



The Actuarial Profession
making financial sense of the future

Consultation response
IFRS Exposure Draft ED/2010/9 : Leases

December 2010

About the Actuarial Profession

The Institute and Faculty of Actuaries is the chartered professional body for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuous professional development and a professional code of conduct supports high standards, reflecting the significant role of the Profession in society.

Actuaries' training is founded on mathematical and statistical techniques used in insurance, pension fund management and investment and then builds the management skills associated with the application of these techniques. The training includes the derivation and application of 'mortality tables' used to assess probabilities of death or survival. It also includes the financial mathematics of interest and risk associated with different investment vehicles – from simple deposits through to complex stock market derivatives.

Actuaries provide commercial, financial and prudential advice on the management of a business' assets and liabilities, especially where long term management and planning are critical to the success of any business venture. A majority of actuaries work for insurance companies or pension funds – either as their direct employees or in firms which undertake work on a consultancy basis – but they also advise individuals and offer comment on social and public interest issues. Members of the profession have a statutory role in the supervision of pension funds and life insurance companies as well as a statutory role to provide actuarial opinions for managing agents at Lloyd's.

Sir David Tweedie
Chairman
International Accounting Standards Board
30 Cannon Street
London EC4M 6XH

22 December 2010

Dear Sir David,

IASB Exposure Draft *Leases*

Thank you for giving the Actuarial Profession the opportunity to comment on this Exposure Draft. We do so against the background of our response to the earlier Discussion Paper issued on this subject.

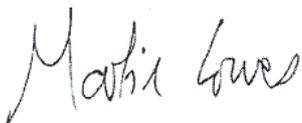
We very much support your overall aim of ensuring that leases are properly reflected on a firm's balance sheet. It is not for us to comment in detail on the proposed accounting model for achieving this. However, we do have a point of principle to make about how it is proposed to proceed, which we believe to be of some importance to the public interest.

All organisations are currently engaged in improving their management of risk and actuaries are much involved in their efforts to do so. Part of good risk management is adequate and appropriate reserving of capital. In this context (and as foreshadowed in our earlier response), we have significant reservations about the approach to the treatment of leases which the Exposure Draft proposes.

If implemented, the proposed model would result in an important distinction between the treatment of leases and of other long term obligations – notably of post-employment benefits as set out in IAS 19. In our submission the justification for this distinction has not been clearly and convincingly set out.

Our reasoning for this view is set out in the attached appendix. We should be very happy to explain our thinking further if you or your colleagues would find that helpful. Please do not hesitate to contact Margaret Watchorn, Pensions Practice Manager on 0207 632 2185, if you would find it useful to follow up our offer of a meeting. She can also be contacted via margaret.watchorn@actuaries.org.uk

Yours sincerely,



Martin Lowes
Chairman, Consultations Group, Pensions Practice Executive Committee

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IASB Exposure Draft Leases

Response by the Actuarial Profession: Appendix

We note that under current accounting standards, the performance statements incorporate a mix of approaches. Some items are marked to market through P&L; some are marked to market but through the statement of comprehensive income; and others – which for many companies are just as large and as volatile – are not marked to market at all. The impression is given to management and investors alike that those items which are marked to market are more risky than those which are not. This influences investor pressures on management, and impacts management behaviour both directly and in response to investor pressure. There is clear risk that decisions made are, as a result, sub-optimal.

In the Basis for Conclusions issued with the Exposure Draft relating to proposed amendments to IAS 19, the IASB state "it is not the responsibility of accounting standard-setters to encourage or discourage particular behaviour. Their responsibility is to set standards that result in the provision of relevant information that faithfully represents an entity's financial position, financial performance and cashflows so that users of that information can make well-informed decisions." We respectfully agree with this statement. However, if different measurement and recognition approaches are applied to economically similar commitments, then we ask:

- Whether different approaches which give very different answers can all faithfully represent arrangements which are economically similar just with different labels depending on how they arise;
- Whether the effect is that the IASB is positively encouraging users to treat some arrangements as more onerous than others which are economically similar, in contradiction of the IASB's own view of its objectives.

The obligation to pay rentals under a lease arrangement is economically the same as the obligation to pay a portfolio of pensions to former employees. The longer dated the lease, the more clear that economic comparison is. The dependence of pension obligations on longevity complicates the calculations, but does not change the economic fundamentals.

The differences between the proposed approach for leases and the current approach for pensions on initial measurement are limited, although we do not understand why the measurement basis for leases is described as being different from fair value rather than as e.g. a pragmatic way to estimate fair value.

However, the proposal that subsequent measurement of leases be on an amortised cost basis is inconsistent with that for pensions. The arguments in favour and against subsequent measurement of lease rental obligations at fair value seem to be the same as those that would apply in respect of

pension obligations. We could not identify any clear arguments from the paper that would justify a difference in approach.

As noted above, a difference in measurement approach between economically similar obligations that have different labels attached to them has real world consequences, and could lead to suboptimal management decisions.

So we have the following further questions:

1. BC 74 argues that it would be inappropriate to measure the liability to make lease payments at fair value because this would be inconsistent with the treatment of non-financial assets. As the liability is a financial liability (as acknowledged in BC 75), this seems in our view, irrelevant. Could a more relevant comparison be with that of other financial liabilities, notwithstanding that the liability is linked to a right-of-use asset?
2. Why are some (not all) financial assets measured at fair value, but non-financial assets are not.
3. Clearly, the cost of a new lease for an aircraft changes significantly from one year to the next. Is there any reason why this should not be reflected in the subsequent measurement of existing aircraft leases – and providing this information would be as decision-useful for investors as providing updated fair value information in respect of financial assets.

Assuming that there is substance in the points we question above, we are concerned that a failure to treat leases similarly to other long term obligations could create confusion; cause capital to be allocated inefficiently; lead to decisions which are in part distorted by the difference between the accounting standard and economic fundamentals; and thus expose companies to unnecessary and wasteful risk.

If the IASB believes that the distinction between the subsequent measurement of financial and non-financial assets should remain, it will be helpful to users of accounts and allow them to make their own judgements if the Board will clearly set out its reasoning for taking this view. In our opinion, the paper relies on the circular argument that the current accounting is how it has always been done and we question whether this is an adequate basis on which to proceed.