Grupo Latinoamericano de Emisores de Normas de Información Financiera

Group of Latin American Accounting Standard Setters

December 18, 2020

IFRS Foundation
Columbus Building
7 Westferry Circus
Canary Wharf
London E14 4HD
United Kingdom

RE: Discussion Paper, Business Combinations – Disclosures, Goodwill and Impairment

Dear members of the IFRS Foundation:

The "Group of Latin American Accounting Standard Setters"[1] – GLASS welcomes the opportunity to comment on the Discussion Paper DP/2020/1, *Business Combinations – Disclosures, Goodwill and Impairment* (the DP).

This response summarizes the points of view of the members of the different countries that comprise GLASS, pursuant to the following due process.

Due process

The discussions regarding the DP were held within a specified Technical Working Group (TWG) created in May 2020. All country members had the opportunity to designate at least one member to participate in this TWG. Each standard setter represented in the TWG carried out different tasks in their respective countries (for example, surveys, internal working groups). All results were summarized, and this summary served as the platform for the TWG discussion process.

The TWG discussed the different points of view included in the summary through virtual conferences. In those conferences, the TWG developed a final document based on the agreed-upon responses and technical points of view of its members. Finally, the TWG document was submitted to the GLASS Board, who discussed its content and included some comments that were considered necessary.

Overall comments

The consensus of the TWG is that the proposals in the DP will be useful to provide better information on the objectives of acquisitions. However, the TWG believes it would be difficult

[1] The overall objective of the Group of Latin American Accounting Standard Setters (GLASS) is to present technical contributions with respect to all Exposure Drafts 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), Costa Rica (Board), Dominican Republic, Ecuador, Guatemala, Honduras, Mexico (Vice Chairman), Panama, Paraguay, Peru (Board), Uruguay (Board) and Venezuela (Board).

to quantify them at the acquisition date and subsequently measure whether the performance of the acquired entity is achieving those objectives, especially if the acquired entity is integrated in a cash generating unit (CGU) of the acquirer. It was considered that it would be even more difficult to quantify the synergies of the acquisition.

Most of the countries in the TWG consider that due to the optimism of management and the shielding effect, the impairment test is not yielding the expected results, and several countries believe that reintroduction of the amortization of goodwill should be reconsidered. The main problem with its reintroduction is to determine the useful life of any goodwill. However, if it is possible to quantify the objectives of the acquisition, it should also be possible to determine how long it is expected to take to recover the investment and hence the useful life of goodwill. In the answers to the specific questions posed in the DP, additional comments are made thereon.

Our answers to the specific questions include comments on simplifying the impairment test, on the presentation of goodwill in the statement of financial position, on the segregation of other intangibles and on other topics.

An additional problem is the accounting treatment of goodwill presently recognized. The majority of the members of the TWG believe that it should be amortized prospectively, determining its remaining useful life when the revised standard is adopted. Several member countries of the TWG indicated that directly affecting equity for the portion that would be considered to already be amortized would be a problem, since an important impact on equity could have negative legal effects in many countries.

Specific Comments

In addition to expanding our above comments, attached please find our specific responses to the questions presented in the DP.

Contact

If you have any questions about our comments, please contact glenif@glenif.org

Sincerely yours,

Jorge José Gil
Chairman
Group of Latin American Accounting Standard Setters (GLASS)

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GLASS Comment Letter on the Discussion Paper

"Business Combinations – Disclosures, Goodwill and Impairment"

Question 1
Paragraph 1.7 summarises the objective of the Board's research project. Paragraph IN9 summarises the Board's preliminary views. Paragraphs IN50–IN53 explain that these preliminary views are a package and those paragraphs identify some of the links between the individual preliminary views. The Board has concluded that this package of preliminary views would, if implemented, meet the objective of the project. Companies would be required to provide investors with more useful information about the businesses those companies acquire. The aim is to help investors to assess performance and more effectively hold management to account for its decisions to acquire those businesses. The Board is of the view that the benefits of providing that information would exceed the costs of providing it. (a) Do you agree with the Board's conclusion? Why or why not? If not, what package of decisions would you propose and how would that package meet the project's objective? (b) Do any of your answers depend on answers to other questions? For example, does your answer on relief from a mandatory quantitative impairment test for goodwill depend on whether the Board reintroduces amortisation of goodwill? Which of your answers depend on other answers and why?

The consensus of the TWG was:

a) There was agreement with the IASB conclusions that there is a need for more useful information for investors on acquisitions, which will help them to gauge its return and hold management accountable. This feature is important for listed entities, open to the public, in which more information is needed by investors. It is a question of the scope of the information, as with the information on segments requested by IFRS 8, *Operating Segments*.

b) Our answers depend on whether the amortization of goodwill will be reintroduced, since this would substantially impact the importance of the impairment test, which has not been demonstrated to be appropriately effective. Regarding the exemption of the quantitative impairment test, that exemption would also depend on reintroduction of goodwill amortization, since if goodwill is amortized, a qualitative test only may be useful to decide whether a quantitative test is needed.

Question 2
Paragraphs 2.4–2.44 discuss the Board's preliminary view that it should add new disclosure requirements about the subsequent performance of an acquisition. (a) Do you think those disclosure requirements would resolve the issue identified in paragraph 2.4—investors' need for better information on the subsequent performance of an acquisition? Why or why not? (b) Do you agree with the disclosure proposals set out in (i)–(vi) below? Why or why not? (i) A company should be required to disclose information about the strategic rationale and management's (the chief operating decision maker's (CODM's)) objectives for an acquisition as at the acquisition date (see paragraphs 2.8–2.12). Paragraph 7 of IFRS 8 *Operating Segments* discusses the term 'chief operating decision maker'. (ii) A company should be required to disclose information about whether it is meeting those objectives. That information should be based on how management (CODM) monitors and measures whether the acquisition is meeting its objectives (see paragraphs 2.13–2.40), rather than on metrics prescribed by the Board. (iii) If management (CODM) does not monitor an acquisition, the company should be required to disclose that fact and explain why it does not do so. The Board should not require a company to disclose any metrics in such cases (see paragraphs 2.19–2.20). (iv) A company should be required to disclose the information in (ii) for as long as its management (CODM) continues to monitor the acquisition to see whether it is meeting its objectives (see paragraphs 2.41–2.44). (v) If management (CODM) stops monitoring whether those objectives are being met before the end of the second full year after the year of acquisition, the company should be required to disclose that fact and the reasons why it has done so (see paragraphs 2.41–2.44). (vi) If management (CODM) changes the metrics it uses to monitor whether the objectives of the acquisition are being met, the company should be required to disclose the new metrics and the reasons for the change (see paragraph 2.21). (c) Do you agree that the information provided should be based on the information and the acquisitions a company's CODM reviews (see paragraphs 2.33–2.40)? Why or why not? Are you concerned that companies may not provide material information about acquisitions to investors if their disclosures are based on what the CODM reviews? Are you concerned that the volume of disclosures would be onerous if companies' disclosures are not based on the acquisitions the CODM reviews? (d) Could concerns about commercial sensitivity (see paragraphs 2.27–2.28) inhibit companies from disclosing information about management's (CODM's) objectives for an acquisition

and about the metrics used to monitor whether those objectives are being met? Why or why not? Could commercial sensitivity be a valid reason for companies not to disclose some of that information when investors need it? Why or why not?

(e) Paragraphs 2.29–2.32 explain the Board's view that the information setting out management's (CODM's) objectives for the acquisition and the metrics used to monitor progress in meeting those objectives is not forward-looking information. Instead, the Board considers the information would reflect management's (CODM's) targets at the time of the acquisition. Are there any constraints in your jurisdiction that could affect a company's ability to disclose this information? What are those constraints and what effect could they have?

The consensus of the TWG was that:

a) There was general agreement that the disclosure of the initial objectives, as well as if these have been subsequently reached, would be useful, based on the CODM viewpoint. One member country believes that to avoid excessive information in the financial statements, this information should be included in management commentary. This would require that it be mandatory.

b) There was general agreement that the disclosures regarding achievement of the stated acquisition objectives should be based on the information reviewed by the CODM, since it is with that information that the business is managed; such information should not be based on theoretical metrics established by IASB. Also, if the CODM discontinues monitoring the objectives or changes in the metrics, it is necessary to disclose those facts. Once again, one member country believes that to avoid excessive information in the financial statements, this information should be included in management commentary.

c) There was general agreement that the information disclosed should be the same as that provided to the CODM to evaluate an acquisition. Any information that would be material would be in such information, and no additional measures should be required.

d) The TWG concluded that commercial sensitivity could inhibit presenting the information with as much detail as analysts might like to have. However, it should be relevant, and the competitive position of the entity should be considered to avoid harm if competitors use such information to their advantage. It should be considered that the required level of information should be greater for listed entities, and there should be a cost/benefit analysis of providing such information.

e) The TWG considered that the information that would be presented at the acquisition date should not be forward-looking, since it only reflects the objectives of management at the acquisition date. In that respect, there are no disclosure restrictions in any of our countries; however, regulators may have a different opinion in the future.

Question 3
Paragraphs 2.53–2.60 explain the Board's preliminary view that it should develop, in addition to proposed new disclosure requirements, proposals to add disclosure objectives to provide information to help investors to understand: • the benefits that a company's management expected from an acquisition when agreeing the price to acquire a business; and • the extent to which an acquisition is meeting management's (CODM's) objectives for the acquisition. Do you agree with the Board's preliminary view? Why or why not?

The majority of the TWG members agreed with disclosing the benefits expected from an acquisition and, subsequently if they are being achieved. It was considered that such information should refer to specific objectives but not the rationale for their determination, since that would be confidential strategic information of the entity. Such information may be available in other documents that the entity publishes and not in its financial statements.

Question 4
Paragraphs 2.62–2.68 and paragraphs 2.69–2.71 explain the Board's preliminary view that it should develop proposals: • to require a company to disclose: ○ a description of the synergies expected from combining the operations of the acquired business with the company's business; ○ when the synergies are expected to be realised; ○ the estimated amount or range of amounts of the synergies; and ○ the expected cost or range of costs to achieve those synergies; and • to specify that liabilities arising from financing activities and defined benefit pension liabilities are major classes of liabilities. Do you agree with the Board's preliminary view? Why or why not?

Although the majority of the TWG members agreed with disclosing the expected synergies, they believe it will be very difficult to quantify them and determine when they would materialize, as well as the costs to achieve them. Also, it will be very difficult to identify in subsequent periods the degree to which these are being achieved and quantify their effect and the related costs. An additional issue will be the feasibility of auditing the quantification of the objectives and the synergies that were estimated, as well as their occurrence, since these are based on management estimates and assumptions made at the date of acquisition. Likewise, it will be almost impossible to audit whether they are being achieved, since when measuring performance there would be a need to segregate the effect of meeting such objectives and achieving the synergies, which would be very subjective. We believe that any such information will have to be identified as unaudited.

Regarding the disclosure of financial liabilities and defined benefit pension liabilities already recognized by the acquired entity, the consensus was that such information should be disclosed. We recommend evaluating whether information should also be disclosed regarding other liabilities or regarding any non-controlling interest at the acquisition date, since it is similar to equity that is being contributed to the combined entity.

Question 5

IFRS 3 *Business Combinations* requires companies to provide, in the year of acquisition, pro forma information that shows the revenue and profit or loss of the combined business for the current reporting period as though the acquisition date had been at the beginning of the annual reporting period.

Paragraphs 2.82–2.87 explain the Board's preliminary view that it should retain the requirement for companies to prepare this pro forma information.

(a) Do you agree with the Board's preliminary view? Why or why not?

(b) Should the Board develop guidance for companies on how to prepare the pro forma information? Why or why not? If not, should the Board require companies to disclose how they prepared the pro forma information? Why or why not?

IFRS 3 also requires companies to disclose the revenue and profit or loss of the acquired business after the acquisition date, for each acquisition that occurred during the reporting period.

Paragraphs 2.78–2.81 explain the Board's preliminary view that it should develop proposals:

- to replace the term 'profit or loss' with the term 'operating profit before acquisition-related transaction and integration costs' for both the pro forma information and information about the acquired business after the acquisition date. Operating profit or loss would be defined as in the Exposure Draft *General Presentation and Disclosure.*
- to add a requirement that companies should disclose the cash flows from operating activities of the acquired business after the acquisition date, and of the combined business on a pro forma basis for the current reporting period.

(c) Do you agree with the Board's preliminary view? Why or why not?

The TWG considered that:

a) It is useful to continue providing pro forma information.

b) It would be convenient to have guidance on how to prepare pro forma information. However, this should not be a detailed checklist and should indicate how judgment should be applied for its preparation. If guidance is not available, there should be disclosure of how the pro forma information was prepared.

c) There was no support to replace the term "profit or loss" with the term "operating profit before acquisition-related transaction and integration costs", since this could result in managing the figures when determining the acquisition-related transaction and integration costs to present a better image.

d) There was support for disclosing operating cash flows as part of the pro forma information.

Question 6
As discussed in paragraphs 3.2–3.52, the Board investigated whether it is feasible to make the impairment test for cash-generating units containing goodwill significantly more effective at recognising impairment losses on goodwill on a timely basis than the impairment test set out in IAS 36 *Impairment of Assets*. The Board's preliminary view is that this is not feasible. (a) Do you agree that it is not feasible to design an impairment test that is significantly more effective at the timely recognition of impairment losses on goodwill at a reasonable cost? Why or why not? (b) If you do not agree, how should the Board change the impairment test? How would those changes make the test significantly more effective? What cost would be required to implement those changes? (c) Paragraph 3.20 discusses two reasons for the concerns that impairment losses on goodwill are not recognised on a timely basis: estimates that are too optimistic; and shielding. In your view, are these the main reasons for those concerns? Are there other main reasons for those concerns? (d) Should the Board consider any other aspects of IAS 36 in this project as a result of concerns raised in the Post-implementation Review (PIR) of IFRS 3?

The TWG concluded that:

a) It is not feasible to design a quantitative impairment test that is significantly more effective, since the shielding effect is very important, as in most cases the acquired business is integrated into a CGU of the acquirer. Two countries believe there is no consensus that the impairment test is better than the amortization of goodwill.

b) There was interest in the "total impairment test", but there was no consensus of how to allocate an impairment loss, whether to the goodwill acquired or to that generated by the acquiring business, which is not recognized on the books. Two countries indicated that an evaluation of whether the impairment test is better than the amortization of goodwill should be made.

c) It was agreed that optimism is an important reason for the untimely recognition of impairment losses, since management may choose scenarios that are overly optimistic. Shielding is undoubtedly an additional problem. Another reason is the grouping of CGUs that have problems with profitable CGUs, which may hide an impairment problem.

d) Something that should be considered in IAS 36 is how to assign goodwill to CGUs, as well as how to determine the useful lives of the assets of a CGU. Some countries believe that a complete review of IAS 36 is warranted.

Question 7
Paragraphs 3.86–3.94 summarise the reasons for the Board's preliminary view that it should not reintroduce amortisation of goodwill and instead should retain the impairment-only model for the subsequent accounting for goodwill. (a) Do you agree that the Board should not reintroduce amortisation of goodwill? Why or why not? (If the Board were to reintroduce amortisation, companies would still need to test whether goodwill is impaired.) (b) Has your view on amortisation of goodwill changed since 2004? What new evidence or arguments have emerged since 2004 to make you change your view, or to confirm the view you already had? (c) Would reintroducing amortisation resolve the main reasons for the concerns that companies do not recognise impairment losses on goodwill on a timely basis (see Question 6(c))? Why or why not? (d) Do you view acquired goodwill as distinct from goodwill subsequently generated internally in the same cash-generating units? Why or why not? (e) If amortisation were to be reintroduced, do you think companies would adjustor create new management performance measures to add back the amortization expense? (Management performance measures are defined in the Exposure Draft *General Presentation and Disclosures*.) Why or why not? Under the impairment-only model, are

companies adding back impairment losses in their management performance measures? Why or why not?

(f) If you favour reintroducing amortisation of goodwill, how should the useful life of goodwill and its amortisation pattern be determined? In your view how would this contribute to making the information more useful to investors?

The consensus of the TWG was:

a) There is support to reintroduce the amortization of acquired goodwill, since it is not considered to have an indefinite life. As time goes by, the economic environment changes, and economic conditions are different from prior ones. However, the reintroduction of goodwill comes with the problem of determining its useful life, which should be based on the business plan made at the acquisition date. Also, an impairment test of the unamortized balance should be made in the first years after acquisition. The majority believe that the useful life of acquired goodwill is finite, and amortization would better present the economic reality when matching revenue and expenses. However, others believe that amortization would be ignored.

b) Most of the members in the TWG believe that there is now evidence that the impairment-only model, which replaced amortization, does not work, basically due to the optimism of management when projecting future cash flows and due to the shielding effect. In that respect, studies have been made in several countries that support that conclusion.

c) Most of the members of the TWG consider that the amortization of goodwill would mitigate the main concerns that companies do not recognize impairment losses on a timely basis, as goodwill is not considered to have an indefinite life, and there would be a matching of income and expenses and as the reduction of goodwill reduces possible impairment as time goes by. However, other members of the TWG believe that amortization would not eliminate the concern regarding a lack of recognition of impairment as it occurs.

d) Most consider that acquired goodwill is different from that subsequently generated through operations, which is not recognized for book purposes due to the inherent difficulty in its determination and the fact that IAS 38 does not allow its recognition.

e) There was a consensus that information is not available to determine whether entities would adjust or create new performance measures. There is presently a performance measure that eliminates amortization, EBITDA, whose use is pervasive. However, we believe additional investigation is needed regarding how information is reported and used regarding amortization and the recognition of impairment losses. In any case, the information in financial statements must be clear so that users may reach their conclusions.

f) We believe that the useful life of goodwill can be determined when determining the estimated period for recovery of the investment at the acquisition date. If it is possible to determine and quantify the objectives of the acquisition, the period for recovery of the investment can be also determined, which is the basis to determine the amortization period. There was a consensus that such period should not be subsequently revised. If, due to the speed and uncertainty of changes in the economy and in the business plan, it is considered that such term should be revised, this would be an indicator of impairment and the corresponding effect should be evaluated.

An additional problem is how to treat the goodwill existing at the date of the change in accounting. Most believe it should be amortized prospectively, determining it useful life from that date. Several countries indicated that affecting equity for the portion that would be considered to be amortized would be a problem, since information on the period for recovery of the investment that was used to determine the purchase price may no longer be available. On the other hand, a significant charge to equity could generate problems in some countries, since in some cases a decrease under a certain limit could be considered a trigger of "technical legal bankruptcy".

Question 8
Paragraphs 3.107–3.114 explain the Board's preliminary view that it should develop a proposal to require companies to present on their balance sheets the amount of total equity excluding goodwill. The Board would be likely to require companies to present this amount as a free-standing item, not as a subtotal within the structure of the balance sheet (see the Appendix to this Discussion Paper). (a) Should the Board develop such a proposal? Why or why not? (b) Do you have any comments on how a company should present such an amount?

All TWG members considered this proposal to be incongruous. Information on the amount of goodwill is already presented in the statement of financial position. Such presentation would cast doubt as to whether goodwill is even an asset and could also have legal consequences in some countries.

Also, the project of *General Presentation and Disclosures* requires that goodwill be presented separately within assets and not combined with other assets. In addition, information on goodwill is already presented in the notes to the financial statements.

Question 9
Paragraphs 4.32–4.34 summarise the Board's preliminary view that it should develop proposals to remove the requirement to perform a quantitative impairment test every year. A quantitative impairment test would not be required unless there is an indication of

impairment. The same proposal would also be developed for intangible assets with indefinite useful lives and intangible assets not yet available for use.

(a) Should the Board develop such proposals? Why or why not?

(b) Would such proposals reduce costs significantly (see paragraphs 4.14–4.21)? If so, please provide examples of the nature and extent of any cost reduction. If the proposals would not reduce costs significantly, please explain why not.

(c) In your view, would the proposals make the impairment test significantly less robust (see paragraphs 4.22–4.23)? Why or why not?

The comments of the TWG were:

a) There was no general support for performing a qualitative test to determine whether or not to perform a quantitative test. This conclusion was based on considering that the indicators of possible impairment should be very robust, otherwise they could allow management to avoid a quantitative test that might be necessary. One country supports the use of qualitative indicators before performing a quantitative test.

b) There was no consensus that this proposal would reduce costs; some countries believe it would, while others believe that only amortization would reduce costs.

c) The majority believe that a qualitative test would be less robust. One country believes that introducing it without goodwill amortization would be the worst-case scenario.

Question 10

The Board's preliminary view is that it should develop proposals:

- to remove the restriction in IAS 36 that prohibits companies from including some cash flows in estimating value in use—cash flows arising from a future uncommitted restructuring, or from improving or enhancing the asset's performance (see paragraphs 4.35–4.42); and

- to allow companies to use post-tax cash flows and post-tax discount rates in estimating value in use (see paragraphs 4.46–4.52).

The Board expects that these changes would reduce the cost and complexity of impairment tests and provide more useful and understandable information.

(a) Should the Board develop such proposals? Why or why not?

(b) Should the Board propose requiring discipline, in addition to the discipline already required by IAS 36, in estimating the cash flows that are the subject of this question? Why or why not? If so, please describe how this should be done and state whether this should apply to all cash flows included in estimates.

The conclusions of the TWG were:

a) Several countries support these proposals; however, the majority believe that guidance is needed regarding the necessary evidence to consider the improvement in the performance of the assets and uncommitted restructurings on future cash flows to determine the value in use. Being budgeted by management is not enough, since it could lead to altering figures to present a better image. There was consensus agreement with using after tax interest rates and cash flows.

b) We do not have any suggestion regarding whether more discipline is needed in addition to that already requested by IAS 36.

Question 11

Paragraph 4.56 summarises the Board's preliminary view that it should not further simplify the impairment test.

(a) Should the Board develop any of the simplifications summarised in paragraph 4.55? If so, which simplifications and why? If not, why not?

(b) Can you suggest other ways of reducing the cost and complexity of performing the impairment test for goodwill, without making the information provided less useful to investors?

The TWG concluded that:

a) Some of the proposals indicated in paragraph 4.55 would be useful, such as not mixing realizable value with value in use to determine future cash flows and possible impairment, and the manner to determine future cash flows should be consistent. The majority of the TWG rejected making the impairment test at the entity level, since there would be more shielding, as profitable CGUs would mask possible impairments in some unprofitable CGUs. There was consensus that it would be useful to have better guidance to identify a CGU and to assign goodwill to each CGU.

b) There were no suggestions for other ways to reduce the cost and complexity of performing the goodwill impairment test.

Question 12

Paragraphs 5.4–5.27 explain the Board's preliminary view that it should not develop a proposal to allow some intangible assets to be included in goodwill.

(a) Do you agree that the Board should not develop such a proposal? Why or why not?

(b) If you do not agree, which of the approaches discussed in paragraph 5.18 should the Board pursue, and why? Would such a change mean that investors would no longer receive useful information? Why or why not? How would this reduce complexity and reduce costs? Which costs would be reduced?

(c) Would your view change if amortisation of goodwill were to be reintroduced? Why or why not?

The comments of the TWG were:

a) There is total agreement with not developing a proposal to allow including some intangible assets in goodwill, since these are different kinds of assets. Other intangible assets (trademarks, patents, workforce, etc.) are identified while goodwill is a residual from comparing the consideration paid with the fair value of the acquired assets. Also, some intangible assets have different useful lives and should be amortized on such basis.

b) There was no support for including other intangible assets in goodwill, even if some of them could be considered to have an indefinite life.

c) Even if amortization of goodwill is reintroduced, other intangible assets should be segregated, since these are of a different nature and their segregation provides useful information.

Question 13.
IFRS 3 is converged in many respects with US generally accepted accounting principles (US GAAP). For example, in accordance with both IFRS 3 and US GAAP for public companies, companies do not amortise goodwill. Paragraphs 6.2–6.13 summarise an Invitation to Comment issued by the US Financial Accounting Standards Board (FASB). Do your answers to any of the questions in this Discussion Paper depend on whether the outcome is consistent with US GAAP as it exists today, or as it may be after the FASB's current work? If so, which answers would change and why?

The TWG believes that the IASB and the FASB should maintain the maximum possible convergence, since following different procedures would create confusion in the market. Each country should evaluate the proposed changes.

Question 14

Do you have any other comments on the Board's preliminary views presented in this Discussion Paper? Should the Board consider any other topics in response to the PIR of IFRS 3?

We have the following suggestions:

a) There should be consistency on how impairment is determined from one year to the next.

b) There should be a project to determine how to amortize investments in other intangible assets.