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March 22, 2002

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

Dear Sir/Madam

This letter responds to the International Accounting Standards Board (IASB) Exposure Draft of Proposed Improvements to International Accounting Standards (IAS). On behalf of the Korea Accounting Institutes (KAI) and 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 of improvements to IAS.

The comments addressed in this letter have been developed by the International Accounting Standards Review Committee (IASRC) of the KAI 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 and some other issues.

Proposed Improvements to International Accounting Standard IAS 1 (revised 1997) Presentation of Financial Statements

Question 1

Do you agree with the proposed approach regarding departure from a requirement of an International Financial Reporting Standard or an Interpretation of an International Financial Reporting Standard to achieve a fair presentation (see proposed paragraphs 13-16)?

The IASRC does not agree with the proposed approach in the paragraphs 13-16, allowing departure from a requirement of an International Financial Reporting Standard (IFRS) or Interpretation of International Financial Reporting Standard to achieve a fair presentation, because the extremely rare cases in which management concludes that compliance with a requirement in an IFRS or Interpretation of IFRS would be so misleading that it would conflict with the objective of financial statements set out in the Framework need not be considered in IAS 1.

Question 2

Do you agree with prohibiting the presentation of items of income and expense as 'extraordinary items' in the income statement and the notes (see proposed paragraphs 78 and 79)?

The IASRC does not agree with the proposed amendment discussed in proposed paragraphs 78 and 79. We believe that reporting extraordinary items as a separate component of the income statement provides useful information on the different persistency of income components, which is relevant to the decision making of financial statements users. Thus, the IASRC recommends the IASB to retain the current standards, but to make an effort to clarify the current definition of 'extraordinary item' set out in the paragraph 6 of IAS 8, which is somewhat ambiguous, or to give clear guidance. In addition, eliminating the category of extraordinary items does not seem to enhance international convergence of accounting standards, since many countries, such as U.S. and Korea, use the category of extraordinary items.

Question 3

Do you agree that a long-term financial liability due to be settled within twelve months of the balance sheet date should be classified as a current liability, even if an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue (see proposed paragraph 60)?

The IASRC does not agree with the amendment discussed in proposed paragraph 60. As discussed in A23, classifying a liability as current or non-current according to whether it is expected to use current working capital of the entity, rather than strictly on the basis of its date of maturity and whether it is callable at the balance sheet date, may provide more relevant information about the liability's future effect on the timing of the entity's resource flows.

Question 4

Do you agree that:

(a) a long-term financial liability that is payable on demand because the entity breached a condition of its loan agreement should be classified as current at the balance sheet date, even if the lender has agreed after the balance sheet date, and before the financial statements are authorised for issue, not to demand payment as a consequence of the breach (see proposed paragraph 62)?

(b) if a lender was entitled to demand immediate repayment of a loan because the entity breached a condition of its loan agreement, but agreed by the balance sheet date to provide a period of grace within which the entity can rectify the breach and during that time the lender cannot demand immediate repayment, the liability is classified as noncurrent if it is due for settlement, without that breach of the loan agreement, at least twelve months after the balance sheet date and:

(i) the entity rectifies the breach within the period of grace; or

(ii) when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified (see proposed paragraphs 63 and 64)?

The IASRC does not agree with the amendment discussed in proposed paragraphs 62-64 with the same reason given in question 3.

Question 5

Do you agree that an entity should disclose the judgements made by management in applying the accounting policies that have the most significant effect on the amounts of items recognised in the financial statements (see proposed paragraphs 108 and 109)?

The IASRC supports the IASB's decision to add proposed paragraphs 108 and 109. Disclosure of judgments made by management in applying accounting principles would enhance the relevance, reliability and understandability of the information reported in financial statements. However, we suggest to delete the word “the most” stated in proposed paragraph 108, because it is not easy to distinguish "the most" significant effect from other significant effects practically without appropriate guidance.

Question 6

Do you agree that an entity should disclose key assumptions about the future, and other sources of measurement uncertainty, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year (see proposed paragraphs 110-115)?

The IASRC believes that the IASB’s additional disclosure requirements proposed in paragraphs 110-115 will enhance the usefulness of financial statements and are also consistent with the Framework.

Proposed Improvements to International Accounting Standard IAS 2(revised 1993) Inventories

Question 1

Do you agree with eliminating the allowed alternative of using the last-in, first-out (LIFO) method for determining the cost of inventories under paragraphs 23 and 24 of IAS 2?

The IASRC does not support the proposed elimination of LIFO method. In general cases, an assumption on physical inventory flows of LIFO method may not represent the actual inventory flows faithfully. However, in some cases, such as a heap of coal or a pile of iron scraps, LIFO may represent the actual physical inventory flows better than FIFO or other methods. Thus, we suggest the IASB to retain LIFO method as an alternative treatment.

Question 2

IAS 2 requires reversal of write-downs of inventories when the circumstances that previously caused inventories to be written down below cost no longer exist (paragraph 30). IAS 2 also requires the amount of any reversal of any write-down of inventories to be recognised in profit or loss (paragraph 31). Do you agree with retaining those requirements?

The IASRC agrees with retaining the requirements stated in paragraph 30. Reversal of write-downs resulting from unexpected change of circumstances is a change in an accounting estimate. Accordingly, the effect of reversal of write-downs should be recognised in profit or loss, consistent with the case of write-downs.

Proposed Improvements to International Accounting Standard IAS 8 (revised 1993)
Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies

Question 1
Do you agree that the allowed alternative treatment should be eliminated for voluntary changes in accounting policies and corrections of errors, meaning that those changes and corrections should be accounted for retrospectively as if the new accounting policy had always been in use or the error had never occurred (see paragraphs 20, 21, 32 and 33)?

The IASRC basically agrees on the elimination of the alternative treatment for voluntary accounting policy changes. Given that KASB adopted the retroactive treatment of accounting policy changes, the proposed amendment is more consistent with Korean accounting standards.

However, we do not agree that the correction of all errors should be accounted for retrospectively. The IASRC believes that the correction of fundamental errors should be accounted for retrospectively and the correction of other errors should be included in the determination of net profit or loss for the current period, as stated in paragraphs 31 and 34 of IAS 8. The retrospective treatment for correction of errors can be used unjustifiably for income smoothing.

On proposed paragraphs 21 and 33, the proposed improvements allow exceptions to comparative restatements in case of undue cost or effort. However, it is not clear what it means to be "undue" cost or effort. Without clear definition of "undue" cost or effort, management normally would have an incentive to abuse these exceptions. The word "prohibitive" might be a better term than "undue".

Question 2

Do you agree with eliminating the distinction between fundamental errors and other material errors (see paragraphs 32 and 33)?

Consistent with comments on question 1 of proposed amendments on IAS 8, the IASRC does not agree with proposed elimination of distinction between fundamental errors and other errors. However, the IASRC partly agrees with the IASB's concern that the existing definition of 'fundamental errors' in IAS 8 is difficult to interpret consistently by management, because the key feature of the definition is also a feature of other material errors. Thus, we recommend the IASB to make additional efforts to develop the better definition of fundamental errors, or to give a practical guidance, such as certain percentage threshold to be determined as fundamental errors.

Proposed Improvements to International Accounting Standard IAS 10 (revised 1999) Events After the Balance Sheet Date

The IASRC supports the IASB's proposed improvements to IAS 10.

Proposed Withdrawal of International Accounting Standard IAS 15(reformatted 1994) Information Reflecting the Effects of Changing Prices

The IASRC supports the IASB's proposed withdrawal of IAS 15.

Proposed Improvements to International Accounting Standard IAS 16(revised 1998) Property, Plant and Equipment

Question 1

Do you agree that all exchanges of items of property, plant and equipment should be measured at fair value, except when the fair value of neither of the assets exchanged can be determined reliably (see paragraphs 21 and 21A)?

The IASRC does not agree with the proposed amendments discussed in paragraphs 21 and 21A. Rather, we supports current standards described in paragraph 22 of IAS 16, prescribing no gain or loss recognition on exchange of a similar asset. The rationale to support this requirement is consistent with the view that gain or loss should not be recognized on exchange of an asset unless the exchange represents the culmination of an earning process. We partly agree the IASB's concern that it might be arbitrary to identify whether assets exchanged are similar in nature and value in some cases. However, we believe that recognizing gains and losses on exchanges of assets regardless of the nature of those transactions may not be justified with above concern. As for exchanges of assets held for use, whether an earning process culminates should be key criteria for recognizing related gain or loss. In another way, we think that it is not proper to recognize gains or losses on exchange transactions depending on whether assets can be reliably measured at fair value as described in proposed ED, not the nature of transactions.

Question 2

Do you agree that all exchanges of intangible assets should be measured at fair value, except when the fair value of neither of the assets exchanged can be determined reliably? (See the amendments in paragraphs 34-34B of IAS 38, Intangible Assets, proposed as a consequence of the proposal described in Question 1.) (Note that the Board has decided not to amend, at this time, the prohibition in IAS 18, Revenue, on recognising revenue from exchanges or swaps of goods or services of a similar nature and value. The Board will review that policy later in the context of a future project on the Recognition of Revenue.)

The IASRC does not agree with the proposed amendment discussed in proposed paragraphs 34-34B with the same reason given in question 1.

Question 3

Do you agree that depreciation of an item of property, plant and equipment should not cease when it becomes temporarily idle or is retired from active use and held for disposal (see paragraph 59)?

The IASRC agrees that depreciation of an item of property, plant and equipment (PPE) should not cease when it becomes temporarily idle or is retired from active use.

However, for PPE held for disposal, we disagree with the IASB proposed amendment. PPE is defined as tangible assets that are held by an enterprise for use in the production or supply of goods or services, for rental to others, or for administrative purposes in paragraph 6 of IAS 16. Accordingly, PPE held for disposal does not meet the definition of paragraph 6 of IAS 16. Thus, it seems to be illogical that an asset which does not meet the definition of PPE should be depreciated according to its useful life, which is the period of time over which an asset is expected to be used by the entity as stated in paragraph 6. The IASRC believes that PPE held for disposal should be reclassified into the category of investment assets and be subject to a periodic impairment test.

Proposed Improvements to International Accounting Standard IAS 17 (revised 1997)
Leases

Question 1

Do you agree that when classifying a lease of land and buildings, the lease should be split into two elements—a lease of land and a lease of buildings? The land element is generally classified as an operating lease under paragraph 11 of IAS 17, Leases, and the buildings element is classified as an operating or finance lease by applying the conditions in paragraphs 3-10 of IAS 17.

The IASRC agrees with the accounting treatment for the lease of land and buildings described under the paragraphs11, 11A, 11B and 11C of IAS 17. Normally, land has an indefinite economic life, and thereby if the ownership is not transferred to the lessee at the end of the lease term, any risk and future benefits in relation to the land portion entirely fall to the lessor. For this reason, the land element should be generally classified as an operating lease by the lessee. The building element is classified as an operating or finance lease in accordance with the paragraphs 3-10 of IAS 17. However, if the title to both elements is expected to pass to the lessee by the end of the lease term (i.e. satisfying the conditions under the paragraph 8 (a) or (b) of IAS 17), the lessee is still required to account for the agreement separating the land and building components on the basis of their relative fair values measured at the inception of the lease, and capitalize each separately. The land and building components should be separately accounted for because of different characteristic embedded in the land and building components (i.e. land is not depreciable and building is depreciable).

With regard to the concept of immateriality described under the paragraph 11C of IAS 17, a threshold for defining immateriality should be specified to avoid the misuse by the lessee. For the reference, 25% of the fair value of the leased property in aggregate is used under the US GAAP.

Question 2

Do you agree that when a lessor incurs initial direct costs in negotiating a lease, those costs should be capitalised and allocated over the lease term? Do you agree that only incremental costs that are directly attributable to the lease transaction should be capitalised in this way and that they should include those internal costs that are incremental and directly attributable?

The IASRC supports the IASB's proposed amendment that lessor's initial direct costs should be added to the measurement of the finance lease receivable (finance lease) or to the carrying amount of the leased asset (operating lease).

However, such costs should be limited to those clearly identified as directly attributable to the specific lease transaction so that they reflect any future risks and rewards in relation to the given lease. Should all incidental costs both directly and indirectly related to a lease transaction be capitalized, the level of the assets and the resulting financial position of the entity would be distorted.

[Other Comments]

Under the present 'substantially all risks and rewards' approach, two leasing transactions will be accounted for very differently in financial statements if one is classified as a finance lease and the other as an operating lease, even if the two leases are economically very similar. With a finance lease, the lessee recognizes on its balance sheet the whole asset (equivalent to 'quasi-ownership' of the leased property) and a matching liability to the lessor; with an operating lease, the lessor recognizes the whole asset and the lessee recognizes no asset or liability. There is no room for recognition of the transfer from lessors to lessees of partial interest in leased assets.

The IASRC believes that the present 'substantially all risks and rewards' approach should be replaced by the new 'asset and liability' approach under which all material leases would be accounted for using the principles established in existing standards for the recognition of assets and liabilities arising under finance leases, as recommended in the Discussion papers (December 1999) by the Accounting Standards Board.

Proposed Improvements to International Accounting Standard IAS 21 (revised 1993)

The Effects of Changes in Foreign Exchange Rates

Question 1

Do you agree with the proposed definition of functional currency as "the currency of the primary economic environment in which the entity operates" and the guidance proposed in paragraphs 7-12 on how to determine what is an entity's functional currency?

The IASRC basically agrees with the proposed definition of functional currency and related guidance, which are consistent with US GAAP stated in SFAS No.52. With regard to the guidance proposed in the paragraphs 7-12 on how to determine what is an entity's functional currency, we think both paragraphs 7 and 8 should be integrated (i.e. stated in one paragraph) and additional provision should be stated that once particular indicators are used, they should be consistently applied unless there are significant changes in the economic facts and circumstances which indicate that different indicators should be used.

Question 2

Do you agree that a reporting entity (whether a group or a stand-alone entity) should be permitted to present its financial statements in any currency (or currencies) that it chooses?

The IASRC supports the proposed amendment of the IASB, if the presentation currency (or currencies) chosen by managements at their discretion is (are) used consistently. For example, most large multi-national groups do not have a single functional currency, but rather comprise operations with a number of functional currencies. For such entities, it may be unclear which currency should be the presentation currency, or why one currency is preferable to another. Further, in some jurisdictions, entities are required to present their financial statements in the local currency, even when that currency is not the functional currency. Accordingly, a reporting entity should be permitted to present its financial statements in any currency (or currencies) that it chooses.

Question 3

Do you agree that all entities should translate their financial statements into the presentation currency (or currencies) using the same method as is required for translating a foreign operation for inclusion in the reporting entity's financial statements (see paragraphs 37 and 40)?

The IASRC agrees that all entities should translate their financial statements in a consistent way as described in proposed paragraphs 37 and 40 depends on the stability of a functional currency In essence, there is no difference between translating an entity's financial statements into the presentation currency and translating a foreign operation for inclusion in the reporting entity's financial statements. For example, translation method should produce the same amounts in the presentation currency for a stand-alone entity as for an identical subsidiary of a parent whose functional currency is the presentation currency.

Question 4
Do you agree that the allowed alternative to capitalise certain exchange differences in paragraph 21 of IAS 21 should be removed?

The IASRC agrees that the allowed alternative to capitalize certain exchange differences in the paragraph 21 of IAS 21 should be removed. This is consistent with the concept that exchange losses do not meet the definition of assets (the potential to contribute, directly or indirectly, to the flow of cash and cash equivalents to the enterprise). The exchange difference should be reflected in profit or loss when the exchange rate changes rather than at some other intermediate date or period. In addition, the circumstances to meet the criteria to capitalize certain exchange differences seem to be very exceptional, almost unlikely to happen in practice.

Question 5
Do you agree that
(a) goodwill and
(b) fair value adjustments to assets and liabilities
that arise on the acquisition of a foreign operation should be treated as assets and liabilities of the foreign operation and translated at the closing rate (see paragraph 45)?

The IASRC could not reach a consensus on the issues of question 5.

Proposed Improvements to International Accounting Standard IAS 24 (reformatted 1994)
Related Party Disclosures

Question 1

Do you agree that the Standard should not require disclosure of management compensation, expense allowances and similar items paid in the ordinary course of an entity's operations (see paragraph 2)?
'Management' and 'compensation' would need to be defined, and measurement requirements for management compensation would need to be developed, if disclosure of these items were to be required. If commentators disagree with the Board's proposal, the Board would welcome suggestions on how to define 'management' and 'compensation'.

The IASRC basically agrees with the amendment described in proposed paragraph 2. However, we believe that 'ordinary course of an entity's operations' need to be clearly defined to warrant consistent applications by each entity.

Question 2
Do you agree that the Standard should not require disclosure of related party transactions and outstanding balances in the separate financial statements of a parent or a wholly-owned subsidiary that are made available or published with consolidated financial statements for the group to which that entity belongs (see paragraph 3)?
(Note that this proposal is the subject of alternative views of Board members, as set out in Appendix B.)

The IASRC does not support the proposed paragraph 3 of IAS 24. We believe that each set of financial statements should be presented on a stand-alone basis. Since all material related party transactions and balances should be identified in the course of consolidation, additional burden would not be significant.

[Other Comments]

The IASRC understands that the proposed paragraph 12 intends to require disclosure of relationship not with all related parties but with parent and subsidiaries only. Then it would rather be part of IAS 27.

Proposed Improvements to International Accounting Standard IAS 27 (revised 2000)

Consolidated Financial Statements and Accounting for Investments in Subsidiaries

Question 1

Do you agree that a parent need not prepare consolidated financial statements if all the criteria in paragraph 8 are met?

The IASRC agrees that a parent need not prepare consolidated financial statements if all the criteria in paragraph 8 are met.

Question 2

Do you agree that minority interests should be presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity (see paragraph 26)?

The IASRC agrees that minority interests should be presented in the consolidated balance sheet within equity, because minority shareholders are also the shareholders of the entity in substance.

Question 3

Do you agree that investments in subsidiaries, jointly controlled entities and associates that are consolidated, proportionately consolidated or accounted for under the equity method in the consolidated financial statements should be either carried at cost or accounted for in accordance with IAS 39, Financial Instruments: Recognition and Measurement, in the investor's separate financial statements (paragraph 29)?

The IASRC disagrees with the IASB's amendment proposed in paragraph 29. Equity accounting can also provide users of consolidated financial statements with relevant information as it shows proportional amount of equity value of the investment. Moreover, in some countries, separate financial statements constitute important financial information required by relevant law. In such a case, separate financial statements should be prepared reflecting the effects in the consolidated financial statements through use of equity method.

In relation to paragraph A13, lenders to the parent might be more interested in seeing the picked-up income as the source of dividend than the dividend income itself from the subsidiaries, for the one under the equity method is more relevant information in assessment of the entity's credit.

Do you agree that if investments in subsidiaries, jointly controlled entities and associates are accounted for in accordance with IAS 39 in the consolidated financial statements, then such investments should be accounted for in the same way in the investor's separate financial statements (paragraph 30)?

The IASRC agrees with the proposed paragraph 30 of IAS 27.

Proposed Improvements to International Accounting Standard IAS 28 (revised 2000) Accounting for Investments in Associates

Question 1

Do you agree that IAS 28 and IAS 31, Financial Reporting of Interests in Joint Ventures, should not apply to investments that otherwise would be associates or joint ventures held by venture capital organisations, mutual funds, unit trusts and similar entities if these investments are measured at fair value in accordance with IAS 39, Financial Instruments: Recognition and Measurement, when such measurement is well-established practice in those industries (see paragraph 1)?

The IASRC agrees with the proposed paragraph 1 of IAS 28.

Question 2

Do you agree that the amount to be reduced to nil when an associate incurs losses should include not only investments in the equity of the associate but also other interests such as long-term receivables (paragraph 22)?

The IASRC agrees with the proposed paragraph 22 of IAS 28.

[Other Comments]

The IASRC believes that it is necessary to provide the accounting treatment for the transaction in which the investor's ownership percentage changes as a result of investee's various capital raising activities.

Proposed Improvements to International Accounting Standard IAS 33

Earnings Per Share

Question 1

Do you agree that contracts that may be settled either in ordinary shares or in cash, at the issuer's option, should be included as potential ordinary shares in the calculation of diluted earnings per share based on a rebuttable presumption that the contracts will be settled in shares?

The IASRC believes that the proposed method is appropriate.

Question 2

Do you agree with the following approach to the year-to-date calculation of diluted earnings per share (as illustrated in Appendix B, examples 7 and 12)?

The IASRC agrees with the proposed approach to the year-to-date calculation of diluted earnings per share. Examples 7 and 12 of Appendix B are consistent with Illustrations 3 and 1 of Appendix C of SFAS No. 128, respectively.

Proposed Improvements to International Accounting Standard IAS 40
Investment Property

Question 1

Do you agree that the definition of investment property should be changed to permit the inclusion of a property interest held under an operating lease provided that:
(a) the rest of the definition of investment property is met; and
(b) the lessee uses the fair value model set out in IAS 40, paragraphs 27-49?

The IASRC does not agree with the proposed approach in that a property interest held under an operating lease should not be permitted to be accounted for as investment property under the present 'substantially all risks and rewards' approach. We think it should be replaced by the new 'asset and liability' approach under which all material leases would be accounted for using the principles established in existing standards for the recognition of assets and liabilities arising under finance leases.

Question 2

Do you agree that a lessee that classifies a property interest held under an operating lease

as investment property should account for the lease as if it were a finance lease?

The IASRC does not agree with the proposed approach in that it conflicts with IAS 17.

Question 3

Do you agree that the Board should not eliminate the choice between the cost model and the fair value model in the Improvements project, but should keep the matter under review with a view to reconsidering the option to use the cost model in due course?

The IASRC agrees that the IASB should not eliminate the choice between the cost model and the fair value model in the Improvements project. As an investment property is measured at its cost due to less-developed property market and valuation in most countries, it would take more time to apply a fair value model.

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Again, thank you for the opportunity to comment on the exposure draft of proposed improvement to IAS. 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,

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Kyung-Ho Kim
Chairman, International Accounting Standards Review Committee
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