



Comment letter on Goodwill impairment test: can it be improved?
European Financial Reporting Advisory Group
35 Square de Meeüs
Brussels B-1 000
Belgium

Dear Madam/Sir,

In the present letter ICAC gives its view on EFRAG Discussion Paper "*Goodwill impairment test: Can it be improved*" published in June 2017 for public comments.

First of all, ICAC welcomes the EFRAG's efforts to expose potential amendments to the goodwill impairment test. We appreciate the opportunity to comment on this DP.

QUESTION 1 - HOW AN ENTITY SHOULD ALLOCATE GOODWILL
(Paragraphs 2.3 to 2.22)

Q1.1 Do you agree with the additional guidance on how an entity should allocate goodwill?

The additional guidance is aimed to achieving greater control when allocating goodwill. With the current model, companies could find incentives to allocate *goodwill* to those CGUs that have greater 'pre-acquisition headroom' or undertake organizational restructuring to avoid impairment in goodwill.

When the impairment test is performed, there is an asymmetry, that the standard does not consider, produced by the existence of previous headroom in the CGU that receives the allocated goodwill. It means that the value checks carried out in subsequent years are not being carried out in equivalent terms.

The problem arises when a comparison between the recoverable amount and the book value that is carried out in subsequent years is made, because in the book value, which is being used for the comparison, the pre-existing head-room has not been reflected (internal goodwill) in the receiving CGU at the time of the acquisition of the new goodwill.

This problem is similar to that generated by the existence of non-controlling interest in the acquiree when the part corresponding to this non-controlling interest has not been included in the measurement of goodwill. However, in this case, the standard clearly regulates that the comparison must be made using equivalent terms for which it imposes the elevation to full amount of goodwill, for the exclusive purposes of quantifying the impairment value.



In our opinion, the same principle should guide to provide a solution to the problem that arises when the acquiring company has "pre-acquisition headroom" in some CGUs (pre-existing goodwill not recognized in accounting) to compensate for impairment losses and avoid with it your accounting recognition.

When the goodwill is allocated among different CGUs, at a level significantly lower than a segment, there is no doubt that by allowing reassignment to a higher level, in the terms in which it has currently been regulated, the accounting standard is introducing negative incentives that may lead to propose an organizational restructuring for reasons of convenience with the aim of avoiding recognition of impairment value.

To avoid this incentive, it could be required that before reallocating the goodwill among the new CGUs, in any case, a goodwill impairment test should be carried out to the level at which it was initially allocated. Only the goodwill that, in its case, subsists is the one that could be distributed in relative terms based on the fair value of the new CGUs.

Regarding the second option proposed in the first suggestion, which is to allocate the goodwill based on the received assets from the acquisition by each CGU, it reduces the meaning of goodwill that is accounting for the expected synergies, since if as a result of an acquisition, synergies are produced in some CGUs but no assets are received in these CGUs, goodwill could not be recognized, which does not seem to make sense.

A different issue is that a practical rule can be introduced in the sense of prohibiting the allocation of goodwill to a group of CGUs. In application of this rule, once the goodwill has been allocated among the different CGUs, the excess of unallocated goodwill could be distributed, as a practical solution, among the different CGUs in proportion to their book value, including the goodwill allocated in the first stage.

On the other hand, in response to the second suggestion, which consists in introducing information on the reconciliation of the goodwill that has been assigned to each CGU in order to be able to track the goodwill, we consider that this idea, as it is raised, it is confusing. Should the proposal be continued, we believe that the way to carry out the conciliation should be better explained. It is not clear from the proposal how the monitoring of each of the goodwill allocated to the different CGUs would be carried out, the follow-up that would have to be carried out on the goodwill in case of restructuring or the amount that would affect the impairment of a CGU to each of the goodwill that it has incorporated.

Q1.2 Do you have any other suggestions to improve this area of the goodwill impairment test?

We suggest that the concept of the "pre-existing headroom" in the acquiring CGU could be assimilated with the same criterion that the standard applies to non-controlling interest, in order to be able to compare homogeneous amounts when applying the impairment test.



QUESTION 2 - WHEN AN ENTITY SHOULD DETERMINE THE RECOVERABLE AMOUNT

(Paragraphs 2.23 to 2.37)

Q2.1 Do you agree with the introduction of an initial qualitative assessment?

The introduction of a "Step Zero" has the advantage of reducing costs, in those cases that they decide to apply it.

The current standard, in paragraph 99, consider the possibility of carrying out a Step Zero to avoid performing an impairment test, although it establishes a series of conditions for its use.

We would consider positive the suggestion of regulating the introduction of the Step Zero, in order to achieve a more homogenous use and to normalize the indicators on which the judgment is based.

This would also reduce the differences between the standards of the FASB and the IASB.

Q2.2 Do you have any other suggestions to improve this area of the goodwill impairment test?

If the initial qualitative assessment were introduced, we would consider it appropriate to establish as caution a maximum period in which the calculations of an impairment test should be performed. For example, at least every 3 years, a goodwill calculation impairment test must be performed, without being able to rely on qualitative assessment.

QUESTION 3 - HOW AN ENTITY SHOULD DETERMINE THE RECOVERABLE AMOUNT

Q3.1 Do you agree with having a single method for determining the recoverable amount?

We consider that it is convenient that when obtaining the recoverable amount it can be reached from the two approaches contemplated in the current valuations. Companies are forced to apply both methods, when the first method results in a recoverable amount lower than the carrying amount in order to obtain a more favorable valuation.

However, it would be interesting to have some explanatory guides about the use and the differences between both methods, in order to justify the differences among value in use (VIU) and fair value less cost of disposal (FVLCD).



In our opinion, it would be convenient to explain in detail the differences between the VIU and the FVLCD calculated from an income approach by updating the free cash flow. Only through a study of these differences can be concluded whether it is appropriate to maintain two methods, or if based on simplicity reasons, it is advisable to establish a single method of calculation.

In case of opting for a single method the risk to introduce rigidity in management should be also analyzed.

Q3.2 Do you agree with the inclusion of future restructurings in the calculation of the value in use?

We consider that this point must be linked to the decision made in the previous point, whether to maintain two valuation methods or leave only one.

If it is decided a single calculation approach, it should include future restructurings in the calculation, but the coherence of the valuation of the future restructuring and the timing of the accounting for restructuring provision should be analyzed, if it be deemed necessary.

Q3.3 Do you agree with allowing the use of a post-tax discount rate?

We consider it reasonable to be able to choose a pre-tax rate or a post-tax rate, provided that it is used in a consistent manner and given information in the notes about the rate used and the reasons to use one or the other.

We find very useful an explanatory guide justifying why the use of the pre-tax rate currently established by the standard is more convenient, and that this question be put in connection with the applicable criteria in terms of the recognition of deferred tax assets.

Q3.4 Do you agree that the impairment test should target internally generated goodwill? Is the goodwill accretion an acceptable way to do so?

The internally generated goodwill highlights one of the inconsistencies of the impairment test and exposes one of the criticisms of the current method.

There is no doubt that the acquired synergies are consumed, however, the difficulty lies in drawing the line that separates the part attributed to the old value and to the new value from the recoverable value. The flow obtained materializes the value of a cost that does not exist in accounting, which is internally generated goodwill.

In any case, to resolve this matter we refer to the answer that has been given to the first question. Any standard that be developed should be based on the principle of comparison of equivalent terms.



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As a general comment we would like to point out that these asymmetries show that the assessment of goodwill is a complex issue, and in consequence amortization is the most practical solution, although it does not respond exactly to the definition of the issue.

Please do not hesitate to contact us if you would like to clarify any point of this letter.

Yours sincerely,

A handwritten signature in blue ink, appearing to read 'Enrique Rubio Herrera', written over a long horizontal line.

Enrique Rubio Herrera

Chairman of ICAC