FINANCIAL SERVICES COMMISSION

Press Release

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AMENDMENTS TO ACCOUNTING STANDARDS FOR FX TRANSLATION

The Financial Services Commission (FSC), The Financial Supervisory Service (FSS), and The Korean Accounting Standards Board (KASB) have agreed to implement a set of measures namely, "Amendments to Accounting Standards for FX Translation." The FSC and the FSS had been engaged in close consultations with market participants such as companies with large foreign debts, financial institutions, and accounting experts regarding the issue of accounting standard of FX translation and transactions. The proposal was affirmed at the Economic and Financial Meeting on December 19, 2008.

I. Background

- Due to the recent surge of won-foreign exchange rate Korean companies are experiencing huge FX translation losses in their annual report.

  * When FX rate increases by KRW 100, companies' FX translation loss and debt each increases by KRW 5trn. (based on US$ 50.16bn of domestic companies' foreign borrowings from foreign exchange banks)

  - As a result of the drastic rise of the FX rate, Korean companies are exposed to adverse business environments such as downgrading on their credit ratings, early debts redemption, an increase in financial costs, and difficulty with obtaining new credit lines.

  - If this situation sustains, financial institutions will have to suffer deteriorating BIS capital adequacy ratio and reduction in their corporate loan facilities. Consequently, this will further prolong the process of economic recovery from the current crisis.

- Therefore, it had been deemed necessary to take timely actions to minimize financial burdens on companies and financial institutions, especially those related to accounting standards.

II. Way Forward

< Basic Principles >

◈ International convergence is to be observed as much as possible in order to safeguard the credibility of domestic companies' financial statements.

(Listed Companies and Large Unlisted Companies)
Earlier adoption of items from the International Financial Reporting Standards. (IFRS) has been recommended to help improve financial soundness, while they are initially scheduled to be implemented in 2011.

(Unlisted SMEs)
Allow special exemptions considering accounting standards for these companies are less strict even in other countries.

1. Listed Companies and Large Unlisted Companies

A. Permission of Revaluation on Property Plant and Equipment (PPE)

- (As-Is) Revaluation of PPE has not been permitted since 2001, and asset value increases for the past decade have not been reflected on the books.
  * Fair Valuation permitted in IFRS (IAS 16)

- (Improvement) Revaluation of real estates, air crafts, and ships is permitted, prior to the adoption of IFRS in 2011.
  *(Amendment) SKAS No. 5 Property, Plant and Equipment

- (Expected Result) Improvements on financial statements such as lowered debt ratio.

【 Example 】

* Fair value of a ship increases from carrying amount of 2,000 won to 3,000 won

(Dr)	Ship	1,000	(Cr)	Equity (Other Comprehensive Income)	1,000

(As-is)

B/S

Ship 2,000	Liability 1,000
	Common shares 1,000

(To-be)

B/S

Ship 3,000	Liability 1,000
	Common Shares 1,000 OCI 1,000

⇒ (F/S impact)

▷ Improvement of debt ratio (As-Is: 100% → To-Be: 50%)

▷ No change in net income

B. Adoption of Functional Currency : Accounting Books based on Foreign Currency

- (As-Is) Even companies with most of their sales and purchases settled in foreign currencies are required to keep their accounting books in KRW during the financial period and perform FX translation at year-end closing.

  - FX rates applied to assets and liabilities differ.

    * When a company purchases a ship with foreign borrowings, the borrowings (monetary) are translated by the year end FX rate, which could be higher, whereas the ship (non-monetary) is translated by the FX rate of the transaction date, which could be lower.

- (Improvement) Functional currency accounting, with which a company keeps its books in its functional currency, is allowed to companies whose most of sales are settled in foreign currencies.

  * Even if functional currency is adopted, financial statements need to be presented in KRW; therefore, all assets and liabilities are translated using one exchange rate at the year end.

  *(Amendment) Establishing new standard related to functional currency in KGAAP

- (Expected Result) Debt ratio and net income will be improved when Won-exchange rate is on the increase because won FX rate will be applied to all assets and liabilities at year end.

【 Example 】

A company purchases a ship for US$ 2 with capital investment of US$ 1 and borrowing of US$1 at the beginning of the year.

*FX rate : Year beginning 1,000 KRW/US$, Year end 1,500 KRW/US$

As-is (Accounting books in KRW)

B/S

Ship 2,000	Liability 1,500 (Foreign debt)
	Common shares 1,000
	Net loss (500)

To-be (Accounting books in US$)

B/S

Ship 3,000	Liability 1,500 (Foreign debt)
	Common shares 1,500

⇒ (F/S impact)

▷ Improvement of debt ratio (As-is: 300% → To-be: 100%)

▷ Improvement of net income (As-is: (500) won → To-be: Nil)

C. Include Application of Non-Derivative Financial Instruments for Foreign Currency Hedging

- (As-is) Only derivatives can be designated as hedging instruments for FX risks of highly probable forecast transactions under KGAAP; therefore, FX translation gains and losses of non-derivative financial instruments are entered into the current period.

  * FX translation gains/losses from derivatives designated as hedging instruments for highly probable forecast transactions can be recognized in equity.

- (Improvement) FX translation gains or losses of a non-derivative financial instrument such as foreign debts are recognized in equity when designated as a hedging instrument for FX risks of a highly probable forecast transaction.

  *(Amendment) KFAS Interpretation 53-70, Derivatives accounting – Effective date: Retrospectively applied from July 1, 2008.

- (Expected Result) Net income will be improved because FX translation gains or losses of a non-derivative financial instrument such as foreign debt designated as a hedging instrument is recognized in equity (OCI) when it meets hedge accounting requirements and the hedge is highly effective.

【 Example 】

A company borrows US$ 1 and designates it as a hedging instrument of a highly probable forecast export of US$ 1, assuming the hedge is highly effective.

*FX rate (₩/$) : Upon borrowing 1,000 won, At year end 1,500 won

(As-is)

B/S

Asset 2,000	Liability 1,500 (Foreign debt)
	Common shares 1,000
	Net loss (500)

(To-be)

B/S

Asset 2,000	Liability 1,500 (Foreign debt)
	Common shares 1,000
	OCI (500)

⇒ (F/S Impact)

▷No change in debt ratio

▷Improvement of net income (As-is (500) won → To-be Nil)

D. Amendment to Accounting Standards for Discontinuing Hedge Accounting of Firm Commitments

- (As-is) When the hedge accounting is discontinued, derivatives (forward contracts, etc.) are terminated before maturities, the assets or liabilities for firm commitments are recognized as profit or loss immediately.

- (Improvement) The entity is permitted to recognize profit or loss during the concerned period when the firm commitments are realized or adjust the carrying value of its assets or liabilities as recognized in its firm commitments, rather than terminating firm commitments altogether when the entity discontinues hedge accounting due to terminated derivatives.

  *(Amendment) KAFS Interpretation 53-70 (Derivatives accounting)

- (Expected Result) It will ease the burden of the entity by lessening P/L volatility in the period when hedge accounting is discontinued due to derivative termination.

【 Example 】

When the forward contract designated as hedging instrument to hedge foreign currency risks for firm commitment is terminated before maturities

(As-is)

Balance Sheet

Firm commitment 0	Debt 1,000
Other assets 2,000	Equity 2,000
	Net losses (1,000)

(To be)

Balance Sheet

Firm commitment 1,000	Debt 1,000
Other assets 2,000	Equity 2,000

* Based on the period when the forward contract is terminated

⇒ (F/S Impact)

▷ Improvement on debt ratio (As-is: 100% → To-be: 50%)

▷ Improvement on net income (As-is: (1,000) won → To-be: Nil)

2. Unlisted SMEs

- (As-Is) In principle, unlisted small and medium-sized entities should apply the same accounting standard that applies to listed entities, except such cases as permitting exemptions. (Unlisted small and medium-sized entities: 14,714 [83.4% of total entities in Korea], Dec. ‘07)

  * Korea enforces very strict disclosure requirements for unlisted small and medium-sized companies compared to other countries.

- (Improvement) For unlisted small and medium-sized entities which applies less strict hedge accounting rules, exemption on foreign currency is permitted in addition to the four amendments for listed entities including asset revaluations among others.

*When translating foreign currencies, entities are to apply foreign currency rate at a specific date i.e. June 30, 2008, rather than year-end date.

*(Amendment) KFAS No. 14 (Exemptions to accounting for small and medium-sized entities)

Basis for conclusion applying the foreign currency rate at June 30, 2008

- It corresponds with the effective date of accounting reaction for financial crisis in EU. (EU permitted exemptions to exclude valuation losses of financial assets from profit or loss from July 1, 2008)
- It approximates long-term average foreign currency rate.(recent 5 year average foreign currency rate: 1,027 won)

Qualifying items for applying the specific date: foreign currency assets or liabilities held as of June 30, 2008.

- Apply year-end foreign currency rate for foreign currency assets or liabilities recognized after July 2008. (Apply year-end rate to prevent foreign currency gains from borrowings facilitated at 1,400 won, during November 2008, if they are translated into interim period foreign currency rate.)

- (Expected Result) Exemptions for small and medium-sized entities are easy to apply in practice and minimize the effect of soaring foreign currency

*improvements on debt ratio and net income

【 Example : 】

(When electing exemptions for small and medium-sized entities.)

- At the beginning of the year, the entity purchased a vessel of US$ 2 through US$ 1 equity investment and US$ 1 borrowings.
- Foreign currency rate: Beginning of the year 1,000 won, June 30, 2008 1,050 won, end of the year 1,500 won

(As-is) B/S

Vessel	2,000	Debt	1,500
		Equity	1,000
		Net losses	(500)

(To-be) B/S

Vessel	2,000	Debt	1,050
		Equity	1,000
		Net losses	(50)

⇒ (F/S impact)

▷ Debt ratio improvement (As-is: 300% → To-be: 110.5%)

▷ Net income improvement (As-is: (500) won → To-be: (50) won)

III. Effect and complementary measures

1. Effect

- These new measures are expected to help overcome economic crisis by lessening accounting burdens of companies and financial institutions in the recent drastic increase in FX rates.
  - For companies: Improvement in financial index is expected especially by decreasing debt ratios and raising net incomes. It can also resolve problems related to a decrease in credit ratings and difficulties in funding.)
  - For financial institutions: Improved BIS ratio and solvency margin ratio are expected while reducing concerns over a corporate loan decrease.

◈ Financial institution application: All items are permitted as long as they comply with IFRS. However, it will be determined by each financial regulatory sectors based on comparability among financial institutions and external and internal reputation.

2. Complementary Measures

- (Investor Protection Measures) The effect of changes in accounting standard is disclosed on the notes and emphasized on the audit report. Practical guidelines will be provided.

- (Limited Application) Entities are allowed to apply the specific-date foreign currency application for only this year. KASB will review and decide whether to extend the application.

IV. Further Proceedings and Time Schedule

1. FSC will exercise the right to request for the amendment of accounting standards.

- As it takes 3 to 4 months for KASB to amend accounting standards, FSC will exercise its requesting right for the amendment. (External Audit Law, Article 13)

  * Companies and auditors can apply amended standards to financial statements for the period ending 2008.

2. Time Schedule

- Financial Services Commission decision: SFC (Dec 24) → FSC(26 Dec)
- KASB amendment and announcement on KGAAP: Mid-January of 2009

  *retrospective application is permitted for the closing of 2008

※ The measures above may be changed through SFC deliberation or FSC decision.