

## **FASB Leases - Topic 842**

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### **Respondent information**

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Preparer

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### **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.

We agree with the proposed definition of a lease because it coincides with our understanding of what constitutes a lease.

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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?

We agree in concept, however, we suggest there should be a provision that would allow companies like ours to opt not to implement the proposed guidance if the overall impact upon the financial statements as a whole is immaterial and/or insignificant. We are a global mutual property insurance company with total assets of \$16.4 billion. The majority of our assets are investments and insurance-related assets. We are a lessee of office space, automobiles and equipment as an incidental part of our business. Our total future lease obligations are \$141 million, less than 1% of our total assets. The accounting approach defined by the FASB exposure draft would require a large and costly work effort for us, with only a minor impact upon our financial statements. We therefore do not believe that the proposed accounting requirements are cost-beneficial to our policyholders, who are our owners and primary users of our financial statements. We also suggest that the FASB substitute the word "significant" for the phrase "more than an insignificant" to improve the readability of the guidance.

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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?

We agree with this approach, because it allows lessors to continue to account for property leases as operating leases, which reflects the true nature of the lease contracts.

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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?

We agree in concept with this approach. The Type A and B lease definitions are relatively straight-forward and practical to apply.

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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?

No, we do not agree because we are unclear on the definitions stated under section 842-10-25-1. What exactly is meant by "significant economic incentive" to exercise a renewal option? Many of our leases provide that the lessee may renew a lease at 95% of the then prevailing market rate. We believe that the 5% discount is reasonable to cover the cost that the lessee would incur to find new office space and the lessor would incur to find a new tenant. Under these circumstances, should the 5% discount be considered a "significant economic incentive"?

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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?

Not applicable to us.

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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?

We agree in concept with this approach because it will immediately recognize the total assets and liabilities and possible adjustment to retained earnings that exist as of the transition effective date and for comparative prior periods that are presented in an entity's financial statements. Again, our concern is with the cost/benefit of the entire proposed guidance to a company like ours for which the total relative impact upon our financial statements would be minimal.

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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?

We agree with the disclosure requirements, as long as they are only required if they are material and significant to the overall financial statements.

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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?

No, the relief measures described above and in the exposure draft would not significantly reduce the cost of implementing the new lease accounting requirements. We recommend that nonpublic entities be exempt from implementing the new lease accounting requirements if the overall impact upon the financial statements as a whole is immaterial and/or insignificant.

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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?

We agree that it is not necessary to provide different recognition and measurement requirements for related party leases.

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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?

We agree that it is not necessary to provide additional disclosures for related party leases, beyond those that are already required under Topic 850.

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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 questions does not apply to us because we do not anticipate having right-of-use assets that would meet the definition of investment property under IAS 40.

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

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

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