The Actuarial Profession
making financial sense of the future

discussion paper response

International Accounting Standards Board

IASB Discussion Paper - Leases Preliminary Views

July 2009

About The Actuarial Profession

The Actuarial Profession is governed jointly by the Faculty of Actuaries in Edinburgh and the Institute of Actuaries in London, the two professional bodies for actuaries in the United Kingdom. A rigorous examination system is supported by a programme of continuing 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's 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 advise 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.

The Profession also has an obligation to serve the public interest and one method by which it seeks to do so is by making informed contributions to debates on matters of public interest.

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www.iasb.org

17 July 2009

Dear Sir/Madam

IASB Discussion Paper *Leases Preliminary Views*

Thank you for offering The Actuarial Profession the opportunity to comment on this Discussion Paper.

We do not comment in detail on the proposals for an accounting model for leases. Instead, we draw attention to the high level differences between the proposed model and the current model (and recent consultations and thinking on a new model) for post-employment benefits – in particular pensions – set out in IAS 19. We do not see a justification for the differences and ask if it is the intent of the IASB to align the high level principles in a later more fundamental review?

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.

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 are the same as those that

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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 leads to sub-optimal management decisions.

The paper argues that measurement of the right to use an asset at fair value would not be appropriate because other non-financial assets are not measured at fair value. This is true, but merely shifts the question to why some (not all) financial assets are measured at fair value, but non-financial assets are not. Would the IASB agree that a fall in the value of non-financial assets is as significant to the value of the company (and therefore investors) as is the same fall in the value of financial assets?

Clearly, the cost of a new lease for an aircraft would cost less now than a couple of years ago. There is no 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.

If the IASB believes that the distinction between the subsequent measurement of financial and non-financial assets should remain, its reasoning will be helpful to users of accounts and allow them to make their own judgements. In our opinion, the paper relies on the circular argument that the current accounting is how it has always been done.

If you have any questions or would like to discuss any of these matters further, please do not hesitate to contact us. Should you wish to do so, please contact Martin Hewitt, Pensions Practice Manager on 0207 632 2185 or via martin.hewitt@actuaries.org.uk.

Yours sincerely,

Robert Hails
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Please reply to Staple Inn

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