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December 2010

Exposure Draft 'Leases'

International Accounting Standards Board
30 Cannon Street, London EC4M 6XH
United Kingdom

Dear Sir or Madam:

The Korea Accounting Standards Board (KASB) has finalized its comments on exposure draft 'Leases'. I would appreciate your including our comments in your summary of analysis.

The enclosed comments represent official positions of the KASB. They have been determined after extensive due process and deliberation.

Please do not hesitate to contact us if you have any inquiries regarding our comments. You may direct your inquiries either to me (cwsuh@kasb.or.kr) or to Mr. Sung-ho Joo (sung-ho.joo@kasb.or.kr), senior researcher of KASB.

Yours sincerely,



Dr. Chungwoo Suh
Chairman, Korea Accounting Standards Board

Cc: Sungsoo Kwon, Director of Research Department

We are pleased to comment on exposure draft 'Leases'. Our comments include views from a public hearing and responses collected from the various associations. We finalized the comment letter through the due process established in KASB.

Exposure Draft 'Leases'

The lease standards which are mutually proposed by the IASB and the FASB are expected to solve most current problems resulting from unrecognition of operating lease on Financial statement and classification between the operating lease and finance lease.

However, per the contents proposed by the ED, the accounting treatments of lessor and lessee are not consistent and there may be deterioration in comparability and difficulty in application.

The hybrid approach which the ED is proposing related to the lessor's accounting has problem of whether to decide the transfer of underlying asset's risk and benefit. Thus, it does not solve problems or reduce complexity caused from the classification of the current finance lease and the operating lease

Among the ED's accounting treatment of lessor, for the performance obligation approach, whether the lease liability recognized by the lessor satisfies the definition of liability in the framework is doubtful. In case that the IASB terminates the use of the performance obligation approach and only selects to use the derecognition approach, the guideline of whether and how the lessor needs to treat a lease which includes land may be needed.

For the derecognition approach, the lessor partially removes the underlying asset however, the lessee recognize "right of use" asset on characteristics of intangible assets. Thus there is incongruence in accounting treatment.

When deciding whether to transfer the risk and benefit of an underlying asset, as mentioned in the B26, one or more indicators are not crucial in deciding. Thus, there may not be consistency in applying these and the comparability may be deteriorated.

Related to the presentation of lessee's statement of financial position, we suggest a linked presentation for the right of use asset and the obligation to pay the lease fee, because the right of use asset and the obligation to pay the lease fee are linked (as mentioned in BC 145), similarly with the asset and liability of lessor under performance obligation approach.

For the short-term lease, consistent with the lessor's accounting, requiring the lessee to recognize the expense at the point when the contractual lease fee is paid over the lease term and disclosing asset and liability related to this as a footnote is appropriate. .

On the other hands, the proposals of the ED considered the perspectives of the information users rather than the perspectives of preparers, lessee or lessor. The lease industries are concerned of crucial change in practice if the standards are set according to the ED

If the operating leases are treated as financial leases according to the ED, the lease industry is concerned that the possibility of lessee's acquiring asset, especially transporting vehicles, through purchasing rather than through operating lease will be higher.

The shipping industry is concerned of decrease in credit risk due to increase in debt to equity ratio when asset and liability of long-term chartering contracts are recognised on financial statements according to the ED. They stated that this may incur change in contracting methods such as shortening the term of contracts.

The companies have decided investment policy related to financing and purchase of assets with considering reasonableness of debt covenant and financial ratio under current lease standard in order to maintain transactions with financial institutes. However, in the course of preparing the ED these kinds of companies' policies are not considered. As a result the social loss may be great.

We proposes that it is necessary to delay the enforcing date of new standard as much as possible

If the effective date of the ED is postponed to the extent that negative influences of each company due to the past lease contracts are sufficiently removed, the transition would be appropriate. However, if not, forbidding the retrospective application to past lease contracts and applying from the new lease contracts occurred after the effective date are appropriate.

When compared with the IFRS non-adopted countries, there may be reverse discrimination due to increase in debt ratio. Also, the comparability of financial statements may be deteriorated with those countries.

For methods to consider the future uncertainty, logical consistency with other standards should also be considered. For example, on the ED of Measurement of Liabilities in IAS 37, the liability amount is measured with the expected present value, as a result the consistency between the standards must be considered as well.

Question 1: Lessees

- (a) Do you agree that a lessee should recognise a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?**
- (b) Do you agree that a lessee should recognise amortisation of the right-of-use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?**

Question 2: Lessors

- (a) **Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term, and (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?**
- (b) **Do you agree with the boards' proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?**

Per the contents proposed by the ED, the accounting treatments of lessor and lessee are not consistent and there may be deterioration in comparability and difficulty in application.

The hybrid approach which the ED is proposing related to the lessor's accounting has problem of whether to decide the transfer of underlying asset's risk and benefit. Thus, it does not solve problems or reduce complexity caused from the classification of the current finance lease and the operating lease

Among the ED's accounting treatment of lessor, for the performance obligation approach, whether the lease liability recognized by the lessor satisfies the definition of liability in the framework is doubtful. In case that the IASB terminates the use of the performance obligation approach and only selects to use the derecognition approach, the guideline of whether and how the lessor needs to treat a lease which includes land may be needed.

For the derecognition approach, the lessor partially removes the underlying asset however, the lessee recognize "right of use" asset on characteristics of intangible assets. Thus there is incongruence in accounting treatment. Furthermore, we are concerned that revenue recognition criteria is consistent with the ED Revenue, especially when lessor recognize revenue and cost of goods sold in some portion of the

underlying asset under derecognition approach; While current revenue standard does not state the partial recognition of goods, Lease ED allows the lessor to do so under derecognition approach

When deciding whether to transfer the risk and benefit of an underlying asset, as mentioned in the B26, one or more indicators are not crucial in deciding. Thus, there may not be consistency in applying these and the comparability may be deteriorated.

Some preparers of the financial statements believe that it is appropriate to supplement current standard through reinforcing the disclosure requirement.

Question 3: Short-term leases

Do you agree that a lessee or a lessor should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

For the short-term lease, consistent with the lessor's accounting, requiring the lessee to recognize the expense at the point when the contractual lease fee is paid over the lease term and disclosing asset and liability related to this as a footnote is appropriate. .

Some preparers of FS believe it is appropriate to set term of short-term lease to be 3 years rather than 1 year considering industry practice.

Question 4

(a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?

We agree in overall but there needs more clarification

The ED defines a lease as a contract in which the right to use a specified asset or assets is conveyed, for a period of time, in exchange for consideration. This definition has possibility of arising issues whether it is lease or not for some ship chartering contracts in the shipping industry

Under time charter contract, charterage depends on BDI (Baltic Dry Index) and can be reduced by the quality of transportation service, which is impossible to expect. This volatility makes shipping companies unable to estimate lease term and payment. Thus, this kind of contract should be excluded from the lease.

Additionally, using an asset other than the specific asset which was designated at the point of contract may happen on some of the transporting contracts of shipping industry. Whether this kind of contract is excluded from the application scope of lease standard is unclear. Thus, there needs additional guideline related to the 'specific asset' proposed by the ED.

(b) Do you agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?

We disagree.

The ED proposes that the transactions which transfer underlying asset's control and all but trivial amount of the risk and benefits are considered as sales transactions and the lease standards are not applied on them. Also, on lessor's accounting when underlying asset's significant risks or benefits are transferred, the derecognition approach is applied. These proposals of the ED increase complexity in accounting. It leads lessors to be required to treat every individual lease contract among the performance obligation approach, derecognition approach and in-substance sales.

Moreover, difference between the classification criteria of in-substance sales and derecognition approach after classified as lease are not clear. In practice, a contract which directs to select one among bargain purchase or extension of lease term on the termination date of lease term exists. Thus, clear guidance on its classification and its reasons should be provided.

(c) Do you think that the guidance in paragraphs B1-B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

We agree.

Question 5: Scope exclusions

Do you agree with the proposed scope of the proposed IFRS? Why or why not? If not, what alternative scope would you propose and why?

We agree.

Question 6: Contracts that contain service components and lease components

Do you agree with either approach to accounting for leases that contain service and lease components? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

We agree with the IASB's proposal if applying the derecognition approach

Question 7: Purchase options

Do you agree that a lessee or a lessor should account for purchase options only when they are exercised? Why or why not? If not, how do you think that a lessee or a lessor should account for purchase options and why?

We agree.

Question 8: Lease term

Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

For methods to consider the future uncertainty, logical consistency with other standards should also be considered. For example, on the ED of Measurement of Liabilities in IAS 37, the liability amount is measured with the expected present value, as a result the consistency between the standards must be considered as well.

Some preparers of FS believe that it is necessary to simplify the estimation of lease term through considering the industry which has large yearly number of lease contracts. In order to do this, they believe that selecting the term with the highest possibility as the lease term should be taken (most likely approach).

Additionally when determining the extension of the lease term, recalculating the lease fee according to the market price at the point of extending the lease is difficult to be viewed as one lease contract. Thus, when calculating the lease term, this should be mentioned in the standard.

Question 9: Lease payments

Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities arising from a lease using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why?

Do you agree that lessors should only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the right to receive lease payments if they can be measured reliably? Why or why not?

For the considering the methods of uncertainty in future, there is necessity to consider the logical consistency within the standard and other standards. Related to the Q8, it is appropriate to additionally review whether other methods need to be used along with the method of deciding the lease term.

Question 10: Reassessment

Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

We agree in principle, however, when the conditions in contract are vague such as time-charter in shipping industry and extension are made frequently, the revaluation according to the amendments increases the volatility of financial statements. Therefore, the guideline related to “ significant change” should be provided.

Question 11: sale and leaseback

Do you agree with the criteria for classification as a sale and leaseback transaction? Why or why not? If not, what alternative criteria would you propose and why?

We agree.

Question 12: Statement of financial position

(a) Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment or

investment property as appropriate, but separately from assets that the lessee does not lease (paragraphs 25 and BC143-BC145)? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?

- (b) Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?
- (c) Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?
- (d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

Related to the presentation of lessee's statement of financial position, we suggest a linked presentation for the right of use asset and the obligation to pay the lease fee, because the right of use asset and the obligation to pay the lease fee are linked (as mentioned in BC 145), similarly with the asset and liability of lessor under performance obligation approach.

Question 13: Statement of comprehensive income

Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in profit or loss (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

When providing the lease is usual activity as shipping industry, it is difficult to determine the business model for each lease contract under derecognition approach in the ED. Thus, the lessor should present the profit and loss of every lease in a single method (preferably in separate line item) regardless of its model.

Question 14: Statement of cash flows

Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153 and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

We believe that it is not appropriate the ED to require to regard the all lessee' s payout of lease fee as financing activity. Therefore, classification should be done with the consideration of their characteristics.

Question 15 Disclosure

Do you agree that lessees and lessors should disclose quantitative and qualitative information that:

- (a) identifies and explains the amounts recognised in the financial statements arising from leases; and**
- (b) describes how leases may affect the amount, timing and uncertainty of the entity's future cash flows (paragraphs 70-86 and BC168-BC183)? Why or why not? If not, how would you amend the objectives and why?**

We agree. However, considering the operation burden related to the disclosure, considering easing the regulation related to the disclosure for the short-term lease is necessary.

Question 16 Transition

- (a) The exposure draft proposes that lessees and lessors should recognise and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88-96 and BC186-BC199). Are**

these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?

- (b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?**
- (c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?**

The companies have decided investment policy related to financing and purchase of assets with considering reasonableness of debt covenant and financial ratio under current lease standard in order to maintain transactions with financial institutes. However, in the course of preparing the ED these kinds of companies' policies are not considered. As a result the social loss may be great.

If the effective date of the ED is postponed to the extent that negative influences of each company due to the past lease contracts are sufficiently removed, the transition would be appropriate. However, if not, forbidding the retrospective application to past lease contracts and applying from the new lease contracts occurred after the effective date are appropriate.

On the other hands, in order to determine that the standard date in which simple retrospective is applied is whether effective date or beginning of fiscal year which is compared with the year of the initial effective date, confirming whether it contradicts with the IFRS 1, IFRS 8 or other standards and necessity for other standards' revision is needed.

Question 17 benefits and costs

Paragraphs BC200-BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree with the boards' assessment that the benefits of the proposals would outweigh the costs? Why or why not?

The proposals of the ED considered the perspectives of the information users rather than the perspectives of preparers, lessee or lessor.

If the operating leases are treated as financial leases according to the ED, the lease industry is concerned that the possibility of lessee's acquiring asset, especially transporting vehicles, through purchasing rather than through operating lease will be higher.

Due to the burden of recognizing the non-core assets on the statements, there is possibility of companies acquiring asset through a loan rather than a lease.

The shipping industry is concerned of decrease in credit risk due to increase in debt to equity ratio when asset and liability of long-term chartering contracts are recognised on financial statements according to the ED. They stated that this may incur change in contracting methods such as shortening the term of contracts.

When compared with the IFRS non-adopted countries, there may be reverse discrimination due to increase in debt ratio. Also, the comparability of financial statements may be deteriorated with those countries.

The preparers of financial statements stated that the new proposals by the IASB do not consider these difficulties of the preparers. Some of them suggested that maintaining the outline of current standard and supplementing the disclosure requirements are appropriate.

Question 18

Do you have any other comments on the proposals?

There is need for sufficient review of the related problems upon introduction of new standard. Therefore, delaying the enforcing date as much as possible is necessary.