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Comment Letter on Leases Exposure Draft

The most significant change in the Leases Exposure Draft (the “ED”) is the deletion of classification between operating lease and finance lease and recognizing all assets and liabilities arising under lease transactions in the statement of financial positions. Asiana Airlines understands that the purpose of ED is to enhance the comparability of financial information through elimination of any arbitrary decisions surrounding lease classification and related accounting treatment.

However, for the reasons stated below, Asiana Airlines believes that it would be difficult to expect the proposed change will successfully meet the purpose in practice but it will only result in financial distress on financial structure of the lessee and increase the financial burden to the company.

Therefore, Asiana Airlines believes that taking alternative measures such as strengthening disclosure requirements and regulatory standards on which type of lease accounting to be uses are more practical assessment.

I Keeping the Present Lease Standards Unchanged

In airlines industry, where customer’s demands particularly in flying destination changes on daily basis, operating lease can best react to these customers’ demand and cope with short-term changes.

Therefore, airline industry uses operating lease accounting for the acquired airplanes since the estimated useful lives of these planes are relatively less

than the term of contract, and the termination of contract is possible at any time of contract term.

The information users may have less comparative financial information if airline industry treats both operating lease and finance lease the same in the matter of accounting substance and recognizes as asset and liability in the statement of financial position. Since operating lease, where 1) the term of contract is relatively less than the estimated useful life of airplanes, and 2) the termination of contract is possible at anytime during the contract tem, and finance lease where 1) the contract is based on the long-term basis, and 2) the most of risks and benefits from the leased asset are passed to lessee, are both considered same in the matter of accounting substance and recognized as asset and liability in the statement of financial statements, the actual economic substance from using airplane may not be properly reflected in the financial statements.

Under the ED, lease transactions used to be accounted for using operating lease, where lease could be terminated before the end of lease-term, now have to be estimated as asset and liability in the statement of financial position with assumption that lease will last until the end of lease-term. Therefore, if operating lease is recognized as asset or liability in the statement of financial position, there are chances of overstating statement of financial position

Additionally, if all lease transactions are accounted for as asset or liability without considering risk and benefits associated with lease transaction,, the comparability of acquired asset and leased asset will be unclear.

Therefore, Asiana Airlines believes that operating lease and finance lease should be recognized differently since the nature of transactions and the effects to financial statements for each type of lease is different. Therefore, the current lease standard should remain but strengthen the classification criteria to prevent any arbitrary decisions surrounding uncertainty in choosing which type of lease to use.

II Alternative Measurements

Asiana Airlines mostly operates its airplane under operating lease, because operating lease reduce cost of purchasing asset since the term of contract is relatively less than estimated useful lives of assets, and contract can be terminated at any time before the end of term accordingly.

When the ED is adopted, the series of problems associated with financial statements are expected to occur since assets and liabilities will increase as a result of recognizing operating lease transactions as asset and liability in the statement of financial positions. These financial problems based on the rise of liability will lead to downgrade of credit rating, financing difficulties and the increase of other related expenses.

With adoption of the ED, Asiana Airlines will become more focusing on the operating strategy for showing financial performance than focusing on sales strategy itself. This misleading operating strategy which only focuses on financial performance will cause serious problem to Asiana Airlines.

Although Asiana Airlines understands that the purpose of recognizing operating lease transactions as asset and liability in the statement of financial positions to provide more reliable financial information, Asiana Airlines believes that alternative measures other than adopting the ED should be undertaken in order to minimize difficulties arising from the adoption of the ED in near term.

Asiana Airlines would like to take the following alternative measures other than adopting the ED.

1. Keeping the Current Lease Accounting Standards Unchanged and Strengthening the Related Disclosure Requirements

With having the current lease accounting standards unchanged but having the related disclosure requirements strengthened throughout diversification

and accuracy of financial information, Asiana Airlines will be able to provide clear financial information to stakeholders.

With considering the substance of lease transactions, the current lease accounting standards clearly define and separate lease transactions depends on which type of lease accounting should be applied. Particularly, operating lease and finance lease are recognized separately in the financial statements under the current lease accounting standard because the contract for operating lease is based on the simple use of lease asset whereas the contract for finance lease is based on asset secured financing.

Therefore, if the disclosure requirements related to lease accounting become more detailed and strengthened, stakeholder of Asiana airlines will be more eligible to make their investment decision.

2. Offset of Lease Assets and Lease Liabilities

Unlike finance leases in which risks and benefits associated with lease asset are passed to lessee when the entitlement is transferred at the agreement, risks and benefits associated with lease asset under operating lease will remain with the lessor even after the agreement. Therefore, while having the substance of lease transactions been considered, lessee under operating lease gains the right to use asset only for the period covered by the lease payment.

Since risks and benefits associated with lease asset are not passed to lessee unless lease fee is paid, and the right to use of lease asset is passed to lessee only for the period the payment covers, lease transactions should not be recognized in advance as asset and liability with assuming that all the risks and benefits with lease asset are already transferred. Accordingly, this advanced recognition of lease asset and liability will overstate the financial statements and mislead the essence of lease transaction.

Therefore, Asiana Airlines recommends offsetting of operating lease assets and liabilities. This will satisfy the purpose of ED and minimize the overstatement of financial statements at the same time.

The gross method should be applied for recognizing asset and liability, but IFRS allows offsetting asset and liability in certain cases.

[IAS 12. Income Taxes]

Under IAS 12, deferred tax asset and liability recognized in connection with government related transactions may offset each other in the statement of financial position, while the balances before offsetting should be disclosed in notes to the financial statements.

[IAS 20 Accounting for Government Grants and Disclosure of Government Assistance]

Under IAS 1020, Government subsidies may be recognized either as deferred revenue or the offset amount of deferred revenue by related asset recognized in the statement of financial position.

Therefore, according to the aforementioned cases, the lease assets and liabilities arising from the same lease transactions should offset each other, and the balances before the offsetting should be disclosed in notes to the financial statements. This will best reflect the economic substance of lease transactions.

3. Take Prospective Accounting Approach for the Changes

If the current lease transitions accounted for using operating lease can be exempted from the ED and remain following the current lease accounting, while future lease transactions on the other hand follow the ED, Aisian Airlines will not face unnecessary financial problems and other difficulties arising from the adoption of the ED. As IASB intends, this progressive adoption of the ED will make sure that operating leases will be later recognized as asset and liability in the statement of financial position in the future year.

One way of these progressive adoptions where the exemption of the new ED is temporarily admitted to mandate financial problems and other difficulties can be disclosing the effect from adopting the new ED for the current lease transactions accounted for as operating lease.

When new accounting standard is adopted, the changes should be retroactively recognized, however, there are some cases where SKAS allows the changes to be reflected in prospective basis of accounting.

[IFRS. 03 Business Combination]

Instead of recognizing the changes retroactively, the business combination occurred before the adoption of IFRS 1103 Business Combination can be prospectively recognized in the financial statements.

[IAS 23 Borrowing costs]

Additionally, when accounting policy of the company is changed as the company adopt IAS. 1023 Cost of Financing, and if the financing cost arose from purchasing eligible asset (after the effective date of capitalization), the cost of financing can be capitalized prospectively.

Therefore, Aisiana Airlines requests not to take retroactive accounting approach for the existing operating lease transactions but to take prospective accounting approach for the new operating lease transactions occurred after the ED

4. Adoption of the New ED after 2015

Asiana Airlines requires at least minimum of five years to reduce financial impact arising from the adoption of the ED and to amend its the operating strategy, and believes that effective date of the ED should be postponed.

In addition, since United States, Japan and other countries are not yet required to adopt IFRS, and financial information will be less comparative accordingly, Asiana Airlines request that effective date of the ED be after 2015.

III Conclusion

When the ED is adopted, there are some possibilities that the essence of business transactions from operating airplanes will be misrepresented in the financial statements. Additionally, with considering financial problems and other difficulties associated with the adoption of the ED, other alternative measures such as strengthening disclosure requirements and regulatory standards on which type of lease accounting to use seem to be practical and feasible than the proposed approach the ED.