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Technical Director
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Financial Accounting Standards Board
401 Merritt 7
P.O. Box 5116
Norwalk, CT 06856-5116

Proposed Accounting Standards Update: Leases (Topic 840)

We appreciate the opportunity to comment on the proposed Accounting Standards Update ("ASU") entitled *Leases (Topic 840)* ("the exposure draft"). BB&T Corporation and its subsidiaries offer full-service commercial and retail banking and additional financial services such as insurance, investments, retail brokerage, corporate finance, treasury services, international banking, leasing and trust.

We support the Financial Accounting Standards Board ("FASB") and the International Accounting Standards Board ("IASB") (collectively "the Boards") in their efforts to provide financial statement users with a complete and understandable picture of an entity's leasing activities. We understand the Boards' concerns related to the current authoritative guidance applied to leasing transactions from a lessee perspective and believe that the right-of-use model outlined in the exposure draft represents a step in the right direction. However, as more fully described in this letter, we have certain concerns related to the definition of "lease term" and the requirement to estimate lease payments using an expected outcome technique. In addition, we have concluded that the perceived benefits associated with the requirement to reassess the carrying amount of the lease liability on a quarterly basis fail to outweigh the potential operational issues and costs associated with such a requirement.

We understand the importance of ensuring an appropriate degree of consistency between the lessor and lessee accounting models. However, as more fully outlined in this letter we believe that the Board should consider changes to the exposure draft that would reduce the complexity of the approach, improve the symmetry between the lessee and lessor accounting models, result in a better matching of revenues with expenses and more closely align the accounting for "residual assets" with the underlying economics of the transactions.

Our concerns related to the exposure draft are outlined below:

Lessee Accounting Model

As indicated above, we believe that the right-of-use model outlined in the exposure draft addresses many of the Boards' concerns related to the accounting for leasing transactions. We understand the Boards' desire to eliminate the "bright lines" used to distinguish between operating and capital leases, and their interest in reflecting all lease obligations on a reporting entity's balance sheet. We believe that the right-of-use model is conceptually sound, the definition of a lease as outlined in the exposure draft is reasonable, and we have no significant objections to the scope exclusions outlined in the exposure draft.

Notwithstanding our general agreement with the right-of-use model, we have concerns related to the application of the proposed rules to leases of relatively low dollar value assets (i.e. office copiers, printers, etc.) and short-term leases. We believe that the application of the proposed model to such leases would be operationally challenging and costly, while at the same time providing virtually no benefit to financial statement users. However, we understand the difficulties faced by the Boards in promulgating a scope exclusion related to such leases and ultimately determined that most of our concerns could effectively be addressed by documenting the immateriality of the estimated misstatement that would arise if the proposed lessee accounting model were not applied to all such leases.

We have summarized certain additional concerns that we have identified related to the proposed lessee accounting model as follows:

We believe the Boards should reconsider the requirement to calculate the present value of a lease obligation based on the longest lease term that is more likely than not to occur:

While we understand the Boards' desire to provide financial statement users with a greater degree of transparency related to a reporting entity's leasing transactions, we believe the requirement to calculate the present value of a lease obligation based on the longest lease term that is more likely than not to occur is flawed and should be reconsidered by the Boards prior to the issuance of the final Accounting Standards Update ("ASU"). This conclusion was primarily based on our belief that the lease payments associated with optional renewal periods generally do not meet the definition of a liability as outlined in Statement of Financial Accounting Concepts No. 6: Elements of Financial Statements, a replacement of FASB Concepts Statement No. 3 (incorporating an amendment of FASB Concepts Statement No. 2) ("FASB Concepts Statement 6").

Paragraph 36 of FASB Concepts Statement 6 states the following with respect to the characteristics of a liability:

A liability has three essential characteristics: (a) it embodies a present duty or responsibility to one or more other entities that entails settlement by probable future transfer or use of assets at a specified or determinable date, an occurrence of a specified event, or on demand, (b) the duty or responsibility obligates a particular entity, leaving it little or no discretion to avoid the future sacrifice, and (c) the transaction or other event obligating the entity has already happened.

We have concluded that lease payments associated with optional renewal periods fail all three characteristics of a liability as they neither embody a duty that results in a probable future transfer of assets or obligate a reporting entity "leaving it little or no discretion to avoid the future sacrifice", nor has the obligating event already occurred. Accordingly, lease renewal periods do not represent liabilities that should be reflected on a reporting entity's balance sheet. However, we acknowledge that certain optional renewal periods could represent a constructive obligation on the part of the reporting entity as outlined in paragraph 40 of FASB Concepts Statement 6:

... although most liabilities stem from legally enforceable obligations, some liabilities rest on equitable or constructive obligations, including some that arise in exchange transactions. Liabilities stemming from equitable or constructive obligations are commonly paid in the same way as legally binding contracts, but they lack the legal sanction that characterizes most liabilities...

A constructive obligation is created, inferred, or construed from the facts in a particular situation rather than contracted by agreement with another entity or imposed by government.

Based on this guidance, we acknowledge that a reporting entity should give appropriate consideration to both legally enforceable obligations (i.e. the contractual lease term) as well as any optional renewal periods that could be interpreted to represent a constructive obligation. While by no means do we believe that all optional renewal periods represent constructive obligations, we acknowledge that all facts related to a given lease transaction should be evaluated in determining the appropriate lease term to use in estimating the present value of future lease payments.

We understand that the Boards considered the use of a higher threshold in identifying the optional renewal periods that should be considered in the determination of the lease liability (and the right-of-use asset) to be recorded related to a given lease. Paragraph BC 119 of the exposure draft states the following:

Some board members would have preferred a higher threshold than "more likely than not", such as "reasonably assured." They are concerned that "more likely than not" could result in more frequent reassessment of the liability, which could diminish the usefulness of financial reporting.

We believe that the use of a higher threshold than "more likely than not," such as "probable" or "reasonably assured", would require reporting entities to consider the existence of constructive obligations, while at the same time eliminating the need to

lease term in subsequent reporting periods.

speculate regarding the exercise of renewal options where constructive obligations do not exist. Such an approach appears to more closely align the calculation of a lease liability with the definition of a liability as defined by FASB Concepts Statement 6. In addition, we believe that a higher threshold would also represent a more operational approach for purposes of determining lease term at the inception of lease, as well as for re-evaluating

The contingent rent provisions reflected in the exposure draft do not meet the definition of a liability and should not be considered in the determination of a lease liability:

Paragraph BC 123 of the exposure draft states the following regarding the Boards' view related to contingent rent:

... in the boards' view, the liability to pay contingent rentals and the right to receive lease payments exist at the date of inception of the lease. Such contingent rentals meet the definition of a liability for the lessee and an asset for the lessor. It is only the amount to be paid that is uncertain.

Based on the definition of a liability as outlined in FASB Concepts Statement 6, we respectfully disagree with the Boards' conclusion. Our views related to this issue were primarily influenced by the guidance in FASB Concepts Statement 6 which states that the third characteristic of a liability is that:

...the transaction or other event obligating the entity has already happened

We do not believe that it is reasonable to conclude that contingent rent, which is generally based on **future** changes in the value of an index, the results of operations of a reporting entity during a **future** reporting period, or the **future** usage of an asset (i.e. hours operated, miles driven, etc.), represents a liability prior to the occurrence of the future events upon which the rent is based. As a result, we believe that the requirement to consider the expected outcome of future events (i.e. contingent rent, term option penalties and residual value guarantees) is flawed and should be reconsidered by the Boards.

To the extent that the Boards move forward with the requirement to consider contingent rent and other similar amounts in determining a lease liability, we believe that the Boards should reconsider the approach for determining the impact of these amounts. We believe that the Boards should eliminate the requirement to consider contingent rents that are based on changes in an index (i.e. the consumer price index). In addition, we believe that the Boards should reconsider the lack of consistency between ASC 450: *Contingencies* ("ASC 450") and the expected outcome approach.

Contingent Rent Based on an Index or Rate

Many leasing transactions reflect adjustments to rental amounts based on changes in an index or rate. The Boards appear to have acknowledged the difficulties associated with

projecting future changes in such indices or rates as outlined in paragraph BC 131 which states the following:

In principle, forecasting techniques should be used to determine the effect of contingencies based on changes in an index or rate. However, forecasting contingencies on the basis of changes in an index or rate requires macroeconomic information that entities may not have readily available. In the boards' view, the usefulness of the additional information obtained using such a forecast would not justify the costs of obtaining it.

Paragraph BC131 goes on to state that reporting entities should use readily available forward information, to the extent that it is available, in determining a lease liability. However, in the absence of such data the use of prevailing rates and indices is considered acceptable. While this guidance provides some relief from the requirement to estimate future changes in indices or rates, we do not believe that the use of prevailing rates and indices provides financial statement users with useful and relevant information upon which to base their investment decisions. Conversely, we believe that the use of prevailing rates and indices effectively requires a reporting entity to make the only assumption related to future events that is most assuredly wrong – that economic conditions will remain unchanged.

In addition, the requirement to reflect future changes in indices or rates in determining the lease liability to record at the inception of the lease has a significant impact on a reporting entity's results of operations. Since the amortization method related to the lease liability is based on an effective interest method, future increases in lease payments are recognized on an accelerated basis. We struggle to understand the conceptual merit of such an approach, and question whether such a requirement provides financial statement users with a more transparent depiction of a reporting entity's results of operations.

We also believe that in most circumstances, recognizing contingent rent in the same period as the event that gives rise to it provides for a better matching of revenues and expenses (i.e. contingent rent provisions based on sales would put the expense in the same period that the sales are generated.) Likewise, most index-based contingent rent arrangements are a proxy for inflation that could reasonably be expected to impact revenue similarly. As a result, we believe that the Boards should reconsider the requirement to consider contingent rents that are based on changes in an index or rate.

Inconsistency between ASC 450 and the Expected Outcome Approach

As noted above, we have concerns related to the inconsistency between ASC 450 and the expected outcome approach being proposed by the Boards. We understand that the Boards considered this issue but ultimately determined that the benefits of the expected outcome approach outweighed consistency concerns as outlined in paragraph BC 125:

The boards noted differences in the approach between Topic 450 and other US GAAP, but concluded that introducing recognition criteria

similar to that in Topic 450 would result in the understatement of right-ofuse assets by lessees and of right to receive lease payments by lessors. It would also decrease comparability, introduce structuring opportunities and increase complexity.

While we understand the Boards' concerns related to minimizing the potential for lease structuring opportunities, we do not believe that such concerns justify the promulgation of accounting guidance that is inconsistent with the current authoritative guidance related to contingencies. Contrary to the Boards' conclusions noted above, we believe that an approach that is consistent with ASC 450 (i.e. probable and estimable) would sufficiently address concerns regarding the structuring of transactions, increase the comparability of financial reporting amongst reporting entities and decrease the associated complexity.

While we acknowledge that reporting entities may have the ability to forecast future sales or other factors over a relatively short period of time (i.e. two to three years), we believe that an inverse relationship exists between the reliability of such estimates and the length of the forecast period. As a result, we believe that the proposed guidance related to contingent rent will drive a significant amount of volatility related to a reporting entity's financial position and operating results. Further, this volatility will be exacerbated by the Boards' proposals related to determining lease term (since these rules will extend the period over which such estimates are required.)

We do not believe that such volatility is in the best interests of financial statement users, and therefore believe that the Boards should consider changes to the proposed model. Consistent with our views related to lease term, we believe that it would be appropriate to implement a "probable" threshold related to contingent rent based on sales or other similar factors. Adopting such an approach would address the Boards' concerns related to lease structuring (i.e. a lease with zero fixed lease payments and high variable payments) by requiring reporting entities to consider contingent rental payments that are considered probable and estimable in the determination of a lease liability. At the same time, this threshold would provide reporting entities with a more appropriate basis for determining the period over which such contingent rents are considered.

The perceived benefits associated with the requirement to reassess the carrying amount of the lease liability on a quarterly basis fail to outweigh the associated operational issues and costs.

Consistent with the concerns of respondents outlined in paragraph BC 133 of the exposure draft, we believe that the costs and operational issues associated with reassessing lease terms and contingent rent on a quarterly basis far outweigh the benefits associated with adopting such an approach. While we acknowledge that the Boards have attempted to address these concerns by limiting reassessments to situations where there are indications that a significant change in the lease liability has occurred, we do not believe that such a requirement provides sufficient relief to reporting entities as an analysis designed to identify significant changes would still need to be performed on each and every lease on a quarterly basis.

Regardless of the Boards' final decisions related to optional lease renewal periods and contingent rent provisions, we do not believe that a reassessment of lease assumptions on a quarterly basis should be required. If the Board ultimately concludes that contingent rent must be considered in the calculation of a lease liability, then any difference in the amount estimated and the actual amount paid should be recorded in the period that it is incurred. Similarly, changes to the term of the lease should be recognized in the period that the change occurs. For example, a renewal period included in the initial lease valuation that does not occur would be de-recognized at the end of the actual lease term utilized. The execution of a renewal period not previously contemplated would result in a revaluation at the date the renewal is consummated, using the best estimates at that date.

We believe that this reassessment approach would result in reasonable and appropriate financial reporting while greatly simplifying the accounting and keeping costs in check.

Lessor Accounting Model

In light of the significant proposed changes to the lessee accounting model, we understand the Boards' decision to undertake a re-evaluation of the lessor accounting model. We believe that the Boards' stated objectives of developing a lessor accounting model that is consistent with the lessee accounting model is appropriate. However, we believe that the Boards should consider simplifying the lessor accounting model by requiring the application of the de-recognition approach to all leasing transactions. The primary benefits associated with simplifying the lessor accounting model include increased comparability amongst reporting entities and appropriate symmetry between the lessee and lessor accounting models.

In addition, as more fully described below we believe that the Boards should consider a slightly modified approach to de-recognizing leased assets that provides reporting entities with the ability to accrete the value of the residual asset over the lease term to its expected fair value at the lease termination date. We believe that accretion of the residual asset provides a more accurate depiction of the economics of a leasing transaction.

Consistent with our views related to lessee accounting, we also have significant concerns related to the proposed rules related to determining lease term and contingent rents and other similar factors in determining the right to receive lease payments related to a given leasing transaction from a lessor perspective. In addition, we believe that the requirement to reassess lease term and contingent rents on a quarterly basis results in significant operational burdens on reporting entities with limited associated benefits to a financial statement user. Since we have previously outlined our primary concerns related to these issues earlier in this letter, we have determined that separate discussion from a lessor perspective is unnecessary.

The Boards should consider simplifying the lessor accounting model by requiring the application of the de-recognition approach to all leasing transactions:

The lessor accounting model outlined in the exposure draft requires lessors to evaluate whether they have retained "significant risks and rewards associated with the underlying asset." From a theoretical perspective, we understand the Boards' intent related to this portion of the exposure draft and believe that it has some conceptual merit. However, in practice we believe that the risks and rewards analysis required by the exposure draft would result in widely varying interpretations of significance and the nature of the risks and benefits that should be considered in performing the analysis, resulting in a lack of comparability amongst reporting entities.

While we understand the factors that were considered by the Boards in determining that it was appropriate to develop two separate accounting models (i.e. the performance obligation and de-recognition approaches), we believe the application of the performance obligation approach results in an unacceptable level of asymmetry between the lessor and the lessee. In our opinion, to the extent that a lessee recognizes an asset based on its right to control an asset over the term of a lease, we believe that the lessor should de-recognize the portion of the underlying asset attributable to the lease term.

From a conceptual perspective, we believe that the performance obligation approach is inconsistent with the right-of-use model being proposed by the Boards. Paragraph BC5(d) of the exposure draft reflects the following discussion related to the benefits of applying the right-of-use model:

... would be consistent with the boards' conceptual frameworks. A rightof-use asset is <u>a resource controlled by the lessee</u> as a result of entering into the lease (a past event) and from which future economic benefits are expected to flow to the lessee. It therefore meets the definition of an asset. (emphasis added)

Paragraph BC16 of the exposure draft states the following related to the performance obligation approach:

The performance obligation approach views the underlying asset <u>as the lessor's economic resource</u>... When the lessor grants the lessee the right to use the underlying asset during the lease term in exchange for a right to receive lease payments from the lessee, <u>it does not lose control of the underlying asset</u> and, thus, continues to recognize the underlying asset in the statement of financial position, with no adjustments. (emphasis added)

Based on the definition of a right-of-use asset as summarized above (i.e. a resource controlled by the lessee), we believe that it must follow that the lessor does not have the ability to control the leased asset during the term of the lease. As a result, we believe that it is inappropriate to view the gross unamortized cost of the underlying asset in a leasing transaction as an economic resource of the lessor, and therefore believe that it would be inappropriate and inconsistent to apply to the performance obligation approach to any leasing transaction, irrespective of any risks or benefits that may exist during or after the lease term.

The Boards should consider modifications to the de-recognition approach that would provide reporting entities with the ability to accrete residual assets to their expected fair value at the lease termination date:

We believe that the de-recognition approach reflected in the exposure draft has technical merit, and could be applied to virtually all leasing transactions. However, we believe that the Boards should consider changes to the model that would provide lessors with the ability to accrete residual assets to their expected fair value at the lease termination date. We believe that such changes will provide financial statement users with more transparent information related to a reporting entity's leasing transactions and better reflect the economics of a leasing transaction.

The Boards considered a requirement to accrete the residual asset to its expected fair value as noted in paragraph BC106 of the exposure draft:

The boards propose that after initial measurement the lessor should not measure the residual asset at fair value because it would be costly for entities and could result in the recognition of unrealized gains. However, the boards think that the carrying amount of a residual asset should be adjusted to reflect any impairment. The boards considered an approach in which the lessor accretes the residual asset during the lease term to its expected value at the end of the lease term. That would reduce the number of situations in which a lessor recognizes large gains on releasing an asset. However, the boards rejected that approach because it would be inconsistent with the cost-based approach to initial recognition. Therefore, the boards propose that lessors should not remeasure the residual asset during the lease term other than for impairment.

While we appreciate the Boards' concern related to the cost associated with determining the fair value of a residual asset, we believe such concerns are mitigated by the fact that management of a leasing business must have the ability to reasonably forecast the fair market value of a residual asset in order to maintain an acceptable level of profitability. As a result, we do not believe that fair market value estimates of residual assets would necessarily result in a significant increase in costs. However, we do not believe that reflecting residual assets at their fair market value at each reporting date necessarily represents the best accounting model to apply to these transactions.

We acknowledge the Boards' concern related to the consistency of the approach related to residual assets. However, we do not believe that the cost-based approach used to determine the carrying value of a residual asset at lease inception represents the most appropriate carrying value of a residual asset over the remaining lease term. We believe that accretion of the residual asset to its expected fair value over the term of the lease represents the most meaningful depiction of the transaction and therefore the most useful information that could be provided to a financial statement user. While we understand the Boards' concerns related to the recognition of unrealized gains, we believe the impairment analyses that must be performed at each reporting date effectively mitigate the associated risk.

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Leveraged Lease Transactions

From a theoretical perspective we understand the Boards' concerns related to retaining the current accounting guidance applicable to leveraged leases. We also understand the desire to achieve convergence with IFRS related to this issue, and acknowledge that the criteria used to qualify for leveraged lease accounting are narrow in scope. However, we believe that the Boards should consider a limited scope exception related to leveraged leases that were originated prior to the transition date of the final ASU related to leases.

In light of the Boards' overhaul of the accounting rules related to leasing transactions, we understand the Boards' desire to eliminate the special accounting guidance related to leveraged leases. However, we have concluded that the costs associated with restating these transactions as of the transition date far outweigh any benefits associated with such retrospective treatment. Each leveraged lease transaction would require analysis from both a lessee and lessor perspective, and most likely require estimates of the fair market value of any residual assets at the transition date.

We question whether financial statement users would benefit from such an undertaking based on the simplified approach outlined in the exposure draft. We believe that the accounting for these transactions would be significantly impacted by the use of current interest rates, as compared to the interest rates that were expected at the consummation of the transaction. In addition, the fair market value of the residual assets recorded at transition would likely be significantly different than the carrying value of such assets had the proposed guidance been applied since the inception of these transactions.

We also believe that it is important to highlight that the many reporting entities were required to re-evaluate the accounting for many leveraged lease transactions as a result of settlements with the Internal Revenue Service that impacted the amount and/or timing of cash flows related to income taxes in these transactions, and the issuance of FASB Staff Position 13-2: Accounting for the Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction in July 2006. We believe that additional changes to pre-existing leveraged lease transactions would be confusing to financial statement users and result in decreased transparency related to these transactions.

Based on the complexities associated with transitioning pre-existing leveraged leases to the model proposed in the exposure draft, we recommend the Boards consider providing a scope exclusion for leveraged lease transactions that were consummated prior to the effective date of the final ASU related to leases. We believe that prospective application of the proposed rules to these transactions would largely address the Boards' concerns related to consistency, and would be much more operational for reporting entities choosing to undertake such transactions.

Other Issues

Apart from the concerns outlined above, we believe that the Boards should consider the accounting for lease incentives during the re-deliberation process and issue guidance as deemed necessary. We believe that the significance of the changes to the lease accounting model necessitate a re-evaluation of the accounting rules related to lease incentives in order to ensure an appropriate degree of consistency.

In addition, to the extent that the Boards make incremental changes to the lease accounting models outlined in the exposure draft, we believe that a re-evaluation of the related disclosure requirements should be undertaken. We believe that many of the disclosure requirements outlined in the exposure draft would be rendered unnecessary if the Board were to consider changes to the lease accounting model. We have summarized a couple of the disclosure requirements that would be rendered unnecessary as follows:

- Reconciliation of opening and closing balances of right-of-use assets and liabilities to make lease payments – to the extent that the Boards simplify the lessee accounting model by limiting management estimation of lease term and contingent rent, we believe that a roll-forward of the activity in such accounts would not be necessary.
- Disclosure of information about significant assumptions and judgments and changes in assumptions and judgments consistent with our views above, we believe that a simplification of the overall model would render this disclosure requirement unnecessary.

We also believe that the requirement to provide a maturity analysis of the right to receive lease payments on an annual basis for the first five years and a total for the remaining lease term is unnecessary. This requirement is inconsistent with the disclosure requirements related to loans and other financial assets, and we believe of limited value to financial statement users. Further, the requirement to distinguish cash flows attributable to minimum amounts receivable in the lease from amounts relating to contingent rent and residual value guarantees would be unnecessary if the Boards were to implement a more simplified approach related to the accounting for contingent rent and other similar terms.

Finally, we encourage the Boards to provide an extended period of time prior to the effective date of this ASU as there are numerous lease arrangements and adequate software to perform the analyses and calculations does not exist.

We would be pleased to discuss our comments with the Board members or the FASB staff at your convenience.

Very truly yours,

Henry R. Sturkie, III

Assistant Corporate Controller