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Technical Director
Financial Accounting Standards Board
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DIRECTV appreciates the opportunity to comment on the Exposure Draft of proposed Accounting Standards Update, Leases (the “ED”).

DIRECTV is the world’s leading provider of digital television entertainment services with over 27 million residential and commercial subscribers in the United States and Latin America.

We commend the Financial Accounting Standards Board (the “FASB”) and the International Accounting Standards Board (the “IASB”, collectively the “Boards”) for developing a converged model for lease accounting and agree with the Boards’ objectives described in the ED. We also agree with the Boards’ desire to provide users of financial statements with a complete and understandable picture of an entity’s leasing activities by implementing accounting that requires entities to reflect assets and liabilities arising from leasing transactions in the statement of financial position. However, we have some concerns regarding the application of the standard, in particular for service providers who use equipment placed at customer sites to deliver the primary service. Our concerns relate to the following aspects of the ED:

- The definition of a lease,
- Determination of distinct service elements, allocation of revenues between service and lease elements and determination of stand-alone sales prices for equipment not separately leased,
- Determination of the lease term,
- The timing and frequency of the reassessment of the lease term, and
- The timing of impairment testing of leased assets when such analysis is concurrent with a reassessment of the lease term.

Our specific comments, along with potential solutions are discussed below in our responses to selected questions posed by the Boards in the ED.
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?

We have a concern that the application guidance for determining whether a contract contains a lease could lead to a conclusion which is inconsistent with the definition itself. Further, such a conclusion would be inconsistent with the way we view our business. Accordingly, we propose to refine the definition.

DIRECTV Background:

Subscribers receive our programming via a satellite dish and set-top receivers installed in their homes. The first set top receiver in a subscriber’s home is provided to them at no charge and we charge a monthly fee for each additional set top receiver under the terms of a month to month equipment agreement. Fees charged for additional receivers, on average, are less than 10% of a typical monthly subscriber bill. Under the terms of a separate programming agreement, new subscribers must commit to purchasing programming for a minimum term of 24 months.

Our set top receivers provide different services, ranging from standard/basic services to advanced services, such as high definition (“HD”) and digital video recording (“DVR”). When a subscriber orders our service, we provide a specific type of receiver (standard, HD, DVR or HD DVR) based on the service they wish to purchase; however as long as we provide a receiver that performs the service requested we are not required to provide a specific receiver under the terms of our agreement with the subscriber. In addition, we retain the right to replace set-top receivers if necessary. An access card located in the set top receiver controls the programming that the subscriber receives. DIRECTV remotely authorizes the access cards, therefore while we may not have physical access to the set top receiver, we are able to control the programming viewed by the subscriber though controlling the access card inside the set top receiver. Upon termination of service, subscribers are required to return the set-top receivers, which we facilitate by sending a recovery kit to the subscriber.

We don’t view our business as leasing set-top receivers, but rather consider the set top receiver to be a component of our broadcast system used to transmit programming to our subscribers. Similarly, we believe that subscribers view our product as a broadcast television service, not the acquisition of specific physical assets. Our contracts do not depend on providing specific assets or convey the right to control the use of a specified asset because we control its utility through the access card and our broadcast system. Accordingly, we do not believe this arrangement should be considered a lease for accounting purposes; however the current definition of a lease in the ED could lead to
that conclusion. We understand that the proposed guidance is consistent with existing guidance in ASC 840-10-15. However, we believe this determination was not critical for many lessors in the past because a determination that the arrangement contained a lease would not have resulted in a meaningful difference in the accounting since the conclusion would have merely changed the description of the revenue received as either operating lease or service revenue. Accordingly, we believe the criteria may warrant further refinement, particularly in regards to equipment such as ours which has no utility without the service and represents a relatively small component of our overall subscriber arrangements.

To determine if a contract is a lease, an entity will be required to apply paragraphs B1-B4 at the inception of the contract assessing whether: (a) the fulfillment of the contract depends on providing a specified asset or assets and (b) the contract conveys the right to control the use of the specified asset for an agreed period of time.

Paragraph B2 provides guidance to determine whether the equipment is explicitly or implicitly specified. The underlying asset is not explicitly identified since it is not specified in the equipment agreement. However, while we have the ability to provide a different receiver at any point, it is not clear whether the equipment is implicitly identified because the terms "infeasible or impractical for a lessor to provide alternative assets in place of the underlying asset during the lease term" and "can substitute another asset for the underlying asset but rarely does so" are not sufficiently clear for us to make such a determination. For example, we often replace malfunctioning set top receivers at no charge to the subscriber; however we do not know if this would qualify as rare or not since this term is not commonly understood by preparers and auditors. We have also actively replaced set-top receivers in cases where we have re-routed the satellite broadcast to a new satellite location and frequency because the subscriber needs slightly different equipment to continue "seeing" the satellite signal. Since we routinely replace set-top receivers, we could conclude that it is feasible and practical to provide alternative assets. It is nonetheless not clear what effort or what cost would be considered infeasible or impractical.

Paragraph B4 provides criteria to determine whether the contract conveys the right to use an asset. The criteria focus on the ability to operate the asset, physically control the asset, or whether the entity obtains all but an insignificant amount of the output or utility of the asset. As mentioned above, the subscriber's right to control the use of the set-top receiver for the purpose of receiving programming is limited by the access granted remotely by DIRECTV through the access card located in the set top receiver. On the one hand, we use this control to limit access to only the programming purchased by the subscriber. In other words, they only can access the content they paid for, despite the fact that additional output is available from the receiver. On the other hand, we are not sure whether this is an important distinction or not, since we would
typically not exercise this control and limit access to purchased content unless a subscriber defaulted on payment. Finally, some subscribers pay for and receive substantially all available programming from the receivers, while others may obtain only a small portion of the potential output. Since the price paid by the subscriber is based on the amount of output, we might logically conclude in accordance with the last sentence of paragraph B4(e) that the subscriber is paying for a service, rather than paying for the right to use the underlying asset because the price paid is based on the amount of output. In summary, our subscribers are not able to unilaterally operate the asset for their full benefit or control the output of the asset in the normal sense, but the criteria in paragraph B4(c) and (d) seem to allow for a conclusion that the subscriber does control the asset to a certain extent as long as they meet their commitment.

We propose that the definition of a lease should be modified to provide a more operational methodology for service companies such as DIRECTV to clearly conclude that similar equipment be excluded from the leasing standard. For example, the standards could state:

Equipment installed by a service provider for use primarily in delivery of the service need not be considered a distinct performance obligation for purposes of the application of both the lease and revenue standards when the equipment has no material independent utility from the service and does not represent a substantial component of the overall arrangement.

Alternatively, additional guidance could be provided which clarifies the terms “infeasible or impractical” and “but rarely does so” in paragraph B2. Also, the determination of whether a contract conveys the right to control the use of an asset could be further modified or clarified with additional implementation guidance. For example, the last sentence of paragraph B4(e) could be moved to the introductory paragraph B4 so that it clarifies that such guidance applies regardless of the control criteria in B4(c) and (d). Also, additional clarification of the term control could be provided so that it is clear whether unilateral control of the asset is relevant, or whether remote control of the asset is important even if such control would only be exercised in the event of default.

While we understand that the standard is meant to be more principles based and less of a “bright line test”, we believe that clarification of these terms will help financial statement preparers properly apply the standard.
Question 6: 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 have a concern regarding the interaction of this ED with proposed Accounting Standards Update, Revenue from Contracts with Customers (the “Revenue ED”). Notwithstanding our view that our set-top receiver arrangements should not meet the definition of leased equipment to be accounted for pursuant to the ED as discussed above in our response to Question 4, we note that the definition of distinct service components in the ED is constructed such that it may be unintentionally difficult for service providers to actually separate the service elements of their arrangements. If the service cannot be distinguished from the lease, the ED requires the entire arrangement to be accounted for as a lease. In our case, where set-top receiver costs represent only about 5% of the anticipated revenue to be earned over an average subscriber life, the more accurate accounting for our arrangements would be to account for the entire arrangement based on the guidance in the Revenue ED. (Note that the aggregate cost of the equipment installed for our over 27 million subscribers is many billions of dollars).

In addition, allocation of revenues between elements under both this ED and the Revenue ED appears to be complicated by the fact that there is not a common definition of the contract term or transaction price to be allocated as discussed in more detail below.

Finally, since we are not in the business of leasing equipment, and have no internal knowledge of how a leasing company might charge for stand-alone leased equipment, it is not clear how much revenue should be estimated for purposes of the allocation.

**Determination of distinct service components**

The proposed accounting guidance in paragraph B5 though B8 of the ED requires that entities identify separate performance obligations within a contract that contains both service components and lease components and allocate payments required by the contract between the service and lease components using the principles proposed in paragraphs 50-52 of the Revenue ED. In making this assessment, entities must determine if the service component is “distinct”. In paragraph B7 (a) of the ED, a service component is distinct if “the entity, or another entity, sells an identical or similar service separately”. The use of the term “separately” is problematic as we generally do not provide our service without providing unique equipment. Others offer similar services, but only through their own unique equipment. Therefore, the service cannot be provided separately from the equipment, which in our case is the set-top receiver.
Paragraph B7 also provides that a service element is distinct if it has a distinct function either on its own or together with other non-leasing goods and services provided to the lessee and if it has a distinct profit margin. In our case, the service has no utility and is in fact unobtainable without the equipment regardless of whether the profit margin is distinct.

As a result of these facts, we are concerned that one might conclude that the entire arrangement is considered a lease pursuant to paragraph B5(b) of the ED. We do not believe that this conclusion faithfully represents the underlying economics of the arrangement, as the equipment is merely a conduit to providing the programming purchased by our subscribers, and the cost of the equipment is relatively insignificant compared to the cost we pay for programming over the average subscriber life.

*Determination of lease term and transaction price*
Our equipment agreements are only month to month agreements. As discussed in our response to the Revenue ED, we believe that the revenue standard is most operable if that standard is interpreted such that it only be applied to the minimum contractual commitment. In addition, the transaction price, which is allocated to all elements, is defined in the Revenue ED to be a “probability weighted amount of the consideration that an entity expects to receive”. However this ED provides for a lease term equal to the longest possible term more likely than not to occur, which could be significantly different from a typical minimum two year contractual commitment and based on a weighted average anticipated subscriber life. Therefore, it is unclear what period would be appropriate for allocation of revenues to the distinct performance obligations.

*Determination of stand-alone sales prices of lease components*
As noted above, if we were to conclude that the service is distinct, we would have difficulty allocating revenues to the leasing transaction because we are not in the business of leasing equipment. In all likelihood, the monthly fee we charge to the subscriber for additional set top receivers is not representative of the amount that would be charged if we or someone else was in the business of leasing set top receivers. Indeed, we charge nothing for the first receiver and a flat fee per additional receiver regardless of the cost or capability of the receiver (e.g. standard, HD, DVR, etc.). There are no third party entities that are in the business of providing set top receivers to subscribers under any type of leasing transactions, so to determine the amount that someone else would charge for such a lease is problematic. Perhaps the fact that we would have difficulty determining a stand-alone sales price based on the guidance in the Revenue ED and the ED is a further indication that the equipment is not a distinct element warranting separate accounting.
To summarize, we have a concern that we would reach the following conclusions based on the ED:

a) As discussed in our response to Question 4(a), our subscriber arrangements include equipment to be treated as leases pursuant the ED,

b) The leased equipment does not meet the criteria to be considered a distinct performance obligation,

c) The ED would therefore require the entire arrangement to be considered a lease, and

d) We would therefore estimate lease performance obligations based almost entirely on anticipated programming service revenues.

In our opinion, the definition of a lease should be modified to provide a more operational methodology for service companies such as DIRECTV to clearly conclude that similar equipment be excluded from the leasing standard. For example, the final standard could be revised as discussed in our response to Question 4(a) above, more specifically, equipment installed by a service provider for use primarily in delivery of the service need not be considered a distinct performance obligation for purposes of the application of both the lease and revenue standards when the equipment has no material independent utility from the service and does not represent a substantial component of the overall arrangement.

Alternatively, the final standard could be revised to allow an assessment of the fundamental nature of the arrangement to determine whether it should be accounted for as a lease or under the Revenue ED, rather than a conclusion that all mixed contracts with non-distinct service and equipment elements must be leases. Otherwise, in order to reach consistency in application, guidance might be needed to help companies who do not separately lease equipment to determine stand alone lease rates for specialized equipment which is not normally leased.

In addition, the final standard should be clear that the lease term in an arrangement containing components to be accounted for pursuant to the Revenue ED should be equal to the anticipated term as determined in the Revenue ED (unless the lease and service elements have clearly defined, but inconsistent terms).
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 a lessor or lessee should determine the lease term and why?

We do not agree that a lessee or 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.

At the inception of a lease agreement, we believe it will be difficult for a lessee or lessor to come to a meaningful conclusion regarding leasing decisions to be made often far into the future. Also, changing business and economic environments could have a dramatic effect on this estimate. These factors undermine the relevance of the amounts that would be recorded at the inception of the lease in the financial statements and as currently defined, the lease term could potentially result in reporting assets and liabilities that do not actually exist. In addition, as currently defined and based on the example in paragraph B17, we think the determination of the lease term is not intuitive and in practice confusing to apply. We think this complexity could ultimately lead to financial statement errors.

As proposed by PricewaterhouseCoopers LLP in their letter to the Boards dated November 30, 2010, we concur that a lease term be defined as the term, based on management’s best estimate, that includes all periods that are virtually certain to occur. Inclusion of periods that are virtually certain to occur will result in recording assets and liabilities that meet the criteria in FASB Concept Statement 6, and in particular “the transaction or other event giving rise to the entity’s right to or control of the benefit has already occurred”. Until a lessee has determined that it is likely they will exercise their right to extend the lease term, the right to use asset does not exist because the decision/expectation to extend the lease term is the event that gives rise to the entity’s right to obtain the benefit of the underlying asset and their right to control it. Options to terminate a lease early would be considered an extension period for purposes of this analysis.
Question 10: Do you agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts and circumstances indicate that there is a significant change in the liability to make lease payments or 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?

We do agree that lessees and lessors should remeasure assets and liabilities arising under a lease when changes in facts and circumstances indicate that there is a “significant” change in the liability to make lease payments or the right to receive lease payments arising from changes in the lease term. However, we are concerned that requiring reassessment at the end of each reporting period could potentially create frequent adjustments that would undermine the relevance and reliability of financial statements and that reassessment at each reporting period could be abused in practice.

We propose that the guidance be revised to require reassessment only when a triggering event occurs or circumstances change that would more likely than not indicate that there is a significant change in the liability to make lease payments or the right to receive lease payments. Such events would include a determination by management that it will or will not seek to exercise options to extend lease terms, or other events described in standards for other asset impairment tests such as the asset impairment guidance in ASC Topics 350-10 and 360-10. Fundamentally, changes proposed at each reporting period should occur only when an event occurs or circumstances change. We believe it would be more straightforward and more consistent with existing practices for preparers to approach the question of changing lease terms using the same triggering event methodology used for impairment testing.

Question 18: Do you have any other comments on the proposal?

The ED does not specify whether reassessment of the lease liability should be performed before or after impairment testing of the right of use asset when an event occurs that would impact both the asset and liability. US GAAP currently does not provide for the reversal of an impairment charge, and since the ED proposes that adjustments to lease liabilities be recorded as an adjustment to the related right of use asset, we propose clarification that the lease liability be adjusted before any asset impairment testing in the final standard.

For example, we lease satellites in order to broadcast our programming. Satellites can have partial or complete failures which result in the loss of either some or all of their remaining life. In such cases, our obligation to make lease payments would be limited to the period the satellite is available for use. Similarly, when an entity decides to exit an
activity, it may determine that it would no longer expect to exercise a renewal option on a leased asset.

We propose that the final standard be modified to specify that the lease liability should be reassessed and adjusted prior to the asset impairment testing. We propose that the adjustment of the lease liability occur by reducing the right of use asset and once this has been completed the guidance in ASU Topic 350 be applied to the remaining right of use asset with adjustments recorded through net income.

In addition, as noted above, at times the lease term (in terms of both useful life and required monthly payments) for our satellites is effectively shortened when the underlying satellite suffers a failure, despite the fact that the contract may provide for a fixed term. We can also imagine instances where a company may lease other unique equipment that cannot be repaired and the lease term is effectively reduced.

In order to maintain the benefits of accurately reporting right of use assets and lease obligations on the balance sheet as proposed in the ED, we believe it would be helpful to clearly define the lease term to be independent of stated terms. The final standard could clarify that when measuring a lease obligation, a lessee may assume a shorter lease term than the minimum contract period as long as all periods and payments are included that are more likely than not (virtually certain) to occur.

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We appreciate the opportunity to provide this comment letter on the ED. If you have any questions regarding our comments, please feel free to contact John Murphy at 310-964-0714 or Steve Adams at 310-964-0807.

Sincerely,

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