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International Accounting Standards Board
30 Cannon Street
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Dear Sirs

EXPOSURE DRAFT ED/2010/9 LEASES

I am writing in response to your request for comments on the draft standard.

I am a UK chartered accountant who has been a partner in PriceWaterhouseCoopers and Ernst & Young as well as having served as the Chief Financial Officer of a number of companies. I am currently chairman of the audit committee of Next plc, a UK based FTSE 100 retailer.

Distinguishing between property and other leases

I will restrict my comments to accounting for property leases as I believe that they are fundamentally different from leases of other items such as plant and machinery. The latter are primarily pure financing agreements which in most instances are an alternative method of financing the purchase of the asset.

I have no problem with the proposed treatment of non-property leases and the vast majority of these are already incorporated on company balance sheets in accordance with the proposed standard.

However, I believe that the proposals for capitalising property leases are fundamentally flawed. Property leases are different from financing leases for many reasons:

- Landlords do not determine the rental for a property using the same criteria as finance houses do for other leases. Landlords endeavour to achieve the best rentals, with upward only rent reviews in many instances, in order to achieve long term capital growth.
- In many territories and in many UK developments, it is simply not possible for a tenant to acquire a freehold interest. The fact that a property is leased does not mean that it is entered into for financing purposes but through force of circumstance. An example would be a store in a shopping mall. By entering into a lease, the business is not attempting to keep liabilities off balance sheet but simply doing business in the only way possible.
- In the vast majority of instances, the life of a property lease will be significantly shorter than the economic life of the property.

- Leasing property actually saves substantial transaction costs such as taxes.

The impact of the proposed standard

It is my view that the proposed treatment of property leases will further complicate financial statements and lead to confusion and misunderstanding among users of accounts.

I strongly contend that the current standards provide sufficient and easily understood information to enable the reader to comprehend and, if desired, adjust the financial statements to reflect alternative scenarios. The Boards make the assumption that current standards do not meet users requirements but, in my opinion, that view is not widely held.

If the proposals are implemented, in the case of Next plc, the impact would be to add some £2 billion (undiscounted) of indeterminable assets and the same amount of arbitrarily calculated liabilities which are to be treated as debt. These amounts are so large (more than three times the size of any other balance sheet item) and so subjective relative to the rest of our balance sheet as to make the balance sheet meaningless.

The balance sheet liability would be calculated at an arbitrary date with a discount factor that would then be frozen. This cannot make for a meaningful number. Comparison between companies and countries would be hindered, not helped.

Our net profit should be unchanged over time but our profit before amortisation could rise by some £200 million or 40%, offset by a notional interest charge. The EBITDA measure will become much less meaningful as it will now exclude what are annual cash payments.

Similarly, our cash flow statement will somehow show significantly higher cash generated from operations with much of the increase going out as debt repayment – which I contend it is not.

It is my belief that users of financial statements will actually adjust out the proposed changes and focus on the figures currently produced rather than the other way round.

Providing sufficient information for users; an alternative

If the current proposals were to be abandoned, it would be quite simple to provide sufficient information for users to make whatever decisions they believe appropriate. Details of future rentals – gross and/or discounted – could be provided in a note together with current year rentals. This could be done at minimal effort and expense.

Other comments

The proposed standard would require substantial investment in order to prepare the required data but it is my view that there is no discernible benefit from incurring such costs. Preparers of accounts are already burdened enough with the preparation of meaningful data. In addition, tax returns in the UK would require substantial adjustment in order to come to a taxable profit. Have the majority of users of accounts really complained about current practice? I think not.

You request comment on various issues but make the presumption that the underlying principle – that all leases should be capitalised – is accepted. It is not. Whether contingent or other indeterminate variables should be incorporated is actually irrelevant if one does not slavishly accept the over-riding principle. Based on the Boards arguments, service charges or even employee contracts should come on to the balance sheet? It is intriguing that the Boards cannot come up with a suitable basis of accounting for lessors to mirror the proposals for lessees – because, I would suggest, property lessors still believe that they own their assets.

Regretfully, I can envisage that it is only a matter of time before companies start producing two sets of accounts – one to comply with IFRS, the other to be meaningful.

The opinions expressed in this letter are my own and you should not construe that they are biased because Next plc has significant property obligations. I am writing because, as a chartered accountant of over 30 years standing, I believe that the proposals for leased property are fundamentally flawed. They will make accounts significantly less comprehensible and create misunderstanding.

Yours faithfully

SD Barber