**Private Company Financial Reporting Committee**
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Judith H. O'Dell CPA CVA
Chair

January 9, 2012`

Ms. Leslie Seidman
Chairman
Financial Accounting Standards Board
401 Merritt 7
Norwalk, CT06856

**Re: Proposed Accounting Standards Update, *Real Estate – Investment Property Entities (*"Proposed ASU*")***

Dear Ms. Seidman:

The PCFRC has reviewed and discussed the Proposed ASU in light of entities that are common in the world of private companies. The FASB is well aware of the private company structure in which an entity is created to hold real estate that is used by a related operating company. It appears that the Proposed ASU was specifically drafted to exclude those entities. The PCFRC provides these comments with typical private company entities in mind.

***Respondent Question 1:*** *The proposed amendments would require an entity that meets the criteria to be an investment property entity to measure its investment property or properties at fair value rather than require all entities to measure their investment properties at fair value. Should all entities measure their investment properties at fair value or should only an investment property entity measure its investment properties at fair value? Why? Is fair value measurement of investment properties operational? Please describe any operational concerns.*

***PCFRC Response:*** The PCFRC does not believe that all entities should measure their investment properties at fair value. Users of private company financial statements have repeatedly said that fair value information in financial statements is not particularly useful. In addition, current banking regulations require banks to obtain annual appraisals of real property that secures debt, which provides these users with fair value information. To require private company entities to measure investment property at fair value would be costly and provide no additional benefit to users. The PCFRC believes

that only an investment property entity should be required to measure its investment properties at fair value.

***Respondent Question 3:*** *Do the criteria in the proposed amendments appropriately identify those entities that should be required to measure their investment property or properties at fair value, and, therefore, should be excluded from the scope of the lessor accounting model in the proposed Update on leases? If not, what changes or additional criteria would you suggest, and why are those criteria more appropriate?*

***PCFRC Response:*** The PCFRC believes that the proposed amendments are intended to scope out private company related party entities that lease property to operating companies. However there could be some confusion in interpreting the requirements. Perhaps topic 973-10-15-2 (b) (1) should be clarified to state that "The entity's OR A RELATED PARTY's own use in the production or supply of goods or services …"

***Respondent Question 8:*** *To be an investment property entity, the proposed amendments would require that the express business purpose of an entity is to invest in a real estate property or properties for total return with an objective to realize capital appreciation, for example, through disposal of its real estate property or properties. Real estate properties held by an entity for either of the following purposes would not meet this criterion:*

*a. The entity's own use in the production or supply of goods or services or for administrative purposes*

*b. Development for sale in the ordinary course of business upon completion (such as land developers and home builders).*

*Should an entity whose express business purpose is to hold real estate properties for the reasons listed above be excluded from the amendments in this proposed Update? If not, why? Is the express-business-purpose criterion operational? Please describe any operational concerns.*

***PCFRC Response:*** The PCFRC believes that an entity whose express purpose is to hold real estate properties for the reasons listed above should be excluded. However, as stated above, the PCFRC believes there should be a clarification that if the entity holds real estate properties for lease to a related party for that entity's use in production or supply of goods and services, it should be excluded. The PCFRC recommends that the express business purpose guidance concerning "affiliates", which is contained in topic 973-10-55-12 of the Proposed ASU (paragraph 6), be presented earlier in the Proposed ASU (most likely in topic 973-10-15-2) to better highlight and clarify that the express business-purpose criterion principles extend to affiliates of the entity. Example 5 at 973-10-55-37 and 38 makes this clear, but it should be expressly stated earlier in the Proposed ASU.

***Respondent Question 9:*** *To meet the express-business-purpose criterion, the implementation guidance in this proposed Update would require that an investment property entity have an exit strategy to dispose of its real estate property or properties to realize capital appreciation to maximize total return. An entity that invests in a real estate property or properties to collect rental income long term and does not have an exit strategy for its real estate property or properties would not be an investment property entity under the proposed amendments. Should those entities be excluded from the amendments in this proposed Update? If not, why? Is the exit strategy requirement operational? Please describe any operational concerns.*

***PCFRC Response:*** While the PCFRC generally agrees with the express- business-purpose criterion, the exit strategy requirement may create some opportunity for structuring to obtain a desired accounting treatment. Does the exit strategy need to be written? For example, there are many private entities that hold apartment and office buildings as rental properties. Interests in these in many cases may have been inherited and the entity may have numerous investors who do not meet the definition of "related parties" (as defined in the Master Glossary). The entity may be professionally managed through a family office. Thus these entities would seem to meet the definition of an investment property entity except there may not be a formally stated exit strategy. In weighing the costs of appraisals versus applying the proposed complex lessor accounting standards, those private entities may find it advantageous to state an exit strategy in order to be an investment property entity. The standard as written appears to provide flexibility for these types of private investment property entities. The PCFRC is uncertain about whether that is the intention of the FASB and suggests that the FASB consider this issue further.

***Question 12:*** *The proposed amendments would require real estate properties other than investment properties that are held by an investment property entity to be measured in accordance with other U.S. GAAP. Should an investment property entity be required to measure those properties at fair value with all changes in fair value recognized in net income instead of applying other U.S. GAAP? Why or why not?*

The PCFRC generally agrees that an investment property entity should be required to measure its properties at fair value. However, the exposure draft at 973-360-35-7 requires that if an investment entity subsequently begins the development of an investment property with the intention to sell the property once it is complete, the investment property shall continue to measure the property at fair value until it is sold. BC65 states that the board decided not to provide a practicability exception to the fair value requirement for investment properties under construction. PCFRC members believe that a practicability exception for properties under construction would be appropriate for private investment company entities. The cost of providing a FAS 157 measurement for a property under construction at each reporting period during construction would outweigh the benefits. Lender users of the entity's financial statements would value the property under construction based on their own

methodologies. As an example, a bank user member of PCFRC reports that properties under construction are valued on an appraisal as completed and as stabilized basis with lending underwriting standards limiting loan advances to no more than 100% of cost or 75% of stabilized value whichever is the smaller. This bank defines stabilized value as the value after the project is expected to reach about 95% occupancy.
Investor users may be more interested in the projected cost to complete and the estimated completion date than in the fair value at each reporting period.

***Respondent Question 18:*** *The proposed amendments would require an investment property entity to recognize rental income on investment properties subject to a lease when lease payments are received or as the lease payments become receivable in accordance with the contractual terms of the related lease rather than on a straight-line or other basis. Is that basis of recognizing rental revenue appropriate for investment properties measured at fair value? If not, why?*

***PCFRC Response:*** As stated in our answer to Question 9 above, it might be very attractive to avoid the proposed lessor accounting. If the property is measured at fair value, recognizing rental income as payments are received or as the lease payments become receivable is appropriate.

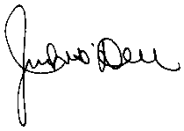
***Respondent Question 24:*** *The proposed amendments would apply to both public and nonpublic entities. Should the proposed amendments apply to nonpublic entities (such as private companies and not-for-profit organizations)? If not, how should the proposed requirements differ for nonpublic entities and why?*

***PCFRC Response:*** The Committee believes that there are some recent tentative decisions that the FASB has made relative to the ongoing *Leases* project that might influence whether or how the FASB proceeds with the Proposed ASU. Also there are yet-to-be deliberated issues in the *Leases* project about related party entities that cannot yet be assessed in relation to investment property entities. Finally, those decisions within the *Leases* project could effectively call into question the necessity of the Proposed ASU and a separate *Investment Properties* project and whether the project should somehow be encompassed within the current *Investment Companies* project. As such, the PCFRC cannot reasonably comment on whether the Proposed ASU should apply to nonpublic entities until the outcome of certain deliberations in the *Leases* project is known. The Committee recommends that final action on the Proposed ASU be deferred until those deliberations are finalized and respondents are given the opportunity to then comment further on the Proposed ASU in light of the decisions made in the *Leases* project.

Regarding the issue of related party entities referred to above and any future decisions the FASB may make concerning the accounting and reporting related to those entities, the PCFRC advises that the real estate carried by related party entities should not be required to be measured at fair value due to the cost that would be incurred by the entity and the lack of perceived benefit to those who use private company financial statements.

The PCFRC appreciates the FASB's consideration of these recommendations and concerns. Please feel free to contact me if you have any questions or comments.

Sincerely,



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