December 15, 2010

Technical Director
File Reference No. 1850-100
Financial Accounting Standards Board
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Re: Proposed Accounting Standards Update, Leases (Topic 840)

We are pleased to submit our comments for your consideration regarding the exposure draft on leases published by the Financial Accounting Standards Board and International Accounting Standards Board (collectively referred to as the Boards). We fully support the Boards’ efforts to develop a new approach to lease accounting that would ensure that assets and liabilities arising under leases are recognized in the statement of financial position. However, our review of the proposed standards has identified a number of concerns that are discussed below and on the following pages.

Union Pacific Corporation owns one of America’s leading transportation companies, Union Pacific Railroad Company (UPRR), the largest freight railroad in North America in terms of revenues. UPRR is a party to numerous agreements to lease locomotives, railcars, and other equipment and facilities related to the operation of our railroad. In addition, UPRR is a major land owner and, at any point in time, is the lessor of approximately 7,000 parcels that are not currently required in the operation of our railroad.

**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?

We agree that a lessee should recognize a right-of-use asset and a liability to make lease payments under the base term of the lease as discussed in our response to question 8.

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?

We agree that a lease can be viewed as a financing arrangement and interest on the liability should be recognized over the term of the obligation. However, we believe that it may be more meaningful to investors if the amortization of the asset and liability are recognized on a straight
line basis over the term of the lease, which better matches the benefits received from the leased asset with the lease cost.

**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?

We agree that derecognition is appropriate under certain lease agreements where the risks and rewards have been transferred. However, we believe that significant judgment will be required to determine the amount to be derecognized which may result in inconsistent application. We believe that only in limited circumstances should an asset be derecognized and revenue recognized at the commencement of the lease.

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?

We believe that only in limited circumstances should an asset be derecognized and revenue recognized at the commencement of the lease. In our opinion, most transactions should not be treated as sales and the revenue should be earned over the term of the lease.

c) Do you agree that there should be no separate approach for lessors with leverage 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?

No comment.

**Question 3: Short-term leases**

The 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 twelve 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 profit or loss 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 IFRSs and would recognize lease payments in profit or loss 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?

We believe that accounting for short-term leases in the manner proposed may be extremely burdensome for companies to apply and the cost of indentifying and tracking the leases would not be justified by the benefits to financial statement users. We believe that the simplified requirements proposed for short-term leases will necessitate an assessment at every reporting period of every agreement that includes the use of an asset, regardless of the duration of the contract. For companies that lease a number of non-core assets, these assessments will require considerable effort to identify and track the leases. Even companies that deem the use of short-term leases immaterial to the understanding of the financial statements will need to assess every agreement in order to come to that conclusion.

While we fully understand the conceptual principles behind the recognition of short-term leases, we believe the main criticism of the existing lease model is the fact that some companies are not presenting the core assets used in operations in their statements of financial position. Requiring companies to assess a number of non-core leased assets and make significant judgments on their anticipated use would not benefit financial statement users. The existing model that allows for leases with an initial term of less than one year to be recognized only in the statements of income provides financial statement users sufficient information related to the use of short-term leased assets and the impact on a company's financial position without increasing costs or administrative burden.

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 generally agree with the proposed definition of a lease that requires providing a specified asset and the right to control the use of the specified asset. However, in certain arrangements, identifying a specified asset and determining if a company has the right to control that asset may not be clear. In the railroad industry, freight cars of one railroad may be utilized by another railroad under "Car Hire" arrangements that are mandated by federal law to ensure an adequate supply of freight cars and facilitate efficient movement of freight throughout the country. Car Hire payments apply when a freight car owned by a railroad is interchanged and used by another railroad. Generally, the use of the freight car is short-term in nature, but a railroad may continue to use the freight car for longer periods of time in order to ensure the efficient movement of freight and utilization of resources. Car Hire payments will apply until the asset is returned to the owner. At any point in time, UPRR has thousands of freight cars on its lines that are owned by other railroads or third parties. Likewise, many of UPRR's owned freight cars may be utilized by other railroads. This type of arrangement is clearly not a financing arrangement, but exists as a means to ensure the efficient movement of freight and utilization of resources.

The definition of a lease, found in paragraph A1 of Appendix A, reads, "A contract in which the right to use a specified asset [emphasis added] (the underlying asset) is conveyed, for a period of time, in exchange for consideration." Appendix B further explains that to be a specified asset, the asset must either be explicitly or implicitly identified. To be implicitly identified it must be either impossible or extremely impractical to provide a substitute for the underlying asset. This is clearly not the case in Car Hire arrangements. As such, we believe that these arrangements would not be considered lease agreements under the proposed definition. This
conclusion is further supported by paragraph B3 of Appendix B which reads, "A contract that permits an entity to substitute a similar asset for the specified asset after the date of commencement of the lease does not contain a lease because the underlying asset is not specified, even if the contract explicitly identifies a specified asset [emphasis added]." Thus, even if a Car Hire arrangement explicitly identifies a freight car (which it does not), the fact that a railroad can readily substitute a different freight car is evidence that the arrangement is not a lease.

We suggest that any final standard provide clarifying guidance related to asset utilization arrangements of this nature.

a) **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?**

No comment.

b) **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?**

We believe that additional examples and clarifying guidance would be helpful in distinguishing leases from service contracts.

**Question 5: Scope exclusions**

The exposure draft proposes that a lessee or a lessor should apply the proposed IFRS 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 IFRS? Why or why not? If not, what alternative scope would you propose and why?**

No comment.

**Question 6: Contracts that contain service components and lease components**

The exposure draft proposes that lessees and lessors should apply the proposals in 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 proposals in 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 that contracts containing a lease and a non-distinct service component should be combined and accounted for solely as a lease by the lessee and lessor as proposed by the FASB. However, we believe that the definition of distinct in paragraph B7 is too rigid and should be expanded to encompass the economic substance of transactions that may not apply under such a restrictive definition. We believe that bifurcating contracts based on the economic substance of the transaction should be allowed and the final standard should include examples of the accounting for such transactions.

**Question 7: Purchase options**

The exposure draft proposes that a lease contract should be considered as 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 agree that a lessee or a lessor should account for purchase options only when they are exercised. Purchase options inherently involve a high degree of judgment and any standard that would allow for companies to exercise significant judgment would ultimately lead to inconsistent application and decrease comparability of financial information.

**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?

We believe that the lease term should only include the base lease period and not include any renewal periods. In a leasing transaction, a renewal option is not an unconditional obligation to pay and should not be considered a liability of the company until the future event that gives rise to an obligation occurs. In most leasing transactions, the intent of the company is not to commit to a defined stream of payments because of the inherent uncertainty surrounding the future use of the asset. Requiring companies to exercise significant judgment in assessing the probability of exercising renewal options would, in our opinion, lead to greater disparity in the comparability of financial information across companies. Therefore, we believe that any options to extend the lease term should only be recognized upon execution of the options.
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 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 measured reliably? Why or why not?

We believe that contingent rentals and expected payments under term option penalties and residual value guarantees should only be recognized when companies have present economic obligations. For term option penalties and residual value guarantees, a present economic obligation may exist at the inception of the lease, depending on the definition of the lease term. In these situations, we agree that an asset and a liability should be recognized if the amounts can be reliably measured. However, contingent rentals that are based on the future use of an asset do not give rise to a liability and should not be recognized until the future event that gives rise to the obligation (the actual use of the asset) occurs. In our opinion, requiring companies to recognize assets and liabilities without an unconditional financial obligation would be misleading.

Contingent rentals require a company to take a future action and, consequently, we do not believe that requiring companies to exercise significant judgment in assessing the likelihood of contingent rentals would provide investors with relevant and reliable information to assess a company's current obligations. We also believe that including contingent rentals only when they can be reliably measured would lead to variability in practice and make information less comparable across companies.

Under current guidance, a company is required to disclose the amount of contingent rentals for the period, which we believe provides investors with the information they need to assess a company's use of assets under contingent arrangements without recording obligations that will undoubtedly vary from actual payments.

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?

Consistent with our responses to questions 8 and 9, we agree that assets and liabilities arising under a lease should be remeasured when 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. However, we believe that remeasurement of lease assets and liabilities should be performed only when a renewal option is exercised or a lease contract is modified, thereby creating a binding obligation to the company. Requiring companies to reassess large numbers of leases for changes in assumptions that may never materialize would be extremely challenging.
and costly and would not provide financial statement users with useful or comparable information. Remeasurement of a lease over the course of the base lease term could result in companies increasing assets and liabilities in one period and decreasing them in a future period based on changing assumptions, neither of which may ultimately materialize into actual cash flows.

**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?

No comment.

**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 or investment property as appropriate, 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?

We agree that assets and liabilities arising from a lease should be presented separately from owned assets when material. However, we prefer that this be presented in the notes to the financial statements.

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, totaling 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?

No comment.

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?

We agree, however, we believe that only in limited circumstances should an asset be derecognized and revenue recognized at the commencement of the lease. In our opinion, most transactions should not be treated as sales and the revenue should be earned over the term of the lease. We believe that this information should be presented in the notes to the financial statements rather than on the statement of financial position.

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 agree, but would prefer that this be presented in the notes to the financial statements.

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 profit or loss (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 agree that lease income and lease expense should be presented separately when material. In addition, we believe that netting lease income and lease expense may be appropriate under sublease arrangements.

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 agree with the presentation of cash flows arising from leases as financing activities for lessees and operating activities for lessors.

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

We agree that disclosure should be provided to users of financial statements in order to make informed decisions.

(paragraphs 70–86 and BC168–BC183)? Why or why not? If not, how would you amend the objectives and why?

Question 16

a) The 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 agree that use of a simplified retrospective approach would be the most cost effective and meaningful transition method. In addition, we believe that allowing a full retrospective application would create confusion and decrease comparability for the users of financial statements. We are concerned about the date of initial application regardless of the approach. Given the significant number of leases that exist at some companies, including ours, and the complexity and judgment that may be involved in determining lease assets and liabilities, we recommend that the Boards give careful consideration to the effective date of any final standard. Even with a simplified retrospective approach, it is likely that companies will need to develop new systems and processes for identifying and tracking leases and for documenting assumptions and judgments used in valuing those leases. The time required to properly document and account for such a significant change cannot be understated and should be weighed heavily by the Boards in order to provide users of financial statements meaningful and accurate information.

**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 that certain aspects of the proposed requirements are an improvement. However, we are very concerned that implementation of all the proposed changes will require significant time and resources. The cost of indentifying and tracking short-term leases as well as the cost to measure and reassess all leases under the proposed definitions would not be justified by the benefits to financial statement users. We encourage the Boards to consider a more practical and cost efficient application of the model based on our responses to these questions.

**Question 18**

Do you have any other comments on the proposals?

No comment.

**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?

No comment.
Should you have any questions regarding this letter, please do not hesitate to contact me.

Sincerely,

Jerry C. Gose
Assistant Vice President – Financial Reporting
Union Pacific Railroad Company