International Accounting Standards Board
Working Group on Leases
30 Cannon Street
London EC4M 6XH
United Kingdom

For the attention of Rachel Knubley

3rd December 2010

Dear Sirs,

**IFRS Exposure Draft on Leases (August 2010)**

We are responding to your invitation to comment on the Exposure Draft on Leases, as published in August 2010, on behalf of Swire Pacific Limited.

Swire Pacific Limited has diversified interests in five operating divisions: Property, Aviation, Beverages, Marine Services and Trading & Industrial. The Group is both a lessor and a lessee. Assets (investment property and vessels) are held for deployment on operating leases and the Group leases land and buildings, vessels and other equipment under operating leases.

Swire Pacific’s Aviation Division includes a 42.97% investment in the Cathay Pacific group and we would therefore like to draw your attention to their response letter dated 29th October 2010. We support Cathay Pacific’s view on the proposals contained within the Exposure Draft from the point of view of a lessee and have reiterated some of their concerns in the points below.

**General Remarks:**
We welcome the opportunity to respond to the Exposure Draft on Leases. We support the joint efforts of the International Accounting Standards Board (IASB) and the US Financial Accounting Standards Board (FASB) to reduce diversity in accounting treatments and complexity of lease accounting. However, whilst we agree that the existing standard on lease accounting (IAS 17) requires further improvement, we do not support the proposals made by the boards outlined in the Exposure Draft.

In our view the proposals will create more complexity and will fail to improve on the current standard in terms of misleading users and the manipulation of results. Furthermore, in trying to address the deficiencies in the quality of information in relation to lessees, the Boards have added complexity for lessors and we would question whether you have managed to achieve a “consistent accounting model” for both lessees and lessors.
The boards seem to have considered only one group of users of financial statements and in trying to meet their requirements have obscured the view of other users. We would strongly question whether the limited benefits will justify the incremental effort and cost involved in adopting the new standard.

Specific Points:

Renewal options and contingent rents:
We are in support of Mr. Cooper’s position in the Basis for Conclusions document relating to the inclusion of optional lease periods and contingent rentals and feel these will add real complexity.

The estimated payments from renewal and contingent rents do not meet the definition of liabilities under existing standards. They are not present obligations nor do they arise out of a past event. If all optional lease payments and contingent rents are included on the balance sheet, then the resulting liability and related measures of financial leverage and credit risk will be over-stated.

The inclusion of contingent rentals using an expected outcome approach would require companies to develop different scenarios and probabilities based on information that could differ from lease to lease coupled with the need to reassess the estimates. One of the arguments with current lease accounting is that investors are required to make arbitrary estimates and adjustments to the financial statements of lessees for the effects of operating leases. However, under the proposed changes, it would seem that the preparers of financial information rather than investors would now be the ones having to make unreliable estimates. This in turn, we believe, could lead to the manipulation of results in order to achieve a desired outcome.

The proposed changes mean that there is a further requirement to make continual reassessments of the lease terms and contingent rentals and then to constantly adjust the related estimates as facts and circumstances change. We believe this continual readjustment would lead to significant P&L volatility from one reporting period to the next.

Increase in complexity:
A concern for us is the increase in complexity that the proposals would bring and how costly and time-consuming it will be for preparers of financial information if adopted, not just during the initial transition but also at each accounting period.

We are also concerned that the proposed transition requirements would not grandfather existing leases and would require adjustment of comparative periods.
Lessor and Lessee inconsistency and “doubling effect”:
In attempting to deal with deficiencies in the quality of information in relation to lessees, the boards have decided to also change the accounting for lessors as it is “important to have consistent accounting for lessees and lessors”. However, there seems to be inconsistency. Firstly, the boards have agreed on a single accounting model for lessees but a dual model for lessors. The dual model introduces more subjectivity as lessors are able to come up with different approaches under the same lease conditions. Secondly, under the dual model if the performance obligation approach is adopted, then an asset would be created in the lessor’s financial statement. At the same time, the lessee is also recognizing the same asset in its financial statements. Furthermore, the requirement for both lessees and lessors to estimate payments will lead to a lack of symmetry between two parties on either side of the same contract and a lack of comparability among lessors and lessees.

Distortion of financial metrics:
The new proposals could affect key performance metrics. An increase in assets and liabilities is highly likely to result in lower asset turnover ratios, lower return on capital, and an increase in debt to equity ratios, which could result in non-compliance with existing loan covenants or impact future borrowing capacity. The effect of this is likely to mean that the banking industry, like investment analysts currently, will be forced to make estimates and adjustments in order to strip out the impact of the increased liabilities on a company’s gearing. By solving a deficiency for one set of users, we believe the boards will create problems and add complexity for others.

We use a number of key metrics in annual performance appraisals for each of the operating divisions and in presentations to credit rating agencies. The distortion of the key metrics will make this information confusing to both management and other users or require considerable time to restate prior year comparatives.

It is also interesting to note that all lease costs will now go below the EBITDA line. The proposed changes, as we understand it, are intended to address the concerns of investors. However, investors use EBITDA as the key income statement performance measure. Therefore, it would seem that investors will still need to make adjustments to include the lease costs in order to get back to an EBITDA number they are familiar with.

Residual value risk:
One of the key considerations of asset management (indeed we believe the overriding consideration in most cases) is to manage the exposure to residual value risk. We do not enter into an operating lease as a means of financing but as a means of managing exposure to residual value and to benefit from the flexibility that these operating leases provide. Retaining the accounting distinction of operating leases reflects the commercial reality of management decision-making. By eliminating the operating lease treatment we believe that this important distinction will be lost.
Under the proposed model, the users of financial statement are likely to interpret recognition of an asset on the balance sheet as being a reflection of an exposure to residual value risk on these assets. However, for operating leases, in practice the residual value risk continues to reside with the lessor. The lessee is only exposed to contractual obligations under the lease. In this instance, the proposed accounting treatment omits the commercial reality and the legal/contractual position.

**Front loaded lease expenses:**
There is a conceptual issue for lessees in that there will be a mismatch between the recognition of the ‘financing’ expense and the economic benefits realized from the lease. The revenues generated from the use of the leased asset are not reported in the same periods as the lease costs. This may have a number of impacts – it will erode retained earnings and create capital needs in the short term and could lead to manipulation. For an aircraft or shipping operating lease, the economic benefits from the lease are not materially different over the lease period. However, under the current proposals, higher financing expenses at the early part of the lease would be recorded and lower financing expenses at the latter part.

**Non-core and low value leases:**
Non-core and low value assets should be excluded from the standard. The standard suggests that a simplified accounting model for short-term leases (12 months or less) would be used. In reality, the majority of short-term leases would exceed the 12-month cut-off and consequently the simplified accounting approach would have limited value. The benefit to users of financial statements of including low value and non-core leases in the standard simply cannot justify the time that will be spent on preparing the information.

**Alternative Approach:**

We support the Boards’ efforts to improve financial reporting and converge to one set of global accounting standards. However, we urge the boards to reconsider those aspects of the Exposure Draft noted above and our recommendations below prior to issuing a final new standard.

The inclusion of optional and contingent lease period rents should be removed from the scope of the Exposure Draft. These seem to proposals that add significant complexity, create a lack of transparency and are open to manipulation.

If the inclusion is deemed necessary by the Boards, we would recommend that the optional lease period rents should be reflected in the measurement of recognised assets and liabilities only when the arrangement includes an incentive to extend the lease period but not when the exercise of options to extend merely depends on future business conditions.
The inclusion of non-core or low value leases should be removed from the scope. Failing this, the board should develop some materiality threshold, either for individual leases or for the cumulative value of certain lease categories. Common sense should prevail and some consideration of the costs/benefits would suggest that tracking, adjusting and reporting on every piece of leased equipment, property or machinery is not practical.

The Boards should consider setting out clear guidelines on what they deem to be the true income statement performance measure and should consider whether in some respects they are not just defeating the purpose of the Exposure Draft by including lease costs below EBITDA and requiring investors to make adjustments to the financial statements anyway.

The Boards should consider creating separate treatment to deal with specific industries (aviation, shipping etc) which utilize operating leases for managing residual risk so that users do not interpret incorrectly recognition of an asset on the balance sheet as being exposure to residual value risk.

Finally, the Boards should also consider removing the structuring opportunities that are possible under the existing standard. We recognize that one of the criticisms of the existing standard is that companies have successfully structured leases in order to avoid having to recognize assets on the balance sheet. We recommend that the structuring opportunities in the existing standard be removed by re-writing the standard as a principle-based standard focusing on the difference in substance between an ‘in-substance purchase’ and ‘other leases’. The outcome would be to ensure any “in-substance purchase” is recognised as an asset.

We would welcome the opportunity to discuss these views in further detail with you. If you have any questions regarding our comments, please do not hesitate to contact the undersigned on +852 2840 8676 or at robertetchells@swirepac.com.

Yours sincerely,

\[Signature\]

For and on behalf of Swire Pacific Limited
Robert P. Etchells
Finance Manager