

## **Meeting Summary**

### **Discussion on HKICPA Request for Information: PIR of AG 5**

**Date:** 11 November 2016

**Venue:** Offices of HKICPA

**Participant:**

Not disclosed, practitioner

#### **Specific responses with respect to the RFI**

##### Common control combinations encountered

1. This practitioner has mainly encountered two forms of common control combinations:
  - (a) Those performed prior to an IPO for the purpose of restructuring to prepare the group for listing.
  - (b) Those performed in listed entities for the purpose of acquiring a business from another group entity.

##### Method of accounting elected

2. For financial statements prepared under HKFRS, if the transactions are considered as common control business combination, she commented that AG 5 would be generally be applied for those transactions. For financial statements prepared under IFRS, given that the IASB has not issued any standard to deal with common control business combination, her observation was that some companies listed in HK (that prepare financial statements in accordance with IFRSs) used the similar approach which was the 'principles of merger accounting' to account for common control combinations.
3. She observed that in practice some preparers/practitioners would view the underlying substance of pre-IPO common control combinations differently from those occurred subsequent to the IPO. This is because the economic substance of the transactions are different:
  - (a) Pre-IPO common control combinations are typically internal group restructures with no cash involvement, whilst
  - (b) Post-IPO common control transactions may be arm's length acquisitions with cash consideration and external minority interests involved.
4. Specific to listed companies, some preparers/practitioners would prefer to apply the acquisition method because the fair value of the acquired businesses would be reflected. Nevertheless, other preparers/practitioners consider that there is no benefit in applying the acquisition method as recognising the fair value of the acquired assets would result in higher depreciation expenses.
5. She agreed that accounting methods do not have to be consistently applied for pre-IPO and post-IPO common control transactions due to the difference in their

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underlying economic substance.

#### Controlling party and carrying values

6. She is of the opinion that the controlling party should be the ultimate parent as this is usually the majority shareholder who injected capital into the businesses. Therefore, the assets and liabilities of the acquired business or entity should be recorded at the book values as stated in the financial statements of the ultimate parent.
7. However, in practice, information might not be available at the ultimate controlling party level. For example, in common control combinations within PRC state-owned enterprises, the ultimate parent might be a government authority and there would be no IFRS financial information available at that level.
8. With respect to illustration 1 in the RFI and assuming IP is listed; the majority shareholder in both UP and IP are typically the same. Therefore, it may difficult for a practitioner to determine the controlling party which is making the economic decisions.
9. She therefore raised the following suggestions with respect to AG 5:
  - (a) Should there be guidance and/or examples added with regard to determining who the controlling party is?
  - (b) Should there be a practical expedient for cases where the controlling party is identified as the ultimate parent but where financial information is unavailable?
  - (c) Should there be required disclosure of which entity has been identified as the 'controlling party'?

#### Minority Interests

10. She considers the example contained in AG 5 to be unclear, and unreflective of real-life fact patterns as it is too simple.
11. She raised the following suggestions for AG 5 with respect to minority interests:
  - (a) Should there be an example added where there are complex and multiple changes to the minority interests before and after the common control combination? For example, this example would provide increased guidance on how to account for changes in minority interest after the restructuring, especially when the controlling party acquires more equity interest from the minority interest holders after the common control acquisition. Currently, this point is not explained clearly in AG 5.
  - (b) Should there be a practical expedient or amendment to AG 5 with respect to aligning the presentation of minority interests with the legal form of the reporting entity? See paragraph 15 below.

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#### Comparatives

12. She is aware that there is diversity in practice. Although in her personal experience, she noted that entities have restated comparatives, she understands that:
- (a) Comparative amounts in financial statements prepared for IPO are typically always restated, essentially to meet listing requirements regarding profit thresholds and operating history.
  - (b) She understand that cost burden for preparers to restate the comparative figures. However, she believed that this is consistent with the fundamental principles of merger account (i.e. as if the restructuring had been completed in the earliest period presented).

#### Accounting for consideration paid

13. She has observed three forms of consideration paid: cash, shares, and convertible bonds:
- (a) For cash consideration not yet settled as at year-end, or convertible bonds issued as consideration in the current year, many preparers/practitioners would not restate comparatives and record a 'hypothetical' liability. Re cash consideration, there is no restatement of comparatives either.
  - (b) For consideration paid by shares, the additional share capital would normally be booked immediately upon completion date of the transaction and restatement made for prior years due to the specific requirements in AG5.
14. She notes that there are two areas of challenges that AG 5 does not currently address:
- (a) Why the different forms of consideration would result in different accounting treatments as laid out above?

#### Disclosures

15. Challenges related to the disclosures required by AG 5 are:
- (a) fair value measurement of consideration (which is non-cash); and
  - (b) Whether the requirement to present the third balance sheet is applicable when there is a retrospective restatement
16. She does not think that disclosures as per RFI paragraphs 7(i) or 7(k) or Appendix 2 would be useful. For paragraph 7(j), does thinks that AG 5 could be amended to require 'compliance with HKAS 24 *Related Party Disclosures*'.

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17. Finally, an important disclosure that is necessary would be the identification of the controlling party.

#### Other effects

18. Other than mentioned above, she does not think any other areas of guidance are necessary for AG 5. Currently, there is no restatement in the cashflow statement in practice, and calculation of the earnings per share would vary depending on how the consideration paid is measured.