

Stuart Dickie Chief Financial Officer

14 December 2010

Sir David Tweedie Chairman International Accounting Standards Board 30 Cannon Street London EC4M 6XH United Kingdom

Dear Sir David,

## Re: Comments to Leases Exposure Draft

We welcome the opportunity to respond to the Leases Exposure Draft issued by IASB.

Whilst our Group understands the objective of the exposure draft is to provide information in the financial statements regarding the amounts and timing of cash flows arising from lease contracts, our fundamental concern is that the proposed changes in the exposure draft do not reflect the underlying economic substance of hotel lease arrangements.

# Significant Judgments Required

Under the proposed right-of-use model, the lessee would be required to gross up both the leased assets and the corresponding lease liabilities on the balance sheet based on the present value of the lease payments, discounted using the lessee's incremental borrowing rate.

This model requires significant judgments. Two companies with identical leases making different assumptions, such as discount rates, renewal options and contingent payment to be made over the lease term, could result in very different amounts being recorded on the balance sheet. This subjectivity would distort comparability rather than enhancing comparability to the users of the financial statements.

#### Front-end Loaded Expenses

According to the exposure draft, in the profit and loss account, the lease payment would be allocated between amortization expense and interest expense estimated by the reduction of lease liability using the effective interest method. As such, the timing of the P&L expense would accelerate compared to the rental expense under the straight line method in the existing model.

We are concerned that the P&L expense recognized would be front-end loaded as compared to the actual operating lease payment. The accelerated recognition of interest expense and amortization in the earlier years undoubtedly represents a <u>mismatch</u> with the timing of the actual cash payment.



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#### Hotel Leases

The proposed changes do not reflect the true economic substance of the hotel leases in the hotel industry. In a typical hotel lease agreement which contains both a base rent and a variable rent component, the base rent is subject to CPI adjustments and the variable rent is based on hotel revenues. Based on the exposure draft, the hotel lessee would in effect be penalized by the escalation of the base rent due to CPI adjustments, as well as by the growth in hotel turnover in future years in the variable rent component.

To force hotel companies who have much longer leases to recognize such front-end loaded expenses in the earlier year of the lease is illogical and does not reflect the underlying economic substance of the arrangement.

#### Implications with Investors and Bankers

The gross up on the balance sheet would inevitably affect debt covenants and gearing ratios, which were not envisaged at the time when the financing arrangements were originally agreed upon. Whilst the debt covenants could be re-negotiated with the banks, however, this would appear to be unwarranted as there has actually been no change to the underlying financial strength of the company. Indeed, with the existing disclosure requirements on operating lease commitments, banks already make their own adjustments for the off-balance sheet leases.

In addition, many investors now look to EBITDA as a proxy for cash flows generated from operations for the purposes of comparing business performance of companies within the same industrial sector. Clearly, with the implementation of the proposed changes, financial metrics like EBITDA and EPS would be affected. Lease payments (comprising substantially cash payments) would be replaced by amortization and interest expense, which are excluded from EBITDA. Therefore, investors would no longer be able to regard EBITDA as a proxy for cash flows from operations. Moreover, as mentioned above, the front-end loaded aspect accelerates these expenses which has the effect of reducing profits and EPS in the earlier years of a lease. Such inconsistency and distortion is considered unhelpful for the investor community.



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### Cost of Implementation vs. Benefit to Users

The proposed model also puts a great burden on companies due to the need to put systems in place and establish processes for data collection, as well as to keep track of and reassess assumptions on an ongoing basis. Rather than simplifying the lease accounting to improve financial reporting, the proposed changes are extremely onerous and introduce more subjectivities and uncertainties. This subjectivity would distort comparability rather than improving comparability to the users of the financial statements.

Yours sincerely

Stuart Dickie

Chief Financial Officer

c.c. Hong Kong Institute of Certified Public Accountants

Enclosure

# About the Mandarin Oriental Hotel Group

Mandarin Oriental Hotel Group is an international hotel investment and management group with deluxe and first class hotels, resorts and residences in sought-after destinations around the world. The Group now operates, or has under development, 42 hotels representing over 10,000 rooms in 27 countries, with 17 hotels in Asia, 13 in The Americas and 12 in Europe, Middle East and North Africa. In addition, the Group operates, or has under development, 13 *Residences at Mandarin Oriental* connected to its properties. The Group has equity interests in a number of its properties and net assets of approximately US\$2.1 billion as at 30th June 2010.

Mandarin Oriental's aim is to be recognized widely as the best global luxury hotel group, providing 21st century luxury with oriental charm in each of its hotels. This will be achieved by investing in the Group's exceptional facilities and its people, while maximizing profitability and long-term shareholder value. The Group regularly receives recognition and awards for outstanding service and quality management. The strategy of the Group is to open the hotels currently under development, while continuing to seek further selective opportunities for expansion around the world.

The parent company, Mandarin Oriental International Limited, is incorporated in Bermuda and has a premium listing on the London Stock Exchange, with secondary listings in Bermuda and Singapore. Mandarin Oriental Hotel Group International Limited, which operates from Hong Kong, manages the activities of the Group's hotels. Mandarin Oriental is a member of the Jardine Matheson Group.