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27 May 2026

Exposure Draft

Proposed Amendments to Accounting Guideline 5 (Revised) *Merger Accounting for Common Control Combinations*



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

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FOREWORD

This exposure draft (“ED”), accompanied by an explanatory memorandum, is developed and approved by the Financial Reporting Standards Committee (“FRSC”) of the Hong Kong Institute of Certified Public Accountants (“the HKICPA”). It explains the background and the proposed amendments to Accounting Guideline 5 (Revised) *Merger Accounting for Common Control Combinations*.

EXPLANATORY MEMORANDUM

I. Introduction

1. This memorandum provides the background and an explanation of the proposed amendments to Accounting Guideline 5 (Revised) *Merger Accounting for Common Control Combinations* (“AG 5”).

II. Background

2. In 2016, the HKICPA undertook a [post-implementation review](#) (“PIR”) of AG 5. The objective of the PIR is to seek stakeholder feedback on the benefits, challenges and other effects of applying AG 5. The work performed by the HKICPA, the responses received and key issues identified are summarised in the PIR [Feedback Statement](#) issued in August 2018.
3. The 2016 PIR identified several accounting issues, some of which were addressed through limited [amendments to AG 5](#) in 2020. However, the following four issues were not addressed (“Outstanding Issues”) because, at that time, the FRSC considered that these matters might be affected by the outcome of the International Accounting Standards Board (“IASB”)’s then project on Business Combinations under Common Control (“BCUCC”):¹
 - (a) Clarifying the scope of AG 5;
 - (b) Specifying who the controlling party is and what carrying values should be used in recognising the net assets of the acquired entity or business²;
 - (c) Clarifying the accounting for different forms of consideration paid; and
 - (d) Considering the appropriateness of restating comparatives.
4. The IASB began deliberations on the BCUCC project in late 2021. After extensive discussions and considering the feedback received, the IASB decided in November 2023 not to develop requirements for reporting BCUCC and discontinued its work on the project.³ Although this project did not result in any new accounting requirements for BCUCC, the feedback received by the HKICPA during its local outreach on the IASB’s DP provided additional insights for addressing the Outstanding Issues. Following the discontinuation of the IASB’s BCUCC project, the FRSC decided to resume its efforts towards addressing the Outstanding Issues.

¹ The IASB published its preliminary views on the accounting for BCUCC in a [Discussion Paper](#) (DP) in November 2020 to seek public comments. The HKICPA submitted its [comment letter](#) on the DP in August 2021.

² For the purpose of this Explanatory Memorandum, acquired business refers to the business that is transferred between entities or businesses that are ultimately controlled by the same party or parties both before and after the business combination.

³ A [project summary](#) was published in April 2024, summarising the research findings and decisions of the IASB.

III. Recent developments on the Outstanding Issues

5. Since then, the HKICPA undertook research and conducted outreach, including engagement with the HKICPA's advisory panels⁴, to obtain new input to reassess the significance and pervasiveness of the Outstanding Issues for local entities and to evaluate possible solutions to address those issues. Based on the research findings and outreach feedback, certain issues are still considered pervasive and could be addressed by amending AG 5. In addition, several areas have been identified where the clarity of AG 5 could be further enhanced. The FRSC has therefore focused on addressing these issues, as outlined below.

(a) *Scope of AG 5*

6. Respondents to our 2016 PIR commented that AG 5 lacks clarity regarding the applicability of merger accounting to common control combinations that do not involve businesses. On the one hand, AG 5.2 defines a common control combination as “a business combination in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory”. On the other hand, AG 5.5 infers that transactions not representing “the combination of two or more businesses” are outside the scope of AG 5. Respondents considered this an inconsistency in scope.
7. The FRSC noted that the HKICPA issued Amendments to HKFRS 3 *Definition of a Business* in 2019, clarifying the meaning of “business” to help entities determine whether a transaction should be accounted for as a business combination. This clarifies that merely combining entities that do not constitute a business would not be considered as a business combination. Accordingly, common control combinations that do not involve businesses fall outside the scope of AG 5.
8. Following the issuance of the Amendments to HKFRS 3, feedback from our recent outreach indicates that this issue is no longer considered significant. Nevertheless, the FRSC believes the current wording in AG 5 could be further enhanced to clarify its scope and align with the extant requirements of HKFRS 3 *Business Combinations*. Hence, the FRSC proposes adding references in AG 5.2 and AG 5.5 to the definitions of “business” and “business combination” as set out in Appendix A of HKFRS 3.⁵

(b) *Controlling party and carrying values*

9. AG 5.9 requires entities to measure the assets, liabilities and equity of the combining entities or businesses using the existing book values from the controlling parties'

⁴ Business Combinations Reporting Entity Advisory Panel and the Investment Circular Reporting Advisory Panel, both of which comprise accounting technical experts on capital market transactions.

⁵ “Business” and “business combination” are defined in Appendix A of HKFRS 3. “Business” refers to “an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.” “Business combination” refers to “a transaction or other event in which an acquirer obtains control of one or more businesses.”

perspective. However, AG 5 does not define controlling party. Respondents to our 2016 PIR expressed mixed views on who the controlling party is (ultimate, intermediate or immediate parent) and therefore which existing book values should be used for merger accounting in a multi-layered group. In addition, practical issues arise in obtaining the existing book values from controlling parties that are individuals or entities that do not prepare HKFRS financial statements.

10. Recent research findings and outreach feedback indicate that this issue remains pervasive among local entities. Nevertheless, the FRSC observed that, as AG 5 has been in practice for some time, most entities have been applying a similar approach to determining which controlling parties' perspective should be used to recognise the existing book values. This approach typically involves a holistic assessment of entities' specific facts and circumstances and the use of judgement to determine which level of the controlling party's existing book values is most relevant for merger accounting and aligns with the principle in paragraph 2.4 of the *Conceptual Framework for Financial Reporting* (CF) that provides useful financial information to users of financial statements in making economic decisions.⁶ In making this determination, entities generally consider factors such as the nature of the transaction, the purpose of the financial statements (e.g. for an initial public offering application), the availability of HKFRS financial information from the controlling party and the costs and benefits of selecting one controlling party over the others.
11. The FRSC noted that this established approach has been working well in practice and provides relevant and useful information to users of financial statements. The FRSC also noted that respondents from our recent outreach emphasised the need for transparency in understanding the factors considered by entities when determining which controlling parties' perspective should be used to recognise the existing book values. Therefore, instead of prescribing requirements on which level of the controlling party's existing book values must be used, the FRSC considered it more beneficial to enhance clarity and transparency regarding how entities determine the book values of the combining businesses to be recognised in the consolidated financial statements of the combined entity.
12. Accordingly, the FRSC proposes to:
 - Add a reference in AG 5.2 to the definition of common control combinations, including the concept of "controlling party" as outlined in paragraphs B2-B4 of HKFRS 3;
 - Add a new paragraph AG 5.9A to emphasise the need for judgement to determine which controlling parties' perspective should be used to recognise the existing book values of the assets, liabilities and equity of the combining entities or businesses. This assessment should take into account entities' specific facts and circumstances and align with the principle of useful financial information set out in CF 2.4; and

⁶ CF 2.4 states that "If financial information is to be useful, it must be relevant and faithfully represent what it purports to represent. The usefulness of financial information is enhanced if it is comparable, verifiable, timely and understandable."

- Add a disclosure requirement in AG 5.19(c) to specify the basis for determining the controlling parties' perspective in accordance with AG 5.9A and the identity of that controlling party if it differs from the ultimate controlling party disclosed in AG 5.19(b).

(c) *Measurement of shares issued as consideration*

13. Respondents to our 2016 PIR expressed concerns about how shares issued as consideration for common control combinations should be measured, particularly when the combined entity is not publicly listed. In practice, entities apply varied measurement approaches, such as measuring shares at the net asset value of the acquired entity or business, at the fair value of shares issued or at cost.
14. Feedback from recent outreach revealed that some respondents supported a single uniform measurement to reduce diversity in practice. However, most respondents opposed this, expressing concerns that it might lead to potential misinterpretation that such an approach could also apply to other transactions involving share considerations, creating potential risks of divergence from HKFRS Accounting Standards and unintended consequences.
15. Specifically, these respondents highlighted that HKAS 27 *Separate Financial Statements* does not prescribe any specific method for measuring the cost of investment in a subsidiary under a common control combination. As a result, adding a measurement method for share consideration in AG 5 may be seen as amending the cost concept in HKAS 27, creating potential inconsistency with HKAS 27.
16. These respondents further believed that the diversity in practice largely reflects the wide range of common control combinations and their differing circumstances. They contended that "one size does not fit all" – there is no single measurement suitable for all these combinations. In some cases, fair value may be more relevant when the shares issued by the combined entity are listed, as it is a market-based measurement that reflects the perspective of market participants. In other cases, net book value may be more reliable and cost-effective for combinations that are not conducted at arm's length. These respondents highlighted the need for flexibility in measuring investment costs to ensure that the resulting information is both relevant and faithfully represents the underlying economic substance.
17. Furthermore, these respondents considered that measuring share considerations for common control combinations is not a significant issue in the context of consolidated financial statements. This is because under merger accounting, the changes to the total equity of the combined entity typically equal the existing book values of the acquired entities or businesses. Essentially, it is simply an allocation of the share consideration between share capital and merger reserve, as any difference between the consideration and the existing book values of the assets and liabilities of the acquired entities or businesses is recognised within equity. Additionally, entities usually disclose their measurement approach in the financial statements and this practice is well accepted by the market.

18. The FRSC acknowledged the respondents' feedback and noted that it aligns with the HKICPA's responses to the IASB's DP, where no significant concerns were raised about the IASB's preliminary view not to prescribe a specific measurement approach for shares issued by the receiving entity (i.e. the combined entity) as consideration for a business combination under common control.⁷
19. In the FRSC's view, specifying a particular measurement approach for common control combinations could ensure consistent application across entities. However, such an approach may overlook the unique circumstances of each common control combination that warrant different measurement methods. In addition, developing a single measurement method would require careful consideration of all scenarios and transactions, as well as the potential interaction with other HKFRS Accounting Standards, which would entail significant time and resource investment.
20. After weighing the costs and benefits for specifying a single measurement approach and considering the significance of the issue, the FRSC tentatively decided not to prescribe a measurement approach for share consideration in AG 5. Instead, it proposes a new disclosure requirement regarding how the share consideration is measured for common control combinations in AG 5.19(g). The FRSC believes that this proposed disclosure can enhance the transparency of the measurement of shares issued as consideration in such combinations, thereby enabling users of financial statements to compare the approaches applied by entities, evaluate the implications on financial statements and make informed decisions. The proposed disclosure is also consistent with the practice of some entities that already disclose the measurement methods for these transactions.

(d) *Restating comparatives*

21. Consistent with our 2016 PIR findings, respondents from our recent outreach continue to express concerns about the requirement to restate comparatives as if the combinations had occurred from the date when the combining entities or businesses first came under common control. This retrospective approach is typically required for pre-IPO combinations under capital market regulations, and the restated financial information is considered useful for analysing trends in the financial performance of the listing business. However, many respondents questioned the usefulness of restated financial information for other common control combinations, such as those undertaken after an IPO or by private entities that are not preparing for an IPO.
22. Some users emphasised that, for post-IPO combinations, their focus and information needs shift to the future prospects of the target business, rather than the restated financial information of the combined entity. They considered that the separate historical financial information of the target, which is required to be presented in an investment circular if a Hong Kong listed entity undertakes a major or very substantial acquisition⁸,

⁷ Paragraphs 4.25–4.28 of the [DP](#) outline the IASB's preliminary view and reasons for not prescribing an approach for measuring the consideration paid in the receiving company's own shares.

⁸ [Rule 4.06](#) of the Main Board Listing Rules and [Rule 7.05](#) of GEM Listing Rules require that for a circular in connection with a very substantial acquisition or a major transaction on the acquisition of a business or a company, the accountants' report must include the three-year track record of the business or companies to be acquired.

is more relevant for forecasting future performance. As a result, restated financial information is often viewed as less useful in this circumstance. These users also perceived the restated financial information as pro forma in nature, reflecting a group structure that did not exist before the combination.

23. Respondents further highlighted the practical challenges and costs involved in obtaining reliable historical financial information of the acquired entities or businesses for restating comparatives. This issue is particularly difficult for conglomerates with group entities operating in different jurisdictions. When these entities conduct common control combinations and prepare their financial statements using IFRS Accounting Standards, they generally do not present restated comparative information as IFRS Accounting Standards do not specify any accounting requirements for common control combinations. This poses challenges for the holding company in Hong Kong when it applies AG 5, which requires restating comparatives.
24. In some cases, there may be a lack of proper books and records of the acquired entities or businesses (especially if they are unincorporated), making their straightforward carve-out from the seller's accounting records challenging. Restating comparatives to include unincorporated businesses (e.g. branches) could also be seen as contradicting the legal rights and obligations of the acquired branches which are not conferred until after the combination.
25. In light of the above, respondents observed that the costs and complexities associated with restating comparatives often impose significant burdens for preparers and auditors, resulting in situations where the costs outweigh the benefits. Hence, they recommended amending AG 5 to allow entities the option to account for common control combinations prospectively, without restating comparatives.
26. The FRSC noted that feedback from respondents aligns with comments received by the HKICPA during its consultation on the IASB's DP in 2021. At that time, our local respondents expressed similar views to those outlined in paragraphs 21-25 above and believed that an accounting policy choice for restating comparatives for common control combinations would cater for the information needs of different users and help resolve the practical challenges encountered by preparers.⁹
27. The FRSC acknowledged the concerns raised by the respondents and considered their recommendation. After evaluating the costs and benefits of restating comparatives, the FRSC tentatively decided to introduce a practical expedient when applying AG 5. This practical expedient serves as an alternative to the retrospective approach described in AG 5.10(c) and AG 5.11, aiming to reduce undue burdens on preparers without altering the underlying principles of merger accounting. By applying this practical expedient, entities are allowed to:
 - Not restate comparatives for periods prior to the common control combination;

⁹ Paragraph 13 of the [HKICPA's comment letter](#) on the DP.

- Present the assets, liabilities, equity, income and expenses of the acquired entities or businesses in the consolidated financial statements from the date of common control combination, which is the date on which the combined entity obtains control of the acquired entities or businesses; and
- Recognise the assets, liabilities and equity of the combining entities or businesses at the controlling parties' existing book values in the consolidated financial statements based on principles in AG 5.9 and 5.9A.

If entities have elected to apply the practical expedient, they are required to disclose that fact.

28. The FRSC then deliberated whether the use of the practical expedient should be subject to specific criteria and cost-benefit considerations. The FRSC noted that respondents generally advocated allowing flexibility in selecting the accounting policy for restating comparatives to suit the different circumstances of the entities, without setting any conditions. Considering the wide range of common control combinations mentioned above, the FRSC agreed that entities should consider their specific facts and circumstances and apply judgement in selecting the accounting policy that aligns with the principle of useful information in the CF. This approach ensures that the resulting financial information is reliable and relevant to the economic decision-making needs of users of financial statements. With this in mind, the FRSC tentatively decided not to prescribe any specific criteria (including cost-benefit considerations) and to allow flexibility for entities to apply the practical expedient without having to meet any conditions.
29. The FRSC further considered whether such an accounting policy could be applied on a transaction-by-transaction basis to provide flexibility to entities based on their specific facts and circumstances. The FRSC noted that paragraph 13 of HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*¹⁰ requires an entity to select and apply its accounting policy consistently for similar transactions, other events and conditions. Accordingly, the FRSC considered that once an entity has selected an accounting policy for restating (or not restating) comparatives, it should consistently apply that policy to similar common control combinations.
30. The FRSC also considered the implications for the calculation of earnings per share when entities issue ordinary shares as part of a common control combination and elect to apply the practical expedient not to restate comparative information. The FRSC referred to the requirement in paragraph 22 of HKAS 33 *Earnings per Share*. By analogy to this requirement, the FRSC considers that ordinary shares issued as part of the combination should be included in the weighted average number of shares only for the period from the date of common control combination, as the combined entity consolidates the profits or losses of the acquired entities or businesses from that date. Therefore, the FRSC proposes adding AG 5.20A to specify the calculation of the weighted average number of shares when entities choose not to restate comparatives.

¹⁰ When HKFRS 18 *Presentation and Disclosure in Financial Statements* was issued in July 2024, the HKICPA changed the title of HKAS 8 to HKAS 8 *Basis of Preparation of Financial Statements*, which is effective for annual reporting periods beginning on or after 1 January 2027.

31. To support implementation, the FRSC proposes adding illustrative examples that compare the use of the practical expedient not to restate comparatives under AG 5.11A with the approach of restating comparatives under AG 5.10(c) and AG 5.11.

IV. Summary of proposals

32. The table below summarises the proposed key changes to AG 5 discussed above:

Reference for AG 5	Details
(a) Scope of AG 5	
Amend AG 5.2 and AG 5.5	Add references to Appendix A of HKFRS 3 for the definitions of “business” and “business combination”.
(b) Controlling party and carrying values	
Amend AG 5.2	Add a reference to paragraphs B2-B4 of HKFRS 3 for guidance on the definition of common control combinations and the concept of “controlling party”.
Add AG 5.9A	Highlight the use of judgement to determine which controlling parties’ perspective should be used to recognise the existing book values of the assets, liabilities and equity of the combining businesses.
Add AG 5.19(c)	Add a disclosure requirement to specify the basis for determining the controlling parties’ perspective in accordance with AG 5.9A and the identity of that controlling party if it differs from the ultimate controlling party disclosed in AG 5.19(b).
(c) Measurement of shares issued as consideration	
Add AG 5.19(g)	Add a disclosure requirement on how shares issued as consideration are measured.
(d) Restating comparatives	
Add AG 5.11A and amend AG 5.17	Introduce a practical expedient that allows entities to include the income, expenses, assets, liabilities and equity of the acquired entities or businesses prospectively from the date of the common control combination. Entities applying this expedient shall disclose that fact.
Add AG 5.20A	Add a requirement on the calculation of weighted average number of shares when applying merger accounting using AG 5.11A.

Reference for AG 5	Details
Appendix to AG 5	Add examples to illustrate the use of the practical expedient not to restate comparatives under AG 5.11A compared to restating comparatives under AG 5.10(c) and 11.

33. The FRSC also proposes certain editorial revisions to AG 5 to align the terminology to that used in HKFRS Accounting Standards.

Transition and effective date

34. The FRSC proposes that the amendments be applied prospectively. That is, these amendments would apply only to common control combinations with a date of combination on or after the effective date of the proposed amendments, with earlier application permitted. This is because applying the amendments retrospectively could be costly and impracticable, particularly in relation to the practical expedient not to restate comparatives. A retrospective application would require entities that decide to apply the practical expedient to reverse pre-combination financial information of the acquired entities or businesses for common control combinations that occurred before the effective date of the amendments in previously restated financial statements. Furthermore, such retrospective application would provide limited benefits to users of financial statements, who mainly focus on the future performance of the acquired entities or businesses for decision making purposes.
35. Subject to the feedback received, the FRSC intends to finalise the amendments to AG 5 in the second half of 2026. With this timeline in mind and considering that the proposed amendments are to be applied prospectively, the FRSC proposes that the amendments take effect for common control combinations that occur on or after the beginning of the first annual reporting period beginning on or after 1 January 2028. Early adoption will be permitted.

V. Key impact of the proposed amendments to local entities

36. In proposing amendments to address stakeholder concerns in applying AG 5, the FRSC considered the potential impact on entities engaged in common control combinations, including listed and private entities, as well as IPO applicants across various industries. The FRSC also evaluated the implications of the proposed amendments for investors and analysts of common control combinations who rely on the financial statements of the combined entity to make informed investment decisions, as well as for regulators assessing the eligibility of IPO applicants for listing.
37. As detailed in Section IV above, the proposed changes to address Outstanding Issues (a) to (c) are limited to clarifying the existing requirements and enhancing the disclosure provisions in AG 5. They do not represent a fundamental change to the underlying principles of AG 5. Specifically, the proposals to disclose the basis for determining which

controlling parties' perspective has been used to recognise the existing book values of the combining businesses and the identity of that controlling party under AG 5.19(c), as well as to disclose the measurement method of share consideration for common control combinations under AG 5.19(g), are based on readily available information. The FRSC believes that these proposed disclosures could improve the transparency and comparability of financial information for users of financial statements, without imposing an undue burden on entities in meeting the additional disclosure requirements.

38. The FRSC views the major change of the ED as the introduction of a practical expedient that allows entities not to restate comparatives. This proposal addresses concerns raised by stakeholders who contended that, for certain common control combinations, the costs of preparing restated comparatives exceed the associated benefits (see paragraphs 21-25). The FRSC believes that applying the practical expedient can alleviate the burden on preparers in preparing restated comparatives for the combined entity. The practical expedient is particularly beneficial for common control combinations undertaken after IPO or by private entities, where users of financial statements may not rely on restated financial information for decision making.
39. To apply the practical expedient, entities are required to elect, upon initial application of the amendments to AG 5, not to restate comparatives for common control combinations. In making the selection, the FRSC considers that entities should apply judgement based on their specific facts and circumstances, taking into account factors, including:
- applicable regulatory requirements;
 - information needs of users of financial statements;
 - practical challenges in obtaining reliable historical financial information for the acquired entities or businesses; and
 - costs and benefits of restating comparatives.
- Once an accounting policy is selected, it must be applied consistently to similar common control combinations in accordance with HKAS 8.13.
40. It is important to note that, in certain circumstances, entities are generally required to restate comparatives for common control combinations and therefore cannot apply the practical expedient. For example:
- Pre-IPO common control combinations, where restated financial information is mandated by relevant capital market regulations; and
 - Companies dually listed on the Stock Exchange of Hong Kong and the stock exchanges in Chinese Mainland (such as Shanghai Stock Exchange or Shenzhen Stock Exchange) that apply China Accounting Standards for Business Enterprises ("CASBE") in their annual financial statements.^{11&12} These entities, to which AG 5

¹¹ Paragraph 2 of [Appendix D2](#) of Main Board Listing Rules and paragraph 18.04 of [Chapter 18](#) of GEM Listing Rules.

¹² Paragraphs 32, 38 and 43 of [CASBE 33 Consolidated Financial Statements](#).

does not apply, must continue to ensure compliance with the relevant requirements in CASBE.

VI. Invitation to comment

41. The HKICPA invites comments on the proposals in this ED, particularly on the questions set out below. Comments are most helpful when they:

- refer to specific paragraph(s) to which they relate;
- include the reasons for the comments; and
- make specific suggestions for any proposed changes to wording.

When a respondent agrees or disagrees with the proposal in this ED, it will be helpful for the FRSC to be made aware of this view.

42. The FRSC will consider all comments received **in writing** by 27 May 2026.

VII. Questions for respondents

- | |
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| <ol style="list-style-type: none">1. Do you agree with the amendments proposed in this ED? If not, please specify which parts of the proposals you disagree with, why, and what you propose instead.2. Do you agree with the effective date for the proposed amendments to AG 5? If not, please specify why, and what you propose instead. |
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Accounting Guideline 5 (Revised)

Merger Accounting for Common Control Combinations

The proposed amendments are shown using tracked changes.

This revised Accounting Guideline is effective for common control combinations that occur on or after the beginning of the first annual reporting period beginning on or after 1 January ~~2022~~028.



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Hong Kong Accounting Guideline 5 (Revised)

Merger Accounting for Common Control Combinations

Introduction

1. Starting from 1 January 2005, HKFRS 3 *Business Combinations* applies to all business combinations except where a combination is specifically excluded from its scope. For those business combinations outside the scope of HKFRS 3, for example, business combinations involving entities or businesses under common control, there is no specific accounting standard addressing the appropriate accounting treatment.
2. HKFRS 3 defines a business combination involving entities or businesses under common control as “a business combination¹ in which all of the combining entities or businesses are ultimately controlled by the same party or parties both before and after the business combination, and that control is not transitory”. Such business combinations are referred to hereafter in this Accounting Guideline as “common control combinations” to distinguish them from other business combinations which fall within or outside the scope of HKFRS 3. [Paragraphs B2-B4 of HKFRS 3 provide further guidance on the definition of common control combinations, including the concept of controlling party \(or parties\).](#)
3. HKAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*², paragraphs 10-12, contain requirements for the selection of accounting policies in the absence of a [HKFRS Accounting Standard³ or an Interpretation](#) that specifically applies to an issue. Common control combinations fall outside the scope of HKFRS 3. Accordingly, an entity selects an appropriate accounting policy in accordance with the requirements set out in HKAS 8 and many entities consider that merger accounting is an appropriate accounting policy for common control combinations.
4. This Accounting Guideline sets out the basic principles and procedures of merger accounting when recognising a common control combination. If there is any inconsistency between this Guideline and any [Hong Kong Financial Reporting Standard or Interpretation \(collectively referred to as “HKFRSs”\); HKFRS Accounting Standard, that HKFRS Accounting Standard or Interpretation](#) is to be followed. Certain HKFRSs, [Accounting Standards](#) may contain guidance or requirements that are relevant for the accounting for a common control combination using merger accounting. For example, HKAS 8 requires accounting policies to be applied consistently for similar transactions, HKFRS 10 *Consolidated Financial Statements* addresses consolidation principles and the treatment of a disposal of a subsidiary and HKAS 37 *Provisions, Contingent Liabilities and Contingent Assets* addresses provisions for restructuring. Accordingly, an entity should apply that guidance or those requirements, instead of, or in addition to, the guidance set out in this Accounting Guideline when applying merger accounting.

¹ “Business” and “business combinations” are defined in Appendix A to HKFRS 3. “Business” refers to “an integrated set of activities and assets that is capable of being conducted and managed for the purpose of providing goods or services to customers, generating investment income (such as dividends or interest) or generating other income from ordinary activities.” “Business combination” refers to “a transaction or other event in which an acquirer obtains control of one or more businesses.”

² When HKFRS 18 *Presentation and Disclosure in Financial Statements* was issued in July 2024, the HKICPA changed the title of HKAS 8 to HKAS 8 *Basis of Preparation of Financial Statements*, which is effective for annual reporting periods beginning on or after 1 January 2027.

³ “HKFRS Accounting Standard”, as defined in the Preface to HKFRS Accounting Standards, includes all Hong Kong Financial Reporting Standards, Hong Kong Accounting Standards (HKASs) and HK (IFRIC) Interpretations, HK Interpretations and HK (SIC) Interpretations (collectively referred to as “Interpretations”) approved by the Council of the HKICPA and currently in issue.

5. A common control transaction involving inserting a shell entity between a parent entity and a single subsidiary or between a parent entity and a group of subsidiaries is not a business combination, and accordingly is not a “common control combination” in this Accounting Guideline. This is because the shell entity is not a business¹ as defined in HKFRS 3 and therefore the transaction does not represent the combination of two or more businesses. Because no substantive economic change has occurred to the composition or ownership of the group, in practice, these transactions may be accounted for by applying a principle similar to that for a reverse acquisition. The consolidated financial statements of the shell entity represent the continuation of the financial statements of the single subsidiary or the group of subsidiaries. However, the equity structure in the consolidated ~~balance sheet~~statement of financial position of the shell entity reflects the equity structure of the shell entity.

The principles

6. The concept underlying the use of merger accounting to account for a common control combination is that no acquisition has occurred and there has been a continuation of the risks and benefits to the controlling party (or parties) that existed prior to the combination. Use of merger accounting recognises this by accounting for the combining entities or businesses as though the separate entities or businesses were continuing as before.
7. In applying merger accounting, financial statement items of the combining entities or businesses for the reporting period in which the common control combination occurs, and for any comparative periods disclosed, are included in the consolidated financial statements of the combined entity as if the combination had occurred from the date when the combining entities or businesses first came under the control of the controlling party or parties.
8. Where the combining entities or businesses include an entity or a business previously acquired from a third party, the financial statement items of such entity or business are only included in the consolidated financial statements of the combined entity from the date of the previous acquisition using the acquisition values recognised at that date.
9. A single uniform set of accounting policies is adopted by the combined entity. Therefore, the combined entity recognises the assets, liabilities and equity of the combining entities or businesses at the carrying amounts in the consolidated financial statements of the controlling party or parties prior to the common control combination. If consolidated financial statements were not previously prepared by the controlling party or parties, the carrying amounts are included as if such consolidated financial statements had been prepared, including adjustments required for conforming the combined entity’s accounting policies and applying those policies to all periods presented. These carrying amounts are referred to below as **existing book values from the controlling parties’ perspective**. There is no recognition of any additional goodwill or excess of the acquirer’s interest in the net fair value of the acquiree’s identifiable assets, liabilities and contingent liabilities over cost at the time of the common control combination to the extent of the continuation of the controlling party or parties’ interests. Similarly, in accordance with HKFRS 10, the effects of all transactions between the combining entities or businesses, whether occurring before or after the combination, are eliminated in preparing the consolidated financial statements of the combined entity.

9A. In a multi-layered group with more than one level of controlling party or parties (e.g. immediate, intermediate or ultimate parent level), entities shall use judgement to determine which controlling parties’ perspective should be used to recognise the existing book values of the assets, liabilities and equity of the combining entities or businesses. In doing so, entities shall consider their specific facts and circumstances and align with the principle in paragraph 2.4 of the Conceptual Framework for Financial Reporting to ensure that the financial information is useful to users of financial statements.

The procedures

10. The practical effects of merger accounting are that:
- (a) the net assets of the combining entities or businesses are consolidated using the existing book values from the controlling parties' perspective (see paragraphs 9 – 9A). The assets and liabilities of the acquired entity or business should be recorded at the book values as stated in the consolidated financial statements of the controlling party (i.e. it will require recording of the fair value of the identifiable assets and liabilities of the acquired entity or business at the date of original acquisition from third parties by the controlling party, any remaining goodwill arising on the previous acquisition and any non-controlling interests in the acquired entity recorded in the consolidated financial statements of the controlling party). When the controlling party does not prepare financial statements, the carrying amounts of the acquired entity are included as if such consolidated financial statements had been prepared;
 - (b) no amount is recognised as consideration for goodwill or excess of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities over cost at the time of common control combination, to the extent of the continuation of the controlling party or parties' interests; and
 - (c) comparative amounts in the financial statements are presented using the principles as set out in paragraph 10(a) above as if the entities or businesses had been combined at the previous balance sheet date end of the preceding reporting period unless the combining entities or businesses first came under common control at a later date.
11. The consolidated ~~income~~ statement of profit or loss and other comprehensive income includes the results of each of the combining entities or businesses from the earliest date presented (ie. including the comparative period) or since the date when the combining entities or businesses first came under the control of the controlling party or parties, where this is a shorter period, regardless of the date of the common control combination. The consolidated ~~income~~ statement of profit or loss and other comprehensive income also takes into account the profit or loss and other comprehensive income attributable to the non-controlling interests recorded in the consolidated financial statements of the controlling party.
- 11A As a practical expedient to paragraphs 10(c) and 11, entities may elect not to restate the comparative information for periods prior to the common control combination. Entities selecting this accounting policy shall present the assets, liabilities, equity, income and expenses of the acquired entities or businesses in the consolidated financial statements of the combined entity from the date of the common control combination. Once an entity has selected an accounting policy for not restating comparative information, it must apply that policy consistently to all similar common control combinations.
12. Expenditure incurred in relation to a common control combination that is to be accounted for by using merger accounting is recognised as an expense in the period in which it is incurred. Such expenditure includes professional fees, registration fees, costs of furnishing information to shareholders, and salaries and other expenses involved in achieving the common control combination. It also includes any costs or losses incurred in combining operations of the previously separate businesses.
13. Consolidation is performed in accordance with HKFRS 10. The principal consolidation entries are as follows:
- (a) the effects of all transactions between the combining entities or businesses, whether occurring before or after the common control combination, are eliminated; and
 - (b) since the combined entity will present one set of consolidated financial statements, a uniform set of accounting policies is adopted which may result in adjustments to the assets, liabilities and equity of the combining entities or businesses.

Accounting period covered by a newly formed parent

14. A common control combination may be effected by setting up a new parent which acquires the issued shares or equity of the combining entities or businesses in exchange for the issue of its own shares. In such cases, the first accounting period of the new parent will frequently be a period of less than a year, ending on the balance-sheet reporting date chosen for the group. This will normally be the existing balance-sheet reporting date of one or more of the combining entities or businesses.
15. Frequently, the date of formation of the new parent will not coincide with the beginning or end of the group's accounting periods. Strictly, if the parent is a Hong Kong incorporated company, the Companies Ordinance requires the consolidated financial statements to cover the accounting period of the parent. It could be argued that this requirement prevents the disclosure of comparative information. In substance, however, where the combining entities or businesses are continuing to trade as before, but with a new legal parent, it is appropriate to prepare consolidated financial statements as if the parent had been in existence throughout the reported periods presented with a prominent footnote explaining the basis on which consolidated financial statements are prepared.

Disclosures in addition to those required by applicable HKFRSs

Accounting Standards

16. Entities applying this Accounting Guideline in accounting for a common control combination using the principles of merger accounting shall disclose in their consolidated financial statements the fact that this Guideline has been used.
17. Entities shall disclose the accounting policy applied in accounting for a common control combination by using the principles of merger accounting. Details of the accounting policy shall include, but not be limited to, a discussion of the specific principles and bases applied under merger accounting. If entities have elected to apply the practical expedient in paragraph 11A not to restate the comparative information, they shall disclose that fact.
18. Bearing in mind the necessity of showing a true and fair view, entities applying this Accounting Guideline shall disclose in their consolidated financial statements significant details of the common control combinations.
19. For each common control combination accounted for by using merger accounting, the following information shall be disclosed:
 - (a) the names and brief descriptions of the combining entities (other than the reporting entity);
 - (b) the name and a brief description of the ultimate controlling party;
 - (c) the basis for determining which controlling parties' perspective has been used to recognise the existing book values of the assets, liabilities and equity of the combining entities or businesses, and the name of such controlling party if it differs from the ultimate controlling party;
 - ~~(e)~~(d) the date of the common control combination;
 - ~~(d)~~(e) the reasons for the common control combination and a description of how the reporting entity obtained control;
 - (ef) the composition of the consideration and fair value of the consideration other than shares issued;
 - (f)(g) a description of how the shares issued as consideration are measured;

(h) the nature and amount of significant accounting adjustments made to the net assets and net profit or loss of any entities or businesses to achieve consistency of accounting policies, and an explanation of any other significant adjustments made to the net assets and net profit or loss of any entity or business as a consequence of the common control combination; and

(g) — i) a statement of the adjustments to consolidated reserves.

Earnings per share

20. Ordinary shares issued as part of a common control combination which is accounted for using merger accounting with comparative information restated under paragraphs 10(c) and 11 are included in the calculation of the weighted average number of shares for all periods presented because the consolidated financial statements of the combined entity are prepared as if the combined entity had always existed. Therefore, the number of ordinary shares used for the calculation of basic earnings per share in a common control combination which is accounted for using merger accounting is the aggregate of the weighted average number of shares of the entity whose shares are outstanding after the combination.

20A. Entities that have elected to apply the practical expedient in paragraph 11A not to restate comparative information shall include the ordinary shares issued as part of a common control combination in the calculation of the weighted average number of shares only for the period from the date of the common control combination.

Effective date and transition

21 This revised Accounting Guideline shall be applied prospectively to is effective for common control combinations that occur on or after the beginning of the first annual reporting period beginning on or after 1 January 20222028. Earlier application of this revised Accounting Guideline is permitted. If an entity applies this revised Accounting Guideline for an earlier period, it shall disclose that fact.

APPENDIX

Examples

This Appendix does not form part of the Accounting Guideline and is included for illustrative purposes only.

Under AG 5 (Revised), an entity may elect not to restate comparative information for common control combinations, replacing the previous mandatory requirement for restatement. This election shall be applied prospectively to common control combinations with a date of combination on or after the effective date of the amendments, with earlier application permitted.

Example 1 illustrates the application of merger accounting with comparative information restated in accordance with paragraphs 10(c) and 11 of AG 5 (Revised).

Examples 2A and 2B illustrate how the transition provisions in paragraph 21 of AG 5 (Revised) apply when comparatives are not restated (Example 2B) and compare the resulting effects with a scenario where comparatives continue to be restated (Example 2A):

- Example 2A: On initial application of the Amendments to AG 5 (Revised), the practical expedient in paragraph 11A is not applied. As a result, comparative information continues to be restated in accordance with paragraphs 10(c) and 11 of AG 5 (Revised).
- Example 2B: On initial application of the Amendments to AG 5 (Revised), the practical expedient in paragraph 11A is applied and comparative information is therefore not restated.

Example 1

Background information

Entity P has a number of subsidiaries. This example looks at three subsidiaries – Entity X, Entity Y and Entity A.

Entity P acquired 100% of Entity X for HK\$18,000 many years ago. At that time, Entity P recorded goodwill of HK\$3,000 and fair value of net identifiable assets acquired of HK\$15,000 (which is equal to the then carrying amounts of the assets acquired).

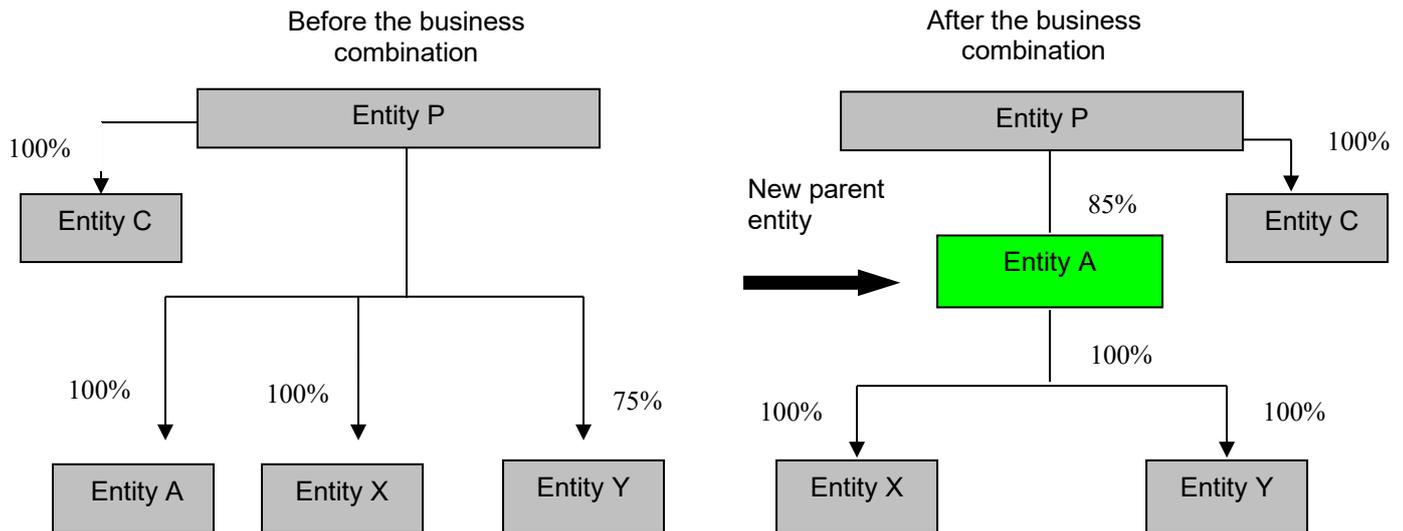
Entity P set up Entity Y with a party outside the group, Shareholder S, many years ago. Entity P's cost of investment in Entity Y was HK\$15,000, being 75% of the share capital of Entity Y.

On 1 January 20X0, Entity P formed a new entity, Entity A, through share capital injection of HK\$10,000.

On 31 December 20X1, Entity A acquired 100% shareholdings in Entity X and Entity Y from Entity P and Shareholder S. In return, Entity A issued 7,000 and 3,000 ordinary shares with par value of HK\$1 each to Entity P and Shareholder S, respectively. Entity A, Entity X and Entity Y have financial year ends of 31 December. The fair values of assets and liabilities of Entity Y as at 31 December 20X1 are equal to their carrying values.

Entity A applies the principles of merger accounting in accordance with AG 5 (Revised) for common control combinations and restates the comparative information under paragraph 10(c) and 11 of AG 5 (Revised).

Ignore any tax effect arising from the business combination.



The ~~income statements~~ of profit or loss of Entity A, Entity X and Entity Y for the year ended 31 December 20X1 are:

	<u>Entity A</u> HK\$	<u>Entity X</u> HK\$	<u>Entity Y</u> HK\$
Revenue	<u>2,000</u>	<u>40,000</u>	<u>50,000</u>
Profit or loss	<u>(4,000)</u>	<u>20,000</u>	<u>20,000</u>

~~The balance sheets~~ The statements of financial position of Entity A, Entity X and Entity Y as at 31 December 20X1 are:

	<u>Entity A</u> (before issue of shares) HK\$	<u>Entity A</u> (after issue of shares#) HK\$	<u>Entity X</u> HK\$	<u>Entity Y</u> HK\$
Investment in subsidiaries	-	223,000	-	-
Other assets	5,000	5,000	100,000	120,000
Net assets	<u>5,000</u>	<u>228,000</u>	<u>100,000</u>	<u>120,000</u>
Capital (including share premium)	10,000	233,000	10,000	20,000
Accumulated profits (losses)	(5,000)	(5,000)	90,000	100,000
	<u>5,000</u>	<u>228,000</u>	<u>100,000</u>	<u>120,000</u>

The 10,000 new shares issued by Entity A as consideration are recorded at a value equal to the deemed cost of acquiring Entity X and Entity Y (HK\$223,000). The deemed cost of acquiring Entity X is HK\$103,000, being the existing book values of net assets of Entity X as at 31 December 20X1 (HK\$100,000) plus remaining goodwill arising on the acquisition of Entity X by Entity P (HK\$3,000). The deemed cost of acquiring Entity Y is HK\$120,000, being the existing book values of net assets of Entity Y as at 31 December 20X1. The deemed cost used in this example is for illustrative purposes only and does not necessarily represent the value to be reported in the individual financial statements of Entity A as the cost of acquiring the subsidiaries.

The ~~income statements~~ of profit or loss of Entity A, Entity X and Entity Y for the year ended 31 December 20X0 are:

	<u>Entity A</u> HK\$	<u>Entity X</u> HK\$	<u>Entity Y</u> HK\$
Revenue	<u>1,000</u>	<u>38,000</u>	<u>45,000</u>
Profit or loss	<u>(2,000)</u>	<u>15,000</u>	<u>12,000</u>

~~The balance sheets~~ The statements of financial position of Entity A, Entity X and Entity Y as at 31 December 20X0 are:

	<u>Entity A</u> HK\$	<u>Entity X</u> HK\$	<u>Entity Y</u> HK\$
Net assets	<u>9,000</u>	<u>80,000</u>	<u>100,000</u>
Capital (include share premium)	10,000	10,000	20,000
Accumulated profits/(losses)	<u>(1,000)</u>	<u>70,000</u>	<u>80,000</u>
	<u>9,000</u>	<u>80,000</u>	<u>100,000</u>

Analysis

As Entity A, Entity X and Entity Y are under the common control of Entity P before and after the business combination, the business combination is specifically excluded from the scope of HKFRS 3.

The directors of Entity A choose to account for the acquisition of the shareholdings in Entity X and Entity Y using the principles of merger accounting.

Under the principles of merger accounting, the assets and liabilities of Entity X and Entity Y are consolidated in the financial statements of Entity A using the existing book values as stated in the consolidated financial statements of Entity P immediately prior to the combination. This procedure requires recording of goodwill arising on the original acquisition of Entity X by Entity P and non-controlling interest in Entity Y as stated in the consolidated financial statements of Entity P immediately prior to the combination. There is no recognition of any additional goodwill or excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over cost at the time of this combination.

The consolidated ~~income statement~~ of profit or loss of Entity A for the year ended 31 December 20X1 is:

	<u>Entity A</u> HK\$	<u>Entity X</u> HK\$	<u>Entity Y</u> HK\$	<u>Adjustment</u> HK\$	Adj	<u>Consolidated</u> HK\$
Revenue	<u>2,000</u>	<u>40,000</u>	<u>50,000</u>			<u>92,000</u>
Profit or loss	<u>(4,000)</u>	<u>20,000</u>	<u>20,000</u>	5,000	(Y1)	36,000
Attributable to the former non-controlling interest in Entity Y						(5,000)
Attributable to the equity holders of Entity A						<u>31,000</u>

Adjustment:

- (Y1) Being an adjustment to reflect the profit attributable to the non-controlling interest in Entity Y prior to the combination.

The consolidated balance sheet statement of financial position of Entity A as at 31 December 20X1 is:

	<u>Entity A</u> HK\$	<u>Entity X</u> HK\$	<u>Entity Y</u> HK\$	<u>Adjustments</u>		<u>Consolidated</u> HK\$
				HK\$	Adj	
Goodwill				3,000	(X1)	3,000
Investments in Entity X and Entity Y	223,000	-	-	(103,000)	(X3)	-
Other assets	5,000	100,000	120,000	(120,000)	(Y5)	225,000
Net assets	228,000	100,000	120,000			228,000
Capital (include share premium)	233,000	10,000	20,000	(10,000)	(X3)	233,000
				(20,000)	(Y5)	
Other reserve	-	-	-	(85,000)	(X3)	(160,000)
				(75,000)	(Y5)	
Accumulated profits / (losses)	(5,000)	90,000	100,000	(5,000)	(X2)	155,000
				(25,000)	(Y4)	
	228,000	100,000	120,000			228,000

Adjustments

Relating to Entity X:

- (X1) Being an adjustment to record goodwill arising on the original acquisition of Entity X by Entity P as stated in the consolidated financial statements of Entity P immediately prior to the combination (HK\$3,000).
- (X2) Being an adjustment to eliminate the accumulated profits of Entity X generated prior to the original acquisition of Entity X by Entity P (HK\$5,000).
- (X3) Being an adjustment to eliminate the share capital of Entity X against the related investment cost of Entity A. An adjustment of HK\$85,000 has been made to a separate reserve in the consolidated financial statements of Entity A.

Relating to Entity Y:

- (Y4) Being an adjustment to reflect the profits attributable to the non-controlling interest in Entity Y prior to the combination.
- (Y5) Being an adjustment to eliminate the share capital of Entity Y against the related investment cost of Entity A. An adjustment of HK\$75,000 has been made to a separate reserve in the consolidated financial statements of Entity A.

Paragraph 10(a) of this Accounting Guideline indicates that any non-controlling interests in the combining businesses reflect the amounts recorded in the consolidated financial statements of the controlling party, in this case Entity P. Accordingly, the 25% shareholdings in Entity Y held by third parties before the combination have been presented as non-controlling interests. After the combination, Entity Y became a wholly-owned subsidiary of Entity A; as such, no non-controlling interests have been presented in the consolidated balance sheet statement of financial position of Entity A as at 31 December 20X1. Since the non-controlling interests in Entity Y were acquired at the same time as the common control combination, the change in the non-controlling interests is accounted for as an equity transaction at the date of the combination.

The consolidated ~~income~~ statement of profit or loss of Entity A for the year ended 31 December 20X0 is:

	<u>Entity A</u> HK\$	<u>Entity X</u> HK\$	<u>Entity Y</u> HK\$	<u>Adjustment</u> HK\$	Adj	<u>Consolidated</u> HK\$
Revenue	<u>1,000</u>	<u>38,000</u>	<u>45,000</u>			<u>84,000</u>
Profit or loss Attributable to the non- controlling interest	<u>(2,000)</u>	<u>15,000</u>	<u>12,000</u>	3,000	(Y1)	25,000 (3,000)
Attributable to the equity holders of Entity A						<u>22,000</u>

Adjustment:

(Y1) Being an adjustment to reflect the profit attributable to the non-controlling interest in Entity Y.

The consolidated ~~balance sheet~~ statement of financial position of Entity A as at 31 December 20X0 is:

	<u>Entity A</u> HK\$	<u>Entity X</u> HK\$	<u>Entity Y</u> HK\$	<u>Adjustments</u> HK\$	Adj	<u>Consolidated</u> HK\$
Goodwill				3,000	(X2)	3,000
Investments in Entity X and Entity Y	-	-	-	193,000 (103,000) (90,000)	(1) (X4) (Y5)	-
Other assets	9,000	80,000	100,000			189,000
Net assets	<u>9,000</u>	<u>80,000</u>	<u>100,000</u>			<u>192,000</u>
Capital (include share premium)	10,000	10,000	20,000	193,000 (10,000) (20,000)	(1) (X4) (Y5)	203,000
Other reserve	-	-	-	(85,000) (75,000)	(X4) (Y5)	(160,000)
Non-controlling interests	-	-	-	25,000	(Y5)	25,000
Accumulated profits /(losses)	(1,000)	70,000	80,000	(5,000) (20,000)	(X3) (Y5)	124,000
	<u>9,000</u>	<u>80,000</u>	<u>100,000</u>			<u>192,000</u>

Note: The comparative figures are restated as if the entities had been combined at the previous balance sheet date end of the preceding reporting period. The consolidated share capital represents the share capital of Entity A adjusted for the share capital issued for the purposes of the business combination.

Adjustments

(1) Being an adjustment to push back the capital issued for the purposes of the business combination (HK\$193,000, of which HK\$103,000 relating to Entity X and HK\$90,000 relating

to Entity Y). The aim of the consolidated financial statements in merger accounting is to show the combining entities' results and financial positions as if they had always been combined. Consequently, the share capital in respect of 7,000 shares issued for the purposes of the business combination has to be shown as if it had always been issued.

Relating to Entity X:

- (X2) Being an adjustment to record goodwill arising on the original acquisition of Entity X by Entity P as stated in the consolidated financial statements of Entity P immediately prior to the combination (HK\$3,000).
- (X3) Being an adjustment to eliminate the accumulated profits of Entity X generated prior to the original acquisition of Entity X by Entity P (HK\$5,000).
- (X4) Being an adjustment to eliminate the share capital of Entity X against the related investment cost of Entity A. An adjustment of HK\$85,000 has been made to a separate reserve in the consolidated financial statements of Entity A.

Relating to Entity Y:

- (Y5) Being an adjustment to eliminate the share capital of Entity Y against the related investment cost of Entity A. Prior to the business combination, Entity P only had 75% equity interest in Entity Y. Non-controlling interests of HK\$25,000 was recorded as at 31 December 20X0. An adjustment of HK\$75,000 has been made to a separate reserve in the consolidated financial statements of Entity A.

Earnings per share

Based on the same facts as per the above example, the calculation of basic earnings per share for each period presented in the consolidated financial statements of Entity A is based on the consolidated profit (excluding the profit attributable to the non-controlling interests), and on the 17,000 shares (comprising 10,000 shares of Entity A in issue throughout the two years ended 31 December 20X1 and 7,000 shares of Entity A issued on 31 December 20X1 as consideration for the equity interests in Entity X and Entity Y acquired from Entity P).

Example 2A

Background information

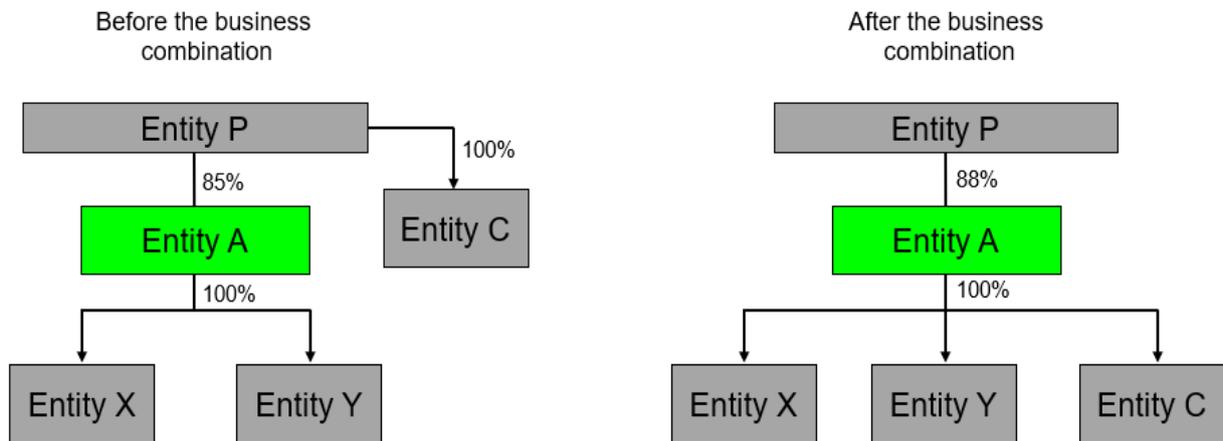
Assume the same facts as in Example 1 above.

On 1 March 20X2, Entity A acquired 100% of Entity C from Entity P. In return, Entity A issued 5,000 ordinary shares with par value of HK\$1 each to Entity P.

Entity P acquired Entity C from a third party many years ago by paying an amount equal to the fair value of the net identifiable assets acquired. At the then acquisition date, Entity C's accumulated profit was HK\$5,000. Entity C's revenue and profit for the year ended 31 December 20X1 was HK\$55,000 and HK\$27,500 respectively.

On initial application of the Amendments to AG 5 (Revised), Entity A decided not to change its accounting policy for common control combinations and continues to restate its comparative information under paragraphs 10(c) and 11 of AG 5 (Revised).

Ignore any tax effect arising from the business combination.



The statements of profit or loss of Entity A, Entity X, Entity Y and Entity C for the year ended 31 December 20X2 are:

	<u>Entity A</u> <u>HK\$</u>	<u>Entity X</u> <u>HK\$</u>	<u>Entity Y</u> <u>HK\$</u>	<u>1 January to</u> <u>28 February</u> <u>Entity C</u> <u>HK\$</u>	<u>1 March to</u> <u>31 December</u> <u>Entity C</u> <u>HK\$</u>
Revenue	1,500	40,200	50,300	10,000	50,000
Profit or loss	(4,500)	20,200	20,300	5,000	25,000

The statements of financial position of Entity A, Entity X, Entity Y and Entity C as at 31 December 20X2 are:

	<u>Entity A</u> <u>HK\$</u>	<u>Entity X</u> <u>HK\$</u>	<u>Entity Y</u> <u>HK\$</u>	<u>Entity C</u> <u>HK\$</u>
<u>Investment in subsidiaries[#]</u>	<u>328,000</u>	<u>-</u>	<u>-</u>	<u>-</u>
<u>Other assets</u>	<u>500</u>	<u>120,200</u>	<u>140,300</u>	<u>130,000</u>
<u>Net assets</u>	<u>328,500</u>	<u>120,200</u>	<u>140,300</u>	<u>130,000</u>
<u>Capital (include share premium)</u>	<u>338,000</u>	<u>10,000</u>	<u>20,000</u>	<u>30,000</u>
<u>Accumulated profits/ (losses)</u>	<u>(9,500)</u>	<u>110,200</u>	<u>120,300</u>	<u>100,000</u>
	<u>328,500</u>	<u>120,200</u>	<u>140,300</u>	<u>130,000</u>

This amount includes 5,000 new shares issued by Entity A as consideration for acquiring Entity C on 1 March 20X2. These shares are recorded at a value equal to the deemed cost of acquiring Entity C (HK\$105,000), being the existing book values of net assets of Entity C as at 1 March 20X2. The deemed cost used in this example is for illustrative purposes only and does not necessarily represent the value to be reported in the individual financial statements of Entity A as the cost of acquiring Entity C.

Analysis

As Entity A and Entity C are under the common control of Entity P before and after the business combination, the business combination is specifically excluded from the scope of HKFRS 3. The directors of Entity A apply merger accounting for the acquisition of the shareholdings in Entity C. As such, the assets and liabilities of Entity C are consolidated in the financial statements of Entity A using the existing book values as stated in the consolidated financial statements of Entity P immediately prior to the combination. There is no recognition of any additional goodwill or excess of the acquirer's interest in the net fair value of the acquiree's identifiable assets, liabilities and contingent liabilities over cost at the time of this combination.

The consolidated statement of profit or loss of Entity A for the year ended 31 December 20X2 is:

	<u>Entity A</u> <u>HK\$</u>	<u>Entity X</u> <u>HK\$</u>	<u>Entity Y</u> <u>HK\$</u>	<u>Entity C</u> <u>HK\$</u>	<u>Consolidated*</u> <u>HK\$</u>
<u>Revenue</u>	<u>1,500</u>	<u>40,200</u>	<u>50,300</u>	<u>60,000</u>	<u>152,000</u>
<u>Profit or loss</u>	<u>(4,500)</u>	<u>20,200</u>	<u>20,300</u>	<u>30,000</u>	<u>66,000</u>

* Assume no adjustments to revenue and profit or loss are needed in accordance with paragraph 13 of AG 5 (Revised).

The consolidated statement of financial position of Entity A as at 31 December 20X2 is:

	Entity A HK\$	Entity X HK\$	Entity Y HK\$	Entity C HK\$	Adjustments HK\$	Adj	Consolidated HK\$
Goodwill	=	=	=	=	3,000	(X1)	3,000
Investments in Entity X, Entity Y and Entity C	328,000	=	=	=	(103,000) (120,000) (105,000)	(X3) (Y5) (C7)	=
Other assets	500	120,200	140,300	130,000			391,000
Net assets	<u>328,500</u>	<u>120,200</u>	<u>140,300</u>	<u>130,000</u>			<u>394,000</u>
Capital (include share premium)	338,000	10,000	20,000	30,000	(10,000) (20,000) (30,000)	(X3) (Y5) (C7)	338,000
Other reserve	=	=	=	=	(85,000) (75,000) (70,000)	(X3) (Y5) (C7)	(230,000)
Accumulated profits/(losses)	(9,500)	110,200	120,300	100,000	(5,000) (25,000) (5,000)	(X2) (Y4) (C6)	286,000
	<u>328,500</u>	<u>120,200</u>	<u>140,300</u>	<u>130,000</u>			<u>394,000</u>

Adjustments

Relating to Entity X:

(X1) to (X3): Being adjustments brought forward from 20X1, refer to Example 1 for details.

Relating to Entity Y:

(Y4) and (Y5): Being adjustments brought forward from 20X1, refer to Example 1 for details.

Relating to Entity C:

(C6) Being an adjustment to eliminate the accumulated profits of Entity C generated prior to the original acquisition of Entity C by Entity P (HK\$5,000).

(C7) Being an adjustment to eliminate the share capital of Entity C against the related investment cost of Entity A. An adjustment of HK\$70,000 has been made to a separate reserve in the consolidated financial statements of Entity A.

In addition, the directors of Entity A restate the comparative information reported in Entity A's consolidated financial statements for the year ended 31 December 20X1 to include the results and financial position of Entity C for the same period, as follows:

The consolidated statement of profit or loss of Entity A for the year ended 31 December 20X1 is:

	<u>Consolidated (before including Entity C)⁺ HK\$</u>	<u>Entity C HK\$</u>	<u>Consolidated* HK\$</u>
Revenue	92,000	55,000	147,000
Profit or loss	36,000	27,500	63,500
Attributable to the former non-controlling interest in Entity Y	(5,000)		(5,000)
Attributable to the equity holders of Entity A	31,000	27,500	58,500

⁺ Extracted from the consolidated statement of profit or loss of Entity A for the year ended 31 December 20X1 in Example 1.

^{*} Assume no adjustments to revenue and profit or loss are needed in accordance with paragraph 13 of AG 5 (Revised).

The consolidated statement of financial position of Entity A as at 31 December 20X1 is:

	<u>Consolidated (before including Entity C) HK\$</u>	<u>Entity C HK\$</u>	<u>Adjustments HK\$</u>	<u>Adj</u>	<u>Consolidated HK\$</u>
Goodwill	3,000	=			3,000
Investment in Entity C	=	=	105,000	(1)	=
			(105,000)	(C9)	
Other assets	225,000	100,000			325,000
Net assets	<u>228,000</u>	<u>100,000</u>			<u>328,000</u>
Capital (include share premium)	233,000	30,000	105,000	(1)	338,000
			(30,000)	(C9)	
Other reserve	(160,000)	=	(70,000)	(C9)	(230,000)
Accumulated profits	155,000	70,000	(5,000)	(C8)	220,000
	<u>228,000</u>	<u>100,000</u>			<u>328,000</u>

Adjustments

- (1) Being an adjustment to push back the capital issued of HK\$105,000 for acquiring Entity C. The aim of the consolidated financial statements in merger accounting is to show the combining entities' results and financial positions as if they had always been combined. Consequently, the share capital in respect of 5,000 shares issued for acquiring Entity C has to be shown as if it had always been issued.

Relating to Entity C:

(C8) Being an adjustment to eliminate the accumulated profits of Entity C generated prior to the original acquisition of Entity C by Entity P (HK\$5,000).

(C9) Being an adjustment to eliminate the share capital of Entity C against the related investment cost of Entity A. An adjustment of HK\$70,000 has been made to a separate reserve in the consolidated financial statements of Entity A.

Earnings per share

The calculation of basic earnings per share for the year ended 31 December 20X2 is based on the consolidated profit of Entity A and on the 25,000 shares (comprising 20,000 shares of Entity A in issue throughout the year ended 31 December 20X2, plus an additional 5,000 shares of Entity A issued on 1 March 20X2 as consideration for acquiring Entity C from Entity P).

The calculation of basic earnings per share for the year ended 31 December 20X1 is based on the consolidated profit (excluding the profit attributable to the non-controlling interests) presented in the financial statements of Entity A, and on the 22,000 shares (comprising 10,000 shares of Entity A in issue throughout the year ended 31 December 20X1, plus an additional 7,000 shares of Entity A issued on 31 December 20X1 as consideration for acquiring Entity X and Entity Y from Entity P, and an additional 5,000 shares of Entity A issued on 1 March 20X2 as consideration for acquiring Entity C from Entity P).

Example 2B**Background information**

Assume the same facts as in Example 2A above, except that Entity A elects to apply the practical expedient in paragraph 11A of AG 5 (Revised) not to restate the comparative information, thereby presenting the results and financial position of Entity C from the date of common control combination i.e. 1 March 20X2.

Analysis**The consolidated statement of profit or loss of Entity A for the year ended 31 December 20X2 is:**

	<u>Entity A</u> HK\$	<u>Entity X</u> HK\$	<u>Entity Y</u> HK\$	<u>Entity C</u> HK\$	<u>Adjustments</u> HK\$	<u>Adj</u>	<u>Consolidated</u> HK\$
Revenue	1,500	40,200	50,300	60,000	(10,000)	(C10)	142,000
Profit or loss	(4,500)	20,200	20,300	30,000	(5,000)		61,000

Adjustment

(C10) Being an adjustment to eliminate the pre-acquisition revenue and profit of Entity C as the consolidated statement of profit or loss of Entity A only presents the results of Entity C from the date of the common control combination.

The consolidated statement of financial position of Entity A as at 31 December 20X2 is:

On 1 March 20X2, Entity A recognises the assets, liabilities and equity of Entity C using the existing book values from Entity P's perspective in accordance with the principle outlined in paragraph 9 of AG 5 (Revised).

As in Example 2A, Entity A makes the same adjustments C6 and C7 to eliminate Entity C's pre-acquisition profit, share capital and Entity A's investment cost in Entity C, with consequential adjustment of HK\$70,000 in a separate reserve. Furthermore, Entity A carries forward the same adjustments relating to acquisition of Entity X (X1 to X3) and Entity Y (Y4 and Y5).

As a result, the consolidated statement of financial position of Entity A as at 31 December 20X2 remains the same as that presented in Example 2A. In both scenarios, Entity A's accumulated profits as at 31 December 20X2 include the accumulated profits generated by Entity C since its acquisition by Entity P, amounting to HK\$95,000. However, for Example 2B, Entity A recognises HK\$70,000 of Entity C's accumulated profits as at 1 March 20X2, followed by a post-acquisition profit of HK\$25,000. This differs from Example 2A, where Entity A recognises accumulated profits of HK\$65,000 as at 1 Jan 20X2 and Entity C's full year profit of HK\$30,000.

Since the assets, liabilities, equity, income and expenses of Entity C are included in Entity A's consolidated financial statements prospectively, without restating comparative information, Entity A's results for the year ended 31 December 20X1 and financial position as at 31 December 20X1 include only those of Entity A, Entity X and Entity Y. Therefore, Entity A's consolidated financial statements for the year ended 31 December 20X1 are the same as those presented in Example 1, reproduced as follows:

The consolidated statement of profit or loss of Entity A for the year ended 31 December 20X1 is:

<u>Revenue</u>	<u>HK\$</u> <u>92,000</u>
<u>Profit or loss</u>	<u>36,000</u>
<u>Attributable to the former non-controlling interest in Entity Y</u>	<u>(5,000)</u>
<u>Attributable to the equity holders of Entity A</u>	<u>31,000</u>

The consolidated statement of financial position of Entity A as at 31 December 20X1 is:

<u>Goodwill</u>	<u>HK\$</u> <u>3,000</u>
<u>Other assets</u>	<u>225,000</u>
<u>Net assets</u>	<u>228,000</u>
<u>Capital (include share premium)</u>	<u>233,000</u>
<u>Other reserve</u>	<u>(160,000)</u>
<u>Accumulated profits</u>	<u>155,000</u>
	<u>228,000</u>

Earnings per share

The calculation of basic earnings per share for year ended 31 December 20X2 is based on the consolidated profit of Entity A as shown above. In accordance with paragraph 20A of AG 5 (Revised), ordinary shares issued as part of acquiring Entity C are only included in the calculation of the weighted average number of shares from the date of the common control combination, i.e. 1 March 20X2. Accordingly, the weighted average number of shares for calculating the basic earnings per share for the year ended 31 December 20X2 is 24,192 shares (comprising 20,000 shares of Entity A in issue throughout the year ended 31 December 20X2, plus an additional 5,000 shares of Entity A issued on 1 March 20X2 as consideration for acquiring Entity C from Entity P, weighted for the period from 1 March to 31 December 20X2).

The basic earnings per share for the year ended 31 December 20X1 is not restated for the acquisition of Entity C and remains the same as that presented in Example 1.