For the 4th EEG Meeting

Transactions Under Common Control

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The views expressed in this presentation are those of the UCC research team of KASB, not necessarily those of the KASB

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Background

- **The significance of UCC transactions**

  - ✓ **UCC transactions occur frequently** in various business contexts, such as tax savings, corporate reorganization, etc., and **have significant effects on financial statements**.

  - ✓ We are not able to provide world-wide data but the transactions in Korea reveals the urgent need for relevant standards.

Out of the total number of 747 combinations occurred during 2004 ~ 2011 in Korea, 522, or 70%, were common control transactions

Background

- **Lack of accounting standard for UCC transactions**

IFRS & US-GAAP, which are leading accounting standards in the world

have not yet provided an organized and consistent standard for UCC transactions

Such lack of standard causes diversity in practice, which in turn brings about deteriorated comparability of accounting information

Background

- **IASB's work to establish the standard is still underway**

2007	IASB's decision to add to active agenda
2009	Project discontinuance
2011	Publication of DP on accounting for BCUCC by EFRAG and OIC
2012	IASB's decision to give a priority to re-commencing research on BCUCC in May EEG meeting with an agenda for UCC in Dec
2013	IASB will launch a research project on UCC

Objective

- **The objective of the presentation and paper**
  - ✓ **To suggest the issues and questions related to UCC transactions**

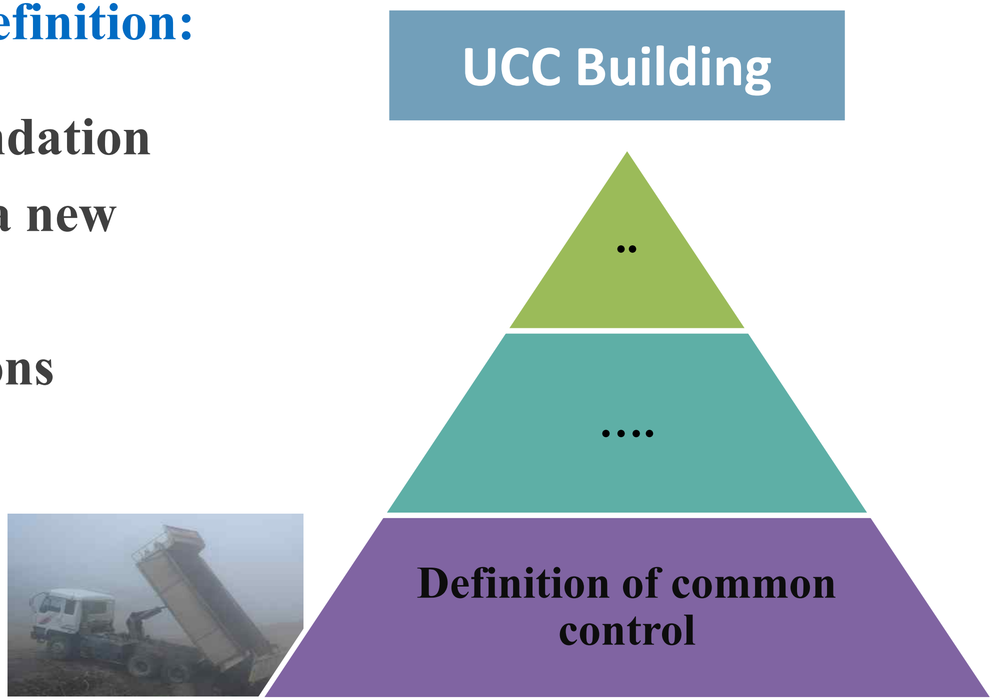
    => Members of the EEG would have an active discussion at the meeting
  - ✓ The result of the EEG discussion would **contribute** to the future **UCC research project of the IASB**

Definition of common control

- **Definition of common control is a basic concept of UCC.**

  ✓ **Clarifying the definition:**

  Lay a firm foundation for developing a new standard on UCC transactions

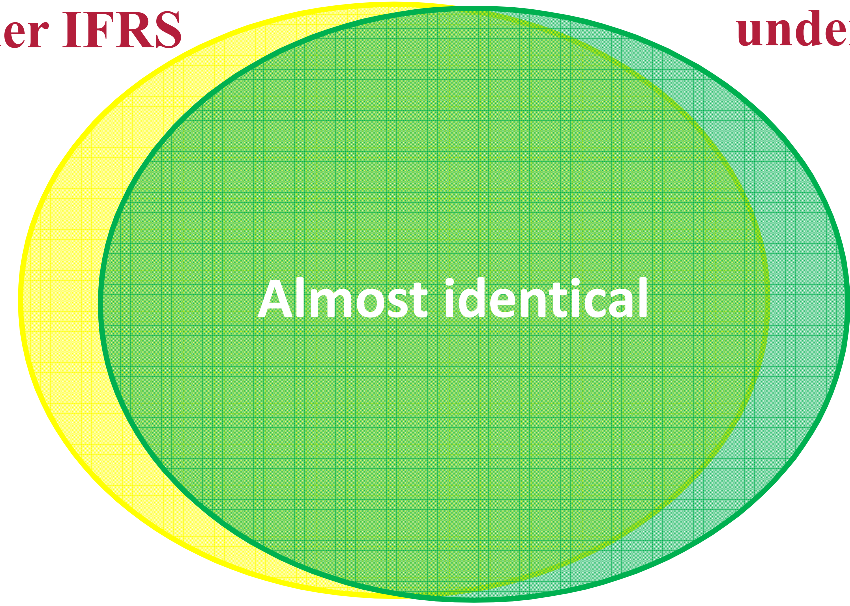


Definition of common control

IFRS vs US-GAAP

Definition of common control under IFRS

Definition of common control under US-GAAP



Only difference is definition of control
(in IFRS 10 of IFRS and in ASC 810 of US-GAAP)

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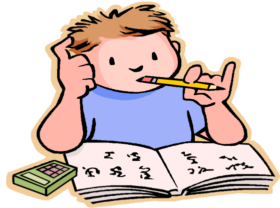
Definition of common control

Definition of common control

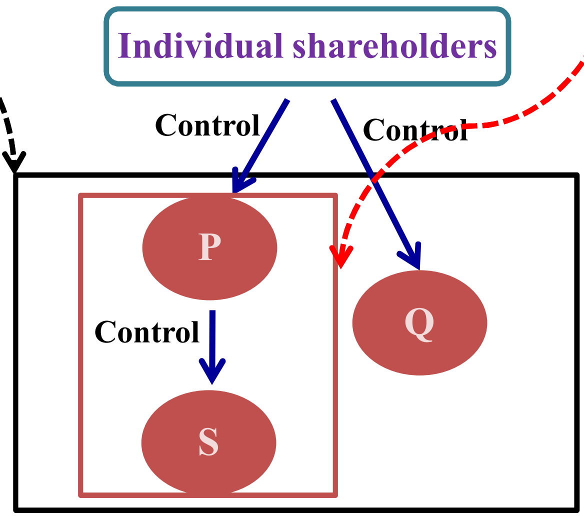
View A | **View B**



Relationship between Views

<Scope of UCC(includes individuals and entities(IFRS&US-GAAP)

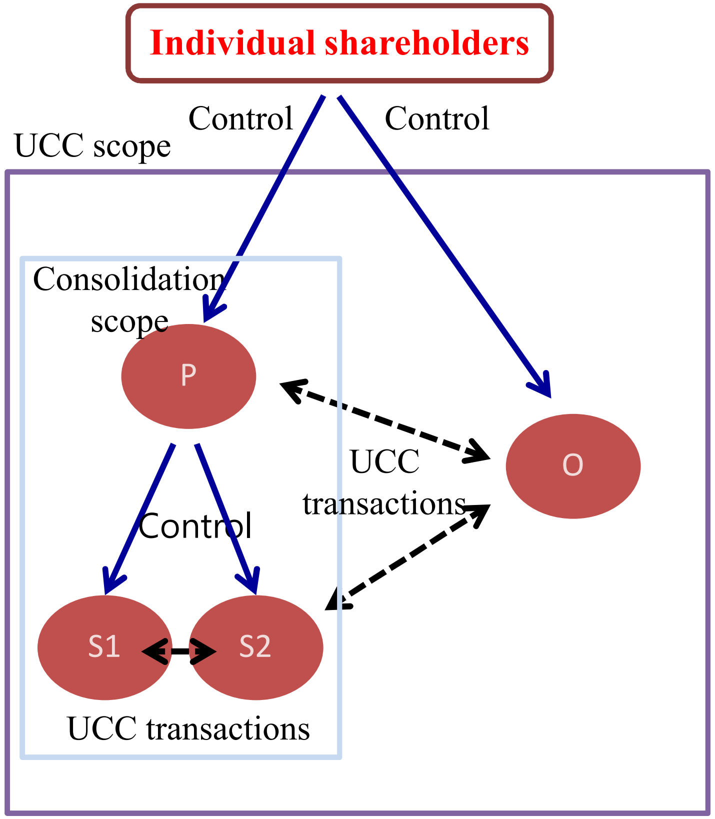
⊃ Scope of UCC(limited to entities only)=Scope of consolidation>



Definition of common control

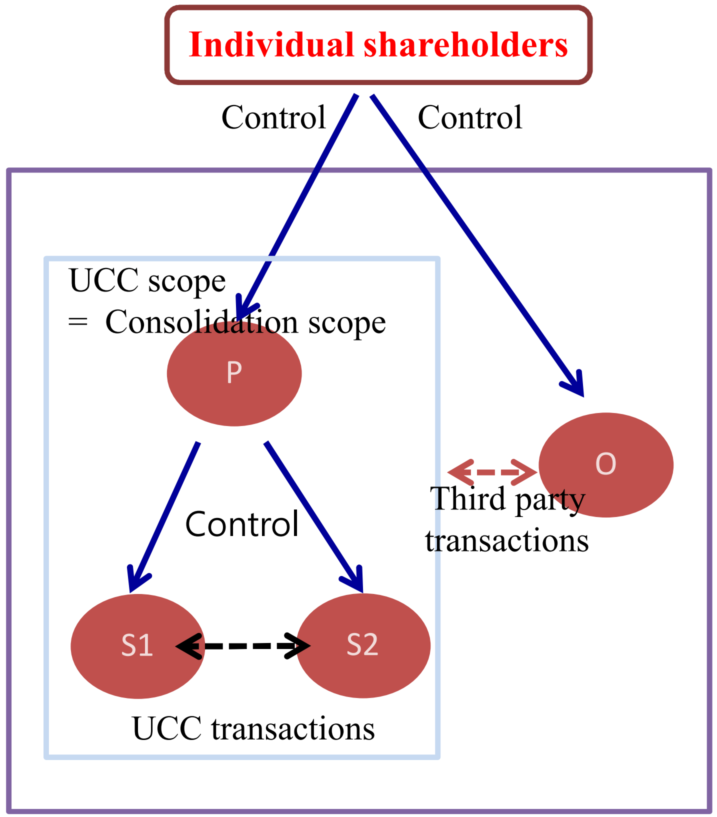
View A:

All transactions within the consolidation scope and with those outside the consolidation scope are UCC transactions.



View B:

Only those transactions within the consolidation scope are UCC transactions.



Definition of common control

Questions for EEG

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)

Identifying common control

- **Criteria for identifying common control**
  - ✓ **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 close relatives**

IFRS ??

US-GAAP ??

Identifying common control

IFRS vs US-GAAP

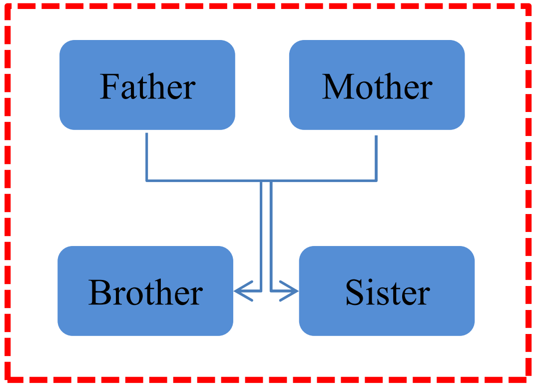
Almost identical

For Instance,

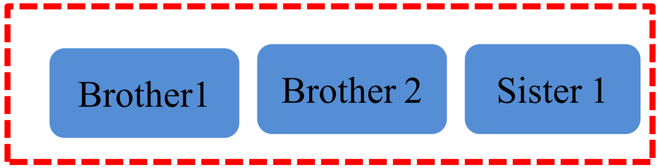
IFRS ??

US-GAAP ??

1. Single family (or lineal family)



2. Siblings



Identifying common control

- **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 IFRS nor US-GAAP provide detailed identification criteria**
- **Due to the lack of clear criterion, there may be divergent interpretations**
  - ✓ **It would lead to diversity in determining the scope of UCC transactions and undermine comparability**

Identifying common control

Questions for EEG

***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)?**

***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)?**

***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)**

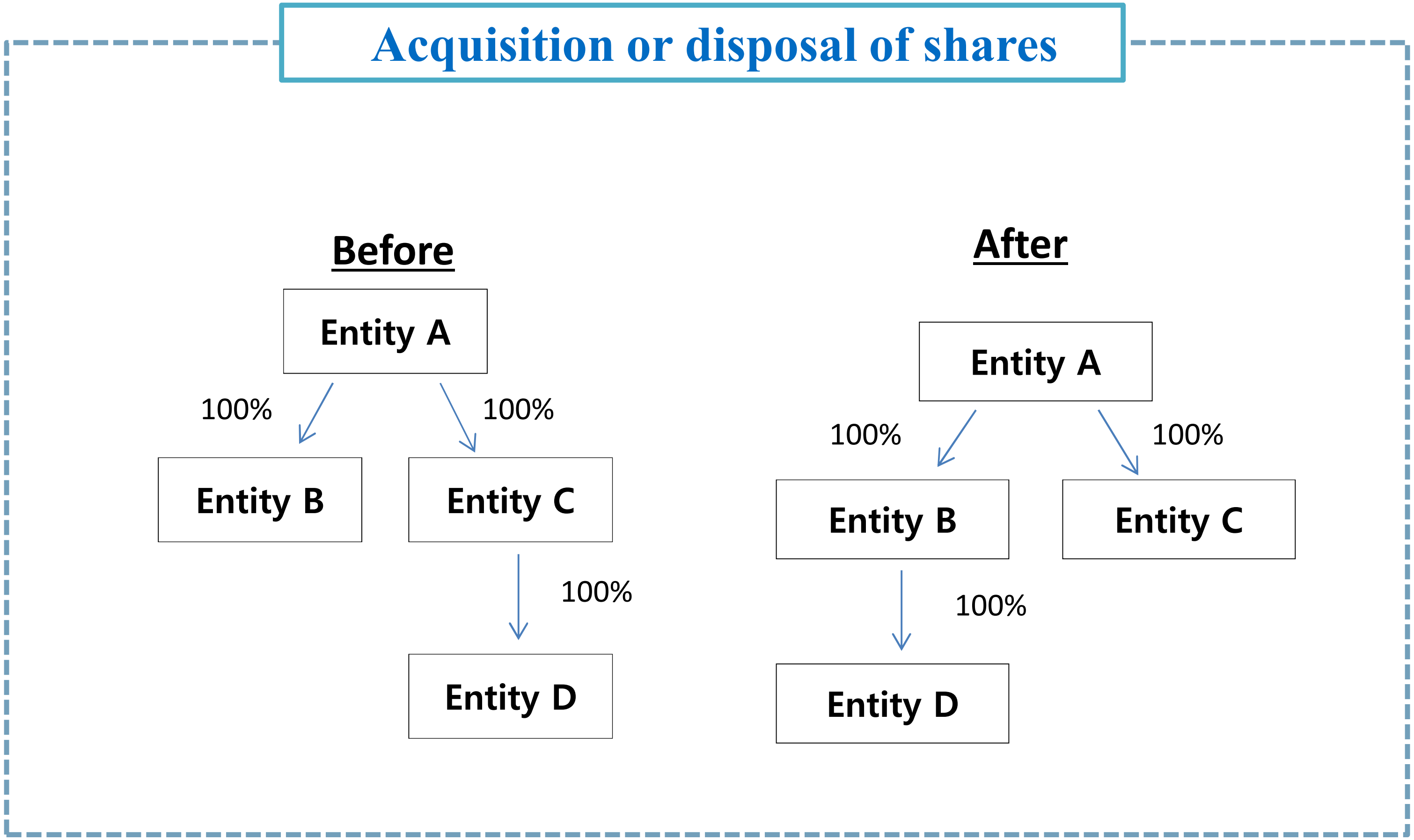
Type of UCC transactions

Type of UCC transactions

- **UCC transactions include all transactions conducted between entities under common control, such as business combinations, spin-offs, and investment in kind**

- **Business combinations under common control**
  - ✓ **Acquisition or disposal of shares**
  - ✓ **Merger**
  - ✓ **Acquisition and disposal of business**

Type of UCC transactions



Type of UCC transactions

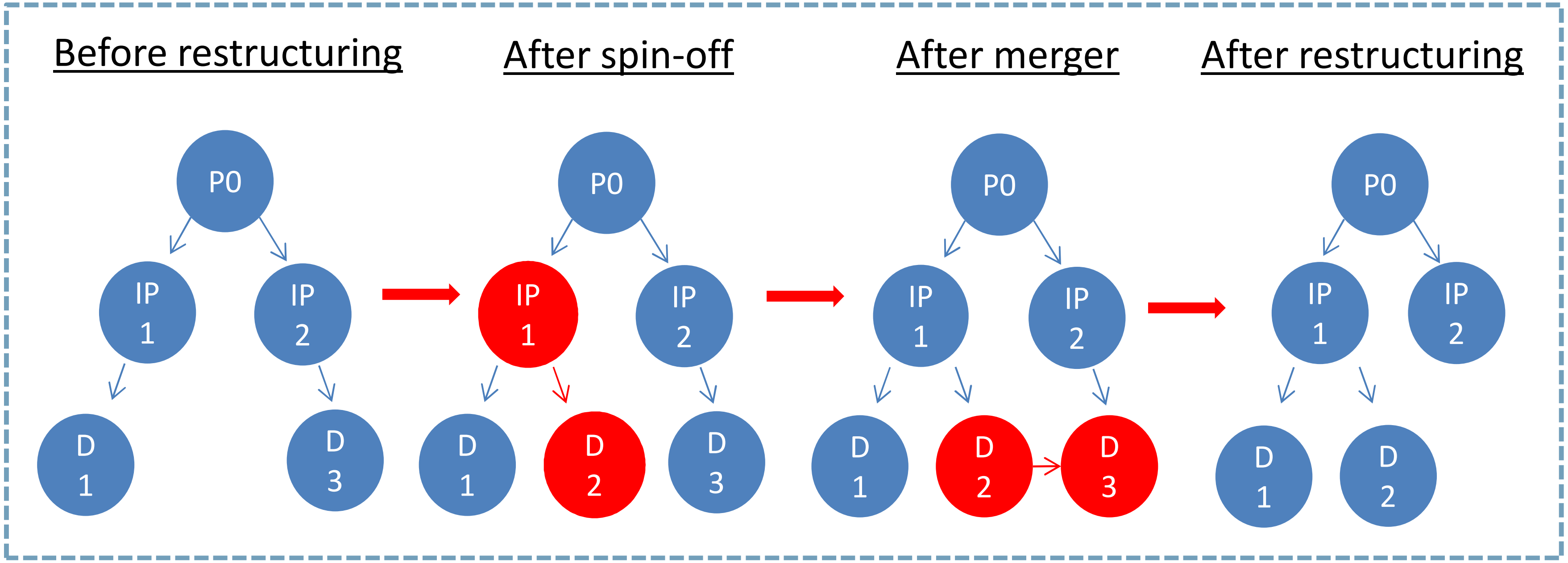
- **Spin-off**
  - ✓ **Type A spin-off**
  - ✓ **Type B spin-off**

- **Investment in Kind**
  - ✓ **It is essentially identical to Type A spin-off**

Type of UCC transactions

Transactions under common control in practice

- **Spin-off (Type A) and simultaneous merger**
  - ✓ **In order to restructure the hierarchy among entities under common control, below transactions occur**



Type of UCC transactions

Discussion

- **UCC project should deal with only BCUCC for a proposed set of accounting principle**
  - ✓ **Due to time constraint and the need to provide a timely guidance**

VS

- **UCC project should address all UCC types in an inclusive manner because**
  - ✓ **Transactions under common control often arise as a combination of various transactions**
  - ✓ **Accounting divergence between BCUCC and other UCC transactions**

Type of UCC transactions

Questions for EEG

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

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Type of UCC transactions

Discussion

- Another point is that one transaction under common control often includes various forms of transactions
  - ✓ 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 abuse accounting differences for its reporting purposes

Type of UCC transactions

Questions for EEG

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)?

Accounting for UCC transactions in consolidated F/S

General accounting principles

- **General accounting principles**
  - ✓ **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.**

Accounting for UCC transactions in consolidated F/S

- **General accounting principles**

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>

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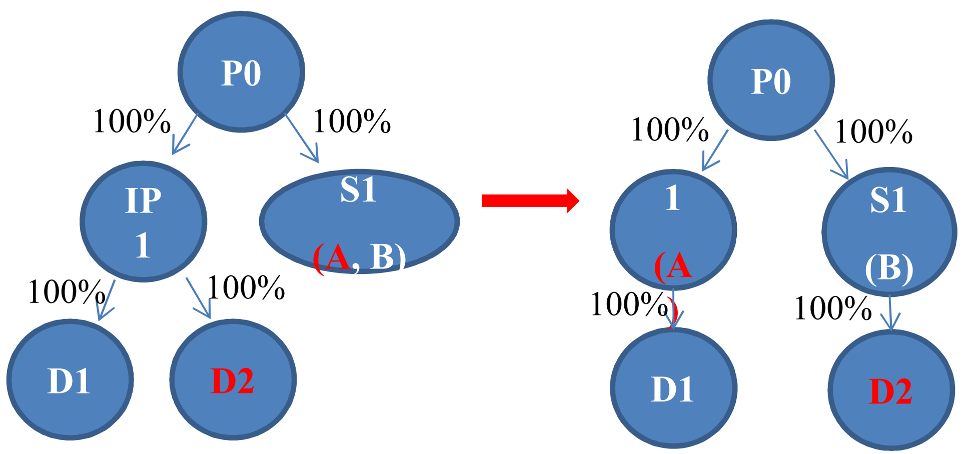
Accounting for UCC transactions in consolidated F/S

- **Example 1**

[Example 1]

Before business acquisition | **After business acquisition**



[Facts]

- P0, IP1 and S1 are all publicly listed

- S1 operates two businesses (Business A, Business B)

- <u>P0 has a 100% ownership in IP1</u> and S1

- D1 and <u>D2 are the wholly owned subsidiary of IP1,</u> and <u>IP1 has no convertible bonds or public bonds</u>

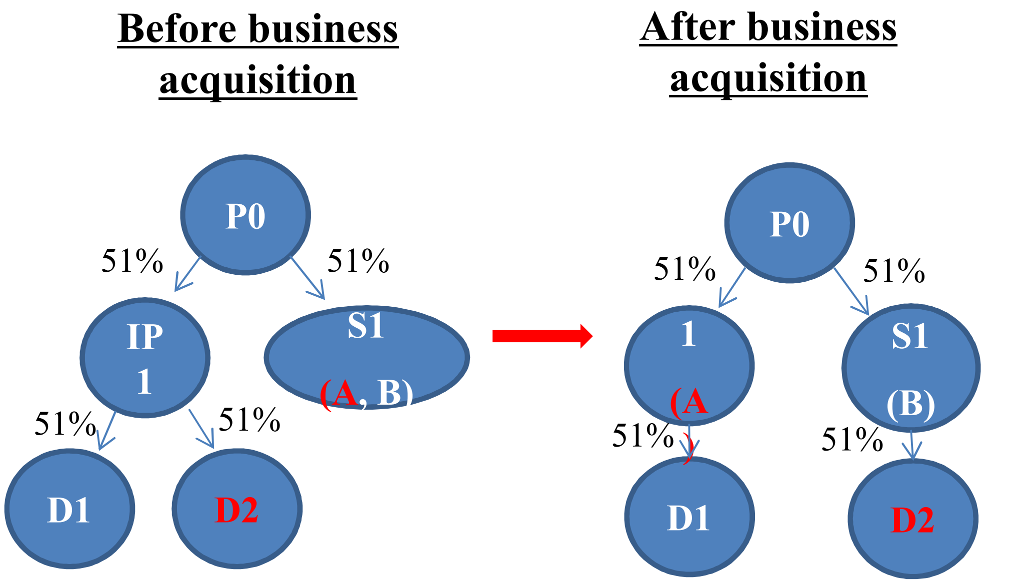
<BCUCC transactions>

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

Accounting for UCC transactions in consolidated F/S

- Example 2

[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

Accounting for UCC transactions in consolidated F/S

- **Question: What accounting method should be used in IP1's consolidated F/S?**
- **Analyses**

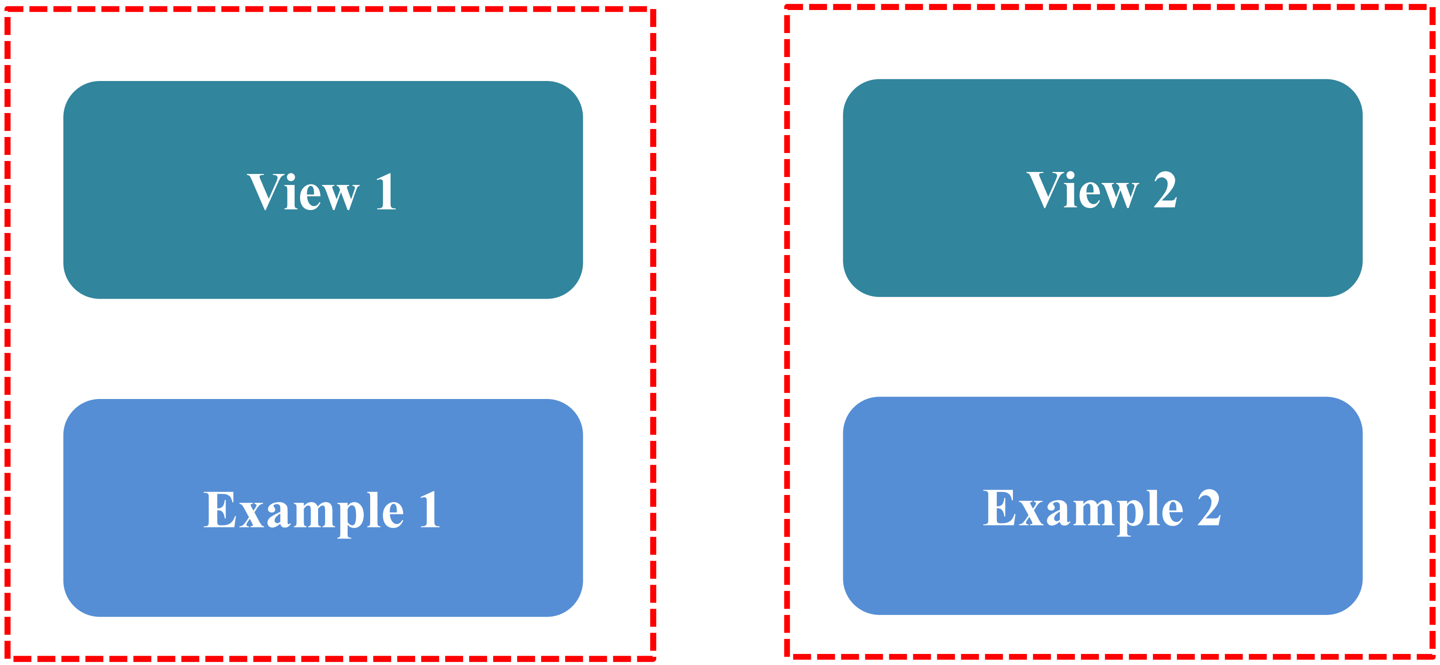
Factors to be considered	Example 1	Example 2
Ultimate controlling shareholder	100%	51%
Non-controlling shareholders	X	49% (significant)
Convertible bonds investors	X	O
Global bonds investors	X	O

Accounting for UCC transactions in consolidated F/S

- **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**

Accounting for UCC transactions in consolidated F/S

- **Relation between View and Example**



Accounting for UCC transactions in consolidated F/S

Questions for EEG

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)

Accounting for UCC transactions in consolidated F/S

Questions for EEG

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 in consolidated F/S

Accounting for UCC transactions – Book value method

- **General concept**
  - ✓ **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.**

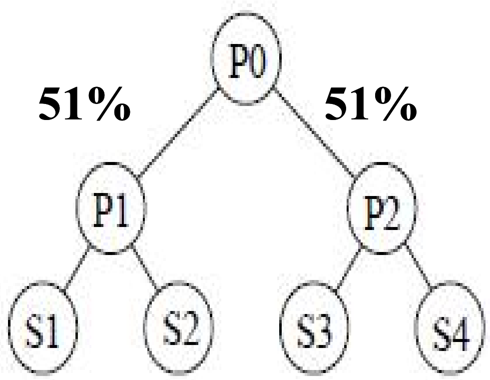
Accounting for UCC transactions in consolidated F/S

- **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*

Accounting for UCC transactions in consolidated F/S

- **In 2010, the KASB surveyed the members of the IFASS and Big 4 accounting firms with respect to which book value should be used in a UCC transaction.**
- **Below are the issues and questions raised in the KASB's survey:**

[Example]



Facts

- **P0, P1 and P2 are all publicly traded**
- **P0 has a 51% ownership in P1 and P2**
- **S1 and S2 are the wholly owned subsidiary by P1, and S3 and S4 are by P2**
- **P1 purchases the 100% ownership of S3 from P2.**

Accounting for UCC transactions in consolidated F/S

- **Questions:**

  (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

Accounting for UCC transactions in consolidated F/S

- **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 (A, B, or C)
Canada	▪ Fair value(Exchange value)	▪ If book value should be used, the book value of S3 in P0's consolidated F/S (A)
England	▪ Book value	▪ P1 has an option to choose among the alternatives (A, B, or C)

Accounting for UCC transactions in consolidated F/S

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

Jurisdiction	Question 1	Question 2
Germany	▪ Book value or Fair value	▪ Book value of S3 in P2 consolidated F/S (B)
Japan	▪ Book value	▪ Book value of S3 (C)
Korea	▪ Book value	▪ Book value of S3 in P0 consolidated F/S (A)
USA	▪ Book value	▪ Book value of S3 (C)

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

Accounting for UCC transactions in consolidated F/S

<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 or Fair value</td><td rowspan="3">▪ P1 has an option to choose among the alternatives (A, B, or C)</td></tr>
<tr><td>E&Y</td></tr>
<tr><td>KPMG</td></tr>
<tr><td>PWC</td><td>▪ If book value is chosen, the book value of S3 in P0’s consolidated F/S (A)</td></tr>
</table>

Accounting for UCC transactions in consolidated F/S

- **The result of the survey is summarized below:**

<Question 1>

Book value	New basis	Both	Total
4	1	6	11

<Question 2>

Alternative A	Alternative B	Alternative C	Any of the Three	Total
2	2	2	5	11

Accounting for UCC transactions in consolidated F/S

Questions for EEG

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 of the agenda paper, do you think is appropriate?

Accounting for UCC transactions in consolidated F/S

Accounting for UCC transactions – Fair value method

- **General concept**
  - ✓ **IFRS 3 may be applied to BCUCC transactions if the UCC transaction is accounted for at fair value from the independent reporting entity perspective.**
  - ✓ **However, some argue 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.**

Accounting for UCC transactions in consolidated F/S

- **The following alternatives exist when fair value method is applied to UCC 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*

Accounting for UCC transactions in consolidated F/S

Questions for EEG

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?

Accounting for UCC transactions in separate F/S

The need for accounting guidelines in separate F/S

- **Conflicting perspectives**
  - ✓ **Some countries argue that it is important that accounting for UCC transactions in separate F/S is provided concretely because it may significantly affect separate F/S which are required to be prepared and important in practice**
  - ✓ **On the other hand, others insist that separate F/S are just supplementary statements or prepared under local GAAP rather than IFRS. Therefore, it is inefficient to address detailed accounting guidelines for separate financial statements as the time and cost are limited.**

Accounting for UCC transactions in separate F/S

Questions for EEG

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?)

Q5.1) 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 separate F/S

Accounting for UCC transactions in separate F/S

- **The concept and definition of the separate F/S in IFRS**
  - ✓ ***Definition (IAS 27 amended 2011 Paragraph 4) …***
  - ✓ ***Definition (IAS 27 amended 2008 Paragraph 4) …***
  - ✓ ***Paragraph 10 (IAS 27 amended 2011) …***
  - ✓ ***BC7 (IAS 27 amended 2011) …***
  - ✓ ***BC10 (IAS 27 amended 2011) …***

Accounting for UCC transactions in separate F/S

- **Due to the definition and nature of the accounting for separate F/S provided in IAS 27, the following conflicting views exist regarding the accounting for UCC transactions in separate F/S:**

View A

UCC transactions are viewed as transactions with no economic substance and accounted for at book value even in separate F/S

View B

Considering the characteristics of separate financial statements set out in IAS 27, UCC transactions are accounted for at fair value

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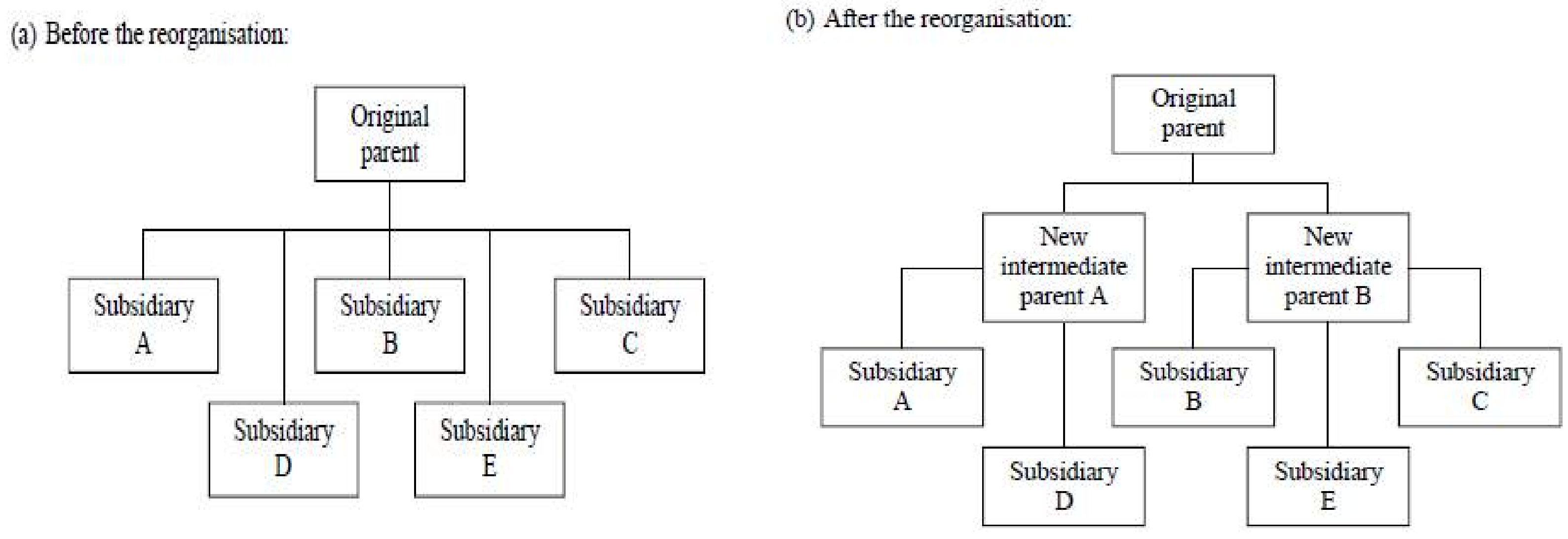
Accounting for UCC transactions in separate F/S

- **The current views of the IFRS IC regarding UCC transactions in separate F/S**

<IFRS IC Agenda paper ‘Group reorganizations in separate F/S’>

The issue



Accounting for UCC transactions in separate F/S

<IFRS IC Agenda paper ‘Group reorganizations in separate F/S’>

Views suggested

- ✓ ***View 1 : Measure by fair value of consideration given***
- ✓ ***View 2 : Measure by previous carrying amount basis***

IFRS IC decision

- ✓ ***View 1 : Measure by fair value of consideration given***

Accounting for UCC transactions in separate F/S

Questions for EEG

***Q5.3)* With respect to the accounting for UCC transactions in separate financial statements, which of the two views described in paragraph 6.9 of the agenda paper, i.e., View A and View B, do you agree with? And what are your reasons?**

***Q5.4)* 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?**

Accounting for UCC transactions in separate F/S

Questions for EEG

Q5.5) 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?

Distinct features of UCC transactions in Korea

The characteristics of corporate groups in Korea

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

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%

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Distinct features of UCC transactions in Korea

- **For listed companies, non-controlling interest is greater than controlling interest (continued)**

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%

Distinct features of UCC transactions in Korea

- **There are many listed intermediate parent companies**

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%

Distinct features of UCC transactions in Korea

Major reasons for the distinct features of Korea

- **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**
  - ✓ **Lack of systems such as Mandatory Tender Offer**

Distinct features of UCC transactions in Korea

Questions for EEG

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?

Thank you!