disclosures required are unnecessary and are likely to be commercially sensitive.

18. Do you agree with the disclosure requirements in paragraph 85 of the Exposure Draft (paragraphs 24 and 100-101 of the Basis for Conclusions)?

No. The subsequent monitoring of actual cash flows should be carried out and adjustments to current year figures made accordingly, but there should not be a

requirement to disclose impairment losses that would have been recognised in prior years.

19. Do you agree that an enterprise should not be required to give information on how cash-generating units are determined (paragraphs 102-105 of the Basis for Conclusions)? If you believe that such information should be required, please indicate which details should be required.

Yes.

20. Should an enterprise be required to disclose any information other than that disclosed in questions 15-19 to this Invitation to Comment?

No.

Appendices

21. Should any material in Appendix 1 be amended or deleted? Should any further guidance be added to the appendix? (Note: the Board does not intend to publish appendix 3, Basis for Conclusions, with the final Standard.)

The Appendices are the ideal place to give guidance on how, in practice, an appropriate discount rate is to be estimated.

22. Do you agree with the consequential changes to IAS 16, Property, Plant and Equipment (Appendix 2, Proposed Amendments to Other International Accounting Standards)?

Yes. These changes appear reasonable.

Other Comments

23. Do you have any other comments on the proposed International Accounting Standard?

No.