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File Reference 1850-100: Exposure Draft - Leases

We appreciate the opportunity to comment on the Exposure Draft: Leases (ED). Regions Financial Corporation ("Regions" or "the Company"), with approximately $133 billion in assets, is one of the United States’ largest full-service providers of consumer and commercial banking, trust, securities brokerage, mortgage and insurance product services. Regions serves customers in 16 states across the South, Midwest and Texas, and through its subsidiary, Regions Bank, operates approximately 1,800 banking offices and a 2,200 ATM network. We provide brokerage services and investment banking through over 300 offices of Morgan Keegan & Company, Inc.

Overall, we are in support of the IASB and FASB convergence projects, and Regions encourages the Boards to work closely together in order to provide a more unified approach to financial accounting for the benefits of its users than currently exists. We are very concerned with the significant amount of workload and projects currently being deliberated by the Boards, and urge the Board to maintain diligence in its efforts to adequately address all the challenges and implementation issues prior to adoption.

Executive Summary

We support the Board’s efforts to improve lease accounting, and acknowledge that the current model is widely viewed as failing to meet the expectations of financial statement users. The right-of-use model proposed in the ED addresses many of these concerns. However, there are a number of application and conceptual issues that should be addressed for this ED to be consistently applied and operational. These key issues include the measurement of leases for lessees that have complex provisions including term extension options and contingent payments, the determination of the incremental borrowing rate, the conceptual benefits of the ‘hybrid approach’ to lessor accounting and proposed transition provisions.
Lessee accounting

We agree that the proposed ED accomplishes the Board’s objective to recognize assets and liabilities arising under operating lease arrangements where entities currently are not. We do not agree however with the measurement of the right-of-use asset and liability to make lease payments as it involves more complex provisions.

Complex leases that contain term extension provisions should only be recognized where the definition of a liability is met for the lessee. We disagree with the measurement principle ‘the longest period more likely than not to occur’, and our view is that ‘reasonably certain’ is a higher threshold and more consistent with current accounting principles for liability recognition. We understand that users of financial statements approach lease accounting from a liability perspective, and we are concerned that the Board’s proposal will result in recognizing liabilities that do not meet the definition of liabilities under existing guidance. We believe that changing the recognition threshold for extension options to ‘reasonably certain’ would increase the consistency of application and reduce the complexity and frequency of this assessment.

We believe that including future contingent rentals as a component of the right-of-use asset can in many cases create a mismatch between the accounting amortization of that right-of-use asset and the economic benefit associated with its use. Consider two basic examples of a retail company whose future contingent rentals are based on sales and assume 100% of all contingent payments are included in the right-of-use-asset. The ED would cause the expenses to be front loaded (through the use of the interest method) when the economic benefit would be realized towards the end of the lease, as the retail company is realizing the intrinsic value of the lease through increased sales as a result of location recognition by customers and the local community. This pattern effectively increases the intrinsic value of the lease to the retail company. Now consider the opposite, where no contingent rents are capitalized, the company has the same sales experience. If the contingent rentals were recognized on an as incurred basis, profitability would be more appropriately stated and no artificial intrinsic value would be built over time and would therefore result in a better accounting recognition match. Accordingly, we also believe that the ED should only require contingencies that are in the control of the lessee to be included in the measurement as they meet the definition of a liability, therefore eliminating ‘usage’ based contingencies from measurement until realized.

We encourage the Boards to consider adding additional guidance regarding the lessee’s determination of its incremental borrowing rate in order to promote consistency across entities. The Boards should consider the difficulty of obtaining this information for lessees that have not recently obtained financing of a similar term. Additionally, the Boards should consider the availability of rate information for leases that are tied to an index. Prospective information for such rate features may not be readily available or reliable.

We also believe the ED should include as practical expedients the recognition of the right-of-use-asset based on lease agreements that are collectively immaterial to the financial statements. Lease arrangements that are non-core in nature and ‘operational’ in their value to a firm should continue to be accounted for under the current operating lease model and reported as operating cash flows. These leases are typically high volume, small dollar arrangements and can include such items as copiers, fax machines, and personal computers. The ongoing costs to maintain adequate records for balance sheet recognition for such agreements greatly outweigh any perceived benefit for users.
We agree that the right-of-use asset should be treated as a tangible asset similar to the asset subject to the lease agreement. We urge the Boards to clarify this point in order to promote consistency for regulatory reporting, as it is currently unclear how the right-of-use asset recognition will be viewed by regulatory bodies.

Lessor Accounting

We do not believe that the proposed changes in the ED related to lessor accounting are as fully developed as the proposed lessee models. We acknowledge the Board’s task of developing a consistent model for both lessors and lessees, but we do not believe the ‘hybrid’ lessor model proposed accomplishes this objective. The ‘hybrid’ model does not appear to be an improvement to the current capital lease criterion model and the operational burden arising from this change will come at substantial costs. We recommend that lessors continue to apply existing lease accounting guidance until the Boards are able to develop a lessor approach that is fully developed and includes additional fieldwork and analysis.

There are numerous joint projects in various stages of completion that the Boards aim to complete over a shortened time horizon that will impact the ability to adequately focus on the lessor model. We believe it is in the Board’s interest to focus on changes to lease accounting for lessee and postpone lessor accounting until adequate resources can be devoted to this topic.

Transition

We believe that the implementation for lessees will be complex and a cost burden to implement for many. For this reason, the ED should provide for a relatively long effective date to reflect this complexity. A minimum of two to three years will be required to transition to the new standard, and even longer depending on the Board’s conclusions regarding lessor accounting.

As a final lessor accounting model is contemplated, we believe that lessor accounting for leverage leases should be ‘grandfathered’ for existing leverage leases at the effective date of the new standard. The leverage lease environment has changed significantly in recent years, and many leverage lease portfolios are in ‘run off’ status. Therefore, adopting new accounting standards to an existing leverage lease portfolio would require a significant amount of time, involve complex tax computations and be of little benefit to financial statement users.

Thank you for your attention to these comments and for considering our views on your exposure draft for leases. If you have any questions about our comments or wish to discuss this matter further, please contact me at (205) 326-4972.

Sincerely,

Brad Kimbrough
Executive Vice President, Controller and Chief Accounting Officer