Statutory Issue Paper No. 31

Leasehold Improvements Paid by the Reporting Entity as Lessee

STATUS
Finalized March 16, 1998

Original SSAP and Current Authoritative Guidance: SSAP No. 19

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. Current statutory guidance for leasehold improvements is limited and does not give specific guidance as to admissibility. Leasehold improvements are referred to in the real estate section of the Accounting Practices and Procedures Manuals for Life and Accident and Health and for Property and Casualty Insurance Companies. GAAP guidance allows leasehold improvements to be recorded as assets.

2. This issue paper establishes statutory accounting principles for leasehold improvements that are consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

3. For statutory accounting purposes, leasehold improvements shall be defined as lessee expenditures that are permanently attached to an asset a reporting entity is leasing under an operating lease.

4. Leasehold improvements that increase the value and enhance the usefulness of the leased asset meet the definition of assets defined in *Issue Paper No. 4—Definition of Assets and Nonadmitted* Assets (Issue Paper No. 4). Such expenditures also meet the criteria defining nonadmitted assets in that same paper (i.e., the asset is not readily marketable and available to satisfy policyholder obligations). Accordingly, such assets shall be reported as nonadmitted assets and charged against surplus and 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 as defined in *Issue Paper No. 67—Depreciation of Property and Amortization of Leasehold Improvements.* Leasehold improvements that do not meet the definition of an asset shall be charged to expense when acquired.

DISCUSSION

5. Issue Paper No. 4 defines an asset as "*probable future economic benefits obtained or controlled by a particular entity as a result of past transactions or events*." Issue Paper No. 4 also states that an asset not readily marketable and available to satisfy policyholder obligations *"shall be recorded as a nonadmitted asset and charged against surplus."* This is consistent with the Statement of Concepts, which states that a reporting entity's "*ability to meet policyholder obligations is predicated on the existence of readily marketable assets available when both current and future obligations are due."* Leasehold improvements meet the definition of an asset in that they provide future economic benefit to the reporting entity. However, because such assets are not readily available to satisfy policyholder obligations (i.e., they will revert to the lessor at the end of the lease term) they are considered nonadmitted assets. This is also consistent with the concept of conservatism included in the Statement of Concepts.

Drafting Notes/Comments

- Accounting for leases is addressed in *Issue Paper No. 22—Leases*.
- Lessors often provide or pay for improvements to leased property; Issue Paper No. 22 requires lessees to consider the value of such concessions and normalize rent revenue and rent expense on operating leases.

RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

Statutory Accounting

6. Current statutory guidance is in the Accounting Practices and Procedures Manual for Life and Accident and Health and for Property and Casualty Insurance Companies, Chapter 4, Real Estate. Chapter 4 states:

> Because real estate leasehold improvements revert to the lessor at the end of the lease and the lessee receives benefits from the improvements only during the life of the lease, a leasehold improvement is subject to amortization over the lease life.

Generally Accepted Accounting Principles

7. GAAP guidance is very limited other than in *FASB Statement of Financial Accounting Concept No. 6*, *Elements of Financial Statements* (CON 6), which states:

> Most assets presently included in financial statements qualify as assets under the definition in paragraph 25 because they have future economic benefits... Inventories of raw materials, supplies, partially completed products, finished goods, and merchandise likewise obviously fit the definition as do productive resources, such as property, plant, equipment, tools, furnishings, leasehold improvements, natural resource deposits, and patents.

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- Accounting Practices and Procedures Manual for Life and Accident and Health Insurance Companies, Chapter 4, Real Estate
- Accounting Practices and Procedures Manual for Property and Casualty Insurance Companies, Chapter 4, Real Estate
- *Issue Paper No. 4—Definition of Assets and Nonadmitted Assets*
- *Issue Paper No. 22—Leases*

Generally Accepted Accounting Principles

- *FASB Statement of Financial Accounting Concept No. 6*, *Elements of Financial Statements*

State Regulations

- No additional guidance obtained from state statutes or regulations.

