Cisco Systems, Inc.
170 West Tasman Drive
San Jose, CA 95134-1706

Phone: 408 526-4000
Fax: 408 526-4100
www.cisco.com

September 13, 2013

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

Mr. Hans Hoogervorst, Chairman
International Accounting Standards Board
30 Cannon Street
London EC46xh
United Kingdom

VIA EMAIL: director@fasb.org

Project: Leases (File Reference No. 2013-270)

Dear Mr. Golden:

Cisco Systems, Inc. ("Cisco") appreciates the opportunity to comment on the Exposure Draft of the Proposed Accounting Standards Update (Revised), *Leases* (Topic 842) ("Proposal" or "Exposure Draft"). This Exposure Draft is one of the most significant convergence efforts between the Financial Accounting Standards Board ("FASB") and the International Accounting Standards Board ("IASB") (collectively, the "Boards") as it changes the way leases have been accounted for by lessees and lessors for over 30 years.

Cisco's primary business activities are to design, manufacture, and sell Internet protocol-based networking and other products related to the communications and information technology industry and provide services associated with these products and their use. In addition to sales on an open credit basis, we also enter into customer financing arrangements. Our financing arrangements include leases, loans and financed service contracts. We believe customer financing is a competitive factor in obtaining business, particularly in serving customers involved in significant infrastructure projects.

Overview and Summary

We support the proposal to lease accounting that requires an entity to recognize assets and liabilities for the rights and obligations created by leases and believe this to be a positive step in addressing the main criticism of existing accounting guidance for leases. While we acknowledge the improvements made from the 2010 Proposed

Accounting Standards Update, *Leases*, significant complexity and judgment remains in several areas, including the guidance for identifying a lease and assessing lease classification. We are also concerned with the potential degree of costs, both from an initial implementation and ongoing compliance perspective. The requirements to separate lease and non-lease components and develop processes to support dual approaches for subsequently measuring right-of-use assets and lease liabilities, combined with the potential reassessment requirements, are of particular concern. We believe the Boards can simplify the accounting approach without compromising the main objectives of the Proposal and provide the following feedback in our specific comments:

- Improve the guidance to address assets that are incidental to the delivery of services;
- Explicitly allow for the aggregation of components that are part of an integrated system as the unit of account;
- Reconsider the decision usefulness of applying the leases guidance to non-core assets and the practicability of separately accounting for certain non-lease components such as software and firmware;
- Apply a single, simplified straight-line model for recognizing a lessee's lease expense and utilize disclosures for targeted reporting improvements;
- Better align the lessor classification with the underlying business strategy or harmonize the classification threshold for property and non-property such that derecognition is more consistent with existing standards;
- Allow for an alternative transition approach similar to the tentatively agreed alternative for the forthcoming standard on Revenue Recognition;
- Provide additional clarity and perform additional due diligence to justify the user benefits from anticipated costs for incremental disclosure requirements.

We support the Boards' objectives to provide additional transparency and more meaningful information to users of the financial statements. Again, these needs must be carefully balanced against the level of effort and costs necessary to provide additional information in new disclosures. We urge the Boards to address our concerns and specific comments below through continued outreach efforts and future deliberation sessions.

Specific Comments

Our specific comments related to the Exposure Draft are expressed below.

Scope and Scope Exceptions

We agree that not all contracts involving tangible assets would contain embedded leases. We support the Boards' notion in paragraph 842-10-15-16 that although tangible assets may be transferred to a lessee to allow performance of a service contract, there may be situations where those tangible assets could not be used independent of the related services and therefore, those tangible assets are incidental to the service. The Boards' view in paragraph BC105.f. is "that when the use of an asset is an inseparable or nondistinct part of the overall services being provided to a customer, the customer does not obtain the right to control the use of the asset". While we believe this view is appropriate, the criteria in paragraph 842-10-15-16 narrowly limit the application of this approach and therefore, we suggest deleting the language that prevents application when the goods or services are sold separately. For example, there may be service contracts with underlying tangible assets that could be theoretically used independently to derive benefits, for example in conjunction with another service provider, but is restricted from doing so because the asset must be returned if the related service is discontinued. We expect that such situations should also result in the asset being deemed incidental to the service because the potential benefits derived from the tangible asset are contingent on and inseparable from the service contract.

We also support the Boards' view that components of a lease contract do not always require separation and treatment as individual leases. Otherwise, this requirement would greatly increase the operational efforts for preparers and the informational benefits are not readily apparent. At Cisco, we lease to third party customers a combination of hardware as part of an integrated system, and distinguishing between asset types and accounting for them separately would be cumbersome, difficult, and not result in more meaningful information for users. We believe the Boards can go one step further to ease the implementation burden by allowing aggregation of components into a single unit of account from an accounting perspective if those components are interrelated and elements of a single arrangement.

We believe the Boards should reconsider the inclusion of non-core assets within the scope of the Proposal. While a common definition may be difficult to establish for all entities, we believe that general guidelines can be developed that could be applied in a practical and useful manner. With adequate disclosure of the nature of non-core assets that are being leased, users should have sufficient transparency to allow for adequate understanding and comparability.

We also believe that the treatment of essential software or firmware should be more thoroughly considered and addressed in the guidance for separating non-lease components. Although the Proposal is clear that leases of intangible assets are not in-scope, separating non-lease intangible asset components, such as firmware or essential software that are incidental to tangible assets, would be both impractical and costly.

Classification of Leases

To identify lease transactions that are similar to a sale (and financing), the Boards have proposed to distinguish leases as either Type A or Type B based on the level of the lessee's consumption of the economics embedded in the underlying asset. To facilitate this assessment, assets have been broadly separated as property or non-property. However, as the Boards have acknowledged, this classification approach may not consistently produce a result that reflects the underlying economics.

Further, the thresholds relative to the lease term and present value of lease payments that are used to distinguish lease types are nebulous and somewhat arbitrary criteria for evaluating the level of consumption. We generally support the approach to eliminate bright line thresholds and instead use qualitative thresholds, but we believe a further improved solution would be the elimination of consumption thresholds altogether for classification purposes. If a complex and subjective approach can only partly distinguish leases to more faithfully reflect the underlying nature of the transaction, we believe a more simplistic approach that improves upon existing guidance in ASC 840 and IAS 17 *Leases* should be pursued that can be well understood and consistently applied. Disclosures can provide additional information regarding the types of underlying assets and nature of the business involving those assets.

Lessee Accounting

We support the main objective of the Proposal that requires a lessee to recognize a right-of-use asset and a lease liability. Consistent with our feedback regarding the classification of leases and considering that both Type A and Type B leases have a uniform initial measurement, we believe a single model should be applied by the lessee to subsequently measure the right-of-use asset and lease liability. A less complex and more understandable approach is one that results in the recognition of a single lease expense on a straight-line basis. Therefore, we encourage the Boards to reconsider whether more than one expense recognition pattern truly provides more useful information to users and, if so, whether those situations are limited to unique circumstances. We believe this approach also supports the FASB's other objectives to achieve consistency and comparability.

The Boards should consider targeted disclosures rather than requiring application of a different measurement model (i.e., Type A) such as in long-term leases of property. Instead of applying a dual-model approach as a means for separately measuring and reporting the lease expense for financing-type leases, incremental disclosures could provide users additional information regarding financing costs that would not otherwise be available through presenting a single lease expense (on a straight-line basis). This more balanced approach would support user needs for additional transparency while limiting the operational complexity for preparers.

Lessor Accounting

We understand the Boards' desire to simultaneously address the lessor's accounting approach for leases and also understand the Boards' rationale for proposing a dual-model approach for lessor accounting. We believe the revised dual-model classification approach proposed for the lessor is an improvement from the original dual-model proposal that included a performance obligation approach. In our 2010 comment letter on the Proposed Accounting Standards Update, *Leases*, we expressed our significant concerns with that model. We can also appreciate the practical and fundamental challenges that restrict the Boards' ability to achieve symmetrical accounting among lessees and lessors. However, we do not believe complete symmetry from a lessee and lessor perspective is a necessary requirement for completion of this project.

Although we believe the current dual-model approach for lessors could continue unchanged alongside a revised and simplified lessee model, we also support the receivable and residual approach for certain leases where control over the use of the underlying asset has been transferred to the lessee. However, consistent with our December 2010 comment letter on the Proposed Accounting Standards Update, *Leases*, and our above comments regarding the proposed classification guidance, we believe that the underlying business strategy should primarily dictate whether application of the residual and receivable approach is appropriate, not the type of underlying asset and level of consumption of that underlying asset. Again, the complexity and judgment required to distinguish leases based on the proposed classification guidance is challenging and, more importantly, the consumption principle does not consistently reflect the underlying economic substance of the lease. Further, we also question why a threshold of "significant" is the appropriate level for derecognizing the underlying asset from the lessor's perspective. For a lease to be accounted for similar to a sale of the underlying asset, we would expect a much higher threshold such as "substantially all". The Boards appear to have a similar view in BC118.

Transition

In addition to the retrospective approach, the Boards have provided an alternative approach, the modified retrospective approach. As the Boards have noted, the modified retrospective approach only provides limited relief for lessors and even for lessees, will be a substantial exercise given the complexity of the Proposal. The Boards can also ease transition by providing an alternative transition method similar to the one tentatively accepted for the joint FASB/IASB project, Revenue Recognition. The alternative transition method would apply the Proposal to all existing leases as of the effective date and all subsequent leases. The cumulative effect of applying the new standard to existing leases would be reflected in opening retained earnings. In the year of adoption, a reconciliation for line items impacted between previous leases guidance and the new leases guidance would be disclosed with narrative to describe significant changes.

Disclosure

We agree with the Boards' objective of providing relevant information to users of financial statements to better evaluate the amount, timing, and uncertainty of cash flows arising from leases. However, the amount of detail and level of disaggregation should be carefully considered against the cost and operational burden imposed on preparers of financial statements. We are concerned that certain information needed for the proposed disclosures (e.g., ongoing line item reconciliations) will require significant cost and effort to build systems to provide data that has limited benefit to the users of the financial statements. This concern can be partly addressed through simplifying the approach for lessee accounting with application of a single model and a consistent measurement approach for recognizing the lease expense, thereby reducing subjectivity that would otherwise need to be supported and explained through detailed disclosures.

We thank the Boards for the opportunity to provide our comments on this Exposure Draft. If you have any questions regarding our letter or would like to discuss our views in further detail, please feel free to contact me at (408) 526-7815.

Sincerely,

Prat Bhatt

Prat Bhatt
Senior Vice President, Corporate Controller &
Chief Accounting Officer
Cisco Systems, Inc.