Offshore Marine Service Association

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Technical Director
Financial Accounting Standards Board (FASB)
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RE: File Reference No. 2013-270, FASB Exposure Draft: *Leases*

Dear Board Members:

Thank you for the opportunity to respond to the FASB's Exposure Draft on Leases (Topic 842). The Offshore Marine Service Association ("OMSA") is a national association of the offshore marine transportation service industry and a spokesman for our 216 member organizations with over 300,000 industry personnel employed worldwide. We understand that the Exposure Draft will impact companies from both a lessor and a lessee perspective; however, our response is primarily focused on the proposed lessor accounting guidance which we expect will have the greatest impact on our members.

While we conceptually agree with the Board's core objective of a lessee recognizing assets and liabilities associated with some traditionally off-balance sheet leasing arrangements to better reflect the economics of those transactions in their financial statements, we believe that the Exposure Draft contains an overly broad and ambiguous definition of the term "lease". We are concerned that the proposed definition may be interpreted in such a manner that requires the application of the Exposure Draft's accounting models to transactions that are not legal or economic leases. We are fundamentally opposed to any accounting model that treats underlying equipment operated in the delivery of services as "leased" equipment for accounting purposes. Even though a client with a service contract obtains the benefits from the use of the underlying equipment and may even direct its use, the service provider retains all the risks of operating the underlying equipment and, therefore, should not treat the underlying equipment as leased equipment. In our opinion, to do otherwise distorts the legal and economic realities of the service contract.

Within our industry, our primary concern relates to the accounting and financial reporting by our members of vessel time charters. A time charter of a vessel is not a legal or economic lease of a vessel, but rather a contract to perform specified services for a specified period of time using a specified vessel. If time charters were interpreted to include a lease component under the Exposure Draft, our members would be required to replace the economically accurate accounting model currently in use today with an accounting model that introduces unnecessary judgments and complexity into the revenue recognition process, reduces understanding, transparency and comparability of financial information across our industry, and essentially transforms our members into finance companies with portfolios of Type A and Type B leases (which they are not) from today's service companies (which they most certainly are).

Through discussions with our members and users of industry financial information, we believe that the application of the proposed Exposure Draft will hinder transparency because this model does not match the underlying economics of our industry's typical transactions or business model and is heavily impacted by estimates and judgments which can vary widely from company to company within our industry. For these reasons, the standard as currently proposed would make it harder for users of our financial statements to compare companies across our industry. Furthermore, our users rely on certain metrics (such as average day rates, utilization and days worked) that are well established within our industry. These metrics are extensively used by our industry managers and investor community. The proposed rules could result in a financial analysis that is much more difficult to prepare and degrade manager and investor understanding of reported industry numbers through its complexity.

Overall, we are also concerned with the practical application of the Exposure Draft by lessors. We believe that the proposed accounting model is overly complex and that the costs of implementing the Exposure Draft will far outweigh the presumed benefits of the proposal. Specifically, the daily determination of current fair value and future residual value for vessels in our industry will be a significant burden on our members due to the lack of verifiable pricing data (we do not have a "Kelly Blue Book" available to our industry) and will reduce the comparability of financial information across our industry (different companies could use different, but reasonable, judgments to determine amounts such as estimates of residual values which could lead to different accounting for similar transactions). In addition, our industry may be inherently exposed to excessive reassessment of lease accounting as the frequent changes in the timing of maintenance, drydock, and other activities that unexpectedly take industry vessels out of service could impact the measurement of the lease. We believe our members will need to significantly increase their administrative staffs in order to implement the proposed accounting model yet still face significant exposure for error or misapplication of guidance within their financial control environments given the complexities involved.

Industry Background

The offshore marine transportation service industry offers a worldwide fleet of support vessels to major integrated oil companies, large independent oil and gas exploration and production companies, and emerging independent companies involved in offshore oil and gas exploration, development and production facilities. Our industry is comprised of companies varying in size that range from regional operators with one or few vessels to multi-national operators with extensive fleet profiles.

Offshore support vessels deliver cargo and personnel to offshore installations; handle anchors and mooring equipment required to tether rigs to the seabed; tow rigs and assist in placing them on location and moving them between regions; and carry and launch equipment such as remote operated vehicles or "ROVs" used underwater in drilling, well-completion and emergencies. In addition to supporting drilling activities, industry vessels also support offshore construction and maintenance work, provide accommodations for technicians and specialists, and provide standby safety support and emergency response services.

Our members primarily earn revenues from the time charter and bareboat charter of their offshore support vessels to customers based upon daily rates of hire. Under a time charter, a vessel is provided to a customer but the industry member remains responsible for all operating expenses, typically excluding fuel. Under a bareboat charter, a vessel is provided to a customer (normally another industry member) and the customer assumes responsibility for all operating expenses and all risk of operation. Vessel charters may range from several days to several years.

Charter hire rates are set by market participants based on the supply and demand factors of the industry within the area of operation. Volatile market conditions exist within the industry resulting in constant charter hire rate changes. In many cases, the decision to charter a vessel for an extended period is not based solely on a specific vessel but rather on a fleet-wide basis. For example, a five year charter may be entered into to lock in today's rates on a vessel and provide a hedge to possible future declines in rates over the operator's remaining fleet.

Common characteristics of the **time charter** of an offshore support vessel are as follows:

- Commitment of a specified vessel for a specified period of time to perform services at the request of charterer (subject to certain substitution rights, usually as approved by charterer and not unreasonably withheld).

- Owner retains operational risk of vessel and is responsible for the vessel's navigation; Charterer has limited rights as to the vessel services such as providing instructions for loading and discharging points and access to the vessel's capabilities.

- Charterer does not have substantive rights of ownership regarding items such as control over capital improvements ("leasehold improvements") or ongoing maintenance decisions.

- Owner incurs all costs of operating vessel (except for fuel which is normally on the account of the charterer).

- Vessel is chartered as part of a service to the charterer. Critically, at no time does a charterer have the right to control the vessel. On the contrary, a typical time charter contains specific language that states: *"The entire operation, navigation, and management of the Vessel shall be in the exclusive control and command of the Owners, their Master, Officers and Crew. The vessel will be operated and the services hereunder will be rendered as requested by the Charterers, subject always to the exclusive right of the Owners or the Master of the Vessel to determine whether operation of the Vessel may be safely undertaken. In the performance of the Charter Party, the Owners are deemed to be an independent contractor, the Charterers being concerned only with the results of the services performed."* (From BIMCO Time Charter Party for Offshore Service Vessels Code Name: Supplytime 2005).

Common characteristics of the **bareboat charter** of an offshore support vessel are as follows:

- Commitment of a specified vessel for a specified period of time.

- Charterer assumes all operational risk of vessel and is responsible for the vessel's navigation.

- Charterer incurs all costs of operating vessel.

- Arrangement constitutes a triple net lease of the vessel.

Within our industry, contractual arrangements with customers may also include certain hybrid charters such as a bareboat charter with a purchase option, a bareboat charter with the provision of additional limited defined services or a bareboat charter with variable rates of hire depending on the results of a charterer's time charter to a third party. Back-to-back charter arrangements are also common in the industry including the bareboat-in and time charter-out of a vessel with the middle party being the operator of vessel, the time charter-in and time charter-out of a vessel with the middle party acting as broker/agent for a commission, or the bareboat-in and bareboat-out of a vessel with the middle party providing finance services to its customer.

Implications of Exposure Draft on Industry Accounting and Financial Reporting for Time Charters

As stated above, we do not believe that the time charter of a vessel constitutes a lease of a vessel. Our view is that the underlying vessel specified in a time charter is so integral and closely associated with the overall service provided to a customer that it renders the bifurcation of a separate lease component meaningless to the service provider's accounting model for revenue recognition. There is no discernible financial reporting benefit for the service provider to bifurcate lease and non-lease components of a time charter as both components are required to earn total time charter hire. We also believe the vessel should not be removed from the owner's balance sheet as the owner retains the risk associated with the operation of the vessel and benefits from ongoing vessel maintenance, regulatory certification and capital improvements beyond the charter period.

A time charter is essentially a daily hire contract. If the service is not provided as required under a time charter for a particular day, the charter rate is not paid for that day. Downtime (service not provided) occurs regularly within our industry for a multitude of reasons. Examples include vessels undergoing repair or drydock, certification issues with regulatory authorities, lack of available and qualified crew and provisioning issues. Irrespective of why the service is not being provided, the entire charter hire rate for a particular day is not paid by the customer if the service is not provided. Creating two distinct accounting models for each potential component of a time charter (Type A or Type B lease component accounting and non-lease component accounting) ignores the legal and economic reality of a time charter and will add a level of complexity and cost that will far outweigh the presumed benefits of the proposal.

Notwithstanding our view that time charters are not leases, if a time charter is determined to include a lease component under the proposed Exposure Draft, the negative consequences on accounting and financial reporting within our industry would include the following:

- The users of our industry financial statements will not benefit from the proposed accounting changes due to increased complexity. We currently recognize revenue on time charters as services are performed and earned under a daily rate of hire. A day rate multiplied by the number of days worked equals revenue. The calculation is very simple, easily understood and provides transparency to the users of our industry financial statements. Time charter metrics of average day rates, utilization and days worked are well established within our industry and extensively used by our industry managers and investor community.

- Industry managers and investors will still want to know the non-bifurcated time charter financial information and metrics as currently prepared under existing practices (a non-GAAP measure under the Exposure Draft) in order to understand the complete economic results of time charter activity, thereby potentially creating two sets of books within the industry. Existing time charter metrics are extensively used in the financial disclosures of industry companies and enable a discussion of financial results in simple terms within the context of price and volume components. Currently, the discussion of price is in terms of average day rates while the discussion of volume is in terms of average utilization. The proposed rules will result in a financial analysis much more difficult to prepare and degrade manager and investor understanding of reported industry numbers through its complexity.

- Bifurcation of a lease component within a time charter is an onerous provision that will make industry accounting of a time charter operationally difficult to apply and unnecessarily complex.

    - Time charter hire rates are set based on current market conditions and the embedded lease component rate will not be readily apparent to market participants.
    - There is no market available to price the non-lease component of a time charter. In the context of the Exposure Draft, services provided in addition to the vessel would include crewing, vessel provisions, vessel maintenance (routine repairs as well as regulatory docking), certification and safety programs, shore-based support, insurance as well as other costs. No one within our industry (or elsewhere) provides these services on a stand-alone basis to vessel owners.
    - Entering into time charters is a daily exercise for industry operators. Significant management judgment will be required to price each component amid volatile market conditions and will create significant audit difficulties due to the lack of verifiable pricing data. (Note: Entering into time charters is also a daily exercise for our industry's customers. They rely on competitive quotes from our industry to set time charter hire rates and do not have access to an operators' day to day financial detail. We are very concerned that our industry's customers will not have access to the appropriate information needed to bifurcate the lease and non-lease components of a time charter.)

- Given the complexities of identifying the lease component of a time charter, the subsequent classification of the lease component as either a Type A or Type B lease will also be complex as the separation of the components and allocation of consideration will affect lease classification.

- The determination of current fair values and future residual values of vessels amid volatile market conditions will prove problematic and create significant audit difficulties due to the lack of verifiable pricing data. The subjective assessment and the level of management judgment associated with future residual values will impact the comparability of financial reporting across our industry as our members will most certainly have differing views on future market expectations.

- Downtime within time charter periods and unexpected operating costs occurs routinely in our industry and will lead to excessive reassessment of lease accounting. Specifically, the frequent changes in the timing of maintenance, dry dock, and other activities that unexpectedly take the vessel out of service could impact the measurement of the lease. The additional administrative costs incurred by our members will far outweigh the benefits of the proposal.

Implications of Exposure Draft on Industry Accounting and Financial Reporting for Bareboat Charters

We do not believe the proposed exposure draft should be adopted and applied to bareboat charter arrangements as the level of complexity and costs will far outweigh the presumed benefits of the proposal. As discussed above, the subjective assessment and the level of management judgment associated with future residual value will impact the comparability of financial reporting across our industry as our members will most certainly have differing views on future market expectations. We do however agree that bareboat charters are essentially leases of vessels and meet the spirit of the definition of a "lease" as set forth in the Exposure Draft.

Conclusion

While we certainly appreciate the efforts that the FASB undertook in creating the Exposure Draft, we do not believe the proposed accounting model improves upon the existing model our industry currently uses today. The application of the proposed accounting model introduces significant judgments and complexity into the revenue recognition of our members that we believe would reduce the understanding, transparency and comparability of financial information across our industry, and will significantly increase the administrative costs of our members.

We request that the Board reconsider its definition of a “lease” in order to more narrowly define the term and include only those financing arrangements that have been traditionally considered leases. Specifically, we request that the definition of a lease excludes any underlying equipment that is operated by a service provider in the delivery of their services to customers or, alternatively, consider removing time charters from the scope of this Exposure Draft. Additionally, we request the Board reconsider the overall benefits of the Exposure Draft to the investing community compared with the substantial costs that companies will incur to comply with the proposal’s complexities from both a lessee and lessor perspective.

Respectfully,

James L. Adams
President and CEO