December 13, 2010

Submitted via email (director@fasb.org)

Technical Director
Financial Accounting Standards Board
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Re: File Reference No. 1850-100, Exposure Draft: Leases

Apple Inc. ("Apple" or the "Company") is pleased to have the opportunity to comment on the Financial Accounting Standards Board's ("FASB" or the "Board") exposure draft of the Proposed Accounting Standards Update Leases, issued August 17, 2010 (the "ED"). We support the FASB's effort to provide financial statement users with a more complete depiction of an entity's leasing transactions and the assets and obligations resulting from these transactions. However, we have some concerns in the manner in which the ED attempts to meet this objective. We believe a number of areas in the ED should be modified to allow for a more practical standard and avoid costly implementation and maintenance of leasing arrangements where there is not a related benefit to users of financial statements. Specifically, we propose that:

- The requirement for lessees to include renewal options and contingent rental payments should be removed;
- The Board should refine the guidance to provide a more practical approach to accounting for service and lease components in a service arrangement;
- Short-term leases should be expensed as incurred and not subject to capitalization;
- Certain disclosure requirements in the ED should be modified or removed; and
- The method and timing of transition should be further evaluated based on feedback from the FASB's discussion paper on Effective Dates and Transition Methods.

We have responded to the FASB's invitation to comment from the perspective of a lessee consistent with the majority of our leasing transactions. Our views on these matters are explained in more detail in the following paragraphs.

The requirement for lessees to include renewal options and contingent rental payments should be removed.

We generally believe lease payments under a non-cancellable lease contract represent a present obligation consistent with FASB Concepts Statement No. 6 and thus a corresponding right-of-use asset and liability should be recognized. However, we do not believe that including contingent rental payments or renewal options in the measurement of the right-of-use asset and obligation to make rental payments is appropriate, both conceptually and operationally.
From a conceptual perspective, the obligation resulting from payments during the renewal option period as well as contingent rental payments do not meet the definition of a liability. This is because the liability does not arise from a present obligation. When a renewal option is exercised, there becomes an obligation to make rental payments. Until this point, the costs associated with the lease during the renewal option period are avoidable and at the discretion of the option holder. Therefore, we do not believe renewal options should be contemplated when measuring the lease obligation. Similarly for contingent rental payments, there is no obligation to make rental payments until the event that the contingency relates to occurs. Contingent rental payments are often tied to performance directly or indirectly related to the leased asset, such as payment based on a percentage of store sales. Because management often has the ability to make decisions that could significantly change the resulting cash outflow under these types of leases, the potential future payments do not represent a liability. Accordingly, we believe that contingent rent should be expensed as incurred.

Additionally, under the proposed guidance a lessor would include contingent rentals received only if it can reliably measure the receivable, while a lessee would be forced to estimate contingent rentals using a probability-weighted approach. The lessor guidance acknowledges that it might be difficult for a lessor to obtain information from the lessee to estimate future lease receipts. Many of the challenges facing a lessor in estimating contingent rent are similar to that of a lessee. We believe the guidance for a lessor recognizing a receivable should be based on information generally available and consistent with that used by a lessee in recognizing its payable, which appropriately considers the challenges in estimating future contingent rentals and is limited to present obligations.

From an operational perspective, the inclusion of renewal options and contingent rental payments introduces complexity that will be challenging to implement and costly, yet provides little, if any, benefit to users of the financial statements. Companies will face a significant challenge in making estimates used to measure and recognize the right-of-use asset and liability, which will require complex evaluations on a lease-by-lease basis. Renewal options are often multiple years out and difficult to estimate the probability of exercise. Similarly, for contingent rental payments, there is inherent difficulty in estimating payments under the lease contract for periods outside of a company's forecast period. For leases with longer terms, the population of likely outcomes increases while the ability to estimate decreases making the basis for management's estimate less reliable. This could result in recognition of assets and liabilities that are materially different than the actual outflow of economic resources. Further, while some aspects of the ED can be automated through costly and time-consuming system enhancements, the consideration of renewal options and contingent rental payments would inherently be a manual exercise. Accordingly, the inclusion of these estimates in the financial statements will be operationally impractical and costly, providing little or no benefit to users of the financial statements.

Should the Board choose to retain the concept that lease payments under a renewal option and contingent rental payments meet the definition of a liability, we believe that alternative approaches be provided. With respect to lease term, we acknowledge that certain leases for unique assets are important to a company's operations and a renewal option is nearly certain of being exercised. The Board should consider if an alternative model that meets the objective of this proposed standard, which requires only highly certain or mandatory renewal options be included in the lease term. The current definition of lease term under ASC 840 Leases provides an appropriate framework to decide whether a renewal period should be included. For example, periods that are covered by a bargain renewal option or where the lease imposes a penalty on the lessee if they do not renew would be included in the lease term. With respect to contingent rental payments, we believe that the Board should provide alternative techniques to estimate future cash flows from a probability-weighted approach, including management's best estimate or a most likely outcome approach. We expect these two approaches will align the guidance between lessees and lessors and provide management flexibility to employ more efficient modeling of future expected payments. Whereas a probability-weighted approach would be costly and not practical to implement and will not result in a better estimate of expected results.

In addition, we would ask for more clarification and implementation guidance addressing what would be considered a significant event that would warrant reassessment. We believe that the requirement to reassess leases and potentially adjust the right-of-use asset and liability on a quarterly basis will be one of the most costly and challenging aspects of the ED. Therefore, the implementation guidance should provide a practical approach that limits the need to continually reassess each
leasing arrangement. In developing this guidance, we would suggest the Board look to ASC 360-10-35 *Impairment or Disposal of Long-Lived Assets*, providing similar types of such events or changes in circumstances that companies should monitor.

*The Board should refine the guidance to provide a more practical approach to accounting for service and lease components in a service arrangement.*

We support the concept contained in the ED that, for arrangements containing both service and lease components, the service component must be distinct for it to be identified and accounted for separately from the lease component. The first criterion in paragraph B7(a) of the ED provides that a service is considered distinct if the company, or another company, sells an identical or similar service separately. This basic principle is largely consistent with current accounting guidance and should be relatively straightforward to apply in practice.

The second independent criteria in paragraph B7(b) states that a service component is considered distinct if the company could sell the service separately because the service has both a distinct function and distinct profit margin. The concept of a distinct function can be analogized to existing guidance in ASC 605-25. However, the concept of a distinct profit margin, as defined as having distinct risks and resources, does not exist in current guidance, and we are concerned it might not be possible to identify the distinct risks and resources. If the service component does not meet the "distinct" criteria, the entire transaction would be recorded as a lease even if inconsistent with the nature and economics of the arrangement.

To address this issue, we believe that the Board should reconsider the guidance on how to allocate payments if the service is clearly distinct but a distinct profit margin cannot be identified. The Board should also clarify why a distinct profit margin is indicative that a company could provide a service on a standalone basis or remove it as a requirement and focus on distinct function. If the Board retains the requirement to identify both distinct function and profit margin, we believe a company should be able to allocate to the service component if it has a reasonable basis to do so. A reasonable basis could be supported by a company's experience or by observable experience of other companies. If an amount cannot immediately be allocated to the service component of an arrangement because the service is not provided separately by the company or another company, we believe that an appropriate approach includes estimating the value of the service and allocating the remainder to the lease component.

*Short-term leases should be expensed as incurred and not subject to capitalization.*

We believe that short-term leases should not be subject to capitalization and should be expensed as incurred similar to lessor accounting guidance as noted in paragraph 65 of the ED. This approach avoids the significant effort and cost associated with accounting for and measuring short-term assets and liabilities and represents a practical way of handling this class of lease transactions.

We believe that the objective of providing useful information to users of the financial statements is achieved for short-term leases by recognizing in the income statement payments for short-term leases over the lease term, consistent with lessor treatment for short-term leases. The pattern of recognition will also align with the usage of the related asset in short-term leases. This approach provides a practical way to present meaningful information while avoiding significant costs and effort in accounting for and measuring these short-term assets and liabilities.

We believe that short-term leases have a different risk profile that reduces the likelihood of abuse. The Board's concern that leases could be structured to avoid capitalization is mitigated through the economic exposure that a lessee and lessor face by modifying key terms. If a lease were written in favor of option renewals as opposed to a fixed term, the lessor would be exposed to taking back an asset earlier than under a fixed term lease. If a lease did not contain an option renewal clause that provided the lessee with rights for continued use beyond the contractual term, there is a natural economic disincentive due to the risk that the asset would not be available at desirable terms, if at all, to the lessee in the future.
Whether or not the Board chooses to retain short-term leases in the scope of this exposure draft, the proposed guidance should further clarify the definition of a short-term lease (paragraph BC 41) and whether the inclusion of options to renew or extend are based on the maximum “contractual” lease term or the maximum lease term that is more likely than not to occur. For the reasons noted in this letter, we believe short-term leases should be defined as a non-cancellable term of 12 months or less. Should the Board decide to retain the inclusion of renewals in the definition of the lease term, we believe these renewals should be limited to those that are highly certain of being exercised.

**Certain disclosure requirements in the ED should be modified or removed.**

We agree that disclosures are necessary to help users of financial statements understand the nature and extent of leasing arrangements that an entity enters into. However, we believe the disclosure requirements put forth in the ED, along with the significant increase in disclosures proposed by other projects, are too expensive and take relevance away from those that are truly important. We feel that it is critically important for the FASB to address disclosure requirements as part of an overall disclosure project as unnecessary disclosures can be misleading or diminish the importance of other relevant disclosures.

With respect to disclosure requirements in the ED, the maturity analysis disclosure will reflect uncertain future events or payments in that renewal options and contingent rents would be included in the table. The same difficulties related to renewal options and contingent features in a lease that we expect companies to encounter in recording assets and liabilities discussed in this letter will be present in the disclosure requirements. Accordingly, we believe that the requirement to disclose a maturity analysis of the liabilities to make lease payments showing the undiscounted cash flows be limited to the non-cancellable contractual period and should exclude contingent rentals.

In addition, we support limiting the required disclosures to those that provide users with useful information. For example, the disclosure of a sale-leaseback or initial direct costs incurred appear to be required even if insignificant. Overall, we feel it is important for the Board to clarify that these disclosure requirements are only necessary if material or useful to a user’s understanding of the financial statements.

Lastly, while the maturity analysis is clearly noted as an annual disclosure, the ED is not clear with respect to the frequency of all other disclosure requirements; however, we understand the intent is for the ED’s leasing disclosures to be presented quarterly. We believe that quarterly disclosures should be limited to material changes to previously disclosed annual information. Quarterly disclosures will increase the ongoing cost of implementing and administering this ED without a corresponding benefit to users of the financial statements.

**The method and timing of transition should be further evaluated based on feedback from the FASB’s discussion paper on Effective Dates and Transition Methods.**

We support the Board’s conclusion that a simplified retrospective approach is an appropriate transition method. While retrospective application could be provided as an alternative, we believe that a simplified retrospective approach will be more efficient to implement than a full retrospective approach.

The implementation of the proposed guidance will take significant time and effort to develop accounting systems and implement the related internal controls. The Board will need to consider the timeframe for adoption in the context of other proposed accounting standards as part of the FASB’s broader project on effective dates and transition methods.

*We appreciate the opportunity to comment on this important topic. We agree with the Board that there are benefits to users of the financial statements if lease obligations are reflected on the balance sheet. In order to achieve the benefits of providing users with an accurate depiction of a Company’s assets and liabilities, we feel it is equally important to ensure that the guidance is operational for*
preparers. We believe that if the Board modifies key aspects of the proposed standard, such as those related to renewal option terms, contingent rental payments, and disclosures, the benefits will outweigh the costs associated with adoption.

Please contact me at (408) 862-1401 if you have any questions regarding our response or other aspects of the ED.

Very truly yours,

Betsy Rafael
Vice President, Corporate Controller
and Principal Accounting Officer