Korea Accounting Institute KAI

Korea Accounting Standards Board KASB

Severance Building 24th Flr.
84-11, 5-ka Namdaemunro
Chungku, Seoul, 100-753, Korea
Tel : 02) 2259-0150~60
Fax : 02) 2259-0170~1

October 11, 2002

CL 21

The Secretary-General
International Accounting Standards Boards
30 Cannon Street, London EC4M 6XH
United Kingdom

Dear Sir:

This letter responds to the International Accounting Standards Board (IASB) Exposure Draft of Proposed Amendments to IAS 32 and IAS 39 (the Exposure Draft). On behalf of the Korea Accounting Standards Board (KASB), I commend the IASB for its continuing efforts to improve international accounting standards and appreciate the opportunity to comment on the Exposure Draft.

The comments addressed in this letter have been developed by the International Accounting Standards Review Committee (IASRC) of the KASB and does not represent an official position of the KASB. Official positions of the KASB are determined only after extensive due process and deliberation to which this letter has not been subjected.

The remainder of this letter provides the IASRC's comments on questions raised in the Exposure Draft.

Proposed Amendments to IAS 32

Question 1 - Probabilities of different manners of settlement (paragraphs 19, 22, and 22A)

Do you agree that the classification of a financial instrument as a liability or as equity in accordance with the substance of the contractual arrangements should be made without regard to probabilities of different manners of settlement? The proposed amendments eliminate the notion in paragraph 22 that an instrument that the issuer is economically compelled to redeem because of a contractually accelerating dividend should be classified

as a financial liability. In addition, the proposed amendments require a financial instrument that the issuer could be required to settle by delivering cash or other financial assets, depending on the occurrence or non-occurrence of uncertain future events or on the outcome of uncertain circumstances that are beyond the control of both the issuer and the holder of the instrument, to be classified as a financial liability, irrespective of the probability of those events or circumstances occurring (paragraph 22A).

The IASRC agrees with the proposed change since the basic approach of IASB is to classify financial instrument as liability or equity depending on the content of the contractual arrangements rather than the form of settlement. The proposed amendment would reduce the possibility of arbitrary classification of liabilities and equity.

Question 2 - Separation of liability and equity elements (paragraphs 28 and 29)
Do you agree that the options in IAS 32 for an issuer to measure the liability element of a compound financial instrument initially either as a residual amount after separating the equity element or based on a relative-fair-value method should be eliminated and, instead, any asset and liability elements should be separated and measured first and then the residual assigned to the equity element?

The IASRC agrees with the elimination of relative fair value method since under IAS 39 all financial liability is to be recognized initially at the fair value of the consideration received, not any relative value.

Question 3 - Classification of derivatives that relate to an entity's own shares (paragraphs 29C – 29G)
Do you agree with the guidance proposed about the classification of derivatives that relate to an entity's own shares?

The IASRC supports the IASB's decision on the guidance proposed about the classification of derivatives that relate to an entity's own shares.

Question 4 - Consolidation of the text in IAS 32 and IAS 39 into one comprehensive Standard
Do you believe it would be useful to integrate the text in IAS 32 and IAS 39 into one comprehensive Standard on the accounting for financial instruments? (Although the Board is not proposing such a change in this Exposure Draft, it may consider this

possibility in finalising the revised Standards.)

The IASRC believes that the consolidation of IAS 32 and IAS 39 into one comprehensive standard would be useful and ease the application. However, the integration would only be effective when the two standards are reorganized and rewritten to reflect all current contents while reducing the length of the standards.

Proposed Amendments to IAS 39

Question 1 - Scope: loan commitments (paragraph 1(i))
Do you agree that a loan commitment that cannot be settled net and the entity does not designate as held for trading should be excluded from the scope of IAS 39?

The IASRC agrees with the proposed amendment on scope exception of IAS 39. Excluding a loan commitment that cannot be settled net and the entity does not designate as held for trading from the scope of IAS 39, would simplify the accounting for both holders and issuers of a loan commitment. In addition, we believe that it would bring the consistency with the measurement of a loan or receivable that is originated if the holder of the loan commitment exercises its right to obtain financing, because changes in market interest rates do not affect the measurement of an asset measured at amortized cost.

Question 2 - Derecognition: continuing involvement approach (paragraphs 35-57)
Do you agree that the proposed continuing involvement approach should be established as the principle for derecognition of financial assets under IAS 39? If not, what approach would you propose?

The IASRC does not agree with the proposed continuing involvement approach as the principle for derecognition of financial assets. We are on the same side of the two dissenters' view presented in Appendix D and recommend the IASB to retain the exiting standards in IAS 39.

Question 3 - Derecognition: pass-through arrangements (paragraph 41)
Do you agree that assets transferred under pass-through arrangements where the cash flows are passed through from one entity to another (such as from a special purpose entity to an investor) should qualify for derecognition based on the conditions set out in paragraph 41 of the Exposure Draft?

The IASRC reserves the comments on question 3, because we do not agree with the IASB's proposed principle of dereconition as described in the answer to the question 2.

Question 4 - Measurement: fair value designation (paragraph 10)
Do you agree that an entity should be permitted to designate any financial instrument irrevocably at initial recognition as an instrument that is measured at fair value with changes in fair value recognised in profit or loss?

The IASRC does not agree with the IASB's decision that an entity should have an option to designate any financial instrument at initial recognition as held for trading. We concern that this would bring an entity's arbitrary designation of financial instruments. The IASB's concern, which is the distinction on measurement between liquid debt securities that are acquired upon issue and liquid debt securities that are acquired shortly afterwards, may be settled otherwise, for example, by modifying Implementation Guidance.

Question 5 - Fair value measurement considerations (paragraphs 95-100D)
Do you agree with the requirements about how to determine fair values that have been included in paragraphs 95–100D of the Exposure Draft? Additional guidance is included in paragraphs A32–A42 of Appendix A. Do you have any suggestions for additional requirements or guidance?

The IASRC supports the proposed guidance on the methods to determine fair values. We believe that the proposed paragraphs provide the better guidance for measuring the fair value of financial instruments, especially for the case that an explicit market price is not available.

Question 6 - Collective evaluation of impairment (paragraphs 112 and 113A–113D)
Do you agree that a loan asset or other financial asset measured at amortised cost that has been individually assessed for impairment and found not to be individually impaired should be included in a group of assets with similar credit risk characteristics that are collectively evaluated for impairment? Do you agree with the methodology for measuring such impairment in paragraphs 113A-113D?

The IASRC agrees to the IASB's propsal that individually unimpaired assets need to be collectively evaluated for impairment. Such collective assessment for impairment will be based on historical default data for groups of similar credit risk characteristics. However, such empirical data will be available for only very sophisticated financial institutions that keep records of past credit ratings and their default history. Thus, we recommend the IASB to consider the practical difficulties in application of such analysis which majority of the entities are expected to experience.

Question 7 - Impairment of investments in available-for-sale financial assets (paragraphs 117–119)
Do you agree that impairment losses for investments in debt and equity instruments that are classified as available for sale should not be reversed?

The IASRC does not support the proposed amendments described in paragraphs 117-119. We believe that impairment loss is an estimation of probable loss and when the basis for such estimation is cured or eliminated, the impairment loss amount should be recovered.

Question 8 - Hedges of firm commitments (paragraphs 137 and 140)
Do you agree that a hedge of an unrecognised firm commitment (a fair value exposure) should be accounted for as a fair value hedge instead of a cash flow hedge as it is at present?

The IASRC supports the IASB's proposal discussed in paragraphs 137 and 140. The change in fair value of a hedging instrument that is designated and is effective as the hedge of a fair value exposure in an unrecognized firm commitment should be accounted for as a fair value hedge. In addition, to achieve convergence with US GAAP, an entity should be permitted to designate as cash flow hedge when there is a foreign currency risk associated with a firm commitment.

Question 9 - 'Basis adjustments' (paragraph 160)
Do you agree that when a hedged forecast transaction results in an asset or liability, the cumulative gain or loss that had previously been recognised directly in equity should remain in equity and be released from equity consistently with the reporting of gains or losses on the hedged asset or liability?

The IASRC agrees with the proposed amendment in paragraph 160. We share the view that it is illogical to increase or decrease an entity's equity at the time of purchase of an asset or the issue of a liability that results from a hedged forecast transaction.

Question 10 - Prior derecognition transactions (paragraph 171B)
Do you agree that a financial asset that was derecognised under the previous derecognition

requirements in IAS 39 should be recognised as a financial asset on transition to the revised Standard if the asset would not have been derecognised under the revised derecognition requirements (ie that prior derecognition transactions should not be grand fathered)? Alternatively, should prior derecognition transactions be grand fathered and disclosure be required of the balances that would have been recognised had the new requirements been applied?

The IASRC believes that transition without any grand fathering will result in excessively time consuming process, especially for transfer of assets that occurred not within a few years. Therefore, we recommend the IASB to allow the grand fathering for the prior transactions and require the disclosure of balances only in the foot notes. In addition, the IASB should clearly require the disclosure of such grand fathering provision on adoption of the new standard so that the information users are fully aware of the grand fathered application.

* * *

Again, thank you for the opportunity to comment on the Proposed Preface. The IASRC is willing to address any questions or concerns with regard to the above comments at your convenience. Such should be forwarded to Jaewon Yoon, KASB staff at jwyst1@kasb.or.kr.

Sincerely,

김 경 호

Kyung-Ho Kim
Chairman, International Accounting Standards Review Committee
Vice Chairman, Korea Accounting Standards Board