Hong Kong Institute of Certified Public Accountants
香港會計師公會

Meeting summary of HKICPA roundtable discussion

Date: 11 May 2021, Tuesday
Time: 4:00 p.m. – 7:00 p.m.

IASB Discussion Paper (DP) on Business Combinations under Common Control (BCUCC)

Ernest Lee, Chairman of Financial Reporting Standards Committee of HKICPA, and partner of Deloitte Touche Tohmatsu, welcomed participants and introduced the event.

Sue Lloyd, IASB Vice-Chair, and Jianqiao Lu, IASB member introduced the DP. Richard Brown and Yulia Feygina, IASB technical staff, provided an overview of the DP and moderated the discussion.

When to apply which measurement method

- Two investors generally agreed with the IASB preliminary views on when to apply which measurement methods to BCUCC, particularly, one investor considered that the acquisition method should be applied when the transaction affects non-controlling shareholders (NCS) of the receiving company.
- A preparer considered that the nature of BCUCC are not all the same and therefore agreed that there should not be one single method for reporting BCUCC. This preparer considered that under the related party exception, it is important to clarify who the related parties are and at which point in time to consider that there are related parties, particularly, for IPO cases. This preparer was concerned that companies would abuse the use of the related party exception in order to achieve the use of a book-value method while the economic substance of the transaction is similar to that of a business combination under IFRS 3 *Business Combinations*.
- A practitioner considered that the definition of related parties in IAS 24 *Related Party Disclosures* is very broad, and not all related parties can have access to the internal information of the receiving company. Also, the information needs of some related parties are the same as those of the NCS. Therefore, this practitioner suggested that the IASB considers removing the related party exception, so the optional exemption can be applied to related parties as well.
- A practitioner questioned whether a receiving company is considered to have applied a consistent accounting policy to BCUCC applying the IASB preliminary views, in particular,
  - when a private company is required to change its accounting for BCUCC after it becomes listed; and
  - the optional exemption seems to be available transaction by transaction. Different measurement methods may be applied to different BCUCC undertaken by the receiving company, depending on the decisions made by the NCS. Also, a different decision is likely to result when there is a change in the shareholder composition of the company.
- An investor asked how the IASB preliminary views would apply to the following cases:
  - BCUCC undertaken for IPO
  - BCUCC undertaken by listed companies
  - BCUCC undertaken by listed companies for privatization, e.g. spin-off

- A practitioner noted that financial instruments with conversion rights, e.g. preference shares that will be converted into ordinary shares upon listing, are common in IPO cases. This practitioner considered that the IASB should further explore the information needs of these financial instruments holders, and whether they should be considered as NCS when determining the measurement method.
- Another practitioner considered that the optional exemption seems to imply that the acquisition method is better than a book-value method and this practitioner questioned whether the NCS can have the knowledge to tell which measurement method is better for their benefits.
- HKICPA staff shared the following feedback obtained from recent outreach activities:
    - There are concerns about whether the optional exemption would be workable in practice, e.g. how to make sure all NCS are contacted and whether they are able to make the choice for the company's and their benefits.
    - Pre-IPO investors are common but they are not considered as NCS under the DP because the financial instruments that they hold do not meet the definition of equity instruments under IAS 32 *Financial Instruments: Presentation*. Yet some of these financial instruments consist of equity-like feature. Some stakeholders considered that the information needs of these pre-IPO investors should be the same as that of the NCS.
    - The consolidation exemption under IFRS 10 *Consolidated Financial Statements* is different from that of the optional exemption in the DP. The consolidation exemption deals with the types of financial statements (consolidated vs separate) that NCS need while the optional exemption deals with the measurement method for BCUCC, which impact the amount in the financial statements on initial recognition and going forward.
    - Currently, there is no accounting requirement in IFRS that requires a company to apply an accounting policy based on the listing status of a company.

How to apply the acquisition method

- An investor considered that companies may prepare boilerplate disclosures about how the transaction price was set and hence the disclosures may not be useful or meaningful to users. Also, such disclosures usually involve sensitive information of the company particularly in a bargain purchase, and so companies may not want to disclose such information in the financial statements. This investor considered that the disclosure about how the transaction price was set are historical information and its effect has already been reflected in the financial statements. In this investor's view, information about future risks, such as how the transferred company would integrate into the receiving company, would be more useful. This investor agreed that transactions with similar nature as those of the business combinations under the scope of IFRS 3 should apply the disclosure requirements of IFRS 3.
- A preparer noted that the current requirements in IFRS do not require companies to identify, measure and recognise distribution or contribution for related party transactions. This preparer asked whether the IASB preliminary views of identifying and recognising contribution in equity for BCUCC would apply to other related party transactions.

- A practitioner shared that some stakeholders questioned why the receiving company is required to recognise contribution in equity for underpayment but is not required to recognise distribution for overpayment under the DP.

How to apply a book-value method

- A practitioner expressed concerns about measuring the assets and liabilities received using the transferred company's book values, in particular, in the following situations:
  - The group acquired 100% shares of a company from a third party and the acquisition method in IFRS 3 was applied to account for such acquisition. Shortly after the acquisition, that company was transferred to another wholly-owned group company for group restructuring. Applying the DP, a book-value method would be used and the receiving company would measure the assets and liabilities received using the transferred company's book value. This seems to contradict with the existing requirements in IFRS 3 that combinations where control is transitory should be accounted for by using fair value method instead of a book value method.
  - Acquisitions from third parties are common among certain industries. Companies in these industries may also undergo group restructurings. Applying the DP, measuring the assets and liabilities received using the transferred company's book value would mean an aggregation of the transferred companies' book value and it is not meaningful from the group's perspective. It does not provide information about the performance of the transferred companies since they were under common control.
  - In a spin-off transaction, a listed company disposed some subsidiaries. Those subsidiaries may undergo group restructuring for privatization. The information disclosed about the spun-off group in the listed company's consolidated financial statements (as a discontinued operation) would be different from that of the information disclosed in the receiving company's financial statements (which used the transferred company's book value). This would confuse the users.
  - Practical difficulties would arise when the transferred company does not prepare IFRS financial statements. Questions arise as to whether the transferred company need to prepare a new set of financial statements applying IFRS 1 *First-time Adoption of International Financial Reporting Standards.* This practitioner acknowledged that there are practical challenges of using either the transferred company's book value or the controlling party's book value and therefore, suggested the IASB considers circumstances where the use of a particular book value would be better than the other, instead of restricting using one book value.
- Another practitioner shared that there are practical difficulties of using the controlling party's book value in certain cases, e.g. who is the controlling party in a multi-layered group structure.
- A regulator shared that in Hong Kong, a shell company is usually set up as a listing vehicle to effect the acquisitions of existing businesses for the purpose of listing. Listing applicants have been applying a book-value method to such transactions and presenting the pre-combination information of the listing businesses. Users found this information useful for them to analyze the historical results of the listing businesses and make investment decisions. This regulator also considered that such pre-combination information is critical

for regulators to assess whether the listing applicants comply with the listing requirements (e.g. profit tests) in Hong Kong. Therefore, this regulator strongly recommended that the IASB provides an accounting policy choice for companies to choose whether they would like to restate the comparatives.

- A practitioner noted that the IASB preliminarily decided not to provide guidance on how to identify the receiving company. However, this practitioner considered that it is difficult to identify who the receiving company is for transactions involving Newco. Also, applying the IASB's preliminary views, the presentation of pre-combination information would be driven solely by the legal form of the transaction. Different pre-combination information would be presented under scenarios 1 to 3 on slide 13 of the presentation materials despite the fact that the economic substance of those transactions is similar, i.e. to list company A and B. This practitioner considered that the presentation of pre-combination information should be driven by the information needs of users and accordingly, recommended that the IASB provides an accounting policy choice for companies to restate the comparatives to meet users' needs.