

Meeting Summary

Discussion on HKICPA Request for Information: PIR of AG 5

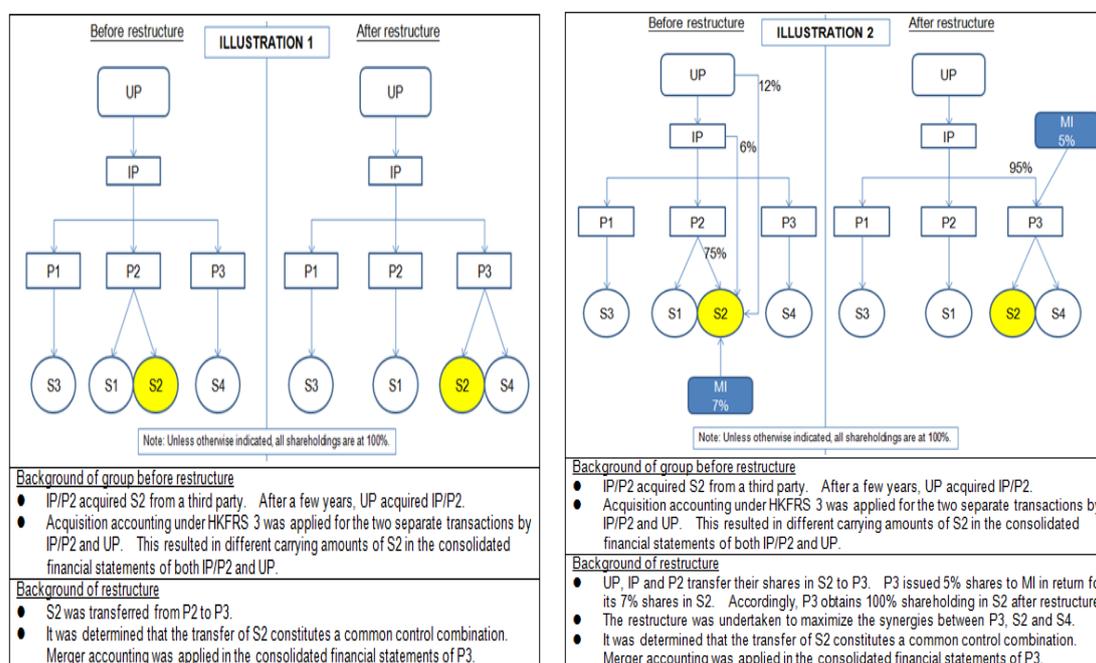
Date: 22 September 2016

Venue: Offices of the CFA Institute

Participant:

Alan Lok, Director of capital markets policy at CFA Institute, with a research focus on market instruments and market structures in the Asia-Pacific region.

In a group reorganization such as Illustration 1 and 2 below, should entity P3 consolidate entity S2 using its fair values or existing book values from UP/IP?



1. Mr. Lok notes that there are two types of investors: one takes a deep analysis into financial information, and the other is more speculative (short term sells/buys based on market chatter).
2. If book values of an acquired entity are carried forward (from the perspective of the controlling party) in the related party acquirer's books, Mr. Lok thinks that it would be necessary to know who is the 'controlling party'. Furthermore, a reconciliation of the financial results before and after a restructure is important—this appeals most to retail investors who typically invests based on speculation more so than an analysis of the company. That is, Mr. Lok thinks it would be useful to see not just the consolidated financial information of the reporting entity; but also the financial information of the acquired entity (as reported in its separate financial statements) reconciled to the financial information as reported by the controlling party's financial statements.
3. If fair values of an acquired entity are recognized or provided in the related party

Meeting Summary

Discussion on HKICPA Request for Information: PIR of AG 5

acquirer's books, Mr. Lok thinks the fair value and book value of the acquired entity should be traced or reconciled—simply stating or recognizing the fair values would be meaningless. He however notes the practical challenges in fair valuing all assets and liabilities.

4. He also thinks that the fair values do not necessarily have to be recorded on the balance sheet—they can be provided as a note. However, he would like to know the fair value as of the latest acquisition date noting that a fair value within 3 years from current date could still be considered relevant, unless something major had occurred during this time.
5. He further emphasized that it is preferable for the book values to be recorded on the balance sheet because investors always calculate the Price to Book ratio and Return on Equity. This makes it easier for analysts to calculate the ratios, and also helps to prevent the potential for inflating the carrying values (anti-abuse mechanism).
6. Mr. Lok also notes that typically in an IPO prospectus, it is very difficult to understand which part of a reorganization is an IPO and which part is not, and whether the entity had previously sought for initial public listing (and if so, whether and how the structure of the IPO changed from the last attempt).
7. **Is this restatement of comparatives as if the current group structure had always existed useful to investors?** Mr. Lok thinks that restatement of comparatives is useful. However, a reconciliation between the previously published comparatives and restated comparatives should be provided. He sees the restatement of comparatives as pro-forma information to show what the group would have looked like if it had always existed—which is useful information for trend analysis on how the newly combined group might have operated.
8. If there is a change in management, then this type of pro-forma information would be even more useful. If there is no change in management, then the business and its results should be fairly stable.

How should minority interests be presented in the financial statements before and after a group reorganization?

9. Mr. Lok thinks that if the minority interests of the acquiring entity have agreed to the restructure, then the calculation of MI of the new acquiring group should be presented. It would not make sense to keep reporting MI from the former controlling party's perspective.

Meeting Summary

Discussion on HKICPA Request for Information: PIR of AG 5

10. As a minority shareholder, he would want to know: (a) the consideration paid and how it was measured; (b) who the transaction was conducted with, i.e. a related party or an external party. This is important to assess the corporate governance of the acquiring entity.

Additional suggested information relating to group reorganisations

11. Other disclosures that Mr. Lok thinks would be useful to users include:
- (a) Management's view of synergies gained from the reorganisations and how the reorganization would benefit the group as a whole;
 - (b) Information that would help investors assess the quality of the group, such as: revenue by employee per office space; stock-keeping units; business product life; internal controls.
 - (c) Any off-balance sheet items such as implicit financial guarantees.
12. Mr. Lok notes that EPS is important to investors, but that typically, investors would calculate EPS themselves based on the recurring profits and share capital structure of the company, for the purposes of trend analysis.