



Grupo Latinoamericano  
de Emisores de Normas  
de Información Financiera

Group of Latin-american  
Accounting Standard Setters

May 30, 2014

## **International Accounting Standards Board**

30 Cannon Street  
London EC4M 6XH  
United Kingdom

### **RE: Request for Information regarding the Post-implementation Review: IFRS 3 Business Combinations**

Dear Board Members,

The “Group of Latin American Accounting Standard Setters” – GLASS<sup>1</sup> welcomes the opportunity to comment on the Request for Information regarding the Post-implementation Review: IFRS 3 Business Combinations (the RFI).

This response summarizes the views of our country-members, in accordance with the following due process.

#### **Due-process**

The discussions about the RFI were held within a specified Technical Working Group (TWG). All country-members had the opportunity to designate at least one member to constitute this TWG.

The representative of each country makes a series of activities to get the opinion of many stakeholders. Based on these activities prepares the opinion in his country and leads to GTT.

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<sup>1</sup> The general objective of the Group of Latin American Accounting Standard Setters (GLASS) is to present technical contributions in respect to all documents issued by the IASB. Therefore, GLASS aims to have a single regional voice before the IASB. GLASS is constituted by: Argentina (Chairman), Bolivia, Brazil (Board), Chile, Colombia (Board), Ecuador, El Salvador, Guatemala (Board), Mexico (Vice Chairman), Panama, Paraguay, Peru, Dominican Republic, Uruguay (Board) and Venezuela (Board). Observers: Costa Rica and Honduras.

The respective TWG member summarized individual responses from each country. At a second stage, the answers presented in each country's summaries were compared and discussed before preparing a consensus response.

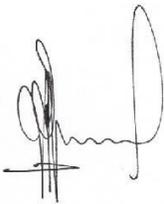
### **Overall comments**

Almost all countries in Latin America have recently adopted or are in the process of full adoption of IFRS. Therefore, practical experience in the application of IFRS 3 is limited, in most cases, to transactions after the transition to IFRS in such countries. Nevertheless, in preparing this response, the TWG members based their opinions in experience gained in the past with entities applying IFRS for group reporting, and in the different standards applicable in each country prior to adopting IFRS.

However, for preparing our global response, we prioritized comments and opinions received from preparers, users and other parties directly involved or affected by the application of IFRS 3.

If you have any questions about our comments, please contact [glenif@glenif.org](mailto:glenif@glenif.org).

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Jorge Gil', with a horizontal line underneath.

**Jorge Gil**

Chairman

Group of Latin American Accounting Standard Setters (GLASS)

## **GLASS' Comment letter on the Post-implementation Review: IFRS 3 Business Combinations**

### **Question 1—Your background and experience**

Please tell us:

- (a) about your role in relation to business combinations (i.e. preparer of financial statements, auditor, valuation specialist, user of financial statements and type of user, regulator, standard-setter, academic, accounting professional body etc.).<sup>(a)</sup>
  - (b) your principal jurisdiction. If you are a user of financial statements, which geographical regions do you follow or invest in?
  - (c) whether your involvement with business combinations accounting has been mainly with IFRS 3 (2004) or IFRS 3 (2008).
  - (d) if you are a preparer of financial statements:
    - i. whether your jurisdiction or company is a recent adopter of IFRS and, if so, the year of adoption; and
    - ii. with how many business combinations accounted for under IFRS has your organisation been involved since 2004 and what were the industries of the acquirees in those combinations.
  - (e) if you are a user of financial statements, please briefly describe the main business combinations accounted for under IFRS that you have analysed since 2004 (for example, geographical regions in which those transactions took place, what were the industries of the acquirees in those business combinations etc.).
- <sup>(a)</sup>Type of user includes: buy-side analyst, sell-side analyst, credit rating analyst, creditor/lender, other (please specify).

### **Response 1—Your background and experience**

- (a) The discussions in regard to the RFI were held within a specified Technical Working Group (TWG) that submitted your questions to groups of preparers, regulators, auditors and accounting professional bodies in the TWG member's countries.
- (b) Responses were answered considering the experience gained in the application of IFRS 3 mainly in Latin-American countries, including Argentina, Mexico, Brazil, Chile and Venezuela; and also in other transactions outside the region in countries such as the United States of America, Romania and Spain.

- (c) Most of the respondents were involved primarily with IFRS 3 (2008), but some of them had experience also with IFRS 3 (2004) and, therefore, were able to contribute with their views in the comparison between the two standards.
- (d) Responses included comments from preparers that, in most cases, operate in countries that had adopted IFRS recently. Nevertheless, the TWG members were knowledgeable and experienced in dealing with business combination accounting in different countries and across different industries.
- (e) Some of the industries with more transactions identified in the responses from the TWG members are real estate, steel manufacturing, and agricultural activities.

### **Question 2—Definition of a business**

- (a) Are there benefits of having separate accounting treatments for business combinations and asset acquisitions? If so, what are these benefits?
- (b) What are the main practical implementation, auditing or enforcement challenges you face when assessing a transaction to determine whether it is a business? For the practical implementation challenges that you have indicated, what are the main considerations that you take into account in your assessment?

### **Response 2—Definition of a business**

- (a) Yes. There was a consensus in the TWG that there are benefits from having separate accounting treatments for business combinations and asset acquisition, being the most important the increased transparency in financial reporting from business combinations accounting.
- (b) It has been observed that there is subjectivity in the application of the rules regarding the determination of whether the transaction is a business combination or the acquisition of an asset, particularly in the real estate or agricultural industries. For example, while it is difficult to assess the differences between the acquisition of an agricultural plot and the purchase of the shares of a company whose sole asset is an agricultural plot, many companies accounted for them differently, some as the acquisition of an asset and others as a business combination. The same happens with the acquisition of a group of assets that do not include all inputs, processes and outputs, but where these can be obtain or performed by any market participant. We believe that the Board should clarify the principles for assessing the capability of the acquirer to produce outputs from the acquired group, and the capability of market participants' ability to produce outputs if there are missing inputs and/or processes. We also suggest the Board clarify the concept of "capable of being

conducted and managed for” included in the guidance on the definition of a business, in order to broaden the scope of the standard, to include development stage entities.

### **Question 3—Fair value**

- (a) To what extent is the information derived from the fair value measurements relevant and the information disclosed about fair value measurements sufficient?<sup>(a)</sup> If there are deficiencies, what are they?
- (b) What have been the most significant valuation challenges in measuring fair value within the context of business combination accounting? What have been the most significant challenges when auditing or enforcing those fair value measurements?
- (c) Has fair value measurement been more challenging for particular elements: for example, specific assets, liabilities, consideration, etc.?

*(a) According to the Conceptual Framework information is relevant if it has predictive value, confirmatory value or both.*

### **Response 3—Fair value**

- (a) We believe that information derived from the fair value measurements is relevant for the users of financial statements because it:
- Allows a more appropriate understanding of the nature of the assets acquired and liabilities assumed and the relevance of each of them to the acquiring entity;
  - Enables identification of opportunities for synergy;
  - Allows easy comparability between transactions carried out in the same industry; and
  - Provides users a sense of the risk of the acquired entity assumed by management of the acquiring entity.

Nevertheless, some aspects might be explored further by the Board that were raised by the TWG, such as:

- Lack of detailed disclosure of the inputs used in measuring fair value
- The requirement to recognize intangible assets separately from others assets when they are seldom sold or transacted separately (e.g. infrastructure and license to operate the infrastructure; or brand for a highly specialized product for which is very difficult to license the brand without transferring the know-how of the product manufacturing)
- The market-participant approach under which IFRS 3 was developed does not give any consideration to the acquirer’s intention with respect to the

acquired assets and liabilities. Therefore, to some extent, it focuses more on the disclosure of a theoretical transaction made by a market participant rather than to an actual transaction performed by a real, willing acquirer. For example, assets acquired within a group that the acquirer does not intend to use, such as a brand, are still measured at fair value from a market participants' perspective. This generates a loss being recognized in the financial statements for something that was never an asset from the acquirers' perspective

- Complexity and subjectivity in the determination of some intangible assets' fair value; and
- Fair valuation of assets and liabilities acquired based on a stand-alone basis does not properly explain the interdependency of those assets as a business, and explanation of what is included in the residual goodwill is not sufficient to explain this.

(b) The most significant valuation challenges raised by the TWG are:

- Contingent consideration and how to factor the probability of future cash outflows in determining the fair value
- Determination of the fair value of 'unique' assets where it is difficult to obtain comparable benchmarks
- Measurement of assets at fair value based on a market participant perspective when that perspective is different from that of the acquirer, and may lead to charges to in the income statement right after the acquisition – for example, brands acquired that the acquirer does not intend to use after the business combination

(c) Items that have been more challenging for the purposes of determining their fair values are those mentioned in b) above.

#### **Question 4—Separate recognition of intangible assets from goodwill and the accounting for negative goodwill**

(a) Do you find the separate recognition of intangible assets useful? If so, why? How does it contribute to your understanding and analysis of the acquired business? Do you think changes are needed and, if so, what are they and why?

(b) What are the main implementation, auditing or enforcement challenges in the separate recognition of intangible assets from goodwill? What do you think are the main causes of those challenges?

(c) How useful do you find the recognition of negative goodwill in profit or loss and the disclosures about the underlying reasons why the transaction resulted in a gain?

#### **Response 4—Separate recognition of intangible assets from goodwill and the accounting for negative goodwill**

- (a) Yes. The TWG agreed that separate recognition of intangible assets is useful to provide greater transparency and a clear detail of all of the assets acquired in a business combination. However, the TWG suggested reviewing the accounting for the deferred income tax impact over the fair value adjustments.
- (b) Some members of the TWG mentioned lack of a comprehensive approach to the measurement of any intangible assets. In addition, there is a perceived high dependence on external consultants for measuring intangible assets. Additionally as this is an area that requires significant judgment, it is difficult to audit. Another challenge is the requirement to perform an annual impairment test for cash generating units containing indefinite-life intangible assets.
- (c) While some in the TWG agree with current accounting for and disclosure of negative goodwill, others raised some concerns. Therefore we suggest the board to re-assess the accounting for negative goodwill and the immediate recognition of a gain. Available alternatives could range from the amortization of goodwill (similar to the scheme provided by IAS 22) to recognition of negative goodwill in OCI, recyclable to the income statement when the acquired business is sold. The latter alternative would have the following benefits:
- Recognition of gain for negative goodwill will be recognized at the same time as the recognition of the gain resulting from the sale of the acquired company; and
  - Assets and liabilities acquired will still be measured at fair value.

#### **Question 5—Non-amortisation of goodwill and indefinite-life intangible assets**

- (a) How useful have you found the information obtained from annually assessing goodwill and intangible assets with indefinite useful lives for impairment, and why?
- (b) Do you think that improvements are needed regarding the information provided by the impairment test? If so, what are they?
- (c) What are the main implementation, auditing or enforcement challenges in testing goodwill or intangible assets with indefinite useful lives for impairment, and why?

#### **Response 5—Non-amortisation of goodwill and indefinite-life intangible assets**

- (a) Information obtained from the annual impairment testing of goodwill and intangible assets with indefinite useful lives is considered very useful, because it assist users in understanding the underlying assumptions relevant to an entity's business, and how a change in those assumptions may impact the recoverability of an investment. Also, respondents in the TWG believe that companies have enhanced their impairment tests due to this requirement. However, many of the respondents in the TWG believe that the IASB should review current requirements to simplify the rules and frequency of impairment testing in accordance with IAS 36, for example considering qualitative aspects to analyze the need for annual quantitative assessment or not according to external and internal events and circumstances that affect business performance.
- (b) TWG members recognize that information required by IAS 36 is relevant and useful for users. However, they noted that implementation issues exist, such as:
- Lack of sensitivity analysis of relevant assumptions
  - Boiler plate disclosures that are not relevant nor specific to the reporting entity; and
  - Poor explanation of the main assumptions and judgments in determining the recoverable amount, and the interaction and interdependency of these assumptions.

We recommend the IASB assessing the causes of such implementation issues in order to determine whether or not to make changes to the information requirements in IAS 36.

- (c) The main challenges raised by the TWG members are:
- Determination of a pre-tax rate to be applied to pre-tax cash flows. While there is consensus in the use of the Weighted Average Cost of Capital as a relevant rate to discount the projected cash flows, this is a post-tax rate from which a pre-tax rate is not easily derived
  - As previously mentioned, given the absence of any exception to the application of IAS 12 in a business combination, any asset (or fair value adjustment of an asset) that is not deductible for tax purposes, generates a deferred tax effect. The corresponding debit entry, per paragraph 22(a) of IAS 12, will increase goodwill. A value in use calculation, which is a pre-tax value, may lead to an impairment charge soon after an acquisition is made, due to the higher amount of goodwill that is recorded as a result of recognising a deferred tax liability. In order to address this anomaly, a test should be performed using fair value less costs of disposal at the date of acquisition and subsequently, if a value in use calculation triggers an impairment charge. We believe that the IASB should reassess the convenience and practicality of maintaining this anomaly.

- Cash flows projections must be prepared specifically for the purpose of impairment testing, as management projections are not based on an “as is” status, but also include management best estimates of future cash flows derived from new investments and products.

### **Question 6—Non-controlling interests**

- (a) How useful is the information resulting from the presentation and measurement requirements for NCIs? Does the information resulting from those requirements reflect the claims on consolidated equity that are not attributable to the parent? If not, what improvements do you think are needed?
- (b) What are the main challenges in the accounting for NCIs, or auditing or enforcing such accounting? Please specify the measurement option under which those challenges arise.

To help us assess your answer better, we would be grateful if you could please specify the measurement option under which you account for NCIs that are present ownership interests and whether this measurement choice is made on an acquisition-by-acquisition basis.

### **Response 6—Non-controlling interests**

- (a) The TWG considers that current requirements provide useful information.
- (b) No challenges were identified in the accounting for NCIs.

### **Question 7—Step acquisitions and loss of control**

- (a) How useful do you find the information resulting from the step acquisition guidance in IFRS 3? If any of the information is unhelpful, please explain why.
- (b) How useful do you find the information resulting from the accounting for a parent’s retained investment upon the loss of control in a former subsidiary? If any of the information is unhelpful, please explain why.

### **Response 7—Step acquisitions and loss of control**

- (a) There were mixed views in the TWG regarding the obligation to remeasure to fair value at the date of the acquisition the previously held interest in an investment and recognize a gain or loss for that remeasurement.

Some of the respondents believe that there is an inherent inconsistency in this approach, as there is a remeasurement and an impact in profit or loss for items that are not remeasured to fair value after acquisition. This also creates a distortion in the actual cost of an acquisition, as the standard assumes that the acquirer is delivering a non-controlling interest as part of the consideration and receiving a controlling interest in exchange, but in fact it is only receiving additional shares in the investee it already had.

Others respondents support the current treatment set out in IFRS 3, as they believe that gaining control is a significant change in the nature of investment to trigger the recognition of a gain. Also this approach is consistent with the requirement to recognize all of the consideration paid at fair value. Finally, this is a practical approach to account for step-acquisitions, as goodwill is now determined once and not based on different fair value estimations at different dates, considering that this is information that it is not always available to the reporting entities.

- (b) Most of the respondents in the TWG consider it inappropriate to recognize a gain or loss on the revaluation of the retained interest in a former subsidiary when control is lost. This is because, to the extent that the remaining investment is not held for trading, the remeasurement does not meet the definition of cost under IAS 28R.

In both cases, respondents raised the issue that fair valuation of these holdings based on current guidance does not consider premiums for control or influence, therefore providing less useful information for the users of the financial statements.

### **Question 8—Disclosures**

- (a) Is other information needed to properly understand the effect of the acquisition on a group? If so, what information is needed and why would it be useful?
- (b) Is there information required to be disclosed that is not useful and that should not be required? Please explain why.
- (c) What are the main challenges to preparing, auditing or enforcing the disclosures required by IFRS 3 or by the related amendments, and why?

### **Response 8—Disclosures**

- (a) Respondents generally support current disclosure requirements.
- (b) Some respondents raised the concern that the cost of preparing all required disclosures exceeds the benefit for users for the use of such information. In this

respect, respondents suggest the IASB to reconsider the need to present pro-forma information of the group assuming the acquisition took place at the beginning of the reporting year, particularly in the case where the acquired business is in different jurisdiction or it did not prepared financial information in accordance with IFRS.

(c) Most of the respondents agreed that:

- The cost of obtaining information is not insignificant
- Measurement and disclosures are not necessarily aligned with the way management priced the transaction, and current disclosures do not provide this insight; and
- Although the disclosure requirements are generally accepted, the experience in implementation of IFRS 3 shows that preparers need to enhance current disclosures to provide information that is much more useful to users.

### **Question 9—Other matters**

Are there other matters that you think the IASB should be aware of as it considers the PiR of IFRS 3?

The IASB is interested in:

- (a) understanding how useful the information that is provided by the Standard and the related amendments is, and whether improvements are needed, and why;
- (b) learning about practical implementation matters, whether from the perspective of applying, auditing or enforcing the Standard and the related amendments; and
- (c) any learning points for its standard-setting process.

### **Response 9—Other matters**

Other matters raised by respondents in the TWG were:

- Pushdown accounting: the IASB should consider developing guidance to allow or require the accounting for the effects of a business combination in the financial statements of the acquiree, similar to the guidance contained under section ASC 805-50-05-8 of the Codification of U.S. GAAP.
- Transactions between entities under common control: the IASB should develop guidance to account for business combinations between entities that are under common control before and after the transaction. Diversity in practice due to

lack of clear guidance for these transactions makes financial statements less comparable.

- Deferred income tax: recognition of deferred income tax effects over fair value adjustments against goodwill results from a more mechanical application of IAS 12 than from a conceptual basis. It also leads to the recognition of day-one impairment when determining the recoverable value based on the value-in-use; and
- Transaction costs: The IASB should reassess the basis for having an inconsistency in expensing transaction costs for business combinations under IFRS 3 and capitalizing them for associates and joint ventures under IAS 28.

### **Question 10—Effects**

From your point of view, which areas of IFRS 3 and related amendments:

- (a) represent benefits to users of financial statements, preparers, auditors and/or enforcers of financial information, and why;
- (b) have resulted in considerable unexpected costs to users of financial statements, preparers, auditors and/or enforcers of financial information, and why; or
- (c) have had an effect on how acquisitions are carried out (for example, an effect on contractual terms)?

### **Response 10—Effects**

- (a) The general approach in IFRS 3 represents a benefit to the financial statements, as it provides more transparency to the accounting and reporting of business acquisitions.
- (b) There were no significant unexpected costs reported by the respondents of the TWG. However, some respondents believe that the cost of implementing IFRS 3 outweighed the anticipated benefits in the reported information.
- (c) Because of the limited experience in the region, respondents did not report situations in which significant changes in the way the transactions were carried out due to the accounting requirements.