55 Water Street
New York, NY 10041
212-438-2000 Tel
212-438-5075 Fax

STANDARD & POOR'S RATINGS SERVICES
McGRAW HILL FINANCIAL

September 16, 2013

Financial Accounting Standards Board
Technical Director
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Via Electronic Submission: director@fasb.org, File Reference No. 2013-270

Re: Proposed Accounting Standards Update (Revised) – Leases (Topic 842)

Dear Sir/Madam:

Standard & Poor's Ratings Services appreciates the opportunity to provide the Financial Accounting Standards Board (FASB) our comments on its "Proposed Accounting Standards Update (Revised) – *Leases (Topic 842)*" (Proposed ASU).

The views expressed in this letter represent those of Standard & Poor's Ratings Services and do not address, nor do we intend them to address, the views of any other affiliate or division of Standard & Poor's Financial Services, LLC or of its parent, McGraw Hill Financial, Inc. We intend our comments to address the analytical needs and expectations of our credit analysts.[1]

General

Given the importance of leasing as a source of business financing and the extensive use of leases by many of the companies we rate, we have a longstanding view that the use of leases can meaningfully alter the financial and liquidity characteristics of an issuer. In our view, the accounting distinction between operating leases (reflected in the financial statements on a pay-as-you go basis) and capital leases (accounted for in a manner similar to a debt-financed acquisition of an asset) is substantially artificial. In both cases, the lessee contracts for the use of an asset from a lessor, entering into a debt-like obligation to make periodic rental payments. Understanding an issuer's leasing activities is important to our credit analysis. As such, we continue to support the FASB's and International Accounting Standards Board's (IASB) coordinated effort to address what we believe are certain shortcomings of the existing accounting models for lessees (e.g., off-balance sheet treatment for operating leases, rules-based nature, ability to structure around bright line tests, and overall complexity of existing standards) and the related disclosures. However, we believe the proposed changes to lessor accounting may hinder the usefulness of entities' financial statements, and so do not support change in this area.

[1] The opinions stated herein are intended to represent Standard & Poor's Ratings Services' views. Our current ratings criteria are not affected by our comments on the Proposed ASU.

While we applaud the Boards' efforts in many respects, we believe there are significant shortcomings in the Proposed ASU.

Key highlights of our letter include:

- We support removing the accounting distinction between operating and finance leases and recording lease obligations on the balance sheet of lessees. In our view, under both leasing activities, the lessee contracts for the use of an asset and enters into a financing arrangement. We view this proposed change as a significant improvement in lease accounting. However, we are concerned about the incomplete balance sheet measurement that will be caused by the exclusion of short-term leases, certain renewal options, and certain variable lease payments. In this regard, we believe the Proposed ASU potentially creates structuring opportunities and could result in significant understatement of the economic assets and liabilities under leases.

- We believe no single amount can provide a complete picture of the complexities associated with leasing arrangements; therefore, balance-sheet recognition should be accompanied by a comprehensive disclosure package that provides a range of possible cash outflows related to all leases (short- and long-term aggregated by major lease type), taking into account management's expectations for renewal options and variable lease payments.

- We do not support drawing any distinctions between different leases from a lessee perspective; neither based on the nature of the underlying asset nor based on the degree of consumption. This creates a divergence in the income and cash flow statements (i.e., for purposes of day-two accounting), which we believe is unnecessarily complex and not decision-useful to our analysis.

- We would prefer a single lease accounting model for lessees, as was set out in the 2010 Proposed Accounting Standards Update, Leases (Topic 840), and essentially akin to the current proposals for Type A leases.

- We do not agree with the lessor accounting in the Proposed ASU. In our view, the proposed changes to lessor accounting could create artificial volatility in the income statement and a disconnect between income recognition and cash receipt, likely impairing the income statement's analytical usefulness.

Lessee Accounting

We generally agree with the right-of-use model for lessees presented in the Proposed ASU, although we are concerned about the measurement of the lease liability and related asset. We have long viewed the accounting distinction between operating and finance leases as substantially artificial because, in both cases, the lessee contracts for the use of an asset, entering into a debt-like obligation. As a result, we adjust reported amounts to eliminate the operating or finance lease distinction by capitalizing lease obligations accounted for as operating leases by corporate issuers. We principally adjust by capitalizing the net present value of disclosed future minimum lease payment commitments and by adjusting profitability and cash-flow measures used in our analysis to reflect our view of the financing nature of this activity. (For further details on our adjustments for operating leases, see "**2008 Corporate Criteria: Ratios And Adjustments**," published April 15, 2008 on RatingsDirect.)

We believe the model in the Proposed ASU could potentially capture the economics of our operating-lease balance sheet adjustment methodology. However, we believe all short-term leases should be included within the scope of the Proposed ASU. We also believe all variable-lease payments should be eligible for inclusion in the initial and subsequent measurement of the lease obligation, including usage or performance-based payments. Further, we believe renewal options should be included in the measurement of the liability using the "most likely" scenario (i.e., the lease term would be the longest possible term that is more likely than not to occur). In our view, not applying the model in this manner could result in significant understatement of the economic assets and liabilities under leases.

We are also concerned about the proposed approach to income statement attribution and cash flow classification for Type B leases, which is inconsistent with our current analytical approach and which we believe is inconsistent with the Boards' own proposed approach to balance sheet recognition. For lessees, we recommend a single approach to income statement attribution and cash flow classification, similar to the proposed Type A lease approach. We believe this is consistent with the balance-sheet recognition as a long-term accreting liability, providing a better economic depiction of the leasing transaction and reducing analytical complexity than the current proposal.

Lessor Accounting
From the lessor's perspective, we generally have supported the accounting as presented in financial statements, believing that it reasonably represents the economics from the perspective of a seller, and choosing not to make analytical adjustments to the financial statements of lessors. We often subscribe to the operating lease model for lessors, which usually results in more analytically relevant revenue amounts, often tracking closely with the pattern of cash receipt. While we believe the proposals as they relate to lessee accounting potentially would be additive to our analysis, the proposed changes to lessor accounting could actually hinder the usefulness of these entities' financial statements. We therefore urge the Boards to reconsider their proposals in this area (detailed in the appendix).

Provide Comprehensive Disclosures
In general, we support the proposals for lessee disclosures in the Proposed ASU, but believe additional disclosures are necessary to provide users a complete picture of companies' leasing activities. The final standard should require disclosures of the range of possible cash outflow scenarios (aggregated by major lease type), because lease transactions could be structured in innumerable ways with various contingent features. These possible scenarios should be treated similarly to other contingencies, and take into account expected option renewals and variable lease payments. This would provide financial-statement users with greater insight about the extent to which cash flows could meaningfully change. Additionally, clear disclosure around the location and amounts reported in the income statement and statement of cash flows would better enable analytical adjustment.

Robust disclosure of leasing activities is especially important given the disparate views of users. Regardless of the decisions reached around recognition and measurement from the lessee and lessor perspectives, disclosures need to be sufficient to allow users to take different analytical approaches to what is presented in the primary financial statements. While the proposed disclosures for lessees, coupled with our recommendations, will largely be sufficient to accommodate users in this regard, we believe the proposed lessor disclosures would not be sufficient to allow users to take an alternative view to that which is presented.

Optionality
Our credit ratings are relative and our approach to financial statement analysis is comparative. The comparability of financial information between issuers is critical to facilitating this analysis. To the extent practicable, we make analytical adjustments to achieve comparability when accounting regimes allow for multiple approaches to accounting for the same transaction.

Unfortunately, the Proposed ASU contains a number of areas that allow for policy elections to be made by issuers, including the optional treatment of short-term leases; the option of nonpublic entities to use the risk-free rate in measuring their lease liability; the option of nonpublic entities to exclude the liability balance reconciliation disclosure; and the option to elect one of two transition methods and the optionality buried within those methods. We urge the Boards to avoid permitting these and any other policy elections and instead mandate a single approach.

We provided more details to certain of your specific questions in the appendix.

* * * * *

We thank you for the opportunity to provide our comments, and we would be pleased to discuss our views with members of the FASB or your staff. If you have any questions or require additional information, please contact the undersigned.

Very truly yours,

Joyce Joseph
Managing Director, Corporate Ratings
Global Head of Accounting and Governance
Standard & Poor's
joyce.joseph@standardandpoors.com
(212) 438-1217

Sam Holland
Director, Corporate Ratings
Standard & Poor's
sam.holland@standardandpoors.com
+44 (0) 20 7176 3779

Mark Solak
Director, Corporate Ratings
Standard & Poor's
mark.solak@standardandpoors.com
(212) 438-7692

Appendix - Responses To Specific Questions In The Proposed ASU

Question 1: Identifying a Lease
Do you agree with the definition of a lease and the proposed requirements in paragraphs 842-10-15-2 through 15-16 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

We approve of the Boards' efforts to develop converged principles around what constitutes a lease. However, as a user of financial information, we find it difficult to conceptualize how these proposed principles will change which contracts currently are treated as leases. We generally accept current practice and do not desire a significant change in which contracts are accounted for as leases. In finalizing the principles, we urge the Boards to provide clear guidance to ensure consistent application across companies and sectors.

One concern we have is that, certain leases of assets that would otherwise meet the definition of a lease are exempt from the provisions of the Proposed ASU, including leases of intangible assets, leases to explore for or use minerals, oil, natural gas, and similar nonregenerative resources, leases of biological assets, and perhaps other arrangements such as service concession arrangements. Because we rate companies globally, comparability of financial reporting is critical to our analysis and achieving convergence in these areas is desirable. We therefore encourage the Boards to ensure that, regardless of the accounting regime under which a company reports, similar arrangements are accounted for consistently, whether accounted for as leases or otherwise.

Question 2: Lessee Accounting
Do you agree that the recognition, measurement, and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

We do not agree that the recognition, measurement, and presentation of expenses and cash flows arising from a lease should vary for different leases. For lessee accounting, we view all leases as a form of financing, and believe there should be symmetrical treatment in the primary statements, i.e., the balance sheet, income statement, and statement of cash flows should present leases as financing transactions.

The Proposed ASU sets out an asymmetrical approach to so-called Type B leases between the balance sheet and income statement: We do not agree with this approach. The model for Type B leases, with a straight-line rent expense in the income statement, prioritizes income statement attribution over balance sheet measurement and the resulting income statement recognition, which in our view is atypical accounting. The straight-line rent expense also has the counterintuitive consequence that the right of use assets for Type B leases would be amortized in a decelerated manner, contrary to the typical economics of asset consumption.

We would prefer a single lease accounting model for lessees, as was set out in the initial Leases Exposure Draft, and essentially akin to the current proposals for Type A leases.

Question 3: Lessor Accounting
Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

We do not agree with the proposal and are, in fact, broadly in favor of retaining the bulk of the current model for lessor accounting. We recognize this takes an asymmetrical view toward leasing relative to our stance on lessee accounting; however, we believe it is more important to arrive at an analytically relevant approach than to unnecessarily adhere to symmetry between parties to a transaction. We also believe current operating lease accounting from the lessor's standpoint would generally be consistent with the pattern of revenue recognition for lessors if accounted for as performance obligations satisfied over time under the Proposed Accounting Standards Update (Revised), Revenue Recognition (Topic 605): Revenue from Contracts with Customers.

In our view, the current accounting model generally sufficiently depicts the economics of lease arrangements from the lessor's perspective. We are not in favor of liberally imputing interest on sales transactions. Most importantly, we find that current operating lease accounting from the lessor's perspective often provides the most decision useful information for our analysis, as the revenues recognized typically closely track the pattern of cash receipts. The proposed changes to lessor accounting could create artificial volatility in the income statement and result in amounts that are not economically representative of the transaction, which likely would impair the income statement's analytical usefulness.

Question 4: Classification of Leases
Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 842-10-25-5 through 25-8, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

As noted above, we do not wish to draw any distinction between different leases from a lessee perspective; neither based on the nature of the underlying asset nor based on the degree of consumption. Indeed, from the lessee's perspective, we believe that a long-term lease of real estate has a financing element to it. The lessee gains access to an asset that they would otherwise have to purchase and finance.

That said, if these lines are retained, we ask the Boards to clarify the definitions of "insignificant" and "major" in this context to help ensure consistent application by issuers.

From a lessor perspective, we believe there are situations where a dual model makes sense: essentially similar to the current one. We believe such a model should consider degree of consumption (as the current model does); however, we do not see the need to differentiate the thresholds based on the nature of the leased asset.

Question 5: Lease Term

Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

We agree with the inclusion of certain lease renewal periods in determining the lease term, but believe the originally proposed approach in the 2010 Proposed Accounting Standards Update, Leases (Topic 840) of using the "most likely" scenario (i.e., the lease term would be the longest possible term that is more likely than not to occur) is a better approach than including only those renewal option periods where there is a "significant economic incentive" to exercise. The Basis for Conclusions in the Proposed ASU says the Boards concluded that requiring an economic incentive provides a threshold that can be applied more easily because it is more objective than a threshold based solely on management's estimates or intent. Because management's intent is likely to be influenced by contractual and noncontractual factors and financial and nonfinancial factors, we believe it should be considered in determining the lease term. We believe management's intent is a very strong aspect to consider when determining lease terms based on the planned purpose and use of the leased asset. Entities could demonstrate intent through budgets and forecasts, and deviations from budgets and forecasts, and by conveying the business need for the asset beyond the initial lease term. Consistent with our aforementioned comments about a comprehensive lease disclosure package, a final standard should mandate disclosures of the factors and basis for the decision by management in arriving at the most likely lease term.

We agree with the need for companies to reassess their conclusions around lease terms when circumstances indicate a lease term needs modifying to reflect a plausible change in relevant factors. Disallowing reassessment of the lease term may cause the financial statements to not fully reflect the economic substance of the company's lease activities which, on occasion, may change, for example, because of certain new financial or business risk exposures or strategy. Accordingly, while we support the requirement to reassess, we recommend the Boards require companies provide disclosures about the circumstances that cause the change in lease terms and the impact on lease assets, liabilities, earnings, and cash flows.

Question 6: Variable Lease Payments

Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

We believe all variable lease payments should be eligible for inclusion in the initial and subsequent measurement of the lease obligation, including usage or performance-based payments. Exclusion of these amounts could result in significant understatement of the economic assets and liabilities under leases. Excluding such variable payments seems to be inconsistent with the Proposed Accounting Standards Update (Revised), Revenue Recognition (Topic 605): Revenue from Contracts with Customers, whereby variable consideration is to be included in the transaction price.

If certain variable lease payments are not included in the measurement of the lease obligation, at a minimum, we believe management should disclose the range of possible outcomes and the probability of contingent rental payments on existing leases.

In the event the final standard includes lessor accounting as proposed, we believe the inclusion of variable lease payments in the measurement should be consistent with the treatment of variable consideration under the Proposed Accounting Standards Update (Revised), Revenue Recognition (Topic 605): Revenue from Contracts with Customers.

Question 7: Transition

Subparagraphs 842-10-65-1(b) through (h) and (k) through (y) state that a lessee and a lessor would recognize and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why?

Are there any additional transition issues the Boards should consider? If yes, what are they and why?

Although we favor the full retrospective approach and appreciate the Boards' intentions to accommodate users in this regard, we understand the difficulties in application. The Basis for Conclusions says "the Boards did not wish to prohibit entities from applying a full retrospective approach because that approach would provide better information to users of financial statements than other approaches". In our view, this approach would undoubtedly provide better information for any given entity; however, information comparability degrades by allowing multiple adoption approaches. Therefore, we strongly favor allowing only a single, mandated approach to adoption.

If the modified retrospective approach is that single approach, we propose one modification: that existing capital leases should be reassessed in the same way as proposed for existing operating leases. Not requiring reassessment allows legacy accounting to linger for years, resulting in ongoing incomparability.

Question 8: Disclosure

Paragraphs 842-10-50-1, 842-20-50-1 through 50-10, and 842-30-50-1 through 50-13 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments, reconciliations of amounts recognized in the statement of financial position, and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

In general, we support the proposals for lessee disclosures in the Proposed ASU, but believe additional disclosures are necessary to give users a complete picture of companies' leasing activities. The final standard should require disclosures of the range of possible cash outflow scenarios (aggregated by major lease type), because lease transactions could be structured in innumerable ways with various contingent features. These possible scenarios should be treated similarly to other contingencies, and take into account expected option renewals and variable lease payments. This would provide financial-statement users with greater insight about the extent to which cash flows could meaningfully change. Additionally, clear disclosure around the location and amounts reported in the income statement and statement of cash flows would better enable analytical adjustment.

The extent of disclosures required of lessees in the Proposed ASU signals the Boards' appreciation that financial-statement users may take an analytically different tack from that which is presented in the financial statements. However, the disclosures required of lessors, in particular those required for Type B leases, do not allow for the same analytical manipulation by financial-statement users. Therefore, if the recognition and measurement proposals for lessors are adopted as proposed, we urge the Boards to require disclosures by lessors sufficient for users to take alternative views from those mandated by the accounting. This may include disclosure of collectability issues on Type B leases to mimic the loss allowance disclosure for Type A lease receivables, disclosure around reassessments of lease payments (it is unclear if the disclosure in 842-30-50-12 requires the inclusion of lease renewal options where there is an economic incentive to exercise), and disclosure of residual values of Type B leases similar to the disclosures required for Type A leases in 842-30-50-10.

Question 9: Nonpublic Entities (FASB Only)
To strive for a reasonable balance between the costs and benefits of information, the FASB decided to provide the following specified reliefs for nonpublic entities:
1. To permit a nonpublic entity to make an accounting policy election to use a risk-free discount rate to measure the lease liability. If an entity elects to use a risk-free discount rate, that fact should be disclosed.
2. To exempt a nonpublic entity from the requirement to provide a reconciliation of the opening and closing balance of the lease liability.

Will these specified reliefs for nonpublic entities help reduce the cost of implementing the new lease accounting requirements without unduly sacrificing information necessary for users of their financial statements? If not, what changes do you propose and why?

We do not believe the Proposed ASU should contain different or optional requirements for nonpublic entities. The financial reporting information needed to issue rating opinions is the same, whether the company or issuance is public or private. We aim to retrieve from private company financial statements the same sort of information that we get from public company financial statements, to uniformly apply our ratings criteria. We strive for consistent, comparable financial information to better enable our peer analysis of companies. Drawing a distinction in the accounting or reporting requirements between public and nonpublic companies is arbitrary, and assumes the sophistication of entities and needs of financial-statement users are driven by this organizational difference. Further, we do not agree with the nonpublic entity option to use the risk-free rate, which does not represent these entities' cost of borrowing. Allowing for such a relief will likely materially impair the comparability of financial information reported by nonpublic entities relative to their public counterparts. In the event nonpublic entities' optional use of the risk-free rate is finalized, we believe nonpublic entities that choose to use the risk-free rate should be required to disclose their incremental borrowing rate, to facilitate potential analytical adjustments financial-statement users may make to their financial statements.