



# IFRS: Lessons from Korea's Experience

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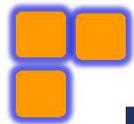
Korea Institute of Finance /  
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**I** Brief Overview of IFRS

**II** Korea's Experience

**III** Lessons Learned



# I. Brief Overview of IFRS

# 1. IFRS vs. K-GAAP



	IFRS	K-GAAP	Transition to IFRS
Principle-based vs. rule-based	Principle-based accounting	Rule-based accounting	<ul style="list-style-type: none"> <li>▪ Greater latitude to preparers</li> <li>▪ Less comparability of financial statements</li> </ul>
Consolidated vs. stand-alone basis	Consolidated basis	Stand-alone basis	<ul style="list-style-type: none"> <li>▪ Scope of consolidation, equity method, etc.</li> <li>▪ Greater emphasis on consolidated-basis financial reporting</li> </ul>
Valuation of assets & liabilities	Fair valuation	Acquisition cost	<ul style="list-style-type: none"> <li>▪ Investment property, tangible assets, and financial liabilities to be fair valued</li> <li>▪ Goodwill not to be amortized but tested for impairment</li> </ul>
Legal & policy considerations	Economic substance	Some special accounting rules	<ul style="list-style-type: none"> <li>▪ Loan-loss provisions to decline under the incurred loss approach</li> <li>▪ Redeemable preferred stock to be treated as liability</li> </ul>

## 2. Global Acceptance of IFRS



- About 120 countries have adopted or are working to adopt IFRS
  - 19 G-20 countries require IFRS or intend to do so soon



	G20	Adoption year
IFRS already in use	U.K.	2005
	France	2005
	Germany	2005
	Italy	2005
	S. Africa	2005
	Australia	2005
	China	2007
	Turkey	2008
	Brazil	2010
	Canada	2011
	<b>Korea</b>	<b>2011</b>
	India	2012?
	Mexico	2012
	Argentina	2012
Russia	2012	
IFRS to be adopted	Indonesia	2013
	U.S.	2015–2016
	Japan	2015–2016

# 3. Changes to IFRS since the Global Financial Crisis

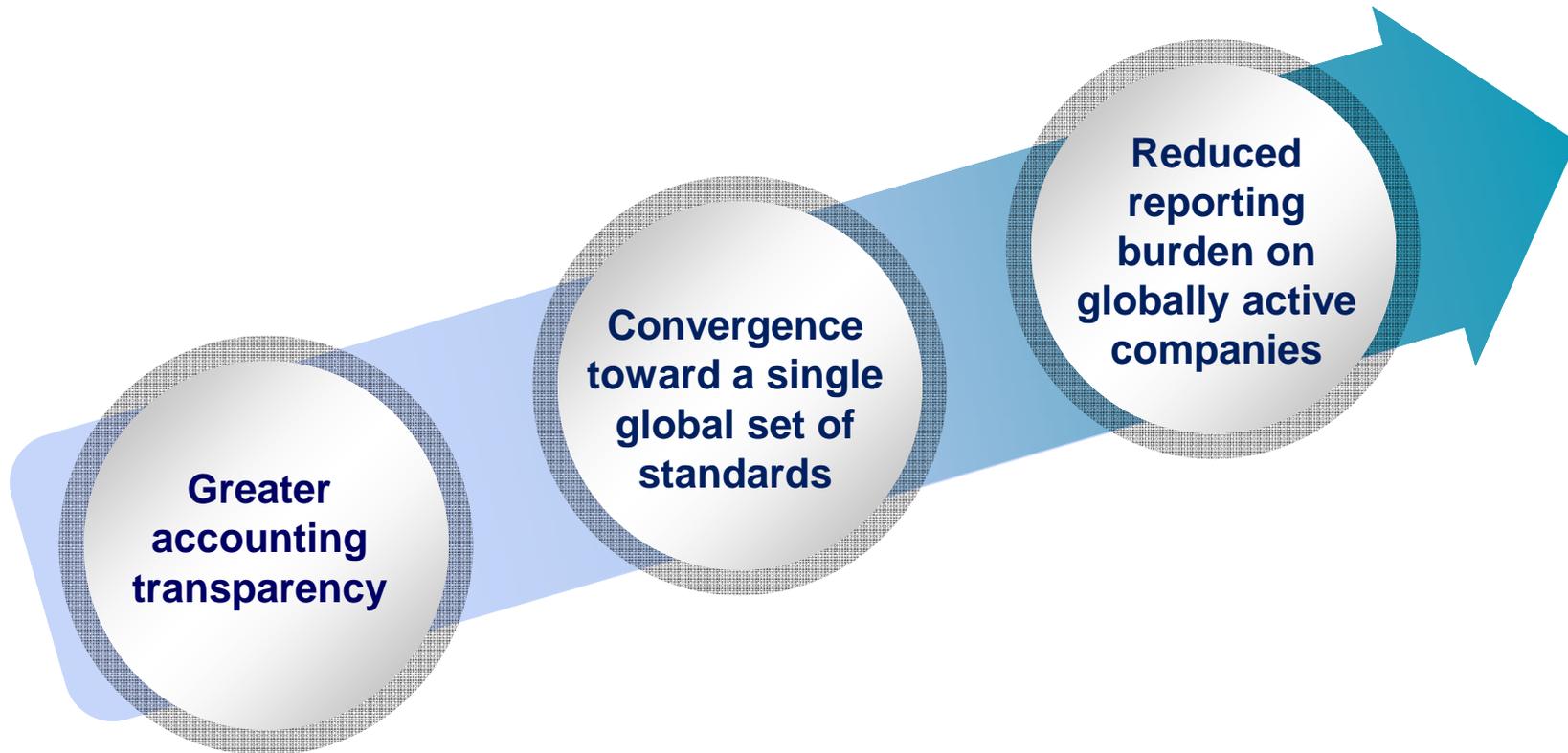


- **The global financial crisis revealed a need for changes to IFRS**
  - **Broader application of fair value, procyclical provisioning rules**
  - **A single set of high-quality global accounting standards to ensure comparability and consistency of accounting information**
  
- **G20 consensus**
  - **Washington & London summits: improvements to IFRS**
  - **Pittsburg summit: convergence of IFRS and U.S. GAAP by June 2011**
  - **Toronto summit: convergence deadline extended to end-2011**
  - **Seoul summit: reaffirmation of commitment to a single set of standards**
  
- **Changes to IFRS**
  - **Classification and measurement of financial instruments, impairment, hedge accounting, asset and liability offsetting**
  - **Some national differences remain unresolved**
  - **The effective year for those changes was pushed back from 2013 to 2015**



## II. Korea's Experience

# 1. Adoption of IFRS in Korea



## 2. IFRS Roadmap



### ■ Preparation for the adoption of IFRS

- IFRS Task Force (Feb 2006)
- Announcement of IFRS Roadmap (Mar 2007)

### ■ Key milestones of IFRS Roadmap

- Early adoption permitted in 2009
- IFRS required for all listed companies in 2011
- Quarterly and semiannual reporting on a consolidated basis: 2011 for companies with assets of KRW2 trillion or more and 2013 for others

	Before 2009	2009–2010	2011–2012	After 2012
Early adopters	K-GAAP	K-GAAP	K-IFRS	
Assets ≥ KRW2 trillion			K-IFRS	
Assets < KRW2 trillion			Exemption from consolidated reporting	
Unlisted companies			Accounting standards for NPEs	

# 3. Progress under IFRS Roadmap



## ■ Changes to laws and regulations

### ➤ Laws

- ✓ FSCMA (Feb 2009) and its Enforcement Decree (July 2008)
- ✓ Act on External Audit of Companies (Feb 2009) and its Enforcement Decree (Jan & Dec 2009)
- ✓ Accounting, disclosure, and other financial regulations

### ➤ Accounting standards

- ✓ K-IFRS (Dec 2007)
- ✓ Accounting standards for non-public entities (Dec 2009)

### ➤ Education and training activities

- ✓ IFRS information sessions and publications
- ✓ Informational website on IFRS (<http://ifrs.fss.or.kr>), pre-clearance procedures

## ■ IFRS Committee

- Representatives from regulators, accounting profession, and academia
- Assessment of the implementation of IFRS Roadmap and other follow-ups

## 4. Companies Subject to IFRS Reporting



### ■ Companies subject to IFRS reporting as of Dec 2011

- **2,061 companies (1,822 listed companies & 239 unlisted financial companies)**
  - ✓ 10.53% of all 19,576 companies subject to independent external audit
  - ✓ 304 financial companies (65 listed companies & 239 unlisted companies)

		Number	Subject to IFRS reporting			Exempted from IFRS
			Listed	Unlisted	Subtotal	
Banks		18	5	13	18	-
Foreign bank branches		38	-	38	38	-
Securities/futures		70	24	46	70	-
Financial holding firms		12	8	4	12	-
Insurance	Life	23	3	20	23	-
	Nonlife	30	10	20	30	-
Asset management		82	-	82	82	-
Real estate trusts		11	1	10	11	-
Mutual savings banks		93	6	-	6*	87
Consumer finance	Credit card companies	7	1	6	7	-
	Others	57	7	-	7	50
<b>Total</b>		<b>441</b>	<b>65</b>	<b>239</b>	<b>304</b>	<b>115</b>

# 5. IFRS Impact Analysis



- **Impact analysis of companies subject to IFRS reporting (May 2011)**
  - **65 companies (17 financial firms & 48 non-financial firms)**
  - **Comparison of financial statements before and after IFRS adoption**
  
- **Key analysis findings**
  - **For banks and financial holding firms, both capital and net income rose**
  - **Automobile, energy, shipping, and airline companies were more affected than other non-financial firms**

<b>Financial firms</b>
<ul style="list-style-type: none"><li>✓ <b>Financial results mostly improved for banks and financial holding companies</b></li><li>✓ <b>Changes in equity</b><ul style="list-style-type: none"><li>▪ Certain financial instruments now treated as equity</li><li>▪ Less loan loss provisions</li><li>▪ Fair valuation of tangible assets</li></ul></li></ul>

<b>Non-financial firms</b>
<ul style="list-style-type: none"><li>✓ <b>Impact on financial results varied across industries</b></li><li>✓ <b>Changes in equity</b><ul style="list-style-type: none"><li>▪ Fair valuation of tangible assets</li><li>▪ Changes in the scope of consolidation</li><li>▪ Investment in subsidiaries carried at cost</li><li>▪ Changes in the treatment of pension liabilities</li></ul></li></ul>

## 6. Korea's Key Accounting Issues and Responses



### ■ Shipbuilding industry

- The IASB proposed to eliminate fair value hedge accounting
- The debt ratio of Korean shipbuilders would rise sharply
- Considering the comments from Korea's regulators, the IASB decided to maintain fair value hedge accounting

### ■ Construction industry: revenue recognition, scope of consolidation

#### Revenue recognition

- ✓ Korea's construction companies typically sell residential units prior to completion
- ✓ This led to some interpretational issues regarding revenue recognition under IFRS
- ✓ The percentage-of-completion method better suits the economic substance of pre-delivery sales contracts

#### Scope of consolidation

- ✓ Under IFRS, some Korean construction companies must consolidate real estate developers for financial reporting
- ✓ This would likely push their debt ratio higher
- ✓ Guidelines for consolidated reporting for construction companies

## 6. Korea's Key Accounting Issues and Responses



### ■ Financial industry: loan loss provisions, retroactive application of IFRS

#### Loan loss provisions

- ✓ **IFRS: incurred loss basis**
- ✓ **Issues**
  - Less loss-absorbing capacity
  - Larger tax liability
- ✓ **Banks were directed to set aside additional provisioning, and additional tax liability was deducted from taxable income**

#### Retroactive application of IFRS

- ✓ **Preparers were required to apply IFRS 9 retroactively**
  - Sale of loans
  - Fair valuation of financial instruments at acquisition
- ✓ **Issues**
  - Rises in NPLs of financial institutions
  - Costs associated with fair valuation
- ✓ **The IASB shared this concern and decided to exempt certain transactions prior to the date of transition to IFRS (Jan 1, 2010 for Korea)**



## III. Lessons Learned

# 1. Korea's Success Factors for IFRS



## Major Push by Regulators

- ✓ Roadmap set by regulators
- ✓ Involvement from accounting profession and other interested parties

## Phased-In Implementation

- ✓ Ample preparation time given to businesses and accounting firms
- ✓ Efforts to minimize impact

## Low Cost & Burden on Business

- ✓ Cost to upgrade within-firm accounting system and consult with accountants
- ✓ Minimum cost to smaller companies

## Public Awareness Campaign

- ✓ IFRS hearings, information sessions, consultation to businesses and accounting profession

## 2. Challenges Ahead



### Businesses

- ✓ Judgment in accounting treatment & internal controls for financial statements
- ✓ Accounting specialists and employee training

### Accounting Firms

- ✓ Expertise and expert judgment on financial statements
- ✓ Specialization and ongoing training

### Market Participants

- ✓ Differences between K-GAAP and IFRS
- ✓ Effective, meaningful training and education for market participants

### Accounting Supervision

- ✓ Voluntary correction restatement of minor errors and omissions
- ✓ Emphasis on audit inspection of consolidated financial statement

# 3. Perspectives for Emerging Economies



## Commitment to Full Adoption

- ✓ Consensus on the need for IFRS
- ✓ Sustained policy support for IFRS adoption
- ✓ Market expertise & infrastructure

## Extended Preparation Period

- ✓ Risk of rushed adoption
- ✓ Major revisions to IFRS after 2008
- ✓ Balanced cost-benefit analysis
- ✓ Desirability of phased-in Implementation

## Degree of Readiness for IFRS

- ✓ Move toward full adoption, but some flexibility needed on the way
- ✓ Resolution of differences and inconsistencies with local standards

## Considerations for EE

- ✓ Emerging Economies Group established under IASB in July 2011
- ✓ Greater EE voice in the IFRS development process



**Thank you**