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LETTER OF COMMENT NO. 18

2 April 2009

Financial Crisis Advisory Group
International Accounting Standards Board
30 Cannon Street, London EC4M 6XH
United Kingdom

Re: Financial Crisis Advisory Group – Input for constituents

Dear Sir or Madam:

The enclosed comments represent official positions of the KASB. They have been determined after extensive due process and deliberation.

Please do not hesitate to contact us if you have any inquiries regarding our comments. You may direct your inquiries either to me (cwsuh@kasb.or.kr) or to Mr. Sung-Soo Kwon (sskwon@kasb.or.kr), Director of Research Department.

Yours sincerely,

A handwritten signature in black ink, appearing to read 'Chungwoo Suh'. The signature is fluid and cursive, with the first name 'Chungwoo' being more prominent than the last name 'Suh'.

Dr. Chungwoo Suh
Chairman, Korea Accounting Standards Board

Question 1

From your perspective, where has general purpose financial reporting helped identify issues of concern during the financial crisis? Where has it not helped, or even possibly created unnecessary concerns? Please be as specific as possible in your answers.

Current general purpose financial reporting, especially foreign currency transaction accounting standard result in creating unnecessary concerns to the companies in emerging market countries that are experiencing abnormal fluctuations in foreign currency rates.

Under current IFRS rules, foreign currency monetary items must be recorded on the balance sheet at their converted values as of the date of the B/S recording. Gain or loss from exchange difference must also be realized at the same time. However, during a financial crisis such as we are experiencing now, an extreme and abnormal amount of exchange differences occur especially in a small open economy that has taken up a free floating exchange rate system.

For the following reasons, the current accounting rules relating to foreign exchange translations do not accurately reflect the economic substance of a small open economy.

- Temporarily rapid fluctuations in currency values later stabilize and the exchange rate for long term foreign currency denominated assets and liabilities at the time of redemption or settlement becomes much different from the rate at the date of the balance sheet. However, under current accounting rules, companies inevitably have to record extreme foreign exchange translation losses in their annual financial statements without taking into account the rates at maturity; resulting in significant fluctuations in their corporate earnings.
- Even when hedge accounting is used and exchange differences do not directly affect the net income, the loss is recorded in other comprehensive income, thus it affects the overall financial ratios such as current ratio and debt ratio further causing a company's financials to look more at risk than in reality.

An airline business, under normal circumstances with a large amount of foreign debt, is a good example of how current accounting rules distort true financials.

<Example: Fluctuation in income of an airline company due to foreign exchange fluctuations>

(in hundred million won)

	2000	2001	2002	2003	2004	2005	2006	2007	2008(3q)
Operating	226	-842	4,568	3,114	3,840	4,325	4,974	6,368	-1,219

Income(A)									
FX rate change	11%	4%	-10%	1%	-13%	-2%	-8%	1%	27%
Exchange difference(B)	-2,810	-2,387	4,974	-272	7,251	1,661	3,494	-593	-12,779
B/A (%)	1,241%	283%	109%	9%	189%	38%	70%	9%	1,048%

As demonstrated in the chart above, in the case of an airline company where there is a fluctuation in the foreign exchange rate, exchange differences are severe to the point where they outweigh the operating income, resulting in a “wag the dog” situation. In other words, key accounting numbers were affected mainly by exchange difference, not by operating performance in 3Q 2008 compared to 2007.

Accordingly, IASB and FASB need to improve foreign currency accounting standards in combination with standard setters of emerging market countries in order to prevent the distortion of a company’s financial statements.

Question 2

If prudential regulators were to require 'through-the-cycle' or 'dynamic' loan provisions that differ from the current IFRS or US GAAP requirements, how should general purpose financial statements best reflect the difference: (1) recognition in profit or loss (earnings); (2) recognition in other comprehensive income; (3) appropriation of equity outside of comprehensive income; (4) footnote disclosure only; (5) some other means; or (6) not at all? Please explain how your answer would promote transparency for investors and other resource providers.

We do not believe that it is appropriate to recognize the ‘dynamic’ loan loss provision in either profit or loss or comprehensive income unless there is an objective measurement for it.

The reason why the ‘incurred loss’ model is required in current IFRS is that the impairment loss should be objectively measured and reliable. In this regard, the ‘dynamic’ provisioning would not be compatible with the current ‘incurred loss’ model as it is based on expectation of long-term business cycles, which is difficult to be verified in an objective manner. Comparability between companies would also be compromised if there is no generally accepted objective method for ‘dynamic’ provisioning.

Furthermore, it is questionable whether such recognition in profit or loss or other comprehensive income is in alignment with the objective of general purpose financial

statements cited in the Conceptual Framework of IFRS where the objective of financial statements is defined as follows.

The objective financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

According to the definition above, although we think that the information of ‘dynamic’ loan loss provision may be useful to some users who are interested in capital adequacy of a company, it may pose a risk of providing distorted information to the users who have different purposes in using the financial statements.

We, however, have an opinion that appropriation of retained earnings for ‘dynamic’ provision would provide useful information considering the Conceptual Framework in which equity is described as follows.

(...)Reserves representing appropriations of retained earnings and reserves representing capital maintenance adjustments may be shown separately. Such classifications can be relevant to the decision-making needs of the users of financial statements when they indicate legal or restrictions on the ability of the entity to distribute or otherwise apply its equity.(...)

Therefore, ‘dynamic’ provision as part of a separate capital classification would fit with this paragraph of the Conceptual Framework, and provide relevant information to the users of financial statements. We would also like to point out that when the ‘dynamic’ provision is separately presented in the equity, comprehensive disclosure as to the nature and content of the provision need to be provided as well.

Question 3

Some FCAG members have indicated that they believe issues surrounding accounting for off-balance items such as securitizations and other structured entities have been far more contributory to the financial crisis than issues surrounding fair value (including mark-to-market) accounting. Do you agree, and how can we best improve IFRS and US GAAP in that area?

Do you agree that accounting for off-balance items contributed to the financial crisis more than fair value accounting?

First of all, it would be necessary to converge the US GAAP with the IFRS with regard to consolidation/derecognition requirements, thereby making global accounting standards more consistent and transparent.

However, it is questionable whether there were critical flaws in current accounting standards that contributed to the financial crisis. We believe that rigorous criteria are already incorporated in current accounting standards, for instance, IAS 39 provides three steps of derecognition threshold: risk and reward, control, and continuing involvement.

It may be argued that the current accounting standards need some improvement, and yet the incentives of securitization would not be entirely contained even if stricter rule is imposed for consolidation/derecognition criteria.

In our view, the problems of off-balance items stems from inappropriate valuation of securitized instruments which may be due to the moral hazard of credit rating agencies or complexities of the terms of the instruments, rather than from defects of accounting standards. Moreover, we also notice that the risk management for Structured Investment Vehicles (SIV) was not so sound that deterioration of SIV's performance amplified the financial crisis.

Hence we believe that the problems of off-balance items were caused by many economic factors, not just by the accounting standards.

How can we best improve IFRS and US GAAP in that area?

We would like to propose that the concept of risk for derecognition criteria be defined specifically. Although risk and reward concept is used for derecognition criteria, it is not clear what risk and reward indicates in IAS 39.

We think that derecognition threshold need to be more rigorous and for this purpose, the risk should be defined broadly. One example would be reputational risk. We know that many banks consolidated their related SIVs for fear of their reputational risk. By the same token, it would be possible to consider including reputational risk in the risk concept for derecognition criteria, when defining the risks for derecognition purpose.

Alternatively, we believe that additional and more detail disclosure requirement for off-balance sheet vehicles would provide useful information to users of financial statements, complementing consolidation/derecognition requirement.

Question 4

Most constituents agree that the current mixed attributes model for accounting and reporting of financial instruments under IFRS and US GAAP is overly complex and otherwise suboptimal. Some constituents (mainly investors) support reporting all financial instruments at fair value. Others support a refined mixed attributes model. Which approach do you support and why? If you support a refined mixed attributes model, what should that look like, and why, and do you view that as a interim step toward full fair value or as an end goal? Whichever approach you support, what improvements, if any, to fair value accounting do you believe are essential prerequisites to your end goal?

The Purpose of the financial reporting is to provide useful information related to the financial position, performance and changes in financial position of an entity, and the information should be useful to a wide range of users in making economic decision.

Therefore, we believe all the qualitative characteristics required for financial information should be considered in determining which measurement model is more appropriate for providing useful information to the users of financial statements.

In addition, we think that all the qualitative characteristics required for financial information should be treated with equal importance because the extent of the importance of each qualitative characteristic might be different among the users of financial statements depending on the objective of using financial statements.

In that sense, contrary to the argument that using fair value as the only measurement method reduces complexity in relation to financial reporting, we think that supporting the use of the single measurement method tends to emphasize only the comparability among qualitative characteristics of financial information.

We believe that every entity has different intention of holding financial instruments because each entity has its own operation model and the environment of that is not the same.

We do not deny that reporting the financial instruments at fair value is more useful in the way of assessing its risk and future cash flows of that instrument, if the instrument is managed at fair value.

However, if the management does not intend to hold for trading the instrument or can not measure the instrument at fair value reliably, cost measurement method would provide more

reliable information to the users of financial statements in making economic decisions and reflect the management's intention of holding the instrument.

We believe that the complexity involved in reporting the financial instrument are due to the inherent complex characteristics of financial instruments, business model in themselves and one business environment rather than the requirement of the IFRS.

In our view, requiring to measure and to account every instrument only at fair value without considering various business models in many nations and various business intentions, may reduce the reliability of the financial information and deteriorate practical applicability.

However, we have to say that there was a dissenting opinion which is for measuring and accounting the instrument only at fair value ultimately. Its view is that measuring the instruments using mixed attributes model should be allowed under exceptional cases within limited range.

Most of all, we believe that the recent arguments in relation to the fair value measurement are due to that 'measurement' project of Framework has not been completed. If the concept of fair value is established and the reason that the financial instruments should be measured and accounted at fair value becomes clearer, we think that the claim of measuring and accounting all the financial instruments at fair value will get more persuasive.

In addition, we think that IASB should consider the situations of many nations, such as South Korea, Canada and India, preparing to adopt the IFRS in 2011, if it is examining the revision of IAS 39 to a large extent. The reason is that considerable practical burden and confusion in practice of the entities would arise in those nations, for the entities in those nations may have to modify the system which was just established for applying the current IFRS from 2011.

Q5

What criteria should accounting standard-setters consider in balancing the need for resolving an 'emergency issue' on a timely basis and the need for active engagement from constituents through due process to help ensure high quality standards that are broadly accepted?

We believe that standard setting procedure is always subject to, at least, minimum due process that would allow all stakeholders the opportunity to provide meaningful comment. Only when dealing with really urgent matters that also need to be stated in the constitution including the characteristics and scope of such an event, IASB can reduce the period for external comments. We have a concern that only English-speaking countries can be benefitted

from 'fast track' procedure for 'urgent' issues, because it takes much more time for non-English countries to adopt the revision.

Question 6

Are there financial crisis-related issues that the IASB or the FASB have indicated they will be addressing that you believe are better addressed in combination with, or alternatively by, other organizations? If so, which issues and why, and which organizations?

The issue of foreign currency accounting has not been discussed globally, although many emerging market countries are suffering from abnormally large devaluation on their currencies. Therefore, as we mentioned on Question 1, we suggest that IASB and FASB improve foreign currency accounting standards in combination with standard setters of emerging market countries.

We believe that the foreign currency issue will be better addressed in combination with standard setters of emerging market countries because this issue is more important and urgent project for emerging market countries than developed countries.