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Accounting for Restructuring under Common Control Entities: An Analysis of the Implementation of Accounting Standard

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This paper addresses the issue of restructuring transaction under common control entities. Based on the Indonesian Accounting Standard, this transaction does not make any substantial changes in the economic ownership, even though ownership of shares, assets or liabilities or other instruments of ownership changes. Revision made in 2004 which is a revision to accounting standard number 38 year 1997 concerning restructuring accounting under common control entities is actually a move to improve the quality of financial statement in order to face transparency required in corporate management. This paper analyses a series of cross ownership transactions done in X and Y. These transactions, using similar accounting standard, result in different implementation in the financial statements of the two companies. The analysis done includes the qualitative characteristics of the quality of the two companies' financial reports. To compare the circumstances, similar analysis is also made to companies listed in the Indonesia Stock Exchange (ISE) making the same restructuring transactions. The result of the research as well as the analysis shows that there is a problem of implementation of accounting standard particularly related to the absence of transition regulations which results in different financial reports, both in the transaction of cross-ownership made by X as well as Y and by other listed companies in the Indonesia Stock Exchange. Different financial statements have reflected different performances, manifested in significant amount.

Field of Research : Financial Accounting,

I. INTRODUCTION

There are many companies in Indonesia which have major ownership characteristics in one particular company. These companies are structured in holding/parent entities, subsidiaries, and sub-subsidiaries, and they are built by merger and acquisition. According to Palepu, Healy and Bernard (2004) these mergers and acquisitions aim to enhance the new economic value of the shareholders through the increase of economic of scale, company's

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performance, profit gained from exchanged resources and tax profit. X and Y are two State-Owned Companies which had cross-ownership as one of the ways to restructure their companies in 2001 and 2002. Both companies also multilisted in Indonesia Stock Exchange (IDX) and New York Stock Exchange (NYSE). Based on these series of restructuring transactions, Y should have recognized a profit whereas X should have suffered a loss, but according to accounting standard, this profit or loss between under common control entities weren't realized, even X and Y are no longer under common control entities. However, problems appear when a new revision to the accounting standard was published.

2. LITERATURE REVIEW

Statement of Accounting Standard Number 38 (Revision of 2004) is an accounting standard which regulates accounting matters related to restructuring transactions including assets transfer, liabilities, stocks or other ownership instruments between common control entities. This standar is a revision to the old one established on 1997. In line with standard number 38 year 1997, as restructuring transactions under common control entities do not result in changes of economic ownership of assets, stocks, liabilities as well as other exchanged ownership instruments, then the assets and liabilities whose ownership is exchanged (in their legal form) must be recorded based on their book value like business consolidation based on pooling of interest. The difference between the transfer price and the book value recorded in the account of Difference Value of Restructuring Transaction Under Common Control Entities. This balance will then be presented as part of equity. This account is not goodwill and will not alter caused by further transfer of assets, liabilities, stocks or other ownership instruments to entities which are not under common control.

The basic revision of this standard which was made in 2004 concerning cross –ownership transaction dealt with paragraph 17 Accounting Standard number 38 (Revision of 2004), stating that the balance of Difference Value of Restructuring Transaction Under Common Control Entities may change, alter or realized caused by : (1) The loss of common control status; (2) the selling of shares to uncommon control entities which were obtained previously by restructuring transaction under common control entities (3) Reciprocal transaction between under common control entities and (4) Quasi-reorganization. In terms of realization period, Accounting Standard number 38 Revision of 2004 does not explicitly explain. There is no transation regulation, but it recommends early implementations.

3. FINDINGS

3 a. Transactions in 2001

On 2000, each of X and Y had stock on A, B, C and D. On April 3, 2001, X and Y had a several transactions of stock-ownership of some subsidiary companies as follows :

1. Acquisition of X of 35% of A.
2. Acquisition of Y of 22.5% of B.
3. Acquisition of Y of 37.66% of C.

Transactions of A, B and C were treated as restructuring transactions under common control entities. According to Accounting Standard Number 38 Year 1997, the difference between the transaction price paid or received and the book value of investment net asset gained or the recorded value of sold investment was presented in the equity as "The Difference Value of Restructuring Transactions Under Common Control Entities". X in its financial report presents that X in substance is suffering a material loss, at amount 172% of the net profit of 2001. The Difference Value of Restructuring Transactions Under Common Control Entities, which is at the negative amount, is presented in the equity section of X financial statement of the book year of 2001. Y in its financial report presents that Y in substance is suffering a material gain, at amount 3 times of the net profit of 2001. In addition, Y on May, 2001 also acquired 45% of capital of B. from an indirect acquisition from non-affiliated company . The amount of capital of Y in B increased from 7.5% to 75%. The Difference Value of Restructuring Transactions Under Common Control Entities is presented in the equity of X financial statement of the book year of 2001.

3 b. Transactions in 2002

On April 2002, X gained all the shares of D from Y (13%) and other shareholders. Shares were not transferred at once, but in stages instead, with the following scheme: 30 % on August, 2002, 14% on September, 2003 and 55 % on closing date December, 2004. On August, 2002, then X has gained control of as well as has consolidated D since August, 2002. In connection with the ownership of 13% of D by Y, then there are restructuring transactions under common control entities.

The record made by Y is different from that of X. Y recognizes the difference due to the restructuring transactions under common control entities in 3 periods, which is parallel with the submission realization of the % shares of Y to X, it was in 2002, 2003 and 2004

3.c. Important Events Affecting *Cross-Ownership* transaction

3.C. 1. The sales of the state-owned-shares in Y

he government sold the shares in Y representing 41.94% ownership on December, 2002. It has changed the status of Y, from State Owned

Enterprise to a Foreign Capital Investment. This condition has reduced the rights owned by the government related to its shares of ownership. Based on Accounting Standard number 38 year 1997, then the loss of common control status due to the loss of government control of Y by the end of 2003 does not change the balance of The Difference Value of Restructuring Transaction Under Common Control.

3.C.2. The sales of shares of A by X to non-affiliated entity.

Cross Ownership transaction between X and Y in 2001 has increased the ownership of X in A to 77.72%. On April, 2002, X sold 12.72% of ownership of A to non-affiliated entity. This transaction has decreased the ownership of shares of X in A from 77.72% to 65%. Based on Accounting Standard number 38 year 1997, then the selling of shares of A to parties which are not under common control, which were obtained previously by restructuring transaction under common control entities, does not affect the balance of the difference due to the restructuring transaction under common control entities.

3.d The Presentation of *Cross-Ownership* Transaction Since the Revision of Accounting Standard on 2004 Took Into Effect

3.d.1. Presentation of X

X had reclassified the existed negative account balance of the difference of restructuring transaction under common control entities as direct adjustment to retained earnings balance on the date of initial implementation of Revised Standard No. 38 per January 1st, 2005. Reclassification resulted appears in the equity part so the value of net equity does not change. There was no effect on Income Statement.

I3.d.2. Presentation of Y

In 2004, Y implemented the Accounting Standard number 38 (Revision of 2004) earlier. Y recognized the actualization of profit on the cross-ownership transaction with X, which had been credited to the “difference of restructuring transaction under common control entities” before. Y represented a consolidated financial statement for the year 2003 for the restrospective acknowledge of the actualization of the profit to Extraordinary Gain actualized on the difference of restructuring transaction under common control entities” in 2003, based on the balance of the difference of restructuring transaction under common control entities which existed before. Because of this extraordinary gain, the 2003 income of Y had become 3 times higher.

4 ANALYSIS AND DISCUSSION

4.1 Analysis of the Qualititative Characteristics of the Financial Statements

4.1.1. Understandable

During the cross-ownership transactions, both X and Y acknowledged a difference between book value and transfer price into the equity as an account of Difference of Restructuring Transactions of Under Common Control Entities. As entities which are under the government control, then profit or loss yielded by each party will automatically increase or decrease owner's capital. Therefore, users of financial reports will find no difficulties in recognizing the effect of these transactions in the financial reports of both X and X. User of financial reports, particularly of X's income statement, will get information that A had already been giving the biggest contribution to X's consolidated revenue. Since there is no accounting treatment to the Income Statement, the income statement is not capable of providing information that there there has been a sacrifice borne by X, that is the negative difference due to the acquisition of A and C from Y. From the point of Y, it is quite easy for users of income statement to understand the actualization of either a profit or a loss in the cross-ownership transaction. This is because the realization is presented as an extraordinary account on The Income Statement. Therefore, the complete financial statement calculates the cost and benefit rising from the cross-ownership transaction.

4.1.2. Relevance

If it is considered based on the limitation of materiality set by capital market regulator concerning material transaction and changes in business main activities, then this cross-ownership transaction has met the material criteria (10% of revenue or 20% of equity).Next, it will be very difficult to accurately determine the predictive value as the financial performance stated in the income statement of X only implicitly reflects the result gained from cross-ownership transaction. In this transaction the profit contribution of A to X on its Income Statement is increasing, yet the sacrifice experienced during the acquisition of X is not shown.

4.1.3 Reliability

To be reliable, with the absence of common control status between X and Y, then cross-ownership should be treated as common acquisition transaction. Based on either legal or economic substances, parties involved in the transaction should acknowledge that both sides sustain either loss or gain over the transaction of trading subsidiaries. In common transaction, realization of loss and profit resulting from the difference between book value and conversion price is the consequences of either losing common control status or selling assets, liabilities, stocks, and other ownership instruments to parties that are not part of common control entities. Thus, when Y is sold to a third party, then both profit and loss over the transaction between state-owned enterprises should be actualized on the same period.

4.1.4 Comparability

When all parts of financial statement (including Balance Sheet, Income Statement, Statement of Equity Conversion and Statement of Cash Flow) of Y, starting from Cross-Ownership transaction up to the realization of the balance differences of restructuring transaction under common control entities, are re-presented, then the financial statement is comparable as each part of it describes cross-ownership transaction. But for X, the analyst have to submit the impact of Cross-Ownership transaction into the Income Statement.

4 2. Comparison Between A Case and The Implementation of Accounting Standard No. 38 (Revision of 2004) to Listed Companies in the Indonesia Stock Exchange (IDX).

Surveys on 326 listed companies in the IDX showed that 86 companies dealt with restructuring transactions under common control entities even before 1997 until 2005, with various kind of transactions, which are as follows:

1. Stocks acquisition : 49 companies.
2. The selling of stock ownership : 11 companies.
3. Selling or buying fixed assets : 6 companies.
4. Merger : 7 companies.
5. Dilusion over stocks ownership : by 3 companies.
6. Conversion of liabilities, receivables and bonds : 3 companies.

To get the exact comparison between X - Y and emiten of IDX, then the restructuring transaction under common control entities of listed companies in the IDX must have same pattern with those of X – Y, which are the existence new transaction under common control entity, and the existence of activity which caused the adjustment (realization) of balance account of the difference of transactional restructuring value of common control entities in company’s equity and was not considered as new transaction. Of 86 listed companies, apart from Y and X, it turned out that only 6 listed companies categorized in two realization trigger as follows:

Of 6 listed companies, there are 2 companies which lose the substance of common control. The first company had a negative balance on The Difference Value of Restructuring Transaction Under Common Control. In 1997. Then, in 2005, they deleted this account balance. There was no reclassification to retained earning or realization of either a profit or a loss. This is not in accordance with the real condition where the company should actually suffer a loss over the transaction. Thus, the Financial Statement did not reflect the condition of the real economic events. The second company do exactlty the same accounting treatment as X.

The stock redemption on company's subsidiary which underlaid the difference of restructuring transaction under common control to parties which were not under common control occurred in 4 companies. The further research of these companies shows all of the companies had an exactly the same accounting treatment as X. From the stock redemption transaction, they reclassified the difference balance into Retained Earning without any effect on Income Statement.

4. 3. Comparison of Accounting Standard Number 38 (Revision of 2004) with the International Accounting Standard and United States Accounting Standard.

4.31 The International Accounting Standards

IAS number 22 of 1995 and IFRS Number 3 of 2004 explicitly stated in the part of standard scope that the standard will not be applied on common control entity restructuring transaction. IASB does not issue special standard for this transaction. Merger activity by common control entity is not prohibited to apply either IFRS No. 3, or other methods (Epstein & Jermakowicz, 2007). Selecting certain accounting policy must be consistently in line with the selection of accounting policy which is regulated in International Accounting standard(IAS) Number 8 about Accounting Practices, Changes in Accounting Estimates and Errors. Entities must be concerned with all of these. If the implementation of Cross-Ownership transaction by Y and X is in accordance with the international standard, then both companies could choose the most appropriate accounting method as long as it is in accordance with IFRS Number 3. The focus of International Accounting standard is that the method selected does not conflict with the IAS Number 8, which regulates the provision of retrospective implementation as regulated in Accounting Standard number 25 in 1995.

4.3.2. United States Standard

FASB Statement Number 141 Revision 2007 concerning Business Combination also do not provide regulation on common control entity restructuring transaction. FSAB nevertheless provides guidelines in common control entity business consolidating accounting, that is on FSAB Statement Number 141 Appendix D paragraph D9 and D11-D18. It is stated in the net assets transferred must be recorded at their carrying amounts of the acquired company. The Balance Sheet and Income Statement should be presented as if the transaction were done from the initial period of financial statement presentation. Thus the previous financial statement has to be re-presented. In this case, Accounting Standard number 38 /1997 and Accounting Standard number 38 Revised in 2004 provide the same statement.

In accordance to United States accounting standard, profit or loss documentation resulting from business merger transaction can only be done in the absence of common control characteristic. Thus, the difference realization of common control entity restructuring transaction of Y's extra ordinary profit in 2003 should be eliminated and reversed to its initial position.

5. CONCLUSION AND REMARK

5.1. Conclusion

Based on the article, the conclusions are as follows:

1. Different implementation of Accounting Standard number 38 (Revised in 2004) on the cross-ownership transaction between X and Y result in different quality of financial statement based on qualitative characteristic of financial statement. The quality of Y's financial statement which realized profit from the difference of common control entity restructuring transaction illustrates a better quality of financial statement, especially on the Income Statement.
2. Different implementation, especially on the balance realization of the difference of common control entity restructuring transaction caused by the absence of transition provision of Accounting Standard number 38 (Revised in 2004). Most of listed companies which lost common control substance made retrospective reclassification.
3. Until now, there are no International accounting standards and United States accounting standard which clearly regulate consolidated business transaction by common control entities into a particular standard. United States accounting standard provides the same guidelines as Accounting Standard number 38/1997 in the initial transaction, yet they prohibit realization of the difference of common control entity restructuring transaction, as has been regulated in Accounting Standard number 38 (Revised in 2004). The International accounting on the other hand does not provide specific guidelines.

5. 2. Remarks

1. Revision on the Financial Accounting standard should provide provisions on transitions. If not, standard must be supplied with guidance on certain initial implementation or guidance with reference to Accounting Standard number 25/1995. Capital Market Supervisory Agency provision on the initial implementation of Accounting Standard number 38 (Revised in 2004) is only effective to public company so that the non-public company has the potential of facing the same problem as X and Y.
2. Since the restructurization transaction under common control entities are happened in a great quantities, International Accounting Standard should give a guidance for this transaction, and then many countries can make their own standard based on this guidance.

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