IASB EMERGING ECONOMIES GROUP 4th MEETING

ISSUE FOR DISCUSSON:

Transactions Under Common Control

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Korea Accounting Standards Board

I. Introduction

Background

1.1 Transactions under common control (hereafter, UCC transactions) are transactions that take place among companies under common control. UCC transactions occur often in various business contexts including business combinations involving entities or businesses group, spin-off of a subsidiary or business, and group restructurings or reorganizations. UCC transactions can have different impacts on financial statements depending upon how they are accounted for.

1.2 Although UCC transactions are frequently carried out in practice and have significant effects on financial statements, IFRS or US-GAAP, which are leading accounting standards in the world, has not yet provided an organized and consistent accounting standard for UCC transactions. Such lack of standard causes diversity in practice which in turn results in deteriorated comparability of accounting information between companies.

1.3 Yet the IASB's work to establish accounting standards for UCC is in an early phase and still underway. The IASB decided to add to its active agenda a project on common control transactions in December 2007. However, due to a scarcity of internal resource, the project came to a halt in 2009. Recently, European Financial Reporting Advisory Group (EFRAG) and Italian accounting organization (OIC) jointly published the discussion paper on accounting for Business Combinations Under Common Control (BCUCC) to urge the IASB to develop related standards. The IASB decided in May 2012 to give priority to re-commencing research on BCUCC. However, a decision on how to conduct a project on BCUCC is only expected after the discussion of the IFRS Advisory Council. The next one is scheduled in February 2013. The expectation is that the IASB will launch a research project, the scope of which is uncertain.

Objective

1.4 In an effort to contribute to the IASB's development of standards for UCC transactions, Korea has proposed UCC transactions as the topic for the 4th Emerging Economies Group (EEG) meeting. This paper addresses various topics of UCC transactions that should be discussed and considered, such as related issues and questions, when establishing standards for UCC transactions including the definition, scope, identification, accounting treatment and more.

1.5 The objective of this paper is to suggest the issues and questions related to UCC transactions so that members of the EEG would have an active discussion at the EEG meeting regarding UCC transactions, and that the result of the EEG discussion would contribute to the future UCC research project of the IASB.

1.6 Below are the key topics discussed in this paper (and to be discussed in the meeting):

- Definition of common control
- Identifying common control
- Types of UCC transactions
- Accounting for UCC transactions in consolidated financial statements
- Accounting for UCC transactions in separate financial statements
- Distinct features of UCC transactions in Korea

II. Definition of common control

2.1 The first topic that should be discussed and examined regarding UCC transactions is the definition of common control. The definition of common control is a basic concept of UCC transactions, and thus clarifying the definition would lay a firm foundation for developing a new standard on UCC transactions. First, the definitions of common control provided under IFRS and US-GAAP are examined in more detail hereafter.

<u>Definition of common control under IFRS</u>

2.2 Under IFRS, there is no specific standard for UCC transactions. However, paragraphs B1 to B3 of IFRS 3 'Business Combinations' define business combinations under common control as below, indirectly providing the concept of common control.

B1 '.. A business combination in which all of the combining entities or businesses ultimately are controlled by the same party or parties both before and after the combination, and that control is not transitory.'

B2 'A group of individuals shall be regarded as controlling an entity when, as a result of contractual arrangements, they collectively have the power to govern its financial and operating policies so as to obtain benefits from its activities. Therefore, a business combination is outside the scope of this IFRS when the same group of individuals has, as a result of contractual arrangements, ultimate collective power to govern the financial and operating policies of each of the combining entities so as to obtain benefits from their activities, and that ultimate collective power is not transitory.'

B3 'An entity may be controlled by an individual or by a group of individuals acting together under a contractual arrangement, and that individual or group of individuals may not be subject to the financial reporting requirements of IFRSs. Therefore, it is not necessary for combining entities to be included as part of the same consolidated financial statements for a business combination to be regarded as one involving entities under common control.'

2.3 The description of control in paragraphs B1 to B3 of IFRS 3 meets the definition of control[1] set out in IFRS 10 'Consolidated Financial Statements,' and states that entities may be controlled by not only another entity but also an individual or group of individuals. Therefore, the scope of common control might be viewed as more comprehensive than the scope of consolidation since the scope of common control might be greater than that of consolidation.

Definition of common control under US-GAAP

2.4 In the FASB's ASC 805 'Business Combinations,' control is described as having a controlling financial interest. A controlling financial interest is generally defined as having a direct or indirect ownership in an entity, with majority voting rights. In other words, other than in special exceptions (e.g., bankruptcy), having a controlling financial interest means to have fifty percent plus one ownership of the voting shares in an entity, which matches the definition of control set out in ASC 810 'Consolidation.' Although common control is not defined under US-GAAP, ASC 805 'Business Combinations' 50-15 provides examples of various transactions classified as those under common control.

(1) An entity charters a newly formed entity and then transfers some or all of its net assets to that newly chartered entity.
(2) A parent transfers the net assets of a wholly owned subsidiary into the parent and liquidates the subsidiary. That transaction is a change in legal organization but not a change in the reporting entity.
(3) A parent transfers its controlling interest in several partially owned subsidiaries to a new wholly owned subsidiary. That also is a change in legal organization but not in the reporting entity

[1] Paragraph 6 in IFRS 10: An investor controls an investee when it is exposed, or has rights, to variable returns from its involvement with the investee and has the ability to affect those returns through its power over the investee.

(4) A parent exchanges its ownership interests or the net assets of a wholly owned subsidiary for additional shares issued by the parent's less-than-wholly-owned subsidiary, thereby increasing the parent's percentage of ownership in the less-than-wholly-owned subsidiary but leaving all of the existing non-controlling interest outstanding.

(5) A parent's less-than-wholly-owned subsidiary issues its shares in exchange for shares of another subsidiary previously owned by the same parent, and the non-controlling shareholders are not party to the exchange. That is not a business combination from the perspective of the parent.

(6) A limited liability company is formed by combining entities under common control.

2.5 In addition, the Emerging Issues Task Force (EITF) issued EITF 02-5 'Definition of control group' [2] in an attempt to define common control in connection with FAS 141 (currently replaced by ASC 805) but failed to reach a consensus. Instead, the SEC concluded that common control exists in following cases:

(1) A single individual or entity owns more than 50% of the voting shares in each entity

(2) A group of shareholders own more than 50% of the voting shares in each entity and there exists evidence in a document form to show that the shareholders have agreed to collectively exercise their majority voting rights.

(3) Lineal family members (including spouses and children but excluding grandchildren) own more than 50% of the voting shares in each entity (but there should be no evidence that the family members are not to collectively exercise their voting rights).

<u>Discussion & Question</u>

2.6 The definition of common control provided under IFRS and the one provided under US-GAAP are quite similar to each other in that both state entities may be controlled by not only another entity but also an individual or group of individuals. However, IFRS and US-GAAP set out different definitions of control for common control (in IFRS 10

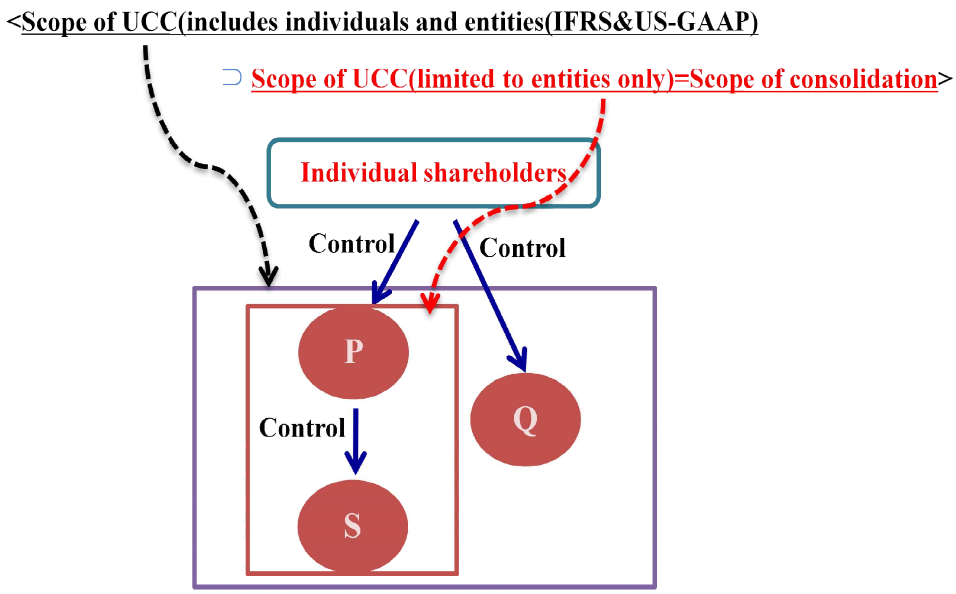
[2] EITF 02-5 Definition of control group: A control group generally is immediate family members or a group of shareholders with contemporaneous written evidence of an agreement to vote in concert.

of IFRS and in ASC 810 of US-GAAP). Thus, the scope of common control may vary between the two sets of standards due to the difference in definitions of control. The difference between the two standards, IFRS and US-GAAP, is caused by the difference in definitions of control set out in the two standards, but not because the concept or definition of UCC is any different between the two standards.

2.7 Some constituents in practice, however, expressed concerns that individuals and entities which were not subject to financial statement preparation in the past may have to face an increased accounting burden as they would be required to prepare financial statement if the scope of common control includes both 'individuals and entities' as stated in IFRS and US-GAAP. Consequently, these constituents favor limiting the scope of common control to only entities, citing accounting burden in practice and cost-benefit reasons. If the scope is limited so, the scope of common control would match that of consolidation.

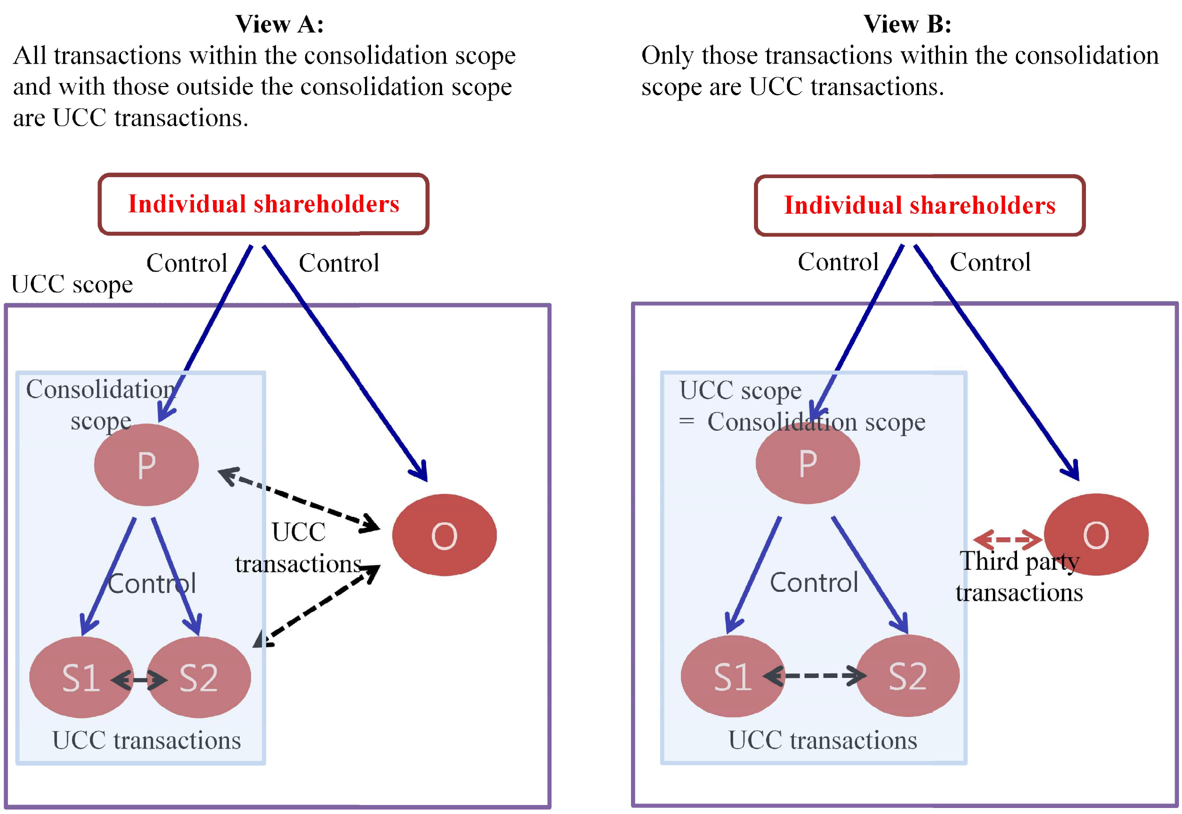
2.8 The relationship between the two different views on the scope of common control is shown in Figure 1.

<Figure 1>



2.9 Consequently, according to the scope of common control under IFRS 3 or US-GAAP, all transactions between entities controlled by an individual (or group of individuals), government, or entity (including the one not required to prepare financial statements) would be regarded as UCC transactions (View A); but according to the view of limiting the scope of common control to match that of consolidation scope, transactions between the controlling entity preparing consolidated financial statements and its subsidiaries would be regarded as UCC transactions (View B). View A and View B are described in Figure 2.

<Figure 2>



2.10 Regarding the aforementioned contradicting Views (View A and View B), the following questions should be asked and discussed.

Questions to participants

Q1.1) *Do you believe the definition of common control set out in IFRS 3 is appropriate? (i.e., regarding all transactions between entities controlled by an individual (or group of individuals), government, or entity (including the one not required to prepare F/S) as UCC transactions, like View A)*

Q1.2) *If not, how should it be revised? (e.g., limit the scope of common control to only entities in order to match the scope of consolidation. That is, regarding transactions between the controlling entity preparing consolidated F/S and its subsidiaries as UCC transactions, like View B)*

Ⅲ. Identifying common control

Criteria for identifying common control

3.1 As described in the definition of common control above, when determining the existence of common control according to IFRS and US-GAAP, a single person or single decision making party, under which entities are commonly controlled, may be an entity, individual or group of individuals, or government.

3.2 When a single entity, or single decision making party composed of entities is an ultimate controlling entity, it is relatively easy to identify the existence of common control. However, when a single decision making party composed of an individual or group of individuals is an ultimate controlling entity, it is relatively difficult to identify the existence of common control. For example, in many cases where a group of individuals controls a number of entities, there is no contractual arrangement if the group is composed of an individual and his/her close relatives. Thus, it is difficult to determine the existence of common control using a criterion of whether there is a contractual arrangement or not. The position of IFRS and US-GAAP regarding this matter is as follows.

IFRS

3.3 In paragraphs B1 to B3 in IFRS 3, a group of individuals are regarded as controlling the entity if the group collectively decides the financing and operating policies of the entity based on a contractual arrangement in order to obtain benefits from the activities of the entity. However, the paragraphs do not state a case where there is no documented contractual arrangement between the individuals in a group.

3.4 According to the interpretations of the IFRS Manual by PWC or E&Y, there exists no common control if there is no documented contractual arrangement between the individuals of a group unless all of the individuals in the group are members of a single family. When determining the scope of a single family, spouses and children are regarded as members of a single family while specific circumstances should be taken into consideration for a group of individuals comprised of siblings.

US-GAAP

3.5 US-GAAP, like IFRS, also supports control by a group of individuals. When lineal family members including spouses and their children and excluding grandchildren own more than 50% of the voting shares in each entity, they are regarded as controlling the investee entity unless there is evidence that the members are not to collectively exercise their voting rights. However, there may be a case where the ownership of entities is divided among siblings and their children in a variety of forms. In such a case, discreet care is needed in identifying the substance of ownership and voting rights. Because there is no official accounting treatment, many listed and non-listed entities apply the guidelines given by the SEC. Prudent judgement is required when determining the existence of common control in cases other than those set out in paragraphs 2.5 (1) to 2.5 (3). In a session led by a SEC official, the following 2 examples were presented as cases where entities are under common control by a controlling group.

(Example 1) Two brothers have secured control of a listed company by collectively holding a 60% interest in the company, and their father holds 100% of interest in two other companies. The companies 100% owned by the father provide services to the listed company collectively controlled by the brothers. If the three companies merge into one, the father and brothers form a controlling group and thus an issue would be raised about whether to allow applying historical cost (book value) for the interests held by them. Regarding this issue, the SEC official said that, unless there is evidence to the contrary, he would not oppose the argument that a group of relatives comprised of father and sons is a controlling group.

(Example 2) An individual, A owns interests in 3 companies. A holds a 60% interest in each of the first two companies and a 45% interest in the third. A has a contractual arrangement with the third company to reacquire the shares held by employees who is discharged or voluntarily retires from the company. Also, A has the ability to discharge employees holding shares. The question here is whether the three companies are under common control. The SEC official said that in order for the third company to be under common control, the employees holding shares should have given voting rights power of attorney that guarantees joint exercise of voting rights to the 45% interest holder.

Discussion & Question

3.6 When a single entity, or single decision making party composed of entities is an ultimate controlling entity, it is relatively easy to identify the existence of common control. However, when a single decision making party composed of an individual or group of individuals is an ultimate controlling entity, it is relatively difficult to identify the existence of common control. Thus, an important part of the criteria for identifying common control may be the criterion about group of individuals.

3.7 While the scope of a group of individuals can be clearly defined when there is a contractual arrangement among the individuals of the group, there are many cases where a group of individuals is composed of close relatives with no contractual arrangement among them. Therefore, various views may exist regarding how close the relatives should be not to require a contractual arrangement when determining them as a group of individuals holing common control.

3.8 As mentioned above, under US-GAAP, a contractual arrangement is not required for lineal family members (including spouses and children but excluding grandchildren), and under IFRS, though there is no explicit standard, similar interpretations as that of US-GAAP are given in accounting firms' manuals. While both sets of standards state that specific circumstances should be taken into consideration when a group of individuals is composed of siblings and their children in a variety of manners, neither of the standards provide detailed identification criteria.

3.9 When determining the scope of common control, the criterion for identifying the scope of a group of individuals is very important. If such criterion is not explicitly provided, there may be divergent interpretations depending on how far the scope of close relative covers and who should be subject to having a contractual arrangement. The divergent interpretations would lead to diversity in determining the scope of UCC transactions and undermine comparability among entities.

3.10 With respect to the criteria for identifying common control aforementioned, the following questions should be discussed.

Questions to participants

<u>***Q2.1)*** *Is it necessary to explicitly provide a criterion for identifying common control (e.g., criterion for determining the scope of a group of individuals)?*</u>

<u>***Q2.2)*** *If so, to what extent, in your opinion, should the scope of close relative, where a contractual arrangement is not needed, cover in relation to the criterion for determining the scope of a group of individuals (where a group of individuals is composed of siblings)?*</u>

<u>***Q2.3)*** *What other areas should the criteria for identifying common control be provided for other than the scope of a group of individuals? (For example, transitory control)*</u>

Ⅳ. Types of UCC transactions

4.1 UCC transactions refer to all transactions carried out between entities under common control and they frequently occur in a variety of transaction forms according to various purposes including tax savings, corporate reorganization, etc. Therefore, UCC transactions include all transactions conducted between entities under common control, e.g., business combinations (acquisition or disposal of shares or business, merger, etc.), spin-offs, and investment in kind.

Business combinations under common control

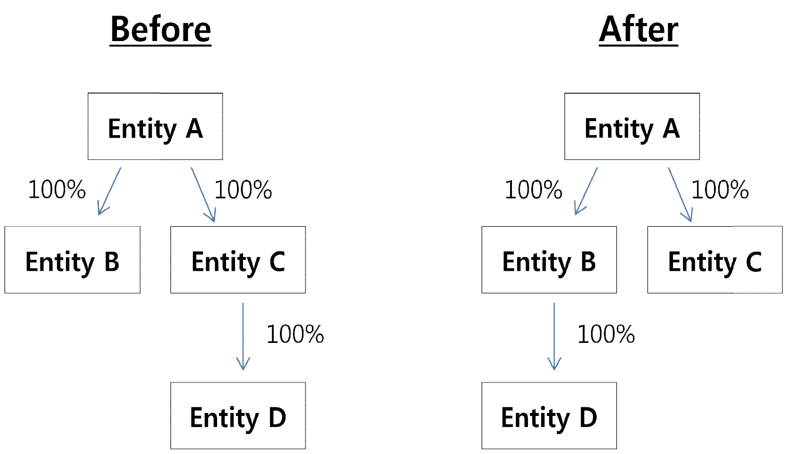
4.2 Business combinations under common control may be divided into acquisition or disposal of shares, merger, and acquisition or disposal of business, and details of each of these types of transactions are set out below.

Acquisition or disposal of shares

4.3 Acquisition or disposal of shares between entities under common control may be classified into: acquisition or disposal of shares of a subsidiary between an ultimate parent company and another subsidiary, between intermediate parent companies, and between another subsidiaries. A good example is group reorganization.

4.4 Figure 3 below shows that if entity C transfers its entity D shares to entity B, entity D becomes a subsidiary of entity B. However, since entities B and C are under control of entity A, the ultimate parent entity (or an individual, i.e., ultimate controlling shareholder), this stock transfer is classified as a transaction under common control.

<Figure 3>



Merger

4.5 Mergers among the ultimate parent company and subsidiaries or among subsidiaries are also examples of UCC transactions. Let's alter a few assumptions from the figure at 3, such that company C acquires company B by a merger. Such merger will alter legal entities, but will not change any economic substance from the viewpoint of the ultimate parent company.

Acquisition and disposal of business

4.6 A transfer of a business from an entity to another entity under common control is also type of a transaction under common control and the nature of the transaction is similar to that of stock transfer.

<u>Spin-off</u>

4.7 Spin-off could be classified as Type A spin-off and Type B spin-off. Details of these transactions are as follows.

Type A spin-off

4.8 This occurs when a company spins off a business unit as a separate legal entity and owns shares issued by the new legal entity. If there is a parent-subsidiary relationship between the existing company and the new company in the case of this spin-off, the transaction is a transaction under common control even if the new entity is a separate legal entity.

Type B spin-off

4.9 This occurs when a company spins off a business unit and swaps shares of the business unit with its own shares. In the case of pro rata Type B spin-off, where existing shareholders distribute their shares to the new entity on a pro rata basis, existing shareholders keep risks and rewards of the existing entity after the spin-off. This transaction is nothing but a legal form change from one entity to multiple entities and is an example of a transaction under common control. Also, a non-pro rata Type B spin-off without control change is an example of a transaction under common control.

Investment in Kind

4.10 Investments in kind are quite similar to Type A spin-offs except for the only difference of whether related transfer includes individual assets and liabilities or legal comprehensive ownership. While investment in kind is similar to transfer of assets in that an individual asset or group of assets are transferred, investment in kind is essentially identical to Type A spin-offs in that the entity that provides investment in kind receives controlling shares. Therefore, investment in kind among entities under common control is also an example of a transaction under common control.

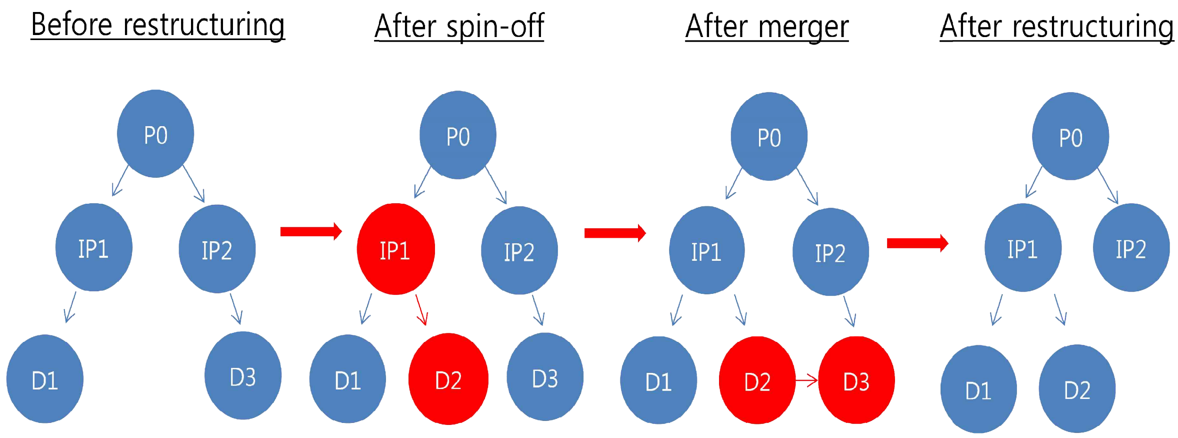
Transaction under common control in practice

4.11 While we classify transactions under common control into mergers, spin-offs, and other types, actual transactions under common control take a combination of these transactions because entities often use transaction under common control as a means to execute corporate strategies such as restructurings. Examples of transactions under common control in practice are as follows.

Spin-off (Type A) and simultaneous merger

4.12 In order to restructure the hierarchy among entities under common control, an intermediate parent company spins off a business unit as a new entity, and then the new entity merges a subsidiary of another intermediate parent company. Figure 4 below illustrates these transactions.

<Figure 4>



4.13 Figure 4 above shows that P0 is the ultimate controlling entity and that IP1 and IP2 are intermediate parent entities that own subsidiaries D1 and D3, respectively. For restructuring, the ultimate controlling entity executes a spin-off (Type A) such that IP1 spins off and creates a new grandson entity, D2, which subsequently acquires D3, a subsidiary of another intermediate parent company, IP2, for the completion of corporate restructuring.

4.14 Similar to the spin-off (Type A) and simultaneous merger transaction above, other combinations of UCC transactions, such as business acquisitions and simultaneous spin-off (Type B), stock acquisition, merger and simultaneous spin-off, could also be examples of transactions under common control, which are often executed to achieve corporate goals such as restructuring, reorganization, and tax savings.

Discussion & Question

4.15 Transaction under common control has various types and each type has a distinctive transaction structure. The most common type is a business combination, which often includes merger, stock acquisition, business acquisition, etc. Therefore, some argue that the UCC project should deal with only business combinations under common control for a proposed set of accounting principle, methods, and guidance due to time constraint and needs to provide a timely accounting guidance.

4.16 Others argue, however, that the UCC project should address all UCC types in an inclusive manner because (1) transactions under common control often arises as a combination of various transactions and (2) accounting guidance specifically designed for BCUCC will cause an accounting divergence between BCUCC and spin-off for one (same) transaction under common control. Therefore, we believe that the following discussion is necessary.

Question to participants

Q3.1) *In the UCC project, should we include all UCC transaction types or only BCUCC for accounting principle, methods and guidance?*

4.17 Another point is that because UCC transactions include mergers, spin-offs, stock transfers and other transactions and one transaction under common control often includes various forms of transaction, there must be one accounting treatment for all types of transactions. If there are alternative accounting treatments (i.e., fair value method for spin-offs and book value method for mergers), an entity UCC might have incentives to exploit accounting differences for its reporting purposes (i.e., an intermediate parent UCC company merges its own subsidiary and spins it off again such that the unit takes advantage of a fair value basis). Thus, we need to discuss the following question.

Question to participants

Q3.2) *In the UCC Project, should we provide a single accounting guidance for all types of UCC transactions? Or should we allow providing alternative methods for varying types of UCC transactions (i.e., fair value method for spin-offs and book value method for mergers)?*

Ⅴ. Accounting for UCC transactions in consolidated financial statements

General accounting principles

5.1 At conceptual level, UCC entities form a single economic entity. Therefore, from the perspective of the ultimate controlling entity and the UCC structure, there are no economic substance changes for any UCC transaction. On the other hand, UCC transactions occur in many different forms in various circumstances. In addition when a party to a UCC transaction is an intermediate parent entity or subsidiary (i.e., non-ultimate controlling entity), the UCC transaction may have economic consequences from the perspective of that party.

5.2 Following the aforementioned logic from the perspective of the ultimate controlling entity, any UCC transaction should not bring any economic consequence and, therefore, there must be no impact on the consolidated financial statements prepared by the ultimate controlling company.

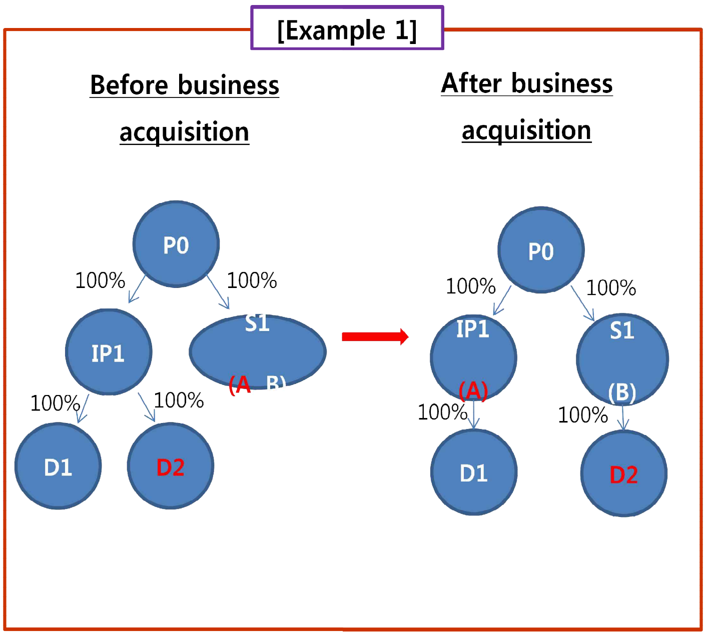
5.3 However, subsidiaries or intermediate parent entities might have two alternative viewpoints. First, one can argue that because subsidiaries are part of the UCC structure, subsidiaries should apply the same accounting treatment as the one applied by the ultimate controlling entity (i.e., from the perspective of the ultimate controlling entity). This logic is based on proprietorship theory, which explains that, to the extent that the controlling entity can exercise the control over subsidiaries regardless of share percentages held by the controlling entity, subsidiaries are part of UCC entities.

5.4 Second, an alternative view is that subsidiaries and intermediate parent entities are separate reporting entities and should provide financial reporting accordingly. According to this view, if subsidiaries have non-controlling interests, subsidiaries have reporting responsibilities not only for the controlling interest but also for the non-controlling interests. In addition, if these subsidiaries had issued global bonds or convertible bonds, fixed income claimants of these securities also would be primary users of financial reporting. Therefore, from the perspective of non-controlling interests or fixed income claimants, transactions among subsidiaries and UCC entities could be viewed as arm's length transactions. Consequently, UCC transactions could be treated as arm's length transactions that might have economic impact on the consolidated financial statements. The following table summarizes these arguments.

Classification	**Ultimate controlling entity**	**Subsidiaries including intermediate parent entities**
View 1	Financial reporting from the perspective of the ultimate controlling entity	Financial reporting <u>from the perspective of the ultimate controlling entity</u>
View 2	Financial reporting from the perspective of the ultimate controlling entity	Financial reporting based on the assumption that subsidiaries and intermediate parent entities are <u>separate reporting entities that are independent from the ultimate controlling entities or other subsidiaries</u>

5.5 It is difficult, if not impossible, to support either view 1 or view 2 unequivocally and the choice between view 1 and view 2 would be boiled down to the demand of information users of subsidiaries and intermediate parent entities. That is, if non-controlling interests of subsidiaries are significant and non-controlling shareholders' information demand is high, then view 2 would be appropriate. Alternatively, if the controlling entities wholly own subsidiaries or if non-controlling interests of subsidiaries are not important (i.e., the ultimate controlling entity is the primary user of accounting information), then view 1, which provides financial reporting of subsidiaries from the perspective of UCC entities, would be more relevant than view 2.

5.6 Let’s illustrate the aforementioned point by examining the following case. An intermediate parent company acquired a business under common control and provided the subsidiary’s stock for a consideration. Net assets and cash flows attributable to the intermediate parent company change due to the transaction. Thus, this BCUCC transaction has an economic substance for the reporting entity, which is an intermediate parent company. Two examples are presented below in relation to the BCUCC transaction. Although the two examples are based on the assumption of the same BCUCC transaction, there are major differences between the financial statements of the two examples with respect to equity structure, convertible bonds and global bonds.



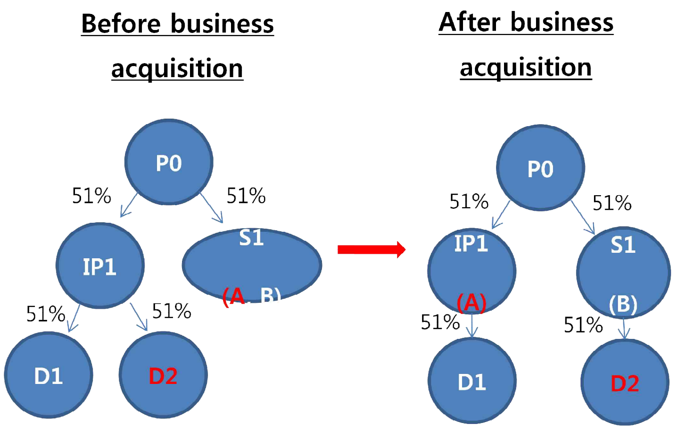
[Facts]

- **P0, IP1 and S1 are all publicly listed**
- **S1 operates two businesses (Business A, Business B)**
- **P0 has a 100% ownership in IP1 and S1**
- **D1 and D2 are the wholly owned subsidiary of IP1, and IP1 has no convertible bonds or public bonds**

<BCUCC transactions>

IP1 purchases business A from S1 and transfers a consideration, which is 100% of the shares of D2

[Example 2]



[Facts]

- P0, IP1 and S1 are all publicly listed
- S1 operates two businesses (Business A, Business B)
- P0 has a 51% ownership in both IP1 and S1, of which 49% are non-controlling interests
- IP1 has a 51% ownership in D1 and has considerable amounts of convertible bonds and global public bonds

<BCUCC transactions>

IP1 purchases business A from S1 and transfers a consideration, which is 100% of the shares of D2

5.7 By reviewing the two examples above, we can ask the following question: What accounting method should be used in IP1's Consolidated F/S? In order to answer the question, the following analyses are necessary.

Factors to be considered	Example 1	Example 2
Ultimate controlling shareholder	100%	51%
Non-controlling shareholders	X	49% (significant)
Convertible bonds investors	X	O
Global bonds investors	X	O

5.8 If we follow the analyses, the major user of the financial statements of IP1 is the ultimate controlling shareholder (P0) in Example 1. On the other hand, the major users of the financial statements of IP1 are diverse, such as non-controlling shareholders, investors in convertible bonds, investors in publicly offered global bonds, etc., in Example 2.

5.9 Now, let's link the results of these analyses to viewpoints provided in 5.3 and 5.4. Accounting treatments following View 1 and View 2 would be more appropriate for Example 1and Example 2, respectively. In Example 1, IP1's primary information user would be the ultimate controlling company. In this case, UCC transactions should not affect the financial reporting from the perspective of the ultimate controlling entity because such transactions would not have any economic consequence among UCC entities. Therefore, book value method would be an ideal choice for IP1, the party to this BCUCC transaction.

5.10 In contrast, Example 2 shows that IP1's primary information user is not only ultimate controlling shareholder, but also other constituents such as non-controlling shareholders, convertible bonds investors, and global bonds investors. Because all these other constituents are assumed to be important information users, IP1 could be better positioned to be a separate reporting entity, for which fair value method would be an appropriate accounting choice. For your information (details will be discussed in Part VII of this discussion paper), most Korean UCC cases are like Example 2 due to the corporate governance system, market structure and regulatory environment.

5.11 Relating to the aforementioned general accounting principles for UCC transactions, we need to discuss the following questions.

Questions to participants

Q4.1) *Do you agree that we dichotomize UCC cases into the UCC entity view and the separate reporting entity view and provide two alternative accounting choices based on the analyses of the information users and their demand? (see paragraphs. 5.3 to 5.10)*

Q4.2) *Do you agree with a viewpoint that UCC transactions are often executed to cater to the benefits and business goals of the ultimate controlling entity and all UCC transactions should be treated as transactions that have no economic consequences among UCC entities regardless of the individual perspective of a single UCC entity among UCC group? (see paragraphs. 5.1 to 5.2)*

__Q4.3)__ Should financial reporting of subsidiaries (including intermediate parent entities) be part of financial reporting of the ultimate controlling entity? Or should it be financial reporting of a separate reporting entity?

Accounting for UCC transactions

(1) Book value method

5.12 Just like the ultimate parent entity, intermediate parent entities or subsidiaries have to transfer the assets and liabilities at book value in a UCC transaction when accounting from the UCC perspective. The book value method focuses on the perspective of the ultimate controlling shareholder. From the perspective of the ultimate controlling shareholder, there is no economic consequence among UCC entities and thus it is argued that it is appropriate not to recognize any gain or loss from the transaction even if the parties to the transaction are subsidiaries or intermediate parent companies.

5.13 There exist many different alternatives as shown below as to which book value should be applied when the book value method is adopted:

Alternative A*: Carrying amounts in the consolidated F/S of the ultimate controlling entity*

Alternative B*: Carrying amounts in the consolidated F/S of the immediately superior controlling entity*

Alternative C*: Carry-over basis of previous carrying amounts*

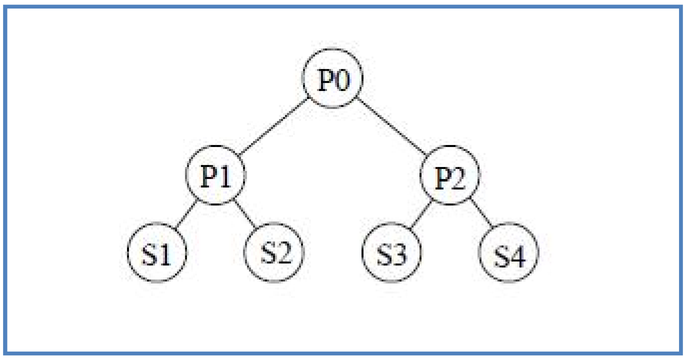
5.14 In IFRS, there is no clear standard for UCC transactions or which of these book values should be selected. However, the IFRS Practice guideline of PWC interprets that, where there is an intermediate parent company, the carrying amounts in the consolidated F/S of the ultimate controlling entity should be used for recognition of the assets and liabilities to be transferred in a BCUCC transaction.

5.15 In 2010, The KASB has surveyed the members of the IFASS and Big 4 accounting firms with respect to which book value should used in a UCC transaction as shown below.

5.16 Below are the issues and questions raised in the KASB's survey:

This example illustrates one of common control transactions, a transfer of the ownership a parent has in a subsidiary to another subsidiary.

P0, P1 and P2 are all publicly traded entities. P0 has a 51% ownership in P1 and P2 respectively. S1 and S2 are the wholly owned subsidiary by P1, and S3 and S4 are by P2. P0 is required to prepare consolidated financial statements for the entire group, and P1 and P2 is presumed to prepare consolidated financial statements for each subgroup.



Question

(1) Which of the two methods, book value method and fair value method, do you think is more appropriate?

(2) P1 purchases the 100% ownership of S3 from P2. If book value is to be used, which book value should be used?

- P0's consolidated F/S
- P2's consolidated F/S
- S3's individual F/S

5.17 Below are the responses from the member countries of the IFASS and Big 4 firms:

<The KASB performed a survey asking IFASS opinions on the issues>

Jurisdiction	Question (1)	Question (2)
Australia	Book value , Exchange value, or Fair value	P1 has an option to choose among the alternatives
Canada	Fair value(exchange value)	If book value should be used, the book value in P0's consolidated F/S
England	Book value	- Book value of S3 - Book value of S3 in P0's consolidated F/S - Book value of S3 in P2's consolidated F/S
Germany	Book value or Fair Value	Book value of S3 in P2 consolidated F/S
Japan	Book value	Book value of S3
Korea	Book value	Book value of S3 in P0 consolidated F/S
USA	Book value	Book value of S3

(Note: These opinions are not official of the respective IFASS)

<The KASB requested views from major accounting firms on the issues>

<table>
<tr><th>Accounting firm</th><th>Question (1)</th><th>Question (2)</th></tr>
<tr><td>Deloitte</td><td rowspan="4">Book Value, Fair Value</td><td rowspan="3">- Book value of S3
- Book value of S3 in P0's consolidated F/S
- Book value of S3 in P2's consolidated F/S</td></tr>
<tr><td>KPMG</td></tr>
<tr><td>E & Y</td></tr>
<tr><td>PWC</td><td>If book value is chosen, the book value of S3 in P0's consolidated F/S</td></tr>
</table>

5.18 The result of the survey may is summarized below:

<Question 1>

Book value	Fair value	Both
4	1	6

<Question 2>

S3's F/S	P0's consolidated F/S	P2's consolidated F/S	Any of the three
2	2	2	5

5.19 For the first question, the option that allows both methods is in the lead followed by the book value method. For the second question, the choice that permits all the options ranked the top with the remaining options tied. As the results imply, responses vary. With this result, it is inferable that under the IFRS any method can be opted for because no matter which method is taken it has respective rationales. Additionally, in practice major accounting firms seem to allow all options available. Consequently the comparability of financial information will be severely damaged.

5.20 Regarding the alternative accounting treatments for book value in a UCC transaction, the following question should be asked and discussed.

Question to participants

***Q4.4)** When accounting for a UCC transaction using book value method, which of the three alternatives, A, B, and C in paragraph 5.13, do you think is appropriate?*

(2) Fair value method

5.21 Subsidiaries (including intermediate parent companies) account for a UCC transaction from an independent reporting entity perspective. Thus, the assets and liabilities transferred in the UCC transaction should be measured at fair value on the acquisition date. Fair value method focuses on the perspective of the stakeholders in the reporting entity. When there is any change made to the economic substance of the subsidiary, i.e., the reporting entity, due to the UCC transaction, it is viewed that it would be appropriate to recognize the UCC transaction as a general commercial transaction from the external stakeholder perspective.

5.22 IFRS 3 is a standard applicable to a business combination between independent third parties in a general market environment. Thus, IFRS 3 may be applied to BCUCC transactions if the UCC transaction is accounted for at fair value from the independent reporting entity perspective. There should also be requirements for other types of UCC transactions like spin-offs and investment in kind to be accounted for at fair value as if they are transactions with third parties.

5.23 However, some argue that, when applying the acquisition method provided in IFRS 3 to BCUCC transactions regardless of the characteristics of UCC transaction, there arise doubts as to whether the goodwill generated from the transaction is de facto goodwill. Thus, they insist that even if fair value method is applied, an adjusted acquisition method in which the characteristics of UCC are reflected should be applied instead of fully applying IFRS 3, for example, perhaps remeasuring recognized assets and liabilities, but not recognizing goodwill, intangibles, or additional liabilities.

5.24 In other words, the following alternatives exist when fair value method is applied to UCC transactions, in particular, BCUCC transactions:

Alternative A*: Acquisition method (recognize goodwill in accordance with IFRS 3 for BCUCC)*

Alternative B*: Adjusted acquisition method (remeasure assets and liabilities at fair value but not recognize goodwill, etc.)*

Alternative C*: Other methods*

5.25 Regarding the aforementioned fair value accounting for UCC transactions, the following question should be asked and discussed.

Question to participants

Q4.5) *When accounting for a BCUCC transaction using fair value method, which of the alternatives, A and B in paragraph 5.24, do you think is appropriate? If neither of the alternatives are inappropriate, what other alternative do you suggest?*

VI. Accounting for UCC transactions in separate financial statements

The need for accounting guidelines on UCC transactions in separate F/S

6.1 Under IFRS, consolidated financial statements are the primary financial statements and separate financial statements are optional supplementary statements used for reference. Thus, IFRS does not provide specific accounting guidelines for separate financial statement in various situations.

6.2 In Some countries, including Korea, entities having subsidiaries subject to consolidation are required to file consolidated financial statements together with separate financial statement under the external audit law. It means that separate financial statements are also part of the primary financial statements that must be prepared. Also, separate financial statements are used in calculating distributable profit under the tax law or various regulatory ratios because separate financial statements are viewed as statements prepared from a legal entity perspective.

6.3 Consequently, it is extremely important that accounting for UCC transactions in separate financial statements is provided concretely because it may significantly affect separate financial statements which are required to be prepared and important in practice. If accounting for UCC transactions in separate financial statements is not clearly provided, comparability may be undermined due to the inconsistency in accounting treatments and thus reliability of separate financial statements locally used for tax or regulation purposes may be deteriorated.

6.4 However, in many countries, separate financial statements are just supplementary statements or prepared under local GAAP rather than IFRS. This is why some argue that it is inefficient to address detailed accounting guidelines for separate financial statements as the time and cost are limited. Thus, it is necessary to discuss the following and examine the need to provide accounting guidelines for UCC transactions in separate financial statements.

Question to participants

Q5.1) *In your jurisdiction, is preparation of separate financial statements a requirement under laws and regulations?*

Q5.2) *In your jurisdiction, are separate financial statements prepared under IFRS?(or local GAAP?)*

Q5.3) *Do you agree that guidance on accounting for UCC transactions in separate financial statements should be provided by including the issue in the UCC project? If not, what are your reasons?*

Accounting for UCC transactions in separateF/S

6.5 Under IFRS, separate financial statements are supplementary statements and thus IFRS does not concretely provide accounting guidelines for separate financial statement, except for the definition and accounting treatment briefly set out in IAS 27 'Separate Financial Statements (amended 2011)' shown below:

Definition (IAS 27 amended 2011 Paragraph 4)*: Separate financial statements are those presented by a parent (ie an investor with control of a subsidiary) or an investor with joint control of, or significant influence over, an investee, in which the investments are accounted for at cost or in accordance with IFRS 9 Financial Instruments.*

Definition (IAS 27 amended 2008 Paragraph 4)*: Separate financial statements as those financial statements of an entity in which the investments are accounted for on the basis of the direct equity interest, rather than on the basis of the reported results and net assets of the investments*

Paragraph 10 (IAS 27 amended 2011)*: When an entity prepares separate financial statements, it shall account for investments in subsidiaries, joint ventures and associates either:*
(a) at cost, or
(b) in accordance with IFRS 9.
The entity shall apply the same accounting for each category of investments. ...

BC7 (IAS 27 amended 2011)*: ... The Board draws a distinction between accounting for such investments as equity investments and accounting for the economic entity that the parent controls. In relation to the former, the Board decided that each category of investment should be accounted for consistently.*

BC10 (IAS 27 amended 2011)*: ... For separate financial statements, the focus is upon the performance of the assets as investments. .. Using the cost method can result in relevant information, depending on the purpose of preparing the separate financial statements. ...*

6.6 Based on the above, separate financial statements may be understood as follows: separate financial statements are based on a legal entity concept since separate financial statements focus on the performance of investment assets based on direct equity investment rather than on the reported performance and net assets. Thus, significant influence or control should not be considered in individual transactions, which means that there is no need to consider whether the other party to the transaction is a subsidiary or associate. In other words, it would be appropriate to view transactions with subsidiaries and associates as independent transactions with third parties.

6.7 For instance, when control is obtained by acquiring additional shares in an associate, this is viewed as a business combination achieved in stage ('a step acquisition') in consolidated financial statements and thus the existing shares are remeasured at fair value and the difference between the remeasured fair value and previous book value is recognized as gain or loss according to paragraph 42 of IFRS 3. This is because in consolidated financial statements, acquisition of control is viewed as an event that significantly changes the substance of the investment and economic environment relating to the investment.

6.8 However, because separate financial statements are prepared based on direct equity investment, IFRS 3 may not be applied to the step acquisition transaction. The additional acquisition cost should merely be added to the previous book value of shares. Yet, the acquisition of control causes the category of investments to change from the existing investments in associates to investments in subsidiaries. According to paragraph BC7 in IAS 27, each category of investment should be accounted for consistently. Therefore, if all investments in associates or subsidiaries were accounted for using the cost method or the fair value method, the change in category would not have any effect.

6.9 Due to the definition and nature of the accounting for separate financial statements provided in IAS 27, the following conflicting views exist regarding the accounting for UCC transactions in separate financial statements.

View A: *Since the acquirer may be determined and the transaction may be designed from the ultimate controlling shareholder perspective, UCC transactions are viewed as transactions with no economic substance and accounted for at book value even in separate financial statements*

View B: *Considering the characteristics of separate financial statements set out in IAS 27, that is, considering that separate financial statements focus on the performance of investment assets based on direct equity investment, UCC transactions should also be* *generally understood as transactions with third parties. Consequently, UCC transactions are accounted for at fair value.*

6.10 An in-depth discussion should be conducted through the UCC Project to examine which of the two views above is appropriate. However, the current views of the IFRS IC regarding UCC transactions in separate financial statements have been partially expressed via the agenda paper 'IAS 27 Consolidated and Separate Financial Statements-Group reorganizations in separate financial statements' reviewed at the meetings held in July and September 2011. The paper was reviewed at the request of an external stakeholder who asked for interpretations regarding how to account for group reorganizations through share exchange in separate financial statements as UCC transactions.

6.11 An external inquirer has presented the following scenario to the IFRS IC and asked whether paragraphs 13[3] and 14[4] (IAS 27 amended 2008 paragraph 38B and 38C) in IAS 27 (amended 2011) may be applied to the scenario by analogy.

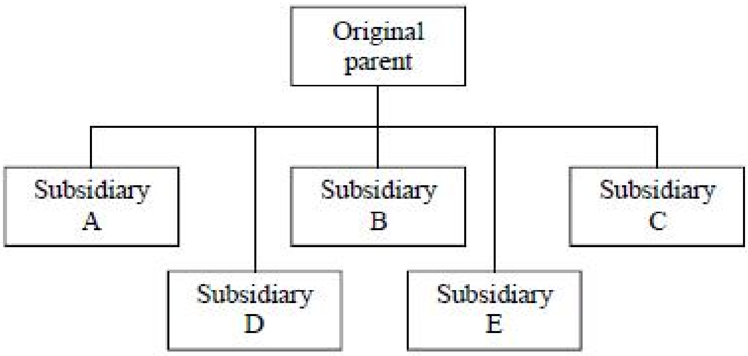
<u>The issue</u>

The request addresses group reorganisations in which the original parent with multiple subsidiaries establishes new intermediate parents between itself and several subsidiaries in a share-for-share exchange, often referred to as a 'one-to-many' parent-subsidiary relationship, as illustrated below. Such reorganisations typically occur before an initial public offering (IPO).

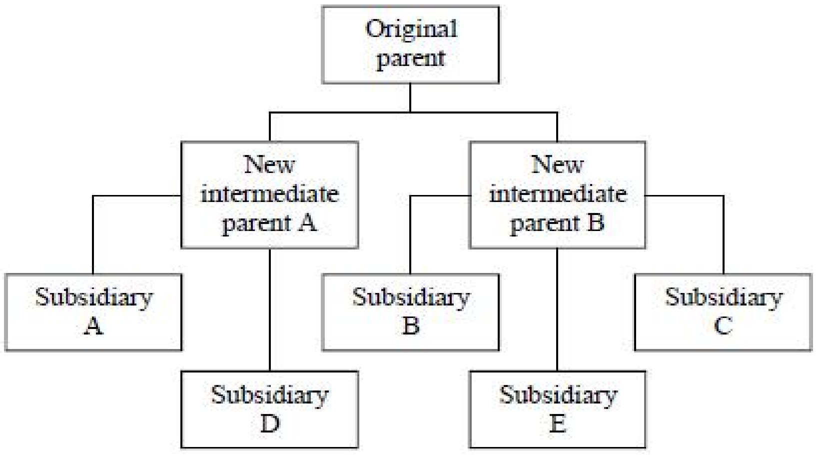
[3] IAS 27 paragraph 13 When a parent reorganises the structure of its group by establishing a new entity as its parent in a manner that satisfies the following criteria:
(a) the new parent obtains control of the original parent by issuing equity instruments in exchange for existing equity instruments of the original parent;
(b) the assets and liabilities of the new group and the original group are the same immediately before and after the reorganisation; and
(c) the owners of the original parent before the reorganisation have the same absolute and relative interests in the net assets of the original group and the new group immediately before and after the reorganisation,
and the new parent accounts for its investment in the original parent in accordance with paragraph 10(a) 'at cost' in its separate financial statements, the new parent shall measure cost at the carrying amount of its share of the equity items shown in the separate financial statements of the original parent at the date of the reorganization.

[4] IAS 27 paragraph 14 Similarly, an entity that is not a parent might establish a new entity as its parent in a manner that satisfies the criteria in paragraph 13. The requirements in paragraph 13 apply equally to such reorganisations. In such cases, references to 'original parent' and 'original group' are to the 'original entity'.

(a) Before the reorganisation:



(b) After the reorganisation:



In such reorganisations, a new intermediate parent typically acquires the original parent's interests in the subsidiaries in exchange for its own equity instruments, ie equity instruments that it issues to the original parent. In other words, the new intermediate parent A, for example, acquires, in the scenario presented above, the original parent's shareholdings in subsidiary A and subsidiary D in exchange for the new equity instruments that it issues to the original parent as part of this reorganisation.

IAS 27 does not define cost. However, we note that based on analogy to other IFRSs (eg IAS 16 Property, Plant and Equipment, IAS 38 Intangible Assets and IAS 40 Investment Property), it is generally understood that cost is the fair value of the consideration given.

For certain reorganisations, however, paragraphs 38B and 38C of IAS 27 (amended 2008) require a different approach for determining the cost of the investments. Instead of determining the cost of the investments by the fair value of the consideration given, these paragraphs require a new intermediate parent to measure cost at the carrying amount of its share of the equity items shown in the separate financial statements of the subsidiaries at the date of the reorganization (previous carrying amount basis).

Different views exist as to whether the new parents may apply paragraph 38B of IAS 27, and measure cost at the carrying amount of its share of the equity items shown in the separate financial statements of the original parent at the date of the reorganisation. Different views suggested are as follows:

<u>View 1 Measure by fair value of consideration given</u>: Proponents of this view believe that new intermediate parents must determine the cost of their investments in the subsidiaries by the fair value of the equity instruments they have issued to the original parents in exchange for the investments in the subsidiaries. They consider this approach to be the application of the general principle which is to determine cost by the fair value of the consideration given and the application of the previous carrying amount basis under paragraphs 38B and 38C of IAS 27 (amended 2008) an exception to that general principle. Proponents of this view reject the application of the previous carrying amount basis for the following two reasons:
(i) the type of reorganisations presented above is not in the scope of paragraphs 38B and 38C of IAS 27 (amended 2008), and
(ii) it is not appropriate to apply an exception to a general principle by analogy.

<u>View 2 Measure by previous carrying amount basis</u>: Proponents of this view believe that new intermediate parents must apply the previous carrying amount basis to determine the cost of their investments in the subsidiaries in the type of reorganisations presented above. They reach this conclusion because they consider such reorganisations to be in the scope of paragraphs 38B and 38C of IAS 27 (amended 2008).

Staff analysis and IFRS IC decision

The staff agreed with the submitter that paragraph 38B of IAS 27 (amended 2008) does not require the application of the previous carrying amount basis to the scenario presented in the submission. Paragraph 38B of IAS 27 only applies if the original parent would establish the new entity as its parent ('when a parent reorganises the structure of its group by establishing a new entity as its parent'). The new intermediate parents A and B are instead established as subsidiaries of the original parent. Consequently, the staff agreed with the proponents of view 1 that reorganisations of groups that result in the new intermediate parent having more than one subsidiary are not within the scope of paragraph 38B and 38C of IAS 27, because criterion in paragraph 38(b) of IAS 27 (amended 2008) is not met. The new group of intermediate parent A also includes, for example, the assets and liabilities of Subsidiary D', whereas the original entity 'Subsidiary A' did not.

The staff agreed with the proponents of view 1 that the general principle for determining cost of an investment in the scope of paragraph 38(a) of IAS 27 is the fair value of the consideration given for the investment. This general principle also respects the concept underlying separate financial statements, namely that such financial statements reflect the boundaries between separate legal entities. Accordingly, paragraph 4 of IAS 27 (amended 2008) defines separate financial statements as those financial statements of an entity in which the investments are accounted for on the basis of the direct equity interest, rather than on the basis of the reported results and net assets of the investments.

Therefore, the staff agreed with view 1 that the previous carrying amount basis cannot be applied by analogy to reorganisation of groups that result in the new intermediate parent having more than one subsidiary. Such parents have to measure their investments in the subsidiaries at the fair value of the consideration given.

The Committee agreed with the staff's opinion that supports view 1. Also, the Committee noted that there is already sufficient guidance in IAS 27 (amended 2008) and IAS 27 (revised 2011). Consequently, the Committee decided not to add this issue to its agenda.

6.12 According to the staff analysis and IFRS IC decision, the general principle is that cost of an investment is measured by the fair value of consideration in separate financial statements when a parent reorganizes the structure of its group under common control, except for certain cases that meet all requirements presented in paragraph 38B of IAS 27 (amended 2008), currently replaced by paragraph 13B of IAS 27 (amended 2011). That is, even if the economic substance of the reorganization does not change from UCC perspective, the previous carrying amount basis may only be applied to those fulfilling the detailed conditions set out in paragraph 38B and 38C of IAS 27 (amended 2008), and cannot be applied by analogy to those that do not meet the conditions.

6.13 However, it is not clear whether the principle of measuring by fair value in the reorganization scenario shown in the IFRS IC's interpretation above may also be applied to other types of UCC transactions, such as business acquisition, merger, and spin-off. Yet this interpretation and intention of the IFRS IC should be taken into account when developing accounting for UCC transactions in separate financial statements as part of the UCC Project.

6.14 Therefore, we should discuss and examine the following questions regarding the accounting treatment for UCC transactions in separate F/S.

Questions to participants

Q5.4) *With respect to the accounting for UCC transactions in separate financial statements, which of the two views described in paragraph 6.9, i.e., View A and View B, do you agree with? And what are your reasons?*

Q5.5) *Do you think that the current interpretation of the IFRS IC regarding entity reorganization in separate financial statements can be applied by analogy to other accounting for UCC transactions in separate financial statement?*

Q5.6) *Do you agree that the current interpretation and intention of the IFRS IC regarding reorganization through share exchange should be considered when the UCC Project addresses accounting for UCC transactions in separate financial statements?*

Ⅶ. Distinct features of UCC transactions in Korea

7.1 A typical ownership structure of Korean entities involves a corporate group in which a major shareholder exercises control over the entities in the group. That is, in many cases in Korea, such group is comprised of a group of powerful monopolistic capitalists or businessmen, or a group of large companies consisting of family members or relatives. These groups are called conglomerates.

7.2 A conglomerate owns a variety of interrelated enterprises in many different markets through diversification which are not subject to relevance issues in terms of production nature. They appear to be independent of each other but in substance they form a group of entities where the entities are controlled in a consistent manner via equity ownership or common management among the affiliated entities. The prime examples are Samsung Group, Hyundai Motor Group, and LG Group in Korea. These conglomerates have contributed greatly to the economic development of Korea and are still important part of Korea's economy.

7.3 Most of these corporate groups are entities under common control of an individual, and thus transactions among affiliated entities within a corporate group are likely to be UCC transactions.

7.4 Corporate groups in Korea have the following characteristics due to the market and regulatory environment unique to Korea.

For listed companies, non-controlling interest is greater than controlling interest

7.5 The percentage of interest owned by a controlling entity in a subsidiary is usually small and thus there are a number of stakeholders in the subsidiary in addition to the controlling entity. In a typical ownership structure of a subsidiary in Korea, there are many non-controlling shareholders besides the controlling entity. This is due to the unique ownership structure of conglomerates and having subsidiaries listed as a means of raising capital.

7.6 According to the data published by the Fair Trade Commission of Korea at the end of 2011, an average percentage of interest that a general holding company owns in a listed subsidiary is 41.9% which is much smaller than that of non-controlling interest. Even for a financial holding company, its average percentage of interest in a listed subsidiary stands at only 45.1%. The trend of changes in general and financial holding companies' average interest in subsidiaries between 2007 and 2011 is shown below.

Changes in general holding companies' controlling interests, Source: Fair Trade Commission

Year	FY '07	FY '08	FY '09	FY '10	FY '11
Listed subsidiaries	40.5%	41.1%	41.0%	40.8%	41.9%
Unlisted subsidiaries	81.8%	82.5%	81.8%	81.5%	82.1%

Changes in financial holding companies' controlling interests, Source: Fair Trade Commission)

Year	FY '07	FY '08	FY '09	FY '10	FY '11
Listed subsidiaries	46.2%	47.7%	47.9%	48.0%	45.1%
Unlisted subsidiaries	94.4%	94.0%	94.2%	94.1%	93.8%

7.7 According to the above tables, the percentage of interest in subsidiaries owned by holding companies did not exceed 50% for the last 5 years, showing a stable trend.

There are many listed intermediate parent companies.

7.8 In Korea, there are many listed intermediate parent companies or listed subsidiaries and thus there exist many stakeholders in the intermediate parent company or listed subsidiary. As of June 2012, examples of corporate groups that include listed intermediate parent companies are: Samsung C&T, Samsung Electro-mechanics, and Samsung Fire & Marine Insurance of Samsung Group, and Kia Motors Corporation, MOBIS, and Hyundai Glovis of Hyundai Motor Group. Current status of major corporate groups is as follows.

Current status of major corporate groups as of June 30, 2012, Source: DART

Group	Samsung	Hyundai	SK	LG	Hanwha	Hanjin
Listed company	17	10	18	11	6	5
Unlisted company	67	46	76	51	47	39
Total	84	56	94	62	53	44
The ratio of listed company	20.2%	17.9%	19.1%	17.74%	11.32%	11.36%

7.9 As shown in the table above, Samsung Group has 17 listed intermediate parent companies or listed subsidiaries, Hyundai Motor Group has 10, and SK Group has 18. Those listed companies are usually the main driving force of each corporate group, significant not only in terms of quantity but of quality as indicated by the asset size, sales amount, net profit, etc.

7.10 In addition, many limited companies issue convertible bonds or issue public offering bonds in the domestic and overseas market. This has resulted in a variety of users of financial statements, such as creditors and potential holders of voting rights.

7.11 We conclude that conglomerates have significantly high ratios of external stakeholders and other non-controlling interests due to the structure of governance and market environment in Korea. Consequently, a great percentage of BCUCC transactions in Korea will fall into Example 2 in paragraph 5.6. That is, Example 1 in paragraph 5.6 is hardly found in a listed company subject to application of IFRS in Korea.

7.12 The controlling entity's interest in the corporate group in Korea is usually less than 50% roughly because of the following two reasons.

Consolidation under local GAAP before IFRS adoption

7.13 When determining the scope of consolidation under Korean local GAAP prior to the IFRS adoption, an entity is considered to control an investee company, and thus is included within the scope of consolidation, when the entity owns more than 30% and is the largest shareholder of the investee company. That is, since an entity can control an investee company when it owns more than 30% of the investee company, there were not many cases where an entity owns more than 50% of a listed company because it would require a considerable amount of money for the acquisition as the listed company would have a large market capitalization .

Lack of systems such as Mandatory Tender Offer

7.14 Mandatory Tender Offer (hereinafter MTO) is a rule which requires anyone who acquires control of a listed company by acquiring shares to publicly promote a tender offer on the remaining shares (non-controlling interest) at a price greater than the acquisition price of the controlling interest for a specified time in the stock market. Through this MTO system, indiscreet M&As may be prevented, control of the existing major shareholders may be protected, and chances for capital gain may be given to minority shareholders. The MTO system is enforced by the applicable law in most European countries including the U.K., Germany, and France, Asian countries including China, Hong Kong, Japan, and Singapore, and the U.S.

7.15 The acquisition price of controlling interest is greater than current share price in the stock market due to the factors like management premiums. Thus, when the MTO system is implemented, minority shareholders would utilize this system to sell their interests at the acquisition price of controlling interests. As for the acquirer of the shares, the acquirer would have to acquire a greater number of shares than the percentage of interest necessary for acquiring control. Consequently, the interest owned by the purchaser is likely to be more than 50%.

7.16 Although Korea had adopted the MTO system[5] in 1997, it was revoked one year after in 1998 as the International Monetary Fund (IMF) advised Korea to encourage M&As to promote restructuring of Korean companies during the Asian Financial Crisis. The lack of MTO system is one of the reasons why Korean companies' ownership structure generally includes a greater share of non-controlling interest than controlling interest.

Questions to participants

Q6.1) *How is the ownership structure of entities in your country formed? (Are they similar to or different from the Korean case?)*

Q6.2) *Are the users of financial statements of entities under common control diverse due to the greater share of non-controlling interest and issuance of public offering bonds in the domestic or overseas market?*

[5] MTO system in Korea: when an acquirer acquires shares of 25% or more in a listed company, the acquirer is required to publically purchase '50% plus one share' in the stock market.

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