

International Chamber of Shipping

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The Chairman
International Accounting Standards Board (IASB)
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Dear Sir,

IASB PROPOSALS ON ACCOUNTING STANDARDS FOR LEASE CONTRACTS – IFRS EXPOSURE DRAFT ED/2010/9

I am writing on behalf of the International Chamber of Shipping (ICS), which is the principal international trade association for shipowners and operators, representing all sectors and trades. ICS membership comprises national shipowners' associations from 35 countries - from the Americas, Asia and Europe - representing around 80% of the world merchant fleet.

Further to your notice of 3 September inviting views on the IFRS Exposure Draft ED/2010/9, we are grateful for this further opportunity to comment on the draft proposals for the reporting of lease contracts.

In particular, there is continuing concern throughout the global shipping industry about the lack of precision in the proposals with regard to the definition of leases. This could give rise to an interpretation that 'time charters' and other contracts governing *operational* arrangements utilised by international ship operating companies fall within the definition. Such arrangements, however, should not be treated as leases, and certainly not as financial leases for accounting purposes, since they are more in the nature of *transportation service contracts*. Furthermore, we do not believe that third parties' understanding of the true financial position of shipping companies will be greatly enhanced by requiring 'time charters' and similar contractual arrangement for transportation services, to appear on company balance sheets.

Accordingly, we have been asked to seek clarity in the rules on the definition of leases and to try and ensure that this will not extend to 'time charters', 'voyage contracts' and

similar arrangements used within international shipping.

The shipping industry is responsible for the movement of 90% of world trade and has developed long established business mechanisms to match supply and demand for the transport of goods and raw materials, in what are very cyclical and highly volatile markets. Included amongst these are 'time charters' and 'voyage charters' as described briefly below and in more detail in the Annex:

- A 'time charter', under which the services of a ship hired for a specified period of time for payment of a daily, monthly or an annual fee, with the charterer-in paying certain voyage costs as may be agreed, such as fuel and port dues. There are various types of time charterparty – see Annex.
- A 'voyage charter' whereby the charterer-out earns freight per tonne of cargo transported on its ship on terms set out in the voyage charterparty contract which specifies the precise nature and volume of the cargo, the port(s) of loading and discharge etc, with all costs being paid by the charterer-out.

In the case of a 'voyage charter' there is no control of the ship by the charterer-in. The charterer-out remains in possession of and operates the ship throughout the contract. A voyage charter should not therefore be considered as a lease since the transaction is essentially the same as booking space on a ship to transport cargo, except that the whole ship is usually utilised.

In the case of a 'trip time charter' (see Annex) the charterer-in has no more control over the vessel than with a 'voyage charter', the main difference being the way in which the charterer-out is remunerated. Such arrangements cannot, in our view, be considered as creating assets or liabilities which should appear on a balance sheet.

For 'period time charters' (see Annex) the charterer-in does have *some* control over the employment of the vessel (such as place of loading/unloading, and cargo carried) but does not have possession of the vessel and does not control its operation. The control/right to direct the use of the vessel is not unconditional. The crewing, maintenance and regulatory compliance remain with the charterer-out. Since the charterer-in does not have unconditional control of the vessel and the charterer-out retains responsibility for the crew, safety, and maintenance of the vessel, we again do not consider that these contractual arrangements - which are for transportation services - create assets or liabilities which should appear on a balance sheet.

Concern has also been expressed about the potential complexity and compliance burden of these proposed new standards, especially if large numbers of charter transactions were to be affected, and if the computations required a recalculation each year, and elements such as effective interest rates had to be calculated back to the beginning of the lease or charter (when the circumstances of the company may have been quite different and even under different ownership). Many ship operators, especially those who are solely charterers-in and have no other ship operating activity, would find such complexity extremely burdensome and expensive to satisfy.

Most importantly, one of the possible consequences of requiring contractual arrangements such as 'time charters' to be recorded on company balance sheets is that many companies could suddenly become in breach of existing covenants with their financing institutions. Such covenants, in relation to capital gearing for example, have been entered into on the basis of current accounting rules, and there can be no presumption that financing institutions will be able to revise or renegotiate contracts. However, such technical breaches of covenants could potentially trigger defaults with unpredictable consequences for individual companies, the shipping industry as a whole, and the smooth flow of international trade.

We respectfully request that the final rules are amended in order to clarify that 'time charters', 'voyage contracts' and other similar contractual arrangements for transportation services used by shipping companies need not be treated as leases to be recorded on company balance sheets.

In the event this recommendation is not accepted, we strongly suggest that it might be more appropriate for changes to the treatment of such arrangements to be applied prospectively only to future contracts.

If, as proposed - and we still hope this will not be the case - ship charters are indeed to be treated as leases, it is vital that accounting requirements for the lessor are aligned with these and are implemented at the same time. It is a characteristic of many shipping companies that they charter out the same ships that they have leased or chartered in, and any inconsistency would create unacceptable anomalies.

We hope that these comments have been helpful in explaining the special characteristics of the international shipping industry, and the need for clear and consistent accounting rules that take account of business practice while avoiding excessive compliance burdens. We remain ready to assist you in any way possible as you continue to develop your proposals.

Yours faithfully

Kiran Khosla
Director Legal Affairs

Annex

Operating charters used in international shipping

There are a variety of forms of charter, with documentation usually based on a series of internationally accepted standard terms, though subject to individual variation and varying lengths (from less than one day to 15 years or more). It may be helpful to summarise the key characteristics of the main types of charter relating to whole ships.

- **Time charter:** the vessel is hired for a specified period of time for payment of a daily, monthly or annual fee, to carry cargo to/from places as ordered by the charterer-in. The charterer-in pays voyage costs. There are two types:
 - **Period time charter:** the ship earns daily hire, paid monthly or semi-monthly in advance. The charterer-out retains possession and mans and operates ship under instructions as to its employment (such as place of loading/unloading and cargo to be carried, to whom bills of lading to be issued) from the charterer-in. The charterer-out remains responsible for safety, navigation, maintenance and regulatory compliance of the vessel. The charterer-in is responsible for fuel and port/voyage costs (such as port dues).
 - **Trip time charter:** fixed on a *time charter* basis for the period of a specific voyage and for the carriage of a specific cargo. The charterer-out earns 'hire' per day for the period determined by the voyage. The charterer-in is responsible for all voyage costs.
- **Voyage charter:** the ship earns freight per tonne of cargo transported on terms set out in the charterparty, which specifies the precise nature and volume of cargo, the port(s) of loading and discharge. All voyage costs are paid by the charterer-out.
- **Bareboat or demise charter:** the charterer-out of the ship contracts (for a fee, usually long term) to the charterer-in for its operation. The ship is then operated by the latter as if they owned it.

The period of the time charter is almost always flexible to allow for practical redelivery at the end of a voyage and in an agreed location, with the hire expressed as a daily rate for a period expressed as +/- days, weeks or months. The actual duration can only be determined when the chartered ship is redelivered. In practice a large proportion of all charters would fall into two or more accounting periods.

(It is recognised that for bareboat/demise charters, the charterer-in has effective control over the ship and, in many cases, the arrangement is similar to a finance lease.)