

1850-100 Comment Letter No. 340 A.P. Møller - Mærsk A/S Esplanaden 50 DK-1098 Copenhagen K

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Date: 15 December 2010

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

Dear Sirs,

#### **COMMENT TO ED/2010/9 ON LEASES**

The A.P. Moller-Maersk Group is a worldwide conglomerate. We operate in some 130 countries and have a workforce of some 115,000 employees. In addition to owning one of the world's largest shipping companies, we are involved in a wide range of activities in the energy, logistics, retail and manufacturing industries.

Before replying on the questions in the exposure draft we would like to present some overall considerations.

We understand the need of users to have comparable financial reports, and that IAS 17 is not fulfilling those needs. A.P. Moller-Maersk has accommodated those needs by providing additional disclosure of the operating lease contracts in the notes to the annual financial statements. Please refer to appendix 1.

We also acknowledge the substantial amount of work IASB and FASB have put into the project for a new common lease standard. This being said, we encourage the Boards to explain more clearly what you aim for in an accounting standard for leases, and to be more precise as to what type of transactions you think will be beneficial for users to see as assets and liabilities in the financial position.

You state in the introduction that leasing is an important source of finance, and that lease accounting should provide users with a complete and understandable picture of an entity's leasing activities. According to the definition lease contracts are conveying the right to use a specified asset for a period of time in exchange for consideration. We believe the problem with this definition and the application guidance is that some contracts are determined as leases even if the purpose for the agreement is not to achieve finance. Please refer to question 4 (a) for further elaboration of our position to this subject.

Another point we would like to emphasise is that we find the complexity in lease accounting is substantially increased by the exposure draft compared to IAS 17. The proposed model requires more processing time, more advanced skills and an upgrade in supporting IT-systems. The implementation and ongoing costs of the changed accounting are therefore considerable. We would appreciate if the Boards consider removing some of the complexity, some of which being:

- 1) Recognise and measure extension options separately from leases and on a net basis
- 2) Exclude contingent payments in the measurement of leases, and at least exclude payments linked to the usage of the asset or to the performance of the lessee
- 3) Clarify and improve the criteria for distinguishing between lease and service contracts
- 4) Remove the inconsistency in accounting for lessee and lessor by removing the performance obligation approach, or to allow a lessor to apply the derecognition approach to any lease, where it represent a more faithful presentation.
- 5) Remove the probability-weighted approach for estimates

- 6) Remove the requirement for recognising lease contracts with duration of less than one year as rightof-use assets. This would be in line with the definition of property, plant and equipment in IAS 16 saying that tangible assets are items expected to be used during more than one period.
- 7) Make a relief provision for lease contracts with duration up to five years for assets not used directly in the revenue-generating activities. The relief would be to treat such contracts as operating lease as in IAS 17
- 8) Reconsider the disclosure requirements, in particular the number of and disaggregation of reconciliation tables

Eventually we are concerned about the business implications some of the proposed provisions will have for the industries we operate within.

We would like to express our support to EFRAG in their comment letter to the exposure draft on leases, which basically includes almost all our concerns to the proposals. Our understanding of good and applicable accounting principles for leases is in line with the views of EFRAG, whereas we face problems in comprehending the direction the Boards are heading.

Below you find our response to the questions in the exposure draft.

## Question 1 The accounting model for lessees.

When the definition of a lease is amended, and the application guidance for distinguishing a lease from a service contract is clarified in line with our comments to question 4 (a), we agree to the accounting model for lessees.

We have dissenting opinion on the proposed accounting for contingent lease payments, extension options and other elements of the measurement which are dealt with in our response to the other questions. In this section we would like to raise some issues in regards to your proposal on the use of discount rate.

- 1) In most cases it would be appropriate to use the interest rate implicit in the lease rather than the lessee's borrowing rate or the rate charged by the lessor. The interest rate implicit in a lease contract reflects the market's assessment of the risks associated with the underlying asset and the rate of return an investor would require at the contract time. This rate will evidently be higher than the funding cost of either the lessee or the lessor and is the discount rate to be used in impairment testing. Therefore, at the time of recognition lessee may face an impairment loss on the right-to-use asset for no business reason. Following, in such cases the initial measurement of the leased asset and the cost of the right-of-use asset should be based on circumstances linked to the asset and not to the financing.
- 2) When, the funding cost is used identical contracts could have significant different accounting impact on two market operators, which would penalize stronger market participants compared to weaker market participants from a credit perspective.
- 3) We don't think it is clear in paragraph 12 (a) whether the lessee's incremental borrowing rate can be used when the rate charged by lessor can be readily determined. Are the two options equally available?

To create consistency in choice of discount rate we recommend the wording from IAS 17.

## Question 2 The accounting model for lessors.

The concept of the right-of-use assets should entail only one accounting model for lessors i.e. the derecognition model. The performance obligation model creates inconsistency in the accounting for lessors and lessees.

The inconsistency is in particular unfavourable to us due to a large number of lease contracts between entities in the Group. Although internal contracts are not reflected in the consolidated accounts, the performance obligation approach applied by internal lessors would impact the segment reporting. Following, the IFRS

principles for segment reporting would result in same assets and their depreciation/amortisation being included in more segments. In addition the separate financial statement of the parent will be impacted.

In order to have a consistent representation of leases between segments, we would have to consider applying the derecognition approach to all internal lessors. IFRS 8 requires explaining of deviations in segment reporting to IFRS principles and we think it is not reasonable to consider such treatment of internal leases as a deviation to IFRS, when the reason for doing so is an inconsistent IFRS standard on leases. Having the option to apply derecognition approach to any lease would eliminate this problem.

Appendix 2 includes an example that shows the impact on the segment reporting by applying the performance obligation approach and the derecognition approach.

## Question 3 Short-term leases (<12 months) – simplified requirements

The proposed accounting of short-term leases is not a sufficient simplification, because the discounting of cash flow is not the time-consuming or complex part of the lease accounting. A relief would be to treat short-term leases similar to operating leases in IAS 17. Also, the requirement to recognise right-of-use assets with duration less than one year is inconsistent with the definition of tangible assets in IAS 16.6 (b).

The Boards should consider allowing for contracts up to five years to be considered short-term, if the assets are not used directly in the revenue-generating activities and the omission to recognise a lease asset/liability is not having a material impact on the financial position. Such provision would exclude a number of lease contracts on office equipment, cars in staff compensation packages, temporary storage or office capacity, etc. and would be a great relief to us.

#### Question 4 (a) Definition of a lease

We object to the definition of a lease being based on a specified asset in all situations.

An asset represents capacity and we understand that the concept of the right-of-use assets reflect the value of this capacity. When a service arrangement is agreed, the question is whether assets used in the arrangement are capacity of the service customer or the supplier. Normally you would say the assets constitute capacity of the service provider in fulfilling his service performance obligations. Nevertheless, according to the definition and the application guidance assets are to be considered capacity of the customer when he has requirements for specific assets used in the service.

We do not believe that requirements for specific assets should always constitute lease contracts. The purpose of a customer's requirements for a specific asset may be to control the output, i.e. the quality of the service, and not the asset itself. If a customer does not have activities similar to services provided by the supplier, an arrangement between the two should not be determined as a lease even if an asset is specific to the provided service. The Boards should consider if the aim of the lease standard is to recognise a right-of-use asset of customers demanding a service, if there is no real or practical alternative for that entity to establish the capacity on his own. In regards to the service provider, contracts should not be determined lease, if the assets are part of a service package and those assets are not supplied without the accompanying service.

An example where we do not think the current definition of a lease is applicable is in the activities in Maersk Drilling. The business unit serves a number of oil companies with drilling of exploration and production wells. The rigs are specialised and complex assets. Maersk Drilling and their customers require a high degree of safety in performing the drilling activities, in regards to both staff and environment. The technical feasibilities as well as the staff expertise and the management set-up are critical parameters. The specialised rig is part of a service package, which is priced as a whole. In our opinion Maersk Drilling is not a lessor of rigs with a service component attached. Neither do we believe our customers see themselves entering into a lease contract with a service component. The rig is a main vehicle in the activities, but not the principal object of the contracts

Concluding, we suggest that the definition of a lease should be amended to "An agreement where capacity of an asset for a period of time is exclusively conveyed for use in the transferee's own activities, in exchange for consideration".

## Question 4 (b) Distinguishing lease from purchase/sale of an asset

We agree with the proposed principles.

## Question 4 (c) Distinguishing lease contracts from service contracts

We refer to our comments to question 4 (a).

## Question 5 Scope exclusions

The Board should consider excluding concession agreements for public infrastructure. IFRIC 12 already recognises the need for separate treatment of some concession agreements.

Below are outlined the differences between concession contracts and typical features of lease contracts for property, plant and equipment:

Differences	Concessions	PPE
Type of asset	Intangible & tangible	Tangible
Transfer of ownership at end	Never	Majority
Life span	Indefinite	Finite
Asset exists at agreement date	Rarely	Yes
Asset useable at agreement date	Rarely	Majority
Length of agreement	Long, < Life	Short, =Life
Option to extend	Majority	Majority
Control over usage	Restricted	Unrestricted
Contingent portion	Majority	Rarely

Leasing of the right to use public owned land and sea is more in line with leases to explore for or use minerals, oil, natural gas and similar resources, which are already excluded by the exposure draft. Classification as an intangible would be in line with the results of IFRIC 12 classification. At the end of the concession contract the terminal control is relinquished back to the lessor in all cases. Not congruous with many other leases, but more in line with extractive rights.

Life of the land as identified by IFRS is indefinite. Indefinite life span assets can theoretically be leased indefinitely meaning that any residual value calculations for depreciation purposes will be equal to the initial recognised asset value and there should be no depreciation charges over the period.

With green fields the leasing of the terminal rights does not give the lessee any benefits until substantial all connected investments have been made. Brown fields often require substantial capital investments before the asset can be used.

Finally, the control element is questionable. How the terminal should be operated, the prices to be charged, and the service level required are determined by the lessor to the extent that terminal operation is almost like an agent relationship.

## Question 6 Contracts that contain service components and lease components

In general, we see no reason why service components should be included in the measurement of right-of-use assets, distinct or non-distinct. EFRAG believes that when a contract includes both a lease and non-distinct

services, a lessee should identify the predominant component and treat the whole contract accordingly. When it is determined that an arrangement contains a lease, and the contract includes a service component, we think the value of the right-of-use asset should be linked to the asset alone. Therefore, service components should always be excluded from the measurement of the lease asset/liability.

If concession agreements for public infrastructure are not excluded from scope we encourage the Boards to state that a license component should be separated and accounted for in accordance with IAS 18.

APM Terminals has container terminal activities in a number of countries and has entered into concession agreements with governments or other bodies. When the price of the concession right is based on volume, the flow of payments follows the revenue generated from the activities. The Boards have proposed to include contingent payments in the present value of the lease. Consequently, the cost of future volume performance is recognised as an asset at the commencement of the lease and interest is charged to the profit and loss statement from this moment. We do not think this front-load of expenses represents a faithful presentation of the financial position and the performance. Appendix 3 includes an example of the financial impact of the proposed treatment on a concession contract with volume based contingent payments.

## Question 7 Purchase options

We agree that purchase options should not be considered in the measurement of lease contracts.

## Question 8 Lease term

We believe that including extension options in the measurement of the lease asset and liability is not compliant with the definition of assets and liabilities in the Framework. In addition, the proposed method is administratively a heavy burden.

We acknowledge that extension options cannot be ignored as entities may structure their lease contracts with a short non-cancellable period and a number of extension options. Therefore we find it justified if the lease standard includes a simple accounting model for extension options, where the favourable or unfavourable position of the option holder and grantor are reflected separately from the lease asset and liability, and where remeasurements of the options do not impact the amortisation of the lease asset/liability.

## Question 9 Lease payments

We agree with EFRAG that contingent payments based on the usage of the asset or the performance of the lessee should be excluded from the measurement of the lease asset/liability. As explained under question 6, volume based payments will front-load costs in the form of interest. We doubt if this consequence has been the intention of the Boards, and we encourage you to reconsider the requirements.

In addition, it is imperative to convince you that the expected outcome technique is not a practical approach for accounting. We oppose the use of probability-weighted estimates, as the identifying of each reasonable outcome and the determination of probabilities is very arbitrary. They are difficult to justify and document and will require more time to produce. We are not convinced that a value from a probability-weighted outcome is more accurate than from a most likely outcome. For simplicity and cost/benefits considerations we sincerely hope the Boards will remove the proposed estimation technique from the standard.

## Question 10 Reassessment

It would be onerous to require periodic reassessments of changes in the obligation or receivable arsing from changes in the lease term or contingent payments and we oppose the proposal.

## Question 11 Sale and leaseback

No comment.

## Question 12 Presentation in statement of financial position (B/S)

It is not clear to us whether a net lease asset for a lessor under the performance approach shall be presented within property, plant and equipment and if no, whether the underlying asset is then excluded from the disclosure requirements in IAS 16.

We are also not sure of the requirements for an intermediate lessor in a sublease. According to the example in the application guidance (B29), the right-of-use asset is excluded from property, plant and equipment in order to present a net sublease asset. Does this mean the right-of-use asset is excluded from the reconciliation schedule required in paragraph 77?

## Question 13 Presentation in statement of comprehensive income (P/L)

Lease income and lease expenses should be presented separate from other items in the notes only.

#### Question 14 Presentation in statement of cash flows

We find it inconsistent that lease payments are classified as financing for lessees and as operating for lessors.

#### Question 15 Disclosures

The number of paragraphs and bullets for disclosures in our opinion is too extensive and will only provide an overload of information for the users. Although it is stated that an entity shall consider the level of details, we find it very difficult to present the very concrete information when having thousands of lease contracts.

For example one disclosure is "A lessee shall provide narrative disclosure about the options that were recognised as part of the right-of-use asset and those that were not", p. 73(a)(iii). In paragraph 78 it is required that "A lessor shall disclose the information about its exposure to the risks or benefits associated with the underlying asset that is used in determining whether to apply the performance obligation approach or the derecognition approach". How the Boards imagine such information to be aggregated for a high number of contracts is not clear to us.

Finally, we find it inappropriate that a reconciliation of opening and closing of the lease liabilities shall be disaggregated by class of underlying asset (p. 77). It should be sufficient to disaggregate the right-of-use asset. Concurrently we do not see the purpose of disclosing a reconciliation of the opening and closing balances for each of (a) rights to receive lease payments, (b) lease liabilities arising from the performance obligation approach, and (c) residual asset arising from leases to which the derecognition approach is applied.

## Question 16 Transition

We agree with the proposed principles for transition.

## Question 17 Benefits and costs

Unless the complexity of the exposure draft is reduced we find it very doubtful that benefits would outweigh the costs.

Further, the proposed accounting of leases may have significant business implications:

- Lease contracts provide flexibility in the scaling of capacity and controlling of costs in regards to
  responding to changes in the market. It is therefore important that entities are not imposed to use a
  discount rate that does not reflect the risks and rewards associated with the underlying asset and which
  may result in impairment at recognition of the leased asset.
- Business decisions of whether to enter into an arrangement may depend on the ability to utilise the cash
  generated from the activities. An undue front-loading of expenses resulting in a longer period before a
  business decision shows profit may result in good and sound businesses are not commenced as investor's
  ability to take home dividends is postponed. In particular this may become a problem for developing
  countries as it could become more difficult for governments to attract private company investors for
  projects such as infrastructure.

Kind regards

## Jesper Cramon

Senior Vice President Group Accounting

# **Notes** to the consolidated financial statements

Amounts in DKK million (in parenthesis the corresponding figures for 2008)

## **26** Commitments

#### Operating lease commitments

As part of the Group's activities, customary agreements are entered into regarding charter and operating leases of ships, containers, port facilities, etc. The future charter and operating lease payments for continuing operations are:

	Container shipping and related activities¹	APM Termi- nals	Tankers, offshore and other shipping activities <sup>1</sup>	Oil and gas activities	Retail activity	Other	Total	
2009								
Within one year	7,602	1,166	2,617	771	255	178	12,589	
Between one and two years	6,172	1,503	2,306	453	206	146	10,786	
Between two and three years	4,969	1,164	2,060	399	174	129	8,895	
Between three and four years	4,390	1,202	1,453	388	128	130	7,691	
Between four and five years	3,611	1,247	1,337	370	104	131	6,800	
After five years	10,111	26,497	6,759	954	310	119	44,750	
Total	36,855	32,779	16,532	3,335	1,177	833	91,511	
Net present value <sup>2</sup>	29,716	16,943	12,298	2,693	950	689	63,289	
2008								
Within one year	10,227	1,315	2,319	384	293	217	14,755	
Between one and two years	7,565	1,094	2,207	165	239	188	11,458	
Between two and three years	6,120	1,079	1,930	58	215	188	9,590	
Between three and four years	5,250	1,116	1,673	57	184	188	8,468	
Between four and five years	4,842	1,156	1,293	42	160	186	7,679	
After five years	13,291	26,292	4,887	64	617	307	45,458	
Total	47,295	32,052	14,309	770	1,708	1,274	97,408	
Net present value <sup>2</sup>	37,474	15,740	11,208	674	1,270	1,029	67,395	

<sup>&</sup>lt;sup>1</sup> About one-third of total time charter payments in Container shipping and related activities as well as Tankers, offshore and other shipping activities are estimated to relate to operational costs for the assets.

Total operating lease costs incurred, including contingent payments related to volume etc., are stated in note 4.

## Capital commitments

At the end of 2009, capital commitments relating to ships, rigs, terminals, etc. on order amount to DKK 35 billion (DKK 64 billion). Furthermore, the Group has investment commitments to concession grantors relating to oil and gas activities and terminal activities of DKK 2 billion (DKK 3 billion) and DKK 3 billion (DKK 2 billion), respectively.

The Group has made an offer to purchase three oil expansion projects in the Gulf of Mexico of USD 1.3 billion. Subsequently, other project participants chose to exercise their pre-emption right for two of these projects, which reduces the commitment to USD 300 million.

In connection with the agreed sale of Norfolk Holdings B.V. to DFDS, the Group has committed to purchase or subscribe new shares in DFDS, respectively, for a part of the proceeds, at a value in the order of EUR 200 million calculated based on the share prices on the balance sheet date.

<sup>&</sup>lt;sup>2</sup> The net present value has been calculated using a discount factor of 6%.

## Lease between segments

## Performance obligation approach

Carrying amount of vessel at the commencement of the lease	15.000
Remaining useful life of asset (years)	15
Lease period (years)	3
Annual lease payments	1.200
Interest rate charged by lessor	8%
Present value at the commencement of the lease	3.093

		Year	· 1	
	Segment A		Elim.	Group
	(Lessor)	(Lessee)		
	( )	(,		
Lease income (internal)	1.031	0	-1.031	0
Depreciation & Amortisation	-1.000	-1.031	1.031	-1.000
Segment result	31	-1.031	0	-1.000
Interest income (internal)	247	0	-247	0
Interest expense (internal)	0	-247	247	0
Profit before tax	278	-1.278	0	-1.000
Vessel	14.000	0	0	14.000
Right to use asset (internal)	0	2.062	-2.062	0
Right to receive lease payments (internal)	2.140	0	-2.140	0
Lease performance obligation (internal)	-2.062	0	2.062	0
Total property, plant & equipment (segment assets)	14.078	2.062	-2.140	14.000
The second of th				
Equity	15.278	-1.278	0	14.000
Lease liability (internal)	0	2.140	-2.140	0
Internal cash pool	-1.200	1.200	0	0
Total equity and liabilities	14.078	2.062	-2.140	14.000
W				
Vessel			_	
Opening	15.000		0	15.000
Depreciation	-1.000			-1.000
Closing	14.000	0	0	14.000
Right to use asset				
Opening		0	0	0
Addition		3.093	-3.093	0
Amortisation		-1.031	1.031	0
Closing	0	2.062	-2.062	0
Right to receive lease payments				
Opening	0		0	0
Addition	3.093		-3.093	0
Interest charge	247		-247	0
Disposal	-1.200		1.200	0
Closing	2.140	0	-2.140	0
Lease performance obligation				
Opening	0		0	0
Addition	3.093		-3.093	0
Interest charge			0	0
Disposal	-1.031		1.031	0
Closing	2.062	0	-2.062	0
Logo liekility				
Lease liability		0	0	^
Opening Addition		2 003	3 003	0
Addition Interest charge		3.093	-3.093	0
		247	-247 1 200	0
Disposal		-1.200 2.140	1.200 -2.140	0
Closing	0	2.140	-2.140	0
Equity				
Opening	15.000	0	0	15.000
тсі	278	-1.278	0	-1.000
Closing	15.278	-1.278	0	14.000

## Lease between segments

## Derecognition approach

Carrying amount of vessel at the commencement of the lease 15.000
Fair value of vessel at the commencement of the lease 15.463 1)
Remaining useful life of asset (years) 15
Lease period (years) 3
Annual lease payments 1.200
Interest rate charged by lessor 8%
Present value at the commencement of the lease 3.093

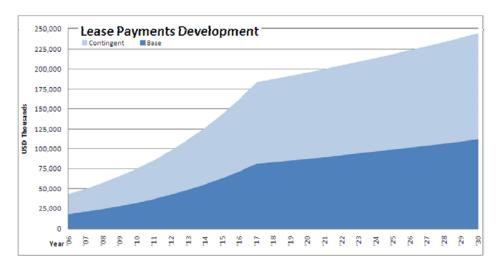
	Year 1				
	Segment A Se		Elim.	Group	
	_	(Lessee)		о. о шр	
	(200001)	(200000)			
Gain/loss on partial derecognition of leased assets (internal)	93	0	- 93	О	
Depreciation & Amortisation	0	-1.031	31	-1.000	
Segment result	93	-1.031	-62	-1.000	
Interest income (internal)	247	0	-247	0 0	
Interest income (internal)  Interest expense (internal)		-247	247	0	
	340				
Profit before tax	340	-1.278	-62	-1.000	
Versel		0	14.000	14.000	
Vessel	0	0	14.000	14.000	
Residual asset (internal)	12.000	0	-12.000	0	
Right to use asset (internal)	0	2.062	-2.062	0	
Total property, plant & equipment (segment assets)	12.000	2.062	-62	14.000	
Right to receive lease payments (internal)	2.140	0	-2.140	0	
Total assets	14.140	2.062	-2.202	14.000	
Equity	15.340	-1.278	-62	14.000	
Lease liability (internal)	0	2.140	-2.140	0	
Internal cash pool	-1.200	1.200	0	0	
Total equity and liabilities	14.140	2.062	-2.202	14.000	
Vessel					
Opening	15.000		0	15.000	
Addition				0	
Depreciation			-1.000	-1.000	
Disposal	-15.000		15.000	0	
Closing	0	0	14.000	14.000	
g					
Residual asset					
Opening			0	О	
Addition	12.000		-12.000	0	
Disposal	12.000		12.000	o	
Closing	12.000	0	-12.000	0	
Closing	12.000		- 12.000		
Right to use asset					
Opening		0	0	0	
Addition		3.093	-3.093	0	
Amortisation			1.031	0	
	0	-1.031		0	
Closing	0	2.062	-2.062	U	
Diabet to accept to the constant					
Right to receive lease payments					
Opening	0		0	0	
Addition	3.093		-3.093	0	
Interest charge	247		-247	0	
Disposal	-1.200		1.200	0	
Closing	2.140	0	-2.140	0	
Lease liability					
Opening		0	0	0	
Addition		3.093	-3.093	0	
Interest charge		247	-247	0	
Disposal		-1.200	1.200	0	
Closing	0	2.140	-2.140	0	
Equity					
Opening	15.000	0	0	15.000	
тсі	340	-1.278	-62	-1.000	
Closing	15.340	-1.278	-62		
Ciosing			-02	14.000	

Appendix 3 1850-100 Comment Letter No. 340

## Case in APM Terminals

Terminal with a concession agreement with a government

- 25 year concession (21 years remaining) with option to extend
- Contingent portion based on volumes: potentially 130% of fixed lease payment
- If volumes are below a certain level, concession can be terminated by lessor



Lease payments including probable contingent payments in 2013:

- Fair value: USD 3,515 mill and present value: USD 1,183 mill
- Balance sheet increases 6.9 times will fluctuate y-o-y due to contingent payments
- "Front loading" ends in year 10 /2023, when cumulative P&L impact -USD 545m
- 50% of "unloading" occurs in final 2 years

