Project **New items for initial 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 how an entity accounts for impairment testing of goodwill when non-controlling interest (NCI) is recognised.
2. A formal interpretation request on these issues was not made to the IFRS Interpretations Committee (Interpretations Committee). However, as part of the staff's outreach activities, three separate papers relating to these issues were received. These papers recommended that the staff consider whether amendments could be made to IFRSs to clarify current guidance.
3. The issues raised in the three papers relate to the:
   - (a) requirements for calculating the 'gross up' of the carrying amount of goodwill when partial goodwill is recognised because NCI is measured on a proportionate share basis;
   - (b) allocation of impairment losses between the parent and NCI; and
   - (c) reallocation of goodwill between NCI and controlling interests after a change in a parent's ownership interest in a subsidiary that does not result in a loss of control.
4. These three issues arise in situations when:

(a) both NCI, measured on a proportionate share, rather than fair value basis, and non-present ownership interests ('NPOI') exist; 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 shareholders (eg because of the existence of a control premium); or

(c) there are subsequent changes in ownership between the parent and NCI shareholders, but the parent maintains control.

5. 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

6. 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* ('IAS 36 Appendix C').

7. 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.

8. The analysis included in the request focuses on the guidance in IAS 36 Appendix C relating to the impairment testing of cash-generating units (CGUs) with goodwill and NCI. It identifies concerns in applying the guidance in IAS 36 Appendix C, including complexities that Illustrative Example 7A in IAS 36 does not address.

Staff analysis

Key principles in IFRSs relating to these issues

9. The key principles, and exceptions to those principles, in IFRSs, relating to the issues addressed in this agenda paper are as follows:

IFRS 3 Business Combinations

Measurement principle

18 The acquirer shall measure the identifiable assets acquired and the liabilities assumed at their acquisition-date *fair values*.

(Principle 1 – the fair value measurement principle)

19 For each business combination, the acquirer shall measure any non-controlling interest in the acquiree either at fair value *or at the non-controlling interest's proportionate share of the acquiree's identifiable net assets*.

(Exception 1 – measurement of NCI on a proportionate share basis)

Non-controlling interest in an acquiree

B45 The fair values of the acquirer's interest in the acquiree and the non-controlling interest on a per-share basis might differ. *The main difference is likely to be the inclusion of a control premium in the per-share fair value of the acquirer's interest in the acquiree or, conversely, the inclusion of a discount for lack of control (also referred to as a minority discount) in the per-share fair value of the non-controlling interest.*

(Exception 2 – impact of a control premium/minority discount)

Measurement of non-controlling interest (NCI)

IE44D Paragraph 19 of IFRS 3 states that for each business combination, the acquirer shall *measure at the acquisition date components of non-controlling interest in the acquiree that are present ownership interests* and entitle their holders to a proportionate share of the entity's net assets in the event of liquidation *at either fair value or the present ownership instruments' proportionate share* in the acquiree's recognised amounts of the identifiable net assets. *All other components of non-controlling interest must be measured at their acquisition-date fair value,* unless another measurement basis is required by IFRSs.

(Exception 3 – recognition of NPOI)

IAS 36 *Impairment of Assets*

Allocating an impairment loss

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.

(Principle 2 – goodwill gross up to include unrecognised NCI goodwill)

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.*

(Principle 3 – allocation of impairment loss on the same basis as that on which profit or loss is allocated)

C8 If an impairment loss attributable to a non-controlling interest relates to goodwill that is not recognised in the parent's consolidated financial statements (see paragraph C4), that impairment is not recognised as a goodwill impairment loss. In such cases, only the impairment loss relating to the goodwill that is allocated to the parent is recognised as a goodwill impairment loss.

(Principle 4 – allocation of impairment loss between recognised and unrecognised goodwill)

NCI Paper 1 – NCI is measured on a proportionate share basis and includes NPOI

10. The first paper addresses two issues that arise when:

    (a) NCI exists (which is measured on a proportionate share basis in accordance with **Exception 1**); and

    (b) NPOI exists (which is recognised in accordance with **Exception 3** and measured at fair value).

11. These issues relate to:

    (a) **Issue 1.1** – the identification of different approaches that may be applied to calculate the 'gross up' in accordance with **Principle 2**.

    (b) **Issue 1.2** – the allocation of impairment losses in applying **Principle 3**.

Issue 1.1 – Gross up calculation

Overview of issue

12. This issue identifies that, in the consolidated financial statements of the parent, because of:

    (a) **Exception 1**, the partial goodwill approach is applied and no goodwill is recognised for the NCI; **and**

    (b) **Exception 3**, goodwill is recognised for the NPOI.

13. Consequently, in applying **Principle 2**, the staff believe that the parent is required to gross up the carrying amount of goodwill allocated to a subsidiary that is also a CGU. This gross up is to include the goodwill attributable to NCI that is already included in the CGU's recoverable amount, but has not been recognised, noting that goodwill has already been recognised for NPOI.

14. The different approaches to performing this 'gross up' calculation are based on:

    (a) parent goodwill (which excludes the goodwill allocated to the NPOI) (Example 1.2 in the request); or

    (b) total consolidated goodwill (which includes the goodwill allocated to the NPOI) (Example 1.3 in the request).

Implications of the issue

15. Example 1.2 allocates goodwill to NCI in an identical manner to how goodwill is allocated in applying **Principle 1** (ie when NCI is measured at fair value, not on a proportionate share basis).

16. In contrast, Example 1.3 leads to a higher goodwill gross up number, because the goodwill gross up includes the amount of goodwill allocated to NPOI, even though it is not associated with a present ownership interest.

17. Proponents of the approach in Example 1.2 believe that the goodwill gross up should:

    (a) reflect **Principle 1,** because the issues are created by exceptions to that principle (specifically, the decision to measure NCI at the acquisition date on a proportionate share basis);

    (b) not be impacted upon by the accounting choice made by the entity in determining, at the acquisition date, an approach to measuring NCI; and

    (c) reflect that NPOI and NCI are both components of total interest that is not controlled by the parent. Consequently, any goodwill attributed to NPOI should be allocated to components of total interest not controlled by the parent and not be attributed to the parent.

18. In contrast, proponents of the approach in Example 1.3 argue that the goodwill gross up should:

    (a) be different from an allocation reflecting **Principle 1** because of the different measurement basis assigned to NCI; and

    (b) not attribute goodwill relating to NPOI to NCI, because NPOI is specifically identified in IFRS 3 as being separate from NCI.

Issue 1.2 – Allocation of impairment losses

Overview of issue

19. The issue identifies that because of **Exception 3**; NPOI is recognised and measured at acquisition date fair value.

20. Consequently, in applying **Principle 3** to allocate impairment losses between the parent and components of non-controlling interests, 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.

21. The issue therefore arises as whether an impairment loss relating to the fair value of the NPOI should be allocated to:

    (a) the parent;

    (b) NCI; or

    (c) a combination of the parent and NCI.

Implications of the issue

22. Examples 1.1 and 1.2 in the request allocate an impairment loss relating to the fair value of the NPOI to NCI.

23. In contrast, Example 1.3 in the request allocates an impairment loss relating to the fair value of NPOI to the parent.

24. The rationale for Example 1.1 and 1.2 is similar to the views described in paragraph 17. In contrast, the arguments supporting the approach in Example 1.3 are similar to those described in paragraph 18.

25. Alternative approaches that are not included in the examples in the request include:

    (a) allocating the impairment loss relating to NPOI between NCI and the parent on a systematic basis; or

(b) proposing a change to **Principle 3** that would allow an impairment loss to be allocated to NPOI even though it is not entitled to a share of any profit or loss of the subsidiary.

NCI Paper 2 – Goodwill is allocated between the parent and NCI on a disproportionate basis

26. The second paper addresses two issues that arise when:

(a) goodwill is allocated between the parent and NCI on a disproportionate basis because of an existence of a control premium **(Exception 2)**; and

(b) NCI includes present ownership interests (which are measured on a fair value basis in accordance with **Principle 1** or on a proportionate share basis in accordance with **Exception 1**).

27. These issues relate to:

(a) **Issue 2.1** – the identification of different approaches that may be applied to calculate the 'gross up' in accordance with **Principle 2**.

(b) **Issue 2.2** – the allocation of impairment losses in applying **Principle 3**.

Issue 2.1 – Gross up calculation

Overview of issue

28. The issue is how **Principle 2** should be applied in performing the goodwill gross up calculation when control premiums exist and are recognised in accordance with **Exception 2**.

29. In this situation, the initial allocation of goodwill between the parent and NCI (reflecting the control premium) may be on a basis that is different from that used to perform the goodwill gross up.

30. Therefore, should an entity perform the 'gross up' calculation based on:

(a) the percentage of the subsidiary acquired by the parent at the acquisition date (thereby ignoring the impact of the control premium); or

(b) the percentage of the subsidiary acquired by the parent at the acquisition date, as adjusted for the impact of any control premium recognised?

Implications of the issue

31. Example 2.1 in the request illustrates issues that may arise if the initial allocation of goodwill between the parent and NCI is on a basis that, because of the impact of a control premium, is different from that used to perform the goodwill gross up.

32. Specifically, Example 2.1 shows that the carrying amount of goodwill calculated for the purpose of the goodwill gross up may exceed the amount of goodwill recognised if NCI were measured at fair value in accordance with **Principle 1**, leading to the parent recognising larger impairment losses in subsequent periods.

Issue 2.2 – Allocation of impairment losses

33. This issue identifies a conflict between the requirements to:

(a) consider control premiums (**Exception 2**) when allocating goodwill on the acquisition date; and

(b) allocate impairment losses (**Principle 3)** based upon how profit or loss is allocated.

34. This is because an allocation of impairment losses based on the ownership percentage basis in accordance with **Principle 3** would be inconsistent with the goodwill attribution percentage basis used for initially allocating goodwill between the parent and the NCI in accordance with **Exception 2**.

35. This issue exists regardless of whether NCI is measured on a fair value basis, or on a proportionate share basis.

Implications of the issue

36. Example 2.1 in the request shows that when a control premium exists, proportionally more goodwill is allocated to the parent, rather than NCI, at the acquisition date.

37. Consequently, when allocating subsequent impairment losses between the parent and NCI, NCI is allocated a greater proportion (based upon its ownership percentage) than the initial amount of goodwill that it is allocated (which reflected the control premium).

38. If the subsidiary is determined to be fully impaired, applying **Principle 3** to allocate impairment losses based upon ownership could lead to the carrying amount of NCI becoming negative, yet the parent could continue to recognise a positive amount of goodwill relating to the subsidiary.

39. As a result, some believe that **Principle 3** should be interpreted in a flexible way. Interpreting in this manner would lead to goodwill being allocated between the parent and NCI on a substantively appropriate basis, rather than being only based upon how profit or loss is allocated between the parent and NCI.

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

40. The third paper considers the implications of a transfer of interest in a subsidiary between the parent and NCI shareholders when the parent retains control before, and after, the transfer. For example, a parent initially owns 80 per cent but then sells 10 per cent to, or purchases an additional 10 per cent from, the NCI shareholders.

41. It addresses three issues that arise when subsequent changes in a parent's ownership interest in a subsidiary that do not result in a loss of control occur, noting that these changes are accounted for as an equity transaction in accordance with paragraph 30 of IAS 27 *Consolidated and Separate Financial Statements*.

42. These issues relate to:

    (a) Issue 3.1 – the identification of different approaches that may be applied to calculate the 'gross up' in accordance with **Principle 2**.

    (b) Issue 3.2 – the allocation of impairment losses in applying **Principle 3**.

(c) Issue 3.3 – the re-allocation of goodwill between recognised, and unrecognised, goodwill when applying **Principle 4** if a control premium exists in accordance with **Exception 2**.

'Gross up' calculation

43. The first issue in NCI Paper 3 is similar to those identified in NCI Paper 1 and NCI Paper 2.

44. It identifies that changes in a parent's ownership interest in a subsidiary that do not result in a loss of control may lead to the need to reallocate goodwill between the parent and NCI.

45. Consequently, it addresses the issue of how, when there is a change in a parent's ownership that does not result in a loss of control, the 'gross up' required by **Principle 2** should be calculated to reallocate goodwill between the parent and NCI.

46. Specifically, questions are raised as to whether the 'gross up' to reallocate goodwill between the parent and NCI should be performed based on the:

(a) initial allocation of interest between the parent and the NCI shareholders; or

(b) updated allocation of interest between the parent and the NCI shareholders, after the change in the parent's and NCI shareholder's ownership interests.

Implications of the issue

47. View 1 in the request requires the goodwill gross up to be calculated based on the initial allocation of interest between the parent and the NCI shareholders.

48. This approach identifies that total goodwill is not changed as a result of subsequent changes in a parent's ownership interest in a subsidiary that do not result in a loss of control.

49. However, some note that this approach would lead to the goodwill gross up calculation being required even if the parent subsequently acquires **all** of NCI.

50. In contrast, View 2 in the request requires the goodwill gross up to be calculated based on the updated allocation of interest between the parent and the NCI shareholders, after the change in ownership interests.

51. Supporters of this approach note that it would then be consistent with the subsequent allocation of impairment losses, which in accordance with **Principle 3**, reflects how profit or loss is allocated between the NCI and the parent.

Allocation of impairment losses

52. The second issue in NCI Paper 3 is also similar to those identified in NCI Paper 1 and NCI Paper 2.

53. The issue identifies that **Principle 3** provides guidance on how impairment losses should be allocated between the interests of the parent and the NCI. In contrast, **Principle 4** does not provide detailed guidance on how any goodwill impairment losses allocated to NCI should then be allocated between recognised, and unrecognised, goodwill attributable to NCI.

54. Consequently, in applying **Principle 4**, the issue arises as to how goodwill impairment losses attributed to NCI in accordance with **Principle 3** should be allocated between recognised and unrecognised goodwill. For example, should it be by allocating:

    (a) impairment losses based on the proportion of recognised NCI goodwill to total (recognised + unrecognised) goodwill attributed to NCI;

    (b) impairment losses initially to recognised NCI goodwill, until recognised NCI goodwill is fully impaired; or

    (c) impairment losses initially to unrecognised NCI goodwill, until unrecognised NCI goodwill is fully impaired.

Implications of the issue

55. Example 3.1, View 1, in the request illustrates the allocation of a goodwill impairment loss between recognised and unrecognised NCI goodwill based on the proportional approach.

56. Supporters of this approach believe that it is consistent with both **Principle 3** and **Principle 4**.

57. Example 3.1, View 2, in the request illustrates allocation in a way that impairment losses are initially allocated to recognised NCI goodwill, and only to unrecognised goodwill once recognised NCI goodwill is fully impaired.

58. Supporters of this approach believe that it is analogous to the guidance in IAS 36.104 requiring recognised goodwill to be impaired first.

59. Example 3.1, View 3 in the request takes the opposite approach to View 2. It illustrates allocation of a goodwill impairment loss first to unrecognised NCI goodwill, and only to recognised NCI goodwill once unrecognised NCI goodwill is fully impaired.

60. Some oppose this approach, believing it to be inconsistent with the **Principle 2** requirements to perform a gross up and allocate goodwill to NCI.

Reallocation of goodwill

61. 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 a change in ownership interest when, in accordance with **Exception 2**, goodwill is allocated between the parent and NCI on a disproportionate basis (eg because of the existence of a control premium).

62. This issue arises regardless of whether, at the acquisition date:

    (a) **Principle 1** is applied, and NCI is measured at fair value; or

    (b) **Exception 1** is applied, and NCI is measured on a proportionate share basis.

Implications of the issue

63. View 1 in Example 3.2 illustrates the reallocation of goodwill based on the amount of goodwill initially allocated to the parent, and consequently ignores the existence of the control premium.

64. In this situation, similar to the concerns raised in NCI Paper 2, the goodwill allocated to NCI may be written down to zero as part of the reallocation process even if the parent does not increase its ownership percentage to 100 per cent.

65. In contrast, View 2 in Example 3.2 illustrates the reallocation of goodwill based on the amount of goodwill initially allocated to NCI and consequently considers the impact of the control premium.

66. In applying View 2, the reallocation of goodwill will only reduce NCI goodwill to zero if the parent acquires 100 per cent ownership in the subsidiary.

Staff recommendation

67. These issues noted reflect concerns that exist in practice in interpreting the current principles and exceptions in IAS 36 and IFRS 3.

IFRS 3

68. In considering the principles and exceptions in IFRS 3, the staff believe the following:

Principle 1 – the fair value measurement principle

69. The staff believe that **Principle 1** is defined in a clear manner and does not give rise to any of the issues discussed in this agenda paper.

Exception 1 – measurement of NCI on a proportionate share basis

70. The staff note that **Exception 1**, which permits entities to measure NCI on a proportionate share, rather than fair value basis, was introduced by the Board when IFRS 3 was revised.

71. Although **Exception 1** does create practical implementation issues, the staff think that the rationale in paragraphs IFRS 3.BC212 ─ BC216 makes it challenging for the Interpretations Committee to recommend the Board to consider further amendments to this exception to address some of the issues noted in this agenda paper.

Exception 2 – impact of a control premium/minority discount

72. This agenda paper shows that **Exception 2** also leads to practical implementation issues. However, although the staff have characterised this as an exception in this agenda paper, the staff think that it is based on a reasonable principle that should be considered in applying IFRS 3 (ie considering the impact of control premiums when accounting for a business combination).

73. Consequently, the staff do not think that the Interpretations Committee should recommend that the Board should make amendments to **Exception 2**.

Exception 3 – recognition of NPOI

74. IFRS 3 revised also expanded the definition of minority interest, when redefining it as NCI, to include NPOI such as options and warrants.

75. The staff think that **Exception 3** does introduce additional complexity, as identified in the issues in the agenda paper, some of which were, in part, highlighted in the Interpretation Committee's discussions on the guidance provided on the measurement of NCI in the 2008 – 2010 *Annual Improvements*.

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

77. However, the staff does not recommend that the Interpretations Committee should recommend that the Board should amend **Exception 3** further because of the recent annual improvement.

Staff conclusion

78. The staff think that, if the Interpretations Committee believe that any of these exceptions and principles in IFRS 3 should be amended to address the issues in this agenda paper, they should recommend that the Board should consider their concerns as part of a post-implementation review of IFRS 3.

79. However, as noted below, the staff believe that the basic concerns in the request relate to the guidance in IAS 36, rather than in IFRS 3.

IAS 36

80. In considering the principles and exceptions in IFRS 3, the staff believe the following:

Principle 2 – goodwill gross up to include unrecognised NCI goodwill

81. The staff believe that **Principle 2**, as currently written, can be interpreted in a broad manner. The staff do not think that the principle specifically requires, or prohibits, an approach to applying the goodwill gross up when:

    (a) both NCI, measured on a proportionate share, rather than fair value basis, and NPOI exist; 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 shareholders (eg because of a control premium); or

    (c) there are subsequent changes in ownership between the parent and NCI shareholders, but the parent maintains control.

82. Consequently, the staff believe that **Principle 2** provides constituents with appropriate flexibility to perform the goodwill gross up in a manner that best reflects the specific facts and circumstances of the relationship between the parent and the subsidiary.

83. In addition, the staff are concerned that any amendment to this principle, for example to provide more specific ‘rules-based’ guidance, may have significant implications on the application of other principles relating to the impairment of CGUs with goodwill and NCI.

Principle 3 – allocation of impairment loss on the same basis as that on which profit or loss is allocated

84. The staff believe that **Principle 3**, as currently written, can be interpreted by some to be very narrow, requiring that goodwill impairment losses must always be allocated between the parent and NCI on the same basis as profit or loss.

85. The staff think that the examples in this agenda paper illustrate that broader application of this principle would improve financial reporting. This broader application would reflect the notion that other approaches to allocating goodwill impairment losses, for example to reflect the impact of NPOI and control premiums, are in accordance with the principles of IAS 36 in reflecting the substance of the impairment loss.

Principle 4 – allocation of impairment loss between recognised and unrecognised goodwill

86. Similarly as for **Principle 2**, the staff believe that **Principle 4**, as currently written, can be interpreted in a broad manner. The staff do not think that the principle specifically requires, or prohibits, the alternative approaches discussed in this agenda paper.

87. Consequently, the staff believe that **Principle 4** also provides constituents with flexibility to perform an appropriate allocation of the impairment loss between recognised and unrecognised goodwill following a change in the parent's ownership interest. Such an allocation can be carried out in a manner that best reflects the specific facts and circumstances of the relationship between the parent and the subsidiary.

88. In addition, the staff are concerned that any amendment to this principle, for example to provide more specific guidance, could be interpreted to be outside the scope of *Annual Improvements* because of the implications that it has for establishing principles relating to the:

    (a) treatment of goodwill when there are subsequent changes in ownership between the parent and NCI shareholders; and

    (b) principles for allocating goodwill between the parent and NCI and determining what goodwill should be allocated.

Example 7A in IAS 36

89. The issues raised in this agenda paper also highlight concerns that constituents have with Example 7A in IAS 36.

90. These concerns primarily relate to whether the ‘mechanical approach’ to impairment testing in Example 7A should be applied in all situations of CGUs that have goodwill and NCI, for example, when the following situations exist:

(a) NPOI exists;

(b) Control premiums and minority discounts are recognised at the acquisition date; or

(c) There are changes in the parent’s ownership interest in a subsidiary that do not result in loss of control.

91. The staff believe that the Illustrative Example is not intended to require that this mechanical approach should always applied when applying the guidance in IAS 36 Appendix C.

Staff conclusion

92. The staff think that that the Interpretations Committee should recommend that the Board should amend **Principle 3**. This amendment would require allocation of the impairment loss on the same basis as that on which profit or loss is allocated, unless an alternative allocation basis would better reflect the substance of the impairment loss.

93. The staff think that that the Interpretations Committee should recommend that the Board should amend **Example 7A** in IAS 36. This amendment would clarify that it provides an illustrative example, but not the only method, of how the guidance in IAS 36 Appendix C should be applied.

94. The staff believe that these amendments can be made without causing conflict with the other principles in IAS 36 relating to the impairment of CGUs with goodwill and NCI.

95. The staff assess this proposed amendment to clarify **Principle 3** as being non-urgent but necessary. The staff therefore think that it meets the current criteria for inclusion in the *Annual Improvements* cycle for 2009-2011.

96. The staff believe that the transition provisions should follow the general principles in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*, and that entities should apply the amendment retrospectively.

97. The staff do not believe that consequential amendments to other standards, including IFRS 1 *First-time Adoption of International Financial Reporting Standards*, are required.

Questions for the Interpretations Committee
1. Does the Interpretations Committee agree with the staff recommendation to propose that the Board should consider the implication of these issues as part of the IFRS 3 post-implementation review? 2. Does the Interpretations Committee agree with the staff recommendation that an amendment should be made to paragraph C6 and Example 7 in IAS 36 to clarify the principles to be applied when performing impairment tests of CGUs with goodwill and NCI? 3. Does the Interpretations Committee agree with the staff recommendation that the Board should include this amendment within the next *Improvements to IFRSs* exposure draft, with proposed retrospective transition requirements? 4. Does the Interpretations Committee have any comments on the draft wording for the amendments presented in Appendix C to the paper? 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 **Appendix B - 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)?

Appendix C – Draft amendment to IAS 36 *Impairment of Assets*

Proposed amendment to IAS 36 *Impairment of Assets*

Paragraph C6, C7, IE67 and IE68E are amended (new text is underlined and deleted text is struck through) and paragraph 140G is added.

Appendix C
Impairment testing cash-generating units with goodwill and non-controlling interests

Allocating an impairment loss

C6 If a subsidiary, or part of a subsidiary, with a non-controlling interest is itself a cash-generating unit, the impairment loss, including amounts attributable to present ownership interests that do not entitle holders to a proportionate share of the entity's net assets in the event of liquidation, is allocated between the parent and the non-controlling interest, on a systematic and rational basis. This ~~the same~~ basis should reflect that on which profit or loss is allocated unless an alternative approach (eg based on the allocation of goodwill between the parent and the non-controlling interest at the acquisition date) would be a more faithful attribution of the impairment loss.

C7 If a subsidiary, or part of a subsidiary, with a non-controlling interest is part of a larger cash-generating unit, goodwill impairment losses are allocated to the parts of the cash-generating unit that have a non-controlling interest and the parts that do not. The impairment losses should be allocated to the parts of the cash-generating unit on the basis of:

(a) to the extent that the impairment relates to goodwill in the cash-generating unit, the relative carrying values of the goodwill of the parts before the impairment; and

(b) to the extent that the impairment relates to identifiable assets in the cash-generating unit, the relative carrying values of the net identifiable assets of the parts before the impairment. Any such impairment is allocated to the assets of the parts of each unit pro rata on the basis of the carrying amount of each asset in the part.

In those parts that have a non-controlling interest, 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 unless an alternative approach (eg based on the allocation of goodwill between the parent and the non-controlling interest at the acquisition date) would be a more faithful attribution of the impairment loss.

Effective date and transition

140G Improvements to IFRSs issued in [date] amended paragraphs C6 and C7. An entity shall apply this amendment for annual periods beginning on or after 1 January 2012. Earlier application is permitted.

Example 7A Non-controlling interests measured initially as a proportionate share of the net identifiable assets

Allocating the impairment loss

IE67 Therefore, CU500 of the CU850 impairment loss for the unit is allocated to the goodwill. In accordance with paragraph C6 of Appendix C of IAS 36, if the partially-owned subsidiary is itself a cash-generating unit, the goodwill impairment loss is allocated to the controlling and non-controlling interests on the same basis as that on which profit or loss is allocated unless an alternative approach (eg based on the allocation of goodwill between the parent and the non-controlling interest at the acquisition date) would be a more faithful attribution of the impairment loss. In this example, profit or loss is allocated on the basis of relative ownership interests. Because the goodwill is recognised only to the extent of Parent's 80 per cent ownership interest in Subsidiary, Parent recognises only 80 per cent of that goodwill impairment loss (ie CU400).

Example 7B Non-controlling interests measured initially at fair value and the related subsidiary is a stand-alone cash-generating unit

Allocating the impairment loss

IE68E Therefore, the full amount of impairment loss of CU150 for the unit is allocated to the goodwill. In accordance with paragraph C6 of Appendix C of IAS 36, if the partially-owned subsidiary is itself a cash-generating unit, the goodwill impairment loss is allocated to the controlling and non-controlling interests on the same basis as that on which profit or loss is allocated unless an alternative approach (eg based on the allocation of goodwill between the parent and the non-controlling interest at the acquisition date) would be a more faithful attribution of the impairment loss.

Basis for Conclusions on proposed amendment to IAS 36 *Impairment of Assets*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

Allocating an impairment loss

BC1 The Board was asked to clarify the principles in Appendix C of IAS 36 *Impairment of Assets* regarding impairment testing cash-generating units with goodwill and non-controlling interests, and the application of these principles in Example 7 of IAS 36.

BC2 The Board noted that Appendix C of IAS 36 provides principles to be applied when allocating goodwill, testing for impairment and allocating impairment loss when a cash-generating unit has goodwill and non-controlling interest.

BC3 However, the Board observed that the principle in paragraph C6 of IAS 36, to allocate impairment losses between the parent and the non-controlling interest on the same basis as that on which profit or loss is allocated, could be interpreted as requiring impairment losses to be allocated in this manner in all circumstances. The Board do not believe this is consistent with the principles and intent of IAS 36. The Board noted that applying an alternative basis for allocating impairment losses between the parent and the non-controlling interest is consistent with the principles of IAS 36 when it more faithfully reflects attribution of the impairment loss.

BC4 This may include circumstances when the entity identified a control premium when the parent acquired the subsidiary. This is because allocation of a goodwill impairment loss on the same basis as that on which profit or loss is allocated would be inconsistent with the initial allocation of goodwill between the parent and the non-controlling interest. It may also include circumstances when present ownership interests exist which do not entitle holders to a proportionate share of the entity's net assets in the event of liquidation. This is because these present ownership interests are measured at acquisition-date fair value, and consequently include an allocation of goodwill, but are not entitled to any allocation of profit or loss.

BC4 Consequently, the Board proposed amendments to paragraphs C6 and C7 of IAS 36, and references made to paragraph C6 in Examples 7A and 7B of IAS 36, to clarify this intent.