Statutory Accounting Principles (E) Working Group

**Maintenance Agenda Submission Form**

**Form A**

## **Issue: Update to Leasehold Improvements**

**Check (applicable entity):**

 P/C Life Health

Modification of Existing SSAP [x]  [x]  [x]

New Issue or SSAP [ ]  [ ]  [ ]

Interpretation [ ]  [ ]  [ ]

Description of Issue:

During 2019, the Working Group adopted substantive revisions to *SSAP No. 22—Leases*, which created SSAP No. 22R. The updated guidance rejects the financing lease treatment that has been adopted in U.S. GAAP but brings in language from ASC Topic 842, which intended to keep SSAP No. 22R as consistent as possible with updated U.S. GAAP. NAIC staff were notified by a company that the revisions to the definition of lease terms in SSAP No. 22R are not consistent with guidance for the depreciable lives of leasehold improvements in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health* *Care Facilities*.

As it stands now, “lease term” is defined in SSAP No. 22R as the noncancelable period of the lease together with options to extend or terminate the lease, if the lessee is reasonably certain to exercise the option. In SSAP No. 19 and SSAP No. 73, the guidance for establishing the life of a leasehold improvement does not allow renewal or option periods to be included. This recommended update will allow the guidance in SSAP No. 19 and SSAP No. 73 to conform with SSAP No. 22R. Note that leasehold improvements remain nonadmitted assets.

Existing Authoritative Literature:

The guidance on “lease term” is included in SSAP No. 22R (language matches ASC Topic 842-10-30-1):

24. An entity shall determine the lease term as the noncancellable period of the lease, together with all of the following:

a. Periods covered by an option to extend the lease if the lessee is reasonably certain to exercise that option.

b. Periods covered by an option to terminate the lease if the lessee is reasonably certain not to exercise that option.

c. Periods covered by an option to extend (or not to terminate) the lease in which exercise of the option is controlled by the lessor.

Leasehold improvements are discussed in SSAP No. 19 and in SSAP No. 73.

SSAP No. 19:

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter of their estimated useful life or the remaining life of the original lease excluding renewal or option periods. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired.

SSAP No. 73:

9. Furniture, medical equipment and fixtures, and leasehold improvements shall be depreciated over their estimated useful lives but for a period not to exceed three years, except for a leasehold improvement which shall be amortized against net income over the shorter of its estimated useful life or the remaining life of the original lease excluding renewal or option periods, using methods detailed in SSAP No. 19.

Activity to Date (issues previously addressed by the Working Group, Emerging Accounting Issues (E) Working Group, SEC, FASB, other State Departments of Insurance or other NAIC groups):

The Working Group adopted substantive revisions to SSAP No. 22 to incorporate language from *ASU 2016-02, Leases (Topic 842)*, which retained the treatment of leases as operating leases by the lessor but incorporated some of the new language and guidance from ASU 2016-02.

**Information or issues (included in *Description of Issue*) not previously contemplated by the Working Group:**

None

**Convergence with International Financial Reporting Standards (IFRS):**

The intent of Topic 842 is to make U.S. GAAP lease treatment more closely resemble that of IFRS lease treatment in *IFRS 16—Leases*.

Staff Recommendation:

NAIC staff recommends that the Working Group move this item to the active listing, categorized as nonsubstantive and incorporate revisions to *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities* as noted below. The updated language will allow leasehold improvements to have lives that match the associated lease term, which is guidance that agrees with U.S. GAAP in ASC Topic 842.

SSAP No. 19:

5. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets established in SSAP No. 4. Within that definition, such items also meet the criteria defining nonadmitted assets. Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus. These nonadmitted assets shall be amortized against net income over the shorter of their estimated useful life or the remaining lease term, as defined in SSAP No. 22R. Leasehold improvements that do not meet the definition of assets shall be charged to expense when acquired.

SSAP No. 73:

9. Furniture, medical equipment and fixtures, and leasehold improvements shall be depreciated over their estimated useful lives but for a period not to exceed three years, except for a leasehold improvement which shall be amortized against net income over the shorter of its estimated useful life or the remaining lease term, using methods detailed in SSAP No. 19.

Staff Review Completed by Jake Stultz, June 2020

Status:

On July 30, 2020, the Statutory Accounting Principles (E) Working Group moved this item to the active listing, categorized as nonsubstantive, and exposed revisions to *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* and *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities*, as illustrated above, to allow the amortization of leasehold improvements to match the associated lease term, which is guidance that agrees with U.S. GAAP, ASC Topic 842.

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