December 15, 2010

VIA E-MAIL: director@FASB.org

Financial Accounting Standards Board and
International Accounting Standards Board

Re: Financial Accounting Standards Board Exposure
Draft - Proposed Accounting Standards Update – Leases
Topic 840 issued August 17, 2010

Ladies and Gentlemen:

Thank you for the opportunity to comment on the proposed Accounting Standards Update for Leases - Topic 840. We appreciate your efforts to improve lease accounting.

Our firm’s clients include numerous middle market entities which participate in lease transactions, many as lessees and many as lessors. In addition, we represent several financial institutions which extend credit to middle market entities. If adopted, the proposed Standards will substantially alter the balance sheet treatment of lease transactions. We are concerned that the proposed Standards are a one size fits all package which, except for minor exceptions, does not address the burdens upon private middle market entities and lenders which extend credit to these entities that will be caused by compliance with the Standards.

In order to conform with GAAP as modified by the Standards, lessor and lessee entities will be forced to change their accounting systems and processes. In addition, there will have to be continuous monitoring and revision with respect to lease transactions which, in all likelihood, may exist at multiple locations.

Entities will be required to predict the future term of all their leases to comply with the proposed Standards. Under the proposed Standards, such prediction requires consideration of options to renew and the likelihood that such renewal will occur. Calculating the term (other than the initial term) and trying to factor in whether or not renewal options will be exercised, is, at best, guesswork which will consume
administrative time and energy. Retail leases will pose a particular challenge in weighing the effect of provisions such as co-tenancy clauses and exclusive use clauses. Lease termination pursuant to these clauses could drastically impact the lease term and defies any reliable prediction.

Another problem under the proposed Standards is the necessity for lessees to separate rental payments into cost components of use (payment for occupancy) and cost components of servicing (operating expenses, real estate taxes, etc.). The servicing costs under the proposed Standards will continue to be expensed, but the use cost would be treated like a financed purchase. Lease cost pass throughs (servicing costs) will need to be segregated. Such segregation may not be difficult for pure net leases; however, such segregation will be administratively burdensome guesswork where servicing costs are either partially or fully blended into the gross rent. The calculation of future rental payments will also require administrative guesswork to weigh the effects of CPI escalators, pass throughs of landlord’s operating costs, percentage rent based upon income and other similar benchmarks.

The results of guesswork concerning lease term and rent amount will no doubt be subject to continual revision and reassessment as facts unfold which are contrary to the “facts” derived from subjective guesswork and predictions in prior years.

The burdens stated above may ultimately incentivize middle market lessees to seek shorter lease terms and avoid renewal and extension options. Such shorter terms would be contrary to the needs of both lessees and lessors to have reasonable predictability and stability in occupancy. Further, lessors could be particularly harmed, since their financing is often based upon the reliability of stable cash flow generated by long term leases in place.

The proposed Standards will also place substantial administrative burdens upon lenders to middle market entities and the borrower entities in credit relationships. Most of these relationships are governed by financial covenants. Implementation of the proposed Standards will distort measurements for covenant compliance. Entities which have not changed their true financial position could be in violation of loan covenants solely because of the change in accounting principles. This disruption will cause borrowers and lenders to follow either one of two courses of action: provide separate financials for the purpose of measuring covenants, such separate financials not prepared in accordance with GAAP, but prepared in accordance with GAAP as it existed prior to implementation of the proposed Standards, or renegotiate financial covenants. Such renegotiation process is not only burdensome but can lead to an open discussion of many issues which otherwise would have remained settled, causing a possible detriment either to borrower or lender or both.
The adverse consequences set forth above do not appear to be balanced by the benefits of the proposed Standards when applied to privately held middle market businesses. Accordingly, we request that you consider altering the application of the Standards to take into account the size of the entity for which statements are being prepared and whether such entity is public or private. Thank you for your consideration of these matters.

Very truly yours,

Joel M. Hurwitz

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