European Financial Reporting Advisory Group

IFRS 3R *Business Combinations*

and

IAS 27A *Consolidated and Separate Financial Statements*

Effects Study Report

Contents

		Pages
1	Executive summary	3 – 5
2	A brief description of how EFRAG carried out its analysis	6
3	A summary of the new standards	7 – 11
4	The IASB's effects study material	12 - 13
5	EFRAG's initial assessment of the costs and benefits of IFRS 3R	14 – 16
6	EFRAG's initial assessment of the costs and benefits of IAS 27A	17 – 18
7	Stakeholders' views on EFRAG's initial assessments of IFRS 3R and IAS 27A	19 – 22
8	EFRAG's final assessment of the costs and benefits of IFRS 3R	23 – 35
9	EFRAG's final assessment of the costs and benefits of IAS 27A	36 – 39
10	EFRAG's overall conclusions	40 - 41

Effects analysis on the costs and benefits of implementing IFRS 3 (Revised) *Business Combinations* and IAS 27 (Amended) *Consolidated and Separate Financial Statements* in the EU

EXECUTIVE SUMMARY

Introduction

a Following discussions between the various parties involved in the EU endorsement process, the European Commission decided in 2007 that more extensive information than hitherto needs to be gathered on the costs and benefits of all new or revised or amended Standards and Interpretations as part of the endorsement process. It has further been agreed that EFRAG will gather that information in the case of IFRS 3 (Revised) *Business Combinations* (IFRS 3R) and IAS 27 (Amended) *Consolidated and Separate Financial Statements* (IAS 27A).

b EFRAG first considered how extensive the work would need to be. For some Standards or Interpretations, it might be necessary to carry out some fair extensive work in order to understand fully the cost and benefit implications of the Standard or Interpretation being assessed. In the case of IFRS 3R and IAS 27A, EFRAG's view was that a detailed assessment about the costs and benefits of implementing IFRS 3R and IAS 27A, was necessary. This approach is explained more fully in the section below 'methodology'.

c EFRAG already carries out a technical assessment of all new and revised Standards and Interpretations issued by the IASB and IFRIC against the so-called endorsement criteria and provides the results of those technical assessments to the European Commission in the form of recommendations as to whether or not the Standard or Interpretation assessed should be endorsed for use in the EU. As part of those technical assessments, EFRAG gives consideration to the costs and benefits that would arise from implementing the new or revised Standard or Interpretation in the EU.

Methodology

d EFRAG started its assessment by reviewing IFRS 3R, IAS 27A and the effects study work carried out the IASB [1]. Based on these discussions, EFRAG reached an initial assessment as to the costs and benefits likely to arise from the implementation of the two standards in the EU. In carrying out this assessment, EFRAG focused primarily on the main changes introduced by IFRS 3R and IAS 27A. They are discussed separately in the main sections of this report.

e EFRAG issued that initial assessment for public comment on 30 July 2008 ('the public consultation'). It invited comment on the assessment by 19 September 2008. The comment letters received in response are available from EFRAG's website (www.efrag.org), and a summary of them is included in this report.

f At the same time, EFRAG decided to carry out some additional, targeted consultations with preparers and users. With that in mind, it prepared two questionnaires which is used as the basis for discussions with a number of

[1] A copy of the IASB's project summary, feedback and effect analysis is annexed to this report.

companies and users ('the private consultations'). In some cases follow-up discussions with the consultee also took place. The individual responses received are confidential, but a summary of the information gathered is included in this report.

g EFRAG also consulted on various aspects of the new standards with its User Panel.

h EFRAG then finalised its assessment in the light of the input received on its initial assessment. Its final assessment is set out in full in the report, and is summarised in the paragraphs below.

Main findings of the Effects Study

IFRS 3R

i To summarise EFRAG reached the following conclusions on each of the amendments discussed on IFRS 3R.

- Additional disclosure—Likely to provide benefits that exceed the costs involved.
- Transition requirements—Likely to result in some increased costs for preparers and users, but those costs are not likely to be significant.
- Amendment 1: Contingent consideration—The costs and benefits will probably largely balance out.
- Amendment 2: Acquisition-related costs—The amendment is unlikely to have significant cost or benefit implications.
- Amendment 3: Step acquisitions—The amendments are likely to result in a cost saving for preparers and benefits (but no costs) for users.
- Amendment 4: Partial acquisitions – acquisitions of less than 100 percent—The costs of this amendment are likely to exceed the benefits.
- Amendment 5: Definition of a business— No significant cost or benefit implications are likely.
- Amendment 6: Fair value as a measurement attribute—No significant cost or benefit implications are likely.
- Amendment 7: Scope—No significant cost or benefit implications likely.

In addition, EFRAG's assessment was reading and understanding the amendments would not involve any significant costs.

j EFRAG then weighed these various costs and benefits. It concluded firstly that Amendments 3 and 4 have the greatest cost and/or benefit implications involved and secondly that the net benefits arising from Amendment 3 exceed the net costs arising from Amendment 4. Therefore, EFRAG's overall assessment is that on balance, the benefits that are expected to arise from the implementation of IFRS 3R in the EU will exceed the costs expected to be incurred.

IAS 27A

k To summarise, EFRAG reached the following individual final conclusions on each of the amendments discussed on IAS 27A.

- Transition requirements to IAS 27A—No significant cost or benefit implications are likely.

- Amendment 1: Changes in ownership interest that do not result in control of another entity being lost—Likely to result in no significant additional costs but significant benefits for users.

- Amendment 2: Changes in ownership interest that result in control of another entity being lost—Likely to result in only insignificant additional costs. However, it will not result in any net benefits for users.

- Amendment 3: Accounting for losses attributable to NCI—No significant cost or benefit implications are likely.

In addition, EFRAG's assessment was reading and understanding the amendments would not involve any significant costs.

l In other words, the only amendment that is likely to have a significant effect is Amendment 1, which is expected to result in significant benefits for users. Therefore, EFRAG's overall assessment is that the benefits that are expected to arise from implementing IAS 27A in the EU will exceed the costs expected to be incurred.

A BRIEF DESCRIPTION OF HOW EFRAG CARRIED OUT ITS ANALYSIS

1 EFRAG started its cost and benefit assessments by considering the work that the IASB has itself carried out on the likely costs and benefits of implementing IFRS 3R and IAS 27A. EFRAG also discussed the IASB's Effect Analysis with EFRAG's User Panel in order to hear its views on the IASB's assessment of the costs and benefits to users.

2 EFRAG's conclusion was that the IASB's effect analysis was a good piece of work that EFRAG could, and should, build on. However, EFRAG did not agree with all the IASB's assessments, nor did it agree with all the underlying rationale used to support those assessments.

3 (Section 3 of this report discusses the IASB's Effect Study material.)

4 EFRAG then developed a detailed methodology that was designed to build on the IASB's work. In particular, EFRAG decided that it needed:

(a) to carry out its own detailed initial assessment of the likely costs and benefits of implementing the new standards and consult publicly with all stakeholders on the results of its initial assessments,

(b) to consult directly with a limited number of preparers who would be affected by the amendments,

(c) to consult with a limited number of users of financial statements; and

(d) to finalise its assessment in the light of all the input received.

5 EFRAG included the results of its initial assessment in an Invitation to Comment, which it issued for public comment on 30 July 2008 and invited public comment by 19 September 2008. At the same time that EFRAG issued its Invitation to Comment, the work described in (b) and (c) started.

6 The input from EFRAG's various consultations with stakeholders is summarised in the respective sections of this report.

7 In October EFRAG finalised its assessment in the light of the input received. This report is the result.

A SUMMARY OF THE NEW STANDARDS

IFRS 3 (Revised) *Business Combinations*

8 A business combination occurs when one entity ('the acquirer') is deemed to have acquired control of another ('the acquiree'). IFRS 3R explains how that acquisition should be accounted for in the financial statements of the acquirer.

9 There are three ways in which the acquirer can obtain control of the acquiree.

(a) The most common way involves the acquirer acquiring the whole of the acquiree in a single transaction. This is a one-step 100% acquisition.

(b) The acquirer acquires control of the acquire by first acquiring an interest that is not a controlling interest and then, in one or more further steps, by increasing that holding until it is a controlling interest. This is often referred to as a step acquisition.

(c) The acquirer acquires control (either in one step or in more than one step) of the acquiree but does not acquire 100% of the acquiree. This is often referred to as a partial acquisition.

One-step 100% acquisition

10 Put simply, under existing IFRS 3 a one-step 100% acquisition is accounted for by:

(a) bringing onto the consolidated balance sheet all the assets and liabilities of the acquiree (other than goodwill) at the amount it is estimated the acquirer paid for them (in other words, at their acquisition date fair value);

(b) recognising the cost of the acquisition (for example, by reducing cash balances if cash consideration is paid and by increasing equity if equity shares are used); and

(c) recognising the difference between the cost calculated in (b) and the aggregate fair value calculated in (a) as goodwill.

Thus, to take a simple example:

Assume Company A buys 100% of Company B for €6m of cash and €4m of equity shares. At that date, Company A estimates that the fair value of Company B's total net assets (other than goodwill arising on acquisition) is €8m. Under existing IFRS 3, Company A will recognise on its consolidated balance sheet the acquiree's net assets of €8m plus goodwill arising on acquisition (henceforth 'goodwill') of €2m. It will also reduce its cash balances by €6m and recognise an increase in equity of €4m.

11 IFRS 3R makes two changes to this accounting. They relate to the treatment of contingent consideration and to the treatment of acquisition-related costs. (Both these changes also apply to the accounting for step acquisitions and partial acquisitions, which are discussed later in this appendix.)

Contingent consideration

12 Sometimes part of the consideration paid by the acquirer is contingent on the occurrence of a future event(s). This is also referred as contingent consideration and can comprise a liability or an equity component.

13 Under existing IFRS 3 contingent consideration is recognised only at the date of acquisition if its payment is probable and it can be measured reliably. Subsequently, if it becomes probable that contingent consideration not so far recognised will be payable and it can by then be measured reliably, it is recognised at that point and adjusted against goodwill.

14 Under IFRS 3R, the acquisition date fair value of any contingent consideration is recognised immediately (and taken into account in calculating the amount of goodwill etc). If that fair value subsequently changes, it will have no impact on the amounts at which goodwill and the other assets and liabilities acquired via the business combination are accounted for.

Acquisition-related costs

15 An acquirer often incurs acquisition-related costs such as costs for the services of valuation experts, legal fees, banking fees and other acquisition-related third party costs, when it undertakes a business combination.

16 Currently acquisition-related costs are included in the cost of the investment (ie in the €10m in our example above), and are therefore taken into account in calculating the value attributed to goodwill. Under IFRS 3R, such costs will be expensed immediately. As was the case with IFRS 3, the costs to issue debt or equity securities will under IFRS 3R be recognised in accordance with IAS 32 and IAS 39.

Step acquisitions

17 Under existing IFRS 3, a step acquisition is accounted for by:

(a) accounting for all the assets and liabilities of the acquiree (other than goodwill) in exactly the same way as for a one-step acquisition (see paragraph 3(a) above). The difference that arises when these identifiable net assets are revalued at the date of the acquisition is recognised in equity;

(b) by adding together the cost of each of the steps to arrive at the aggregate cost of the acquisition; and

(c) determining the goodwill separately on each step and then aggregating it.

Thus, to take a simple example:

Assume Company A acquired a 30% investment in Company B in June 2007 for €2.7m, which included an amount of €0.15m relating to goodwill. The net assets in Company B on that date amounted to €8.5m. In June 2008 Company A acquires the remaining 70% of Company B for €8m in cash. At that date, Company A estimates that the fair value of Company B's total net assets (other than goodwill arising on acquisition) is €9.5m. Under existing IFRS 3, Company A will recognise on its consolidated balance sheet the acquiree's net assets of €9.5m on the date of the acquisition. It reduces its cash balances by €8m, and records goodwill for a total amount of €1.5m calculated in two steps as follows:

- Step 1: Goodwill arising on 30% acquisition: based on the acquisition date: €0.15m

- Step 2: Goodwill arising on 70% acquisition: €8 less €6.65m (€9.5m x 70%) : €1.35m

Furthermore, Company A will derecognise its investment in Company B with a carrying amount of €2.7m (assuming no post acquisition profits) and will recognise a revaluation reserve (in equity) arising on the previously held investment of € 0.3m being the increase in the fair value of the net assets in Company B from Company A's previously acquired interest ((€9.5m-€8.5)X30%)).

18 Under IFRS 3R, the accounting treatment of the identifiable net assets of the acquiree (ie the assets and liabilities of the acquiree other than goodwill) is the same. However:

(a) the fair value of the acquirer's interest in the acquiree immediately prior to the moment control is acquired is calculated and treated as part of the consideration given to acquire the controlling interest. The difference between the fair value of the previously held investment in the acquiree and its carrying amount is recognised in profit or loss.

(b) goodwill is calculated only once—at the date control is achieved—rather than on each step. The amount of goodwill recognised is the difference between consideration given to acquire control (ie the aggregate of the fair value of any previously held investment in the acquiree and the consideration transferred) and the fair value of the identifiable net assets acquired.

Thus to illustrate IFRS 3R, using the example above:

Company A would record net assets of €9.5m and reduce its cash balances by €8m. The fair value of its previously held interest is determined to be €2.75 (after taking into account the effects of the control premium included in the total price paid for the controlling interest). Goodwill would be calculated at the date control is obtained and amounts to €1.25: ((€8+€2.75m) less €9.5). In addition, the difference between the carrying amount of the previously held investment of €2.7 and its fair value (€2.75) of €0.05m is recognised in profit and loss rather than in equity.

Partial acquisitions

19 Under existing IFRS 3, the accounting is as described above except that, because 100% of the identifiable net assets of the acquire are recognised, it is necessary to complete the double-entry by recognising the minority shareholders' (henceforth Non-controlling Interest (or NCI) holders') interest in those net assets.

20 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.

21 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 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, as it includes the amount of goodwill that arises from the parent's share in the consolidated group as well as the share held by the NCI.

Amendments to IAS 27 Consolidated and Separate Financial Statements

22 When a parent-subsidiary relationship exists between two entities, the parent entity is required to prepare a set of financial statements that account for the assets and liabilities of all the members of the group as if the group is a single entity (the consolidated financial statements). IAS 27 sets out how those consolidated financial statements should be prepared.

23 The main purpose of the amendments to IAS 27 is to address the accounting for transactions that involve the non-controlling interest (the NCI) of a group entity. Specifically, the Amendments address the way the following transactions involving NCI are accounted for in the consolidated financial statements:

(a) changes in ownership interest that result in control of another entity being neither gained nor lost;

(b) disposals of interests that result in a loss of control of the acquiree; and

(c) accounting for losses attributable to NCI.

24 Other than the changes in paragraph 28, the amendments to IAS 27 do not change the other requirements in IAS 27.

Changes in ownership interest that do not result in control of another entity being lost

25 After a parent has acquired control of a subsidiary but not a 100% interest, it might decide to buy some (or all) of the remaining interest (ie the NCI). Alternatively, regardless of whether it holds a 100% interest or a smaller but controlling interest, it might decide to sell some of its interest, whist keeping control of that subsidiary.

26 Existing IAS 27 does not specify how such transactions should be accounted for and, as a result, a variety of methods are being used. Under IAS 27A, such transactions are treated as transactions between equity holders (on the one hand the controlling equity holder and on the other the holder of the NCI) in their role as equity holders. This means that any 'gains' or 'losses' arising on such transactions are treated as movements between components of equity and are not recognised in the income statement. Neither does the parent entity recognise or derecognise any net assets in the consolidated balance sheet as a result of such transactions.

Changes in ownership interest that do result in control of another entity being lost

27 A parent may also decide to dispose of some or all of its interest in a subsidiary and, by doing so, to give up its control of that entity.

28 Existing IAS 27 requires the retained interest in the former subsidiary to be measured at its carrying amount prior to the disposal. Any gain or loss on the part of the interest that has been disposed of is recognised in the income statement.

29 IAS 27A requires the parent to remeasure any retained interest at fair value at the date control is lost. Any difference between the carrying amount of the retained investment immediately prior to losing control and its fair value is recognised in profit or loss, along with any gain or loss on the interest disposed of.

Accounting for losses attributable to NCI

30 When the parent has a less than 100% interest in a subsidiary and that subsidiary incurs losses, the losses need to be allocated between the controlling interest and the non-controlling interest.

31 Existing IAS 27 requires the losses to be allocated proportionately between the controlling interest and the non-controlling interest, except that:

(a) losses in a subsidiary that exceed the NCI interest are to be allocated to NCI only if the NCI have a binding agreement to fund the losses. In the absence of such an agreement, the losses are allocated to the controlling interest only; and

(b) if the subsidiary subsequently reports profits, these profits are allocated to the controlling interest until the share of losses previously absorbed by the controlling interest have been recovered.

32 Under IAS 27A, losses are allocated between the parent and NCI in proportion to their ownership interests, even if this results in NCI having a balance that is negative.

THE IASB's EFFECT STUDY MATERIAL

33 When the IASB issued IFRS 3R and IAS 27A, it also issued a publication entitled *Business Combinations II: Project summary, feedback and effect analysis*. The Effects Analysis part of the publication contains an assessment by the IASB of the costs likely to be incurred by preparers to implement the new requirements and by users of financial statements in using the information.

34 In the material, the IASB explains the process and the rationale underlying its assessments. The IASB also makes it clear that:

(a) the evaluations of costs and benefits are necessarily qualitative, rather than quantitative, given the inherent difficulties of quantification;

(b) the focus has been put on assessing the likely costs and benefits of the new requirements relative to the requirements they are replacing (i.e. focusing on whether the relative effect is positive, negative or neutral);

(c) the assessments look only at the likely effects on preparers and users, but not other parties, notably auditors;

(d) the assessments are based on the likely effect of the new requirements. The actual effects will not be known until the new requirements have been applied; and

(e) the assessments of the effect on the financial statements are descriptive rather than judgemental. The IASB makes clear that it cannot assess how a change in the disclosure or measurement requirements will affect individual entities.

35 The IASB further explains that its effect analyses also considered:

(a) the comparative advantage that preparers have in developing information, when compared to the costs that users would incur to develop surrogate information;

(b) the benefit of better economic-decision making as a result of improved financial reporting; and

(c) that there will also be economic effects, and, while these effects are expected to be beneficial to some entities, they are likely to be detrimental to others.

36 Overall, the IASB's assessment of the changes in the new standards is that:

(a) for preparers, preparation costs will be reduced, as preparers will be provided with clearer principles to follow. This will be the case regardless of whether the acquisition is a one-step 100 per cent acquisition or a partial or a step acquisition (although in a partial acquisition, the benefit of any reduced preparation costs will be mitigated if the acquirer measures NCI at fair value). In the IASB's view, the new requirements will not cause preparers to change their accounting systems. The IASB further states that many of the changes made to IFRS 3 and IAS 27 are designed to address areas for which practice is divergent, principally because IFRS does not deal with the issue. The IASB's assessment is that these changes will reduce preparation costs by providing preparers with clearer principles and added guidance in some areas of accounting for business combinations and subsequent accounting; and

(b) for users, some of the changes made to the existing standards have been made to address divergent practice and provide clarification on some areas of acquisition accounting, so the clarifications will improve the comparability of the information provided on business combinations. Furthermore, the new requirements will lead to significant improvements between IFRS and US.

EFRAG'S INITIAL ASSESSMENT OF THE COSTS AND BENEFITS OF IFRS 3R

Introduction

37 EFRAG considered whether, and if so to what extent, implementing IFRS 3R in the EU might involve preparers and users incurring year-one costs and incremental on-going costs, and whether those costs combined are likely to exceed the benefits to preparers and users of financial statements.

38 EFRAG considered the effects of all the changes made in IFRS 3R, compared to the existing IFRS 3. EFRAG also considered the consequences the revisions to IFRS 3 would have on other IFRSs and the amendments thereto.

39 In carried out this initial assessment, EFRAG recognised that it was likely that the level of the overall implementation costs and overall benefits of the new standards would vary and was likely to depend on factors such as:

(a) the terms and conditions of the business combination agreement;

(b) whether the parent acquires control in a one-step 100 percent acquisition of the acquiree or whether control was acquired in two or more steps;

(c) whether the acquisition is for less than 100 percent interest in the acquiree; and

(d) the level of in-house expertise available to assist with implementing the new requirements in year one and thereafter.

EFRAG tried to bear this in mind in its assessment.

40 As previously explained, EFRAG started its assessment by reviewing the effects study material that the IASB had prepared a. EFRAG's conclusion was that the IASB's effects analysis was a good piece of work that EFRAG could, and should, build on. However, EFRAG did not agree with all the IASB's assessments, nor did it agree with all the underlying rationale used to support some of those assessments.

41 EFRAG discussed the potential costs and benefits of implementing IFRS 3R at various EFRAG meetings up to and including the July 2008 meeting.

42 EFRAG based its initial assessment on the changes or amendments that it believed likely to be of most relevance to an assessment of the costs and benefits of implementing IFRS 3R. The main areas affected by those changes are:

(a) contingent consideration (Amendment 1);

(b) acquisition-related costs (Amendment 2);

(c) step acquisitions (ie where the acquirer needs more than one transaction to acquire a controlling interest) (Amendment 3);

(d) partial acquisitions (ie where less than 100 per cent of the acquiree is acquired) (Amendment 4);

(e) the definition of a business (Amendment 5);

(f) fair value as a measurement attribute (Amendment 6); and

(g) scope (Amendment 7).

Before considering those amendments, EFRAG has first carried out an initial assessment of the following more general aspects of implementing IFRS 3R:

(h) reading and understanding the revised requirements;

(i) additional disclosure requirements; and

(j) transitional requirements.

Summary of EFRAG's initial cost and benefit considerations on IFRS 3R

43 On the basis of its initial assessment, EFRAG tentatively reached the following individual initial conclusions on each of the amendments discussed in IFRS 3R.

(a) Reading and understanding the amendments—No significant cost or benefit implications are likely.

(b) Additional disclosure—Likely to provide benefits that exceed the costs involved.

(c) Transition requirements—Likely to result in some increased costs for preparers and users, but those costs are not likely to be significant.

(d) Amendment 1: Contingent consideration—While some preparers will incur additional costs as a result of this amendment, some – but not all users – will benefit from the changes. Overall, the costs and benefits will probably largely balance out.

(e) Amendment 2: Acquisition-related costs— For preparers, there will be no significant effect on preparation costs. For users, this amendment will have little or no cost implications. Overall, the amendment is unlikely to have significant cost or benefit implications.

(f) Amendment 3: Step acquisitions—The amendment is likely to result in a cost saving for preparers and benefits (but no costs) for users.

(g) Amendment 4: Partial acquisitions – acquisitions of less than 100 percent—This amendment will have no significant cost or benefit implications for preparers. For users, the initial assessment is that costs will exceed benefits. Overall, the amendment the initial assessment is that the costs of this amendment are likely to exceed the benefits.

(h) Amendment 5: Definition of a business—EFRAG did not reach an overall tentative conclusion reached when it published its initial assessment for public comment.

(i) Amendment 6: Fair value as a measurement attribute—The only impact these changes will have on preparers and users is that the cumulative effect of the increased use of fair value compared to the existing IFRS 3 could involve some preparers in additional year-one and on-going costs. However, these additional costs are unlikely to be significant. Overall, the initial assessment is that no significant cost or benefit implications are likely.

(j) Amendment 7: Scope—This amendment seems likely to involve some preparers in significant implementation costs, although the majority of companies are unlikely to be affected. For users, the incremental costs are likely to be insignificant. Users will though benefit from the increased comparability and better quality information. Overall, the benefits are likely to exceed the costs.

44 EFRAG tentatively concluded that Amendments 3, 4 and 5 were the main factors listed above that EFRAG needs to weigh in reaching its overall assessment of the revised standard. EFRAG believes that the net benefits arising from Amendment 3 exceed the net costs arising from Amendment 4. As previously explained, EFRAG had not yet reached a conclusion on Amendment 5, when it finalised its initial assessment.

45 EFRAG also thought that it needed to bear in mind that a key objective of revising the existing IFRS 3 was to ensure that the accounting for business combinations is the same whether an entity is applying IFRS or US GAAP. The accounting requirements in IFRS and US GAAP will now be substantially the same, with one key difference: the initial measurement of non-controlling interests. A range of other differences also remain, due to existing differences between other IFRSs and US GAAP. Nevertheless, the fact that IFRS and US GAAP will now be substantially the same will result in benefits for some users.

46 Therefore, EFRAG's overall initial assessment was that, on balance—and subject to EFRAG's final conclusion on Amendment 5—the benefits that are expected to arise from the implementation of IFRS 3R in the EU will exceed the costs expected to be incurred.

EFRAG'S INITIAL ASSESSMENT OF THE COSTS AND BENEFITS OF IAS 27A

Introduction

47 EFRAG has also considered whether, and if so to what extent, implementing IAS 27A in the EU might involve preparers and users incurring year-one costs and incremental on-going costs, and whether those costs in aggregate are likely to be exceeded by the benefits to be derived from implementing the Amendments in the EU.

48 EFRAG considered the effects of all the changes made to IAS 27A, compared to the existing IAS 27. EFRAG also considered the effects the changes to IAS 27 had on the consequential amendments to other IFRSs.

49 EFRAG based its initial assessment on the changes or amendments that it believed likely to be of most relevance to an assessment of the costs and benefits of implementing IAS 27A.

50 These main changes are:

(a) changes in ownership interest that do not result in control of another entity being lost (Amendment 1);

(b) changes in ownership interest that result in control of another entity being lost (Amendment 2); and

(c) accounting for losses attributable to non-controlling interest (NCI) (Amendment 3).

However, EFRAG started by carrying out an initial assessment of the following general aspects of implementing IAS 27A:

(d) reading and understanding the revised requirements; and

(e) transitional requirements.

Summary of EFRAG's initial cost and benefit considerations on IAS 27A

51 The individual initial conclusions reached by EFRAG on the above main amendments to IAS 27A are:

(a) Reading and understanding the Amendments—No significant cost or benefit implications are likely.

(b) Transition requirements to IAS 27A— No significant cost or benefit implications are likely.

(c) Amendment 1: Changes in ownership interest that do not result in control of another entity being lost—This amendment will impose no significant additional costs on preparers or users, but is likely to result in significant benefits for users.

(d) Amendment 2: Changes in ownership interest that result in control of another entity being lost —This amendment will not have significant incremental cost implications for preparers. Neither will the amendment involve users in significant incremental costs, because users can easily adjust out of earnings the gain resulting from the remeasurement of the retained interest if their analysis requires adjustments for such non-recurring items. However, the amendment will not result in any benefits to users mainly because the benefits of comparability are compromised by accounting that EFRAG believes is inappropriate. Overall, the amendment is likely to result in only insignificant additional costs. However, it will not result in any net benefits for users.

(e) Amendment 3: Accounting for losses attributable to NCI—The benefits arising from this amendment are likely to exceed the costs. However, overall no significant cost or benefit implications are likely.

52 In other words, the only Amendment that is likely to have a significant effect is Amendment 1, which is expected to result in significant benefits for users.

53 Therefore, EFRAG's overall initial assessment is that the benefits (that are expected to arise from implementing IAS 27A in the EU will exceed the costs expected to be incurred to implement IAS 27A.

STAKEHOLDERS VIEWS ON EFRAG'S INITIAL ASSESSMENT OF IFRS 3R AND IAS 27A

Public consultation on EFRAG's Invitation to Comment on costs and benefits

54 EFRAG published its initial assessment of the costs and benefits of implementing IFRS 3R and IAS 27A in the EU and supporting analysis (the Invitation to Comment) on 30 July 2008. It invited comments on the material by 19 September 2008.

55 The responses received can be summarised as follows:

(a) All but one of those commenting on EFRAG's assessment of costs and benefits agreed with EFRAG's assessment of the costs and benefits involved for users and preparers in implementing the two new standards in the EU. Those respondents also agreed with EFRAG that the benefits to be derived from the application of the new standards was likely to exceed the costs involved.

(b) One respondent did not fully agree with EFRAG's initial assessment on the costs and benefits. In particular, this respondent disagreed with EFRAG's initial conclusions on Amendment 3 – step acquisitions, mainly because it believes that fair valuing the pre-existing investment in a step acquisition does not produce information that is useful to users of financial statements. It also thought that in any case users were likely to adjust the figures and incur costs to do this. As a result, this respondent thinks that the overall cost savings for preparers associated with the easier accounting for step acquisitions would depend on the circumstances of each transaction.

Direct, private consultation with preparer-companies

Introduction

56 EFRAG consulted directly with a selected number of preparers, and requested their input by mid August 2008.

57 The consultation was done via a questionnaire that asked preparer-companies about the effects of the main changes made to existing IFRSs. In addition, companies were asked for input on the likely effects of the changes to IFRS 3R on the accounting for the "classification, designation, recognition and measurement of identifiable assets and liabilities acquired". Companies were asked for input on the combined effect of implementing 'IFRS 3R and IAS 27A as a single package'.

58 The questions put forward to preparer-companies focused mainly on the likely costs and benefits *relative* to the requirements they are replacing. This approach is similar to the one used by the IASB when it carried out its cost-benefit assessment, and similar to the approach EFRAG followed in its own initial assessment analysis.

59 EFRAG received feedback from 20 companies based in Germany, France, the United Kingdom, Denmark, Poland, Belgium and Italy that operate in various industry sectors, including telecommunications, technology, banking, energy, food & beverages and pharmaceuticals. For reasons of confidentially, the names of the companies cannot be disclosed.

60 All 20 companies completed a questionnaire, which they submitted to EFRAG. In some cases, EFRAG staff held direct face-to-face interviews with the preparer-companies, and in other cases, the companies completed the questionnaire themselves and forwarded it to EFRAG staff. In some of the latter cases, a follow-up discussion by email or conference call took place to clarify certain aspects of the questions asked.

Summary of input

61 In the main, the input provided by the direct consultation with preparers was generally consistent with EFRAG's initial assessment of the costs and benefits for preparers. However, on some issues the consultation provided additional insights on matters for which EFRAG had not reached a conclusive decision; and, on other matters, the findings brought to light new observations on the likely effects on preparers.

62 The input provided by preparers on the overall effect of implementing the new standards can be summarised as follows:

(a) Approximately half indicated that the new standards are unlikely to have major net cost effects. These companies seemed to place greater weight on the beneficial effects of the simplifications provided in the new standards; compared to the potential increase in costs associated with the likely increase in valuation work required by some of the new requirements.

(b) A small minority noted that they were unable to comment on the overall cost-benefit impact without further analysis.

(c) The remaining participants in this part of the consultation observed that they did not expect the costs associated with the new standards to be lower than under the existing standards. However, the indication was that the overall likely increase in preparation costs would not be significant.

(d) Overall, preparers identified the following amendments to IFRS 3R and IAS 27A as likely to result in some additional costs:

(i) The increase in the use of fair value to account for transactions involving contingent consideration, step acquisitions and loss of control in subsidiaries will involve the companies with more costs. More use of fair value will increase the need for external valuation advice and is likely to increase the level of scrutiny of fair values by auditors, both externally and in-house. A further challenge is how to determine the control premium arising in a partial acquisition, which needs to be excluded from the fair valuing of the pre-existing investment. A similar concern was noted with regards to the accounting for the retained investment on loss of control of a subsidiary.

(ii) The increase in complexity associated with the requirement to re-assess assets and liabilities acquired in a business combination, in particular contractual arrangements and derivative instruments. This will involve an increase in in-house man-hours, and potentially increase the involvement of external valuation professionals. The extent of the work is likely to depend on what information can be obtained from the acquiree company. The costs involved can therefore vary.

(iii) The accounting for the replacement of share-based payment awards (pertaining to the acquired company) appears more complex and requires a higher level of precision than under IFRS 3. The accounting is likely to result in an increase in complexity in the valuation process.

(iv) The change to the definition of a business may result in more transactions being accounted for as business combinations.

63 Of the above overall concerns expressed by companies, (d)(i) was the most widely noted. These observations are in line with EFRAG's initial assessment. Some companies mentioned the difficulty involved in determining some of the fair values. However, it is not always clear from the responses whether 'being difficult' to do also means being costly to do. This is because some of the companies noted that they are likely to use in-house valuation expertise, rather than the more costly external advice.

64 The concerns in (ii) and (iii) were expressed by only a few companies. Regarding (ii), companies expressed different views. While some companies expressed concern with the potential additional (and sometimes significant) costs, other companies indicated that clear guidance in IFRS 3R was helpful. EFRAG noted that some companies might be faced with additional costs. This was particularly so for business combinations that involve a variety of contracts including derivative contracts, in which case companies would need to undertake a reassessment exercise of the various contracts acquired. On the other hand, this sort of analysis required under IFRS 3R is generally performed during the due diligence process. For this reason, EFRAG saw no reason to consider this change a significant one. EFRAG also believes that on balance this change to IFRS 3 is unlikely to have significant cost/benefit implications to preparers and users, and for this reason as not discussed this amendment in detail in this report.

65 Finally, (iv) was considered the least problematic, with only one company specifically mentioning this area of accounting as a significant cost concern.

66 In relation to the effects on systems and processes, the overall indication is that there appears to be very little modification required to systems and processes to implement the new requirements. Preparers generally said that the existing systems used by their company's would provide the information required under the new standards, or if changes were required, they would be only 'minor enhancements'.

67 A few preparers specifically noted (either in the overall conclusion or in the individual questions) that the costs involved with implementing the new requirements were likely to be compensated by the benefits of having clearer and simpler requirements in the new standards. Clear accounting principles were noted on the accounting for:

(a) consideration in the form of 'replacement' awards

(b) step acquisitions

(c) re-assessment of assets and liabilities; and

(d) changes in interest (with no loss of control).

68 Half of the preparers mentioned that the accounting for step acquisitions would reduce costs. Other preparers mentioned that they would be unaffected by the benefits of having simpler accounting requirements (for example step acquisition accounting) as these were areas that did not affect their business combinations.

Direct, private consultation with users

Introduction

69 As previously explained, when EFRAG discussed the initial assessment of the effects the new standards, it decided it would be necessary to carry out additional effects study work on costs and benefits of the new standards, by consulting directly with users of financial statements.

70 EFRAG staff approached various European users/user organisations and invited them to take part in this private consultation. Users were asked to complete a questionnaire and remit it to EFRAG staff.

71 EFRAG staff received feedback from 4 user/user organisations. Two users are from Germany, one from the United Kingdom and one from a Ukrainian user organisation.

72 Similar to the approach taken when addressing the cost/benefit effects of the new standards on preparers, the questions asked to users focused on the main changes to existing IFRSs and on 'comparing' the likely costs and benefits *relative* to the requirements they are replacing.

73 EFRAG also discussed aspects of the new standards and of its assessments with the EFRAG User Panel.

Summary of input

74 Overall, the input gathered from users was broadly in line with EFRAG's initial assessment on users. Specifically:

(a) Users generally indicated that that the benefits to be achieved from having information on business combinations under IFRS 3R and IAS 27A will be higher than the benefits of information under IFRS 3 and IAS 27A.

(b) Most of the users consulted believe that the incremental costs to users associated with implementing IFRS 3R and IAS 27A are likely to be insignificant. One user said that it was unable to respond to this question.

(c) Users did not raise costs concerns on any of the main changes made to the existing standards.

75 For some of the amendments, some users indicated that the benefits to be achieved are likely to be more significant than initially assessed by EFRAG, because the information would be more relevant and more comparable. This was particularly the case in respect to the accounting for step acquisitions (under IFRS 3R) and loss of control of a subsidiary (under IAS 27A).

EFRAG'S FINAL ASSESSMENTS OF THE COSTS AND BENEFITS OF IMPLEMENTING IFRS 3R

76 EFRAG's detailed final assessment of the costs and benefits of IFRS 3R and IAS 27A is presented in the sections below. In developing its final analysis EFRAG has considered:

(a) the input provided by stakeholders on the invitation to comment on its initial assessment,

(b) the information obtained directly from preparer-companies who are assessing the effects of implementing the new standards, and

(c) the discussions and direct consultations EFRAG had with users of financial statements regarding the effects to users of the changes to the new standards

77 A summary of the input provided by stakeholders on (a) – (c) has been discussed in the paragraphs above.

78 Similar to its initial assessment, EFRAG based its final assessment on the main changes or amendments that it believed likely to be of most relevance to an assessment of the costs and benefits of implementing IAS 27A.

Reading and understanding the amendments

Costs and benefits for preparers and users

79 Whenever accounting requirements change, preparers and users need to read and understand the new requirements and this will inevitably involve an incremental year-one cost. In the case of IFRS 3R:

(a) Preparers will need to assess the impact the changes will have on the consolidated financial statements in year-one and thereafter. For example, they will need to understand:

(i) the subsequent accounting and its implications for assets and liabilities recognised in a business combination that result in changes in their fair value being recognised in profit and loss; and

(ii) the implications of the transaction-by-transaction 'free-choice' measurement option on how to initially measure non-controlling interests (NCI) and how that choice will affect the acquisition of all (or some) of the remaining NCI.

(b) Preparers will need to understand the implications of applying the new requirements prospectively to business combinations accounted for in accordance with IFRS 3R, while applying the requirements in existing IFRS 3 to business combinations undertaken before the transition to IFRS 3R.

(c) Preparers will need to assess the impact the changes will have on the planning and the process associated with the business combinations and on communication with stakeholders and personnel from the investor-relationship department.

(d) Users will need to understand why the numbers in the financial statements are different and what this means when performing their analysis and comparing year-to-year figures. Users will also need to consider the effects of the changes on ratios; for example the entity's return-on-capital might be affected because of the change in the basis of the calculation.

80 For certain types of business combinations, the implications of the changes that will result from IFRS 3R are relatively easy to understand. However, for certain other types, the changes resulting from IFRS 3R will have a significant effect on the concepts underlying the reported numbers; in these cases the learning exercise will be greater—and indeed greater than is the case for many new and revised standards and interpretations.

Conclusion

81 Nevertheless, EFRAG's assessment overall is that there are not likely to be any significant costs involved for preparers or users in reading and understanding IFRS 3R.

Additional disclosures

Costs and benefits for preparers and users

82 IFRS 3R requires preparers to provide additional disclosures compared to IFRS 3, mainly to support the changes made to existing IFRS 3 and to provide users with information on the effects of those changes in year-one and thereafter.

83 Some of the additional disclosure requirements will involve an increase in year-one and on-going costs for preparers as they have to gather the required information for the first time on the date of the acquisition and thereafter. However, EFRAG's understanding is that generally all or some of the information will be readily available within the entity and that, as a result, the incremental costs involved are likely to be insignificant. Furthermore, the additional disclosures will result in additional on-going publication costs, although in EFRAG's view that cost is likely to also be insignificant.

84 EFRAG also considered the effects of the additional disclosure on users of financial statements. EFRAG's view is that the disclosures are likely to provide useful explanations on the information reported on business combinations.

Conclusion

85 EFRAG's assessment overall is that the benefits arising from these disclosure requirements are likely to exceed the insignificant costs that are likely to be involved.

Transition requirements

Costs and benefits for preparers and users

86 The requirements in IFRS 3R are to be applied prospectively for annual periods beginning on or after 1 July 2009. Earlier application is permitted, but only for periods beginning on or after 30 June 2007. This means that the carrying amounts of assets and liabilities that arose under business combinations prior to the application of IFRS 3R will not be adjusted. It also means that, except for the

accounting for deferred tax benefits of the acquire and when the combination involves mutual entities or a contract alone combination, transactions occurring before the application of IFRS 3R will continue to be accounted for under IFRS 3. For instance, changes in the amount recognised for contingent consideration will continue to be accounted for as an adjustment to goodwill.

87 Because the transition to IFRS 3R is to be done prospectively, EFRAG's assessment is that the transition itself will not result in incremental costs to preparers. However, preparers will have to track those transactions that relate to business combinations undertaken under IFRS 3 separately from those undertaken under IFRS 3R. Preparers are already tracking which business combinations were previously accounted for under IFRS 1 (when IFRS was adopted for the first time) and which were recorded under IFRS 3, so IFRS 3R will be adding a third method of accounting for business combinations, which would also need to be tracked in order to account for business combinations post acquisition date. Maintaining systems to monitor and track such transactions will result in some incremental ongoing costs for preparers.

88 The lack of comparability arising from prospective application of IFRS 3R will also increase costs to users.

89 EFRAG's overall assessment is that these incremental costs to preparers and users are unlikely to be significant.

Amendment 1: Contingent consideration

Costs and benefits to preparers

90 IFRS 3R clarifies that an acquirer is required to account for contingent consideration separately from compensation for future services which, similar to the accounting for other future services, is recognised in profit and loss if and when incurred. As a result, preparers will henceforth need to evaluate the agreements with the selling shareholders to identify which arrangements involve additional payments comprise "genuine" contingent consideration and which involve compensation for future services. EFRAG's assessment is that the incremental cost involved will be insignificant.

91 In addition, IFRS 3R requires contingent consideration to be recognised at fair value at the date of the acquisition, rather than including contingent consideration in the cost of a business combination at the acquisition date if the additional payment or refund is probable and can be measured reliably. IFRS 3R requires contingent consideration to be classified as either a liability or as equity. It also provides specific guidance on how to subsequently measure the contingent consideration, and states that after initial recognition, an obligation for contingent consideration that is classified as a liability is required to be remeasured, with changes in the fair value being recognised in profit and loss. In line with the guidance in existing IFRS, if the obligation is classified as equity, remeasurement is not required.

92 In its assessment of this new requirement, IASB indicated that this change is likely to result in significantly more contingent consideration arrangements being recognised at the date of the acquisition. Such arrangements would need to be recognised at fair value and thus would involve preparers with increased preparation costs.

93 EFRAG believes that, as a result of this change, preparers are likely to have to:

(a) modify their accounting systems to allow for different inputs of information needed to comply with the new requirements;

(b) modify their accounting systems so that, to the extent that contingent consideration has been classified as a liability, changes in the liability will be identified and recognised in profit and loss; and

(c) engage additional valuation experts (perhaps external consultants) and seek professional advice.

94 Generally, any change to accounting is likely to be more costly to implement if implementation requires systems' changes. As mentioned above, this change to IFRS 3 is likely to involve some form of system changes in year-one. In addition, preparers are likely to seek additional expert advice to assist them with determining an estimate of the fair value of the contingent consideration. The effects of these two changes are likely to involve preparers with additional, not insignificant, costs.

Costs and benefits for users

95 The IASB assessed the effect of this change to be positive for users. In its view:

(a) The information should be more comparable because all contingent consideration arrangements will be accounted for in the same way.

(b) Analysis costs are likely to be lower as a result of the change, mainly because of the increased disclosure requirements. It will also be easier to monitor the settlement of these arrangements.

(c) The IASB noted that users "have told us that they are concerned that acquirers will have an incentive to overstate the liability. By doing so the acquirer is able to recognise a gain associated with a reduced obligation if the combined entity does not perform as well as expected. Therefore, the users are more sceptical about whether the information will be more useful." The IASB nevertheless concluded that the information resulting from this new requirement will be more useful because it provides a better measure of the consideration for which the acquirer is liable and also ensures that the accounting for the business combination is more complete at the acquisition date.

96 EFRAG's assessment is that the IASB is right to point to the enhanced comparability, improved measurement of the consideration given, increased disclosures, and greater accountability. These are all likely to result in information provided on contingent consideration being more complete, understandable and easier to monitor, resulting in an improvement in the information provided and thus benefit users. For some users, this benefit might be significant.

97 On the other hand, EFRAG's assessment is also that:

(a) the concern raised by users (and referred to in paragraph 103 (c) above) is a valid concern and could have an effect on the benefits that would otherwise arise; and

(b) the need to use assumptions and estimates to determine the fair value of the liability for the additional consideration might have an effect on the comparability of the information provided on contingent consideration.

98 As a result, EFRAG is not convinced that the effect on some users would always be positive. EFRAG understands that users are likely to pay special attention to the information produced on contingent consideration, particularly when the amounts are significant. The added scrutiny might involve some users with added costs. On the other hand, it will mitigate the concern in (c) above (or some of the concern).

Conclusion

99 EFRAG's assessment is therefore that, while some preparers will incur additional costs as a result of these changes, some—but not all users—will benefit from the changes. Overall, EFRAG's assessment is that these costs and benefits probably largely balance out.

Amendment 2: Acquisition-related costs

Costs and benefits to preparers

100 IFRS 3R requires all acquisition-related costs, other than costs to issue debt or equity instruments, to be recognised as expenses at the date of the acquisition, rather than included in the cost of the acquisition as is required at present.

101 The IASB's assessment was that this change would have no impact on preparation costs. That was also EFRAG's final assessment.

Costs and benefits to users

102 The IASB assessed this change to have a neutral effect on users. It explained its reasoning as follows:

"(a) users tell us that if they are using an earnings-based model to value the entity they will adjust these costs out of earnings. We are told that the marginal cost of making that adjustment is low because analysts and investors are already reviewing the financial statements and making other adjustments.

(b) there is no effect on the comparability of the information because the accounting for acquisition costs appears to be consistent.

(c) some users tell us that they prefer these costs to be recognised as an expense and disclosed. They think that this is preferable to including these costs in goodwill. Others tell us that they are indifferent because they do not pay much attention to either goodwill or acquisition costs."

103 EFRAG understands that some users want these costs to be capitalised, and some do not; and, if the costs are expensed, generally users will adjust them out of earnings because they are one-off costs.

Conclusion

104 EFRAG's assessment is that for preparers, there will be no significant effect on preparation costs. For users, this change will have little or no cost or benefit implications for users. Overall, EFRAG's assessment is that the amendment will not have any significant cost or benefit implications.

Amendment 3: Step acquisitions

Costs and benefits to preparers

105 IFRS 3R removes the requirement to measure each asset and liability acquired in a step acquisition separately. Instead, goodwill is measured only once—at the date control is achieved. In addition, the difference between the carrying amount of the previously held investment and its fair value is recognised in profit and loss.

106 The IASB assessed the new accounting for step acquisitions to be positive for preparers, on the basis that preparation costs will be reduced significantly.

107 EFRAG agrees that this change will indeed simplify the accounting treatment of step acquisitions in the way the IASB described, and therefore reduce the costs incurred by preparers in accounting for such acquisitions.

108 On the other hand, the change will require an additional valuation (of the previously held investment) at the time the acquirer obtains control of the acquiree, which will involve preparers with additional costs to estimate the fair value of the previously held interest. The challenges faced by preparers to determine the fair value of the pre-existing investment will vary. EFRAG understands that one of the more challenging tasks that some preparers might be faced with when determining the fair value of the pre-existing investment, is determining the value for the control premium for the acquired entity, which needs to excluded from the fair value of the non-controlling investment previously held. Some preparers are likely to involve valuation experts to assist them with producing the information under this amendment, thus incur additional costs.

109 EFRAG understands that some preparers will value the entire equity interest when they achieve control of an entity. Consequently, some preparers might already determine a 'fair' value for the pre-existing investment under existing IFRS 3, or will be able to obtain this information without incurring undue cost and effort.

110 Furthermore, EFRAG's understands that step acquisitions do not occur very frequently, and when they do occur the amounts involved are sometimes insignificant.

111 EFRAG's assessment is that the accounting for step acquisitions will, on balance, result in a cost saving for preparers. Depending on how entities undertake their step acquisitions, for some preparers this cost saving is likely to be significant.

Costs and benefits to users

112 The IASB assessed that users would also benefit from this change in accounting, mainly because the change is likely to enhance comparability and usefulness of financial information, with no significant additional costs for users.

113 EFRAG agrees that this change will result in increased comparability. Some users have indicated that they believe that comparability will increase significantly. The indication is also that for some users the information provided is more useful and relevant than the information in existing IFRS 3, mainly because of the way goodwill in a step acquisition is determined.

114 However, it is also EFRAG's_understanding is that only some users think the information will be improved for other reasons too. Some users view the gain that would be recognised on the pre-existing holding as 'theoretical' and of little informational value. In addition, some users might be concerned with the impact the option on measuring NCI initially will have on goodwill, and thus dilute some of the potential benefits of having a more consistent way of determining goodwill in a step acquisition.

115 IFRS 3R requires the gain recognised on the previously held investment to be disclosed. In the view of some users, because of the added disclosure there would be no additional costs to carry out the adjustment to earnings. This is mainly because users already adjust out of earnings other types of one-off gains, thus the cost of adjusting this gain is likely to be marginal.

116 EFRAG's assessment is therefore that the new requirements will bring some added benefits to most users (primarily in the form of improved comparability and increase in usefulness of information) and will involve no incremental costs for users.

Overall conclusion

117 EFRAG's assessment is that the revisions to the accounting treatment of step acquisitions will result in a cost saving for preparers and benefits (but no costs) for users.

Amendment 4: Partial acquisitions

Costs and benefits to preparers

118 For a business combination in which the acquirer achieves control without buying all of the equity interest in the acquiree, IFRS 3R requires the remaining equity interests (the non-controlling interests (NCI)) to be measured either at fair value or at the non-controlling interests' proportionate share of the acquiree's net identifiable assets. This measurement option is available on a transaction-by-transaction basis. Under existing IFRS 3, only the proportionate interest approach is permitted. In effect, IFRS 3R now permits goodwill to be recognised at a 'grossed-up' or at a 'full goodwill' value.

119 The IASB assessed the effect of adding this option to IFRS 3 as being neutral, mainly because it is an option: entities can choose not to change the measurement approach they use at present.

120 Presently, entities that chose to measure NCI at the acquisition date using the proportionate interest method are required to determine the 'full' amount of goodwill (by grossing up the goodwill allocated to a particular cash-generating unit that is not wholly owned) when performing an impairment test on goodwill. Only one amount for goodwill needs to be determined if an entity chooses to measure NCI initially at fair value, as the goodwill is already recognised at a 'grossed-up' value. However, EFRAG's assessment is that this potential increase in ongoing costs for those

entities that choose to continue using the proportionate method to measure NCI is not likely to be significant.

121 On the other hand, entities that elect to measure NCI at fair value are likely to incur additional valuation costs in order to estimate the fair value of NCI. In EFRAG's view, the costs to preparers associated with measuring NCI at fair value will vary. However, in most cases EFRAG's view is that it is unlikely that those costs will be significant because the fair value of NCI can be determined using available market information. If market information for measuring NCI is not readily available or is costly to obtain, preparers are likely to choose not to measure NCI at fair value.

122 Measuring NCI at fair value at the acquisition date, compared to using the proportionate approach, will also imply that:

(a) goodwill recognised in the consolidated financial statements will be higher; and

(b) the acquisition of all (or some) of the NCI will result in smaller reduction in the equity of the group.

123 EFRAG also notes that, because there is a choice to be made, preparers may incur costs in deciding which option to choose for each of the business combinations undertaken. This will be particularly so if they wish to consider the implications described above on a transaction-by-transaction basis. The free measurement choice might involve preparers with some increased costs if they decide not to apply a consistent accounting policy on how to measure NCI for all their business combinations. This is because preparers will be required to monitor the different measurement bases used for each business combination in case they acquire some (or all) of the NCI at a future date. This is likely to involve preparers in added costs.

124 However, in EFRAG's view preparers are already required to monitor individual business combinations acquired in prior years in order to address matters such as impairment of goodwill and monitor the changes, if any, to contingent consideration and deferred tax benefits associated with those business combinations.

125 In EFRAG's view, the option in IFRS 3R on how to measure NCI initially allow preparers the choice of whether they would like prefer to change their accounting policy or not, or simply use the free choice on a transaction-by-transaction basis. In other words, preparers have the opportunity to evaluate whether they want to incur additional costs. As a result EFRAG believes that preparers will ensure that the benefits to be derived from the choice they make, are greater than the associated costs. This will apply to business combinations accounted for IFRS 3R. However, it will not apply necessarily apply to those business combinations accounted for under existing IFRS 3, as IFRS 3R does not permit previous business combinations to be restated.

126 For the reasons cited above, EFRAG's assessment is that the new requirement will involve those preparers that choose to fair value NCI at the date of the acquisition in some year-one and on-going costs. Preparers might also be faced with some costs resulting from having to decide which option is more suitable for each business combination undertaken. On the other hand, they will no longer have to determine two goodwill amounts when testing for impairment, if the cash-generating unit to which the goodwill is allocated, is not wholly owned.

127 EFRAG's assessment is that taken together these costs are unlikely to be significant.

Costs and benefits to users

128 The IASB assessed the introduction of an option as having a negative effect on users, because it would reduce comparability. In the IASB's view, a mitigating factor is that it is relatively easy for users to adjust an NCI measured at fair value so that it is measured on the proportionate method. It is however not so easy (and is more costly) to adjust an NCI measured on the proportionate method so that it is measured at fair value.

129 On the other hand, the IASB noted that in some cases users will benefit from having information on NCI at fair value at the date of the acquisition. The IASB's understanding is that many analysts value the whole entity and then deduct their estimate of the fair value of the NCI to obtain the value of the parent's share. The cost of that estimate is likely to be reduced for entities that elect to measure NCI at fair value.

130 Comparability of information is unlikely to be affected by the option should preparers continue to use the proportionate method to measure NCI initially. However, in EFRAG's view the introduction of a free choice on a transaction-by-transaction basis will reduce comparability and will thus involve additional costs for users. There will be some benefits for some users in certain situations in introducing the option to fair value NCI—for other users and in other circumstances there may be little if any benefit. EFRAG's assessment however, is that those benefits will probably not exceed the incremental cost arising from the reduction in comparability. The increase in incremental costs will vary depending on whether preparers select a consistent accounting policy or opt to use the 'free-choice' on how to measure NCI.

Conclusion

131 Thus it seems that these amendments will have no significant cost or benefit implications for preparers. For users, the assessment is that costs will exceed benefits. Therefore, EFRAG's overall assessment is that the costs of this amendment exceed the benefits.

Amendment 5: Definition of a business

Costs and benefits for preparers

132 The definition of a business has been amended to clarify that it can include an integrated set of activities and assets that is capable of being operated as a business; IFRS 3 refers to the elements of a business as "being conducted and managed". Additional guidance in IFRS 3R makes it clear that "a business need not include all of the inputs or processes…if market participants are capable of acquiring the business and continuing to produce outputs, for example, by integrating the business with their own inputs and processes".

133 In its Effect Analysis, the IASB did not specifically comment on the effects of the change to the definition of a business.

134 Some members believe the language used in IFRS 3R meant that the boundary between acquisition of businesses and acquisition of assets is unclear; and this

might lead to difficulties in interpreting whether a transaction involves a business as defined in IFRS 3R. In addition, it is likely to increase the amount of judgement applied by preparers to determine when a transaction is a business combination as defined by IFRS 3R, and when it is not. This uncertainty is likely to involve some additional costs for preparers. For similar reasons, these EFRAG members were not convinced that the additional guidance provided in IFRS 3R on what comprises a business would benefit preparers particularly.

135 However, these EFRAG members also understand that this change will only affect a limited number of companies. These companies are likely to incur some additional costs. One EFRAG member pointed out that EFRAG might want to bring to the attention of the IASB or the IFRIC, the issue relating to the 'unclear boundary'.

136 Furthermore, some EFRAG members were concerned that the consequence of the broader definition might be that some transactions that were previously considered asset transactions in IFRS 3 might need to be accounted for as business combinations in accordance with IFRS 3R. In other words, the change might have the effect of extending the scope of the standard. In some cases it might be that the potential broadening of the scope might go beyond what the IASB intended when it issued IFRS 3R. The costs for preparers of an extension in the scope of the standard are discussed later.

137 Overall, the majority of EFRAG members did not believe the cost implications associated with the change in the change in the definition of a business, were a significant issue, mainly because only a limited number of companies are likely to be affected by this amendment.

Costs and benefits for users

138 Some EFRAG members believe that some users will benefit from this new requirement, at no additional cost to them. The benefits arise mainly because of the enhanced comparability that will arise from the amendment. Other EFRAG members do not, mainly because of the reasons explained above in relation to preparers. However, these EFRAG members also think that the majority of companies are not involved in asset transactions or that such transactions were fairly insignificant.

Conclusion

139 On balance, EFRAG believes that this amendment is unlikely to involve preparers and users with any significant implications on costs and benefits.

Amendment 6: Fair value as a measurement attribute

Costs and benefits for preparers

140 There are two separate amendments to consider under this heading.

(a) Amendment 6A: the removal of the application guidance on fair value—IFRS 3R retains the definition of fair value that is currently used in existing IFRS 3, but omits the application guidance included in B16 of IFRS 3. IFRS 3R also adds guidance to the way some assets and liabilities ought to be classified and designated at the date of the acquisition. It clarifies that an acquirer must consider the terms and conditions relating to assets and liabilities that existed on the date of the acquisition, in respect to the initial classification and designation.

(b) Amendment 6B: IFRS 3R requires more use of fair value than IFRS 3—As explained above in Amendments 1, 3, and 4 (contingent consideration, step acquisitions and partial acquisitions), in some cases IFRS 3R requires greater use of fair value for certain aspects on accounting for business combinations. In other cases, such as the accounting for some aspects of step acquisitions (issue 6), the use of fair value will be reduced.

141 In its Effect Analysis, the IASB states that the changes will only affect contingent consideration and step acquisitions. It further explains that whether an entity will need to make additional, or fewer, fair value measurements will depend on the circumstances of the acquisition and provides some examples to this effect.

142 EFRAG believes that Amendment 6A will involve preparers in additional costs, mainly because preparers are likely now:

(a) to spend more time researching other IFRSs or other GAAPs (like US GAAP) to determine how to apply fair value to the components of the business combination; and/or

(b) to engage valuations experts to provide them with guidance on how to value all (or some) assets and liabilities acquired.

However, EFRAG's assessment is that these costs will be insignificant.

143 EFRAG has already assessed each of the changes referred to in Amendment 6B elsewhere in this assessment. Therefore, to avoid double-counting, the assessment made under this heading should relate only to the cumulative effect of the change. EFRAG members have different views on this cumulative effect. Some believe that it results in no particular benefits or costs for preparers. Others however believe that it increases disproportionately the risk involved in preparing the business combination numbers and will therefore result in additional costs as preparers (and their auditors) seek to manage that additional risk.

144 EFRAG's assessment is that the elimination of the guidance in B16 of existing IFRS 3 will not involve preparers in significant additional costs, but that the cumulative effect of the increased use of fair value compared to the existing IFRS 3 could involve some preparers in additional year-one and on-going costs. EFRAG's assessment however is that these additional costs are unlikely to be significant.

Costs and benefits for users

145 In its Effect Analysis, the IASB did not specifically comment on the effects that the increase in the use of fair value or the removal of application guidance on fair value would have on users.

146 When guidance is eliminated, it is always possible that it will result in diversity of practice. EFRAG's assessment, however, is that it is unlikely that significant diversity will arise on the issues that were addressed in the omitted. EFRAG also understands that one of the areas of particular concern to many users is the area on valuing intangibles at fair value, particularly regarding the seemingly arbitrary allocation of value between different intangible assets. This issue was not covered in the omitted guidance.

147 EFRAG's assessment is therefore that users are unlikely to be affected to any significant degree by this change.

Overall conclusion

148 Therefore, to summarise, EFRAG's assessment is that the only impact these changes will have on preparers and users is that the cumulative effect of the increased use of fair value compared to the existing IFRS 3 could involve some preparers in additional year-one and on-going costs. However, these additional costs are unlikely to be significant.

Amendment 7: Scope

Costs and benefits for preparers

149 The scope of IFRS 3R has been extended to include business combinations involving mutual entities and cooperative entities and those combinations achieved by contract alone without obtaining an ownership interest.

150 Presently, business combinations involving two or more mutual entities and business combinations achieved by contract alone are not within the scope of IFRS 3; and no other IFRS provides guidance on how to account for the transactions. As a result, these types of combinations are accounted for in different ways. For example, EFRAG understands that currently, while some combinations of mutual entities and those entities combining by contract alone are accounted for in accordance with the acquisition method (as required in existing IFRS 3). Others are accounted for applying the pooling of interests method using the carrying amounts of the assets and liabilities of the combining entities (both acquirer and acquiree).

151 In its Effect Analysis the IASB noted that for those entities that were outside of the scope of IFRS 3, the application of the acquisition method for business combinations is likely to result in a significant change in accounting, because many mutual entities and those entities entering 'by contract alone' have been applying the pooling of interests method. Those entities are likely to be faced with significantly higher preparation costs when they implement IFRS 3R.

152 EFRAG agrees that, depending on what accounting has been used in the past to account for business combinations, this change could involve some preparers in significant changes in practice and, as a result, could involve significant implementation costs. However, EFRAG is of the view that the majority of entities would not be affected.

Costs and benefits for users

153 The IASB assessed this new requirement to have a positive effect on users, mainly because users will benefit from a reduction in the costs of monitoring different accounting and because the new requirement will result in a significant increase in comparability of financial information relating to business combinations involving mutual entities. The extended scope would require all new business combinations, except for common control transactions and newly formed joint ventures, to be accounted for in the same way.

154 That is EFRAG's assessment too; the incremental costs for users are likely to be insignificant and in any case users are likely to obtain some benefits from the new requirement.

Conclusion

155 Therefore, this new requirement seems likely to involve some preparers in significant implementation costs, although the majority of companies are unlikely to be affected. On the other hand, for users the incremental costs are likely to be insignificant. Users will though benefit from increased comparability and better quality information. Overall, EFRAG's assessment is that these benefits are likely to exceed the costs.

EFRAG'S FINAL ANALYSIS OF THE COSTS AND BENEFITS OF IMPLEMENTING IAS 27A

156 EFRAG's detailed final assessment of the costs and benefits of IFRS 3R and IAS 27A is presented in the sections below. In developing its final analysis EFRAG has considered:

(a) the input provided by stakeholders on its initial assessment,

(b) the information obtained from preparers who are assessing the effects of implementing the new standards, and

(c) the discussions EFRAG had with users of financial statements regarding the effects to users of the changes to the new standards

157 A summary of the input provided by stakeholders on (a) – (c) is included in section 7 of this report.

158 Similar to its initial assessment, EFRAG based its final assessment on the main changes or amendments that it believed likely to be of most relevance to an assessment of the costs and benefits of implementing IAS 27A.

Reading and understanding the Amendments

Costs and benefits for preparers and users

159 Whenever accounting requirements change, preparers and users need to read and understand the new requirements and this will inevitably involve incremental year one cost. In this case, preparers will need to assess the impact the changes would have on the financial statements and, in particular, on the entity's equity should an entity decide to acquire some (or all) of the non-controlling interests (NCI), and how to counteract the effects that transactions with NCI might have on the entity's equity as well as the consequences thereof. Users will need to understand the underlying rationale that has lead to changes in equity in order to perform their analysis of the numbers reported in the financial statements.

160 EFRAG's assessment is that these incremental year-one costs to read and understand the amendments will not be significant to preparers or to users.

Transition requirements

Costs and benefits for preparers and users

161 The main changes in IAS 27A are all required to be applied prospectively for annual periods beginning on or after 1 July 2009. Early adoption is permitted if IFRS 3R is adopted at the same time and the main changes are applied to reporting periods beginning prior to 30 June 2007. As a result, EFRAG's assessment is that the transition requirements will not result in additional costs to preparers. On the other hand, the lack of comparability that arises from prospective application is likely to result in users incurring additional on-going cost, although EFRAG's assessment is that the incremental cost involved is not likely to be significant.

Amendment 1: Changes in ownership interest that do not result in control of another entity being lost

Costs and benefits for preparers

162 IAS 27A requires preparers to account for transactions with NCI involving acquisitions and disposals of interest in a subsidiary entity without loss of control as equity transactions. No further goodwill will be recognised when a NCI is purchased. Neither will goodwill be derecognised when a NCI is disposed of, and control is not lost.

163 Existing IAS 27 is silent on how these transactions are accounted for. This means that there currently is a divergence of practice, and that some entities will need to change the way they account for such transactions.

164 The IASB assessed that preparation costs would be reduced for such transactions, because the absence of guidance in existing IFRS resulted in some preparers having incurred costs by obtaining professional advice on how to account for these transactions.

165 EFRAG agrees that the amendment is likely to mean some preparers will need less professional advice. EFRAG's also believes that, depending on the accounting treatment currently being adopted by preparers, the cost of calculating the information needed to comply with the amendment will in most cases be low, relative to the alternative methods, as it does not require any fair value measurements of assets and liabilities. EFRAG's assessment is that for most preparers these cost savings will probably not be significant.

166 However, preparers might need to monitor transactions involving the purchase of non-controlling interests in order to counteract the reduction in net assets and equity. This will involve setting up tracking procedures and therefore result in some incremental implementation and on-going costs. EFRAG believes that entities with a business model that involves purchases of NCI recognised as part of a business combination will most likely have corresponding tracking procedures in place. The costs of implementing the amendment will thus be limited to assessing the information and monitoring the effects of transactions with NCI. Although this could be quite an extensive exercise for some entities, EFRAG believes that, for preparers as a whole, the year one costs will not be significant.

Costs and benefits for users

167 EFRAG has also considered whether the amendment will benefit users of financial statements and/or whether the amendment will in some way increase the burden on users.

168 EFRAG believes that the comparability that will result from having a single method of accounting for such transactions will be significant.

169 On the other hand, it also believes that the amendment might involve some users in some additional costs because it could make less apparent aspects of this type of transaction that some users are particularly interested in. These potential incremental ongoing costs would not however exceed the benefits mentioned in the preceding paragraph.

Conclusion

170 Overall, EFRAG's assessment is that this amendment will impose no significant additional costs on preparers or users, but is likely to result in significant additional benefits for users.

Amendment 2: Changes in ownership interest that result in control of another entity being lost

Costs and benefits to preparers

171 This amendment requires that, when a parent entity loses control of a subsidiary, it should remeasure at fair value any retained ownership interest in the former subsidiary and recognise any resulting gain or loss in the income statement. Existing IAS 27 is silent on the subject.

172 The IASB assessed the costs involved in this amendment to be relatively low, and concluded that the effect for preparers would be neutral. The parent entity will need to make one new fair value calculation; however, in many cases an entity selling a controlling interest will value its entire interest before doing so, which would mean the fair value of the retained interest would be readily available. Furthermore, the exchange transaction undertaken by the parent will assist in measuring the fair value of the investment it has retained. The IASB also thought providing guidance on how to measure a gain or loss on disposal should reduce audit costs and the costs of seeking professional advice, and therefore benefit preparers.

173 EFRAG agrees with the IASB's assessment and reasoning. EFRAG understands that some preparers generally fair value the entire interest, when undertaking a transaction to dispose of the controlling interest in an entity. For some of these preparers obtaining the fair value of the retained investment, might not pose additional effort (or costs). However, for those entities that do not have the information on fair value of the retained investment, obtaining that valuation will involve additional costs for preparers. For example, some preparers might need to consider changes to their accounting systems and the level of valuation expertise required to estimate the fair values of the ownership interests that are retained in a previously held subsidiary when control in that subsidiary is lost.

174 EFRAG has concluded that, overall, this amendment will not have any significant cost implications for preparers.

Costs and benefits for users

175 The IASB assessed the affect on users to be positive. EFRAG agrees that the accounting for loss of control of a subsidiary and the remeasurement of the retained investment will be comparable as all entities will be measuring the gain or loss on disposal on a consistent basis. Going forward, the retained investment will be recognised initially on a consistent basis for all entities. Presently this was not the case, as entities would carry forward the carrying amount, which is likely to be based on mixed measurement models.

176 For similar reasons, EFRAG's assessment is that, because of the enhanced comparability, some benefit for users will arise from this amendment.

177 However, the view of the majority of EFRAG members is that the accounting that IAS 27A requires is not the most appropriate of the alternatives available and this largely offset the benefits to users of having information that is more comparable.

Conclusion

178 EFRAG agrees that the amendment will not have significant incremental cost implications for preparers. Neither will the amendment involve users in significant incremental costs, because users can easily adjust out of earnings the gain resulting from the remeasurement of the retained interest if their analysis requires adjustments for such non-recurring items.

179 However, EFRAG believes that the amendment will result in only limited benefits to users mainly because, as explained above, the benefits of comparability are compromised by accounting that EFRAG believes is inappropriate.

Amendment 3: Accounting for losses attributable to NCI

Costs and benefits to preparers

180 Existing IAS 27 requires losses in a subsidiary that exceed the NCI to be allocated to NCI only if the NCI owners have a binding agreement to fund the losses. In the absence of such an agreement, the losses are attributable to the controlling interest only. If the subsidiary subsequently reports profits, these profits are allocated to the controlling interest until the share of losses previously absorbed by the controlling interest have been recovered.

181 IAS 27A requires losses to be allocated between the controlling interest and NCI based on their proportionate ownership interest, even if that means the NCI becomes a negative number.

182 EFRAG's assessment is that the amendment will be simpler to apply than the existing requirements, and is therefore likely to result in a reduction in preparation costs.

Costs and benefits to users

183 The IASB's assessment was that this amendment would have no effect on the costs of users. EFRAG shares that view.

184 EFRAG's assessment is also that some users might find the information provided as a result of the amendment more useful than that provided under existing IFRS. On the other hand, for other users it might be less useful.

185 EFRAG's assessment is that the amendment is unlikely to affect users in any significant way.

Conclusion

186 Overall, EFRAG's assessment is that, although the benefits arising from this amendment are likely to exceed the costs, there are not likely to be any significant cost or benefit implications.

EFRAG'S OVERALL CONCLUSIONS

Overall cost-benefit considerations on the implementation of IFRS 3R in the EU

187 To summarise, EFRAG reached the following individual final conclusions on each of the amendments discussed on IFRS 3R.

(a) Reading and understanding the amendments—No significant cost or benefit implications are likely.

(b) Additional disclosure—Likely to provide benefits that exceed the costs involved.

(c) Transition requirements—Likely to result in some increased costs for preparers and users, but those costs are not likely to be significant.

(d) Amendment 1: Contingent consideration—The costs and benefits will probably largely balance out.

(e) Amendment 2: Acquisition-related costs—The amendment is unlikely to have significant cost or benefit implications.

(f) Amendment 3: Step acquisitions—The amendments are likely to result in a cost saving for preparers and benefits (but no costs) for users.

(g) Amendment 4: Partial acquisitions – acquisitions of less than 100 percent—The costs of this amendment are likely to exceed the benefits.

(h) Amendment 5: Definition of a business— No significant cost or benefit implications are likely.

(i) Amendment 6: Fair value as a measurement attribute—No significant cost or benefit implications are likely.

(j) Amendment 7: Scope—No significant cost or benefit implications likely.

188 EFRAG's assessment is that it is Amendments 3 and 4 are the main factors listed above that EFRAG needs to weigh in reaching its overall assessment of the revised standard. EFRAG believes that the net benefits arising from Amendment 3 exceed the net costs arising from Amendment 4.

189 It needs also to be borne in mind that a key objective of revising the existing IFRS 3 was to ensure that the accounting for business combinations is the same whether an entity is applying IFRS or US GAAP. The accounting requirements in IFRS and US GAAP will now be substantially the same, with one key difference: the initial measurement of non-controlling interests. A range of other differences also remain, due to existing differences between other IFRSs and US GAAP. Nevertheless, the fact that IFRS and US GAAP will now be substantially the same will result in benefits for some users.

190 Therefore, EFRAG's overall assessment is that on balance, the benefits that are expected to arise from the implementation of IFRS 3R in the EU will exceed the costs expected to be incurred.

Overall cost-benefit considerations on the implementation of IAS 27A in the EU

191 To summarise, EFRAG reached the following individual final conclusions on each of the amendments discussed on IAS 27A.

(a) Reading and understanding the Amendments—No significant cost or benefit implications are likely.

(b) Transition requirements to IAS 27A— No significant cost or benefit implications are likely.

(c) Amendment 1: Changes in ownership interest that do not result in control of another entity being lost—Likely to result in no significant additional costs but significant benefits for users.

(d) Amendment 2: Changes in ownership interest that result in control of another entity being lost —Likely to result in only insignificant additional costs. However, it will not result in any net benefits for users.

(e) Amendment 3: Accounting for losses attributable to NCI—No significant cost or benefit implications are likely.

192 In other words, the only Amendment that is likely to have a significant effect is Amendment 1, which is expected to result in significant benefits for users.

193 Therefore, EFRAG's overall assessment is that the benefits that are expected to arise from implementing IAS 27A in the EU will exceed the costs expected to be incurred.

Stig Enevoldsen
Chairman, EFRAG
7 November 2008