

December 15, 2010

Leslie F. Seidman, Acting Chairman
Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116
(Sent by e-mail to director@fasb.org)

Re: File Reference No. 1850-100, Proposed Accounting Standards Update,
"Leases"

Dear Ms. Seidman:

The International Business Machines Corporation ("IBM," "We" or "the company") appreciates the opportunity to comment on the Proposed Accounting Standards Update, "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 are also supportive of this project's overall objective of improving the accounting for leases.

In our July 2009 comment letter on the Board's Discussion Paper, "Leases:

Preliminary Views", we identified several concerns with the proposed model.

While the proposed ASU has addressed some of these issues, we continue to have concerns with some of the requirements, most notably the lessor accounting model, the requirement to estimate lease terms, and the interaction with services arrangements.

Within current accounting standards, both ASC Topic 840 and IAS No. 17 distinguish in-substance purchases from rentals. Under U.S. GAAP, this is

accomplished through "bright-line" tests, while under International

Financial Reporting Standards ("IFRS"), this is accomplished through a combination of bright-lines and principles. The company recognizes the concerns raised by the U.S. Securities and Exchange Commission ("SEC") over off-balance sheet financing and the application of the current bright-lines in U.S. GAAP. While we believe the proposed approach in the Exposure Draft meets the simple objective of recording lessee obligations on the balance sheet, the Company is not fully convinced the proposed models for lessee and lessor accounting provide superior information versus the current lease accounting model. In addition, we are concerned that the cost of

implementing the proposed ASU is greater than the benefits perceived to be realized.

Lessee Accounting - Right-of-Use Model

While the company understands the recognition of an asset representing the right to use a leased item is a necessary consequence from recognizing a liability, the company is still not convinced the right-of-use model meets the definition of an asset in the conceptual framework, especially when options and contingencies are added. A lease is an executory contract that provides conditional access to an asset should the lessee fulfill its ongoing obligations under the contract. If a lessee fails to make payments, its right of use will be terminated.

We do not believe that options and contingent rentals (other than those tied to an index) 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. We believe that options and contingent rentals should only be recognized in the financial statements when an obligation has been created. If the Boards proceed with the inclusion of options and contingent rentals, we strongly recommend that that Boards increase the recognition threshold to "highly probable" or "virtually certain" from the currently proposed "more likely than not".

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 and contingent rentals in order to determine the appropriate lease term and lease payments. This assessment would need to be made on a recurring basis in order to ensure that changes in judgment are properly accounted for during the lease term. We believe the costs associated with maintaining this type of analysis far outweigh the benefits. Additionally, we believe that this type of accounting potentially lends itself to manipulation and structuring of contract terms in order to obtain a more favorable accounting answer.

We believe the right-of-use model would result in the grossing up of the statement of financial position, giving financial statement users a false sense of the assets that are readily available for use by the company in paying its future financial obligations. Further, we are 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 in a final standard guidance on how to distinguish leasing contracts from other executory contracts.

Lessor Accounting

If the right-of-use model is chosen for lessees, we believe that the new leasing standard should focus on symmetry between the lessee and the lessor. Therefore, we support a derecognition model that requires the lessor to remove the portion of the asset that the lessee is required to capitalize for all leases. If a lessee is deemed to have an obligation to the lessor, that lessor should record the change in financial position in the period the change occurs. The arrangement can not be unconditional to

the lessee and conditional to the lessor. If the Boards reject this approach, we believe the current lessor accounting model is far superior to the proposals in the Exposure Draft. However, if the Boards proceed with the proposed ASU, as a manufacturer with a captive leasing entity, we would agree that the current lessor proposal is certainly better than a completely ratable approach for lessor accounting.

Leases and Services Arrangements

The company notes that the new standard carries forward criteria to use in order to determine when a lease exists versus a services arrangement.

However, paragraph B2 of the proposed ASU includes the addition of the phrase "...but rarely does so in practice." We are concerned that this new guidance may substantially change the current guidance in both US GAAP and IFRS in such a way that significantly expands the scope of the leasing standard. 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.

While we support the need 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 have outlined our suggestions herein. Further, due to the amount of system and process changes necessary to adopt the model as both a lessee and lessor, we believe an effective date of at least 3 years from finalization will be required. Attached is an appendix providing the company's view on certain questions posed in the Exposure Draft.

Thank you for the opportunity to comment on the Discussion Paper. If you have any questions, please contact me at (914) 766-3190.

Sincerely,

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Gregg L. Nelson
Vice President, Accounting Policy & Financial Reporting IBM Corporation
Appendix A

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?

Response:

We do not believe the right-of-use model provides superior information to users compared to current lease rules and disclosures. While the proposed approach accomplishes the simple goal of recognizing lease obligations on the balance sheet, we are still not fully convinced the right-of-use meets the standard definition of an asset. In addition, the approach is inconsistent with the

proposed performance obligation model for lessors since the existence of an obligation from the lessee to the lessor is based on the premise that the lessor has substantially completed its performance obligation by transferring the right-of-use of the leased item and no further obligation exists.

(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?

Response:

Use of the effective interest rate method attempts to portray economically different transactions as similar events. Specifically, a lease is not the same economically to a collateralized borrowing given the residual and potentially continuing involvement by the lessor. Therefore, we do not support use of the effective interest rate method. We believe the linkage between the asset and liability recognized in the proposals supports a symmetrical approach to amortization. Therefore, the Boards should explore alternatives so that expense more closely aligns to the outflow of cash for transactions that are not in-substance purchases to lessen this impact.

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 model would you propose and why?

Response:

As highlighted above, we support a derecognition approach for all leases that are not in-substance purchases. We believe that lessor and lessee accounting should be as symmetrical as possible. Under this derecognition approach, the accounting follows the premise that the company has sold a portion of an asset and, therefore a portion of the value of that asset should be derecognized. The value remaining represents the lessor's residual interest in the asset after the right has expired. With respect to the lessor models proposed in the ED, the majority of constituents, as indicated in paragraph BC24, supported using a derecognition approach for most leases. If the Boards proceed with the proposed lessor models, we believe further clarification should be provided in order to assist in the analysis of when "the lessor retains exposure to significant risks or benefits." In paragraph BC27, the Boards indicate that "an entity's business model will indicate which model would be appropriate." To ensure consistent application and comparability between entities, we ask the Boards to provide additional guidance relating to when each model should be applied.

(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?

Response:

As mentioned in our response to question 2(a), we favor the derecognition approach for all leases, as we believe it is simpler to administer for the lessor and consistent with the accounting proposed for the lessee. However, if that approach is not favored, we believe the proposed approach should be modified to allow the assets, liabilities, income and expenses under the performance obligation model to be consistent with the current operating lease model, as we believe that at the end of the day you basically have a rental, and to record gross assets and liabilities to simply net them provides little benefit to financial reporting. We also think that straight-line expense is more indicative of the transaction as well.

Additionally, we do not believe that lease payments should be based on options to renew or contingent rentals. Options do not represent a contractual right until they have been exercised. Contingent rentals are not considered lease payments until the contingency for which they are associated with has occurred or been satisfied. We believe that both options and contingent rentals should be accounted for when an obligation to perform has been created and not before that time. However, if options and contingent rentals are to be included in the determination of the lease payments, we believe that they should be evaluated based on a threshold higher than "more likely than not." We believe that an appropriate threshold would be a "highly probable" or "virtually certain" threshold.

Question 3: Short-term leases (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 the lease payments plus initial direct costs. Such lessees would recognize lease payments in profit and loss over the lease term.

(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 profit and loss, 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 and loss over the lease term.

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?

Response:

As long as the short term approach for lessees and lessors remains an option and not a requirement, we support it.

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?

Response:

Yes, we agree that a lease is defined appropriately.

(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?

Response:

Yes, we agree with the criteria in paragraphs B9 and B10 for distinguishing a lease from a contract that represents a purchase or sale. We believe the proper accounting should be consistent with the guidance included in the exposure draft on revenue.

(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 alternative guidance do you think is necessary and why?

Response:

We support the carry forward of the current guidance in both US GAAP and IFRS for distinguishing a lease from a service contract. However, we note the inclusion of the additional phrase in paragraph B2 "...but rarely does so in practice." We do not support this inclusion as it would potentially expand the scope of this standard to transactions that are not dependent on

an asset. Further, this approach would use management's intent to distinguish between very different accounting models. This would significantly change the current model where exchangeable assets are currently accounted for separately from the services they relate to.

Question 6: Contracts that contain service components and lease components Do you agree with the FASB and/or IASB's 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?

Response:

Yes, we agree with the Boards' approach to accounting for leases that contain service and lease components. We believe that there should be a separation of services components from lease components based on the Boards' criteria. However, we would like further clarification on the definition of "distinct" services to better understand how this concept will be applied consistently in practice. For example, would future maintenance costs be included in the lease obligation whether it was part of the lease or contracted for separately?

Question 7: Purchase options

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?

Response:

Yes, we agree that a lessee or lessor should only account for purchase options as they are exercised since an option does not meet the definition of a liability. We believe it is very difficult to ascertain the likelihood of exercising purchase options at the date of initial assessment, thereby making it difficult to assess the fair value of each option without the use of arbitrary judgments. The only exception is if the purchase option is deemed to be a bargain.

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 lessor should determine the lease term and why?

Response:

No, we do not agree that the lease term should take into consideration a "more likely than not" approach to assessing the impact of options to

extend or terminate the lease. Similar to purchase options, renewal options do not represent a contractual right or obligation until they have been exercised or economically compel one party to exercise their right.

We believe that renewal options should be accounted for when an obligation to perform has been created and not before that time. However, if renewal options are to be included in the determination of the lease term, we feel a higher threshold should be set in determining the lease term: instead of "more likely than not", we feel a "highly probable" or "virtually certain" threshold would be more appropriate. This measure should be based on business factors as well as past experience with the particular lessee.

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?

Response:

We support recording contingent rentals similar to current practice, that is only when linked to an index. Payments linked to performance or usage should be recognized at the time the event occurs only. We do not believe performance or usage based contingent rentals meet the definition of a liability, therefore we do not support their inclusion in the liability.

If concerns around structuring dictate that they be included, then the higher threshold referred to in the response to question 8 should be invoked.

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?

Response:

We believe that the right-of-use model should apply only to the contractual obligations of both parties and, therefore, outside of impairment reviews, reassessment should not be required. However, if the Board continues to require reassessment, we agree that this

reassessment should only be performed when there has been a significant triggering event.

While this approach will require companies to develop processes to capture these events, performing detailed reassessments will be burdensome and costly to implement. In addition, we would appreciate further guidance on how significance should be determined—based on significance to the contract or based on the company's materiality.

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? 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?

Response:

Yes, we agree that if the proposed model is adopted and amounts are material, a lessee should present liabilities to make lease payments separately from other financial liabilities and should present right-of-use assets as a separate line item within property, plant and equipment.

(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? 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?

Response:

Yes, we agree that if the proposed model is adopted, this is superior to grossing up the balance sheet. However, we would ask that the Boards consider a presentation of lessor performance obligation assets consistent with today's operating lease model without the grossing and netting.

(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? 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?

Response:

If material, lessors should present the right to receive lease payments and the residual asset together in one section in order to provide linkage between the two items, and disclose the residual asset information separately in the notes.

(d) Do you agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position? Why or why not? If not, do you think that an intermediate lessor should disclose this information in the notes instead?

Response:

No, we do not agree that lessors should distinguish assets and liabilities that arise under a sublease in the statement of financial position. These assets and liabilities are no different than assets and liabilities that arise from a lease. We believe the amounts should be shown together in the statement of financial position and if amounts are significant, they should be disclosed 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 the income statement?

Why or why not? If not, do you think that a lessee should disclose that information in the notes instead? Why or why not?

Response:

Under the proposed model, we believe the income and expenses associated with leasing should be separately identified, if material.

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? 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?

Response:

We do not object to the Boards' conclusions relating to the presentation within the statement of cash flows and as separate line items. However, our preference would be for this information to be presented in the notes given the fact that currently these items may be presented in several items on the cash flow statement today.

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?

Why or why not? If not, how would you amend the objectives and why?

Response:

We believe the disclosure of this information will be burdensome and the costs associated with obtaining this information far outweighs the benefits. Furthermore, we do not see the benefit to the user of the financial statements from the disclosures cited above. Rather, we believe the amounts disclosed on the face of the financial statements and an explanation of these amounts will be sufficient. In addition, consideration should be given to the disclosure requirements necessary for interim reporting versus annual reporting. There should be less requirements on an interim basis, especially if there have been no material changes since the prior annual reporting.

Question 16: Transition

- (a) This exposure draft proposed that lessees and lessors should recognize and measure all outstanding leases as of the date of initial application using a simplified retrospective approach. Are these proposals appropriate? Why or why not? If not, what transitional requirements do you propose and why?

Response:

We agree with the initial application as proposed, without, however, a look-back on "more likely than not" items (options, contingent rentals, etc.). Further, given the complexity of the new model and the various I/T changes required by both lessees and lessors, we believe an effective date of at least 3 years from finalization will be required.

- (b) Do you think full retrospective application of lease accounting requirements should be permitted? Why or why not?

Response:

Yes, we believe a company should be given the option for full retrospective application, however, we do not believe this should be a requirement.

(c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why?

Response:

We believe that there are many transitional issues, such as implementation of new systems and education of accountants that the Boards need to consider when determining the appropriate timetable for the implementation of this guidance. We believe an effective date of at least 3 years from finalization will be required. The interoperability of this standard and the determination of an effective date with the proposed revenue recognition standard must also be considered.

Question 17: Benefits and costs

Do you agree with the boards' assessment that the benefits of the proposals would outweigh the costs? Why or why not?

Response:

We believe it is important to reiterate that while we believe the proposed approach meets the Boards objectives, we are not fully convinced the proposed models for lessee and lessor accounting provide superior information to the current lease accounting model. In addition, we are concerned that the cost of implementing the proposed ASU is greater than the benefits perceived to be realized.

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