American Bankers Association
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Technical Director
Financial Accounting Standards Board
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Via email: director@fasb.org

File Reference: No. 1850-100 *Leases*

Dear Technical Director:

The American Bankers Association (ABA) appreciates the opportunity to comment on the exposure draft, *Leases* (ED). ABA brings together banks of all sizes and charters into one association. ABA works to enhance the competitiveness of the nation's banking industry and strengthen America's economy and communities. Its members – the majority of which are banks with less than $125 million in assets – represent over 95 percent of the industry's $12.7 trillion in assets and employ over 2 million men and women.

Banking institutions are not only preparers of financial statements as lessees and lessors, but are also users of financial statements that analyze and depend on such statements of customers. We have surveyed credit officers of member institutions regarding key aspects of the proposal, and their responses are reflected in our comments.

A cost/benefit study should be documented.

Our informal research found that while commercial banking credit officers generally make adjustments to factor in the impact of an operating lease on operating leverage, a majority of them are satisfied with the current accounting and do not believe the proposed changes are needed. In fact, the adjustments they currently make allow for quick analysis, and this analysis is complicated by the complexities in the terms of the ED. Considering that this proposal will impact the vast majority of businesses in the U.S., large and small, ABA urges FASB and IASB to document a detailed cost/benefit analysis before a final standard is issued.

We understand that "off-balance sheet financing" has been subject to criticism in the past. However, considering the adjustments currently made by credit analysts, we question whether the benefits financial statement users will receive through implementation of this proposal are worth the massive additional costs that are expected in order to prepare and audit the information. In other words, we are not convinced that better decisions in employing capital will be made as a result of the rules being proposed. Current lease accounting in GAAP generally conforms to International Financial Reporting

Standards. Therefore, a delay that might result from performing a cost/benefit analysis will not have an impact on the ultimate roadmap to convergence.

ABA understands the conceptual basis behind the proposal that right of use assets and obligations should be reflected on lessee balance sheets and be classified the same as that of the underlying asset. We understand that this provision of the ED is likely to remain in the final standard and we are basing our remaining comments on this assumption. With that in mind, we strongly oppose other major areas of the ED and believe our concerns must be resolved if the FASB intends to move forward with the ED. As we note above, credit officers are not in general agreement with each other on whether a new standard is required. Nevertheless, credit officers, along with those who prepare bank financial statements, are in agreement about the following points, which are further described in this comment letter:

- A right of use asset should be limited to contractual amounts. Contingent amounts based on future use or revenues should not be included.
- A right of use asset should include only minimum payments due and amounts under renewal options that are probable of payment.
- The process to continually re-estimate contingent rents and likely renewals is too complicated.
- Practical expedients should be considered.
- Right of use assets should be classified as the same as the underlying leased asset.
- More implementation guidance is needed on incremental borrowing rates.
- A minimum two to three year transition will be required after issuance.

A right of use asset should be limited to contractual amounts. Contingent amounts based on future use or revenues should not be included.

In the event that it is determined that the benefits of recording the right of use asset exceed the costs, we strongly believe that the measurement of the right of use asset and liability should not include the impact of contingencies based on estimated future use or revenues. This requirement introduces unnecessary complexity into the process, is subject to significant unreliability, and also does not add to the analysis of collectibility of cash flows.

Using the retail industry as a simple example, the proposed approach would often cause loan officers to make adjustments to retail borrower financials to back out leasing costs that are recorded prior to the period the sales occur in order to analyze operating results and cash flows. Due to such amounts being based on assumptions regarding future revenues, we also question how such an estimate qualifies as a liability under the conceptual framework and are concerned that the internal controls and audit process over these pro forma estimates will be particularly burdensome. From a practical perspective, these amounts add unnecessary noise when determining how such amounts reconcile to other sales forecasts that are being provided by management.

A right of use asset should include only minimum payments due and amounts under renewal options that are probable of payment.

The impact of renewal options within the leasing contract should be included only if it is probable (through economic compulsion) that such an option will be exercised. While this may provide room to structure leases in order to minimize the recorded assets on the balance sheet, bankers believe that recording the value of renewal options negates the actual reduction in risk that the lessee assumes precisely because of the negotiated option terms. These estimates will distort the amount of leverage used by the lessee and it complicates the analysis to project lessee cash flows for the sake of collectibility. We believe that using a "probable" (through economic compulsion) threshold, rather than a "more likely than not" threshold, is much easier to operationalize and to audit. The following examples, or something similar, could be used within the implementation guidance:

- Example: A company that leases land with a ten year lease that contains a ten year renewal option, and the company constructs a building that is depreciated over twenty years. Since the company has made such a long-term commitment with the construction of the building, economic compulsion would make the renewal probable.

- Example: A retailer leases space with short-term agreements containing renewal options in a shopping center of a town in which there are limited other shopping locations. Successful retail results would provide economic compulsion for the company to exercise the renewal options, since it would be highly improbable the company could relocate to another location in the town.

The process to continually re-estimate contingent rents and likely renewals is too complicated.

The proposed process to estimate the impact of renewal options and contingencies is too complicated for most companies – large and small – for the benefits of such information to exceed the costs to provide it. This process is too complicated for many companies to perform at lease inception, much less periodically (which, for practical purposes, is the requirement). Small business borrowers should not be expected to perform such analysis, and we believe that the costs of providing and auditing this information will be significant. The "probable" (through economic compulsion) threshold for renewals would help eliminate much of the complexity and would give the credit analyst a more practical understanding of what is being recorded.

Practical expedients should be considered.

Because of the prevalence of leases used by virtually all companies, we are concerned about the costs to comply with this ED. We understand that "off-balance sheet" assets can understate the leverage position of certain companies and that leasing terms have often been structured to avoid "on balance sheet" treatment. However, the vast majority of businesses enter into leasing agreements for assets that are neither critical to the revenue-generating or funding processes of their organizations nor material to their financial statements. This ED will add significant costs to each company in order to record and maintain these agreements on an ongoing basis.

With this in mind, we strongly recommend that FASB consider allowing practical expedients when approving a final standard. Such practical expedients could consist of:

- Allow right of use assets to be recorded only for those leased assets that collectively are material to the financial statements, with disclosure regarding what is not recorded on the balance sheet (and qualitative disclosure as to why they are not recorded), along with applicable minimum future lease payments.

- Allow undiscounted measurement of right of use assets not material to the financial statements. These assets would then be amortized on a straight-line basis.

- Under such practical expedients, rental payments and receipts will be reported as operating cash flows (as currently reported), instead of splitting them between operating and financing cash flows.

We believe the main objective of the Leases Project is to capture risk and leverage from leased assets that currently are not captured. By allowing companies to use such practical expedients, the project will achieve the objective while not overburdening businesses of all sizes in complying with the standard.

Right of use assets should be classified as the same as the underlying leased asset.

We agree with the portion of the ED that defines a right of use asset as a tangible asset within property, plant, and equipment. Under current accounting standards, assets recorded under capital leases are classified the same as the respective leased asset, and the ED is consistent with this concept. With this in mind, we recommend that the reference in the basis of conclusions paragraph BC72 to *Topic 350: Intangibles – Goodwill and Other* be removed, as this appears to leave the question open of how to classify these assets.

More implementation guidance is needed on incremental borrowing rates.

Determining an incremental borrowing rate may be a complicated process for many businesses. Banking institutions, for example, have access to many different credit facilities. Therefore, more guidance in deciding how to determine the appropriate rate will be required. Looking at it from the perspective of a small business, however, many such businesses do not have borrowing facilities from which they can base an incremental rate. Because of the wide ranging impact of this ED, more guidance will be required for these entities in order to implement a final standard in a cost effective manner.

A minimum two to three year transition will be required after issuance.

The systemic impact of the changes proposed in the ED should not be underestimated, as these changes will impact how lenders analyze the creditworthiness of their customers. Further, the proposal will require companies to maintain information they have never maintained and to forecast into the future as they never have.

Because of the significant impact on the accounting for the majority of businesses in the U.S. and the potential for changes in loan covenant status for many borrowers, we believe that a minimum of two to three years will be required to transition to the new standard. Implementation will be especially complicated for lenders who will likely need to examine preliminary financial statements in order to determine how covenants will need to change. Due to the complexities and judgments required in the ED, these preliminary results may change as adjustments are likely to be made during the initial audit process. Analyses that are based on current industry norms will also need to be reevaluated, as those norms will change. These are merely a few factors in the transition process that must be considered so that the business of lending is not subject to unnecessary delays.

Thank you for your attention to these matters and for considering our views. Please feel free to contact me (mgullette@aba.com; 202-663-4986) if you would like to discuss our views.

Sincerely,

Michael L. Gullette