IFRS Interpretations Committee Meeting

Staff Paper

Agenda reference 17

Date July 2010

Project **New items for consideration**

Topic **IAS 36 *Impairment* - Accounting for impairment testing of goodwill when non-controlling interests are recognised**

Purpose of this paper

1. The purpose of this paper is to document the staff analysis and recommendations relating to a request to clarify how an entity accounts for impairment testing of goodwill when non-controlling interest (NCI) is recognised.

2. The issues raised in the three papers included in the request specifically relate to the:

   (a) requirements for calculating the 'gross up' of the carrying amount of goodwill;

   (b) allocation of impairment losses; and

   (c) re-allocation of goodwill between NCI and controlling interests.

3. These three issues arise in situations when:

   (a) NCI includes both present ownership interests, measured on a proportionate share basis, and non-present ownership interests ('NPOI'); or

   (b) goodwill is allocated between the parent and NCI on a basis that is disproportionate to the percentage of equity owned by the parent and the NCI shareholder; or

   (c) there are subsequent changes in ownership between the parent and NCI.

4. This paper:

(a) provides background information on this issue;

(b) analyses the issues included in the request;

(c) makes a staff recommendation; and

(d) asks the Committee whether they agree with staff recommendation.

Background information

5. The staff received an analysis including three separate papers relating to the application of the guidance in Appendix C of *IAS 36 Impairment of Assets* ('Appendix C').

6. This analysis is summarised by the requestor in Appendix A to this agenda paper. The three separate papers, together with related examples, are attached separately to this agenda paper.

7. The analysis included in the request focuses on the following guidance in Appendix C relating to impairment testing cash-generating units with goodwill and non-controlling interests:

> C4 *If an entity measures non-controlling interests as its proportionate interest* in the net identifiable assets of a subsidiary at the acquisition date, rather than at fair value, goodwill attributable to non-controlling interests is included in the recoverable amount of the related cash-generating unit but is not recognised in the parent's consolidated financial statements. As a consequence, *an entity shall gross up the carrying amount of goodwill allocated to the unit to include the goodwill attributable to the non-controlling interest.* This adjusted carrying amount is then compared with the recoverable amount of the unit to determine whether the cash-generating unit is impaired.
>
> C6 If a subsidiary, or part of a subsidiary, with a non-controlling interest is itself a cash-generating unit, *the impairment loss is allocated between the parent and the non-controlling interest on the same basis as that on which profit or loss is allocated.* (emphasis added)

8. Some of the issues identified in the request arise because of the following changes that have been made to IFRSs, specifically to IFRS 3 *Business Combinations*:

(a) the amendment to expand the definition of minority interest, when re-defining it as NCI, to include NPOI such as options and warrants; and

(b) the guidance provided on the measurement of NCI in 2008 – 2010 *Annual Improvements*.

This clarified that the proportionate share approach to measuring NCI identified in IFRS 3.19 is only applicable to present ownership interests entitling holders to a proportionate share of the entity's net assets in the event of liquidation.

Staff Analysis

9. The key issues identified in the analysis provided in the request are summarised below:

NCI Paper 1 - Application of the guidance in IAS 36.C4 and IAS 36.C6 when NCI is measured on a proportionate share basis and includes NPOI

10. The first paper addresses two issues that arise when NCI includes both present ownership interests (which are measured on a proportionate share basis in accordance with IFRS 3.19) and NPOI (which is measured at fair value).

11. These issues do not arise when the present ownership interest component of NCI is measured at fair value.

'Gross up' calculation

12. The first issue relates to the identification of different approaches that may be applied to calculate the 'gross up' identified in IAS 36.C4.

13. This is because different goodwill amounts may be calculated as a result of the use of the proportionate share (rather than fair value) measurement basis for NCI and of the existence of the NPOI.

Allocation of impairment losses

14. The second issue relates to application of the guidance in IAS 36.C6.

15. The request notes that in accordance with this guidance, no impairment loss would be allocated to the NPOI, because the NPOI:

    (a) does not represent a present ownership interest in the subsidiary; and

    (b) is not entitled to a share of any profit or loss of the subsidiary.

16. Consequently, the issue arises as to how an impairment loss should be allocated when a cash-generating unit includes goodwill, NCI and NPOI.

Recommendation in the request

17. NCI Paper 1 includes illustrative examples highlighting potential approaches to address these issues.

18. The request proposes that both of these issues could be addressed as part of *Annual Improvements* through the inclusion of illustrative examples or additional guidance.

NCI Paper 2 - Application of the guidance in IAS 36.C4 and IAS 36.C6 when goodwill is allocated between the parent and NCI on a disproportionate basis

19. The second paper in the request addresses an issue of how the guidance in IAS 36.C6 should be applied when goodwill is allocated between the parent and NCI on a disproportionate basis.

20. The paper acknowledges that goodwill may be allocated between the parent and NCI on a disproportionate basis because, as observed in IFRS 3.B45, a control premium or minority discount exists.

21. These issues may arise regardless of whether the present ownership interest component of NCI is measured at fair value or on a proportionate share basis.

'Gross up' calculation

22. First, the paper identifies concerns, similar to those expressed in NCI Paper 1, as to how the 'gross up' in IAS 36.C4 is calculated in this situation when NCI is measured on a proportionate share, rather than on a fair value basis.

Allocation of impairment losses

23. Secondly, the request questions whether it is appropriate for an impairment loss to be allocated between the parent and the NCI on the same basis as that on which profit or loss is allocated, in accordance with IAS 36.C6.

24. This is because an allocation of impairment on this ownership percentage basis would be inconsistent with the goodwill attribution percentage basis used for initially allocating goodwill between the parent and the NCI.

Recommendation in the request

25. NCI Paper 2 includes illustrative examples highlighting potential approaches to address this issue.

26. The request proposes that additional illustrative examples could be provided, for example in Example 7A of IAS 36, or by adding some guidance in Appendix C of IAS 36.

NCI Paper 3 - Application of the guidance in IAS 36.C4 and IAS 36.C6 when there are subsequent changes in ownership between the parent and NCI

27. The third paper considers the implications of a transfer of interest in a subsidiary between the parent and NCI, when the parent retains control before, and after, the transfer (eg a parent initially owns 80 per cent but then sells 10 per cent to the NCI).

28. This paper identifies that the guidance in paragraph 30 of IAS 27 *Consolidate and Separate Financial Statements* requires changes in a parent's ownership interest in a subsidiary that do not result in a loss of control, such as the sale of this 10 per cent interest, to be accounted for as equity transactions.

29. These issues may arise regardless of whether the present ownership interest component of NCI is measured at fair value basis or on a proportionate share basis.

'Gross up' calculation

30. The first issue in NCI Paper 3, similar to those identified in NCI Paper 1 and NCI Paper 2, relates to how the 'gross up' in IAS 36.C4 should be calculated when there is a change in a parent's ownership that does not result in a loss of control.

31. Specifically, questions are raised as to whether the 'gross up' is to be updated after a change in ownership interests. This includes whether a 'gross up' is still required to be performed after the NCI has been fully acquired by the parent.

Allocation of impairment losses

32. The second issue notes that goodwill may be allocated to, but not recognised in the carrying amount of, NCI (eg because the NCI was recognised on a proportionate share basis, rather than on a fair value basis).

33. However, the subsequent sale by the parent of, for example, 10 per cent of the subsidiary equity to the NCI shareholder may lead to a reallocation of goodwill between the parent and NCI, and consequently to the recognition of a portion of goodwill as NCI.

34. If there is a subsequent goodwill impairment loss, the request identifies the question of how this impairment loss should be allocated between the recognised and unrecognised components of goodwill associated with NCI.

Reallocation of goodwill

35. The third issue in NCI Paper 3 identifies a lack of guidance in determining how the reattribution of goodwill between the parent and NCI should be calculated following this change in ownership interest when, in accordance with the fact pattern in NCI Paper 2, goodwill is allocated between the parent and NCI on a disproportionate basis.

Recommendation in the request

36. NCI Paper 3 includes illustrative examples that focus on the second and third issues identified.

37. The request proposes that guidance could be provided on which of the various approaches identified are, or are not, in accordance with IFRSs.

Staff recommendation

38. The staff believe that the issues identified combine requests for clarification on some of the wording in IAS 36 and for guidance on its application. These issues arise primarily because of the Board's 2008 revision of IFRS 3.

39. The staff are concerned about whether the separate issues can be addressed individually, or whether they should instead all be assessed collectively. This is because the staff believe that the issues identified have significant overlap.

40. As a result, the staff recommend that the Committee should propose that the Board should address all of these issues as part of the IFRS 3 post-implementation review.

41. If the Committee disagrees with the staff recommendation, the Committee could ask the staff to perform additional work to see if either an annual improvement or an interpretation could address some, or all, of the issues identified.

Staff recommendation
1. Does the Committee agree with the staff recommendation that the Committee should propose that the Board should address these issues as part of the IFRS 3 post-implementation review? 2. If the Committee disagrees with the staff recommendation, what does the Committee recommend?

Appendix A – Details of the request

A1. The staff received the following summary of the issues included in the request.

A2. Copies of the NCI Papers and illustrative examples noted in the staff analysis are included in a separate appendix to this agenda paper.

A3. All information has been copied without modification by the staff. The examples that it provides are in the attachments to this agenda paper.

There are three papers, which deal with several related issues:

Paper 1 - The Annual Improvement to IFRS 3 proposes that non-present ownership interests be recognised as NCI and measured at fair value (or in accordance with other IFRS, if applicable). We are wondering, in such cases, how this affects the 'gross-up' of goodwill for the annual impairment test when NCI is measured using the proportionate share of net assets (that is, how do you do the gross-up)? In cases when there is an impairment loss to be recognized, our understanding is that such loss would not be allocated to the non-present ownership interests. This may be an area where illustrative examples or guidance should be provided.

Paper 2 - When there is a control premium paid in an acquisition, the goodwill attributed to the parent and to the NCI might be disproportionate to their relative ownership interests. When the fair value approach is used to measure NCI, and there is subsequently an impairment loss, the NCI might absorb a disproportionately larger share of the impairment losses. In addition, similar to the issue noted in Paper 1, we are wondering how the control premium affects the 'gross-up' of goodwill for the annual impairment test when NCI is measured using the proportionate share of net assets (that is, how do you do the gross-up)? In cases when there is a control premium and there is an impairment loss to be recognized, we believe that the allocation of losses between the parent and NCI could cause NCI to become negative when the parent has a control premium, because the loss allocated to NCI is higher than its allocated goodwill. We are wondering whether this was the IASB's intention.

Paper 3 - There are several issues when there is a change in ownership interests between the parent and NCI and NCI is measured using the proportionate share of net assets. First, we are wondering how the IASB intended users to 'gross up' the carrying amount of goodwill for impairment testing purposes - using the original or current ownership interest? Does an entity continue to perform the 'gross-up' after it has acquired all of the NCI? How does the entity allocate and recognise impairment losses relating to NCI? How does the entity reallocate goodwill upon a change in ownership interests when the goodwill allocated to parent and NCI are not proportionate to their respective ownership interests (i.e. caused by control premium)?