



THE CREDIT FINANCE
ASSOCIATION OF KOREA

March 29, 2010

Sir David Tweedie
Chairman
International Accounting Standards Board

Dear Sir David

The Credit Finance Association of Korea (CFAK) is highly interested in the project on the amendments of lease accounting standard worked by IASB(International Accounting Standards Board) and FASB(Financial Accounting Standard Board, hereinafter collectively referred to as Board) together.

The Boards have their intention to publish the Exposure Draft of lease accounting for lessor and lessee during the first half of 2010 considering the responses from all around the world to the Leases Discussion Paper: Preliminary Views (hereinafter referred to as the "Lease DP") announced in March 2009. CFAK would like to strongly recommend the Boards to have full considerations on comments from interested parties from all around the world by publishing separate Lessor accounting DP (Discussion Paper) before issuing Lease ED.

In addition, since CFAK expects accounting approach (ex: right-of-use model) presented in the Lease DP to give big impacts on the lease industry, CFAK decided to submit comments on the lease accounting standard amendment project even though it is not the official period to receive the comments.

CFAK is looking forward for the Boards to positively considering our comments.

Yours faithfully,

Kang, Sang Baek

Vice-chairman, The Credit Finance Association of Korea

I. Need for Lease DP (Lessor Accounting) publication

1. Status of project on Lease related accounting standard amendments by IASB (International Accounting Standard Board)

CFAK recommends the Boards to publish "Lessor Accounting DP" separately and receive comments before issuing Lease ED planned in 2010.

IASB provisionally decided to apply performance obligation approaches in case of applying right-of-use model to lessor after publishing Lease DP in March 2009. But there are different views on applying performance obligation approaches with right-of-use model to current lessors. In addition, according to the discussions in the current IASB meeting held in July and November 2009, there might be various accounting models to the performance obligation approach application but IASB have not officially received any comments from the countries adopted IFRS.

- Approaches of Performance Obligation
 - Approach A - Show all three items gross
 - Approach B - Show the lease receivable net of the performance obligation
 - Approach C - Show the leased item net of the performance obligation

2. Need for Lease DP (Lessor Accounting) publication

Therefore, CFAK urges the Boards to publish Lease DP in the perspective of lessor including more details on accounting approaches from the lessor's view, receive responses of lease industry from the all around the world and finalize lease accounting standard even if the planned timeline for issuing Lease ED in 2010 and Lease accounting standard in 2011 is delayed.

In addition, CFAK recommends the Boards to issue Lease ED considering basic principle of lessor accounting as below.

- Basic principle of lessor accounting
 - Accuracy of accounting treatment
 - Providing lessor's financial status accurately and fairly

- Application of economic substance
Presenting the financial position according to economic substance considering lessor's revenue model and exposure to risks

- Understandability of accounting information and consideration of efficiencies)
Considering benefits to information gathering costs and understandability of financial information users

- Consideration on lessee accounting
Consistency with lessee accounting treatment based on basic concept of accounting principle

II. Lessor Accounting

1. Current Status

According to the current Lease accounting standard (IAS 17), the classification of leases is based on the extend to which risks (including the possibilities of losses from idle capacity or technological obsolescence) and rewards (including expectation of profitable operation over the asset's economic life and of gain from appreciation in value of realization of a residual value) incidental to ownership of a leased asset lie with the lessor or the lessee as finance lease and operating lease.

And International Accounting Standards Board (hereinafter refer to as IASB) and US Financial Accounting Standards Board (hereinafter refer to as FASB) tentatively decided to apply the Right-of-use model to recognize the right and obligation to all lease contracts as asset and liability respectively by lessee through Leases DP: Preliminary Views, hereinafter refer to as Lease DP in March 2009 as a result of criticisms on the about reliability and relevancy of financial statements through not recognizing as asset and liability (particularly, operating lease) within the existing lease accounting standard.

In addition, Lease DP suggested 'derecognition approach' and 'performance obligation approach' considering lessor's application of right-of-use model and it is tentatively determined to adopt performance obligation approach in IASB Meeting held in November 2009.

According to the performance obligation approach, lessor has obligation to permit lessee to use leased asset and right to be paid rentals in accordance with lease

agreement simultaneously and it is deemed for lessor not lose right to control over the leased asset throughout the lease term. Therefore, lessor recognize the right to be paid rentals through lease agreement as an 'asset' and the obligation to permit the lessee to use the leased asset as a 'liability' and does not derecognize the existing lease asset from the book.

2. Issues for Performance Obligation Approach

(1) Consideration on transferring control

According to the performance obligation approach tentatively decided to adopt by IASB, it is deemed for lessor not to lose the control over leased asset even though lessor transfers the right to use leased asset through lease agreement. However, if lessor provides the right to use leased asset to lessee through lease agreement, it is necessary to consider risks and rewards incidental to ownership of a leased asset, which is lease term is most of economic life of lease asset. Therefore, IASB's performance obligation approach of IASB based on IASB's premise of maintaining the lessor's control over the leased asset has problems that lessor maintains the leased asset not considering the transferability of control over leased asset, which is not applying economic substances.

(2) Problems associated with comparability

Basically, right-of-use model is the approach to derecognize the off-balance financial effect in the lessee's financial statement by newly recognizing the right and obligation as an asset and a liability in accordance with lease agreement. However if lessor applies performance obligation approach, it is expected to arise problems associated with comparability of financial statement between leasing companies and other industries even though there are no changes in terms and conditions in the lease agreement. That is, a manufacturing company acquires tangible assets like machinery for producing as operating activities and leasing company acquires tangible assets for lease as operating activities. Even though it has different lease characteristics to tangible asset for manufacturing and leasing company as producing activity and lease activity respectively, serious problems to comparability between companies can be created if asset and liability from lease activity are additionally recognized in the financial statement. In addition, leasing company can distort financial ratios as follows.

- Increment of total asset amount and liability ratio
- Increment of Leverage ratio (Interest-bearing Liability/Capital)
- Decrement of ROA ,etc

(3) Increment of information gathering cost and accounting complexity

If performance obligation approach tentatively adopted by IASB is applied to lessor, lessor should recognize new asset (lease receivables) and new liability (performance obligation liability) in the financial statement as well as continually recognizing leased asset. Leasing company is required to recognize two assets and one liability to the single lease agreement in the financial statement and apply different accounting treatments to leased asset and liability at each reporting date in accordance with performance obligation approach. Therefore, if leasing company apply accounting treatment described above to all lease agreements, it is expected to increase information process cost and need more time and cost and to arise problems for accounting users to understand accounting information due to complexity of accounting treatment.

3. CFAK's basic views on Lease DP

CFAK thinks that is it not appropriate for lessor to apply performance obligation approach to recognize new asset and liability without consideration on transferability of control right in accordance with substantive ownership of leased asset due to the problems mentioned above.

Meanwhile, if it is required to apply performance obligation approach commented in the IASB meeting held in July 2009, CFAK thinks approach B or C which is showing the receivable and leased item net of the performance obligation is more appropriate rather than approach A showing all three item gross considering information process cost and complexity of accounting treatment.

- Approaches of Performance Obligation (IASB Meeting held in July 2009)
 - Approach A - Show all three items gross
 - Approach B - Show the lease receivable net of the performance obligation
 - Approach C - Show the leased item net of the performance obligation

III. Scope exclusions

1. Short-term lease

(1) Current Status

Lease DP published in March 2009 considered the scope exclusions of new lease accounting standard to "short-term lease". However, IASB tentatively decided to apply 'simplified accounting' which is excluding only valuation on present value according to the discussions in the IASB Meeting held on January 20, 2010. On the other hands, according to the simplified accounting treatment, lessee recognizes the total amount of lease payment of lease contract with which a maximum possible lease term is less than 12 months as gross amounts payable as a liability and right-of-use asset as an asset respectively.

(2) CFAK's comments

CFAK thinks that it is appropriate to continually apply the existing operating lease accounting treatment to 1 year lease term or short term lease less than 1 year rather than applying right of use model in accordance with the lease DP.

➤ Leases cancelable at any time

According to the "right-of-use" model of lessee proposed by IASB through Lease DP, lessee should measure the "right (right to use lease asset)" and "obligation (obligation to pay rentals)" respectively and recognize as an asset and a liability. However, since short-term lease generally has "leases cancelable at any time" condition, it is impossible to measure asset and liability due to the uncertainty of lease term. The short-term lease including "leases cancelable at any time" condition does not meet the definition of an asset and the obligation to pay rentals, therefore it is appropriate to apply the existing operating lease accounting treatment rather than new principle (right-of –use model) noted in the Lease DP.

➤ Consideration of Materiality

It is necessary to consider the materiality to adopt new accounting principle for financial reporting. Regarding the materiality consideration, CFAK does not expect short term leases (leases in which the lease term is less than 1 year) to give material financial impacts to lessors and lessees. For example, it needs substantial amount of costs (ex: information processing and maintenance fee) for lessee to recognize asset and liability respectively to short-term leases (leases in which the lease term is less than 1 year) in

accordance with the new accounting standard noted in the Lease DP. Therefore it is appropriate to apply the new accounting principle of Lease DP to "short-term lease" in the perspective of the materiality.

➤ Possibilities of decline of lease business

Generally, most of short-term leases are small amount lease contract in the characteristic of lease contract and most of lessees are sole proprietor or proprietor of small business. And the advantages of lease business compared to other substitutes (ex: installment financing for purchase and disposal) to lessee is "simplified accounting treatment and expense treatment for tax reporting". Therefore, if it forces for lessee to recognize asset and liability to all types of lease contract regardless of classification of operating finance lease in accordance with the new accounting principle, the advantages of simplified accounting and tax treatment are not available anymore, it is expected for the lease business to decline. As a result, it needs for short-term lease not to be applied new accounting standard for making the most out of advantages of simplified accounting and tax treatment.

2. Scope exclusions for small business and small amount of lease contract

(1) Current Status

According to the IASB Meeting held in December 2009, it is tentatively decided to preclude the application of lease accounting standard to items described below and not to preclude it to non-core assets.

- Lease accounting standard scope exclusions
 - Intangible asset lease
 - Leases to explore for or use natural resources such as minerals, oil and natural gas
 - Biological asset lease

(2) CFAK's comments

CFAK believes it is more reasonable not to apply new accounting standard presented in the lease DP to "lease contract for small business and small amount of lease contract" in addition to the scope exclusions described above.

1) Small Business

Normally, small business uses automobiles or computers, etc through lease agreement for additional activities rather than major activities. Therefore, if it is required for small business as a lessee to use right of use model presented in the lease DP, it is expected to dramatically increase information process cost and maintaining cost and cost to prepare related financial information since all lease contracts should be presented in the statement of financial position. Meanwhile, considering the number of financial information users for small business is relatively small, the economic benefit as a result of applying new lease accounting standard falls short of increment of social cost and ineffectiveness. Therefore, CFAK thinks it is more reasonable for IASB to separately establish new accounting standard for small business (ex: non-listed companies & companies with under KRW 10billion of total asset) not recognizing asset and liability in accordance with right-of-use model in terms of cost and benefit.

2) Small amount of lease contract

Most of small businesses and sole proprietors generally make lease agreement to the "small amount" of property during the "short lease term". Therefore if lessee recognizes asset and liability to small amount of lease contract in accordance with right-of-use model, effect on derecognition of off-balance finance from the financial statement of lessee might not be so big. In relation to this, CFAK believes it is more reasonable for lessee with small amount lease contract (ex: less than \$ 500,000 as per lease contract) to recognize the lease payment evenly throughout the lease term by applying the existing operating lease accounting treatment without separate recognition of leased asset and leased liability in terms of materiality.