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ALLINA
Hospitals & Clinics

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Financial Accounting Standards Board
401 Merritt 7, PO Box 5116
Norwalk, CT 06856-5116
United States

Dear Board Members

Invitation to comment – Exposure Draft *Leases*

Thank you for the opportunity to comment on the Financial Accounting Standards Board's (FASB) Exposure Draft (ED) *Leases*.

Allina Health System is a Minnesota nonprofit corporation with revenues of $3.0 billion and assets of $2.6 billion. Allina is located in Minnesota and western Wisconsin and consists of ten hospitals, physician clinics, and various other health related entities and six foundations supporting health related services. Allina employs over 22,000 employees.

Allina Health System is engaged in both capital and operating leases of real estate and equipment. In 2009, Allina recorded $43 million operating lease expense and disclosed $145 million of aggregate future minimum operating lease payments, had $7.9 million of capitalized lease debt, and $25.6 million of financing obligation liability relating to space lease obligations in which Allina is considered the owner of the building under current lease accounting guidance.

We agree with the Board's efforts to improve lease accounting and the conceptual changes that would ensure all rights and obligations arising under leases are recognized in the statement of financial position. However, we do have certain concerns with the ED as proposed and would like to see improvements to the ED.

We would like to see the accounting standard for leases be more principals based rather than a list of complex rules. The unintended consequence is that payments that do not meet the proposed definition of a liability will be capitalized. The inflated capitalized amounts are then recognized in an accelerated cost pattern, further exacerbating the negative financial reporting results for lessees. In its current condition the ED does not improve lease financial reporting for the investor and significantly increases the administrative burden on companies.

We believe the measurement should be more straight-forward. There is a considerable amount of subjectivity and judgment in the probability weighted measurement that will be required by the proposed standard – particularly concerning lease term and contingent rent. Only renewal terms and contingencies that are reasonably certain to be exercised should be included.

We believe that issues of leasehold improvements; incentives; and the build to suit construction period (originally EITF Issue 97-10) transactions should be addressed.

We believe there should be further clarification of lease definition and scope exclusions for internal use software and timeshare arrangements.

There will be significant administrative costs to assess, implement and sustain the requirements in the ED as proposed. The ED will have an impact on IT systems, human capital, financial reporting and accounting functions, and internal controls.

Factors such as increased audit fees, compliance with the Dodd-Frank Act, and the impact to management incentive programs based on financial results should be considered when finalizing the retrospective implementation. The significant increase in recorded liabilities for both lessees and lessors is also likely to negatively impact financial debt covenants.

The current economic environment and healthcare reform leads to many unknowns that would make the probability requirements of the ED difficult to implement at best. Lease payments are also subject to the economic environment and change depending on original lease term and renewal options.

Please see the attached Appendix for responses to specific questions included in the ED.

If there are any questions, please contact Cathryn Killian at 612-262-0648, or at Cathryn.Killian@allina.com.

Respectfully,

Allina Health System

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Vice President, Finance & Treasury

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Appendix
Responses to Questions for Respondents in Exposure Draft *Leases*

Question 1: Lessees
(a) Do you agree that a lessee should recognize a right-of-use asset and a liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?
(b) Do you agree that a lessee should recognize amortization of the right-of-use asset and interest on the liability to make lease payments? Why or why not? If not, what alternative model would you propose and why?

> Yes, we agree that a lessee should recognize a right-of-use asset and a liability and that amortization and interest should also be recognized on the right-of use asset and liability, for long-term leases.

Question 2: Lessors
(a) Do you agree that a lessor should apply (i) the performance obligation approach if the lessor retains exposure to significant risks or benefits associated with the underlying asset during or after the expected lease term and (ii) the derecognition approach otherwise? Why or why not? If not, what alternative approach would you propose and why?
(b) Do you agree with the boards' proposals for the recognition of assets, liabilities, income and expenses for the performance obligation and derecognition approaches to lessor accounting? Why or why not? If not, what alternative model would you propose and why?
(c) Do you agree that there should be no separate approach for lessors with leveraged leases, as is currently provided for under US GAAP (paragraph BC15)? If not, why not? What approach should be applied to those leases and why?

> We believe a more straightforward model that links to the revenue recognition ED and the lessee model, with recommended changes, would be a better approach for lessors.

Question 3: Short-term leases
This exposure draft proposes that a lessee or a lessor may apply the following simplified requirements to short-term leases, defined in Appendix A as leases for which the maximum possible lease term, including options to renew or extend, is 12 months or less:

(a) At the date of inception of a lease, a lessee that has a short-term lease may elect on a lease-by-lease basis to measure, both at initial measurement and subsequently, (i) the liability to make lease payments at the undiscounted amount of the lease payments and (ii) the right-of-use asset at the undiscounted amount of lease payments plus initial direct costs. Such lessees would recognize lease payments in the income statement over the lease term (paragraph 64).
(b) At the date of inception of a lease, a lessor that has a short-term lease may elect on a lease-by-lease basis not to recognize assets and liabilities arising from a short-term lease in the statement of financial position, nor derecognize any portion of the underlying asset. Such lessors would continue to recognize the underlying asset in accordance with other Topics and would recognize lease payments in the income statement over the lease term (paragraph 65).
(See also paragraphs BC41−BC46.)
Do you agree that a lessee or a lessor should account for short-term leases in this way? Why or why not? If not, what alternative approach would you propose and why?

> No, we believe short term leases, where the optional lease period reasonably certain of exercise is twelve months or less, should continue to be recorded as operating leases.

Definition of a lease
This exposure draft proposes to define a lease as a contract in which the right to use a specified asset or assets is conveyed, for a period of time, in exchange for consideration (Appendix A, paragraphs B1−B4 and BC29−BC32). This exposure draft also proposes guidance on distinguishing between a lease and a contract that represents a purchase or sale (paragraphs 8, B9, B10 and BC59−BC62) and on distinguishing a lease from a service contract (paragraphs B1–B4 and BC29−BC32).

Question 4
(a) Do you agree that a lease is defined appropriately? Why or why not? If not, what alternative definition would you propose and why?

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(b) Do you agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale? Why or why not? If not, what alternative criteria would you propose and why?
(c) Do you think that the guidance in paragraphs B1–B4 for distinguishing leases from service contracts is sufficient? Why or why not? If not, what additional guidance do you think is necessary and why?

> No, we believe there needs to be more clarification between a lease contract and other executory contracts to ensure executory costs are accounted for separately from leases.

Scope

Question 5: Scope exclusions
This exposure draft proposes that a lessee or a lessor should apply the proposed guidance to all leases, including leases of right-of-use assets in a sublease, **except leases of intangible assets,** leases of biological assets and leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (paragraphs 5 and BC33−BC46).
Do you agree with the proposed scope of the proposed guidance? Why or why not? If not, what alternative scope would you propose and why?

> We believe software licensing agreements, including licensing internal use software, and timeshare arrangements should be excluded from the ED scope.

Question 6: Contracts that contain service components and lease components
This exposure draft proposes that lessees and lessors should apply the guidance in proposed Accounting Standards Update, *Revenue Recognition* (Topic 605): *Revenue from Contracts with Customers,* to a distinct service component of a contract that contains service components and lease components (paragraphs 6, B5−B8 and BC47−BC54). If the service component in a contract that contains service components and lease components is not distinct:
(a) The FASB proposes the lessee and lessor should apply the lease accounting requirements to the combined contract.
(b) The IASB proposes that:
(i) A lessee should apply the lease accounting requirements to the combined contract.
(ii) a lessor that applies the performance obligation approach should apply the lease accounting requirements to the combined contract.
(iii) a lessor that applies the derecognition approach should account for the lease component in accordance with the lease requirements, and the service component in accordance with the guidance in the exposure draft on revenue from contracts with customers.
Do you agree with either approach to accounting for leases that contain service and lease components? Why or why not? If not, how would you account for contracts that contain both service and lease components and why?

> We believe executory and common operating costs associated with leases should be accounted for separately, not capitalized as part of the right-to-use asset, and that this should be clarified in the ED.

Question 7: Purchase options
This exposure draft proposes that a lease contract should be considered terminated when an option to purchase the underlying asset is exercised. Thus, a contract would be accounted for as a purchase (by the lessee) and a sale (by the lessor) when the purchase option is exercised (paragraphs 8, BC63 and BC64).
Do you agree that a lessee or a lessor should account for purchase options only when they are exercised? Why or why not? If not, how do you think that a lessee or a lessor should account for purchase options and why?

> We believe purchase options should be included in the lease accounting if there is reasonable certainty that it will be exercised.

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Measurement
This exposure draft proposes that a lessee or a lessor should measure assets and liabilities arising from a lease on a basis that: 8 (a) assumes the longest possible term that is more likely than not to occur, taking into account the effect of any options to extend or terminate the lease (paragraphs 13, 34, 51, B16−B20 and BC114−BC120).
(b) includes in the lease payments contingent rentals and expected payments under term option penalties and residual value guarantees specified by the lease by using an expected outcome technique (paragraphs 14, 35, 36, 52, 53, B21 and BC121−BC131). Lessors should only include those contingent rentals and expected payments under term option penalties and residual value guarantees that can be reliably measured.
(c) is updated when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments, including expected payments under term option penalties and residual value guarantees, since the previous reporting period (paragraphs 17, 39, 56 and BC132−BC135).

Question 8: Lease term
Do you agree that a lessee or a lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease? Why or why not? If not, how do you propose that a lessee or a lessor should determine the lease term and why?

> No, we believe the lease term should be determined by the term that is reasonably certain to be exercised. Over time changes in economics, technologies, business circumstances, etc. impact the attractiveness and risks of leases.

Question 9: Lease payments
Do you agree that contingent rentals and expected payments under term option penalties and residual value guarantees that are specified in the lease should be included in the measurement of assets and liabilities arising from a lease using an expected outcome technique? Why or why not? If not, how do you propose that a lessee or a lessor should account for contingent rentals and expected payments under term option penalties and residual value guarantees and why?

Do you agree that lessors should only include contingent rentals and expected payments under term option penalties and residual value guarantees in the measurement of the right to receive lease payments if they can be reliably measured? Why or why not?

> No, we believe lease payments should only include contingent payments that are based on factors outside lessee operations or control of the lessee.

Question 10: Reassessment
Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts or circumstances indicate that there is a significant change in the liability to make lease payments or in the right to receive lease payments arising from changes in the lease term or contingent payments (including expected payments under term option penalties and residual value guarantees) since the previous reporting period? Why or why not? If not, what other basis would you propose for reassessment and why?

> No, we believe reassessment should occur on an annual basis. If leases are recorded based on terms that are reasonably certain without operating and service costs or contingent payments, more frequent reassessment would not be necessary.

Sale and leaseback
This exposure draft proposes that a transaction should be treated as a sale and leaseback transaction only if the transfer meets the conditions for a sale of the underlying asset and proposes to use the same criteria for a sale as those used to distinguish between purchases or sales and leases. If the contract represents a sale of the underlying asset, the leaseback also would meet the definition of a lease, rather than a repurchase of the underlying asset by the lessee (paragraphs 66−67, B31 and BC160−BC167).

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Question 11
Do you agree with the criteria for classification as a sale and leaseback transaction? Why or why not? If not, what alternative criteria would you propose and why?

> We believe the ED should clarify criteria and should be based on revenue recognition guidance. We also believe the ED should address and improve accounting for build-to-suit and lessee involvement with construction issues. (Originally EITF Issue 97-10)

Presentation
This exposure draft proposes that lessees and lessors should present the assets, liabilities, income (or revenue), expenses and cash flows arising from leases separately from other assets, liabilities, income, expenses and cash flows (paragraphs 25−27, 42−45, 60−63 and BC142−BC159).

Question 12: Statement of financial position
(a) Do you agree that a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as if they were tangible assets within property, plant and equipment, but separately from assets that the lessee does not lease (paragraphs 25 and BC143−BC145)? Why or why not? If not, do you think that a lessee should disclose this information in the notes instead? What alternative presentation do you propose and why?
(b) Do you agree that a lessor applying the performance obligation approach should present underlying assets, rights to receive lease payments and lease liabilities gross in the statement of financial position, totalling to a net lease asset or lease liability (paragraphs 42, BC148 and BC149)? Why or why not? If not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?
(c) Do you agree that a lessor applying the derecognition approach should present rights to receive lease payments separately from other financial assets and should present residual assets separately within property, plant and equipment (paragraphs 60, BC154 and BC155)? Why or why not? Do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?
(d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position (paragraphs 43, 60, BC150 and BC156)? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

> We believe there should be an option of presenting lease transactions separately on the face of the financial statement or in the notes to the financial statements. We believe right-of-use assets should be presented as if they were tangible assets within property, plant and equipment.

Question 13: Income statement
Do you think that lessees and lessors should present lease income and lease expense separately from other income and expense in the income statement (paragraphs 26, 44, 61, 62, BC146, BC151, BC152, BC157 and BC158)? Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

> We believe there should be an option of presenting lease transactions separately on the face of the financial statement or in the notes to the financial statements.

Question 14: Statement of cash flows
Do you think that cash flows arising from leases should be presented in the statement of cash flows separately from other cash flows (paragraphs 27, 45, 63, BC147, BC153 and BC159)? Why or why not? If not, do you think that a lessee or a lessor should disclose this information in the notes instead? Why or why not?

> We believe there should be an option of presenting lease transactions separately on the face of the financial statement or in the notes to the financial statements.

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Disclosure

Question 15
Do you agree that lessees and lessors should disclose quantitative and qualitative information that:
(a) identifies and explains the amounts recognized in the financial statements arising from leases; and
(b) describes how leases may affect the amount, timing and uncertainty of the entity's future cash flows? (paragraphs 70−86 and BC168−BC183)? Why or why not? If not, how would you amend the objectives and why?

> We believe adding leases to the statement of financial position already provides greater transparency and that it should not require significant more disclosure than currently required.

Transition

Question 16
(a) This exposure draft proposes that lessees and lessors should recognize and measure all outstanding leases as of the date of initial application using a simplified retrospective approach (paragraphs 88–96 and BC186−BC199). Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?
(b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?
(c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

> We are concerned with the changes to prior period financial results and the impact on financial performance based management incentive plans under a retrospective approach.

Benefits and costs

Question 17
Paragraphs BC200–BC205 set out the boards' assessment of the costs and benefits of the proposed requirements. Do you agree with the boards' assessment that the benefits of the proposals would outweigh the costs? Why or why not?

> We believe the costs outweigh the benefits as currently proposed. The human capital needs will be significant to incorporate the estimates and judgments required in the ED as proposed.

Other comments

Question 18
Do you have any other comments on the proposals?

> We believe the Board should address the accounting treatment for:
> - lease incentives
> - funded or unfunded leasehold improvements
> - Leases with related parties
> - Lessee activity during the construction period

Non-public entities

Question 19
Should any of the proposed guidance be different for non-public entities (private companies and not-for-profit organizations)? If so, which requirement(s) and why?

> We believe there should be simplified requirements for private companies and not-for-profit organizations.