

24 April 2012

Mr Hans Hoogervorst
Chairman
The International Accounting Standards Board
30 Cannon Street
LONDON EC4M 6XH

Dear Mr Hoogervorst,

LEASES PROJECT – APRIL 2012 LESSEE OUTREACH

Further to our participation in the Lessee outreach session held in Melbourne, Australia on 23 April 2012, we have set out below our main observations as we presented at that session, relating to:

- In-substance purchases
- Our preferred approach for subsequent measurement of the right-of-use asset, and
- Foreign exchange volatility

Our comments focus on accounting for lessees only.

Air New Zealand ("Air NZ") is party to a significant number of lease arrangements for mainly aircraft and property. As such, we have a vested interest in ensuring we voice our opinion on the development of the new standard on leases. To date, we have participated in two lessee workshops in Melbourne, Australia, and previously met with Sir David Tweedie in Wellington, New Zealand in late 2010. As noted in our submission on the Leases Exposure Draft (comment letter #741), Air NZ supports the general principles within the original Exposure Draft for financial reporting of leases by lessees, of recognising assets and liabilities arising under leases in the Statement of Financial Position, although we do have significant concerns around the treatment of foreign exchange.

We have also supported most of the proposed developments subsequent to the original exposure draft, with a few exceptions. Our comments on those developments were submitted in a further letter to Sir David Tweedie dated 30 June 2011.

The issues raised in this letter are as follows:

In-substance purchases

Whilst the original exposure draft effectively scoped out existing finance lease arrangements where a bargain purchase option existed at the inception of the lease, the Boards tentatively decided at their 14 March 2011 meeting that guidance should not be provided within the Leases standard for distinguishing a lease from a purchase or sale of an underlying asset. At the same meeting, the Boards also tentatively decided that lease payments should include the exercise price of a bargain purchase option in the lessee's liability to make lease payments.

These tentative decisions brought existing finance leases containing a bargain purchase option back within the scope of the Leases standard. We have previously brought to the attention of the IASB the fact that some significant differences will arise in accounting for such finance leases when compared to existing

accounting treatment. We do not consider such differences to be appropriate – entities are generally indifferent as to whether they finance the outright purchase of an item of property, plant and equipment through secured debt or through a finance lease arrangement. The accounting treatment of the asset and liability arising under a purchase or a finance lease should therefore be the same. Finance leased assets are currently measured in the same way as purchased assets – where a part of the asset has a different useful economic life to that of the rest of the asset, that part is depreciated separately to the whole. Under Approaches A and C as presented at the outreach session, the right of use asset arising under a current finance type lease would be depreciated as a single asset, with no componentisation until such time as the purchase option was exercised.

This would result in a significantly different amortisation profile of the right of use asset than is the case for current accounting for both finance leased assets and owned assets, which are consumed under very similar pattern of benefits profiles.

Air NZ is of the opinion that paragraphs B9 and B10 of the original Exposure Draft should be reinstated in order that leases which are in-substance purchases are accounted for as for purchases.

Preferred approach to the subsequent measurement of the right of use asset

In the light of our comments above, and assuming that Approaches B and D would exclude in-substance purchases from their scope, Air NZ prefers Approach B for subsequent measurement of the right of use asset. In contrast to Approach D, Approach B allows for an element of financing where lease payments are not straight line over the term of the lease – Air NZ considers this more appropriate than applying a “blanket” straight line approach as would be the case with Approach D.

We note that under Approach B,

- a) The right of use asset is viewed as being a different type of asset to other non-financial assets, and
- b) The right of use asset and the lease liability are viewed as being inextricably linked throughout the term of the lease (and not just at commencement).

Foreign exchange

We disagree with the Boards' tentative decision at the joint Board meeting held on 31 May – 2 June 2011 that foreign exchange differences relating to the liability to make lease payments should be recognised in profit or loss, consistent with foreign exchange guidance in existing IFRSs and US GAAP.

As you are aware, reporting entities, within the airline and shipping industries in particular, would experience significant foreign exchange volatility as a result of this requirement. In respect of operating leases (as currently defined under IAS 17) this volatility arises through an accounting requirement rather than the creation of any additional economic exposure.

We note that under Approach B, the fact that the right of use asset and the lease liability are inextricably linked would require that when a foreign currency denominated lease liability is retranslated to the entity's functional currency each period, the right of use asset would also be retranslated each period. The resulting exchange movements on both the right of use asset and the lease liability would offset in the income statement.

We also note, that this would not apply to leases which have been scoped out as in-substance purchases, thus preserving the equality of treatment between purchased and finance leased assets/liabilities, but eliminating the foreign exchange volatility arising through an accounting anomaly on operating type leases.

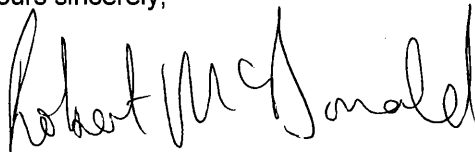
Our policy is to continue to make rational risk management decisions based on real economic exposures as opposed to achieving a particular accounting outcome. The fact that foreign exchange volatility would be recognised in the current period's earnings in respect of lease obligations which will not be incurred for many years to come and where the Group does not bear any of the residual risk relating to the leased asset, does not provide decision-useful information to users of the financial statements. Our preference is to instead

apply Approach B, and adjust the right of use asset for foreign exchange differences arising on retranslation of the foreign currency denominated liability to make lease payments, as they relate to future reporting periods. This more appropriately represents the underlying economics and would avoid users having to re-work the IFRS financial statements, which is clearly undesirable.

Whilst current operating lease obligations are taken into account in assessing hedge cover requirements, it would be impractical and excessively expensive to put cover in place on the term obligations when they are brought onto the statement of financial position.

If you have any queries or require further clarification of any matter contained in this letter, please contact either Katrina Meredith (katrina.meredith@airnz.co.nz) or Julie Vodanovich (julie.vodanovich@airnz.co.nz).

Yours sincerely,

A handwritten signature in black ink that reads "Robert McDonald". The signature is written in a cursive, flowing style.

Robert McDonald
Chief Financial Officer

cc Patrina Buchanan