

NATIONAL ASSOCIATION OF CHINESE SHIPOWNERS

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27 August 2013

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

Dear Sir/Madam:

Re: Revised Exposure Draft: Leases (May 2013)

We are responding to the invitation of the IASB and FASB (the “boards”) to comment on the revised *Leases* exposure draft issued on May 16 (the “revised ED”).

Through paragraphs BC102 to BC106, we understand that the boards have tried to address those common concerns about the 2010 Exposure Draft relating to charter arrangements in the shipping industry and have changed the proposed application guidance on assessing whether an arrangement contains a lease or a service, or both for ‘the right to control the use of an asset’ to be more consistent with the concept of control applied in the consolidation requirements and revenue recognition proposals. And, the boards have also simplified the proposals by permitting a lessee not to recognize assets and liabilities for leases with a maximum lease term of 12 months or less. However, the difficulties and problems in applying the proposed model remain, and we are of the strong opinion that the proposed standard should not be introduced.

Based on the revised ED, paragraphs 6-19, “a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration” [para.6], a lease would exist when both of the following conditions are met: [para.7]

(a) fulfillment of a contract depends on **the use of an identifiable asset** [paras. 8-11];

- being able to identify an asset, rather than one of a number of assets of a particular specification, is fundamental to the definition of a lease
- if the supplier has the substantive right to substitute the asset (without requiring the consent of the customer and no barriers, but excluding if the asset is not operating properly or a technical upgrade becomes available) throughout the term of contract, fulfillment of a contract does not depend on the use of an identified asset
- a capacity portion of an asset (for example, a contract for the right to use a percentage of an asset's capacity that is less than substantially all of the capacity of the asset) cannot be an identified asset because the capacity portion is not physically distinct

and

(b) the contract conveys **the right to control the use of the identifiable asset** for a period of time in exchange for consideration [paras. 9-19].

- if throughout the term of the contract, the customer has the ability to direct the use of the identified asset and derive the benefits from use of the identified asset.

Shipping companies offer transportation services either by using their own vessels or by chartering of vessels owned by other ship owners. Generally, there are three main types of agreements: 1) voyage charter, 2) time charter, and 3) bareboat charter.

A voyage charter is a transportation service agreement made between a shipping company and a vessel owner to carry the cargo from the designated port of loading to another designated port of unloading. According to the agreement, the vessel owner retains the responsibility to maintain its vessel in an appropriate, fully operable condition by managing the captain and crew members on board; and, all costs and risks in relation to the vessel being employed on the voyage will be paid

by the vessel owner. By applying the guidance in paragraphs 6-19 (key concepts as aforementioned), we will not consider a voyage charter as a lease under current practices.

However, in case of time charter agreements, the assessment of whether they meet the definition of a lease under the revised ED is more complex. For example, according to the agreement, the vessel owner has a right to substitute the underlying asset with the same specifications (size and type of the vessel, minimum speed, etc.); however, the vessel owner might not exercise such right in practice. Although the boards have included additional guidance in paragraph 9 to help determine when substitution rights are substantive, we are concerned that different charter parties might have different judgment on such substitution clause in their contracts and might result in similar contracts being treated differently. In addition, sometimes time charter agreements could be considered as an extension of voyage charter agreements for a longer or specific period. Since the vessel owner retains the same responsibilities as described in the above voyage arrangements, we will consider both voyage and time charter arrangements shall be treated as transportation service contracts.

On the other hand, bareboat charters meet the definition of a lease based on the revised proposal as they typically convey the right of use an identified vessel. Under such charter arrangements, shipping companies as charterers have the responsibilities to maintain and operate the identified vessels as if they own them for the duration of the charters, which may vary from multiple months to years. Although we understand the boards' intention to improve the quality and comparability of financial reporting by providing greater transparency about leverage, we are still concerned that the recognition of lease liabilities under the proposed ED in such charter arrangements will have a negative impact on gearing for many shipping companies, resulting in potential breaches or renegotiation of their financial covenants associated with debt agreements. Furthermore, vessel owners would be required to remove their vessels from their balance sheets when the vessels are put on leases, even for lease terms of only a couple of years. Therefore, we believe that it will cause the misjudgment of users of the financial statements.

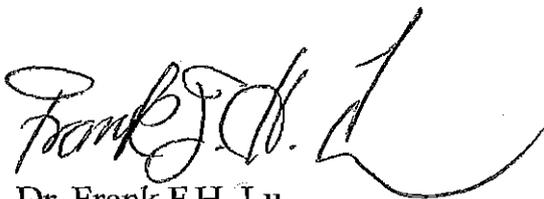
Consistent with the 2010 Exposure Draft, the revised ED eliminates off

balance sheet accounting for lessees, and a new asset representing the right to use the leased asset for the lease term and a liability representing the obligation to pay rental are recognized for all leases, except for short-term leases. However, under the revised ED, the boards are now proposing two different expense recognition patterns for different types of leases: Type A leases (front-loaded expense) and Type B leases (straight-line expense).

Under this approach, a vessel is not a property, and therefore many leases of vessels shall be treated as Type A, unless the lease term represents an insignificant portion of the vessel's total economic life, or the present value of the fixed lease payments is insignificant relative to the fair value of the leased vessel. We are concerned that the boards do not define what is meant by 'insignificant' in the proposals, so different interpretation and judgment might result in different classifications for similar transactions. In addition, we also question the new lease classification approach for vessels (non-property) and buildings (property). Even though they might be similar transactions economically, the lease classification will be different and therefore different lease accounting will be applied.

In summary, we believe that the revised ED will result in significant cost and complexity for preparers and a negative impact on the shipping industry; therefore, we strongly suggest the boards reconsider whether the proposed standard should be introduced.

Yours faithfully



Dr. Frank F.H. Lu

Chairman

National Association of Chinese Shipowners

CC : Asian Shipowners' Forum