



August 15, 2013

International Accounting Standards Board
30 Cannon Street
London EC4M 6 XH
United Kingdom

Technical Director
File Reference No. 2013-270
Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856
United States

Dear Board Members,

Flowserve Corporation has reviewed the Exposure Draft of the revision of the 2010 Proposed Accounting Standards Update (the "Exposure Draft") issued by the IASB and the FASB ("the Boards") on May 16, 2013. We appreciate the opportunity to comment, and we present our comments from our perspective as a financial statement preparer and lessee of a significant volume of mostly individually insignificant assets.

Flowserve is a manufacturer and aftermarket service provider of flow control systems that are used to support global infrastructure industries, including oil and gas, chemical, power generation, water management, and general industrial markets. We are a highly-decentralized company, and leasing is not a primary aspect of our business model. We have more than 150 sites in more than 50 countries and over 65% of our business is conducted by non-U.S. sites. We utilize approximately 30 ERP systems globally and do not maintain a single, centralized system to account for our leases on a global basis.

We estimate that we lease over 3,600 assets. To prepare for the proposed changes to lease accounting standards, we have initiated a project to collect our decentralized lease data and estimate the impact of the proposed changes on Flowserve's consolidated financial statements. To date, we have collected detailed information on over 80% of our total leased assets. Our lease portfolio consists primarily of leases for vehicles and office equipment (mostly printers and copiers) and to a lesser extent, industrial machinery and real estate. Local site accounting personnel negotiate, execute, account for and report the majority of our leases. We present our comments based on this data.

GENERAL COMMENTS

Overall, we concur with the concept of recognizing leased assets on the balance sheet. However, we are concerned about the level of effort it will take to navigate the judgments and considerations necessary to calculate the amount that must be recorded, as well as the effort required to subsequently re-assess such judgments. For an organization such as ours, where leasing is not a financing activity, but primarily a matter of convenience (or viewed as a service), this effort is unlikely to be viewed as a value-added activity by our senior operational management.

We believe that parts of the proposed standard are overly complex, including the initial measurement of the right of use asset and related liability, which the questions in the proposed standard do not address. We are concerned that treating components of the agreement differently for measurement of the initial right of use asset and the related initial lease liability creates significant opportunity for error or misapplication.

QUESTION 1: Identifying a Lease

We request additional clarity on the matter of a supplier's substantive right to substitute an asset.

We agree with the definition of a lease and the proposed requirements for how an entity would determine whether or not a contract contains a lease. We also think that the exceptions make sense, conceptually. However, we believe that more clarity is needed concerning a supplier's substantive right to substitute the asset. Specifically, when considering the existence of potential barriers to substitution, we would like to see the word "significant" added to the phrase "no barriers (economic or otherwise)" to clarify that the existence of insignificant barriers (e.g., administrative costs incurred to substitute the asset, geographic distance between the lessor and the leased asset's location, costs of personnel deployed to perform the substitution, etc.) would not preclude the existence of the substantive right to substitute. It seems clear from the example provided in 842-10-15-6 (b) (1) that the intention is not to create an insurmountable threshold for this issue, but we are concerned that the phrase "no barriers" indicates zero tolerance.

We request that the Boards consider adding more widely relevant examples to the standard, specifically to 842-10-55-6, to illustrate how an entity determines whether a contract is, or contains, a lease.

We feel strongly that certain high volume, low value assets (e.g., copiers, printers, ordinary vehicles, etc.) that issuers use for administrative, rather than operational purposes, should be excluded from this standard. In our assessment of our lease agreements, we learned that leased vehicles constitute 60% of the total number of leases, but only 27% of annual lease expense. Similarly, printers and copiers constitute 26% of the total number of leases, but only 6% of annual lease expense. We lease these types of administrative use assets as a matter of convenience; to account for them under the proposed requirements would require a level of effort that significantly outweighs the usefulness of the information.

We believe that the standard already contains some applicable exceptions in the definition of a lease. The type of leased asset on which we focused for exclusion may not meet the definition of a lease if the intended use of the asset is such that the substantive right to substitute exists.

We also have assets that may not meet the definition of a lease if the lessee does not have the right to derive benefits from the use of the asset because the lease of that asset is incidental to the delivery of services. We believe more relevant examples of these types of exceptions that financial statement preparers can use as a benchmark would be beneficial.

We found Example 2 of the coffee machine and services very helpful in terms of applying the exception of a leased asset that is incidental to services. However, the other examples of exceptions are less widely applicable for lessees. We think that an example of lease accounting for administrative office equipment (printers or copiers) or for general use vehicles would be helpful in creating clarity and consistency in practice.

QUESTION 2: Lease Accounting

We request that the non-public company exception to using the incremental borrowing rate for measuring lease value be extended or that an example be added to further clarify the Boards' expectations.

We agree with the recognition of right of use assets and related liabilities on the balance sheet. We understand the measurement guidance and our only comment related to measurement is in regards to the interest rate used in the measurement. The definition of incremental borrowing rate in the Exposure Draft is clear. However, we are a global company, and our sites locally negotiate, execute, account for and report the majority of our lease agreements. In most cases, these sites do not have an established line of credit and fund capital expenditures through local or regional cash flows. As a result, an "incremental borrowing rate" by the definition in the Exposure Draft is not readily available for these entities. We anticipate that, similar to the Board's findings for non-public companies, the exercise of calculating an incremental borrowing rate for every individual leased asset will quickly become unmanageable due to the endless combinations of relevant factors (e.g., country, lease term, commencement date, and level of investment).

We acknowledge that the issue is not new as an incremental borrowing rate is used under ASC 840 to determine lease classification of operating versus capital. However, we believe that the impact of the incremental borrowing rate is greatly increased by the requirements in the Exposure Draft. Under ASC 840 we could use a broad estimate, corroborate the outcome of that 90% test using our parent company incremental borrowing rate and perform a sensitivity analysis to further support the test's outcome. Under the proposed standard the incremental borrowing rate that we use for each individual asset directly impacts the balance sheet. Additionally, under the existing guidance this rate is only required to be assessed at lease commencement. The proposed requirement to re-assess when and if certain factors change (lease term, existence of economic incentive or referenced interest rate, if applicable) in ASC 842-20-35-6 and 35-7 increases the burden.

We have considered and are unsure of whether our non-U.S. subsidiary lessees would qualify for the exception discussed in ASC 842-10-65-1, as the lessee in these cases is a non-public company, although the ultimate legal parent is public. We believe that the use of our public parent's incremental borrowing rate for all leased assets is inappropriate because it does not reflect the cost of country specific factors or location specific factors. Please provide a practical expedient for determining the incremental borrowing rate for non-public subsidiaries of public companies.

We request that the Boards consider simplifying the income statement and cash flow presentation of expenditures resulting from leased assets.

We believe that the classification of lease-related expenditures in three separate lines on the income statement and two separate categories on the cash flow statement is overly complex. We anticipate that this will require significant effort to train accounting personnel, re-work financial reporting systems and analyze the period over period impact of this change. Moreover, we do not believe that this will result in an overall improvement in the quality of the financial statements. We propose that the Boards simplify the presentation in the financial statements to a single line item.

QUESTION 4: Classification of Leases

We request additional clarity/examples on the matter of assessing the economic life of an asset for lease classification purposes, as well as adequate time to assess the economic life of all assets prior to the effective date.

In general, we understand the purpose and the application of the classification of type A and type B leases and do not disagree with the concept. However, the specific wording used in the Exposure Draft is difficult to interpret and difficult to implement, especially in a decentralized organization like ours. We believe that the classification issue, as presented in the Exposure Draft, may result in significant diversity in practice among lessees.

As the term “economic life” is newly defined in the proposed guidance, our first question is whether this new term is meant to be consistent with our standard “useful life” or “depreciable life” that we currently use for calculating straight-line depreciation of our capitalized assets. If so, we request that the relationship be explicitly clarified. If not, we anticipate that estimating the total economic life of every leased asset, as well as the remaining portion of that economic life, will take substantial time and effort. We acknowledge that estimation of the economic life of a leased asset is a current requirement under ASC 840. However, under current guidance we are able to use Flowserve’s established standard depreciable lives as a proxy for economic life. If an asset’s economic life is longer than its depreciable life (e.g., buildings in Europe), it has no impact on our lease classification test under ASC 840 because most of our leases are operating leases. However, because the economic life determines the income statement presentation under the proposed guidance, it will impact our financial statements.

Further, we are unclear about the exception criteria in paragraphs 842-10-25-6 and 25-7. Please consider providing additional guidance and/or examples of what constitutes a “major part” and an “insignificant part” of life, and “substantially all” and “insignificant part” of fair value, as described in the exceptions to the general lease classifications by asset type. Again, we expect that a significant diversity in interpretation and practice will result, with no real improvement in the quality of financial information. We have begun socializing some of these concepts and terms with our site personnel, and their immediate response is to request clarification of the terms. Despite the proposed literature’s allowance of “judgment”, in order to promote consistency across our de-centralized organization, we will likely require our sites to comply with centrally-set “bright lines” that we determine are acceptable within the parameters described by the guidance.

QUESTION 5: Lease Term

We do not believe that the “significant economic incentive” to exercise a lease option should be the single determining factor of the term and payment schedule.

In many cases, we believe that the decision to exercise a termination option, purchase option, renewal option, etc. may be made despite the lack of significant economic incentive. We believe that the inclusion/exclusion of the impact of lease options should be based on an assessment of **both**: 1) the intentions of the lessee; and 2) the existence or non-existence of a significant economic incentive. If the lessee **either** intends to exercise the option **or** has significant economic incentive to do so, only then should the lease term and payments include the impact of those options.

QUESTION 7: Transition

We request that the Boards allow adequate time for transition when determining the effective date of the standard.

Overall, we believe that the two proposed transition approaches are reasonable and our only additional request is that the Boards allow adequate time for transition when determining the effective date for this proposed standard. Flowserve is a global company, and we negotiate, execute, account for and report most leases at the local site level. The accounting personnel at our sites are fully utilized in day-to-day operational accounting and will need to be allotted extra time to learn and implement new procedures to comply with the proposed regulations. Training our personnel on the technical accounting of the proposed lease standards will be a significant investment of time and resources, since this standard will affect how they negotiate leases, initially recognize leases, monitor leased assets, account for leased assets and approach changes in business circumstances that could impact the recorded lease and related disclosures.

Additionally, we are unaware of any fully developed ERP solutions at this point. We request that the Boards consider the time it will take for those market solutions to become available and the time it will take for companies to analyze the options, select a provider and implement the solution.

Thank you for your consideration of our comments. Please do not hesitate to contact us for additional detail.

Sincerely,

A handwritten signature in blue ink, appearing to read 'M. S. Taff', with a stylized flourish at the end.

Michael S. Taff,
Senior Vice President, Chief Financial Officer