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Financial Accounting Standards Board
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Dear Board Members and Staff:

We are writing to comment on the proposed changes to lease accounting standards as outlined in your Discussion Paper "Leases: Preliminary Views", which was issued on March 19, 2009.

Introduction

U.S. Realty Advisors, LLC ("USRA")¹ believes that FASB's and IASB's fundamental objective of creating accurate, complete, clear and economically reflective financial statement presentations is undermined by the standards for lease reporting suggested in the Discussion Paper. In fact, eliminating the current distinction (as reflected in FAS Statement No. 13 and its related pronouncements – "FAS13") between operating leases and finance/capital leases will move financial statements in the opposite direction, providing the reader with more "data" but much less accurate, clear and useful "information" about the company.

If, at the margin, there are certain perceived current abuses of FAS13, we suggest that they be specifically addressed through the normal interpretive mechanisms of FASB and IASB. However, we believe that the accounting profession already has moved to a disciplined and rigorous interpretation of FAS13 that has eliminated past abuses. We suggest below certain simple changes to FAS13 that will provide meaningful additional information and perspective on operating lease obligations.

In contrast, the complete restructuring proposed by the Discussion Paper will undermine FASB's and IASB's fundamental disclosure and presentation objectives and will dramatically distort the financial statements of lessees. Rather, these objectives can best be served by (i) retaining the current dichotomy between operating leases and finance/capital leases, and (ii) requiring additional operating lease information to be included within the financial statements and footnotes.

Below we discuss specific conceptual concerns about the proposals described in the Discussion Paper. More importantly, as an alternative to the proposals in the Discussion Paper, we indicate the supplemental operating lease disclosure information that we suggest be required in lessee financial statements under FAS 13.

¹ U.S. Realty Advisors, LLC has been in the net lease real estate ownership business for 20 years, and its principals have been in the real estate ownership business for between 25 and 41 years. Over the years, we have been involved in more than \$18 billion of real estate transactions.



Conceptual Concerns About the Discussion Paper

- The Discussion Paper indicates the correct objective of seeking “to recognize the identified assets and liabilities of the lessee, *i.e.*, the lessee’s right to use the leased item and its obligation to pay for that right.” (Appendix C.8.) However, creating a right-of-use asset that is to be amortized over the lease term will make it more difficult for the reader of the financial statement to understand the lessee’s true financial obligation and remaining asset.
- The standards in the Discussion Paper materially will distort rental expense recognition by the lessee. Under FAS13, rental expense is arithmetically averaged over the lease term. Although some have felt that this treatment overstates rental expense in the early years (when stepped rents typically are lower), arithmetic averaging is generally viewed as a reasonable, if not perfect, approach. What is proposed in the Discussion Paper would create, even for a lease with flat rents, an irrational high-to-low rent charge that bears absolutely no relation to economic or financial reality. This will mean that the annual rent charge will simply be a number that bears what likely is an inverse connection to what has happened economically and financially. Where are the disclosure, accuracy and reality that financial statements are supposed to provide?
- In the Discussion Paper, rent payments in renewal option terms would be included in the primary term if the “most likely” outcome is that the lease option will be exercised. In current practice, there is no evidence that the existing FAS13 standards of renewal term exercise are being abused. In fact, given the substantial business uncertainty confronting companies in their operations, and the frequency and flexibility with which companies are willing to change operating strategies, we believe companies and the accounting profession have thoughtfully and reasonably established standards under FAS13 by which to determine if renewal options are likely to be exercised. In contrast, the type of detailed analysis prescribed in the Discussion Paper will require a highly subjective debate between the lessee and its auditor that will not improve current practice, will create no consistency of practice and will overstate lessee obligations solely on the basis of projections of unknown, distant and constantly changing conditions.
- In the Discussion Paper, “cost” must be determined in order to book the asset and report expense. This proposed approach would utilize an interest rate that, under either possible method, would overstate the liability and rental expense of a higher credit tenant and understate them for a lower credit tenant. This perverse result would further misstate the lessee’s economic cost and provide little or no useful, and possibly even misleading, information to a reader of the financial statements. Cost comparisons would be impossible, and the economic reality of rental expenses would be obscured, at best.

(Interestingly, under FAS13, discounting for purposes of the 90% test also is done using an interest rate (either the implicit rate in the lease or the incremental borrowing cost) that makes it easier for a lessee with lower credit quality to achieve operating lease status.)

Suggested Operating Lease Changes Under FAS13

1. Calculate the annual earnings charge for rent expense by using the following approach:



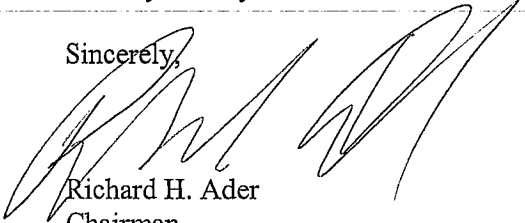
- a. If each of the scheduled annual rent payments is within a 25% variance from the arithmetic average of the annual primary term rent payments, use the actual annual payment in each year as the earnings charge for that year.
 - b. If each of the scheduled annual rent payments is not within a 25% variance from the arithmetic average of the annual primary term rent payments, use the arithmetic average of the annual primary term rent payments as the earnings charge for every year.
2. In addition to the current footnote disclosure of the absolute amount of rental payments under operating leases for the current year, the next five years, and all subsequent periods, require disclosure in the same footnote of the present value of the remaining primary term rent payments. This additional information will provide the reader of the financial statements with the clearest possible indication, as of the end of each reporting period, of the lessee's potential future economic exposure (or liability, if you will) under its leases. It will do so with directness, simplicity and complete logic.

For this purpose, FASB could publish monthly rates for short-, medium- and long-term operating lease transactions that would be uniformly used by all lessees regardless of credit quality. This rate (the "Published Rate") would be based on a practical formula that takes into account general market interest rate conditions at that time. The discount rate for the present value calculation would be the average of the Published Rates in the three months ending with the end of the current reporting period.

We respectfully submit that accurate, complete, clear and economically reflective financial statement presentations will not be achieved by adopting the approach or methodology presented in the Discussion Paper. On the other hand, the suggested changes to FAS13 will achieve these objectives in an efficient, logical and economically rational way.

Thank you for your consideration of these thoughts.

Sincerely,



Richard H. Ader
Chairman