

STAFF PAPER

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IASB/FASB Meeting

Project	Goodwill and impairment project		
Paper topic	Progress report: Improving the impairment requirements		
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Objective of this paper

1. The goodwill and impairment project is expected to run in two concurrent phases—a goodwill and other intangible assets phase and an impairment phase. The purpose of this agenda paper is to provide an update on our progress in the impairment phase.

Structure of this paper

2. This paper includes the following sections:
 - (a) Update since September meeting with the US Financial Accounting Standards Board (FASB)
 - (b) Objective of improving the impairment requirements
 - (c) Summary of approaches being considered
 - (d) Proposed next steps
 - (e) Appendix A: Feedback from the Post-implementation Review (PIR) of IFRS 3 *Business Combinations* on the impairment requirements
 - (f) Appendix B: High level comparison of US GAAP and IFRS Standards for impairment of non-financial assets
 - (g) Appendix C: Mechanics of the Pre-acquisition Headroom (PH) Approach
 - (h) Appendix D: Example to illustrate the PH Approach

Update since September meeting with the FASB

3. The Board discussed the impairment phase of this project at its October 2015 and February-May 2016 meetings. The following were discussed and developed:
 - (a) The objectives for the impairment phase (see paragraph 8)
 - (b) A number of possible approaches to addressing the objectives. These are described in paragraphs 9-19 and Appendix C.

The meetings were not decision-making meetings.

4. At the November 2015 meeting of the Capital Markets Advisory Committee (CMAC) the staff asked for CMAC members' views on how they currently use the information provided by entities about goodwill and impairment.
5. At the December 2015 meeting of the Accounting Standards Advisory Forum (ASAF), the staff asked for feedback on the Board's initial discussions in October 2015 and for advice on the way forward with the project.
6. At the March 2016 meeting of the Global Preparers Forum (GPF), the staff sought the views of GPF members on improving the disclosure requirements about goodwill and impairment to provide better, more timely information, to users of financial statements.
7. At the May 2016 Board meeting, staff from the Accounting Standards Board of Japan (ASBJ) and the European Financial Reporting Advisory Group (EFRAG) presented their data research, which includes quantitative information from 2007 to 2014 about the amount and trends of reported goodwill, impairment and intangible assets in four major indices in the US, Europe, Australia and Japan. The staff have provided what they think are the key points in paragraph 6 of Agenda Paper 18A for this meeting.

Objective of improving the impairment requirements

8. Two objectives of the impairment phase of the goodwill and impairment project:
 - (a) Consider whether the impairment test could be simplified and its application improved without loss of information for investors.
 - (b) Consider whether information can be improved for investors without imposing costs that would exceed the benefits provided by the

improvements. This includes considering investors' concerns that the current requirements result in impairment losses being recognised too slowly and in too small amounts ('too little, too late').

Summary of approaches being considered

Possible approaches to simplify/assist application of impairment test (paragraph 8(a) of objective)

Discussed at October 2015 and February 2016 Board meetings¹

Approach 11 One model approach

9. The objective of IAS 36 *Impairment of Assets* is to prescribe the procedures that an entity applies to ensure that its assets are carried at no more than their recoverable amount. IAS 36 defines recoverable amount as the higher of an asset's (or cash generating unit's (CGU's)) fair value less costs of disposal (FVLCD) and its value in use (VIU). VIU is the entity's estimate of the present value of the future cash flows to be derived from continuing use and disposal of the asset.
10. In practice, many entities determine FVLCD using a discounted cash flow calculation because CGUs are not usually traded in active markets. Some think that it is confusing to use different inputs for VIU and FVLCD when both are estimated using discounted cash flow calculations. We had some feedback that requiring entities to look at a single method (single calculation), rather than the higher of two methods, might reduce complexity without a loss of information for users of financial statements. One of the following methods could be considered for that single-model:
 - (a) Method 1: Fair value less costs of disposal (FVLCD)
 - (b) Method 2: Value in Use (VIU)
 - (c) Method 3: Method depends on how the entity expects to recover the asset

Approach 12 Relief from annual test

11. IAS 36 requires a CGU to which goodwill has been allocated to be tested for impairment annually, and whenever there is an indication that the unit may be

¹ The detailed staff analysis of these approaches is in February 2016 IASB Agenda Paper 18C and October 2015 IASB Agenda Paper 18B.

impaired. We have had some feedback that requiring an impairment test only if impairment indicators are present for goodwill and other indefinite life intangible assets may reduce complexity ('indicator-only approach'). This would also be consistent with the approach for finite life assets in the scope of IAS 36.

12. We could also consider introducing one or both of the following additional indicators for goodwill to make the indicator-approach for goodwill more robust:
- (a) a qualitative assessment of whether it is more likely than not that the fair value of a CGU (or group of CGUs) to which goodwill is allocated is less than its carrying amount; and/or
 - (b) an assessment of whether actual performance of the acquisition was worse than its expected performance. This might operate only during the first few years following an acquisition, for example three years.

Approach 13 Improving VIU

13. Modifying the VIU calculation to address some of the concerns in paragraph A3 of Appendix A. Some possible approaches:
- (a) removing the requirement to use a pre-tax discount rate because post-tax rates can be observed and are often used in practice;
 - (b) not requiring management to make adjustments to their forecasts to exclude estimated future cash inflows or outflows that are expected to arise from a future restructuring to which an entity is not yet committed or improving or enhancing the asset's performance; and/or
 - (c) consider whether education material could be developed to address other areas of difficulty such as better explaining the differences between the market perspective (used in FVLCD) and the entity perspective (used in VIU) and how to determine the terminal value/growth rate.

Approach 14 Guidance on allocating goodwill to CGUs

14. Developing guidance (or education material) on allocating and reallocating goodwill to CGUs, in particular to address concerns we have received from preparers that such allocation is difficult to apply in practice and concerns we have received from

accounting firms that over aggregation (grouping) of CGUs is common. New guidance or requirements could help to ensure that goodwill is allocated at the appropriate level.

Possible approach to address concerns impairment is too little too late (paragraph 8(b) of the objective)

Discussed at March and April 2016 Board meetings²

Pre-acquisition headroom (PH) Approach

15. The PH Approach would apply to circumstances in which acquired goodwill is allocated to pre-existing CGUs (or groups of CGUs) of the acquirer. In such circumstances there is concern that the difference between the carrying amount of the CGU and its recoverable amount immediately before the acquisition shelters the acquired goodwill from impairment. This difference is referred to as the ‘pre-acquisition headroom’ or ‘PH’. Such a difference may arise, for example, from unrecognised pre-existing assets of the CGU and also differences between the carrying amounts and recoverable amounts of the pre-existing assets of the CGU. The objective of the PH Approach is to remove this sheltering effect from the impairment test by incorporating the PH, measured at the acquisition date, into the impairment test calculation. The PH Approach would help to address concerns that impairment losses are being recognised too slowly and in too small amounts (‘too little, too late’) as a result of the headroom provided by the acquirer’s pre-existing assets. The mechanics of the PH Approach are set out in Appendix C.

Possible approaches to improve disclosures about goodwill and impairment (paragraph 8(b) of the objective)³

Discussed at February and March 2016 Board meeting⁴

² The detailed staff analysis of the PH Approach is in April 2016 IASB Agenda Paper 18A. This approach was previously referred to as the PAH Approach.

³ Regardless of which approaches are considered to improve the disclosure requirements, a review of the existing disclosure requirements in IAS 36/IFRS 3 would be undertaken. The staff think the aim of this review would be to see if we can improve the existing requirements to assist better application and remove any requirements that are no longer necessary in light of any new disclosures we add.

⁴ The detailed staff analysis of these disclosure approaches is in March 2016 IASB Agenda Paper 18B.

Approach D1 Key performance targets

16. Disclosure of the key performance targets supporting the purchase price paid, and hence supporting the amount of goodwill recognised. The staff envisage this would include measurable targets and therefore would incorporate:
- (a) a quantitative, as well as qualitative, explanation for the purchase price paid. Such explanation would include the targets management has identified as benefits of the acquisition and in support of the acquisition price; and
 - (b) identification of the periods over which targets are expected to be achieved (for example an increase in revenue at 5 per cent per year for 3 years).

The staff would expect the key performance targets to follow from management's own assessment which it performs when determining whether to undertake the acquisition and which are communicated to investors in support of the acquisition.

Approach D2 Comparison with actual performance

17. An annual comparison of actual performance against the key performance targets for a number of years following the acquisition. The staff think the number of years should be driven by the time horizon used by management when determining the key performance targets in Approach D1. The Board may want to also consider requiring a minimum period, for example three years.

Approach D3 Goodwill breakdown

18. Disaggregation of the amount of goodwill at the reporting date into the contributing past acquisitions.

Approach D4 Goodwill recoverability

19. For each significant acquisition in the breakdown in Approach D3, an explanation to justify why the amount of goodwill is recoverable. For example management would be required to consider what evidence there is that synergies and going concern value remain from each major past acquisition.

Possible next steps

20. The staff recommend that the following should be the next steps for the impairment phase of the goodwill and impairment project going forward:
21. Step 1: Develop the PH Approach further by considering the following:
 - (a) Pros and cons, including the likely behavioural incentives/effects, of the different methods that could be used to allocate an impairment loss between acquired goodwill and the PH (paragraph C13 lists possible methods).
 - (b) More examples of how the PH Approach would apply, including:
 - (i) a scenario where pre-acquisition deficit exists that would not be fully recognised as an impairment loss on identification of this indicator of impairment in accordance with the requirements in IAS 36 (for example because the CGU is mainly comprised of financial assets); and
 - (ii) an impairment loss arises primarily because of the effect of an increase in the discount rate in the measurement of recoverable amount of the CGU / group of CGUs.
22. Step 2: Solicit feedback from the Accounting Standards Advisory Forum (ASAF) on the approaches being considered for improving the impairment requirements.
23. Step 3: Perform field testing and additional outreach with preparers, users and auditors about the possible disclosures D1 and D2. The objective would be to help us understand what information would be both meaningful and possible to prepare, identify any potential audit issues and decide what information would be appropriate in the financial statements (or at least incorporated by cross-reference), as opposed to solely considered as part of management commentary.

Appendix A: Feedback from the IFRS 3 PIR on the impairment requirements

A1. The Board’s report and feedback statement on the IFRS 3 PIR provided the following next steps to address impairment:

Area of focus	Assessed significance	Possible next steps
Effectiveness and complexity of testing goodwill for impairment.	High	Research will be undertaken. We could review IAS 36 and we could consider improvements to the impairment model; particularly whether there is scope for simplification.

A2. The PIR identified concerns that the current impairment requirements are costly and complex to apply and there are some shortcomings in the information provided to investors. Consequently, some think the benefit of the information provided to investors does not justify the costs of applying the current impairment requirements.

A3. The main challenges in applying the current impairment requirements identified during the PIR were:

- (a) the overall costs involved in performing the impairment test, including the requirement to perform it annually;
- (b) limitations of the value in use (VIU) calculation, including the prohibition on including expansion capital expenditures in cash flow projections and the requirement to use a pre-tax discount rate; and
- (c) the high degree of subjectivity in the assumptions used in the impairment test, including allocating goodwill to cash-generating units (CGUs) for impairment testing purposes, and reallocating that goodwill if a restructuring occurs.

A4. The following are the key messages we heard from users of financial statements about the current information provided about goodwill and impairment:

- (a) Some say the current information is useful because it provides confirmatory value about the performance of the acquisition and about the stewardship of management.
- (b) However some say the current information has limitations for the following main reasons:

- (i) impairment losses are recognised too late.
 - (ii) impairment calculations are inherently very judgemental and the assumptions used in the calculations are subjective.
 - (iii) disclosures are not sufficient to assess whether the main inputs/assumptions are reasonable. However some users said that some of the current disclosures are useful; these included discount rates used, long-term growth rates, profit and capital expenditure assumptions and sensitivities.
 - (iv) insufficient information to help them understand the subsequent performance of the acquired business and whether main targets/synergies of the acquisition are met, which are considered key to their analysis.
- (c) Some users focus more on the timing of the impairment write-down and its overall magnitude rather than the specific amount of impairment recognised.

A5. Based on our user outreach during and subsequent to the PIR, users appear to be particularly interested in understanding the following information about goodwill and impairment:

- (d) what management thought were the key drivers that justified the valuation of the acquisition (and hence the amount of goodwill);
- (e) assessing whether an acquisition has been successful; and
- (f) assessing the accountability of management.

**Appendix B: High-level comparison of IFRS Standards and US GAAP
(impairment of non-financial assets)**

B1. The staff have prepared the following summary of the main differences between the current requirements in IFRS Standards and US GAAP for impairment of non-financial assets that are relevant to our discussions at this meeting.

IFRS	US GAAP		
<p>One-step impairment test.</p> <p>The carrying amount of an asset or CGU is compared with its recoverable amount. Recoverable amount is the higher of its fair value less costs of disposal and its value in use.</p> <p>The impairment loss is measured as the difference between carrying amount and recoverable amount.</p>	<p>Goodwill:⁵</p> <p>Two-step impairment test.</p> <p>Step One—The carrying amount of a reporting unit is first compared with its fair value. If the carrying amount is higher than the fair value, an entity must perform Step Two. If the carrying amount is lower than the fair value, no impairment is recorded.</p> <p>Step Two—Calculate the implied fair value of goodwill. The impairment loss recognised is the amount by which the carrying amount of goodwill exceeds the implied fair value of goodwill within its reporting unit.</p> <p>Optional qualitative assessment: An entity may first assess qualitative factors to determine whether the two-step goodwill impairment test is necessary. If the entity determines, based on the qualitative assessment, that it is more likely than not that the fair value of a reporting unit is below its carrying amount, the two-</p>	<p>Indefinite-lived intangible assets:</p> <p>One-step impairment test.</p> <p>The carrying amount of an asset is compared with its fair value.</p> <p>The impairment loss is recognised as the excess of the carrying amount over the fair value of the asset.</p> <p>Optional qualitative assessment: An entity may first assess qualitative factors to determine whether quantitative impairment test is necessary. If the entity determines, based on the qualitative assessment, that it is more likely than not that the fair value of an indefinite-lived intangible asset is below its carrying amount, the quantitative impairment test is performed. Examples of events and circumstances that an entity would need to consider in doing qualitative impairment test are provided.</p>	<p>Long-lived assets:</p> <p>Two-step impairment test.</p> <p>Step One—The carrying amount is first compared with the undiscounted cash flows. If the carrying amount is lower than the undiscounted cash flows, no impairment loss is recognised.</p> <p>Step Two—If the carrying amount is higher than the undiscounted cash flows, an impairment loss is measured as the difference between the carrying amount and fair value.</p>

⁵ The FASB have published proposals to simplify the goodwill impairment test (see paragraph B2).

	<p>step impairment test is performed. Examples of events and circumstances that an entity would need to consider in doing qualitative impairment test are provided.</p> <p>An entity can bypass the qualitative assessment for any reporting unit in any period and proceed to Step one of the two-step test.</p>	<p>An entity can bypass the qualitative assessment for any asset in any period and proceed to the quantitative test.</p>
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IFRS STANDARDS	US GAAP
Impairment testing is required when there is an indication of impairment.	Similar requirement.
Annual impairment testing is required for goodwill, indefinite life intangible assets and intangible assets not yet available for use. Annual test may be performed at any time during the year provided performed at the same time each year.	Similar requirement except intangible assets not yet available for use are tested only if there is an indicator of impairment.
Depending on the circumstances, assets may be tested for impairment as an individual asset, as part of a CGU or as part of a group of CGUs. When possible, an impairment test is performed for an individual asset. Otherwise, assets are tested in CGUs.	Depending on the circumstances, assets are tested for impairment as an individual asset, as part of an asset group or at the reporting unit level. Depreciable assets are tested for impairment in asset groups unless an individual asset generates identifiable cash flows largely independent of the cash flows from other asset groups.
A CGU is the smallest group of assets that generates cash inflows that are largely independent of the cash inflows of other assets or groups of assets.	An asset group is the lowest level for which there are identifiable cash flows that are largely independent of the net cash flows of other groups of assets. A reporting unit is an operating segment or one level below an operating segment if certain conditions are met. (Both may differ from a CGU under IFRS Standards.)
Goodwill is allocated to CGUs or groups of CGUs that are expected to benefit from the synergies of the business combination from which it arose. Each unit or group of units shall represent the lowest level at which goodwill is monitored for internal management purposes and shall not be larger than an operating segment.	Goodwill is allocated to reporting units that are expected to benefit from the synergies of the business combination from which it arose.
An impairment loss for a CGU is allocated first to any goodwill and then pro rata to other assets in the CGU that are within the scope of IAS 36.	An impairment loss for an asset group is allocated pro rata to assets in the asset group, excluding working capital, goodwill, corporate assets and indefinite-lived intangible assets.
Reversals of impairment are recognised, other than for impairments of goodwill.	Reversals of impairments are prohibited.

Proposed changes to US GAAP

- B2. In May 2016 the FASB published a proposed Accounting Standards Update that would simplify the impairment test in US GAAP. The proposals would simplify the impairment test for goodwill by removing Step 2 of the impairment model—the requirement to perform a hypothetical purchase price allocation to calculate the implied fair value of goodwill when the carrying value of a reporting unit exceeds its fair value. Upon the removal of Step 2, the impairment charge recognised against goodwill would be the excess of the carrying amount over the fair value of the reporting unit, limited to the carrying amount of goodwill.

Appendix C: Mechanics of the Pre-acquisition Headroom (PH) Approach

- C1. This appendix includes the following sections:
- (a) What issue is being addressed by this approach?
 - (b) The PH Approach.
 - (c) Strengths and weaknesses of the PH Approach

What issue is being addressing?

Issue

- C2. For the purposes of testing goodwill for impairment, paragraph 80 of IAS 36 *Impairment of Assets* requires goodwill acquired in a business combination to be allocated, from the acquisition date, to each of the acquirer's GGUs or groups of CGUs ('units') that are expected to benefit from the synergies of the combination.
- C3. Consequently, if goodwill is allocated to an existing unit of the acquirer and that unit's recoverable amount exceeds its carrying amount, the excess will provide an instant buffering effect against recognition of an impairment loss of the goodwill allocated to the unit. This buffering effect might arise, for example, because the unit contains unrecognised internally generated goodwill/intangible assets at the acquisition date.
- C4. A buffering effect would only arise if goodwill is allocated to existing CGUs of the acquirer and not if goodwill arising on the acquisition is allocated only to the acquiree. There would also be no significant buffering effect at the time of allocation of the goodwill, if goodwill is allocated to a unit where the unit's recoverable amount is very close to its carrying amount.

Example

- C5. An acquirer purchases an acquiree for CU50 and recognises an amount of CU15 for goodwill in accordance with IFRS 3.⁶ Following the acquisition, the acquirer may discover that some of its key targets supporting the purchase price paid were too

⁶ Monetary amounts are denominated in 'currency units' (CU)

optimistic, for example because of unforeseeable difficulties in integrating the acquiree into its existing business. Consequently the acquirer may estimate that goodwill is overstated by approximately CU7. Assume, for simplicity, that goodwill is allocated to a single existing CGU of the acquirer. Assume also that the CGU's recoverable amount exceeds its carrying amount by more than CU7 before the allocation.

- C6. For the purposes of impairment testing, the excess of the CGU's recoverable amount over its carrying amount would fully support the estimated overstatement of goodwill. It is therefore unlikely that an impairment loss would be recognised if the CGU was tested for impairment soon after the goodwill was allocated to the CGU. Hence, this buffering effect could prevent impairments being recognised on a timely basis, increasing concerns that goodwill is overstated.

The PH Approach

How would this approach address the issue outlined above?

- C7. The PH Approach would incorporate into the impairment test calculation any excess, existing at the date of acquisition, of the recoverable amount over the carrying amount of the existing CGUs (or groups of CGUs) to which goodwill is allocated. This would respond to concerns that impairment losses are being recognised too little, too late' as a result of the headroom provided by the acquirer's pre-existing assets (including any unrecognised internally generated goodwill/other assets).

Mechanics of the PH Approach

Basic mechanics in the period of acquisition

- C8. The staff suggest the approach should be applied as follows:
- (a) Step One: determine which of the acquirer's CGUs, or groups of CGUs, are expected to benefit from the synergies of the combination and determine how the goodwill will be allocated (as is currently required by IAS 36). For example, assume goodwill is expected to be allocated to units A, B and C of the acquirer (the units could be an individual CGU or a group of CGUs).

- (b) Step Two: before allocating goodwill or any other assets of the acquiree, calculate the recoverable amount of each of units A, B and C, at the date of acquisition, using pre-acquisition assumptions in the calculation. ‘Pre-acquisition assumptions’ are the assumptions for those units excluding the effects of the acquisition (ie the assumptions for the unit immediately before the acquisition, assuming that the acquisition would not take place). The excess of a unit’s recoverable amount over its carrying amount at the date of acquisition using pre-acquisition assumptions is the ‘pre-acquisition headroom’ (‘PH’) in that unit. The PH is calculated purely for the purposes of testing the unit for impairment (ie it is never recognised as an asset). If a unit’s carrying amount exceeds its recoverable amount at the date of acquisition using pre-acquisition assumptions, this indicates that the unit is impaired prior to the acquisition (and that there is no PH for that unit). This would be an indicator some of the existing assets in the unit are impaired.
- (c) Step Three: allocate the goodwill and any other assets (if the acquired business is being integrated into the acquirer’s existing business) from the acquiree to units A, B and C, as required by IAS 36.
- (d) Step Four: because goodwill is allocated to them, those units would need to be tested for impairment before the year-end (and on an annual basis) under the requirements in IAS 36. The impairment test would be performed for each of units A, B and C as follows:
- (i) The recoverable amount of each unit would be determined as normal in accordance with IAS 36 (ie post-acquisition assumptions and after the allocation of goodwill and any other assets of the acquiree).
 - (ii) The recoverable amount of each unit determined in (i) would be compared to the total of:
 - 1. the carrying amount of that unit (including the allocated goodwill and other allocated assets of the acquiree); plus
 - 2. the PH existing in that unit determined in step two.

- (iii) If the recoverable amount of a unit exceeds the total of 1 and 2, no impairment loss is recognised for that unit.
- (iv) However, if the total of 1 and 2 exceeds the recoverable amount, that excess would be recognised as an impairment loss.
- (v) Any impairment loss would be allocated
 - 1. first to reduce the carrying amount of the recognised goodwill allocated to the unit;
 - 2. then secondly against the PH (this is a notional allocation because the PH is not recognised in the financial statements); and
 - 3. then to other assets of the unit by applying the existing requirements of IAS 36.

Comparison with existing approach

- C9. Steps one, three and four are required by IAS 36. Consequently, the only differences between the PH Approach in paragraph C8 and the existing approach in IAS 36 are:
- (a) the inclusion of an additional step to calculate the PH, step two; and
 - (b) the requirement to consider the PH in step four.

Once no further goodwill remains in the unit, the PH would no longer be considered by the entity.

- C10. These differences would only apply if some goodwill is allocated to the acquirer's existing CGUs. They would not apply if goodwill arising on the acquisition is allocated only to the acquiree. This is not a shortcoming of the PH Approach, because if goodwill is only allocated to the acquiree, there would be no buffering effect from the acquirer's existing assets against recognising an impairment loss.

Other methods for allocating the impairment loss (paragraph C8(d)(v))?

- C11. A PH could arise for a combination of several reasons and so may consist of different components, including:
- (a) Internally generated goodwill in the unit arising from the existing synergies in the business and the management team.

- (b) Other internally generated intangible items in the unit that do not meet the recognition criteria.
 - (c) Differences between carrying amounts and recoverable amounts on other assets in the unit, which will be affected by the entity's accounting policies and by the assumptions used in measuring recoverable amount. For example, the recoverable amount of the entity's property may be higher than the carrying amount of the property measured under the cost model.
 - (d) Management's assumptions in measuring the recoverable amount of the unit. For example if recoverable amount is based on VIU, it will depend on management's assumptions about expected cash flows, discount rate, growth rates etc.
- C12. In paragraph C8(d)(v) the staff have proposed to allocate the impairment loss in full to goodwill before the PH for the following reasons:
- (a) The primary objective of introducing the PH Approach is to remove the buffering effect of the acquirer's pre-existing assets to respond to concerns that impairment losses are being recognised too slowly and in too small amounts ('too little, too late'). Allocating impairment losses to goodwill before the PH would provide an earlier signal of impairment to the market and is consistent with this objective.
 - (b) Unless the PH is analysed into its components (see paragraph C13) to enable a meaningful allocation, any allocation of an impairment loss between the PH and the recognised goodwill would be arbitrary. The staff think requiring an entity to distinguish between the components of the PH would be subjective, and unnecessarily costly and complex.
 - (c) IAS 36 requires an impairment loss to be allocated first to goodwill and then to other assets. To be consistent with this requirement, any allocation of impairment between the PH and goodwill would at least require the internally-generated goodwill component of the PH to be identified. As noted in (b) the staff think componentisation of the PH would be subjective, and unnecessarily costly and complex.

- (d) It may be clear that the PH primarily consists of components other than internally generated goodwill. For example the unit may contain land measured at historical cost that has a much greater fair value. In this case, allocation of the impairment loss to the PH, before first reducing the recognised goodwill to zero, would be inappropriate.
- (e) The PH will be affected by the entity's accounting policies for assets and liabilities in the unit and by management's assumptions in measuring recoverable amount of the assets and of the unit. For example, the carrying amount of an item of machinery will depend on management's assumptions regarding its useful life and pattern of consumption. If the impairment loss was allocated proportionately between goodwill and the PH, the amount allocated to goodwill would likely be arbitrary.

C13. Nevertheless, the staff think there are several methods that could be considered for allocating the impairment loss:

- (a) in full to goodwill before the PH (used in paragraph C8(d)(v));
- (b) in full to the PH before goodwill (essentially the existing allocation method in IAS 36);
- (c) proportional allocation between the PH and goodwill; or
- (d) in full to goodwill unless the entity can demonstrate that a different allocation is appropriate. For example, assume there is a significant increase in the discount rate after the PH is calculated, but there are no other significant changes in the unit. The recoverable amount of a unit would fall but it may be clear that it does not relate primarily to an impairment of the acquired goodwill. In such a circumstance adjustment of the PH, to reflect the subsequent change in discount rate, might be appropriate.
- (e) another more sophisticated method. However, unless the components of the PH are analysed to enable a meaningful allocation, any allocation of an impairment loss between the PH and the recognised goodwill would likely be arbitrary. Furthermore, requiring an entity to distinguish between the components of the PH may be subjective, costly and complex.

Future impairment tests

- C14. Conceptually, it would be appropriate to remeasure the PH every time an impairment test is performed because over time the unit's assets and liabilities (upon which the PH was calculated) could change significantly. However, the staff note that this would result in remeasurement of any internally generated goodwill included in the PH amount. This would be inconsistent with the accounting treatment of the recognised goodwill, which is being tested for impairment.
- C15. Nevertheless, the staff think that if the Board wishes to consider remeasurement of the PH this could be done in one of two ways:
- (a) Method one: Stripping out the effect of the acquisition, ie determining the difference between the unit's recoverable amount and its carrying amount on the date of each impairment test as if the acquisition never happened. This would give the revised headroom in the unit for the existing business.
 - (b) Method two: Stripping out the effect of the goodwill in the unit, ie determining the difference between the unit's recoverable amount and its carrying amount on the date of each impairment test, excluding the goodwill. This would give the total revised headroom in the unit, including any assets allocated from the acquiree (except for the goodwill).
- C16. The staff think requiring remeasurement of the PH for each impairment test would add cost and complexity that would outweigh the benefits of updating that measurement. The staff note the following:
- (a) Method one would require the entity to make artificial assumptions about the existing business of the acquirer, ie assumptions as if the acquisition never happened. Over time it would be very difficult for an entity to distinguish the effects of the acquisition from the effects of the existing business of the unit. The staff think that this calculation would be extremely subjective, particularly when performed a significant time after the acquisition and when the entity undertakes multiple acquisitions.
 - (b) Method two would effectively be requiring the entity to determine the recoverable amount of the goodwill in the unit. In developing IFRS 3, the

Board observed that goodwill cannot be measured other than as a residual, and that measuring the fair value of goodwill directly would not be possible.⁷

- C17. In addition to concerns from investors about impairments being recognised ‘too little too late’, some preparers say that the impairment test is already costly and complex. The staff think that incorporating the PH, without remeasurement, would go a long way towards addressing investors’ concerns without adding significant cost and complexity to the impairment test.

Future acquisitions

- C18. The staff do not think that the PH should be remeasured every time an impairment test is performed. Nevertheless, the staff suggest that an entity should be required to perform a revised calculation of the unit’s PH if it makes a second acquisition and further goodwill is allocated to the same unit. The revised calculation would determine the PH existing in the unit at the time of the second acquisition. The revised PH would replace the original PH from the first acquisition. The single revised PH amount would be used from then on for the purposes of impairment testing of that unit.
- C19. When calculating the unit’s revised PH on the date of the second acquisition (ie prior to incorporating any goodwill/assets from the second acquisition), the goodwill and assets from the first acquisition would be included in the unit. In other words, the staff suggest this should be a calculation of the PH of the unit at the date of the second acquisition, not a remeasurement of the PH associated with the assets held prior to the first acquisition.
- C20. IAS 36 does not require goodwill allocated to a unit to be tracked by individual acquisition for impairment testing. In other words, IAS 36 effectively treats all goodwill allocated to the same unit as one asset. Consistent with this, the staff think it is appropriate to have a single PH for each unit, rather than a separate PH for each acquisition giving rise to goodwill in that unit.

⁷ See paragraph BC202 of the Basis for Conclusions accompanying IFRS 3 (2008).

Future disposals/restructurings

- C21. Paragraph 86 of IAS 36 requires that if goodwill has been allocated to a CGU and the entity disposes of an operation within that CGU, the goodwill associated with the operation disposed of is measured on the basis of the relative values of the operation disposed of and the portion of the CGU retained, unless the entity can demonstrate that some other method better reflects the goodwill associated with the operation disposed of.
- C22. The staff suggest it would be appropriate to apply the same requirement to the PH. Therefore, the PH should be allocated on the basis of the relative values of the operation disposed of and the portion of the CGU retained unless the entity can demonstrate another basis is more appropriate. An example of another basis might be if the entity can demonstrate that the PH mainly relates to the difference between the carrying amount and recoverable amount of a significant piece of land retained in the CGU. In this case the entity may be able to demonstrate that it is more appropriate to keep the PH within the portion of the CGU retained, rather than eliminate part of it.
- C23. Paragraph 87 of IAS 36 requires that if an entity reorganises its reporting structure in a way that changes the composition of one or more CGUs to which goodwill has been allocated, the goodwill shall be reallocated to the CGUs affected. This reallocation is also performed using a relative value approach similar to that used when an entity disposes of an operation within a CGU, unless the entity can demonstrate that some other method better reflects the goodwill associated with the reorganised units. The staff suggest it would be appropriate to apply the same requirement to the PH for consistency with our proposals for allocating the PH on disposal.
- C24. Under the proposals in paragraphs C21-C23, the unit's PH would not necessarily be allocated on the same basis as the unit's goodwill in the case of a disposal or restructuring. For example, the staff suggest an entity could allocate goodwill based on relative values and the PH on some other basis, or vice versa.

Should a PH be used in any other cases?

- C25. The staff does not think that a PH should be incorporated into the impairment test for other assets tested at the CGU (or group of CGUs) level, such as corporate assets.

C26. The staff think that using a PH for testing goodwill for impairment is an appropriate additional safeguard to respond to a unique issue:

- (a) Unlike other assets, goodwill is not a distinct asset that can be separately and reliably measured on acquisition. Consequently, it is measured as a residual amount. This means there is potentially a greater risk of overstatement of goodwill on initial recognition than other assets.
- (b) Goodwill comprises several different, often difficult to distinguish components. Consequently allocating goodwill to CGUs, or groups of CGUs, for the purpose of impairment testing is likely to be a more subjective process than allocating other assets, such as corporate assets, to CGUs/groups of CGUs.
- (c) Goodwill often contributes to the cash flows of multiple CGUs. Requiring the PH of each unit to which goodwill is allocated to be incorporated into the impairment test of goodwill removes the incentive to allocate more goodwill to a unit in which the recoverable amount greatly exceeds the carrying amount (ie has a significant buffer against impairment).
- (d) Goodwill is often a significant figure in an entity's balance sheet in comparison with other assets. During the post-implementation review of IFRS 3 we received concerns from investors that goodwill impairment losses are being recognised 'too little, too late'.

Costs versus benefits of step two

C27. The staff do not think adding step two to the impairment test would add significant cost or complexity. Determining the PH would require an additional calculation of recoverable amount for units to which goodwill is allocated. This would be a one-time cost at the time of acquisition. The staff think this calculation would be no more onerous than the calculation involved in the current goodwill impairment test, which is required at least annually.

C28. Furthermore, the staff note that if an entity allocates goodwill to a unit that already contains goodwill, the entity will have already calculated the recoverable amount of that unit within the last twelve months (because of the annual impairment test

requirement). If there have been no significant changes in the assumptions used in that calculation, the entity may be able to update its recent calculation rather than calculating recoverable amount from scratch.

Strengths and weaknesses of the PH Approach

C29. The staff think the strengths of the PH Approach are:

- (a) Responding to investors' concerns that impairment losses are being recognised 'too little, too late' by removing the buffering effect against recognising an impairment loss from the acquirer's existing assets. Removal of the buffer existing on acquisition means that an impairment of goodwill will be more likely under the PH Approach than under the current approach. Hence, the PH Approach is likely to result in recognition of earlier, larger impairment losses.
- (b) Measurement of the PH would be a one-time cost at the time of acquisition. The staff think this calculation would be no more onerous than the calculation currently required by the goodwill impairment test.
- (c) The PH will be most effective in the first impairment test following an acquisition, because this test will take place soon after the PH is determined. However because the 'frozen' PH would be used in future tests it will also help accelerate impairment losses after the first year.
- (d) Under IAS 36, management cannot recognise an immediate loss even if it determines soon after the acquisition date that the assumptions used in setting the purchase price were too optimistic, and it can estimate the overstatement of goodwill. The staff think it would be difficult, and subjective, to quantify what part of goodwill relates to an overpayment or overstatement even after the purchase price allocation. Consequently, the staff agree with this restriction in IAS 36. Nevertheless, this treatment may be partially responsible for investors' concerns that goodwill may be overstated. The staff think that the PH Approach is an effective way of addressing this concern. Under the PH Approach any overstatement of goodwill on acquisition would likely be caught by the first impairment test

after the acquisition. This is because the buffering effect on acquisition, that might provide a shield against the impairment loss, would be removed.

C30. The staff think the weaknesses of the PH Approach are:

- (a) The PH is determined on acquisition and not updated at the time impairment tests are carried out. Consequently, while the PH would remove the buffering effect from the acquirer's existing assets in the unit at the date of acquisition, it would not remove any increase in the buffering effect of those assets over time.
- (b) Similarly, the approach would not take into account any potential decline in the buffering effect of the acquirer's existing assets over time. This means it also has the potential to result in 'over impairment' of goodwill.

C31. Although the PH Approach is not perfect, the staff think that the PH Approach would improve the effectiveness of the impairment test, and help to address inventors' concerns that impairment losses are being recognised 'too little too late'. Plus, the staff do not think this approach would add significant cost or complexity to the impairment test for preparers.

Appendix D: Example to illustrate the PH Approach.

Illustration 1 (first acquisition)

Fact pattern

- D1. Company X has a 31 December year-end. On 1 September 2016, Company X purchases 100 per cent of Company Y for CU150 and measures the goodwill acquired at CU55 in accordance with IFRS 3.
- D2. Company X has three CGUs, A, B and C, with carrying amounts of CU100, CU200 and CU300 respectively at the date of acquisition of Company Y.
- D3. Company X determines the following allocations of the goodwill and assets of Company Y between its CGUs for impairment testing (as required by IAS 36):

	CGU A	CGU B	CGU C	Total
Identifiable net assets of Company Y	CU35	CU60	-	CU95
Goodwill arising on acquisition of Company Y	CU20	CU35	-	CU55

- D4. Assume for simplicity that in this example there is no change in the carrying amount of Company X's net assets and Company Y's net assets between the date of acquisition and the date of performing the impairment test.
- D5. Assume that the recoverable amounts of CGU A and CGU B at the date of the impairment test are CU190 and CU300 respectively (determined in accordance with IAS 36 as normal, ie after including Company Y allocations of net assets and goodwill, and using the assumptions for the CGUs post acquisition of Company Y).

Applying the PH Approach

- D6. In order to determine the PH, the recoverable amounts of CGUs A and B would need to be determined at the date of acquisition of Company Y, based on the pre-acquisition assumptions and before allocation of Company Y. Assume the recoverable amounts of CGUs A and B determined on this basis are CU140 and

CU220 respectively. As noted in paragraph D2, the carrying amounts of CGUs A and B are CU100 and CU200 respectively (before allocation of Company Y).

D7. Consequently, for the purposes of the impairment test, a PH of CU40 (=140-100) exists for CGU A and a PH of CU20 (=220-200) exists for CGU B.

D8. IAS 36 requires CGU A and CGU B to be tested for impairment before the year-end (and on an annual basis), because goodwill is allocated to those CGUs.

D9. At the date of the impairment test, amounts relating to CGUs A and B are:

	CGU A	CGU B
Identifiable net assets excluding goodwill (includes Company Y allocation)	CU135 (=100+35)	CU260 (=200+60)
Goodwill arising on acquisition of Company Y	CU20	CU35
Carrying amount	CU155	CU295
PH (not recognised as an asset)	CU40	CU20
Total of the carrying amount of the CGU plus the PH	CU195	CU315

D10. Outcome of the impairment test:

(a) CGU A: Recoverable amount (CU190) < Carrying amount of CGU plus PH (CU195). Impairment of CU5 allocated to the goodwill recognised on acquisition of Company Y.

(b) CGU B: Recoverable amount (CU300) < Carrying amount of CGU plus PH (CU315). Impairment of CU15 allocated to the goodwill recognised on acquisition of Company Y.

D11. Consequently, the carrying amounts of the CGUs of Group X⁸ after the impairment test are as follows:

	CGU A	CGU B	CGU C
Identifiable net assets excluding goodwill	CU135	CU260	CU300
Goodwill (after allocation of impairment)	CU15 (=20-5)	CU20 (=35-15)	CU0
Carrying amount of CGUs	CU150	CU280	CU300

Illustration 2 (second acquisition)

Fact pattern

D12. Same fact pattern as illustration 1. On 1 July 2017 the carrying amount of Group X's CGUs A, B and C are as follows:

	CGU A	CGU B	CGU C
Identifiable net assets excluding goodwill	CU145	CU240	CU250
Goodwill	CU15	CU20	CU0
Carrying amount of CGUs	CU160	CU260	CU250

D13. On 1 July 2017 Group X purchases 100 per cent of Company Z for CU200 and measures the goodwill acquired at CU61 in accordance with IFRS 3. Company X allocates Company Z in full to its existing CGU A.

D14. Assume for simplicity that in this example there is no change in the carrying amount of the net assets of the companies between the date of acquisition of Company Z and the date of performing the impairment tests of CGUs A and B. Assume also that the annual impairment test of CGUs A and B is performed after the acquisition of Company Z takes place.

⁸ Group X consists of Company X and its subsidiaries (currently only Company Y).

D15. CGU A and CGU B would need to be tested for impairment during the year, because goodwill is allocated to those CGUs.

- (a) Assume the recoverable amount of CGU A after allocation of Company Z at the date of the impairment test is CU400 (determined in accordance with IAS 36 as normal, ie after including Company Z allocations of net assets and goodwill, and using the assumptions for CGU A post acquisition).
- (b) Assume that the recoverable amount of CGU B is CU250 at the date of the impairment test.

Applying the PH Approach

CGU A

D16. The allocation to CGU A of goodwill from the acquisition of Company Z will require measurement of a revised PH for CGU A. The recoverable amount of CGU A would need to be determined at the date of acquisition of Company Z, based on the pre-acquisition assumptions and before allocation of Company Z goodwill and other assets. These pre-acquisition values and assumptions would nevertheless include the Company Y allocations

D17. Assume the recoverable amount of CGU A on 1 July 2017 based on the pre-acquisition assumptions and before allocation of Company Z is CU196. Consequently, a revised PH of CU36 (=196-160) exists for CGU A.

D18. At the date of the impairment test, the amounts relating to CGU A are as follows:

	CGU A
Identifiable net assets excluding goodwill (includes Company Z allocation)	CU284 (=145+139)
Goodwill	CU76 (=15+61)
Carrying amount	CU360
Revised PH (not recognised as an asset)	CU36
Total of the carrying amount of the CGU plus the PH	CU396

D19. Outcome of the impairment test of CGU A: Recoverable amount (CU400) > Carrying amount of CGU plus the PH (CU396). No impairment.

CGU B

D20. At the date of the impairment test, the amounts relating to CGU B are as follows:

	CGU B
Identifiable net assets excluding goodwill	CU240
Goodwill	CU20
Carrying amount	CU260
PH (not adjusted as no goodwill allocated from Company Z)	CU20
Total of the carrying amount of the CGU plus the PH	CU280

D21. Outcome of the impairment test: CGU B: Recoverable amount (CU250) < Carrying amount of CGU plus pre- acquisition headroom (CU280). Impairment of CU20 allocated to the goodwill arising on acquisition of Company Y. The remaining CU10 is allocated against the PH, not the other assets of CGU B.

D22. As there is no goodwill remaining in CGU B, the PH allocated to CGU B will be disregarded for future impairment tests.

D23. Note: If the recoverable amount of CGU B had been CU230, CU20 would have been allocated to goodwill, CU20 would have been allocated against the PH and CU10 would have been allocated to other assets of the unit in accordance with IAS 36.

Illustration 3 (disposal of part of an operation)

Fact pattern

D24. Same fact pattern as illustrations 1 and 2. On 1 February 2018 the carrying amount of CGU A is as follows:

	CGU A
Identifiable net assets excluding goodwill	CU260
Goodwill	CU76
Carrying amount of CGU	CU336

- D25. On 1 February 2018 Group X sells for CU100 an operation that is part of CGU A. The carrying amount of the net assets in the operation excluding goodwill at the time of sale is CU70. Assume the goodwill associated with the operation is measured on the basis of the relative values of the operation disposed of and the portion of CGU A retained in accordance with paragraph 86(b) of IAS 36. The recoverable amount of the portion of CGU A retained is CU300.

Allocation of goodwill and PH between operations disposed and retained

- D26. Assuming goodwill and PH are both allocated on the basis of relative values:
- (a) The portion of the CGU disposed of is 25% of the CGU based on relative value ($=100/(300+100)$). Hence, 25% of the goodwill in CGU A is included in the operation sold.
 - (b) 25% of the PH would be removed from future impairment calculations.
- D27. Consequently:
- (a) Goodwill of CU19 ($=0.25 \times 76$) is allocated to the operation disposed of.
 - (b) A PH of CU9 ($=0.25 \times 36$) would be allocated to the operation disposed of, leaving a PH of CU27 in CGU A for use in future impairment tests.
- D28. Immediately following disposal of part of CGU A, amounts relating to CGU A are:

	CGU A
Identifiable net assets excluding goodwill (includes Company Z allocation)	CU190 ($=260-70$)
Goodwill	CU57 ($=76-19$)
Carrying amount	CU247
Remaining PH	CU27 ($=36-9$)