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Via email to director@fasb.org

Technical Director
Financial Accounting Standards Board
401 Merritt 7
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Re: Proposed Accounting Standards Update (Revised) – *Leases (Topic 842)*, File Reference No. 2013-270

Chevron Corporation (Chevron) appreciates the opportunity to provide comments to the Financial Accounting Standards Board and the International Accounting Standards Board (the "Boards") regarding the proposed Accounting Standards Update, *Leases (Topic 842)* (the "Proposed ASU").

Chevron is a global, integrated energy company based in San Ramon, California. The company explores for, produces and transports crude oil and natural gas; refines, markets and distributes transportation fuels and other energy products; manufactures and sells petrochemical products; generates power and produces geothermal energy; provides energy efficiency solutions; and is developing energy resources for the future, including biofuels. The company's activities are widely dispersed geographically, with operations in North America, South America, Europe, Africa, Asia and Australia.

Chevron has participated with other member companies of the American Petroleum Institute (API) in recent months to prepare comments to the Boards on the Proposed ASU. Chevron fully endorses the comments made in that letter. In the following discussion, we highlight several matters of particular importance to Chevron.

Overall, Chevron believes the Boards have gone well beyond the original objective of improving transparency around lease obligations, resulting in unnecessary complexity and excessive costs for financial statement preparers, with little resulting benefit for financial statement users. We also believe the proposed definition of a lease is extraordinarily difficult to apply and may result in effects on the income statement that do not reflect the economics of the transaction. This will likely lead to a lack of comparability among companies in the same industry, and potentially cause confusion among users of the financial statements. Additionally, assuming the Boards proceed with the model proposed in the ASU, we believe there are key aspects that require clarification to assist preparers in applying them consistently in practice. Finally, given the material accounting and reporting changes included in this exposure draft, companies will need a significant period of time to review contracts, enhance financial systems, and implement new business processes and internal controls.

Following is a brief summary of our primary concerns:

Complexity and cost

We believe the Boards have created a measurement model that is overly complex and difficult to apply in practice, while providing little additional benefit to financial statement users. We think the proposed standard will cause companies to incur significant costs to develop systems and controls necessary to support the initial measurement and subsequent re-measurement of a lease. Specifically, the proposed provisions will require lessors and lessees to implement new modules in their financial systems to track and account for leased assets or create custom applications with complex interfaces to the financial systems. To fully implement the ASU as proposed, we estimate it will cost Chevron in the tens of millions of dollars. We do not believe the limited benefits provided by the proposed ASU outweigh the significant, direct costs that will be incurred.

Given the magnitude of the changes being proposed, the impacts will be far reaching. Businesses process changes will be required at Chevron in multiple areas, including finance and accounting, tax, treasury, procurement, legal, IT and operations. There will be significant change management issues and training requirements, highlighting areas of management judgment and ensuring consistent application across the international enterprise. Companies of our size have thousands of contracts that will need to be reviewed to determine if a lease exists under the proposed accounting requirements. Once all leases have been identified (a huge undertaking), a significant effort will be required to gather the necessary data elements to support initial measurement and recognition of the leases. In addition, processes and system tools for periodic reassessment will need to be developed to capture contractual changes and update management judgments relating to renewals and reflect changes to variable payments based on indices or rates. A simple spreadsheet application will not suffice, so complex systems will need to be created (either custom-developed by Chevron or by multiple financial systems providers) and implemented to effect this change in the accounting records. Following the initial implementation, ongoing costs for systems and business process support and internal controls for the new lease accounting requirements will be significant.

In summary, we believe the significant implementation and ongoing costs related to this proposed standard will shift company resources and employee focus away from other activities that more clearly benefit our shareholders. We believe the Boards must further evaluate the cost/benefit balance prior to issuing a final standard and urge the Boards to perform more outreach on costs and benefits.

Consistency and comparability

The current exposure draft defines a lease in a simple manner that works in numerous straightforward applications. However, in practice, there are many additional factors that will influence management assessments and could result in different accounting outcomes for companies involved in similar contracts, depending on their assessment of "control."

When a contract contains both service and lease components and the service component is not distinct, we agree that the service component should be quantified and excluded from the lease based on the observable standalone price for such service. In the absence of an observable, stand-alone price, companies should be able to allocate the value of the contract between the lease and service components based on information provided by the lessor or management's best estimate, rather than simply combining

such components into a single lease component as prescribed in the current exposure draft. Including the service component with the lease component would overstate both assets and liabilities.

We believe the addition of the reference to significant economic incentive in the determination of the lease term introduces another opportunity for inconsistent application and variability by preparers. Considerable costs will be incurred to make an initial assessment and periodically reassess the economic incentive. We suggest that the Boards consider removing the "significant incentive to renew" criterion and simply define the lease term as the non-cancellable period.

Implications for the oil and gas industry

As described in detail in the API comment letter, the proposed ASU raises additional and unique complexities for the oil and gas industry as a result of its impact on joint venture arrangements. Consistency and comparability are key elements necessary for investors to evaluate the financial statements of companies within a particular industry. Based on the current exposure draft, this comparability is diminished by different accounting treatment for joint venture operators and non-operators. Operators generally enter into contracts for goods and services which could be construed as a lease, in which case the operator would record the right of use asset and liability, while the non-operator partners would simply record their share of the cash rental payments. In the case of Type A leases, this would create distinct financial statement impacts for companies that tend to operate joint venture projects, compared with entities that do not act as operators. This is particularly concerning given the disclosure requirements associated with ASC 932 – *Extractive Activities – Oil and Gas*. We also believe that the inconsistent application of the concept of "control" could lead to further reductions in comparability across the industry.

To address these concerns, we believe the Boards should consider allowing all leases to be treated as Type B leases or permitting an accounting policy election to treat all leases as Type B. Alternatively, we believe that lease costs that are included in the carrying amount of another asset must be considered Type B leases. To do otherwise will create significant accounting inconsistencies between joint owners in the same assets. Broader use of Type B treatment would remove one of the decision points forced on preparer's that will likely lead to inconsistent application of the standard.

Presentation and disclosure

In our view, amounts related to leases should be disclosed in the notes to the financial statements, rather than being separately presented on the face of the financial statements. We believe disclosure in the notes provides a consistent presentation format for financial statement users and allows preparers to properly aggregate information for financial statement presentation. We also believe that the proposed disclosure requirements are extensive and provide little additional benefit to users. Further, we request the Boards to consider limiting quarterly disclosures to significant changes from annual disclosures.

Transition

Given the material changes included in this exposure draft, companies will need a significant period of time to review contracts, enhance financial systems, and implement the new business processes and internal controls. We urge the Boards to provide three or more years between publishing the final standard and the first comparative period requiring restatement. If the new standard is issued in mid-2014,

the effective date of the new standard would need to occur no sooner than 2020 to ensure the necessary system enhancements are in place by year-end 2017 to support comparative reporting.

As the Board's evaluate this initiative in conjunction with other accounting enhancements currently being considered, we also believe that preparers should not be required to implement this initiative concurrent with other significant ASU's. We urge the Boards to ensure a staggered implementation of these new requirements to alleviate the need for companies to adopt several multifaceted accounting and reporting requirements at the same time. Our detailed responses to selected questions posed by the Boards in the Proposed ASU are included in the attached Appendix.

In light of the serious concerns described above and in the Appendix, we strongly urge the Boards to reconsider the proposal, addressing the cost/benefit balance and reducing the complexity of the accounting. We believe that significant changes are needed to meet the needs of both preparers and users of financial statements.

We trust our comments are helpful to the Boards in determining next steps for the project. If you have any questions on the content of this letter, please contact Al Ziarnik, Assistant Comptroller, at (925) 842-5031.

Very truly yours,

Appendix – Responses to Selected Questions

Question 1: Identifying a Lease

This revised Exposure Draft defines a lease as "a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration." An entity would determine whether a contract contains a lease by assessing whether:

> ***1. Fulfillment of the contract depends on the use of an identified asset.***
> ***2. The contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.***

A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset. Do you agree with the definition of a lease and the proposed requirements in paragraphs 842-10-15-2 through 15-16 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any, to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

We believe the lease definition will be difficult to implement in many real-world situations. Specifically, we do not believe the definition provides sufficient guidance for companies to make decisions concerning whether or not a contract contains a lease in situations where goods and services are bundled together in the arrangement. Below are examples of the types of situations, which are prevalent in our industry, that the Boards should consider in order to have a full appreciation of the complexities inherent in the proposed definition.

In the oil and gas industry, exploration and production (E&P) companies enter into service arrangements with rig owners (contractors) to drill oil and gas wells on a day-rate basis. The primary equipment the contractor uses to drill the well is a drilling rig. Even though all contracts are different, there is generally some degree of shared control of the drilling rig between the contractor and the E&P company. The contractor's personnel are onsite and control the operations of the rig, maintenance, etc. The E&P company is responsible for giving directions to the contractor to ensure the wellbore, the main output of the arrangement, is constructed to its specifications. The E&P company's decisions relate to well location, wellbore size, depth to drill, etc. Under the proposed lease definition, both the contractor and E&P company "direct the use of the identified asset."

Another example in our industry is where the owner of petroleum products (a petroleum company) enters into terminal storage agreements with another party (storage operator) to store petroleum products. The tanks used for storage may be specifically identified in the contracts and substitution is either not allowed or is not feasible. Similar to the example above, there is shared control between the parties. The storage operator owns the tanks and the petroleum company owns the inventory in the tanks. The petroleum company schedules the movement of product in and out of the tanks, while the storage operator executes these activities. The petroleum company receives the benefits from the use of the tanks, but could not do so without the services provided by the operator. Additionally, the services are not sold separately by other suppliers, and the tanks would likely not be considered incidental to the delivery of the services.

To make the definition of a lease more functional, we believe service contracts that contain an identified asset should not be considered to be leases, or to contain leases, when the service company's personnel operate and maintain the asset and the owner of the asset being constructed, stored, or transported is limited to making sure the activity is performed to its specifications. Specifically, we do not view any part of these arrangements as similar to financing the purchase of the identified asset. Therefore, we ask that the Boards consider adding language to this effect in paragraphs 842-10-15-10 through 14 that addresses these situations.

In addition, we believe when an asset and a vendor's services are tied together and where the equipment and the service are inseparable, the contract should not be considered a lease. In determining when a contract represents a service instead of a lease, the Board should eliminate the words in 842-10-15-16(b) that state "The asset is incidental to the delivery of services because the asset has been designed to function only with the additional goods or services provided by the supplier. In such cases..." while retaining the remainder of the words in that subsection (b). This will allow for proper accounting as service contracts for those arrangements where the equipment and services are bundled and not sold separately by the supplier or others.

Question 2: Lessee Accounting

Do you agree that the recognition, measurement, and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

We believe the proposed lessee accounting requirements are far too costly and complex to implement for the limited incremental benefit that users will receive from having leases reflected on the balance sheet. In certain situations we also believe these proposals will generate results that do not reflect the economics of the transaction. Additionally, there are issues related to lease costs that the Boards need to clarify or address.

We are also concerned with the requirement that lessees must have observable standalone prices to separate services from lease components. Not only will it be costly for lessees to gather this price information, there will be many situations where similar services may not be routinely provided independently by service providers. While the standard requires lessors to allocate costs, it does not permit lessees to use this information. We believe that requiring lessees to ignore this information, which in many cases can be part of the contract, and account for services as a lease simply because these prices are not "observable standalone prices" does not faithfully represent the economics of the transaction. Therefore, we ask that the Boards consider permitting lessees to use cost information provided by a lessor or management's best estimate to allocate remaining costs on a commercially reasonable basis between lease and services. Including the cost of the service portion of contract in the lease component will overstate assets and liabilities.

We also believe the Boards need to address issues concerning the amortization of the right of use asset and the unwinding of the discount on the lease liability as interest, when these lease costs for the use of an identified asset are to be charged to and included in the carrying amount of a constructed asset. This is especially critical in the oil and gas industry.

For example, if an E&P company determines that a drill rig is considered a Type A lease, the wells drilled by the rig will each be charged on a different basis depending on when they were drilled. Although the contractor charges for use of the drilling rig on a day rate such that each well attracts the same amount of cost each day the rig is on the well, a Type A cost structure will cause the first well to be charged a higher day rate than the second well, the second well more than the third, etc. This is an inappropriate result. Additionally, treating a drilling rig as a Type A lease will also cause the various partners in a well to accrue different amounts related to the same well costs. The operator of the well will charge its wells as noted above and the non-operating partners will charge their portion of the well on a cash basis as billed by the operator. This reduces the comparability of the Costs Incurred, Capitalized Costs and Results of Operations tables that make up the Supplementary Oil and Gas Tables for Oil and Gas Producing Companies (ASC 932-235-50).

We believe that the Boards could address these issues by removing from the proposal's scope contractual arrangements in which the identified asset is used to construct, store or transport another asset and the associated costs are ultimately recorded to property, plant and equipment or inventory. If the Board continues to believe that these arrangements should be included in the scope of these proposals, we believe it is absolutely critical that "lease costs" that will be capitalized under other GAAP be considered Type B leases.

Finally, we believe the Boards need to clarify the phrase in 842-20-35-2 that states "unless the costs are included in the carrying amount of another asset in accordance with other Topics ..." As currently written, it is not clear if this relates to accounting for capitalized interest under ASC 835 or to situations where the lease cost is capitalized as the cost of another asset. Because we do not view interest costs associated with the unwinding of the discount on the lease liability as borrowing costs, we strongly oppose including them as part of capitalized interest under ASC 835, especially for Type B leases. Therefore, we believe clarification needs to be provided concerning whether any interest cost pursuant to 842-20-35-2(a) and (b) is to be considered for capitalization under the principles in ASC 835-20.

Question 4: Classification of Leases
Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 842-10-25-5 through 25-8, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

We believe the Boards should consider allowing all leases to be treated as Type B leases or permitting an accounting policy election to treat all leases as Type B. This would remove one of the decision points forced on preparer's that will likely lead to inconsistent application of the standard.

If the FASB does not agree to do away with Type A leases entirely, we believe the guidance in 842-10-25-6 for an underlying asset that classifies those leases as Type A unless (i) the lease term is for an insignificant part of the economic life of the underlying asset and (ii) the present value of the lease payments is insignificant relative to the fair value of the underlying asset, is set much too low. In particular, we believe a standard higher than "insignificant" is more appropriate, and suggest that language such as that used in the current U.S. GAAP capital lease test that classifies leases as capital leases if the lease term represents 75 percent or more of the useful life of the underlying asset.

Finally, it is our opinion that lease costs that are included in the carrying amount of another asset must be considered Type B leases. To do otherwise will create significant accounting inconsistencies between owners in the same assets.

Question 5: Lease Term
Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease term and why?

Not only will the requirement to continually reassess the lease term be costly, it will present an operational challenge to maintain ongoing manual processes, including necessary internal controls, to achieve consistent results across an organization the size of Chevron for what is inherently an interpretative judgment call. Added to these internal costs are those of the external auditor, whose audit scope will also increase to review these judgments and the related additional entries the ongoing accounting will create. Therefore, we suggest that the Boards consider removing the "significant incentive to renew" criterion and simply define the lease term as the non-cancellable period.

Question 6: Variable Lease Payments
Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

We support the exclusion of variable lease payments that are not based on a rate or index from the measurement of the lease liability and related right-of-use asset.

However, we do not support the proposals to reassess variable lease payments based on an index or rate (including interest rates). Specifically, we believe that changes in indices are typically not significant and therefore believe that the proposed reassessment does not justify the additional cost of financial systems and manual efforts needed to monitor for changes in the index or rate, recalculate the lease liability and related right-of-use asset for impacted leases, record the related entries and reset the related right-of-use asset depreciation schedules. Further, we believe that this requirement is not reasonable for interest rates, specifically, as rates change frequently, which would likely result in reassessment and related accounting for these changes at each reporting period. For these reasons, we ask that the Boards consider excluding payments based on an index or rate from the measurement of the lease liability.

If the Boards continue to believe that these payments should be included, then we suggest that the changes in variable lease payments based on an index or rate, including interest rates, be reflected as changes in income when they occur (similar to variable lease payments that are not based on an index or rate), unless there is a change in relevant factors related to the lease term – at which point the index or rate in effect at that time would be included in the recalculation of the lease liability and right-of-use asset and related accounting. While we do not consider this an ideal choice, we believe it provides a better balance between costs of compliance and the minor incremental benefits financial statement users receive from the current proposals.

Question 7: Transition
Subparagraphs 842-10-65-1(b) through (h) and (k) through (y) state that a lessee and a lessor would recognize and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why? Are there any additional transition issues the Boards should consider? If yes, what are they and why?

We appreciate the Board's reconsideration of transition methodologies and decision to provide options for companies to consider. While full retrospective is technically the most accurate, it continues to be the most onerous and impractical approach for a company such as ours with potentially thousands of leases to account for under the proposed standard. The other option provided is modified retrospective, which is supposedly easier to implement as it approximates full retrospective with fewer calculations. However, to approximate the entries under this alternative, the historical data gathering is still necessary and extremely burdensome, resulting in little, if any, benefit to preparers.

We strongly urge the Board to reconsider simplified retrospective and/or prospective adoption as additional options which would alleviate significant costs and burdens on companies. We understand the Boards' concerns around the magnification of the artificial front-loading of interest expense inherent in the simplified retrospective approach, but this front loading is intrinsic in all Type A leases. If the straight line (Type B) approach were applicable for all – or more – leases, this front-loading impact would be eliminated and cash flows and expenses would align.

Prospective adoption would be preferred as it enables companies to implement the new rules with the least burden. It is true that financial statements would not fully reflect the totality of leasing activities for some time, but it will take years for the financial community to comprehend the changes contemplated by this exposure draft, so the gradual convergence of this pronouncement seems reasonable.

An alternative to consider is a multi-faceted approach where a company would retrospectively account for individually material leases, with prospective implementation for others. Since most of the work entails a large number of small dollar leases, this would achieve the objectives of the Boards and companies.

Furthermore, to apply new accounting rules such as the ones proposed here for leases, most large companies will need to implement a system solution to capture and retain transaction detail needed to comply with the requirements in the Proposed ASU. We believe the most cost-effective software solution for these new requirements will need to be developed by the vendors of the major ERP systems. The time required to complete this software development work is uncertain, but we expect that most ERP software vendors will wait to develop new functionality until the standards are finalized. Software development and testing may take 9-18 months or longer before release to customers. This will be followed by installing and testing the new software. If insufficient time is allowed for the ERP software vendors to develop the new functionality, preparers could be forced to create custom software solutions and complex interfaces to multiple ERP systems. Additional time will be needed after software installation to deploy training across multiple U.S. and international work locations.

While it is difficult to estimate the timeline required for this work, we believe that at least 3 years will be required to complete these activities in advance of the first comparative reporting period. If the new

standard is issued in mid-2014, the effective date of the new standard would need to occur no sooner than 2020 to ensure the necessary system enhancements are in place by year-end 2017 to support comparative reporting.

Additionally, there are a number of exposure drafts at varying stages of completion. We would urge the Board to ensure a staggered implementation of these new requirements to alleviate the need for companies to adopt several multifaceted reporting requirements at the same time, further increasing the demands on companies and introducing additional complexity and the likelihood of error.

Question 8: Disclosure
Paragraphs 842-10-50-1, 842-20-50-1 through 50-10, and 842-30-50-1 through 50-13 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments, reconciliations of amounts recognized in the statement of financial position, and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

We appreciate the Boards' reconsideration of lease presentation and strongly support the option for lessees to present leases separately in the notes, rather than presented on the face of the statement of financial position. We believe disclosure in the notes provides more complete and consistent presentation format for financial statement users and allows preparers to properly aggregate information for financial statement presentation, as provided for under SEC materials, ASC 205, *Presentation of Financial Statements*, and IAS 1, *Financial Statement*. Therefore, we ask the Boards to reconsider the proposed requirements to present lease information separately in the income statement and the statement of cash flows and provide an option to disclose in the notes, similar to the Boards' decision on the statement of financial position.

While we agree with some of the changes that have been made to the disclosures in the revised exposure draft, we still believe that the proposed requirements are extensive, place undue burden on the preparer and provide little additional benefit to users. We ask the Boards to reconsider the cost/benefit of these requirements, specifically limiting quarterly disclosures to significant changes for annual disclosures, as provided for under SEC guidance in regulation S-X rule 10-01, *Interim Financial Statements* and FASB ASC 270, *Interim Reporting*.