

**From:** Gregg Nelson [mailto:gln@us.ibm.com]  
**Sent:** Thursday, September 12, 2013 10:22 AM  
**To:** Director - FASB  
**Subject:** File Reference No. 2013-270, Proposed Accounting Standards Update (Revised), "Leases"  
**Importance:** High

September 12, 2013

Mr. Russell Golden, Chairman  
Financial Accounting Standards Board  
401 Merritt 7  
P.O. Box 5116  
Norwalk, CT 06856-5116

(Sent via e-mail to [director@fasb.org](mailto:director@fasb.org))

Re: File Reference No. 2013-270, Proposed Accounting Standards Update (Revised), "Leases"

Dear Mr. Golden:

The International Business Machines Corporation ("IBM" or "the company") appreciates the opportunity to comment on the Proposed Accounting Standards Update (Revised), "Leases" (the "proposed ASU" or "exposure draft"), issued by the Financial Accounting Standards Board ("FASB") and the International Accounting Standards Board ("IASB").

The company continues to support the FASB and the IASB ("the Boards") in their efforts to converge U.S. GAAP and IFRS. We also continue to support the objective of improving the accounting for leases. However, while the proposed ASU reflects improvements from the first exposure draft, we still have significant concerns regarding the model. Our concerns are focused on the overall complexity inherent in the model, the right-of-use approach, the introduction of a dual model for lease classification, the income statement attribution approach, the interaction with services arrangements, the disclosure and transition requirements and the cost to implement and maintain compliance with the requirements. While the approach in the exposure draft accomplishes the goal of recording lessee obligations on the balance sheet, the company is not fully convinced the proposed model will provide superior information for users of financial statements versus the current lease accounting model. In addition, it is very likely that the costs related to the proposed ASU will be greater than the benefits perceived to be realized.

#### ***Lease Classification – Dual Model***

Overall, we do not support the new approach in the exposure draft for lessees to classify leases based on the expected consumption of the economic benefits of the underlying asset. Equipment and property leases are legally and in substance the same. The proposed ASU introduces a consumption concept to determine what leases are equivalent to purchases with debt financing and which leases are not. The determination of a Type A or a Type B lease leads to a dual method of expense recognition and presentation in the financial statements. Today's two model approach – capital and operating leases – has been replaced by a different two model approach. The proposed classification of leases increases the complexity and will introduce confusion for both preparers and users of financial statements. All leases should be treated using the same principles regardless of the underlying asset.

#### ***Lessee Accounting – Right-of-Use Model***

The company's views regarding the right of use model have not changed from our 2010 comment letter. While we understand that the recognition of an asset representing the right to use a leased item is a necessary consequence from recognizing the liability, the company is still not convinced that the right-of-use model meets the definition of an asset in the conceptual framework, especially when renewal options are added. A lease is an executory contract

that provides conditional access to an asset provided the lessee fulfills its ongoing obligations under the contract. As an executory contract, the lessee, having the right of use, does not have the same degree of control as it would if the underlying asset was owned.

We do not believe that options meet the definition of an asset or a liability. Contingencies of these types are not legal obligations of the lessee and do not represent enforceable rights for the lessor. While we appreciate the Boards intent on providing protection against structuring concerns, we believe that options and contingent rentals should only be recognized in the financial statements when an obligation has been created.

In addition, under the proposed ASU, a significant amount of judgment would need to be applied to each contract term as it relates to options, contingent rentals and other factors in order to determine the appropriate lease term and lease payments. This assessment would need to be made each reporting period in order to ensure that changes in circumstances are properly accounted for during the lease term. This periodic reassessment of the lease term will drive significant cost on lessees. We believe the costs associated with maintaining this type of analysis far outweigh the benefits. We recommend that the lease term should be determined at lease inception and be re-evaluated only upon renewal or extension. If the Boards proceed with these requirements, we recommend that additional guidance and implementation examples be provided to ensure consistent application of these factors and what constitutes a significant economic incentive.

The right-of-use model will result in the grossing up of the statement of financial position, potentially giving financial statement users a false sense of the assets that are readily available for use by the company to meet its future goals and obligations. Further, we continue to be concerned whether use of this model would give standard setters a proxy to apply similar rules to other executory contracts. We encourage the Boards to include guidance on how to distinguish leasing contracts from other executory contracts.

#### ***Dual Model for Income Statement Attribution***

If the Boards proceed with the dual model for lease classification, the company does not support a dual model for income statement attribution for lessees. The dual model approach introduces unnecessary complexity, especially for certain long lived equipment and integral equipment. Equipment operating leases are executory contracts where the rent payment is for the periodic use of the asset. These types of leases should have straight line expense. This approach is consistent with the current model, matches the economic nature of the lease, would not materially change an investor's view and would significantly reduce the cost of implementation of the proposed ASU. The complexity introduced with the dual model far outweighs the perceived benefits. A key objective of this project was to address deficiencies in the balance sheet with respect to operating leases. However, much of the complexity is being driven by the proposed changes in the income statement. Investors and users do not seem highly concerned with understanding the allocation between operating and financing expense for these leases.

#### ***Leases and Services Arrangements***

The company notes that the exposure draft includes criteria to be used to determine whether the contract is a lease or contains a lease. The factors are very judgmental and could easily result in inconsistent application especially when separating lease components from non-lease components in services arrangements for both lessors and lessees. We are concerned that the new guidance may substantially change the current guidance in both U.S. GAAP and IFRS in such a way that expands the scope of the leasing standard. Today, accounting for an operating lease and a services arrangement is very similar so there is very little pressure placed on this distinction. We encourage the Boards to revisit this topic and provide further clarification due to the increased importance of this decision under the right-of-use model.

#### ***Disclosure and Transition Requirements***

Similar to our comment letters regarding the revenue project, we believe the disclosure of certain roll-forward information contained in the exposure draft would be burdensome and the costs associated with obtaining this information would far outweigh the benefits. Due to the outreach performed by the Boards with preparers and users, the disclosure requirements in the final revenue recognition standard were amended to provide users with decision-useful information while balancing the burdens and costs to preparers. Similarly, we support the elimination of the roll-forward of lease liabilities, lessor lease receivables and residual assets, and replacing these requirements with disclosures of opening and closing balances along with key drivers during the period. We encourage the Boards to

conduct extensive outreach with preparers and users before concluding on the disclosure requirements.

In addition, consideration should be given to the disclosure requirements necessary for interim reporting versus annual reporting. There should be fewer requirements on an interim basis; especially if there have been no material changes since the prior annual reporting.

In addition, for lessees, the company believes the disclosure requirements should be limited to lease components only. Non-lease components, like services, when separated from a lease component, should not be subject to lease disclosure requirements simply because the items were contracted together in the same arrangement. These services may relate to disparate parts of an entity's operations (e.g. lease of machinery for production with a maintenance contract, and lease of photocopiers with a maintenance contract in the same location), and we are unsure what further insights this disclosure requirement provides. Moreover, since it only includes a maturity analysis of cash flows related to contracts with embedded leases and not all services contracts, it provides no truly relevant information.

The company feels that there should be harmonization between the transition options for the revenue recognition and leases projects. Similar to the revenue recognition project, we propose that one transition alternative include a January 1, 2017 adoption date with a cumulative adjustment to retained earnings on that date. Many of the company's long-term services contracts contain leases. Analyzing every contract only once for re-characterization under the new standards would be both time and cost efficient. This recommendation is predicated on the Boards issuing a final standard that provides preparers with sufficient time to implement the standard, which we believe is two to three years at a minimum.

#### ***Costs***

To implement the new requirements, preparers will incur significant costs to develop new systems, modify existing systems and develop new processes and controls. The proposed standard, due to its complexity and the significant judgments inherent in the model, will also drive ongoing compliance costs that will have a notable impact. In addition, costs are likely to be proportionately greater for leases that require on-going adjustments such as CPI adjustments every quarter, and leases of low value items, which comprise the largest volume, but not the largest monetary value, of lease contracts. In order to reduce costs, preparers should be permitted, as a practical expedient, to aggregate assets under a master lease agreement. Preparers can also reduce costs by using capitalization thresholds; guidance is required in this area as discussed below.

#### ***Capitalization Thresholds***

The proposed ASU should clarify the accounting when capitalization thresholds are applied. The lessee could record the lease liability and immediately record the expense, or record the expense as incurred, like today's operating leases. We support the continuation of operating lease accounting.

While we understand the desire to address off-balance sheet concerns with a new standard, we question whether a right-of-use approach as outlined – which will add significant complexity and operational burden – will provide incrementally useful information to investors and other users of financial reports. We note that certain investors have already indicated that the proposal is not an improvement to current accounting and have suggested that the Boards consider enhanced footnote disclosures. We urge the Boards to consider this approach, or consider a simpler model that meets the objective of recording lease liabilities without a wholesale revision of existing lease accounting.

Thank you for the opportunity to comment on the Exposure Draft. If you have any questions, please contact me at (914) 766-2008.

Sincerely,

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