

Microsoft Corporation
One Microsoft Way
Redmond, WA 98052-6399

Tel 425 882 8080
Fax 425 936 7329
<http://www.microsoft.com/>



December 15, 2010

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

Re: File Reference No. 1850-100

Dear Technical Director:

Microsoft appreciates the opportunity to respond to the Exposure Draft (ED), “Leases”. We agree with the conclusion that a lease results in an asset representing a right to use the leased asset for the lease term and a liability to make lease payments. However, we do not agree with the Boards’ conclusion on subsequent measurement which treats all leases as a financing transaction similar to the issuance of debt and the purchase of an asset. Rather, Microsoft believes the more faithful representation would be to reflect leases as an operating transaction in which a lessee incurs an expense for the right to use the underlying asset at the same time it receives the right and consumes the benefit. Accordingly, we believe the lessee should recognize rental expense during the lease term, which better reflects the economics of most lease contracts. Furthermore, we note that the ED contains guidance for distinguishing between a lease and a purchase and we agree that transactions that represent a purchase of the underlying asset should be accounted for as a purchase.

We struggled with the reasons why the Boards’ rejected this approach as articulated in paragraph BC10 of the Basis for Conclusions of the ED. The boards’ reasons, along with Microsoft’s views, are provided below:

BC10 However, in the boards’ view, the alternative approach described in paragraph BC8 has the following problems:

- (a) the treatment of the liability to make lease payments would be inconsistent with the treatment of other financial liabilities, which could reduce comparability for users of financial statements because no interest expense is recognized.

Microsoft’s views – Under the approach articulated above, the liability to make lease payments would be accounted for as proposed in the right-of-use model and accreted using the interest method. The right-of-use asset would be subject to mortgage-based amortization. Accordingly, the balance sheet treatment of the liability would be consistent with the treatment of other financial liabilities. Furthermore, we strongly believe the recognition of rental expense in the income statement during the lease term better reflects the economics of most lease

transactions rather than the boards' proposal to recognize amortization/depreciation of the asset and interest expense as if the entity had purchased the asset by issuing debt.

(b) although the value of the right-of-use asset and the liability to make lease payments are clearly linked at the inception of the lease, they are not necessarily linked subsequently because the value of the right-of-use asset can change with no corresponding change to the liability to make lease payments. Some board members view the purchase of the right-of-use asset as similar to the purchase of property, plant and equipment because the consideration is paid in installments. The consideration would not be linked to the fair value of the property, plant and equipment under existing US GAAP.

Microsoft's views – We agree that the value of the right-of-use asset can change with no corresponding change to the liability to make lease payments and that the consideration would not be linked to the fair value of the property plant and equipment under existing US GAAP. However, we also note that the ED rejected an approach to record the subsequent measurement of the right-of-use asset at fair value. Furthermore, the ED contains guidance for distinguishing between a lease and a purchase and we believe that a lease is not a purchase of property, plant and equipment and should not be treated as such.

(c) the treatment of amounts recognized in the income statement is inconsistent with the boards' view that the lessee has acquired a right-of-use asset and is paying for that right over the term of the lease.

Microsoft's views – We do not see the inconsistency and believe recognizing rental expense as articulated above is consistent with a right-of-use model since it faithfully represents the right to use the underlying asset at the same time it receives the right and consumes the benefit.

Our responses to the discussion questions raised in the ED are attached and are mostly answered from the prospective of a lessee. If you have any questions, please contact me at (425) 703-6094.

Sincerely,

Bob Laux
Senior Director, Financial Accounting and Reporting

Attachment

Question 1— (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?*

Response: Microsoft agrees with the conclusion that a lease results in an asset representing a right to use the leased asset for the lease term and a liability to make lease payments. However, we do not agree with the Boards' conclusion on subsequent measurement which treats all leases as a financing transaction similar to the issuance of debt and the purchase of an asset. Rather, Microsoft believes the more faithful representation would be to reflect leases as an operating transaction in which a lessee incurs an expense for the right to use the underlying asset at the same time it receives the right and consumes the benefit. Accordingly, we believe the lessee should recognize rental expense during the lease term, which better reflects the economics of most lease contracts. Furthermore, we note that the ED contains guidance for distinguishing between a lease and a purchase and we agree that transactions that represent a purchase of the underlying asset should be accounted for as a purchase.

Question 2— (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?*

Response: We agree that a lessor should apply the performance obligation approach if the lessor retains exposure to significant risks or benefits associate with the underlying asset during or after the expected lease term and the derecognition approach otherwise. However, similar to our comments on lessee accounting, under the performance obligation approach we believe the lessor should recognize rental income over the term of the lease reflecting the right to receive lease payments based on the lessee's use of the leased item.

Question 3— *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?

Response: Microsoft agrees with the proposed accounting for short-term leases.

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?*

(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?

Response: We believe a lease is defined appropriately and agree with the guidance on distinguishing a lease from a purchase or sale and a lease from a service contract.

Question 5— *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?

Response: Microsoft agrees with the proposed scope.

Question 6— *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?

Response: Microsoft believes that if the service component is not distinct in a contract that contains a service component and a lease component, the contract should be accounted for as a lease.

Question 7— *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?

Response: Yes, we agree that a lessee or a lessor should account for purchase options only when they are exercised.

Question 8— *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?*

Response: Microsoft agrees that the lease term should be based on the longest possible term that is more likely than not to occur.

Question 9— *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?

Response: We agree with the proposal that contingent rentals and expected payments should be estimated. However, we do not believe it is necessary to mandate a probability-weighted approach and believe different estimation techniques may be appropriate based on the facts and circumstances.

Question 10— *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?*

Response: Microsoft agrees that lessees and lessors should remeasure assets and liabilities under a lease when changes in facts and circumstances indicate there are significant changes.

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?*

Response: We agree 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 the leaseback meets the definition of a lease.

Question 12— *(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?

Response: Microsoft believes that lease assets and liabilities should be presented separately if they are material to the financial statements. However, similar to our previous comments, since a lease is not a purchase of property, plant and equipment, right-of-use assets should not be presented as if they were tangible assets within property, plant and equipment.

Question 13— *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?*

Response: If material, we believe these items should be presented separately. However, as indicated in our cover letter, we believe a lessee should recognize rental expense during the lease term, which better reflects the economics of most lease contracts.

Question 14— *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?*

Response: If material, we believe these items should be presented separately. However, as indicated in our cover letter, we do not agree with the Boards' conclusion on subsequent measurement which treats all leases as a financing transaction similar to the issuance of debt and the purchase of an asset. Rather, Microsoft believes the more faithful representation would be to reflect leases as an operating transaction in which a lessee incurs an expense for the right to use the underlying asset at the same time it receives the right and consumes the benefit.

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?

Response: We continue to be concerned with the significant increase in the volume of required disclosures and it is imperative that the FASB have an overarching disclosure criterion that takes into account a potential new disclosure in the context of all existing disclosures, as unnecessary disclosures can be damaging or misleading if relevant information is obscured. We were surprised the ED did not contain a comprehensive disclosure example, so that one could judge potential new disclosures in the context of all existing disclosures.

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?

Response: Microsoft recommends a transition alternative similar to that allowed under Accounting Standards Update 2009-13. This alternative will provide users comparable information while lessening the burden of adoption on preparers.

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?*

Response: Except for the items previously noted, we believe the ED is an improvement to existing lease accounting requirements and justifies the cost to implement the changes.