

January 11, 2018

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

Dear Chairman Golden,

The Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2016-02---Leases (Topic 842) (“the ASU”) with the intentions to improve financial reporting regarding leases. Certain companies within the pharmaceutical industry (“we”)(see below for list of companies supporting this letter), wish to highlight issues that have arisen associated with the transition to the ASU. The issues we highlight in this letter are not a reflection of the quality of the standard, but rather reflect implementation issues that have arisen due to the significant change in processes and the need for new controls to ensure the initial and ongoing accounting, and presentation and disclosure for our lease portfolios comply with the ASU, as well as the complexities surrounding the identification and accounting for embedded leases. Furthermore, this letter is not being written because we have delayed our own adoption and implementation efforts towards the ASU, but rather because the work done to date has brought these issues to the forefront of our collective concerns.

Due to recent industry discussions surrounding difficulties in adopting the new ASU we believe the FASB’s tentative conclusion to amend the ASU and provide companies with an additional transition method should be adopted and made permanent, and we believe it is prudent to formally request a delay in the effective date of the ASU by one year. The driving factor for requesting this delay is major concerns regarding system readiness and the availability of service providers to support these systems. Additionally, if relief is not provided for complexities surrounding the accounting for embedded leases, adopting the ASU by the current effective date will be very difficult.

System readiness

Currently, most companies account for its lease portfolio in a decentralized manner using end-user computing spreadsheets (such as Excel models) to determine the initial and ongoing lease accounting, as well as the aggregation of consolidated operating lease activity for annual disclosure purposes. While current processes are sufficient to appropriately address the existing limited accounting and reporting requirements, there are significant changes in accounting and reporting for leases under the ASU that companies would not be able to comply with unless they make several additions/changes to their existing processes. For example, in addition to the requirement to account for all operating leases on the balance sheet, there are also a number of new quarterly and annual disclosures that will require lease information that companies do not currently gather broadly for the entire lease portfolio (such as: separate maturity analyses of its operating lease liabilities and finance lease liabilities, short-term lease

costs, variable lease costs, weighted average lease term, among several others). As such, companies with a large lease portfolio will be required to implement a new leasing software to properly account for leases and satisfy the reporting and disclosure requirements. This will also require significant changes to existing business processes and the need for new internal controls to ensure appropriate completeness and accuracy of data inputs for the new disclosures. To date, we are not aware of any marketed software solution that is fully compliant with all requirements under the ASU. The various systems available to the public are able to partially satisfy the requirements of the ASU; however, in order to fully comply with the ASU, companies will be required to perform numerous manual workarounds. These manual workarounds will require companies to incur a significant amount of time and money. The shortcomings of the software systems span the array of requirements of the ASU, including both technical accounting and reporting requirements.

In working with our selected lease software solution providers, or through our evaluation of various software solutions, we have identified the following limitations, which vary by software provider, in the ability of current software solutions to comply with the ASU:

- Segregation, collection, and disclosure of variable lease costs;
- Accounting for reassessment events, including modifications, and related measurement criteria;
- Disclosures of weighted average discount rates and lease terms;
- Automatic calculation of lease escalations based on an index, nor reassessments based on index fluctuations;
- Lessor accounting;
- Ability to update the assessment regarding the likelihood of exercising lease options;
- Reporting on lease activities and associated transactional activities after the lease is initially entered into the software;
- Ability to use various historical exchange rates. Some software systems are only capable of using the exchange rate on the current reporting date;
- Required system interfaces between a company's legacy ERP system and the specific lease accounting software, which requires extensive implementation efforts and costs

While the list above is not exhaustive, it paints a picture of the various shortfalls of current software systems, and illustrates the amount of manual effort companies will need to undertake to comply with the ASU. For example, as many systems cannot segregate, collect, and disclose variable lease costs, companies will be required to perform a substantial amount of additional manual work. Companies will need to first identify leases with variable payments, establish the lease within the lease software, and then separately tag or identify each single variable payment in the Company's ERP system as a variable lease payment to ensure all payments are appropriately associated to the identified lease. For leases that contain fixed and variable payments, many of the invoices from the lessor/vendor contain only one charge, and do not specifically identify fixed and variable charges. As such, companies will have to request an itemization of fixed and variable charges on its invoices, and from there only enter the fixed payment information into the lease software, and then manually differentiate the fixed and variable payment within the company's ERP system to effectively track variable payments. If the lessor/vendor

will not comply with the request, companies will have to make its best estimate to distinguish between fixed and variable charges. A small number of vendors are currently developing reports that plan to comply with the ASU, however, they will not commit to a date when these reports will be finalized. Lastly, as the current lease software is not capable of reporting variable lease costs, companies will have to generate ad hoc or manual reports from its ERP system to comply with all mandatory disclosures.

Many software providers have communicated they are working on an updated version of the software to address many of the identified issues. However, the software providers will not commit to a date when the newest version of the software will be available, and if the release will even occur in 2018, or that it will ensure effective compliance with the ASU without further testing or modification. Additionally, we have been advised that the proposed updates will still not be fully compliant with the ASU, but rather will allow companies to employ fewer manual workarounds in order to comply with the ASU. If a significantly different or upgraded version of the software is released in mid to late 2018, companies will have a very short time period to install, load all data, and adequately test the new software. This short time period presents a significant risk to companies to ensure the system and associated processes and controls are operating effectively by the end of 2018.

In addition to the software limitations noted above, we have also noticed significant resource constraints at the various software providers. As more companies are signing up with the various providers, the resources currently available to assist companies in its implementation are noticeably stretched. In addition, as companies progress through the implementation of the software, the amount of customization and time needed from the software representatives significantly increases. Given the current resource constraints and the significant amount of companies who have yet to select a software provider, we believe the availability of resources will become an even larger and more prevalent issue as we approach the effective date of the ASU.

In light of the current lease software system limitations, the unknown timeline of when these software systems will be fully compliant, and the limitations on resources at the software providers we believe the FASB should defer the implementation of the ASU for one year, while maintaining an election to adopt earlier.

Embedded Leases

In addition to the system challenges noted above, there are also implementation issues regarding the technical complexities surrounding embedded leases, with the most significant complexity being the ability to determine the fair value of the embedded lease. Determining the fair value at which to capitalize an embedded lease, more specifically an operating lease, is a new requirement under the ASU. In order to determine the fair value of the embedded lease, companies will need to be able to establish a fair value methodology and be able to collect all relevant data points.

In discussions amongst peers within the pharmaceutical industry, as well in discussions with the external auditors of these companies, many companies are facing challenges in determining a logical, repeatable, routine, and cost-effective method to determine the fair value of an embedded lease. The various forms of payment streams associated with embedded leases (fixed vs. variable), and determining what

components of the contract those payments relate to require significant judgement. Being able to apply this information and determine a fair value for the right of use asset and liability is proving to be very difficult, and one with which there is no consistent methodology or agreement among companies and its external auditors. For example, in the pharmaceutical industry most companies contract with third party contract manufacturing organizations (CMO) to produce medicines for the company, including either the entire medicine or a part of the medicine along the production cycle. In most of these instances, the contract establishes payment for finished products (which could be both fixed and variable), yet there may be an implicit asset within the contract that could be identified as a lease. If identified as a lease, it would require significant judgement to try to separate the components of the payment stream between the cost of making the finished goods product (raw materials, labor and overhead) and the cost for the right of use asset that was utilized by the CMO to make the finished goods product. As part of this judgement, companies would have to determine the probability of how the lessor will use the identified asset over the term of the arrangement. Very similar issues exist in agreements with contract research organizations (CRO), which is a common contract within the pharmaceutical industry where third party research organizations perform clinical research activities on behalf of the pharmaceutical company.

In order to collect all the necessary information to determine the fair value of the embedded lease, companies would most likely be required to reach out to the lessor to understand how the lessor is using the asset. This may create roadblocks in a company's ability to value the lease for multiple reasons. First, the lessor may not be willing to share this information with the lessee as it may be proprietary. Second, not all lessors and/or vendors will be prepared to answer all the questions and provide all the necessary information. If lessee's are unable to obtain the data for the reasons above, it will require even more judgement and assumptions from the lessee to try and determine the fair value of the embedded lease.

This creates additional challenges because external auditors will need to audit the assumptions and data used to determine the fair value assigned to the embedded lease. If there is no consistent, logical, and cost-effective method to determine the fair value, significant judgement and assumptions are involved, and companies are reliant upon information from third parties such as the lessor or vendor, companies will be routinely challenged by its external auditors on the fair value assigned to the lease. This process will most likely create inconsistencies across not only the pharmaceutical industry, but across all companies and audit firms, on how to properly value an embedded lease. Additionally, this will require an excessive amount of time from both the company and the external auditor in order to become comfortable with the fair value.

The various unknowns and complexities surrounding embedded leases noted above present challenges in implementing the new lease standard by the current effective date. In order to address these challenges, we believe the FASB should either provide relief to registrants through additional clarifying guidance to help limit the embedded leases to those that are directly provided for in the lease contracts, or scope embedded leases out of the ASU entirely. If relief is not provided, it will be challenging for companies to implement the standard by the ASU's current effective date.

Thank you for your consideration,

