



asian-oceanian
standard-setters group

THE EIGHTH ANNUAL AOSSG MEETING

Building the future of IFRS together
29-30 November 2016 New Zealand

Business Combinations Under Common Control (BCUCC)

Staff of the Standard Setting Department,
Hong Kong Institute of Certified Public Accountants (HKICPA)



OBJECTIVE

"To generate discussion on the possible conceptual rationale for the accounting for BCUCC"

Overview of Presentation

- ✓ Background
- ✓ Conceptual Framework considerations
- ✓ AOSSG discussion points
- ✓ Next steps
- ✓ Hong Kong common control combinations



BACKGROUND

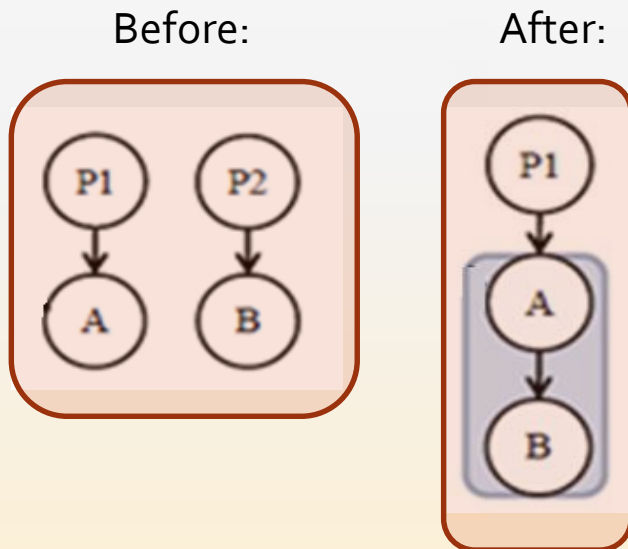
What is a Business Combination (BC)

What is a Business Combination under Common Control (BCUCC)

What is the issue at hand

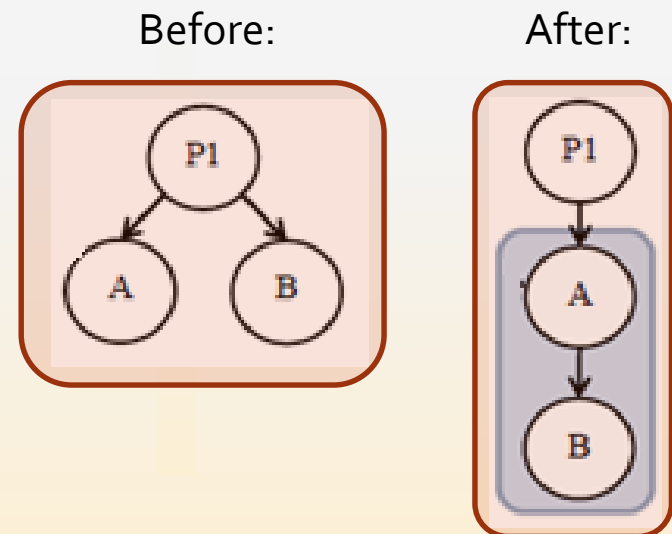
Business Combination (BC)

- ✓ Where an acquirer obtains control of one or more businesses.
- ✓ Usually undertaken to maximize economic benefits by expanding via vertical and/or horizontal integration.



BC under Common Control (BCUCC)

- ✓ Combining businesses are ultimately controlled by the same party(ies), before and after the combination; and control is not transitory.
- ✓ Usually undertaken:
 - to maximize operational efficiencies;
 - for the purposes of an IPO; or
 - similar to BC?



What is the issue at hand?

IFRS 3 scope-out

Arguably, BCUCC are different as:

- ✓ they are internally directed transactions rather than arm's-length exchanges; and
- ✓ the purpose of such transactions could be different (i.e. maximize internal synergies).

Consequences

- ✓ No standard for BCUCC.
- ✓ Under IAS 8, management selects an accounting policy.
- ✓ Diversity in practice, within and across jurisdictions.



CONCEPTUAL FRAMEWORK

(Based on the IASB's tentative decisions in October 2016)

General purpose financial reporting (GPFR) objective

Who is the 'reporting entity'

Characteristics of useful information

GPFR objective

"To provide financial information about the reporting entity that is useful to primary users in making resource allocation decisions

Primary Users

- ✓ Existing and potential investors, lenders and other creditors.
- ✓ Not management, regulators, other public members.

Resource Allocation Decisions

- ✓ to buy, sell or hold equity and debt instruments;
- ✓ to provide or settle loans and other forms of credit;
- ✓ to exercise rights while holding investments; and
- ✓ to assess how well management effectively and efficiently discharges its responsibilities.

Who is the Reporting Entity

"An entity that chooses, or is required, to prepare GPFR"

Boundary

- ✓ Does not have to be a legal entity—can comprise only a portion of an entity or two or more entities.

Perspective

- ✓ Financial information are prepared from the perspective of the reporting entity as a whole, not from the perspective of any particular group of investors, lenders or other creditors.

GPFR needs to describe the economic activities of a reporting entity.

Characteristics of useful information

"Information is useful if it is relevant and faithfully represents what it purports to represent"

Faithful representation

- ✓ Complete, neutral, free from error.
- ✓ Substance of an economic phenomenon instead of legal form.
- ✓ Affected by measurement uncertainty.

Relevance

- ✓ Capable of making a difference in the decisions made by users.
 - Has predictive value, confirmatory value or both.

Comparability, Verifiability, Timeliness and Understandability.



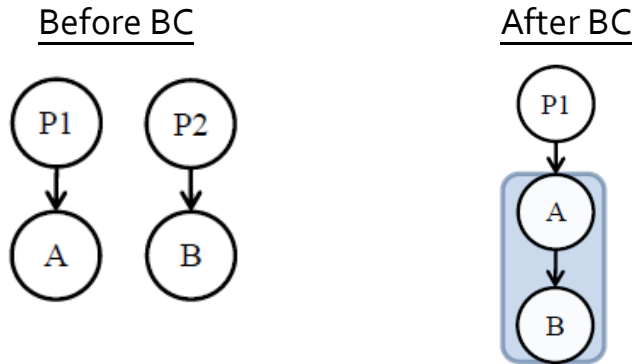
AOSSG DISCUSSION POINTS

Discuss the possible conceptual rationale for the accounting for BCUCC using the Conceptual Framework

Privately-Held entities

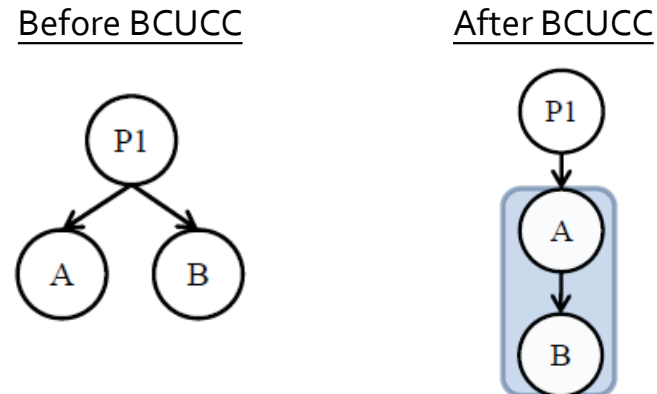
BUSINESS COMBINATION

Entity A and Entity B are controlled by different parties, P1 and P2, respectively. Entity A acquires Entity B.



BCUCC

Entity A and Entity B are controlled by the same party, P1. Entity A acquires Entity B.



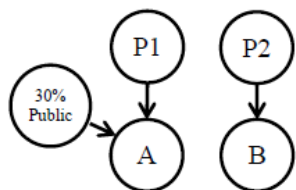
1. If A prepares consolidated GPFR, from A's perspective:
 - ✓ Who are A's primary users in both BC and BCUCC scenarios?
 - ✓ What is the economic substance of the BC and BCUCC scenarios?
 - ✓ What information provides relevance and faithful representation?
2. If P1 prepares consolidated GPFR, from P1's perspective:
 - ✓ Who are P1's primary users in both BC and BCUCC scenarios?
 - ✓ What is the economic substance of the BC and BCUCC scenarios?
 - ✓ What information provides relevance and faithful representation?
3. What would be your response if P1 is an individual?

Listed entities

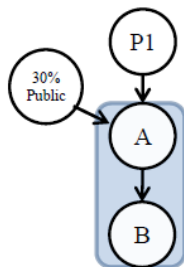
BUSINESS COMBINATION

Entity A and Entity B are controlled by different parties, P1 and P2, respectively. There are non-controlling public shareholders in Entity A. Entity A acquires Entity B.

Before BC



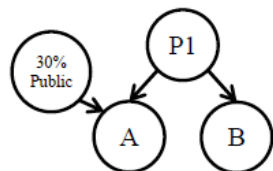
After BC



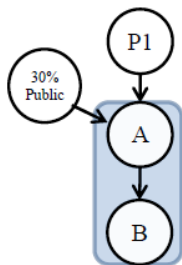
BCUCC

Entity B is wholly-owned and controlled by Entity P1. Entity A is 70% owned and controlled by Entity P1, and 30% owned by non-controlling public shareholders. Entity A acquires Entity B.

Before BCUCC



After BCUCC



1. If A prepares consolidated GPFR, from A's perspective:

- ✓ Who are A's primary users in both BC and BCUCC scenarios?
- ✓ What is the economic substance of the BC and BCUCC scenarios?
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2. If P1 prepares consolidated GPFR, from P1's perspective:

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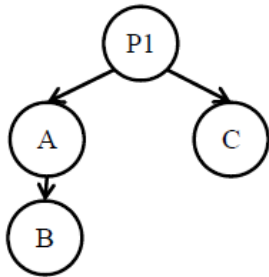
3. What would be your response if: (a) P1 is an individual and (b) P1 is also a 30% publicly listed company?

For the purpose of IPO

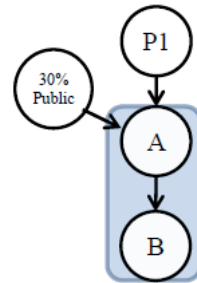
BUSINESS COMBINATION

Entity P1 is privately-held and wholly-owns entities A, B and C. Entity P1 decides to sell 30% of A in an IPO. There is no BCUCC in preparation for the IPO.

Before BC



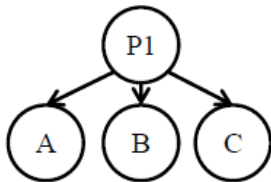
After BC and IPO



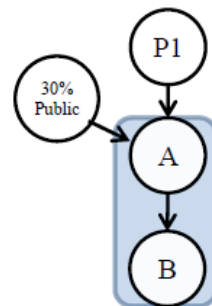
BCUCC

Entity P1 is privately-held and wholly-owns entities A, B and C. In preparation for the IPO, Entity A acquires Entity B. 30% of A is then sold in an IPO.

Before BCUCC



After BCUCC and IPO



1. If A prepares consolidated GPFR, from A's perspective:

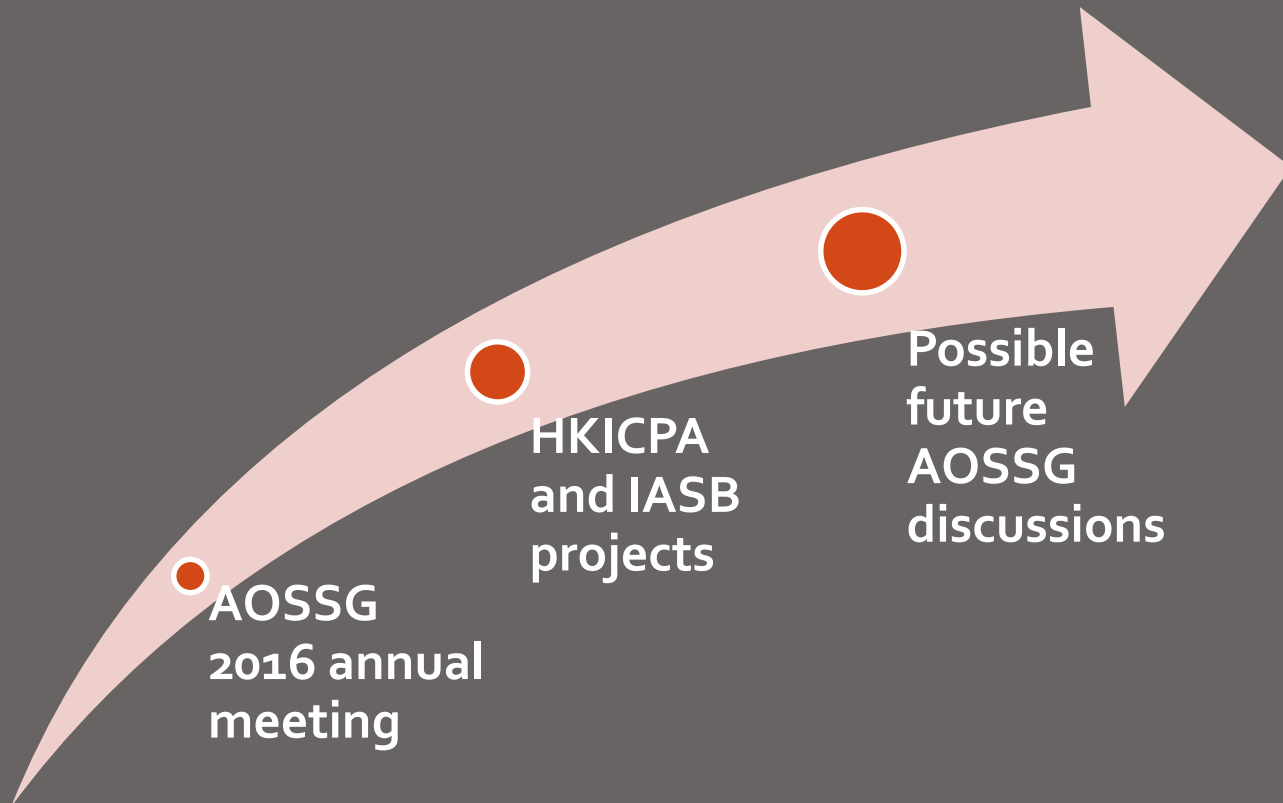
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2. If P1 prepares consolidated GPFR, from P1's perspective:

- ✓ Who are P1's primary users in both BC and BCUCC scenarios?
- ✓ What is the economic substance of the BC and BCUCC scenarios?
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3. What would be your response if P1 is an individual?

NEXT STEPS





APPENDIX: HONG KONG COMMON CONTROL COMBINATIONS

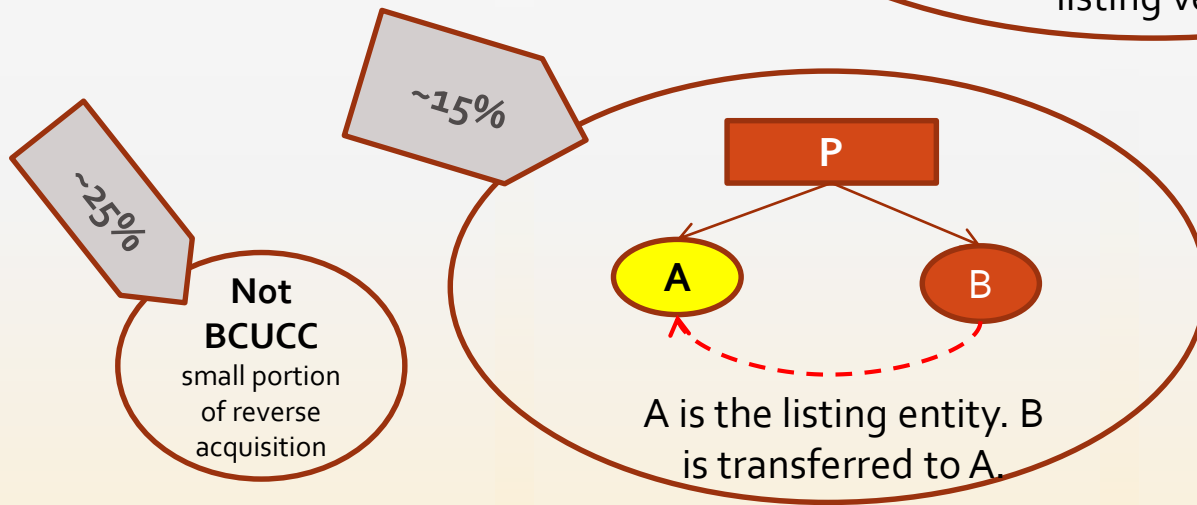
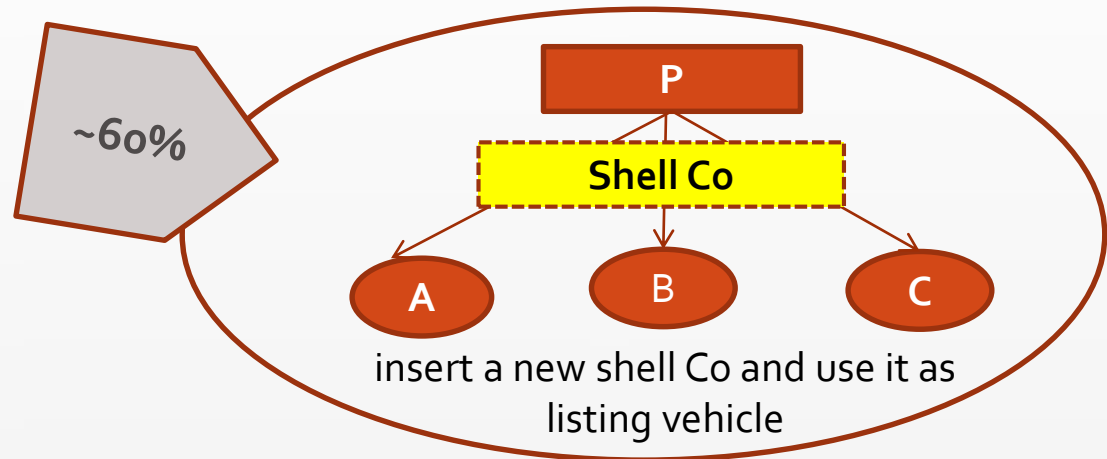
Common control re-organisations for IPO

BCUCC in listed companies

Tentative findings

Common control re-organisations for IPO

We performed a desktop review of 268 newly listed companies from 2013-2015 (comprising 80% of all newly listed entities).



BCUCC in Listed Companies

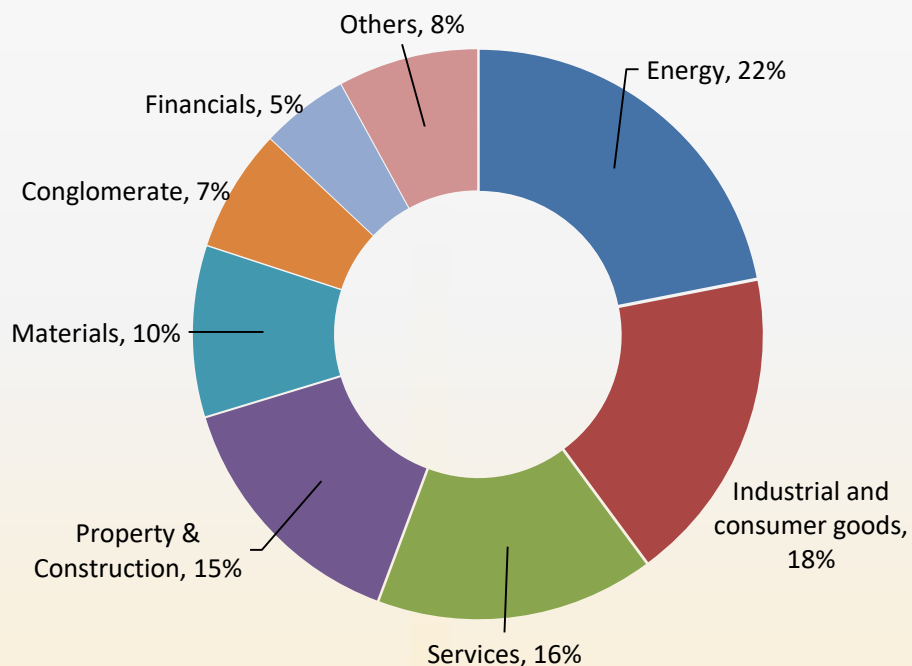
We performed a desktop review of 880 Hong Kong listed companies (comprising 70% of Hong Kong market cap).

Around 102 common control combinations took place in the 3 years from 2013-2015.

That is, at least 30 common control combinations per year.

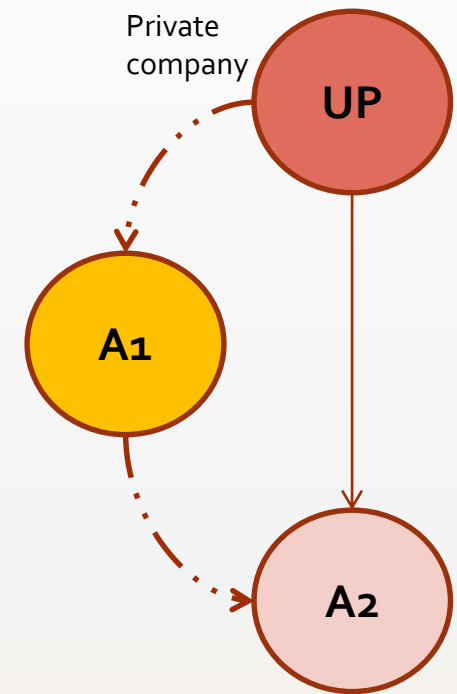
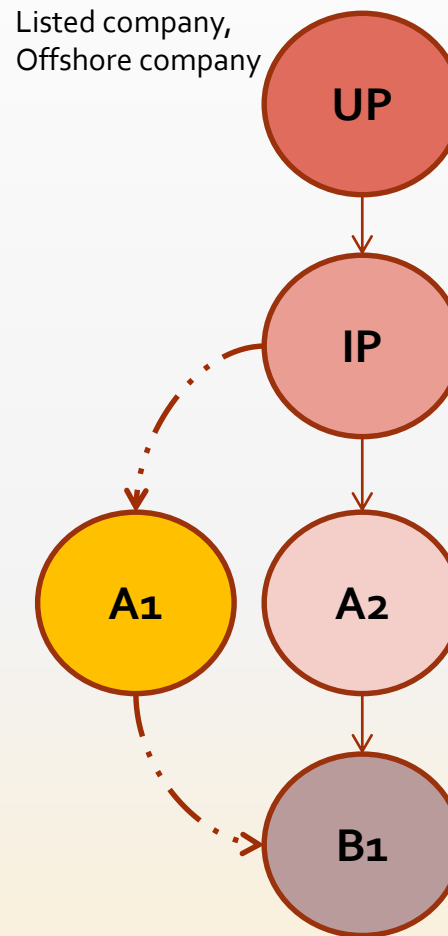
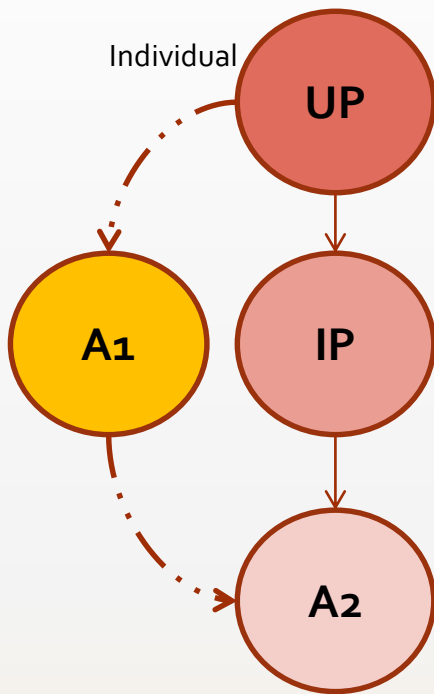
The 102 common control combinations from 2013-2015 occurred in 82 companies (comprising 14% of Hong Kong market cap).

The companies fall into the following industries:



BCUCC in Listed Companies (cont'd)

Commonly seen structures in Listed Entities: A2 is usually a reporting entity



Tentative findings

Desktop Review to date

- ✓ Predecessor method (merger principles) commonly applied by companies that undertook BCUCC.
 - To meet the listing requirements, most IPO entities apply predecessor method.
 - There is a suspicion that some listed entities undertook BCUCC, but they are not reported as such so as to apply acquisition method.

Stakeholder outreach

- ✓ BCUCC occur regularly in private, family-held groups.
- ✓ Users say that fair values are important information but not necessarily acquisition accounting.
- ✓ Preparers, practitioners and academics say that if a BCUCC has underlying economic substance, then acquisition accounting may be appropriate.
 - An academic thinks that 'fresh start' accounting may be more appropriate than acquisition accounting in some BCUCC.

Diversity in accounting for economically similar transactions