

15 Dec 2010

IASB - International Accounting Standards Board FASB - Financial Accounting Standards Board 401 Merritt 7
Norwalk T 06856-5116

Re: File No. 1850 - 100 Proposed Lease Accounting Standard Changes

Dear Sirs:

Thank you for the opportunity to offer our comments to you on the proposed changes to the Lease Accounting Standard as outlined in the August 2010 Exposure Draft.

Question 1: Lessees

- (a) Do you agree that a lessee should recognize a right-to-use asset and a liability to make a lease payments?
- (b) Do you agree that a lessee should recognize amortization of the right-to-use asset and interest on the liability to make lease payments?

Answer:

We agree with the intent of the proposed approach to recognize the right-to-use asset and it's corresponding liability. As well, we agree with the objective to bring the sum of the total asset and liability to zero at the end of the lease term. It also seems to be best to amortize the asset and recognize implied interest on the liability.

However, we disagree with the propose methodology being proposed for either lessees or lessors.

To use the straight-line amortization method is to severely distort the entire cash flow process to the point that the "reported" information has no reasonable comparison to the "actual" cash flow being expended. This is even more pronounce when the suggested lease term should include all option periods.

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Many of the previously submitted comments have provided fine examples indicating the distortion of how using straight-line amortization methods result in overly inflated numbers. As such, we do not need to re-state or provide additional examples of the obvious distortions.

We believe a more reasonable approach to the amortization process is to use the effective interest amortization methodology. This will result in financial numbers being reported that more accurately reflect the lessee's and lessor's economics for each lease transaction during each respective year.

Under our comments below regarding Question 8, and especially during economic times similar to those we have currently, too often the intent of both lessees and lessors at the beginning of the lease term does not completely come to realization. As we have seen during these troubling times, lessees have filed for bankruptcy failing to honor to the terms of the lease.

Or the lessor, as a result of losing previously anticipated tenants, fails to keep the mortgages current and loses the property to foreclosure. The acquiring lender elects to not keep the remaining leases and as a result, both parties no longer have the economic conditions previously forecasted.

By utilizing the effective interest method to amortize the rental payments, each party to a lease transaction will be able to accurately report their "actual" yearly cash flow.

This process will be even more important at any point in time that a lease term is terminated early, re-negotiated for a shorter or longer term, has adjustment of rental values, or any of the many aspects that happen in the real world of leasing.

Things change. Intent changes. Economic conditions change. The only constant in our lives is change.

The straight-line amortization method becomes a straight jacket with its distorted values, and as such will choke the life out of the true financial condition of either the lessee or the lessor.

Question 8: Lease Term

Do you agree that a lessee or lessor should determine the lease term as the longest possible term that is more likely than not to occur taking into account the effect of any options to extend or terminate the lease?

Answer:

In a word – NO! The suggested lease term "option or options" in and of itself has too many potential arguments as to whether a "option" is legally enforceable or not enforceable, controlled by the lessee or controlled by the lessor. Is it a "true" option or simply a first right of refusal?

The potential concept of attempting to include all possible or likely lease terms that include legally unenforceable options as part of the initial calculation is a dream world concept or someone's imagination. IT IS NOT REALITY!

An option by definition is a right to choose a course of action subject to certain conditions. Until an option is fully exercised AND a definitive lease is written AND fully executed AND a legally enforceable agreement is put into place, an option is so much "WHAT IF?".

It could compare to dropping a small stone into the ocean thereby creating a small ripple in the surface of the ocean. Similarly, until an option is fully exercised and all the appropriate documentation becomes legally enforceable, it has no financial impact between the parties involved.

It is our opinion such option agreements, whether written as a true option or as a first right of refusal, are highly uncertain future events that may or may not take place.

Without an legally enforceable agreement between the parties, how can anyone correctly indicate in a financial statement their true financial condition, "IF", the vast majority of the lease term is someone's pipe dream?

We do not believe anyone can predict the long term future as accurately as being suggested under the Exposure Draft. It is doubtful that even the most sophisticated larger corporate real estate departments will achieve even a 30% to 40% accuracy rate.

A larger percentage might be achievable for the smaller non-public entities. But my experience has shown too often, lessees tend to want to move at the end of their lease terms, or want substantial expansions or contractions, if they elect to stay in place.

Either way, changes seem to always be required to be made. As indicated above: Things change. Intent changes. Economic conditions change. The only constant in our lives is change.

To require either lessees or lessors to consider including such imagined events, will cause untold financial troubles as to not be worth the time and effort required by both parties to try to gaze into their respective crystal balls, while attempting to determine the course of their financial futures.

Using a best guess "most likely" time frame versus a detailed, definitive and legally enforceable contract will result in severe, as well as in some cases, substantial financial adjustments. As such, the public at large investing in the various public organizations will cry "foul" and demand restitution when things do not turn out as management projected or imagined. All because management and their auditors were unable to foresee their reality from the clouded over crystal ball imagination of future events.

And where and from who is that restitution going to come from? Who is going to be held accountable for not accurately determining the "most likely" course of events relating to their leases? Especially when you are attempting to look 10, 15, 20 or even 25 years into the future. Will the person who imagined the course of action still be employed by the same corporation 5, 10 or 15 plus years into the future? Probably not.

Yes we do agree corporate management should be making appropriate long term plans and in fact should be negotiating options for their leases. But having a option to do or not do something in the future, is not the same as being held financially accountable for it today.

This process is even further degraded by the suggested process within the Exposure Draft of each lessee and each lessor, individually, making their own determinations as to what is the defined "most likely" lease term of the transaction between the parties at that particular moment.

The corporate lessee's idea of a the most likely term, can and will be substantially different than that which is decided by the real estate lessor. Both could and most will have different ideas of how the future course of events will take place.

Historically, far too many lessees have failed to complete all of the lease terms outlined in their lease documents. Far too many lessors have seen their properties suddenly become very vacant due to key major tenants no longer being financially viable.

The only time frame that should be included in any financial projection is that in which the lessee or lessor have a legally binding and enforceable contract in place. Whether the legally enforceable lease time frame is three years, five years, 10, 15 or 20 years, it matters not. Whatever the defined lease time happens to be, is the time frame the financial calculations should be based on.

If the lease term changes as a result of negotiations between the parties, that is the time to re-measure the financial outcome and to make appropriate changes to the financial statements.

Question 12: Statement of financial position

(b) Do you agree that a lessor applying the performance obligation approach should present underlying assets, right-to-receive lease payments and lease liabilities gross in the statement of financial position, totaling to a net lease asset or lease liability (paragraphs 42, BC148 and BD149)? Why or why not? In not, do you think that a lessor should disclose this information in the notes instead? What alternative presentation do you propose and why?

Answer:

NO! we do not agree with the proposed application of the right-to-receive lease assets and liabilities being presented with the other hard assets of the building and associated land. The proposed format is unprecedented. Assets should be contained in the asset section and liabilities should be in the liabilities section.

To do otherwise is confusing. If this is to be the case, why not move the mortgage liabilities under the building and land section and call it "net equity"?

Each "category" should be presented by and of itself on the financial statement.

One category should be the PPE items totaling to a number; one category should be "buildings" totaling to a number; another category as "land" totaling to a number; another category should be "right-to-receive lease assets" or "right-to-use lease assets" totaling to a number. All the above should be listed in the "ASSET" section of the financial statement along with all the other corporate assets with the grand total of all assets presented as "Total Assets".

In the "LIABILITIES" section of the financial statement should be a category of the "lease liabilities". The above should be listed in the "LIABILITIES" section of the financial statement along with all the other corporate liabilities with the grand total of all liabilities presented as "Total Liabilities".

Depending on the size of the reporting entity, it would certainly make sense to report summary totals on the financial statements with definitive supporting statements detailing the specifics of the entire leased portfolio.

Question 16: Transition

(c) Are there any additional transitional issues the boards need to consider? If yes, which ones and why.

Answer:

Most companies do not presently collect all the information and assumptions related to their leases that they will need in order to comply with the proposed Lease Accounting Standard. In fact, many corporate lessee companies do not even have an inventory of their corporate leases. Nor do many real estate lessors have the necessary detailed leasing information on their lease portfolios that they could vouch as being completely accurate enough to be the basis for the amounts that will go on their respective balance sheets.

What organization can still put their hand on old lease agreements from two, three or four years ago? Corporate lessees and real estate lessors have quite a bit of work before them to be ready to comply with these proposed standards.

Moreover, computer software applications don't even exist yet to easily collect the required lease data and assumptions, to be able to manipulate that data, and to be able to export it to the corporate financial accounting systems. Software vendors are highly unlikely to put significant resources into developing such applications until the new Lease Accounting Standard is finalized. Plus, it could take them one to two years or longer before their new applications are ready for the mass market with all the software glitches worked out.

It would be unreasonable to require any companies to apply the standard to a date prior to the issuance of the new Lease Accounting Standard. So, if the new Lease Accounting Standard is issued on or about 1 July 2011, then the earliest potential Effective Date should not be until 1 July 2014. And since organizations deserve to have a little bit of notice before they need to start the new Lease Accounting Standard procedures, it is our recommendation that the earliest Effective Date should not actually start until 1 January 2015.

In which case, the new Lease Accounting Standard would have to be applied no earlier than 1 January 2012. This should allow sufficient notice to all lessees and lessors to put into place the documentation processes necessary to start complying with the new Lease Accounting Standard.

There may be a period of time that such procedural and accounting systems may be somewhat the result of manual systems, but eventually, software companies will be able to provide computer applications to help simplify the processes.

As a result, no one has to expend unnecessary manpower and financial resources to re-do any previously stated or published financial statements, which in the long run will have no economic benefit to anyone. Let everyone start utilizing the new Lease Accounting Standard using fresh, clean financial statements.

Thank you for your consideration of the above views.

Sincerely yours,

/s/ James T Saint, CCIM, MRICS Chartered Facilities Management Surveyor