Jörgen Holmquist
Director General
European Commission
Directorate General for the Internal Market
1049 Brussels

7 November 2008

Dear Mr Holmquist

Adoption of IFRS 3 (Revised) *Business Combinations*

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards we are pleased to provide our opinion on the adoption of IFRS 3 (Revised) *Business Combinations* (IFRS 3R), which was published by the IASB on 10 January 2008. It was issued as an Exposure Draft in June 2005 and EFRAG commented on that draft.

The objective of IFRS 3R is to establish principles and requirements on how an acquirer in a business combination recognises and measures in its financial statements the results of the acquisition transaction. The changes made to existing IFRS 3 by IFRS 3R are intended to:

- ensure that the accounting for business combinations is largely the same whether an entity is applying IFRS or US GAAP; and
- improve the accounting for business combinations, by providing additional requirements and guidance in certain areas and in making the accounting in other areas more internally consistent and more principle-based.

The main changes made are summarised in paragraph 3 of Appendix 1 of this letter.

The amendment becomes effective for annual periods beginning on or after 1 July 2009.Earlier application permitted, as long as it is not applied to an annual accounting period beginning before 30 June 2007.

EFRAG has carried out an evaluation of IFRS 3R. As part of that process, EFRAG issued a draft version of this letter for public comment and, when finalising its advice and the content of this letter, it took the comments received in response into account. EFRAG's evaluation is based on input from standard setters, market participants and other interested parties, and its discussions of technical matters are open to the public.

EFRAG supports IFRS 3R and has concluded that it meets the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards that:

- it is not contrary to the ‘true and fair principle’ set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

- it meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

For the reasons given above, EFRAG believes that it is in the European interest to adopt IFRS 3R and, accordingly, EFRAG recommends its adoption. EFRAG's reasoning is explained in the attached 'Appendix 1 - Basis for Conclusions'.

A minority of EFRAG members (two) have concerns about IFRS 3R that cause those members to believe that EFRAG should not recommend IFRS 3R for endorsement. The reasoning of those members is explained in the attached 'Appendix 2—Dissenting View'.

On behalf of the members of EFRAG, I should be happy to discuss our advice with you, other officials of the EU Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely,

Stig Enevoldsen
EFRAG, Chairman

APPENDIX 1
BASIS FOR CONCLUSIONS

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on IFRS 3R.

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity as a contributor to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of the final IFRS or Interpretation on the issue.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the European endorsement criteria, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.

1 When evaluating the merits of IFRS 3R, EFRAG considered the following key questions:

(a) Are the requirements of IFRS 3R consistent with the IASB's *Framework for the Preparation and Presentation of Financial Statements* ('the Framework')?

(b) Would IFRS 3R's implementation result in an improvement in accounting?

(c) Does the accounting that results from the application of IFRS 3R meet the criteria for EU endorsement?

2 Having formed tentative views on the above issues and prepared a draft assessment, EFRAG issued that draft assessment on 30 July 2008 and asked for comments on it by 19 September 2008. EFRAG has considered all the comments received in response, and the main comments received are dealt with in the discussion in this appendix.

3 Under existing IFRS 3, the acquirer measures the cost of the business combination, recognises (with some exceptions) the acquiree's identifiable assets and liabilities at their acquisition date fair value, and treats any excess of the cost of the business combination over the aggregate acquisition date fair value of the acquiree's identifiable assets and liabilities as goodwill. From a technical perspective, the main changes that IFRS 3R introduces are as follows.

(a) Under existing IFRS 3, the amount of the consideration was determined and used as the basis for the accounting. IFRS 3R makes three changes to the way the amount of the consideration is calculated:

(i) **Accounting for contingent consideration (Amendment 1).**

Existing IFRS 3 requires contingent consideration to be included in the amount of the consideration for the business combination if and when the additional payment or refund is probable and can be measured reliably. Generally, contingent consideration is measured at the amount the acquirer will be required to pay for the consideration. Subsequent changes to contingent consideration are accounted for as adjustments to the consideration for the acquisition, meaning that goodwill will change. There is no time limit on the adjustment of contingent consideration. Such adjustments are generally made as a result of a change in estimates, or when an amount becomes probable and can be reliably measured.

IFRS 3R requires contingent consideration to be measured at fair value at the date of acquisition. The probability recognition criterion in existing IFRS 3 is deleted. Changes in the fair value of contingent consideration that occur after the measurement period are accounted for in accordance with other IFRSs, which means inter alia that contingent consideration classified as a liability will be remeasured through profit or loss and other contingent consideration (which would be treated as equity) will not be remeasured.

(ii) **The treatment of acquisition-related costs (Amendment 2).**

Existing IFRS 3 requires that costs directly attributable to the acquisition are included in the cost of the acquisition. Generally, such costs would include costs incurred by the acquirer to accomplish the business combination (legal fees and similar costs). The costs incurred to issue debt or equity securities are recognised in accordance with IAS 32 and IAS 39; meaning that costs for issuing debt are deducted from the debt's carrying amount and the costs of issuing equity instruments are recognised directly in equity.

IFRS 3R requires all acquisition-related costs to be recognised as expenses at the date of the acquisition, except that the costs to issue debt or equity securities will continue to be recognised in accordance with IAS 32 and IAS 39.

(iii) When the entity obtains control of the acquiree having previously had a non-controlling interest in the acquiree, the acquirer is treated as having given up that pre-existing interest as part of the transaction. The fair value of the pre-existing interest at the date of acquisition is therefore included as part of the consideration amount. This issue is dealt with in this letter under the heading 'step acquisitions'.

(b) There are changes made to the way in which **step acquisitions** are accounted for (**Amendment 3**).

Existing IFRS 3 requires each transaction (each step) to be treated separately; in other words, the acquirer would use the cost and the fair value information at the date of each exchange transaction to determine the amount of goodwill to be recognised, and the goodwill amount recognised at any time would be the sum of all the goodwill that has arisen on each step of the business combination.

IFRS 3R requires that, when control is achieved in stages, the fair value of any previously held (ie pre-existing) interest is, as explained in paragraph (a)(iii) above, treated as disposed of and therefore as part of the consideration given to acquire control; and as a result included in the determination of goodwill. Furthermore, any difference between the pre-existing interest's fair value at the date control is acquired and its carrying amount at that date is recognised in profit or loss.

This means that goodwill from previous purchases is ignored and determined only once: on the date control is obtained.

(c) There are changes made to the way **partial acquisitions** are accounted for (**Amendment 4**). The changes have implications both for the amount at which NCI is recognised and the amount at which goodwill is recognised.

In existing IFRS 3, goodwill is recognised only to the extent that it is attributable to the acquirer's interest in the acquiree; meaning that goodwill is recognised based on the parent's share of the goodwill. Furthermore, an acquirer measures NCI at its proportionate interest of the fair value of the acquiree's identifiable net assets.

IFRS 3R permits entities to continue to measure NCI in accordance with the existing IFRS 3. However, it also permits entities to measure NCI at its fair value at the date control is acquired. This is a free choice that can be applied business combination-by-business combination. One effect of exercising this option is that the difference between the fair value of the NCI and the amount at which it is measured initially under existing IFRS 3 (at its proportionate interest of the fair value of the acquiree's identifiable net assets) would usually increase the amount at which goodwill is measured. This is sometimes referred to as the 'full goodwill' method.

(d) IFRS 3R also amends **the definition of a 'business'** (**Amendment 5**).

(e) IFRS 3R also omits the guidance in existing IFRS 3 on how to apply the **fair value measurement** requirement to certain assets and liabilities acquired in a business combination (**Amendment 6**). The above changes to the existing requirements result in greater use of fair value measures when accounting for certain types of business combination; this issue is discussed below under the heading 'Amendment 6'.

ARE THE REQUIREMENTS OF IFRS 3R CONSISTENT WITH THE IASB'S FRAMEWORK?

4 EFRAG considered whether the new requirements in IFRS 3R are consistent with the IASB's Framework. For this purpose, it focused on the main changes described in the preceding paragraph.

5 EFRAG believes there are two aspects of the Framework that are relevant to this consideration.

(a) The qualitative characteristics of financial information (relevance, reliability, comparability and understandability). As the Amendments are judged against the qualitative characteristics later in this appendix, this section does not focus on that aspect of the Framework.

(b) The material dealing with the elements of financial statements (in particular about the definitions of assets and liabilities).

The consideration given by the acquirer for the business combination

6 The changes made as to the amount to be attributed to the consideration given by the acquirer for the business combination relate primarily to measurement. As the Framework says little about measurement that is definitive, the possibility of the new measurement requirements being inconsistent with the Framework generally does not arise, with two exceptions: contingent consideration and acquisition-related costs.

Amendment 1—Contingent consideration

7 According to paragraph 49 of the Framework, a liability is "a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits". Paragraph 91 of the Framework explains that a liability is recognised "when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the amount at which the settlement will take place can be measured reliably".

8 IFRS 3R requires an acquirer to recognise a liability for contingent consideration regardless of how probable it is that the consideration will be paid. Although there is no explanation in IFRS 3R's Basis for Conclusions as to how this treatment might be reconciled to the Framework, the IASB has argued in other contexts that this removal of the probability threshold is consistent with the Framework because it is certain both that the acquirer has an obligation (a stand-ready obligation) and that there will be an outflow of resources (because the mere act of standing-ready to pay involves an outflow of resources).

9 However, EFRAG does not accept this argument. Even if one accepts that a stand-ready obligation is the sort of obligation envisaged in the liability definition, the mere act of standing-ready to pay does *not* necessarily involve an outflow of resources. Therefore, in EFRAG's view the effect of the new treatment of contingent consideration will sometimes be to recognise liabilities that do not meet the Framework's recognition criteria.

10 EFRAG notes that the IASB argues that IFRS 3R's treatment of contingent consideration is necessary because otherwise the acquisition date accounting would ignore the fact that the acquirer has agreed to make contingent payments. It also noted that there are a number of other instances in existing IFRS, most or all of which also involve the use of fair value measures, where this inconsistency with the Framework arises.

11 For the above reasons, although EFRAG believes that this aspect of IFRS 3R is not consistent with the Framework, the majority of EFRAG members believe the inconsistency is acceptable. Other EFRAG members however do not.

Amendment 2—Acquisition-related costs

12 IFRS 3R changes the accounting for acquisition-related costs. The IASB justifies this new treatment by arguing that acquisition-related costs do not represent assets of the acquirer at the acquisition date because the benefits obtained are consumed as the services are received—which in their view is the date of the acquisition.

However, according to paragraph 49 of the Framework, an asset is "a resource controlled by the enterprise as a result of a past event and from which future economic benefits are expected to flow to the enterprise". In other words, assets are resources, not costs. Costs are amounts used to measure assets. Therefore, it is EFRAG's view that the argument used to justify this new treatment of acquisition-related costs is not valid.

13 On the other hand, EFRAG also believes that whether acquisition-related costs are included as part of the cost of the business combination is a measurement issue—and the Framework says little about measurement that is definitive. Therefore, the possibility of the new measurement requirements being inconsistent with the Framework does not arise.

Amendment 3—Step acquisitions

14 EFRAG believes that the Framework says nothing that is of relevance to IFRS 3R's treatment of step acquisitions.

Amendment 4—Partial acquisitions

15 As already explained, the changes to the requirements for partial acquisitions relate mainly to the treatment of NCI and goodwill. The principle on which the fair valuing of NCI/full goodwill methodology is based is that the consolidation model should present consolidated financial statements as a single economic entity (entity perspective), rather than the mixed entity/parent perspective that is used in IFRS currently. Therefore the goodwill recognised should not be just the proportionate goodwill arising on the parent shareholders' interest in the subsidiary; it should include goodwill arising on the NCI, too. That way, the goodwill arising on the entity's acquisition of the subsidiary is recognised.

16 In EFRAG's view, the entity or parent perspective is not something that is addressed fully in the Framework. Some issues are addressed, but others are not. For example, under the Framework, NCI is equity. However, it does not follow that, just because NCI is equity, an entity perspective has to be applied.

17 On the other hand, the Framework is silent on a number of issues that would have an impact on the perspective chosen. For example, it is not clear which entity is the reporting entity when consolidated financial statements are prepared: the parent or the group. Because of this absence of material in the Framework, EFRAG concluded that Amendment 4 is not inconsistent with the Framework.

Amendment 5—Definition of a business & Amendment 6—Fair value as a measurement basis

18 EFRAG believes that the Framework says nothing that is of relevance to Amendments 5 or 6.

Conclusion

19 Because of this absence of material in the Framework, EFRAG concluded that IFRS 3R is not inconsistent with the Framework except in one respect (Amendment 1), where the majority of EFRAG members thought the inconsistency was acceptable.

WOULD IFRS 3R's IMPLEMENTATION RESULT IN AN IMPROVEMENT IN ACCOUNTING?

20 EFRAG next asked itself whether the changes to IFRS contained in IFRS 3R were likely to result in an improvement in the financial information provided. For this purpose, EFRAG assessed each of the Amendments already described in turn.

Amendment 1—Accounting for contingent consideration

Initial measurement

21 The majority of EFRAG members are of the view that the requirement to recognise the acquisition date fair value of any contingent consideration as part of the consideration amount for the business combination will result in an improvement in the information provided. That is because they believe that a delay in recognising liabilities that are contingent on a future outcome or event could cause financial statements to be incomplete and thus diminish their usefulness in making economic decisions. However, one EFRAG member is concerned about the apparent 'disconnect' between IFRS 3R and the requirements in IAS 37 created by this change (the removal of the 'probability' criterion meant that liabilities were measured differently under IFRS 3R and IAS 37) and the implications that this could have for the subsequent accounting.

22 The change will result in the need for additional estimates to be made, but most EFRAG members believe that this will not be a significant issue; the use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability as long as the estimates used can be reasonably determined. Some EFRAG members however noted that this was yet another area in which estimation and judgement was needed in acquisition accounting and, taken as a whole, the degree of estimation and judgment involved was now becoming a concern. (This concern is discussed further under Amendment 6.)

Subsequent measurement

23 The majority of EFRAG members had some concerns about IFRS 3R's requirement that subsequent changes in the fair value of any contingent consideration liability should be recognised in profit or loss; and that if the contingent consideration did not result in a liability, no adjustment at all should be made for fair value changes.

(a) Some were concerned that having more values based on information that required a high degree of estimation introduced volatility in profit or loss, rendering the financial statements less relevant to users.

(b) Some noted that there are several reasons why a buyer and seller enter into contingent consideration, but argued that, where the changes in fair value reflected an uncertainty about the value of the business at the acquisition date, they should be accounted for as part of the cost of the acquisition rather than in profit or loss.

24 Some EFRAG members saw some benefits in the change. In particular:

(a) Some EFRAG members believe that in a business combination most contingent payments would be linked to the future performance of the acquired entity and in such cases it made sense for changes to the performance-based consideration to be recognised in profit or loss. In effect, they were post-acquisition events, which generally are recognised in profit or loss. Accounting for changes that arise from changes in future performance targets, as an adjustment to goodwill, would create a 'mismatch' in the financial statements.

(b) Some EFRAG members also believe that the new requirements for contingent consideration would improve comparability of financial reporting because all contingent arrangements in business combinations would be accounted for in same way.

<u>Conclusion</u>

25 The majority of EFRAG members have concluded that some aspects of Amendment 1 are likely to result in an improvement in the information provided, some are likely to have the opposite effect, and overall they probably balance out.

Amendment 2—Accounting for acquisition-related costs

26 The majority of EFRAG members believe that expensing acquisition-related costs makes it difficult for the financial statements to fulfil their stewardship objective because the acquirer is not made accountable for the full cost invested in the business combination. However, some other members do not agree; in their view the Amendment will have no significant impact on the quality of the information provided.

Amendment 3—Step acquisitions

27 The majority of EFRAG members agree that Amendment 3 is likely to result in an improvement in the information provided, because presently practices diverge, which compromises comparability. The majority also agree that achieving control is a significant event, and some thought this justified remeasuring the pre-existing interest and recognising a gain or loss in profit or loss. In their view the acquirer had given up an NCI and acquired a controlling interest, and fair valuing the asset given up was the usual practice in non-cash exchange transactions. Some others thought that, although such an exchange has not taken place, remeasurement is still appropriate due to the event of control being achieved.

28 However, others were not convinced, arguing that the pre-existing interest (the NCI) has merely been transformed, not given up, and is therefore not part of the exchange. In their view, the treatment required by the Amendment could misrepresent the transaction.

Amendment 4—Partial acquisitions

29 IFRS 3R permits entities to continue to measure NCI in accordance with the existing IFRS 3. However, it also permits entities to measure NCI at its fair value at the date control is acquired. EFRAG members believe two issues arise from this; they are discussed separately below.

<u>Fair value as a measurement attribute for NCI</u>

30 EFRAG considered the effect that measuring NCI initially at fair value and recognising 'full goodwill' would have on the information provided. EFRAG noted that the general principle to fair value NCI is consistent with the general approach in IFRS 3R that all components shall be measured at fair value.

31 Although there were some concerns about whether NCI could be measured at fair value reliably, EFRAG recognised that the existence of an option addressed such concerns.

32 Some EFRAG members thought that measuring NCI at fair value was an aspect of the entity perspective and, in their view, applying the entity perspective would not provide information that is relevant to the primary users of consolidated financial statements, the shareholders of the parent entity.

33 Although the majority of EFRAG members did not share this concern, few of them thought that being able to fair value NCI and being able to recognise full goodwill would result in a general improvement in the information provided. They noted though that this accounting treatment was not mandatory, and would therefore probably be most used in exactly the circumstances in which it does result in improvements.

<u>The option</u>

34 EFRAG also considered what the effect would be on the information provided of introducing into IFRS a transaction-by-transaction choice as to how to measure NCI and goodwill.

35 EFRAG believes as a matter of principle that options in standards generally reduce the usefulness of the resulting information. Furthermore, some EFRAG members thought that the IASB was permitting "options" on an ad-hoc basis depending on circumstances, and this was having an effect on the consistency and, as a result, on the quality of the information provided.

36 On the other hand, the majority of EFRAG members accept that there are some circumstances in which fair valuing some or all of the NCI can result in an improvement in the information provided. In their view, having an option allows NCI to be fair valued in those circumstances, without requiring NCI to be fair valued in other circumstances. Furthermore, as already mentioned, having an option also leaves room for an alternative approach to be adopted when it is difficult to estimate NCI's fair value. Some EFRAG members also believe it is relevant that NCI is not usually significant compared to total equity.

37 Another concern that some members had was that the existence of this option in IFRS 3R appears not to have been reflected fully in the standard's other requirements. In other words, the standard's other requirements largely assume that NCI will be recognised initially at fair value and as a result take insufficient account of the fact that that will not always be the case. However, the majority of EFRAG members did not see this as a major concern.

<u>Conclusion</u>

38 The majority of EFRAG members believe that fair valuing NCI and recognising full goodwill will not have a significant effect on the quality of the information provided. The existence of a free choice that can be exercised on a transaction-by-transaction basis has advantages and disadvantages in terms of the information provided.

39 On balance, the majority of EFRAG members believe that, if judged in isolation, the inclusion of a transaction-by-transaction choice would not improve the information provided. However, EFRAG understands that, had this option not been included in

IFRS 3R, it might not have been possible for the IASB to revise existing IFRS 3 and that, as a result, the inclusion of this option made the improvements that IFRS 3R makes possible. Therefore, this option is best judged in the context of the revised standard as a whole.

Amendment 5—Definition of a business

40 IFRS 3R has changed the definition of 'a business'. EFRAG believes that the main change to the definition itself is the introduction of the word "capable", which has the effect of broadening the definition. EFRAG understands that the purpose of this change is to make it clear that a business does not need to include all the inputs or processes that the seller used as long as market participants would be capable of operating the business by integrating it into its own inputs and processes. This point is reiterated in the guidance accompanying the amended definition.

41 The majority of EFRAG members thought this change in definition and additional guidance would not have a significant practical effect in most cases. In their view, transactions that would not fall under the definition in existing IFRS 3 would also not fall within the new definition.

42 However, some EFRAG members were concerned that the revised definition and guidance—particularly the guidance about market participants—might bring into the scope of IFRS 3R transactions that were better accounted for in other ways and that what they saw as a lack of clarity in the revised definition might result in a divergence of practice.

Amendment 6—Fair value as a measurement attribute

<u>Guidance on fair value measurement</u>

43 Although there has been no change to the definition of 'fair value' in existing IFRS 3, the guidance on how to measure certain assets and liabilities at fair value that was in the existing standard has been omitted from IFRS 3R. Some EFRAG members were concerned about this omission because they regarded the guidance as pragmatic, practical and useful. They thought a result of the omission could be that the fair value notion would be inconsistently applied in practice. However, the majority of EFRAG members were not concerned about the issue. In their view, the guidance in paragraph B16 of existing IFRS 3 is not consistent with the fair value measurement objective. Omitting the guidance eliminates this inconsistency. They also noted that there was sufficient material in the existing literature on fair value measurement to understand the concept in the context of business combinations.

<u>Increase in the use of fair value measures</u>

44 IFRS 3R requires greater use of fair value than hitherto, in that:

(a) any contingent consideration is required to be measured at fair value on initial recognition and the components that are classified as liabilities are required to be remeasured at fair value too,

(b) any pre-existing interest needs to be measured at fair value if and when control is acquired, and

(c) there is an option to measure any NCI at fair value.

45 Some EFRAG members are concerned about this increased use of fair value because, when taken together with the amount of fair value that existing IFRS 3 already requires to be used, the degree of estimation and judgment involved in acquisition accounting has now become in their view very significant. However, the majority of EFRAG members do not share this concern: in their view the use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability as long as the estimates used can be reasonably determined.

Does the accounting that results from the application of IFRS 3R meet the criteria for EU endorsement?

46 In summary, EFRAG has concluded that IFRS 3R is not inconsistent with the Framework except in one respect (Amendment 1), where the majority of EFRAG members thought the inconsistency was acceptable. Furthermore, having considered whether the various amendments in IFRS 3R were likely to improve the information provided, the majority of EFRAG members believe that:

(a) aspects of Amendment 1 are likely to result in an improvement in the information provided, some are likely to have the opposite effect, and overall they probably balance out;

(b) Amendments 2, 5 and 6 are not likely to have a significant impact on the quality of the information provided;

(c) Amendment 3 is likely to result in an improvement in the quality of the information provided; and

(d) the actual accounting change required by Amendment 4 is not likely to have a significant effect on the quality of the information provided, but the decision to allow a transaction-by-transaction choice would not improve the information provided but had to be judged in the context of the revised standard as a whole (because, had the option not been included, it might not have been possible for the IASB to issue a revised version of IFRS 3).

47 Against this background, EFRAG has considered whether IFRS 3R meets the requirements of the European Parliament and of the Council on the application of international accounting standards, in other words that IFRS 3R:

(a) is not contrary to the 'true and fair principle' set out in Article 16(3) of Council Directive 83/349/EEC and Article 2(3) of Council Directive 78/660/EEC; and

(b) meets the criteria of understandability, relevance, reliability and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.

EFRAG has also considered whether it is in the European interest to adopt IFRS 3R.

48 In this context, it is worth noting that EFRAG has previously concluded that the existing IFRS 3 meets the endorsement criteria.

Relevance

49 According to the Framework, information has the quality of relevance when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations. EFRAG considered whether the implementation of IFRS 3R would result in relevant information being omitted from the financial statements. It noted that:

(a) as explained in paragraph 23 above, the majority of EFRAG members had concerns about Amendment 1's subsequent remeasurement requirements, which have the effect of requiring certain items that were previously treated as part of the consideration amount to be either expensed immediately or not adjusted for at all. As a result, some members were concerned that the Amendment might have the effect of obscuring or omitting relevant information. EFRAG noted that IFRS 3R adopted a different approach to changes in estimates relating to contingent consideration compared to IFRS 3; but the approach adopted was consistent with that adopted in other standards that had been assessed to be relevant. EFRAG also noted that Amendment 1 would ensure that the amount of consideration recognised at the date of acquisition included an amount for contingent consideration. This would improve the relevance of the information provided.

(b) the majority of EFRAG members believe that Amendment 2's treatment of acquisition-related costs means that information that is needed for "assessing the stewardship of management" will be obscured, although they note that IFRS 3R requires disclosure of the amount of acquisition-related costs expensed.

(c) some concerns had been raised about whether Amendment 4's focus on the entity perspective would result in relevant information being omitted from the financial statements. However, the majority of EFRAG members do not share the concern; in their view the application of the entity perspective resulted in the provision of some information that was different from that provided under the parent perspective, but no less relevant. They also noted that IFRS 3R also requires the disclosure of information that would help in adjusting the information onto a parent perspective should that be considered necessary.

50 Having weighed up these matters, the majority of EFRAG members concluded that IFRS 3R met the relevance criterion.

Reliability

51 The Framework explains that information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully that which it either purports to represent or could reasonably be expected to represent. EFRAG considered whether the implementation of IFRS 3R would result in reliable information being included in the financial statements. It noted that some members were concerned about the increased use of fair value in accounting for business combinations, and about whether it would always be possible to fair value contingent consideration reliably. However, although some members have concluded as a result of these concerns that the reliability criterion is not met, the majority of EFRAG members have concluded that IFRS 3R still meets the criterion.

Understandability

52 Financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.

53 There is no doubt that some aspects of IFRS 3R involve new notions and will require users to look at aspects of a business combination in a different way than hitherto. However, apart from the comparability issues discussed in the next section, EFRAG does not have any concerns about the understandability of the information that would be provided under IFRS 3R.

Comparability

54 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

55 Amendment 3's new requirements for step acquisitions will, EFRAG believes, result in significant improvements in the comparability of the information provided. IFRS 3R contains numerous other, more minor, clarifications that will also improve the comparability of the information provided. IFRS 3R is also largely converged with US GAAP, which means that comparability has also been enhanced globally by this standard. However, there is no doubt that Amendment 4's transaction-by-transaction choice will have a negative impact on the comparability of NCI and goodwill numbers, and related information (such as goodwill impairment losses). Some EFRAG members also have some concerns about the comparability implications of Amendments 5 (definition of a business) and 6 (omitting the fair value guidance). The fact that the standard is to be applied prospectively to business combinations that take place after the effective date raises further comparability issues.

56 Different EFRAG members attribute different weight to these issues and some EFRAG members do not believe IFRS 3R meets the comparability criterion. However, the majority of EFRAG members believe that it does meet the comparability criterion.

True and Fair

57 For the reasons set out above, EFRAG sees no reason to believe that IFRS 3R is inconsistent with the true and fair view requirement.

European Interest

58 EFRAG members considered whether the benefits of implementing IFRS 3R in the EU exceed the costs of doing so. On balance, EFRAG concluded that the benefits that are expected to arise from implementing IFRS 3R in the EU will exceed the costs expected to be incurred to implement IFRS 3R.

Conclusion

59 After considering all the above arguments, the majority of EFRAG members concluded that on balance IFRS 3R satisfies the criteria for EU endorsement. EFRAG therefore recommends its endorsement.

APPENDIX 2
DISSENTING VIEW

The views of two EFRAG members who voted against recommending endorsement of IFRS 3R are explained in this appendix.

Two EFRAG members (Mr Michael Starkie and Mr Carsten Zielke) believe that IFRS 3R should not be endorsed for use in the European Union and therefore dissent from EFRAG's decision to recommend its endorsement. These EFRAG members have reached this conclusion because they believe aspects of IFRS 3R do not meet the endorsement criteria. In particular:

Relevance

1 IFRS 3R changes the way that contingent consideration is accounted for. Mr Michael Starkie and Mr Carsten Zielke believe that the new requirements result in the provision of information that is not relevant to users of financial statements. Specifically, in the case of an arrangement for contingent consideration, they believe that most of the changes in the fair value of the liability for contingent consideration will reflect uncertainty about the value of the business at the acquisition date and therefore should be dealt with by adjusting goodwill; recognising them as gains and losses in profit or loss means that information that is of no relevance to the entity's performance is being included in a performance statement.

2 IFRS 3R requires acquisition-related costs to be expensed at the date of the acquisition. Mr Michael Starkie and Mr Carsten Zielke believe that such costs are part of the exchange transaction and should therefore be included in the investment amount. In their view, it is the total investment value that preparers of financial statements will be monitoring, and for which preparers have a stewardship responsibility. Therefore, by requiring the costs to be expensed immediately, IFRS 3R will obscure information that is needed for assessing the stewardship of management. They acknowledge that IFRS 3R requires disclosure of the amount of acquisition-related costs expensed, but point out that disclosure cannot make up for inappropriate accounting.

3 IFRS 3R also changes the way that step acquisitions are accounted for. Mr Michael Starkie and Mr Carsten Zielke believe that these new requirements also result in the provision of information that is not relevant to users of financial statements. Specifically, they believe that the requirement to recognise the effect of remeasuring any pre-existing interest in the acquiree at fair value through profit or loss results in the provision of information that has nothing to do with the performance of the entity in profit or loss. In their view, if there is to be a remeasurement of the pre-existing interest, the resulting gains and losses should be recognised in equity.

4 IFRS 3R requires the application of an entity perspective accounting model. Mr Michael Starkie and Mr Carsten Zielke believe that applying that model does not result in the provision of information that is relevant to the primary users of consolidated financial statements, the shareholders of the parent entity. In particular, they believe that the relevant NCI and goodwill amounts are those calculated in accordance with existing IFRS 3; in their view therefore, IFRS 3R's option to measure NCI at fair value will if exercised result in this relevant information being obscured in the financial statements.

Reliability

5 IFRS 3R requires greater use of fair values than hitherto. Mr Michael Starkie and Mr Carsten Zielke believe that, when taken together with the existing requirements in IFRS 3 to use fair value, the use of estimates and judgement involved in a business combination has now become very significant. They believe that this high degree of estimation will mean that often some of the information provided on the business combination will not be reliable.

Comparability

6 IFRS 3R introduces an option on a transaction-by-transaction basis on how to measure the NCI. There is no doubt that the use of alternative accounting treatments in accounting reduces the comparability of financial information, and more so if the alternative treatment can be used on a case-by-case basis, as it can in IFRS 3R. In the view of Mr Michael Starkie and Mr Carsten Zielke, allowing a free choice option as to how to measure NCI will mean that the information provided about business combinations will often not be comparable.

Cost/benefit

7 IFRS 3R, like IFRS 3, requires the identifiable net assets acquired by the acquirer as a result of the acquisition to be recognised. Mr Michael Starkie and Mr Carsten Zielke believe that the outcome of IFRS 3 already often is an arbitrary allocation of value between different intangibles. The added emphasis in IFRS 3R to recognise intangibles separately from goodwill will increase the complexities associated with recognising intangibles separately from goodwill, and therefore will involve additional costs being incurred by preparers. However, it will not enhance the usefulness of the information provided, because in most cases users do not consider the fair values of individual asset categories to be of particular relevance, rather they tend to focus on the value of businesses (collection of assets) and their ability to generate a stream of future cash flows. As such, the costs incurred will not result in commensurate benefits.