

**Statutory Accounting Principles (E) Working Group
Maintenance Agenda Submission Form
Form A**

Issue: Leasehold Improvements After Lease Termination

Check (applicable entity):

| | P/C | Life | Health |
|-------------------------------|-------------------------------------|-------------------------------------|-------------------------------------|
| Modification of Existing SSAP | <input checked="" type="checkbox"/> | <input checked="" type="checkbox"/> | <input checked="" type="checkbox"/> |
| New Issue or SSAP | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |
| Interpretation | <input type="checkbox"/> | <input type="checkbox"/> | <input type="checkbox"/> |

Description of Issue:

During 2019, the Working Group adopted substantive revisions to *SSAP No. 22—Leases*, which created SSAP No. 22R. The updated guidance rejected financing lease treatment that was adopted in U.S. GAAP but incorporated language from ASC Topic 842, which kept SSAP No. 22R as consistent as possible with the principal concepts in the U.S. GAAP standard. The Working Group has addressed several additional FASB Accounting Standard Updates (ASU) since the initial adoption of Topic 842 and NAIC staff have received numerous inquiries from SAP reporting entities since the adoption of the substantive revisions to SSAP No. 22R.

NAIC staff received a question about the treatment of leasehold improvements in situations where a leased property is purchased by the lessee during the lease term and noted that there is no explicit guidance for these situations in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements* nor *SSAP No. 73—Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities*. In these scenarios, it was identified that the reporting entity had acquired the property that was initially subject to a lease; however regardless of the scenario, amortization of leasehold improvements is only permitted over the shorter of the estimated useful life of the improvement or the lease term (as defined in SSAP No. 22R). In a normal lease termination, one where the lessee does not acquire said property, any remaining leasehold improvements shall be immediately expensed. This agenda item has been drafted to clarify this guidance, to eliminate future questions and ensure consistent application.

Existing Authoritative Literature:

Guidance for property improvements and integral equipment is included in *SSAP No. 40R—Real Estate Investments*.

SSAP No. 40R (underlines added for emphasis):

18. Recognition of profit on sales of real estate investments shall be accounted for in accordance with FASB Statement No. 66, Accounting for Sales of Real Estate (FAS 66), except as modified in paragraph 20 of this statement, FASB Emerging Issues Task Force No. 87-9, Profit Recognition on Sales of Real Estate with Insured Mortgages or Surety Bonds, FASB Emerging Issues Task Force No. 87-29, Exchange of Real Estate Involving Boot, FASB Interpretation No. 43, Real Estate Sales an interpretation of FASB Statement No. 66 (FIN 43) and FASB Emerging Issues Task Force No. 00-13, Determining Whether Equipment is “Integral Equipment” Subject to FASB Statements No. 66 and No. 98(INT 06-13). This statement applies to all sales of real estate including real estate with property improvements or integral equipment. The terms “property improvements” and “integral equipment” refer to any physical structure or equipment attached to the real estate that cannot be removed and used separately without incurring significant costs, such as an office building. Additionally, this guidance applies to all transfers of financial assets that are in substance real estate.

31. This statement adopts FASB Interpretation No. 43, Real Estate Sales, an Interpretation of FASB Statement No. 66 (FIN 43), which clarifies that the phrase “all real estate sales” includes sales of real estate with property improvements or integral equipment that cannot be removed and used separately from the real estate without incurring significant costs. This statement adopts FASB Emerging Issues Task Force No. 84-17, Profit Recognition on Sales of Real Estate with Graduated Payment Mortgages or Insured Mortgages, FASB Emerging Issues Task Force No. 89-13, Accounting for the Cost of Asbestos Removal, FASB Emerging Issues Task Force No. 89-14, Valuation of Repossessed Real Estate, FASB Emerging

Issues Task Force No. 90-8, Capitalization of Costs to Treat Environmental Contamination, FASB Emerging Issues Task Force No. 95-23, The Treatment of Certain Site Restoration/Environmental Exit Costs When Testing a Long-Lived Asset for Impairment, FASB Emerging Issues Task Force 97-11: Accounting for Internal Costs Relating to Real Estate Property Acquisitions, FASB Emerging Issues Task Force No. 98-8: Accounting for Transfers of Investments That Are in Substance Real Estate and FASB Emerging Issues Task Force No. 00-13, Determining Whether Equipment is “Integral Equipment” Subject to FASB Statements No. 66 and No. 98, which clarifies the term “integral equipment” as used in this statement.

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 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.

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 in agenda item 2016-02 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 recommend that the Working Group move this item to the active listing, categorized as nonsubstantive and expose revisions to SSAP No. 19 and SSAP No. 73 to ensure that the guidance for the leasehold improvements matched the treatment provided in SSAP No. 40R—Real Estate Investments. These edits will clarify that amortization of leasehold improvements will immediately end when a lease is terminated and will require that any remaining, unamortized leasehold improvement balance be immediately expensed. This will include scenarios where the lease terminates naturally or when the lessee purchases a property it was leasing. It is presumed that the purchase of a property from a third party would include the leasehold improvements as part of the full purchase price.

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. [The amortization of leasehold improvements \(including property improvements and integral equipment\) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity lessor. If leased real estate is acquired, recognition of the real estate shall follow the provisions in SSAP No. 40R—Real Estate Investments.](#)

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. [The amortization of leasehold improvements \(including property improvements and integral equipment\) shall cease, with any remaining amount immediately expensed, in any event in which the lease is terminated in advance of the lease term. This includes situations in which leased real estate is acquired by the reporting entity lessor. If leased real estate is acquired, recognition of the real estate shall follow the provisions in SSAP No. 40R—Real Estate Investments.](#)

Staff Review Completed by Jake Stultz, September 2021

Status:

On December 11, 2021, the Statutory Accounting Principles (E) Working Group moved this agenda item to the active listing, categorized as nonsubstantive, and exposed revisions to SSAP No. 19 and SSAP No. 73 to ensure that the guidance for the leasehold improvements matches the treatment provided in SSAP No. 40. These edits clarify that amortization of leasehold improvements will immediately end when a lease is terminated and will require that any remaining, unamortized leasehold improvement balance be immediately expensed. This will include scenarios where the lease terminates naturally or when the lessee purchases a property it was leasing.

<https://naiconline.sharepoint.com/teams/FRSStatutoryAccounting/NationalMeetings/A.NationalMeetingMaterials/2021/13.FallNationalMeeting/Exposures/21-25-LeaseholdImprovementsafterLeaseTermination.docx>