Statutory Issue Paper No. 23

Property Occupied by the Company

STATUS
Finalized March 16, 1998

Original SSAP: SSAP No. 40; Current Authoritative Guidance: SSAP No. 40R

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. A reporting entity is required to record its investment in real estate that is occupied by the company as a separate line item in the Invested Asset section of the statutory balance sheet. Additionally, a reporting entity is required to record rental income and expense related occupancy of its own building. Under GAAP, property used predominantly in a reporting entity's operations is classified as an asset outside of invested assets. Additionally, GAAP prohibits the recognition of imputed investment income and rental expense for real estate used in the business.

2. The purpose of the issue paper is to establish statutory accounting principles for home office that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

3. For statutory accounting purposes, any real estate which is owned by and is more than 50% occupied by the reporting entity and its affiliates shall be considered "real estate occupied by the company." "More than 50% occupied" shall mean that the square footage occupied by the reporting entity and its affiliates totals more than 50% of the rentable square footage of the property, including common areas. This shall include property occupied by the reporting entity which is not necessarily home office (e.g. claims processing, data processing and branch centers). Property which does not meet this 50% requirement shall be classified as property held for the production of income or property held for sale.

4. A reporting entity's investment in property occupied by the company meets the definition of an asset as defined in *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets* (Issue Paper No. 4) and is an admitted asset to the extent it conforms to the requirements of this issue paper. The asset shall be recorded in accordance with *Issue Paper No. 40—Real Estate Investments* (Issue Paper No. 40) (e.g., initial capitalization, valuation, including impairments of value, depreciation, interest expense on encumbrances, etc.). A reporting entity shall include in both its income and expenses an amount for rent relating to its occupancy of its own buildings. The amount recorded shall be at a rate comparable to rent received from others and/or rental rates of like property in the same area. If this is unavailable, it shall be derived from consideration of the repairs, expenses, taxes, and depreciation incurred, plus interest added at an average fair rate on the book value of the reporting entity's investment in its home office building.

DISCUSSION

5. The conclusion above clarifies current statutory accounting to include specific guidance on the definition of property occupied by the company. Additionally, the conclusion above changes current guidance to require property occupied by the reporting entity to be evaluated for impairment as specified in accordance with Issue Paper No. 40. Current statutory guidance requires property occupied by the company to be valued at depreciated cost (net of any encumbrances). *FASB Statement No. 121*,

Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of (FAS 121), is adopted in Issue Paper No. 40. The conclusion above rejects paragraph 52 of *FASB Statement No. 60*, *Accounting and Reporting by Insurance Enterprises* (FAS 60).

6. Recording property occupied by the company, net of any encumbrances, as an admitted asset is consistent with the Recognition Concept included in the Statement of Concepts. The Recognition Concept states,

> The ability to meet policyholder obligations as predicated on the existence of readily marketable assets available when both current and future obligations are due. Assets having economic value other than those which can be used to fulfill policyholder obligations, or those assets which may be unavailable due to encumbrances or other third party interests should not be recognized on the balance sheet but rather should be charged against surplus when acquired or when availability otherwise becomes questionable.

Though in a depressed market it may take longer to liquidate than other invested assets, it is generally accepted that real estate is a marketable asset which is available to meet policyholder obligations.

7. So that the statement of operations and yield on invested assets of a reporting entity occupying its own real estate are comparable with a reporting entity that leases its offices under operating leases, rental income and expense are reported for the real estate occupied by the reporting entity. The rent charged should be comparable to the income that would be produced if the reporting entity was renting the real estate to a third party.

Drafting Notes/Comments

- Accounting for real estate is addressed in *Issue Paper No. 40—Real Estate Investments*.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

8. Chapter 4, Real Estate, in the Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies (Life/A&H Accounting Practices and Procedures Manual) contains the following guidance on reporting for real estate occupied by the reporting entity:

> Directly-owned real estate is reported separately in the statutory financial statement. Holdings so reported are classified as properties (a) occupied by the company, (b) acquired in satisfaction of debt, and (c) investments in real estate. These classes may include real estate owned under contract of sale.
>
> In the statutory financial statement, a company must include in both its income and expenses an amount for rent relating to its occupancy of its own buildings. This amount can be the estimate current market rental value of the space involved, or it can be the amount derived from consideration of the repairs, expenses, taxes, and depreciation incurred, plus interest added at an average fair rate on the book value of the company's investment in its home office building. The figure thus determined, being both charged to expenses and credited to income, has no effect either on the company's overall net income or surplus.

9. Chapter 4, Real Estate, in the Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies (P & C Accounting Practices and Procedures Manual) contains similar wording related to the reporting of real estate occupied by the reporting entity.

10. Chapter 19, Investment Income and Net Realized Gains, in the Life/A&H Accounting Practices and Procedures Manual states:

> Rent on Company-Owned Office Building
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> Real estate income from company-owned property includes rent received from the leasing of space to others and also an imputed rental charge for the portion of the building occupied by the company. This rental charge is made on the theory that such space can be rented to others; therefore, the company is entitled to income on its investment. Some states requires that this rent be comparable to rent received from others and/or rental rates of like property in the same area. It should be noted that an offsetting charge is made to rent expense.

11. Chapter 15, Investment Income and Net Realized Gains, in the P & C Accounting Practices and Procedures Manual contains similar wording related to recording rent on real estate occupied by the reporting entity.

Generally Accepted Accounting Principles

12. *FAS 60*, *Accounting and Reporting by Insurance Enterprises*, contains the guidance relating to real estate occupied by the reporting entity. It states:

> Real Estate Used in the Business
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> 52. Real estate shall be classified either as an investment or as real estate used in the enterprise's operations, depending on its predominant use. Depreciation and other real estate operating costs shall be classified as investment expenses or operating expenses consistent with the balance sheet classification of the related asset. Imputed investment income and rental expense shall not be recognized for real estate used in the business.

13. FAS 121 contains the following guidance for real estate occupied by the reporting entity:

> Assets to Be Held and Used
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> Recognition and Measurement of Impairment
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> 4. An entity shall review long-lived assets and certain identifiable intangibles to be held and used for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable.
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> 5. The following are examples of events or changes in circumstances that indicate that the recoverability of the carrying amount of an asset should be assessed:
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> a. A significant decrease in the market value of an asset
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> b. A significant change in the extent or manner in which an asset is used or a significant physical change in an asset
>
> c. A significant adverse change in legal factors or in the business climate that could affect the value of an asset or an adverse action or assessment by a regulator
>
> d. An accumulation of costs significantly in excess of the amount originally expected to acquire or construct an asset
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> e. A current period operating or cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with an asset used for the purpose of producing revenue.
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> 6. If the examples of events or changes in circumstances set forth in paragraph 5 are present or if other events or changes in circumstances indicate that the carrying amount of an

asset that an entity expects to hold and use may not be recoverable, the entity shall estimate the future cash flows expected to result from the use of the asset and its eventual disposition. Future cash flows are the future cash inflows expected to be generated by an asset less the future cash outflows expected to be necessary to obtain those inflows. If the sum of the expected future cash flows (undiscounted and without interest charges) is less than the carrying amount of the asset, the entity shall recognize an impairment loss in accordance with this Statement. Otherwise, an impairment loss shall not be recognized; however, a review of depreciation policies may be appropriate.[1]

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[1] Paragraph 10 of *APB Opinion No. 20, Accounting Changes,* addresses the accounting for changes in depreciation estimates, and paragraph 32 addresses the accounting for changes in the method of depreciation. Whenever there is reason to assess the recoverability of the carrying amount of an asset under paragraphs 4 and 5 of this Statement, there may be reason to review the depreciation estimates and method under paragraphs 10 and 32 of Opinion 20. However, an impairment loss that results from applying this Statement should be recognized prior to performing that review. The provisions of Opinion 20 apply to the reporting of changes in the depreciation estimates and method regardless of whether an impairment loss is recognized under paragraph 6 of this Statement.

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7. An impairment loss recognized in accordance with paragraph 6 shall be measured as the amount by which the carrying amount of the asset exceeds the fair value of the asset. The fair value of an asset is the amount at which the asset could be bought or sold in a current transaction between willing parties, that is, other than in a forced or liquidation sale. Quoted market prices in active markets are the best evidence of fair value and shall be used as the basis for the measurement, if available. If quoted market prices are not available, the estimate of fair value shall be based on the best information available in the circumstances. The estimate of fair value shall consider prices for similar assets and the results of valuation techniques to the extent available in the circumstances. Examples of valuation techniques include the present value of estimated expected future cash flows using a discount rate commensurate with the risks involved, option-pricing models, matrix pricing, option-adjusted spread models, and fundamental analysis.

8. In estimating expected future cash flows for determining whether an asset is impaired (paragraph 6), and if expected future cash flows are used in measuring assets that are impaired (paragraph 7), assets shall be grouped at the lowest level for which there are identifiable cash flows that are largely independent of the cash flows of other groups of assets.

9. Estimates of expected future cash flows shall be the best estimate based on reasonable and supportable assumptions and projections. All available evidence should be considered in developing estimates of expected future cash flows. The weight given to the evidence should be commensurate with the extent to which the evidence can be verified objectively. If a range is estimated for either the amount or timing of possible cash flows, the likelihood of possible outcomes shall be considered in determining the best estimate of future cash flows.

10. In limited circumstances, the test specified in paragraph 6 will be applicable at only the entity level because the asset being tested for recoverability does not have identifiable cash flows that are largely independent of other asset groupings. In those instances, if the asset is not expected to provide any service potential to the entity, the asset shall be accounted for as if abandoned or held for disposal in accordance with the provisions of paragraph 15 of this Statement. If the asset is expected to provide service potential, an impairment loss shall be recognized if the sum of the expected future cash flows (undiscounted and without interest charges) for the entity is less than the carrying amounts of the entity's assets covered by this Statement.

11. After an impairment is recognized, the reduced carrying amount of the asset shall be accounted for as its new cost. For a depreciable asset, the new cost shall be depreciated over the asset's remaining useful life. Restoration of previously recognized impairment losses is prohibited.

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- Accounting Practices and Procedures Manuals for Life and Accident and Health Insurance Companies, Chapter 4, Real Estate
- Accounting Practices and Procedures Manuals for Property and Casualty Insurance Companies, Chapter 4, Real Estate
- Accounting Practices and Procedures Manuals for Life and Accident and Health Insurance Companies, Chapter 19, Investment Income and Net Realized Gains
- Accounting Practices and Procedures Manuals for Property and Casualty Insurance Companies, Chapter 15, Investment Income and Net Realized Gains
- *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*
- *Issue Paper No. 40—Real Estate Investments*

Generally Accepted Accounting Principles

- *FASB Statement No. 60, Accounting and Reporting by Insurance Enterprises*
- *FASB Statement No. 121, Accounting for the Impairment of Long-Lived Assets and Long-Lived Assets to Be Disposed Of*

State Regulations

- No additional guidance obtained from state statutes or regulations.

