

December 15, 2010

FASB Technical Director 401 Merritt 7 PO Box 5116 Norwalk, CT 06856-5116

Re: Financial Accounting Standards Board "FASB" and International Accounting Standards Board "IASB" proposed accounting standards update, file #1680-100, Leases.

Technical Director,

American Apparel & Footwear Association is a trade association who's 400 member companies design, produce, and sell the bulk of the \$350billion of apparel and footwear products sold in the domestic market. In addition to representation on Capitol Hill, AAFA offers extensive educational programs to help our members remain competitive in the global marketplace.

On behalf of its membership, AAFA applauds FASB and IASB in your attempt to make financial presentation more transparent and meaningful to financial statement readers. However, AAFA has some significant concerns with FASB's and IASB's draft proposal with regard to leases. Therefore, we urge FASB and IASB to consider the following in developing its final rules concerning leases:

- 1. The impact on a company's banking and other creditor relationships could be significantly stressed as a result of recording leases as an asset and liability on a company's balance sheet, particularly for smaller companies. Many borrowing covenants require that a company not exceed stated ratios of debt to equity or other meaningful parameters. The recording of the entire cost of a lease as a liability will bloat the balance sheet and will, in all likelihood, cause these ratios to be exceeded. This will put companies, many of whom remain financially stressed due to the recession, at a disadvantage in dealing with banks and other creditors, and will, more importantly, require the restructuring of debt instruments at great costs to our members, particularly smaller AAFA member companies.
- 2. Many companies, especially companies with retail stores, have hundreds or even thousands of leases. These leases are necessarily complicated, follow many formats, and many provide for contingent rents that cannot be readily predicted. Under FASB/IASB's proposed rules, our members will be subject to significant new costs of software, personnel, training and the copious amount of initial set up work required, and the annual or more frequent lease reviews, at a time when they can least afford it. We urge FASB and IASB to consider these tremendous costs when analyzing the incremental benefit of adopting the proposed Accounting Standards Update.

- 3. Determining the asset and liability amounts to be recorded requires many far reaching estimates. A lease for retail, warehouse or manufacturing or office facility could easily stretch to twenty or thirty years, including extensions. As an example, booking all future costs on a ten year lease with two five year extensions could differ by a factor of over 200% depending on estimates of the most probable lease term alone. Further, current estimates of costs of a lease extension ten or fifteen years out at market cost or using any future measurement leaves to considerable question the reasonableness of booked costs. By way of example, estimating distant future lease payments for leases written utilizing a percentage of sales as a full or contributing element of a lease payment would require sales projections for say the year 2025 or 2035, which would be pure guesswork. Also, leases utilizing other usage factors would only create wild guesses of future costs that would require booking an asset and liability that could easily distort the balance sheet with meaningless guesstimates creating potentially misleading information. This would particularly apply to a small company with few leases where booked lease liability could represent a much larger percentage of their balance sheet.
- 4. Annual amortization costs could create unnecessary and unwanted volatility in the P&L. Any adjustment or recognition of changes in the assumptions used to create the basis of the asset and liability would affect current P&L. Profitability projection changes on a location by location basis, changes in incremental internal borrowing rates, changes in lease terms upon execution of lease extensions, changes in operating expenses and real estate tax pass throughs, and many other factors would require booking the changes and would add to the annual volatility of projecting far into the future. Also, changing profitability forecasts frequently require a business decision to vacate a lease, causing a write down of the right of use asset affecting the current P&L when the decision is made. However, actual costs of vacation vary from booked costs and could result in a subsequent profit on the same transaction in a following reporting period, crating unnecessary volatility.
- 5. Guidance is needed concerning materiality of leases. Leases covering office equipment and other equipment items may be very small and immaterial at a single location, but under a master lease costs may aggregate into material amounts. Annually evaluating small leases on a location by location basis would be an onerous exercise for little value.
- 6. Further guidance is needed concerning accounting for landlord improvements and lease incentives. In many retail leases these issues may constitute a significant part of an overall lease costs.
- 7. The proposed method of accounting of leases will result in front-end loaded expenses compared to accounting as an operating lease even where actual lease payments are level over a period of years. This serves no purpose other than to distort the income statement and distort year to year comparability.
- 8. There is a disconnect in the requirement that the proposed accounting for leases calls for the booking of an interest expense for the lease obligation where leases do not address the obligation as a debt requiring the payment or recording of interest.
- 9. Since lease expense would be accounted for as interest expense and amortization expense, many important historical financial ratios, such as EBITDA would not be comparable using past performance data.

Recommendation

Based on these extensive operational implementation concerns, and comparability concerns, we recommend that detail of lease accounting remain a footnote in the financial statements, with addition of the suggestions made above, and that leases should continue to be reported on the basis of operating leases. Information presented in the footnote should only include certain or near certain lease conditions and not project contingent lease costs. Doing this would create transparency and uniformity without bloating the balance sheet and possibly stressing a company's relationships with its banks and other creditors.

Thank you for your time and consideration in this matter.

Please feel free to contact me at kburke@appaerlandfootwear.org, or contact my CFO Ralph Reinecke at rreinecke@apparelandfootwear.org, or call at 703-797-9043 to discuss this matter further. I look forward to hearing from you.

Sincerely,

Kevin M. Burke

President and CEO

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