Korea Accounting Institute KAI

Korea Accounting Standards Board KASB

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22 October 2004

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Ms. Andrea Pryde
Assistant Project Manager
International Accounting Standards Board
30 Cannon Street, London EC4M 6XH
United Kingdom

Dear Ms. Andrea Pryde:

The International Accounting Standards Review Committee (IASRC) of the Korea Accounting Standards Board (KASB) sends you its comments on the *ED 7 Financial Instruments: Disclosures*. I would appreciate your including our comments in your summary of analysis that will be presented to the IASB.

The enclosed comments are those of the IASRC and do not represent an official position of the KASB. The official position of the KASB is determined only after extensive due process and deliberation, to which this letter has not been subjected.

Please do not hesitate to contact us if you have any inquiries regarding our comments. You may forward your inquiries either to Mr. Jae-ho Kim (jhkim@kasb.or.kr) or Mr. Kyoung-chun Yu (yukc@kasb.or.kr), both of whom are full-time research staff of the KASB.

Best regards,

Suk S Lim

Dr. Suk Sig Lim
Chairman, International Accounting Standards Review Committee
Vice Chairman, Korea Accounting Standards Board

Encl: IASRC comments on the *ED 7 Financial Instruments: Disclosures*

IASRC Comments on the ED 7 Financial Instruments: Disclosures

■ Question 1 – Disclosures relating to the significance of financial instruments to financial position and performance

> The draft IFRS incorporates disclosures at present contained in IAS 32 *Financial Instruments: Disclosure and Presentation* so that all disclosures about financial instruments are located in one Standard. It also proposes to add the following disclosure requirements:
> (a) financial assets and financial liabilities by classification (see paragraphs 10 and BC13).
> (b) information about any allowance account (see paragraphs 17 and BC14).
> (c) income statement amounts by classification (see paragraphs 21(a), BC15 and BC16).
> (d) fee income and expense (see paragraphs 21(d) and BC17).
> Are these proposals appropriate? If not, why not? What alternative disclosures would you propose?

We believe the proposal is appropriate, as the proposed information may provide better indication of the level of such activities and help users in estimating future income of the entity.

■ Question 2 - Disclosure of the fair value of collateral and other credit enhancements

> For an entity's exposure to credit risk, the draft IFRS proposes to require disclosure of the fair value of collateral pledged as security and other credit enhancements unless impracticable (see paragraphs 39, 40, BC27 and BC28).
>
> Is this proposal appropriate? If not, why not? What, if any, alternative disclosures would you propose to meet the stated objective?

We do not agree with the proposal. When financial assets become impaired, entities are already required to evaluate the fair value of collateral pledged as security and other credit enhancements. Except for such a case, however, if entities are required to disclose in all circumstances the fair value of collateral pledged as security and other credit enhancements, we are worried that the cost that the entities would incur in preparing such information will be far greater than the benefit to the information users.

■ Question 3 – Disclosure of a sensitivity analysis

> For an entity that has an exposure to market risk arising from financial instruments, the draft IFRS proposes to require disclosure of a sensitivity analysis (see paragraphs 43, 44 and BC36-BC39).
>
> Is the proposed disclosure of a sensitivity analysis practicable for all entities?
>
> If not, why not and what, if any, alternative disclosures of market risk would you propose to meet the stated objective of enabling users to evaluate the nature and extent of market risk?

We do not believe that the proposed disclosure would be always practicable. It is advisable that the disclosure of a sensitivity analysis be mandatory for financial institutions that have both abilities and resources to produce such information. However, we believe that the disclosure of a sensitivity analysis should be optional for non-financial institutions that have relatively less abilities and resources to produce such analytical information.

■ Question 4 – Capital disclosures

> The draft IFRS proposes disclosure of information that enables users of an entity's financial statements to evaluate the nature and extent of its capital. This includes a proposed requirement to disclose qualitative information about the entity's objectives, policies and processes for managing capital; quantitative data about what the entity regards as capital; whether during the period it complied with any capital targets set by management and any externally imposed capital requirements; and if it has not complied, the consequences of such non-compliance (see paragraphs 46-48 and BC45-BC54).
>
> Is this proposal appropriate? If not, why not? Should it be limited to only externally imposed capital requirements? What, if any, alternative disclosures would you propose?

We believe that the scope of the proposal should be limited to only externally imposed capital requirements. Requiring mandatory disclosure of any capital targets set by management would be inappropriate as they might be private internal information of the entity.

■ Question 5 – Effective date and transition

The proposed effective date is for periods beginning on or after 1 January 2007 with earlier adoption encouraged (see paragraphs 49 and BC62-BC67). Entities adopting IFRSs and the draft IFRS for the first time before 1 January 2006 would be exempt from providing comparative disclosures for the draft IFRS in the first year of adoption (see Appendix B, paragraph B9). Are the proposed effective date and transition requirements appropriate? If not, why not? What alternative would you propose?

We believe that the proposed effective date and transition requirements are appropriate.

■ Question 6 – Location of disclosures of risks arising from financial instruments

The disclosure of risks arising from financial instruments proposed by the draft IFRS would be part of the financial statements prepared in accordance with International Financial Reporting Standards (see paragraph BC41). Some believe that disclosures about risks should not be part of financial statements prepared in accordance with IFRSs; rather they should be part of the information provided by management outside the financial statements. Do you agree that the disclosures proposed by the draft IFRS should be part of the financial statements? If not, why not?

We agree that the disclosures proposed by the draft IFRS should be part of the financial statements. The financial statements would be incomplete and potentially misleading without disclosures about risks arising from financial instruments.

■ Question 7 – Consequential amendments to IFRS 4 (paragraph B10 of Appendix B)

Paragraph E10 of Appendix B proposes amendments to the risk disclosures in IFRS 4 *Insurance Contracts* to make them consistent with the requirements proposed in the draft

IFRS. The requirements in IFRS 4 were based on disclosure requirements in IAS 32 that would be amended by the draft IFRS. The Board's reasons for proposing these amendments are set out in paragraphs BC57-BC61.

Do you agree that the risk disclosures in IFRS 4 should be amended to make them consistent with the requirements proposed in the draft IFRS? If not, why not and what amendments would you make pending the outcome of phase II of the Board's Insurance project?

We agree that the risk disclosures in IFRS 4 should be amended to make them consistent with the requirements proposed in the draft IFRS. Since the requirements in IFRS 4 were based on disclosure requirements in IAS 32, it is logical to amend the requirements in IFRS 4 in accordance with the amendments proposed in the draft IFRS.

■ Question 8 – Implementation Guidance

The draft Implementation Guidance accompanying the draft IFRS suggests possible ways to apply the risk disclosure requirements in paragraphs 32-45 (see paragraphs BC19, BC20 and BC42-BC44).

Is the Implementation Guidance sufficient? If not, what additional guidance would you propose?

We do not believe that the Implementation Guidance is sufficient. More detailed guidance with numeric examples is needed.

■ Question 9 – Differences from the Exposure Draft of Proposed Statement of Financial Accounting Standards *Fair Value Measurements* published by the US Financial Accounting Standards Board (FASB).

The FASB's Proposed Statement of Financial Accounting Standards *Fair Value Measurements*, which is open for public comment at the same time as this Exposure Draft, proposes guidance on how to measure fair value that would apply broadly to financial and non-financial assets and liabilities that are measured at fair value in accordance with other FASB pronouncements. That Exposure Draft proposes disclosure of information about the use of fair value in measuring assets and liabilities as follows:

(a) For assets and liabilities that are remeasured at fair value on a recurring (or ongoing) basis during the period (for example, trading securities)

(i) the fair value amounts at the end of the period, in total and as a percentage of total assets and liabilities,

(ii) how those fair value amounts were determined (whether based on quoted prices in active markets or on the results of other valuation techniques, indicating the extent to which market inputs were used), and

(iii) the effect of the remeasurements on earnings for the period (unrealised gains or losses) relating to those assets and liabilities still held at the reporting date.

(b) For assets and liabilities that are remeasured at fair value on a non-recurring (or periodic) basis during the period (for example, impaired assets), a description of

(i) the reason for remeasurements,

(ii) the fair value amounts,

(iii) how those fair value amounts were determined (whether based on quoted prices in active markets or on the results of other valuation techniques, indicating the extent to which market inputs were used), and

(iv) the effect of the remeasurements on earnings for the period relating to those assets and liabilities still held at the reporting date.

Disclosures similar to (a)(ii) above are proposed in paragraph 31 of the draft IFRS (and are currently required by paragraph 92 of IAS 32) and disclosures similar to (a)(iii) are proposed in paragraph 21(a).

Do you agree that the requirements in the draft IFRS provide adequate disclosure of fair value compared with those proposed in the FASB's Exposure Draft? If not, why not, and what changes to the draft IFRS would you propose?

In principle, we agree with the proposal in the draft IFRS. However, we are concerned about the problems related to the question 2. As commented on question 2, when financial assets become impaired, entities are already required to evaluate the fair value of collateral pledged as security and other credit enhancements. Except for such a case, however, if entities are required to disclose in all circumstances the fair value of collateral pledged as security and other credit enhancements, the cost that the entities would incur in preparing such information will be far greater than the benefit to the information users. Therefore, in the case of disclosing the fair value of collateral pledged as security and other credit enhancements, paragraphs ? should be required.

■ Question 10 – Other comments

Do you have any other comments on the draft IFRS, Implementation Guidance and Illustrative Examples?

To improve the understandability of the draft IFRS, comprehensive examples showing various preparation methods of all proposed disclosures will be helpful.