1850-100 Comment Letter No. 491

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Sent by email to director@fasb.org

Re: File Reference: No. 1850-100, Exposure Draft: Leases

Dear Madam and Sir,

Exxon Mobil Corporation appreciates the opportunity to respond to the proposals in the Exposure Draft outlining the approach to a new lease accounting standard.

As we stated in our July 2009 comment letter to the boards' Discussion Paper, Leases: Preliminary Views, in general we support the objective to reconsider the approach to lease accounting, recognizing that current ASC 840 and IAS 17 have given rise to many valid criticisms, both in failing to meet the needs of users and in providing the opportunity, through excessive reliance on bright line tests, for entities to structure transactions to keep leased assets and liabilities off the balance sheet.

We therefore agree with the basic principle that lessees should recognize an asset, representing the right-of-use, and a liability, representing the obligation to pay, for lease contracts.

However, we continue to have concerns regarding the practical application and implications of the boards' proposals. In our view, this standard will be excessively complex, particularly related to determining option periods and contingent rentals, and will be burdensome for preparers to implement, without commensurate benefit to users.

We comment below on a number of specific aspects to the proposal which cause concern. We have included our detailed responses to the questions in the attachment. Additionally, we support the comment letter submitted by the Committee on Corporate Reporting (CCR) of Financial Executives International (FEI).

Short-Term Leases

We strongly recommend that short-term leases, defined as leases with durations of one year or less, either be excluded from the scope or provided the same election option that is provided to lessors to not recognize short-term leases on the balance sheet. This would enable companies to avoid the significant effort and cost associated with accounting for and tracking short-term assets and liabilities; instead they should continue to be expensed as incurred.

We do not think this modification will significantly detract from the overall benefits users gain from the proposed approach, and we do not believe it will result in lease terms being restructured to avoid recognizing an obligation given the proposed requirements associated with determining the lease option period.

Lease Obligation Measurement

We do not agree with the boards' proposal that the lease term should be measured as "the longest period more likely than not to occur". In our view, this is a lower threshold than should be used to establish that a liability exists. We believe the lessee should assess the term of the lease considering the fixed non-cancelable period and including renewal periods where factors associated with the lease economically compel the lessee to renew. We recommend the boards go beyond the thresholds used in ASC 840 and IAS 17 of being "reasonably assured" and "reasonably certain" respectively, and include only lease option periods that are "virtually certain".

In addition, we do not agree that all contingent rentals meet the definition of a liability. Where contingent rentals are based on future performance or usage of the asset, the event (which has not yet occurred) giving rise to the liability is what obligates the lessee to pay the rentals. In our view, such contingent rentals should be expensed as incurred, i.e. when the events occur that require the lessee to pay the rentals. Contingent rentals that are not based on future performance or usage should be included if they are "virtually certain", similar to the threshold recommended above for lease option periods.

Further, the proposal related to contingent rentals would be very difficult to apply in practice and may result in over-statement of expenses in the income statement, as the related asset may be amortized in advance of the contingent rental usage. In addition, implementation would be expensive and complex, without commensurate benefit to users.

Remeasurement Proposals

We support the boards' modification to the language regarding the reassessment of the lease liability from "any new facts or circumstances" to "if facts or circumstances indicate that there would be a significant change in the liability". Under the current proposals, a reassessment would occur when an actual event related to the lease, such as a change associated with a renewal option or a substantive change in the terms of the contract, occurs.

Service and Supplies Contracts

The issue of identifying embedded leases in service and supply contracts will become increasingly significant under the new proposals because of the accounting treatment associated with a lease (front-loading of expenses), versus the financial impact of a service contract (expense when incurred). As a result, the guidance provided in this area must be clear and unambiguous. In that regard, we do not agree with the boards' position that an embedded lease is present if the lessor can substitute an asset but rarely does so. The guiding principle

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should be based on control over the decision to make the substitution. If the substitution rarely occurs, but is always at the discretion of the lessor, then the asset is not implicitly specified and the contract is not a lease.

As the boards are aware, this is an area where current practice is already challenging. We encourage the boards to reconsider the guidance in this area.

Disclosures

The disclosure requirements as described in the Exposure Draft are excessive. We encourage the boards to re-examine the costs and benefits of these requirements and limit the amount of disclosures to a level that is practical for preparers to implement and provides useful information to users. For example, quarterly disclosures should be limited to significant changes from the annual disclosures.

Finally, the proposed changes are very significant in what is already a complex area. Significant costs will be incurred to establish the additional functionality required in financial and accounting systems to effectively monitor all. In addition, substantial effort will be required for the initial set-up of each lease and the establishment of processes to ensure that reassessment is conducted in a consistent and appropriate manner. Therefore we strongly recommend that the boards conduct field testing of the new proposals with a range of different preparers and users in order to identify any significant unforeseen issues with implementation and transition before final guidance is issued. This will also provide further insight into the costs and benefits associated with the various facets of the proposals.

We appreciate the boards' consideration of these matters and welcome the opportunity to discuss the above issues. Our responses to the boards' questions regarding the proposed changes are included in Attachment I.

Patrick 7. Moline

Attachment I

RESPONSES TO BOARD QUESTIONS POSED IN EXPOSURE DRAFT

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?

We agree with the proposed lessee accounting model. However, we have specific concerns with certain aspects of more complex lease measurements, such as inclusion of contingent rentals and options.

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?

We believe high-volume / low-value short-term lease arrangements should be expensed as incurred, with associated annual expense disclosed. This would allow companies to avoid burdensome efforts and significant costs associated with accounting for and tracking those short-term leases that would add no incremental value to the investors.

Question 4: Definition of a Lease

- (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?

We agree, as the lease definitions are largely consistent with the existing accounting principles in ASC 840 / IFRIC 4.

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 support the stated lease scope exclusion.

We recommend incorporating current accounting for subleases. The current proposal would be burdensome especially for companies that do not engage in significant subleasing activities.

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 support the principle in the proposed lessee accounting. However, we do not agree that an embedded lease is present if the lessor can substitute an asset but rarely does so. The guiding principle should be based on control over the decision to make the substitution. If the substitution rarely occurs, but is always at the discretion of the lessor, then the asset is not implicitly specified and the contract is not a lease.

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?

The proposal is consistent with the current standard and we support this treatment.

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?

In our view, "the longest period more likely than not to occur" potentially would overstate liabilities. We believe the lessee should assess the term of the lease considering the fixed non-cancelable period and including renewal periods where there are factors associated with the lease which economically compel the lessee to renew. We recommend that the boards go beyond the thresholds used in ASC 840 and IAS 17 of being "reasonably assured" and "reasonably certain" respectively, to including only lease option periods that are "virtually certain".

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?

We strongly disagree that all contingent rentals meet the definition of a liability. Where contingent rentals are based on future performance or usage of the asset, the event (which has not yet occurred) giving rise to the liability is that which obligates the lessee to pay the rentals. In our view, such contingent rentals should be expensed as incurred.

In addition, we do not believe that the expected value approach is appropriate. A probability-weighted estimate can be skewed by inclusion of a number of improbable outcomes, may even result in an outcome that is impossible, and is excessively difficult to implement.

We recommend recognition of a contingent rental liability only upon reaching a level of "virtual certainty".

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?

We agree that a reassessment should occur when an actual event occurs related to the lease, such as a change associated with a renewal option or a substantive change in the terms of the contract.

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?

We recommend that entities be allowed to consider the magnitude and importance of leases to their respective operations and determine whether separate presentation is appropriate.

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?

See response to Question 12.

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?

See response to Question 12.

Question 15: Disclosure

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?

The disclosure requirements as described in the Exposure Draft are excessive. We encourage the boards to re-examine the cost/benefit of these requirements and limit the amount of disclosures to a level that provides useful information to users. We recommend that the quarterly disclosures be limited to significant changes from the annual disclosures.

Question 16: Transition

- (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 appreciate the boards' effort to simplify the transition. However, we strongly urge the implementation be prospective with selective disclosures for comparative periods.

Question 17: Benefits and Costs

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 recommend the boards expand the discussion and testing of benefits and costs associated with the current proposal for short-term leases, contingent rentals and options for more complex leases.

Question 18: Other Comments

Do you have any other comments on the proposals?

Implementation of the proposed lease accounting will result in significant systems costs.

We encourage the boards to engage in additional outreach activities to explore current complexities and make appropriate clarification in the final standard to address those concerns.