

STAFF PAPER

April 2016

IASB Meeting

Project	Goodwill and impairment project		
Paper topic	The pre-acquisition headroom approach to impairment testing		
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Objective of this paper

1. The purpose of this agenda paper is to further develop the staff proposal discussed at the March 2016 Board meeting to modify the impairment test for goodwill.

This paper is an updated version of March 2016 IASB Agenda Paper 18C. Significant changes made:

- In the March paper, the staff identified three possible approaches that the Board could consider to address investors’ concerns that impairment losses are being recognised ‘too little, too late’ (paragraph 12 of the March paper). This paper only develops the main approach from the March paper and does not further consider the other two.
- The following changes have been made to the main approach:
 - Changing the name of the approach to the pre-acquisition headroom (PAH) approach (previously called the day 0 impairment test approach).
 - Referring to the difference between a cash generating unit’s (CGU)’s recoverable amount and its carrying amount before including the acquisition as ‘pre-acquisition headroom’ (or ‘PAH’) rather than ‘internally generated goodwill’.
- The mechanics of the PAH approach and its strengths/weaknesses have been developed further in paragraphs 14-36. This includes consideration of more complex scenarios, such as how the approach might operate if the entity

undertakes further acquisitions, or reorganises/disposes of operations.

- The example in the appendix has been extended to illustrate a second acquisition and disposal of part of an operation (see paragraphs A12 to A27).

2. In addition to developing the PAH approach in this paper, the staff are also considering ways that the impairment test could be simplified and its application improved without loss of information for investors. Some suggestions were discussed by the Board at its February 2016 meeting and include:
 - (a) revisiting the methodology in the calculation of impairment, in particular considering a single model approach rather than the two model approach used to measure recoverable amount;
 - (b) possible relief from the annual impairment test requirement; and
 - (c) simplifying and providing guidance on the value in use calculation, including looking at the discount rate and the limitations placed on the cash flow estimates.
3. The staff will bring these suggestions back for further discussion at a future Board meeting.

Structure of this paper

4. This paper includes the following sections:
 - (a) What issue is the staff addressing in this paper?
 - (b) The pre-acquisition headroom (PAH) approach.
 - (c) Strengths and weaknesses of the PAH approach
 - (d) Staff recommendation and question for the Board.
 - (e) Appendix: Example to illustrate the PAH approach.

What issue is the staff is addressing?

Issue

5. 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 cash-generating units (CGUs) or groups of CGUs (referred to as 'units' in this paper) that are expected to benefit from the synergies of the combination.
6. 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 or other unrecognised internally generated intangible assets at the acquisition date.
7. 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

8. An acquirer purchases an acquiree for CU50 and recognises an amount of CU15 for goodwill in accordance with IFRS 3 *Business Combinations*.¹ Following the acquisition, the acquirer may discover that some of its key targets supporting the purchase price paid were too 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.

¹ Monetary amounts are denominated in 'currency units' (CU)

9. 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 PAH approach

How would this approach address the issue outlined above?

10. The staff envisage that the PAH 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 approach would help to eliminate the buffering effect described in paragraphs 5-9.

Mechanics of the PAH approach

Basic mechanics in the period of acquisition

11. 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' (or 'PAH') in that unit. Note, the PAH 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 would indicate that the unit is impaired prior to the acquisition (and that there is no PAH for that unit). This would be an indicator that 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 any other allocated assets of the acquiree); plus
 2. the PAH 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 PAH (this is a notional allocation because the PAH 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

- 12. Steps one, three and four are already required by IAS 36. Consequently, the only differences between the PAH approach in paragraph 11 and the existing approach in IAS 36 are:
 - (a) the inclusion of an additional step to calculate the PAH, step two; and
 - (b) the requirement to consider the PAH in step four.
- 13. The staff also note that 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 PAH approach, because if goodwill is only allocated to the acquiree, there would be no buffering effect from the acquirer's existing assets (including any unrecognised internally generated goodwill/other assets) against recognising an impairment loss (as explained in paragraph 7).

When should the impairment loss be allocated against the PAH (paragraph 11(d)(v))?

- 14. One might argue that if the recoverable amount of a unit declines in value, the decline could relate just as much to a decrease in the unrecognised internally generated goodwill in that unit as the acquired goodwill allocated to that unit. However, the staff think a unit's PAH would only partially be explained by the acquirer's pre-existing internally generated goodwill at the date of the acquisition.

15. The staff think a PAH could arise for a combination of several reasons and so may consist of different types of 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 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) Managements' estimates and assumptions in measuring the recoverable amount of the unit.
16. The staff think an impairment loss should be allocated first to goodwill before being allocated notionally against the PAH (as set out in paragraph 11(d)(v)) for the following reasons:
- (a) The primary objective of introducing the PAH 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 PAH is consistent with this objective.
 - (b) Unless the components of the PAH are analysed to enable a meaningful allocation, any allocation of an impairment loss between the PAH and the recognised goodwill would be arbitrary. The staff think requiring an entity to distinguish between the components of the PAH 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 PAH and goodwill would at least

require the internally-generated goodwill component of the PAH to be identified. As noted in (b) the staff think componentisation of the PAH would be subjective, and unnecessarily costly and complex.

- (d) It may be clear that the PAH primarily relates to 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 PAH, before first reducing the recognised goodwill to zero, would be inappropriate.
- (e) The PAH 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. If the impairment loss was allocated proportionately between goodwill and the PAH, the amount allocated to goodwill would likely be arbitrary.

17. Because the PAH is determined purely for the purposes of testing goodwill for impairment, the staff suggest that:

- (a) After the recognised goodwill has been fully impaired, the impairment loss would be allocated against the PAH before allocating to other assets of the unit. This is appropriate because:
 - (i) In accordance with paragraph 98 of IAS 36, if there is an indication of an impairment of an asset or individual CGU within a unit to which goodwill has been allocated, the entity would be required to first test that asset or individual CGU for impairment before testing the unit containing the goodwill.
 - (ii) In accordance with paragraph 97 of IAS 36, if the assets or individual CGUs constituting the unit to which goodwill has been allocated are tested for impairment at the same time as the unit containing the goodwill, they would be tested for impairment before the unit containing the goodwill.
- (b) Once no further goodwill remains in the unit, the PAH would no longer be considered by the entity.

Future impairment tests

18. The staff think the unadjusted amount of PAH ('frozen' PAH) should continue to be incorporated in future impairment tests of the unit while goodwill remains in that unit.
19. Conceptually, it would be appropriate to remeasure the PAH every time an impairment test is performed. In theory, the staff think 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).
20. However, the staff think requiring remeasurement of the PAH 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.²

21. 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 using a frozen PAH will go a long way towards addressing investors’ concerns without adding significant cost and complexity to the impairment test. Nevertheless, if Board members would like to explore an approach where the PAH is remeasured every time the impairment test is performed, the staff suggest we should first perform field testing to understand the cost-benefit trade-off of using a remeasured PAH versus a frozen PAH.

Future acquisitions

22. As explained in paragraphs 20-21, the staff do not think that the PAH 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 PAH if it makes a second acquisition and further goodwill is allocated to the same unit. The revised calculation would determine the PAH existing in the unit at the time of the second acquisition. The revised PAH would replace the original PAH from the first acquisition. The single revised PAH amount would be used from then on for the purposes of impairment testing of that unit.
23. When calculating the unit’s revised PAH 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 PAH of the unit at the date of the second acquisition, not a remeasurement of the PAH associated with the assets held prior to the first acquisition.
24. 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

² See paragraph BC202 of the Basis for Conclusions accompanying IFRS 3 (2008).

think it is appropriate to have a single PAH for each unit, rather than a separate PAH for each acquisition giving rise to goodwill in that unit.

Future disposals/restructurings

25. 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.
26. The staff suggest it would be appropriate to apply the same requirement to the PAH. Therefore, the PAH 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 PAH 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 PAH within the portion of the CGU retained, rather than eliminate part of it.
27. 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 PAH for consistency with our proposals for allocating the PAH on disposal.
28. Under the proposals in paragraphs 25-27, the unit's PAH 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 PAH on some other basis, or vice versa.

Should a PAH be used in any other cases?

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

31. The staff do not think adding step two to the impairment test would add significant cost or complexity. Determining the PAH 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.

32. 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.

Illustrative example

33. The staff have provided an example in the appendix to illustrate the mechanics of the PAH approach using an example with two business combinations and a disposal.

Strengths and weaknesses of the PAH approach

34. The staff think the strengths of the PAH 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 PAH approach than under the current approach. Hence, the PAH approach is likely to result in recognition of earlier, larger impairment losses.
 - (b) Measurement of the PAH 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 PAH will be most effective in the first impairment test following an acquisition, because this test will take place soon after the PAH is determined. Nevertheless because the ‘frozen’ PAH will be used in

future impairment tests it will also help to 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 PAH approach is an effective way of addressing this concern. Under the PAH 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.

35. The staff think the weaknesses of the PAH approach are:

- (a) The PAH is determined on acquisition and not updated at the time impairment tests are carried out. Consequently, while the PAH 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.

36. Although the PAH approach is not perfect, the staff think it will go a long way in addressing investors' concerns.

Staff recommendation and questions for the Board

37. The staff think that the PAH 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.

Questions for the Board

- (1) Do Board members have any comments or suggestions on the PAH approach in this paper?

Appendix: Example to illustrate the PAH approach.

Illustration 1 (paragraphs A1 to A11) sets out the same example used in the March agenda paper. Paragraphs A12 to A27 extend this example to consider a second acquisition (illustration 2) and a disposal of part of an operation (illustration 3).

Illustration 1 (first acquisition)

Fact pattern

- A1. 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.
- A2. 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.
- A3. 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

- A4. 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.
- A5. 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 PAH approach

- A6. In order to determine the PAH, 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 A2, the carrying amounts of CGUs A and B are CU100 and CU200 respectively (before allocation of Company Y).
- A7. Consequently, for the purposes of the impairment test, a PAH of CU40 (=140-100) exists for CGU A and a PAH of CU20 (=220-200) exists for CGU B.
- A8. 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.
- A9. At the date of the impairment test, the amounts relating to CGUs A and B are as follows:

	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
PAH (not recognised as an asset)	CU40	CU20
Total of the carrying amount of the CGU plus the PAH	CU195	CU315

- A10. Outcome of the impairment test:

- (a) CGU A: Recoverable amount (CU190) < Carrying amount of CGU plus PAH (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 PAH (CU315). Impairment of CU15 allocated to the goodwill recognised on acquisition of Company Y.

A11. Consequently, the carrying amounts of the CGUs of Group X³ 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

A12. 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:

³ Group X consists of Company X and its subsidiaries (currently only Company Y).

	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

- A13. 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.
- A14. 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.
- A15. CGU A and CGU B would need to be tested for impairment during the year, because goodwill is allocated to those CGUs.
- (a) Assume that 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 PAH approach

CGU A

- A16. The allocation to CGU A of goodwill from the acquisition of Company Z will require measurement of a revised PAH 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

A17. 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 PAH of CU36 (=196-160) exists for CGU A.

A18. 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 PAH (not recognised as an asset)	CU36
Total of the carrying amount of the CGU plus the PAH	CU396

A19. Outcome of the impairment test of CGU A: Recoverable amount (CU400) > Carrying amount of CGU plus the PAH (CU396). No impairment.

CGU B

A20. 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
PAH (not adjusted as no goodwill allocated from Company Z)	CU20
Total of the carrying amount of the CGU plus the PAH	CU280

- A21. 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 PAH, not the other assets of CGU B.
- A22. As there is no goodwill remaining in CGU B, the PAH allocated to CGU B will be disregarded for future impairment tests.
- A23. Note: If the recoverable amount of CGU B had been CU230, then CU20 would have been allocated to goodwill, CU 20 would have been allocated against the PAH and CU10 would have been allocated to the other assets of the unit in accordance with IAS 36.

Illustration 3 (disposal of part of an operation)

Fact pattern

- A24. 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

- A25. 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 CGUA 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 PAH between operations disposed and operations retained

- A26. Assuming goodwill and PAH are both allocated on the basis of relative values:

- (a) 25% of the goodwill in CGU A is included in the operation sold.
- (b) 25% of the PAH would be removed from future impairment calculations.

Consequently:

- (a) Goodwill of CU19 ($=0.25 \times 76$) is allocated to the operation disposed of.
- (b) A PAH of CU9 ($=0.25 \times 36$) would be allocated to the operation disposed of. This would leave a PAH of CU27 existing in CGU A for use in future impairment tests.

- A27. Immediately following the disposal of part of CGU A, the amounts relating to CGU A are as follows:

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