



專業培訓中心
Professional Training Center

HKFRS Issues of Merger and Acquisition

Date 21 March 2014

Time 19:00 – 21:00

Venue Duke of Windsor Social Service Building



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Financial Reporting Council

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Role of FRC

- Conduct independent investigations into possible auditing and/or reporting irregularities in relation to listed entities (auditors)
- Enquire into possible non-compliance with accounting requirements of listed entities (listed companies)

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FRC e-News

http://www.frc.org.hk/en/content07_04.php

- 4 investigation reports issued in 2013
- 9 investigation reports issued in 2012

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Some FRC Investigation Findings

2013.02

- Published price not used for FV measurement of consideration shares

2013.03

- Measurement of consideration shares at agreement price

2013.04

- Assets acquired not measured at FV
- Consideration transferred in acquisition not measured at FV

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2012.03

- Deferred tax liabilities not recognised on FV gain of intangible assets on business combination

2012.05 and 06

- Intangible assets acquired not measured at FV
- Published price not used for FV measurement of consideration shares

2012.09

- Intangible assets acquired not measured at FV

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HKFRS Issues

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Acquisition Method or Merger Accounting

HKFRS 3.4

- Account for business combination by acquisition method

HKFRS 3.2(c)

- HKFRS 3 not apply to business combination under common control

HKFRS 3.B1

- All combining entities/businesses ultimately controlled by same party(ies) before and after business combination and control not transitory

HKFRS 3.B2

- Group of individuals regarded as controlling an entity when, as a result of contractual arrangements, they collectively have control

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HKAS 8.10

- If no specific HKFRS, use judgement in developing accounting policy

HKAS 8.11

- In making judgement, follow requirements in HKFRSs dealing with similar and related issues

HKAS 8.12

- May consider accepted industry practices

AG 5 is not HKFRS and Merger Accounting is a choice!

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“We believe that AG 5 principles should only be applied to special once-off circumstances such as in preparing financial statements in the year of IPO and should not normally be applied for acquisitions made after listing.”

HKEX FS Review Programme Report 2011

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Consideration

HKFRS 3.37

- Consideration measured at FV i.e. sum of acquisition-date FV of assets transferred, liabilities incurred and equity interests issued

Shares as consideration

CB as consideration

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HKFRS 3.38

- Consideration may include assets or liabilities of acquirer
- Remeasure transferred assets or liabilities to FV at acquisition date and recognise resulting profit or loss
- Except for assets or liabilities remain within combined entity after business combination (measure at carrying amounts)

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Identifiable Assets and Liabilities**HKFRS 3.18**

- Measure identifiable assets and liabilities at acquisition-date FV

HKFRS 3.13

- May result in recognising items not previously recognised by acquiree. For example, identifiable intangible assets such as brand name, patent or customer relationship

HKFRS 3.B31

- Recognise, separately from goodwill, identifiable intangible assets

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HKFRS 3.IE16 to IE44

Examples of identifiable intangible assets in business combination

- Marketing-related intangible assets
 - Trademarks
 - Internet domain names
 - Non-competition agreements
- Customer-related intangible assets
 - Customer lists
 - Customer contracts
 - Non-contractual customer relationships

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- Artistic-related intangible assets
 - Books
 - Pictures
 - Video
- Contract-based intangible assets
 - Licensing agreements
 - Lease agreements
 - Franchise agreements
- Technology-based intangible assets
 - Patented technology
 - Computer software
 - Databases

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HKFRS 3.B29

- Determine whether terms of operating lease (acquiree is lessee) favourable or unfavourable
- Recognise intangible asset if terms favourable relative to market terms
- Recognise liability if terms unfavourable relative to market terms

HKFRS 3.B43

- May intend not to use acquired asset, or use in a way different from other market participants
- Measure asset at FV determined in accordance with use by other market participants

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Deferred Tax Liability**HKAS 12.15**

- Deferred tax liability recognised for all taxable temporary differences, except:
 - initial recognition of goodwill
 - initial recognition of asset or liability in transaction not business combination and at time of transaction, affects neither accounting nor taxable profit or loss

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Acquisition in Stages

HKFRS 3.42

- In business combination in stages, remeasure previously equity interest in acquiree at acquisition-date FV and recognise resulting profit or loss
- If AFS investment, other comprehensive income recognised on same basis as disposal

Acquisition-related Costs

HKFRS 3.53

- Account for acquisition-related costs as expenses except for costs to issue debt or equity securities

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Acquisition Date

HKFRS 3.8

- Acquisition date is date on obtaining control of acquire

HKFRS 3.9

- Date obtaining control is generally date transferring consideration (closing date)
- Might obtain control earlier or later than closing date. For example, obtaining control of acquiree before closing date by written agreement

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Contingent Consideration

HKFRS 3.39

- Recognise acquisition-date FV of contingent consideration as part of consideration

Definition: Usually, obligation of acquirer to transfer additional assets or equity interests to former owners of acquiree if specified future events occur or conditions are met.

However, contingent consideration also may give acquirer right to return of previously transferred consideration if specified conditions are met

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HKFRS 3.40

- Classify obligation to pay contingent consideration as liability or equity under HKAS 32 or other applicable HKFRSs

Examples:

- If 2014 acquiree's profit exceeds HK\$50M, acquirer issues 20M additional shares.
- If 2014 acquiree's profit exceeds HK\$50M, 20M additional shares. If exceeds HK\$70M, 30M additional shares
- If 2014 acquiree's profit exceeds HK\$50M, 20M additional shares. If 2015 acquiree's profit exceeds HK\$70M, 30M additional shares.

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HKFRS 3.58

Account for subsequent changes in FV of contingent consideration:

- Equity not remeasured and subsequent settlement accounted for within equity
- Asset or a liability:
 - financial instrument (HKAS 39) measured at fair value through profit or loss or other comprehensive income
 - others in accordance with HKAS 37 or other appropriate HKFRSs

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Measurement Period Adjustments**HKFRS 3.45**

- If initial accounting incomplete, report provisional amounts
- During measurement period, retrospectively adjust provisional amounts to reflect new information obtained about facts and circumstances existed at acquisition date
- Measurement period not exceed one year from acquisition date

HKFRS 3.58

- Changes resulting from events after acquisition date, such as meeting earnings target or reaching specified share price are not measurement period adjustments

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Some Derivatives in Transactions

- Derivatives embedded in CB
 - non-equity CB conversion option
 - early repayment option of issuer
 - early repayment option of CB holders
- Derivatives embedded in agreement
 - option to buy remaining interests
 - option to sell remaining interests

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Reverse Acquisition

HKFRS 3.B19

- Reverse acquisition occurs when entity issuing securities (legal acquirer) is accounting acquiree
- Entity acquired (legal acquiree) is accounting acquirer
- For example, private entity arrange for public entity to acquire its equity interests in exchange for equity interests of public entity
- Accounting acquiree meets definition of business

Use **HKFRS 3.B13 to B18** to identify acquirer

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HKFRS 3.B20

- Acquisition-date FV of consideration based on equity interests legal subsidiary would have issued to give owners of the legal parent the same percentage in combined entity (deemed consideration)

HKFRS 3.B21

- Consolidated financial statements issued under name of legal parent (accounting acquiree) but described as continuation of legal subsidiary (accounting acquirer)

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HKFRS 3.B22

- Assets and liabilities of legal subsidiary (accounting acquirer) measured at pre-combination carrying amounts
- Assets and liabilities of legal parent (accounting acquiree) measured at FV
- Record retained earnings and other equity of legal subsidiary (accounting acquirer) before the business combination

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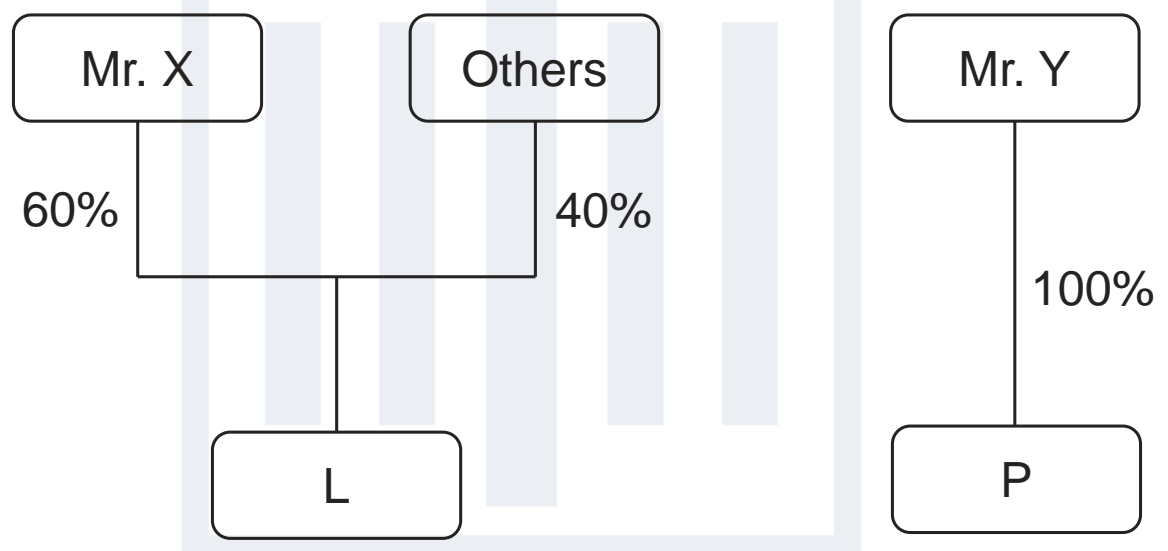
Example 1

- Mr. X owns 60% of a listed company, L
- Number of issued shares of L is 200M
- Mr. Y owns 100% of a private company, P
- L issues 600M shares to acquire P
- Share price of L is HK\$1 per share

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Example 1

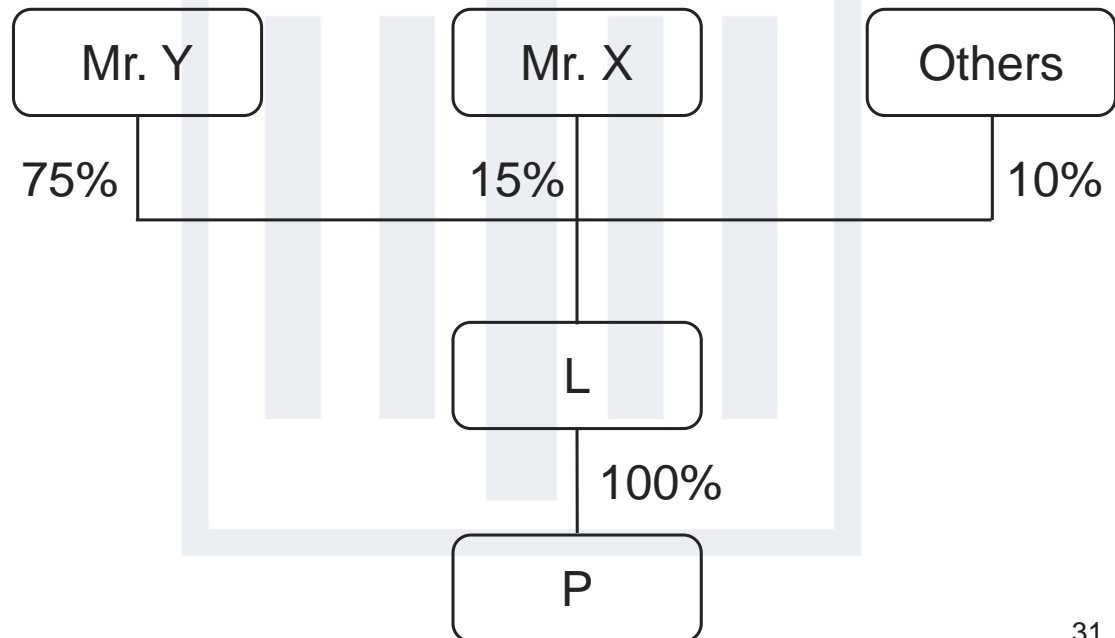
Before



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Example 1

After



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- Consideration is $\text{HK\$}1 \times 600\text{M} = \text{HK\$}600\text{M}$
- Deemed consideration is $\text{HK\$}1 \times 200\text{M} = \text{HK\$}200\text{M}$
- Some annual report disclosure issues
 - share capital
 - directors' remuneration
 - related party transactions

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Example 2

- Same data as example 1
- L is not a business, say dormant shell
- Only asset of L is cash of HK\$50M

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- Share-based payment transaction of P
- Purchase of cash of HK\$50M and listing status
- Deemed consideration is HK\$200M
- HK\$150M is recorded as expense

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Q&A Section ?