

## FASB Leases - Topic 842

Date of Entry: 9/3/2013

### Respondent information

#### Type of entity or individual:

Preparer

#### Contact information:

*Organization:* Hilltop Basic Resources, Inc.

*Name:* Paul J Hennekes

*Email address:* phennekes@hilltopbasic.com

*Phone number:* 513-651-5000

### Questions and responses

1. This revised Exposure Draft defines a lease as “a contract that conveys the right to use an asset (the underlying asset) for a period of time in exchange for consideration.” An entity would determine whether a contract contains a lease by assessing whether: 1. Fulfillment of the contract depends on the use of an identified asset.2. The contract conveys the right to control the use of the identified asset for a period of time in exchange for consideration.A contract conveys the right to control the use of an asset if the customer has the ability to direct the use and receive the benefits from use of the identified asset.Do you agree with the definition of a lease and the proposed requirements in paragraphs 842-10-15-2 through15-16 for how an entity would determine whether a contract contains a lease? Why or why not? If not, how would you define a lease? Please supply specific fact patterns, if any,to which you think the proposed definition of a lease is difficult to apply or leads to a conclusion that does not reflect the economics of the transaction.

Yes, I agree. However, this is essentially the same requirement as current lease accounting. Also, I believe that private company standards for lease accounting should consider the limited number of users of the financial statements (i.e. few owners or one owner and banks).

---

2. This revised Exposure Draft would require an entity to recognize assets and liabilities arising from a lease. When assessing how to account for a lease, a lessee and a lessor would classify a lease on the basis of whether a lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset. This revised Exposure Draft would require an entity to apply that consumption principle by presuming that leases of property are Type B leases and leases of assets other than property are Type A leases, unless specified classification criteria are met. Those classification criteria are different for leases of property and leases of assets other than property to reflect the different natures of property (which often embeds a land element) and assets other than property. The Boards acknowledge that, for some leases, the application of the classification criteria might result in different outcomes than if the consumption principle were to be applied without additional requirements. Nonetheless, this revised Exposure Draft would require an entity to classify leases by applying the classification criteria in paragraphs 842-10-25-5 through 25-8 to simplify the proposals. Lessee Accounting A lessee would do the following:

1. For all leases, recognize a right-of-use asset and a lease liability, initially measured at the present value of lease payments (except if a lessee elects to apply the recognition exemption for short-term leases).
2. For Type A leases, subsequently measure the lease liability on an amortized cost basis and amortize the right-of-use asset on a systematic basis that reflects the pattern in which the lessee expects to consume the right-of-use asset's future economic benefits. The lessee would present the unwinding of the discount on the lease liability as interest separately from the amortization of the right-of-use asset.
3. For Type B leases, subsequently measure the lease liability on an amortized cost basis and amortize the right-of-use asset in each period so that the lessee would recognize the total lease cost on a straight-line basis over the lease term. In each period, the lessee would present a single lease cost combining the unwinding of the discount on the lease liability with the amortization of the right of use asset.

Lessor Accounting A lessor would do the following:

1. For Type A leases, derecognize the underlying asset and recognize a lease receivable and a residual asset. The lessor would recognize both of the following:
  - a. The unwinding of the discount on both the lease receivable and the residual asset as interest income over the lease term
  - b. Any profit relating to the lease (as described in paragraph 842-30-30-7) at the commencement date.
2. For Type B leases (and any short-term leases if the lessor elects to apply the exemption for short-term leases), continue to recognize the underlying asset and recognize lease income over the lease term, typically on a straight-line basis.

Question 2: Lessee Accounting Do you agree that the recognition, measurement, and presentation of expenses and cash flows arising from a lease should differ for different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

Yes. Please see below for further comments.

---

3. Do you agree that a lessor should apply a different accounting approach to different leases, depending on whether the lessee is expected to consume more than an insignificant portion of the economic benefits embedded in the underlying asset? Why or why not? If not, what alternative approach would you propose and why?

Yes. Please see below for further comments.

---

4. Do you agree that the principle on the lessee's expected consumption of the economic benefits embedded in the underlying asset should be applied using the requirements set out in paragraphs 842-10-25-5 through 25-8, which differ depending on whether the underlying asset is property? Why or why not? If not, what alternative approach would you propose and why?

No. Please see below for further comments.

---

5. This revised Exposure Draft would require that a lessee and a lessor measure assets and liabilities arising from a lease on a basis that: 1. Reflects a lease term determined as the noncancellable period, together with both of the following: a. Periods covered by an option to extend the lease if the lessee has a significant economic incentive to exercise that option b. Periods covered by an option to terminate the lease if the lessee has a significant economic incentive not to exercise that option. 2. Includes fixed lease payments and variable lease payments that depend on an index or a rate (such as the Consumer Price Index or a market interest rate) but excludes other variable lease payments unless those payments are in-substance fixed payments. The lessee and lessor would measure variable lease payments that depend on an index or a rate using the index or rate at the commencement date. A lessee would reassess the measurement of the lease liability, and a lessor would reassess the measurement of the lease receivable, if either of the following occurs: 1. There is a change in relevant factors that would result in a change in the lease term (as described in paragraph 842-10-55-5). 2. There is a change in an index or a rate used to determine lease payments. Question 5: Lease Term Do you agree with the proposals on lease term, including the reassessment of the lease term if there is a change in relevant factors? Why or why not? If not, how do you propose that a lessee and a lessor should determine the lease and why?

I believe it is difficult and unclear as to how preparers will determine if "the lessee has a significant economic incentive not to exercise" the options at the end of the initial lease period.

---

6. Do you agree with the proposals on the measurement of variable lease payments, including reassessment if there is a change in an index or a rate used to determine lease payments? Why or why not? If not, how do you propose that a lessee and a lessor should account for variable lease payments and why?

This does not currently impact our business, so I have not thoroughly studied this particular section of the proposed lease accounting.

---

7. Subparagraphs 842-10-65-1(b) through (h) and (k) through (y) state that a lessee and a lessor would recognize and measure leases at the beginning of the earliest period presented using either a modified retrospective approach or a full retrospective approach. Do you agree with those proposals? Why or why not? If not, what transition requirements do you propose and why? Are there any additional transition issues the Boards should consider? If yes, what are they and why?

No. I believe this will result in a burdensome approach, particularly for privately held companies.

---

8. Paragraphs 842-10-50-1, 842-20-50-1 through 50-10, and 842-30-50-1 through 50-13 set out the disclosure requirements for a lessee and a lessor. Those proposals include maturity analyses of undiscounted lease payments, reconciliations of amounts recognized in the statement of financial position, and narrative disclosures about leases (including information about variable lease payments and options). Do you agree with those proposals? Why or why not? If not, what changes do you propose and why?

Broadly, yes, I agree. However, see comments above and below for the burden on privately held companies.

---

9. To strive for a reasonable balance between the costs and benefits of information, the FASB decided to provide the following specified reliefs for nonpublic entities: 1. To permit a nonpublic entity to make an accounting policy election to use a risk-free discount rate to measure the lease liability. If an entity elects to use a risk-free discount rate, that fact should be disclosed. 2. To exempt a nonpublic entity from the requirement to provide a reconciliation of the opening and closing balance of the lease liability. Will these specified reliefs for nonpublic entities help reduce the cost of implementing the new lease accounting requirements without unduly sacrificing information necessary for users of their financial statements? If not, what changes do you propose and why?

Yes, I believe these specified reliefs will help nonpublic entities. However, I believe the burden of compliance may still be costly for certain privately held companies.

---

10. The FASB decided that the recognition and measurement requirements for all leases should be applied by lessees and lessors that are related parties based on the legally enforceable terms and conditions of the lease, acknowledging that some related party transactions are not documented and/or the terms and conditions are not at arm's length. In addition, lessees and lessors would be required to apply the disclosure requirements for related party transactions in Topic 850, Related Party Disclosures. Under existing U.S. GAAP, entities are required to account for leases with related parties on the basis of their economic substance, which may be difficult when there are no legally enforceable terms and conditions of the agreement. Question 10: (FASB Only) Do you agree that it is not necessary to provide different recognition and measurement requirements for related party leases (for example, to require the lease to be accounted for based on the economic substance of the lease rather than the legally enforceable terms and conditions)? If not, what different recognition and measurement requirements do you propose and why?

Yes.

---

11. Do you agree that it is not necessary to provide additional disclosures (beyond those required by Topic 850) for related party leases? If not, what additional disclosure requirements would you propose and why?

Yes.

---

12. The IASB is proposing amendments to other IFRSs as a result of the proposals in this revised Exposure Draft, including amendments to IAS 40, Investment Property. The amendments to IAS 40 propose that a right-of-use asset arising from a lease of property would be within the scope of IAS 40 if the leased property meets the definition of investment property. This would represent a change from the current scope of IAS 40, which permits, but does not require, property held under an operating lease to be accounted for as investment property using the fair value model in IAS 40 if it meets the definition of investment property. Do you agree that a right-of-use asset should be within the scope of IAS 40 if the leased property meets the definition of investment property? If not, what alternative would you propose and why?

This does not currently impact our business, so I have not thoroughly reviewed this portion of the proposal/Exposure Draft.

---

Additional comments - updt. Please provide any additional comments on the Invitation to Comment:

I believe that all leases are a source of financing and that there is an element of time value in all lease arrangements. A lessee makes payments over the lease term to the lessor and in this regard a lease transaction is always similar to financing the acquisition of an asset. I disagree with recognizing lease expense on a "level" basis should all leases be recognized on-balance sheet as this practice does not recognize the complexities in leases with escalation clauses or declining lease payments, nor does it appropriately capture the inherent financing element in all leases. The obligation created under the lease arrangement is an amortizing financial obligation (unless prepaid up front) and the interest expense recognition using the effective interest method reflects the economics of the underlying lease arrangement. I also agree with the Boards' tentative conclusion that a lessee should amortize the right-of-use asset on a systematic basis, which typically would be straight-line. This accounting treatment is consistent with how amortization of finite-lived intangible assets is recognized. I do not think that the amortization pattern for a right-of-use asset should be different. As such, I support application of Approach A to all leases. Approaches B, C and D introduce a new level of complexity and would therefore increase the cost to comply. Furthermore, Approaches B and C do not fully resolve the expense pattern issue raised by constituents. Companies have existing accounting systems that will support the recording and amortization of a right-of-use asset on a systematic (typically straight-line) basis. Notably, such systems would not support application of an annuity-type amortization methodology. Companies also have existing systems to permit the accounting for financial obligations on the effective interest method of accounting. As such, existing accounting systems can support the application of the Boards' current tentative lessee accounting model, including the use of Approach A, which should be considered by the Boards in any cost-benefit analysis.

---

Additional comments - process. Please provide any comments on the electronic feedback process:

---