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The British Helicopter Association's comments on IFRS Exposure Draft ED/2013/6 – Leases

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The British Helicopter Association (“BHA”)

The British Helicopter Association was formed in 1989 and is the Trade Association that represents the interests of nearly all UK commercial, private, corporate, business, Police, Air Ambulance and Helicopter Emergency Medical Service operators and their associated suppliers and service providers.

The Association has some 220 members and is financed by member subscription as a non-profit making organisation that is limited by guarantee. It has strong links with the European Helicopter Association and the Helicopter Association International.

Helicopters and Leasing

Helicopters have some features which make them ideal candidates for operating leases, conditional sales, hire purchases and finance leases.

1. They have long lives – some commercial medium and heavy helicopters fly for over 40 years.
2. Many helicopters, especially the larger ones, hold their values very consistently, so that many helicopters will be worth 75% of original cost after 10 years and often 50% after 25 years, even in low inflationary times. Most helicopters built in the 1970's and still flying are worth more than their original cost in nominal terms.
3. They are easily transportable all over the world and so have a large potential market for secondary sales.
4. There is a clear re-sale market for disposal at the end of leases.

5. Title and financial interests can be easily registered.
6. Sustainable values make them good candidates for asset based finance.

BHA cites these facts merely to illustrate that there is a solid foundation for the facts that are given in its comments on the Exposure Draft.

Helicopter operators either acquire their assets through purchase and ownership or through conditional sales, instalment purchases or finance and operating leases. Often the reasons for preferring one method to another will relate to legal and tax considerations. A preference for operating leases is driven mainly by the wish to transfer risk, particularly value risk, to the lessor or other third parties.

Comments on the Exposure Draft

BHA's response to the Exposure Draft has been drafted by John Sheldon an adviser to the industry responsible for arranging about \$2.5billion worth of operating leases, conditional sales, hire purchases and finance leases over the last ten years for various members of the BHA and for other helicopter operators round the world.

In the course of his work he has come across the different lease accounting rules of most of the OECD countries and has had extensive experience in dealing with lease accounting standards covered by FAS167 (and the preceding US standard outlined in FIN46(R)) and other EITF's in the US.

BHA's Board has adopted the draft as its own comments and recommendations.

Overall Response

BHA is satisfied that its earlier comments have been listened to and, as far as it is aware, the outcome in the new Exposure Draft largely reflects its earlier concerns.

BHA's only remaining comment concerns the emphasis given to straight line amortisation of the Right-of-Use asset and declining interest cost in the hands of lessees. This point is elaborated below.

Lessee amortisation and interest costs of the Right-of-Use Asset

It is clear that helicopter leases will be categorised as type A leases.

Example 14 showing the suggested accounting treatment of a Type A Lease includes the expense of up-front costs and the straight line amortisation of the remaining Right-of Use balance. Interest expense on the declining Right-of-Use balance will be on a declining

basis. This means the helicopter lessees will be faced with an uneven, front-end loaded cost structure compared with the even deduction of a rental stream under current accounting standards.

Paragraphs BC34 and BC403 in the Exposure Draft admit that this is the case and justifies the approach by comparing it with the treatment of owned assets.

The Exposure Draft reports the arguments put forward by those who considered that the income and costs of a lessee over its lease term should be evened out, as they are at present, but rejected them, largely on the basis that A Type lessees with merely a leasehold interest should be treated in exactly the same way in accounting terms as purchasers with a freehold interest.

Whilst BHA accepts that leasehold (Right-of-Use) interests should appear on a lessee's balance sheet, it believes that there is a real distinction between renting and owning helicopters and that, therefore, a lessee should be able to match income and expense during the rental period.

Typically, a helicopter lessee tries to match its lease term with its own contracts with customers such as oil and gas companies or governments. A 5 year term for both would not be unusual. The helicopter operator/lessee usually obtains straight line income from such contracts. The true annual profit from such matched transactions will be shown only if the lessee's overall expenses (whether rental or a mixture of interest cost and amortisation) are spread evenly over the lease term.

There is some indication in the Exposure Draft that Lessees might be able to justify an alternative approach to straight line amortisation and declining interest cost but BHA believes that the fact that all the examples contain only straight line amortisation and declining interest will prejudice auditors in this direction and that it will be too hard for lessees to justify any other approach.

There might also be some justification for evening out interest costs by deferring part of early year interest expense. Here again, auditors will be prejudiced against this approach by the fact that there are no examples of it in the Exposure Draft.

The treatment of lessees may also contrast with that of owners of helicopters who may have more scope to vary amortisation rates and even, perhaps, the treatment of financing cost.

Conclusion and Recommendation

BHA believes that the Exposure Draft takes an over-rigid approach to a Lessee's cost accounting for its Type A lease Right-of-Use asset.

It believes that readers of accounts could get the wrong impression of a helicopter operator's annual results if costs of a lease are skewed to the earlier part of a lease which would be the inevitable result of the application of the Examples given in the Exposure Draft.

BHA accepts that the arguments for a more even expense treatment have been aired in the Exposure Draft but it rejects the argument that a lessee should be in an exactly comparable position to a purchaser. It would like to see a more flexible approach taken in the final accounting standard where it will be easier for lessees to justify an accounting approach yielding an even annual expense.

Peter Norton

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For the British Helicopter Association

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Prepared on 10 September 2013 by:
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