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

13 September 2013

Dear Sirs,

IASB Exposure Draft Leases

Thank you for your invitation to comment on the IASB Exposure Draft Leases published in May 2013. While we appreciate joint efforts by the IASB and FASB to reduce diversity and complexity in accounting treatments, we find that the application of the proposals will result in more complicated financial statements as well as further costs to the preparers. In our view, the proposals would not enhance the quality and comparability of the financial information provided to the users of financial statements. Instead, it will distort the financial statements and make them more difficult to understand. We believe that the cost of gathering data, reviewing the key terms of the lease arrangements, tracking relevant information and reassessing any variable terms will be substantial and will outweigh the claimed benefits of the proposals.

While our feedback may not be exhaustive, we have tried to respond to the specific questions raised in the invitation to comment on the Exposure Draft in an appendix to this letter. Should you need any clarification, please do not hesitate to contact our Mr Pius Lam at pius.lam@oocl.com.

Yours faithfully,

Paul Mok
Group Financial Controller
Appendix

Question 1: Identifying a lease

Do you agree with the definition of a lease and the proposed requirements in paragraphs 6–19 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

Response:

The revised Exposure Draft states that “A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset”.

From our experience, we are of the view that the lessees may not have full “control” of a leased-in asset.

In the shipping industry, shipping companies charter in vessels. Under a usual common vessel charter hire agreement, the lessor is responsible for the repair and maintenance of the vessel and providing a captain and his crew to the lessee. For example, if the chartered-in vessel is leaking fuel and repair is needed, the lessee has no right to decide when and where the vessel should be repaired as this is usually controlled by the lessor. The substance of the lease transaction is only a provision of shipping service by the lessor instead of allowing the lessee to have control over the vessel.

Another example in the shipping industry is that the lessee normally cannot incur substantial capital expenditure to modify the physical conditions of the chartered-in vessel without mutual agreement between the lessee and the lessor. It shows that the lessee may not have the ability to direct the use of the leased assets in this perspective.

From a commercial perspective, we have no objection to the finance lease requirement under the existing IAS 17 because these finance lease arrangements are in substance means to finance the acquisition of assets.

On the other hand, we view an operating lease as a rental agreement, and there is a clean distinction between “lease” and “buy”.
Question 2: Lessee accounting

Do you agree that the recognition, measurement and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

Question 3: Lessor accounting

Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

Question 4: Classification of leases

Do you agree that the principle on the lessee’s expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 28–34, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

Response to Questions 2 to 4:

The Exposure Draft has introduced a dual lease accounting approach. We have the following comments regarding this proposal:

Firstly, we consider that the dual approach will lead to distortion of profit and loss account presentation. For type A leases, expenses are presented as amortization and finance cost whereas the expenses are presented as operating lease expense for type B leases. This difference in presentation will result in distortions in different indicators of a company’s financial performance, e.g. EBITDA, making comparison difficult within the industry.

Secondly, it would be a matter of interpretation and judgment whether to classify a charter hire agreement of a vessel as Type A or Type B. Given the long useful life (20 to 30 years) of a vessel, some shipping companies would classify a 3-year charter hire agreement as Type B lease because the lease does not consume more than an insignificant portion of the economic benefits embedded in the asset. Others might classify the charter hire agreement as Type A lease as they simply treat a vessel as equipment and consider that the front load cost effect of Type A lease can better reflect the pattern in which the lessee expects to consume the asset’s future economic benefits.
In addition to the questions raised above, in the perspective of a lessor, we find the measurement of a residual asset very subjective in the shipping industry. The market price of vessels and charter hire rates are highly volatile. The second-hand market prices for container vessels dropped by approximately 10% to 20% last year while the market charter hire increased by 16% in the first half of 2012 but dropped by 32% in the second half of the same year. This demonstrates the difficulty in measuring the value of the residual asset.

**Question 5: Lease term**

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

**Response:**

We find that the concept of “significant economic incentive” relating to the lease term in the Exposure Draft is relatively subjective and that the amounts recognized by lessee and lessor would not be the same. For example, a lessee may have invested leasehold improvements that are expected to have significant economic value for the lessee when the option to extend or purchase the asset becomes exercisable. However, this information may not be transparent to the lessor such that the lease term used by lessor would be the primary period while the lease term as determined by lessee would include both the primary and extended periods.

In addition, the “reasonably certain” threshold in the existing IAS 17 seems to give a broader principle for lease term determination while B5 and B6 of the Exposure Draft provide specific examples to decide what is significant economic incentive. The proposal has therefore become more for rule-based rather than principle-based.

**Question 6: Variable lease payments**

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

**Response:**

We agree with the requirement that the variable lease payments calculated based on an index or a rate should be re-measured. However, such lease payments are sometimes based on multiple factors and the measurement of the variable lease payments could become very complicated. Moreover, the underlying market index or rate in the calculation of variable lease payments may change from time to time, making it more difficult in the estimation.
We had a recent case in which we entered into a 40-year terminal lease. The terminal is still under construction and the available acreage for use will depend on the construction progress. At the same time, lease payments per acreage are renegotiated every five years. This has given us uncertainty in the estimation of right-of-use asset and lease liability according to the Exposure Draft. For your information, if the Exposure Draft were adopted as standard in 2012, this terminal lease alone would double our group’s total liabilities.

In addition, same as our response to Question 5, the lessor and lessee may have a different set of assumptions relating to the index or rate. This may result in different amounts capitalized for the same lease.