



# Pacific Basin Shipping Limited

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

**13 September 2013**

**Lease – Exposure Draft ED/2013/6  
Comments on the Exposure Draft**

Dear Sirs,

We are a company incorporated in Bermuda and listed and headquartered in Hong Kong. We own and operate modern dry bulk vessels. We hereby make a submission in relation to the above mentioned revised Leases Exposure Draft (the “Revised ED”) issued on 16 May 2013. Our reply focuses on shipping companies.

Overall we consider the Revised ED did not show full understanding of the business characteristics of shipping companies and lacking the commercial consideration. The proposed standard is supposed to improve the quality and comparability of financial reporting by providing greater transparency about leverage, the assets an entity uses in its operations, and the risks to which it is exposed from entering into lease transactions. However our general view is that it may not be so. The proposed standard actually introduces excessive complexity for the accounting requirements. This in turn would increase volatility of the financial position of companies and diminishes the comparability of financial reports.

Lack of full understanding of the business characteristics of shipping companies

As a shipping company, our business is to either i) own ships and take responsibility for the operational costs such as crewing and spare parts, or ii) time charter (inward leases) into the company the service of ships where the responsibility and risks for the operational costs are with third party owners. We then use these ships to earn an income from carrying industrial commodity cargoes for our customers.

The Revised ED assumes that inward leases of ships are financing transactions. This is not the reality and not acceptable. Time charters are not financing transactions and should be treated as if they were similar to leases of property which are considered true leases by the IASB/FASB. Most chartering transactions are made for obtaining the use of a ship and crew at a market rate of hire prevailing on the date of the contract, not a financing rate of hire. In reality time charter of a ship is akin to a lease of a floor of a building or a house for a period of time shorter than the useful life of that building or house and based on the market rental at the date of the lease agreement.

We recommend that time charter of a ship is a purchase of service and should be treated the same way as leases of property.

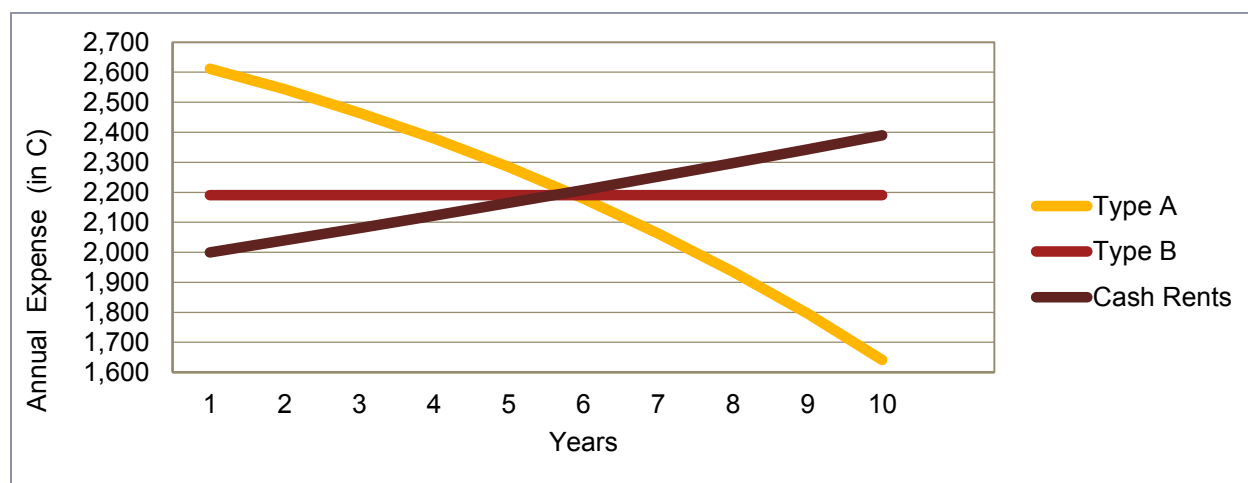
#### Dual model of the lease

We find that the presumption that most leases are assets other than property is financing in nature and hence a Type A lease is not appropriate. The Revised ED proposes two expense recognition patterns under lessee accounting depending on whether the lessee acquires or consumes more than an insignificant portion of the underlying asset. "Insignificant" is open to inconsistent interpretation and judgment.

We have a large fleet of owned ships. At the same time we time charter in a number of ships to complement our owned fleet so as to have the right capacity to discharge our commodity transportation obligations. These time charters are negotiated at market rates which are readily available in the market through sources such as Clarksons, Bloomberg etc and reflect the supply and demand situation of the market. They are indeed very similar to property lease and hence are NOT financing transactions which are Type B leases.

#### Complexity / volatility / Distortion of financial statements

For lessee accounting, below are the income statement implications for Type A and Type B leases compared to the traditional cash rental recognition.



Based on the Revised ED, different accounting treatments may apply for charters made at different times because of variation in rates and variation in lease terms. The income statements within a company could look very different each year which makes comparison difficult. If it is difficult for one company, it is easy to see how difficult it is to compare financial statements of different companies.

As mentioned earlier our business time charters (inward leases) in ships to complement our existing owned fleet. The duration of these time charters may vary a great deal year on year subject to our need at different time. This variation of short term and long term charter will create a lot of variation to our income statement.

Theory vs Reality

We ask the IASB/FASB to appreciate the potential negative commercial as well as financial impact to shipping companies in relation to taxation and financing (bank borrowings) as a result of the proposed standard.

a. Taxation burden

Currently, income from ship operations is exempt from profits tax in Hong Kong. We believe that similar arrangements are found in other jurisdictions. The proposed standard would change charter hire income to interest income. The IASB/FASB has not considered this aspect. In one of the seminars we attended for the first ED, the speaker stated that tax was not their concern. We find that unacceptable and irresponsible. The IASB/FASB should not be mute on this subject where the proposed standard could create significant financial impact to shipping companies globally.

b. Financing (bank borrowings)

Ironically our last point is about financing and by this we mean the traditional bank borrowing to fund the acquisition of vessels.

At the time of writing it is hard to contemplate how the proposed standard would affect our ability to seek new bank borrowings and its on-going administration. We foresee that due to the change in the presentation of the balance sheet, the carrying values of the assets (ships) will change which may affect our ability to obtain finance.

Summary

In essence, the Revised ED continues to create disparity, inconsistency and volatility in financial reporting, potentially significant tax burden and administrative burden to shipping companies, potential commercial uncertainties and may not enable a meaningful presentation of the operation of shipping companies or improve comparability of performance among them.

We urge IASB/FASB to consider and agree that the time chartering of vessels is a purchase of service and is NOT undertaken for financing purposes and its accounting treatment is similar to leases in property. The IASB/FASB should give comprehensive consideration to the commercial and operational nature of the shipping industry.

We would be grateful if the IASB/FASB would take our comments into account in your development of the proposed standard.

For and on behalf of  
Pacific Basin Shipping Limited

