

STAFF PAPER

May 2017

IASB[®] Meeting

Project	Goodwill and Impairment research project		
Paper topic	Improving the effectiveness of the impairment testing model in IAS 36		
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Purpose

1. The purpose of this paper is to:
 - (a) summarise the pre-acquisition headroom (PH) approach; and
 - (b) provide an update on staff research of approaches similar to the PH approach.
2. This paper is for information only and for the Board to consider how the various approaches presented in Agenda Papers 18B–18D affect each other. Consequently, the Board is not being asked any questions on this paper.
3. The Board last discussed the PH approach in April 2016 ([Agenda Paper 18A](#)). Appendix C of [Agenda Paper 18B](#) of the June 2016 joint education session with the Financial Accounting Standards Board of the US explains the mechanics of the PH approach.

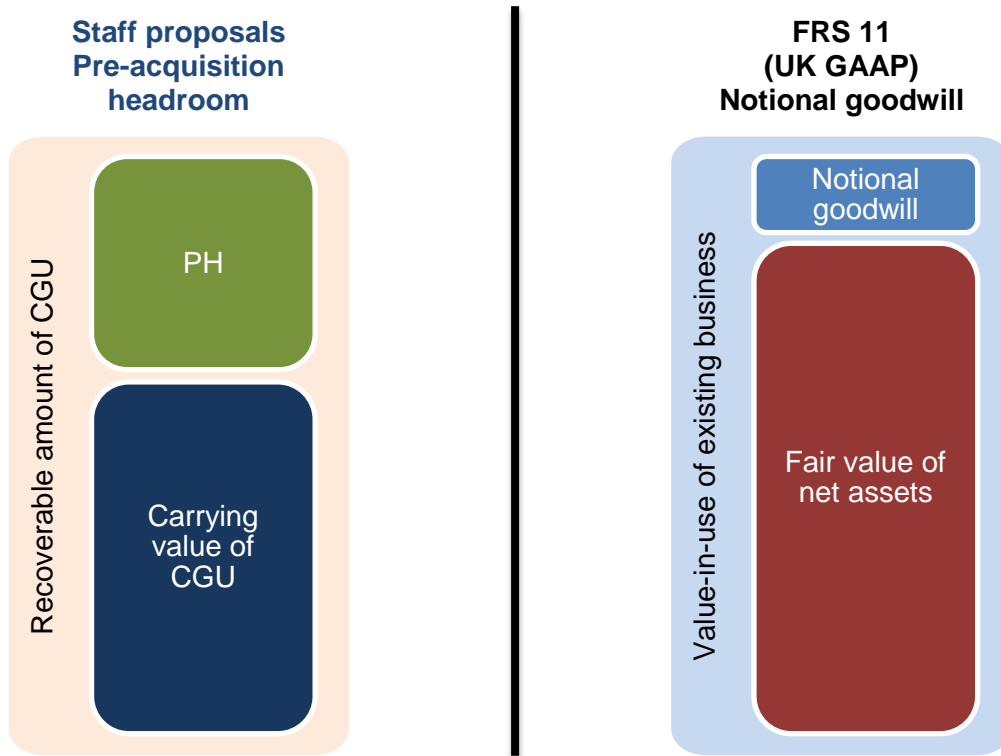
PH approach

4. One of the causes for the current impairment test failing to capture impairment losses at the right time and in the right amounts is the so-called shielding effect of unrecognised internally generated goodwill of a CGU. In situations in which an entity allocated acquired goodwill to a pre-combination CGU that is expected to

benefit from the synergies of the combination, the unrecognised internally generated goodwill of the pre-combination CGU shields the acquired goodwill from impairment by absorbing any negative movements in the recoverable amount of the CGU. Consequently, the acquired goodwill is not impaired or is impaired by a lesser amount. To address this issue, the staff developed the PH approach that was presented to the Board at its March and April 2016 meetings.

5. The difference between the carrying amount of the CGU and its recoverable amount immediately before the combination is referred to as the ‘pre-acquisition headroom’ or ‘PH’. The PH includes any unrecognised assets of the pre-combination CGU, any differences between the carrying amounts and recoverable amounts of the assets of the pre-combination CGU and any internally generated goodwill. The objective of the PH approach is to remove the sheltering effect from the impairment test by incorporating the PH, measured at the acquisition date, into the impairment test calculation. This is done by adding the PH to the carrying amount of the CGU and then comparing the aggregate of the carrying amount and the PH with the recoverable amount of the CGU in measuring any impairment loss.
6. After the June 2016 meeting, we also explored other alternative methods that are similar to the PH approach. In that process we learnt about specified requirements in [Financial Reporting Standard \(FRS\) 11 *Impairment of Fixed Assets and Goodwill*](#) of UK GAAP that involve calculations similar to the PH calculation.
7. FRS 11 was issued in July 1998 and was effective for accounting periods ending on or after 23 December 1998. The development of FRS 11 shadowed the development of IAS 36.
8. Paragraphs 50–53 accompanied by Example 8 of FRS 11 contain requirements that are similar to the PH approach. Those paragraphs apply when an acquired business is merged with existing operations. Applying FRS 11, the headroom is calculated as the difference between the value in use of the existing business immediately before merging the acquired business and the fair value of net assets within that existing business. The headroom is effectively the notional internally generated goodwill of the existing business.

9. The comparison of the PH approach with the FRS 11 approach can be viewed as follows:



10. On discussions with practitioners and review of academic research and publications about the notional goodwill requirement in FRS 11, the information obtained by the staff was not worth pursuing.
11. The staff will continue to develop PH approach and present the analysis to the Board at a future meeting.