

# Statutory Issue Paper No. 161

## Leases

### STATUS

Finalized August 3, 2019

Original SSAP: SSAP No. 22; Current Authoritative Guidance: SSAP No. 22R

### Type of Issue:

Common Area

### SUMMARY OF ISSUE

1. The purpose of this issue paper is to document for the historical record the substantive changes to statutory accounting guidance adopted on August 3, 2019, resulting in a substantively revised *SSAP No. 22—Leases*. This SSAP will be known as *SSAP No. 22—Leases – Revised* (SSAP No. 22R).
2. This issue paper illustrates tracked changes adopted in SSAP No. 22R, with an effective date of January 1, 2020. The substantive revisions adopted within SSAP No. 22R include revised accounting guidance on leases, including leveraged leases and sale-leaseback transactions. For historical record, the adopted revisions to SSAP No. 22R are reflected as tracked changes in Exhibit A. The substantive revisions to SSAP No. 22 were the result of the FASB issuance of *ASU 2016-02—Leases* (Topic 842), which created ASC Topic 842—Leases.

### DISCUSSION

3. This issue paper provides a historical reference that includes tracked changes adopted within SSAP No. 22R. The substantive changes were a result of the Financial Accounting Standards Board (FASB) adopting *ASU 2016-02—Leases* (Topic 842), which created ASC Topic 842—Leases.

### Actions of the Statutory Accounting Principles (E) Working Group

4. In February 2016, FASB issued *ASU 2016-02—Leases*. On April 3, 2016, the Working Group moved agenda item *2016-02: Leases* and exposed three options on how to proceed with statutory accounting lease treatment, which included the following:
  - a. Maintain existing statutory accounting guidance in SSAP No. 22 for the treatment of operating and financing leases with potential new disclosures to capture information on the lease asset and lease liability that would be required under GAAP,
  - b. Adopt ASU 2016-02, with modification, to recognize the lease asset and lease liability, but requiring nonadmittance of the lease asset as an asset not available for policyholder obligations pursuant to *SSAP No. 4—Assets and Nonadmitted Assets*, or
  - c. Adopt ASU 2016-02, with modification, to recognize lease assets and lease liabilities for a lessee's operating and financing leases. Although there would be some modifications anticipated to GAAP, this option would allow the lease asset to be an admitted asset under SAP.
5. On August 26, 2016, the Working Group elected to retain the current statutory accounting treatment for operating and financing leases by lessees, as prescribed in SSAP No. 22, where the lessee treats all leases as operating leases. The Working Group directed NAIC staff to further evaluate ASU 2016-02 and prepare a draft issue paper to document the Working Group's actions and discussions on ASU 2016-02.

6. On August 6, 2017, the Working Group exposed substantive revisions to SSAP No. 22 to incorporate revised U.S. GAAP guidance from ASU 2016-02, modified to retain the operating lease concept for statutory accounting. The revisions to SSAP No. 22R are significant but do not result in significant changes to statutory accounting:

- a. Revisions reflect GAAP guidance from ASU 2016-02, with modifications to continue following the “operating lease” approach for statutory accounting for lessees. (From ASU 2016-02, this modification rejects ASC 842-10-25, as presented in ASU 2016-02, for guidance on treatment of leases as financing leases.) The intent is that all guidance in SSAP No. 22R will agree to that of ASC Topic 842 (as presented in ASU 2016-02), with the exception of the treatment of operating leases for statutory accounting. Statutory accounting treatment for lessors remains largely unchanged.
- b. Revisions clarify the definition of a lease as a contract that involves property, plant or equipment (land and/or depreciable assets), and incorporates consistent language to eliminate questions on whether come sections was intended for certain types of leases (e.g., property leases) whereas other sections of the SSAP was intended for different types of leases (e.g., equipment leases). These revisions explicitly clarify that non-depreciable assets, such as investments and premium receivables, do not meet the definition of property, plant or equipment and cannot be subject of a lease, or a sales-leaseback transaction.
- c. Revisions clarify the language and flow of the document while maintaining the treatment of leases from a statutory accounting standpoint. SSAP No. 22 had several changes since original implementation, and because of this, a user would have to look in multiple areas of the SSAP for guidance. The updated version groups information together more clearly.
- d. Guidance for sale-leaseback transactions brings in language from Subtopic 842-40 (as presented in ASU 2016-02). This guidance contains language updates and does not change statutory accounting for sale-leaseback transactions. Specific guidance for statutory accounting from the prior version of SSAP No. 22 was retained in the current version.
- e. Guidance for leveraged leases brings in language from Subtopic 842-50 (as presented in ASU 2016-02), however leveraged lease treatment to remains the same as the prior SSAP.

7. On August 4, 2018, the Working Group exposed substantive revisions to SSAP No. 22 to incorporate revised U.S. GAAP guidance from ASU 2016-02, modified to retain the operating lease concept for statutory accounting. Revisions in this draft primarily focused on the clarity of the SSAP. On November 10, 2018, the Working Group instructed NAIC staff to continue to work with Interested Parties to complete the project.

8. On April 6, 2019, the Working Group exposed substantive revisions to SSAP No. 22 to incorporate revised U.S. GAAP guidance from ASU 2016-02, modified to retain the operating lease concept for statutory accounting. NAIC staff worked closely with Interested Parties on the draft revisions, and as a result Interest Parties stated that they support the April 6 exposed draft of SSAP No. 22R in their comment letter.

- a. Kaiser Permanente provided the following comments on the April 6 exposed draft:

We would like to propose amendments to Paragraph 16 of SSAP 22R to provide further clarity, make this practical expedient operational, and minimize GAAP to STAT differences. We believe the NAIC’s primary concern is around stakeholders being able to

take advantage of optionality around the treatment of non-lease components when material and not closely related to the lease. We believe that our proposal below does not compromise this risk.

First, we think the guidance can be enhanced to further emphasize the “closely related” concept by providing examples in parenthesis as shown in our proposed revisions below. This will help to provide clarity that this expedient is only intended for these items and stakeholders do not have the option of using it for other types of components not related to the lease. We then propose to change “insignificant part of lease agreement” to “not the predominant components” because often times common area maintenance (a closely related lease element) for instance can be more than insignificant (i.e. more than 10% of overall contract value) but is still not a predominant part of the lease and can be accounted for as a single lease under GAAP. We believe such situations should still be able to apply the practical expedient to keep GAAP & STAT aligned. By limiting the expedient to only non-lease components that are closely related to elements of the lease and where they are not predominant, this still prevents stakeholders from being able to arbitrarily combine non-lease related elements with lease elements and minimizes optionality.

Below are three proposed options for treatment of non-lease components in paragraph 16. Each of these are meant to accomplish the same objectives but just worded/presented in a different way. Our thought process is further described below.

### **Proposed Option #1**

16. As a practical expedient, when non-lease components are [closely related to the elements of the lease \(e.g. common area maintenance, utilities, labor\)](#) and are not the predominant components in a ~~an insignificant part of a~~ lease agreement, a lessee and a lessor may, as an accounting policy election by class of underlying asset, choose not to separate non-lease components from lease components and instead to account for each separate lease component and the non-lease components associated with that lease component as a single lease component. ~~The nonlease components must be closely related to the elements of the lease to be recognized as a single lease component.~~ For lease agreements between related parties, lease and non-lease components must be separated.

### **Proposed Option #2**

16. As a practical expedient, when non-lease components are [not the predominant components in an insignificant part of a](#) lease agreement, a lessee and a lessor may, as an accounting policy election by class of underlying asset, choose not to separate non-lease components from lease components and instead to account for each separate lease component and the non-lease components associated with that lease component as a single lease component. The non-lease components must be closely related to the elements of the lease to be recognized as a single lease component [\(e.g. common area maintenance, utilities, labor\)](#). For lease agreements between related parties, lease and non-lease components must be separated.

### **Proposed Option #3**

16. As a practical expedient, [for lease contracts between unrelated parties when nonlease components are an insignificant part of a lease agreement](#), a lessee and a lessor may, as an accounting policy election by class of underlying asset, choose not to separate non-lease components from lease components and instead to account for each separate lease component and the non-lease components associated with that lease component as a single lease component [if both of the following are met:](#)

- a) \_\_\_\_\_ - The non-lease component(s) ~~must be~~ [closely related to the lease component \(e.g. common area maintenance, utilities, labor\); and,](#)

~~a)b) The non-lease component(s) are not the predominant component(s) in the contract. elements of the lease to be recognized as a single lease component. For lease agreements between related parties, lease and nonlease components must be separated~~

### **Additional Thoughts**

The change we are proposing is use of the term “predominant” instead of “insignificant,” which provides consistency with the term used in ASC 842 for GAAP. We feel that “insignificant” would be too strong and stakeholders would have little benefit at the end of the day from the practical expedient even being in place. Here are the considerations for Predominant vs. Insignificant:

#### 1. Predominant

- a. The guidance within ASC 842 (lessor practical expedient) uses “predominant” so language is consistent with US GAAP
- b. There is interpretive guidance for ASC 842 that allows entities to perform more of a qualitative assessment rather than a detailed quantitative analysis to support whether non-lease or lease components are predominant within a contract, making the expedient more operational.
- c. Would allow more leases to qualify for the practical expedient, and therefore, reduce/mitigate STAT to GAAP differences.
- d. If concern is that entities will design contracts to include non-lease components that are “not” related to lease components, this risk is still addressed by the closely related criterion being in place. The combination of both criteria would appear to still address concerns about undesired non-lease components being accounted for under the leasing guidance.

#### 2. Insignificant

- a. Including such a strong limitation on the significance of non-lease components, can make this practical expedient non-operational for many entities. It can put significant operational burdens on preparers and systems to comply with the guidance. Additionally, it can result in STAT to GAAP differences.
  - b. From a contract perspective under US GAAP, insignificant is typically viewed as ~10% or less. Within Real Estate contracts, common items such as utilities/common area maintenance would likely exceed 10% of total contract value. It is likely the expedient would not apply to these contracts if “insignificant” is used.
- b. NAIC staff considered the comments provided by Kaiser Permanente. Fundamentally, the updated SSAP No. 22R keeps the existing operating lease treatment for all leases. The guidance included in paragraph 16 will only have income statement impact (which line the non-lease expense/revenue would have been reported) and will not affect the balance sheet as it would with the financing lease treatment that is part of U.S. GAAP. The intent of paragraph 16 is to allow easier reporting of leases for companies that have leases with non-lease components included in the contract, which will allow a small amount of maintenance or other expense to be included with the leasing or rent expense, which should save time and effort for the accounting departments for the reporting entities. The most common examples for insurance companies will be common area maintenance for those that have rented facilities and offices or for maintenance contracts that are commonly used for copiers and other office equipment.

- c. Topic 842-10-15-37 does not use a qualifier like “predominant” or “insignificant” for determining when non-lease components can be allowed to be included with lease components for lessees. NAIC staff agree that the interpretation of the use of “insignificant” would be around 10% to possibly as high as 20%. We believe that any higher, that the non-lease amounts should be broken out from the lease component. NAIC staff believe that this is reasonable and provides better financial reporting of lease and rent expense.
- d. The language using the term “predominant” comes from lessor guidance in Topic 842-10-15-42A and 842-10-15-42B, which is the practical expedient for revenue recognition for lessors. Revenue recognition for lessors is covered in paragraphs 28 through 30 of SSAP No. 22R. The guidance in paragraphs 28 through 30 is clear on revenue recognition for lessors for statutory accounting, and while this language is not the same as that of U.S. GAAP, it is consistent with U.S. GAAP in the accounting outcomes when operating lease treatment is allowed. NAIC staff do not believe that the use of the word “predominant” is appropriate for this guidance and could allow significant non-lease costs to be incorrectly categorized on the income statement.
- e. The proposed revisions would result with a deviation from U.S. GAAP, potentially resulting with more agreements being classified as leases under SAP. With the intent to converge with US GAAP on whether an agreement is a lease, the proposed revisions are not recommended for adoption. NAIC staff highlights that the comments were previously received and considered with the same conclusion. Also, the comments were previously discussed with other interested parties’ and they were not supported.

### Effective Date

9. The substantive revisions to SSAP No. 22R are contained in Exhibit A. Users of the *Accounting Practices and Procedures Manual* should note that issue papers are not represented in the Statutory Hierarchy (see Section IV of the Preamble) and therefore the conclusions reached in this issue paper should not be applied until the corresponding SSAP No. 22R has been adopted by the Plenary of the NAIC. SSAP No. 22R contains an effective date of years ending December 31, 2019, with early adoption permitted.

## RELEVANT STATUTORY ACCOUNTING AND GAAP GUIDANCE

### Statutory Accounting

- *SSAP No. 22—Leases*

### Generally Accepted Accounting Principles

- *FASB Accounting Standards Update No. 2016-02*

10. FASB issued ASU 2016-02 to increase transparency and comparability among organizations by recognizing lease assets and lease liabilities on the balance sheet and disclosing key information about leasing arrangements. They believe that to meet that objective, they needed to amend the FASB Accounting Standards Codification and creating Topic 842, Leases. This update, along with IFRS 16, Leases, is the results of the FASB’s and the International Accounting Standards Board’s (IASB’s) efforts to meet that objective and improve financial reporting.

11. FASB noted that many entities utilize leasing as a means of gaining access to assets, of obtaining financing, and/or of reducing an entity’s exposure to the full risks of asset ownership. The prevalence of leasing, therefore, means that it is important that users of financial statements have a complete and

understandable picture of an entity's leasing activities. FASB noted that previous leases accounting was criticized for failing to meet the needs of users of financial statements because it did not always provide a faithful representation of leasing transactions. In particular, it did not require lessees to recognize assets and liabilities arising from operating leases on the balance sheet. As a result, there had been long-standing requests from many users of financial statements and others to change the accounting requirements so that lessees would be required to recognize the rights and obligations resulting from leases as assets and liabilities.

12. FASB noted that the criticisms associated with previous lease guidance related to the accounting for operating leases in the financial statements of lessees and addressing those concerns with lessee accounting was the focus of the Board. FASB decided not to fundamentally change lessor accounting with the amendments in ASU 2016-02. They did note that some changes had been made to lessor accounting to conform and align that guidance with the lessee guidance and other areas within generally accepted accounting principles (GAAP), such as Topic 606, Revenue from Contracts with Customers.

**EXHIBIT A - REVISIONS TO SSAP NO. 22—LEASES****Leases****SCOPE OF STATEMENT**

1. The purpose of this statement is to establish statutory accounting principles for leases ~~by lessors and lessees~~. It addresses:
  - a. Accounting and reporting by lessees;
  - b. Accounting and reporting by lessors;
  - c. Sale-leaseback transactions;
  - d. Leveraged leases for lessors;
  - e. Related party leases; and
  - f. Disclosures.

**SUMMARY CONCLUSION**

2. A lease is defined as a contract or part of a contract ~~an agreement~~ conveying the right to control the use of property, plant, or equipment (land and/or depreciable assets) ~~usually~~ for a stated period of time in exchange for consideration. This definition does not include ~~agreements that are~~ contracts for services that do not transfer the right to use property, plant, or equipment from one contracting party to the other (i.e., employee lease contracts) or service concession arrangements<sup>1</sup>. ~~On the other hand, a~~ Agreements that do transfer the right to control the use of property, plant, or equipment meet the definition of a lease even though substantial services by the contractor (lessor) may be called for in connection with the operation or maintenance of the assets.

~~3. — Integral equipment subject to a lease shall be evaluated as real estate per SSAP No. 10R—Real Estate Investments. Integral equipment or property improvements for which no statutory title registration system exists, the criterion in this SSAP (that the lease transfers ownership of the property to the lessee by the end of the lease term) is met in lease agreements that provide that, upon the lessee's performance in accordance with the terms of the lease, the lessor shall execute and deliver to the lessee such documents (including, if applicable, a bill of sale for the equipment) as may be required to release the equipment from the lease and to transfer ownership thereto to the lessee. This criterion is also met in situations in which the lease agreement requires the payment by the lessee of a nominal amount (for example, the minimum fee required by statutory regulation to transfer ownership) in connection with the transfer of ownership. Notwithstanding the foregoing guidance, a provision in a lease agreement that ownership of the leased property is not transferred to the lessee if the lessee elects not to pay the specified fee (whether nominal or otherwise) to complete the transfer of ownership is a purchase option. Such a provision would not satisfy this SSAP.~~

~~5.3.~~ Property, plant or equipment, (including computer software) as used in this SSAP, includes only land and/or depreciable assets. Therefore, inventory (including equipment parts inventory), other

<sup>1</sup> A service concession arrangement is an arrangement between a public sector entity grantor and an operating entity under which the operating entity operates the grantor's infrastructure (for example, airports, roads, bridges, tunnels, prisons and hospitals) for a specified period of time. A public-sector entity includes a governmental body or an entity to which the responsibility to provide public service has been delegated. In a service concession arrangement, both of the following conditions exist:

- a. The grantor controls or has the ability to modify or approve the services that the operating entity must provide with the infrastructure, to whom it must provide them, and at what price.
- b. The grantor controls, through ownership, beneficial entitlement, or otherwise, any residual interest in the infrastructure at the end of the term of the arrangement.

intangible assets, assets under construction, leases to explore for or use minerals, natural gas and similar nonregenerative resources, and leases of biological assets, such as timber cannot be the subject of a lease for accounting purposes. Additionally, non-depreciable assets, including investments and premium receivables do not meet the definition of property, plant or equipment and cannot be the subject of a lease for accounting purposes. ~~Therefore, inventory (including equipment parts inventory) and minerals, precious metals or other natural resources cannot be the subject of a lease for accounting purposes because those assets are not depreciable. Additionally, intangibles (for example, motion picture film licensing rights or workforce) and rights to explore for minerals, precious metals or other natural resources are not depreciable assets (they are amortized or depleted) so they may not be the subject of a lease.~~

### **Determining Whether an Arrangement Contains a Lease**

4. Determining whether an arrangement contains a lease that is within the scope of this SSAP should be based on the substance of the arrangement. At inception of a contract, an entity shall determine whether that contract is or contains a lease. A contract is or contains a lease if the contract conveys the right to control the use of identified property, plant or equipment (an identified asset) for a period of time in exchange for consideration. A period of time may be described in terms of the amount of use of an identified asset (for example, the number of production units that an item of equipment will be used to produce). ~~Separate contracts with the same entity or related parties that are entered into at or near the same time are presumed to have been negotiated as a package and should, therefore, be evaluated as a single arrangement in considering whether there are one or more units of accounting. That presumption may be overcome if there is sufficient evidence to the contrary.~~

### **Identifying an Asset**

~~6.5.~~ An asset can be identified by being explicitly or implicitly specified within the contract. Although specific property, plant or equipment may be explicitly identified in an arrangement, it is not the subject of a lease if fulfillment of the arrangement is not dependent on the use of the specified property, plant or equipment. A warranty obligation that permits or requires the substitution of the same or similar property, plant or equipment when the specified property, plant, or equipment is not operating properly does not preclude lease treatment. In addition, a contractual provision (contingent or otherwise) permitting or requiring the owner/seller to substitute other property, plant or equipment for any reason on or after a specified date does not preclude lease treatment prior to the date of substitution. Property, plant or equipment has been implicitly specified if, for example, the seller owns or leases only one asset with which to fulfill the obligation and it is not economically feasible or practicable for the owner/seller to perform its obligation through the use of alternative property, plant or equipment. Property, plant or equipment can also be implicitly specified at the time the asset is made available for use by the lessee.

6. Even if an asset is specified, the asset does not qualify as an identified asset if the lessor has the substantive right to substitute the asset throughout the period of use. A lessor's right to substitute an asset is substantive only if (1) the lessor has the practical ability to substitute alternative assets throughout the period of use (for example, the lessee cannot prevent the lessor from substituting an asset, and alternative assets are readily available to the lessor or could be sourced by the lessor within a reasonable period of time), and (2) the lessor would benefit economically from the exercise of its right to substitute the asset (that is, the economic benefits associated with substituting the asset is expected to exceed the costs associated with substituting the asset).

7. An entity's evaluation of whether a lessor's substitution right is substantive is based on facts and circumstances at inception of the contract and shall exclude consideration of future events that, at inception, are not considered likely to occur. Examples of future events that, at inception of the contract, would not be considered likely to occur and, thus, should be excluded from the evaluation include, but are not limited to, the following:



- a. An agreement by a future lessee to pay an above-market rate for use of the asset;
- b. The introduction of new technology that is not substantially developed at inception of the contract;
- c. A substantial difference between the lessee's use of the asset, or the performance of the asset and the use or performance considered likely at inception of the contract;
- d. A substantial difference between the market price of the asset during the period of use and the market price considered likely at inception of the contract.

8. If the asset is located at the lessee's premises or elsewhere, the costs associated with substitution are generally higher than when located at the lessor's premises and, therefore, are more likely to exceed the benefits associated with substituting the asset. If the lessor has a right or an obligation to substitute the asset only on or after either a particular date or the occurrence of a specified event, the lessor does not have the practical ability to substitute alternative assets throughout the period of use. The lessor's right or obligation to substitute an asset for repairs or maintenance, if the asset is not operating properly, or if a technical upgrade becomes available, does not preclude the lessee from having the right to use an identified asset. If the lessee cannot readily determine whether the lessor has a substantive substitution right, the lessee shall presume that any substitution right is not substantive.

9. A capacity portion of an asset is an identified asset if it is physically distinct (for example, a floor of a building or a segment of a pipeline that connects a single lessee to the larger pipeline). A capacity or other portion of an asset that is not physically distinct (for example, a capacity portion of a fiber optic cable) is not an identified asset, unless it represents substantially all of the capacity of the asset and thereby provides the lessee with the right to obtain substantially all of the economic benefits from use of the asset.

### **Right to Control the Use of the Identified Asset**

10. To determine whether a contract conveys the right to control the use of an identified asset for a period of time, an entity shall assess whether, throughout the period of use, the lessee has both:

- a. The right to obtain substantially all of the economic benefits from use of the identified asset.
  - i. To control the use of an identified asset, a lessee is required to have the right to obtain substantially all of the economic benefits from use of the asset throughout the period of use (for example, by having exclusive use of the asset throughout that period). A lessee can obtain economic benefits from use of an asset directly or indirectly in many ways, such as by using, holding, or subleasing the asset. The economic benefits from use of an asset include its primary output and byproducts (including potential cash flows derived from these items) and other economic benefits from using the asset that could be realized from a commercial transaction with a third party.
  - ii. When assessing the right to obtain substantially all of the economic benefits from use of an asset, an entity shall consider the economic benefits that result from use of the asset within the defined scope of a lessee's right to use the asset in the contract.
  - iii. If a contract requires a lessee to pay the lessor or another party a portion of the cash flows derived from use of an asset as consideration, those cash flows paid as consideration shall be considered to be part of the economic benefits that the lessee obtains from use of the asset. For example, if a lessee is required to pay the

lessor a percentage of sales from use of retail space as consideration for that use, that requirement does not prevent the lessee from having the right to obtain substantially all of the economic benefits from use of the retail space. That is because the cash flows arising from those sales are considered to be economic benefits that the lessee obtains from use of the retail space, a portion of which it then pays to the lessor as consideration for the right to use that space.

b. The right to direct the use of the identified asset.

i. A lessee has the right to direct the use of an identified asset throughout the period of use in either of the following situations. Additionally, if the lessee in the contract is a joint operation or a joint arrangement, an entity shall consider whether the joint operation or joint arrangement has the right to control the use of an identified asset throughout the period of use.

(a) The lessee has the right to direct how and for what purpose the asset is used throughout the period of use. If the lessee has the right to control the use of an identified asset for only a portion of the term of the contract, the contract contains a lease for that portion of the term.

(b) The relevant decisions about how and for what purpose the asset is used are predetermined and at least one of the following conditions exists:

(1) The lessee has the right to operate the asset (or to direct others to operate the asset in a manner that it determines) throughout the period of use without the lessor having the right to change those operating instructions.

(2) The lessee designed the asset (or specific aspects of the asset) in a way that predetermines how and for what purpose the asset will be used throughout the period of use.

ii. The relevant decisions about how and for what purpose an asset is used can be predetermined in a number of ways. For example, the relevant decisions can be predetermined by the design of the asset or by contractual restrictions on the use of the asset.

iii. In assessing whether a lessee has the right to direct the use of an asset, an entity shall consider only rights to make decisions about the use of the asset during the period of use unless the lessee designed the asset (or specific aspects of the asset) in accordance with paragraph 104.b.i(b). Consequently, unless that condition exists, an entity shall not consider decisions that are predetermined before the period of use. For example, if a lessee is able only to specify the output of an asset before the period of use, the lessee does not have the right to direct the use of that asset. The ability to specify the output in a contract before the period of use, without any other decision-making rights relating to the use of the asset, gives a lessee the same rights as any lessee that purchases goods or services.

iv. A contract may include terms and conditions designed to protect the lessor's interest in the asset or other assets, to protect its personnel, or to ensure the lessor's compliance with laws or regulations. These are examples of protective rights. For example, a contract may specify the maximum amount of use of an asset or limit where or when the lessee can use the asset, may require a lessee to follow particular operating practices, or may require a lessee to inform the lessor of changes in how an asset will be used. Protective rights typically define the

scope of the lessee's right of use but do not, in isolation, prevent the lessee from having the right to direct the use of an asset.

- v. A lessee has the right to direct how and for what purpose an asset is used throughout the period of use if, within the scope of its right of use defined in the contract, it can change how and for what purpose the asset is used throughout that period. In making this assessment, an entity considers the decision-making rights that are most relevant to changing how and for what purpose an asset is used throughout the period of use. Decision-making rights are relevant when they affect the economic benefits to be derived from use. The decision-making rights that are most relevant are likely to be different for different contracts, depending on the nature of the asset and the terms and conditions of the contract.

11. An entity shall reassess whether a contract is or contains a lease only if the terms and conditions of the contract are changed.

~~8. An arrangement conveys the right to use property, plant or equipment if the arrangement conveys to the purchaser (lessee) the right to control the use of the underlying property, plant or equipment. The right to control the use of the underlying property, plant or equipment is conveyed if any one of the following conditions is met:~~

- ~~a. The purchaser has the ability or right to operate the property, plant or equipment or direct others to operate the property, plant or equipment in a manner it determines while obtaining or controlling more than a minor amount of the output or other utility of the property, plant or equipment,~~
- ~~b. The purchaser has the ability or right to control physical access to the underlying property, plant or equipment while obtaining or controlling more than a minor amount of the output or other utility of the property, plant or equipment, or~~
- ~~c. Facts and circumstances indicate that it is remote that one or more parties other than the purchaser will take more than a minor amount of the output or other utility that will be produced or generated by the property, plant or equipment during the term of the arrangement, and the price that the purchaser (lessee) will pay for the output is neither contractually fixed per unit of output nor equal to the current market price per unit of output as of the time of delivery of the output.~~

~~10. When an arrangement (or a portion of an arrangement) ceases to be a lease or becomes a lease due to a modification to the arrangement or other change discussed above, the following guidance shall be applied to account for the revised categorization of the arrangement:~~

- ~~a. Supply arrangement to operating lease for the Purchaser/Lessee. Any recognized asset (such as a prepaid asset or a derivative) for the purchase contract is considered part of the minimum lease payments and is initially recognized as prepaid rent. Any recognized liability (such as a payable or a derivative) for the purchase contract is considered a reduction of the minimum lease payments and is initially recognized as a lease payable.~~
- ~~b. Supply arrangement to operating lease for the Seller/Lessor. Any recognized liability (such as a deferred revenue or derivative) for the sales contract is considered part of the minimum lease payments and is initially recognized as deferred rent. Any recognized asset (such as a receivable or derivative) for the sales contract is considered a reduction of the minimum lease payments and is initially recognized as a lease receivable provided the asset is recoverable from future receipts.~~

- ~~c. Operating lease to supply arrangement for the Purchaser/Lessee. Any recognized prepaid rent or rent payable is initially recognized as an asset or liability associated with the purchase contract.~~
- ~~d. Operating lease to supply arrangement for the Seller/Lessor. Any recognized deferred rent or rent receivable is initially recognized as a liability or an asset associated with the sales contract, subject to a recoverability test.~~

~~11. If an arrangement contains a lease and related executory costs, as well as other non-lease elements, the classification, recognition, measurement and disclosure requirements of this SSAP shall be applied by both the purchaser and the supplier to the lease element of the arrangement. Other elements of the arrangement not within the scope of this SSAP shall be accounted for in accordance with other applicable generally accepted accounting principles. For purposes of applying this SSAP, payments and other consideration called for by the arrangement shall be separated at the inception of the arrangement or upon a reassessment of the arrangement into (a) those for the lease, including the related executory costs and profits thereon, and (b) those for other services on a relative fair value basis.~~

### Separating Components of a Contract

12. An entity shall identify the separate lease components within the contract. An entity shall consider the right to use an underlying asset to be a separate lease component (that is, separate from any other lease components of the contract) if both of the following criteria are met:

- a. The lessee can benefit from the right of use either on its own or together with other resources that are readily available to the lessee. Readily available resources are goods or services that are sold or leased separately (by the lessor or other lessors) or resources that the lessee already has obtained (from the lessor or from other transactions or events).
- b. The right of use is neither highly dependent on nor highly interrelated with the other right(s) to use underlying assets in the contract. A lessee's right to use an underlying asset is highly dependent on or highly interrelated with another right to use an underlying asset if each right of use significantly affects the other.

13. The consideration in the contract shall be allocated to each separate lease component and non-lease component of the contract. Components of a contract include only those items or activities that transfer a good or service to the lessee.

14. An entity shall account for each separate lease component separately from the non-lease components of the contract. Non-lease components are not within the scope of this statement and shall be accounted for in accordance with the statutory accounting guidance applicable to the non-lease component.

15. An entity shall combine two or more contracts, at least one of which is or contains a lease, entered into at or near the same time with the same counterparty (or related parties) and consider the contracts as a single transaction if any of the following criteria are met:

- a. The contracts are negotiated as a package with the same commercial objective(s).
- b. The amount of consideration to be paid in one contract depends on the price or performance of the other contract.
- c. The rights to use underlying assets conveyed in the contracts are a single lease component.

16. As a practical expedient, when non-lease components are an insignificant part of a lease agreement, a lessee and a lessor may, as an accounting policy election by class of underlying asset, choose not to separate non-lease components from lease components and instead to account for each separate lease component and the non-lease components associated with that lease component as a single lease component. The non-lease components must be closely related to the elements of the lease to be recognized as a single lease component. For lease agreements between related parties, lease and non-lease components must be separated.

### **Modification**

17. An entity shall account for a modification to a contract as a separate contract (that is, separate from the original contract) when both of the following conditions are present:

- a. The modification grants the lessee an additional right of use not included in the original lease (for example, the right to use an additional asset).
- b. The lease payments increase commensurate with the standalone price for the additional right of use, adjusted for the circumstances of the particular contract. For example, the standalone price for the lease of one floor of an office building in which the lessee already leases other floors in that building may be different from the standalone price of a similar floor in a different office building, because it was not necessary for a lessor to incur costs that it would have incurred for a new lessee.

18. An entity shall account for initial direct costs, lease incentives and any other payments made to or by the entity in connection with a modification to a lease in the same manner as those items would be accounted for in connection with a new lease.

### **Accounting and Reporting by Lessees**

19. All leases shall be considered operating leases, which means that rental expense is recognized over the lease term, without recognition of a right-to-use asset or lease liability. Rent on operating leases, reflecting all lease considerations in paragraph 20, shall be charged to expense on a straight-line basis over the lease term. Statutory accounting rejects the recognition of a right-to-use lease asset and the associated lease liabilities.

20. The consideration in the contract for a lessee includes all of the following payments that will be made during the lease term:

- a. Any fixed payments (for example, monthly service charges) or in substance fixed payments, less any incentives paid or payable to the lessee.
- b. Any other variable payments that depend on an index or a rate, initially measured using the index or rate at the commencement date.

~~12. All leases shall be considered operating leases. Rent on an operating lease shall be charged to expense over the lease term as it becomes payable, except as provided in paragraphs 13 and 14.~~

~~13. As discussed in FASB Technical Bulletin 85-3, Accounting for Operating Leases with Scheduled Rent Increases, the effects of scheduled rent increases normally shall be recognized on a straight-line basis over the lease term.~~

~~14. Lease agreements may also include incentives for the lessee to sign the lease, such as an up-front cash payment to the lessee, payment of costs for the lessee (such as moving expenses), or the assumption by the lessor of the lessee's preexisting lease. As discussed in FASB Technical Bulletin 88-1, Issues Relating to Accounting for Leases: Time Pattern of the Physical Use of the Property in an Operating~~

~~Lease; Lease Incentives in an Operating Lease; Applicability of Leveraged Lease Accounting to Existing Assets of the Lessor; Money Over Money Lease Transactions; Wrap Lease Transactions, incentives paid to or payments made on behalf of the lessee shall be considered reductions of minimum lease payments (i.e., the payments that the lessee is obligated to make or can be required to make in connection with the leased properties.) These incentives shall be recognized over the lease term on a straight line basis unless the use of another systematic and rational allocation basis is more representative of the time pattern in which the leased property is physically employed. The lessee's immediate recognition of expenses or losses (e.g., moving costs, losses on subleases, write-offs of leasehold improvements) shall not be changed by this guidance.~~

~~17.21.~~ A lessee should recognize contingent rental expense (in annual periods as well as in interim periods) prior to the achievement of the specified target that triggers the contingent rental expense, provided that achievement of that target is considered probable. Previously recorded rental expense should be reversed into income at such time that it is probable that the specified target will not be met.

~~15.22.~~ For the early termination or non-use of leased property, plant or equipment benefits, the lessee shall recognize liabilities, initially measured at fair value. Liabilities for costs to terminate a contract before the end of its term shall be recognized when the entity terminates the contract in accordance with the contract terms (i.e., gives written notice of termination or negotiated termination with the lessor).

23. Liabilities for costs that will continue to be incurred under a contract for its remaining term without economic benefit shall be recognized as the cease-date (the date the entity ceases using the right conveyed by the contract – i.e., the right to use a leased property). The fair value of the liability at the cease-use date shall be determined based on the remaining lease rentals, adjusted for the effects of any prepaid or deferred items recognized under the lease, and reduced by estimated sublease rentals that could be reasonably obtained for the property, even if the entity does not intend to enter into a sublease. Remaining lease rentals shall not be reduced to an amount less than zero.

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.

25. A lessee shall reassess the lease term or a lessee option to purchase the underlying asset only if and at the point in time that any of the following occurs:

- a. There is a significant event or a significant change in circumstances that is within the control of the lessee that directly affects whether the lessee is reasonably certain to exercise or not to exercise an option to extend or terminate the lease or to purchase the underlying asset.
- b. There is an event that is written into the contract that obliges the lessee to exercise (or not to exercise) an option to extend or terminate the lease.
- c. The lessee elects to exercise an option even though the entity had previously determined that the lessee was not reasonably certain to do so.

- d. The lessee elects not to exercise an option even though the entity had previously determined that the lessee was reasonably certain to do so.

26. At the commencement date, an entity shall include the periods described in paragraph 24~~38~~ in the lease term having considered all relevant factors that create an economic incentive for the lessee (that is, contract-based, asset-based, entity-based and market-based factors). Those factors shall be considered together, and the existence of any one factor does not necessarily signify that a lessee is reasonably certain to exercise or not to exercise an option.

~~16:27.~~ Maintenance costs incurred by the lessee for maintenance on the leased item that do not increase the value and enhance the usefulness of the leased asset shall be expensed when incurred pursuant to SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements (SSAP No. 19). Reimbursable deposits shall be reflected as nonadmitted assets. Deposits paid to the lessor, reimbursable when the lessee incurs costs for lease maintenance activities, shall be recorded as nonadmitted assets. When the amount on deposit is less than probable of being returned, the deposit shall be recognized as an additional lease expense.

### Accounting and Reporting by Lessors

~~18:28.~~ The definition of property, plant and equipment for lessors is defined in paragraph 3 and is the same as for lessees. All leases, except leveraged leases as defined in paragraph 34~~42~~, shall be considered operating leases and accounted for by the lessor as follows:

- a. The leased property, plant or equipment shall be included in the same balance sheet category it would be had the property, plant or equipment not been leased. The property, plant or equipment shall be depreciated following the lessor's normal depreciation policies for such assets;
- b. Rental income shall be reported as investment income as it becomes receivable according to the provisions of the lease. ~~However, as discussed in paragraphs 13 and 14 of this statement, r~~Rentals may be recognized before they become due, if rentals vary from the straight-line basis. The guidance in *SSAP No. 34—Investment Income Due and Accrued* shall be applied to the receivable balance; and
- c. Initial direct costs shall be charged to expense when incurred and shall not be deferred and allocated over the lease term. Initial direct costs are those incremental costs that the lessor has incurred in directly evaluating, negotiating, administering, and closing a lease transaction.

~~19. The sale of property subject to an operating lease, or of property that is leased by or intended to be leased by the third party purchaser to another party, shall not be treated as a sale if the seller or any party related to the seller (related party is defined in SSAP No. 25—Affiliates and Other Related Parties (SSAP No. 25)) retains substantial risks of ownership in the leased property.~~

29. If the terms of a variable payment amount other than those in paragraph 20.b. relate to a lease component, even partially, the lessor shall not recognize those payments before the changes in facts and circumstances on which the variable payment is based occur (for example, when the lessee's sales on which the amount of the variable payment depends occur). When the changes in facts and circumstances on which the variable payment is based occur, the lessor shall allocate those payments to the lease and non-lease components of the contract.

~~20:30.~~ Contingent rental income shall be recognized as revenue when the changes in the factor(s) on which the contingent lease payments is (are) based actually occur.



## Sale-Leaseback Transactions

~~21.31.~~ Sale-leaseback transactions involve the sale of property, plant or equipment by the owner and a lease of the property, plant or equipment back to the seller. ~~Sale-leaseback transactions involve the sale of property by the owner and a lease of the property back to the seller.~~ Sale-leaseback accounting is a method of accounting in which the seller-lessee records the sale and; removes all property, plant or equipment and related liabilities from its balance sheet. The definition of property, plant and equipment eligible for sale-leaseback treatment is in paragraph 3. As noted in paragraph 3, non-depreciable assets, including investments and premium receivables, do not meet the definition of property, plant or equipment, are not allowed to be included in lease transactions, and therefore, are not allowed to be included in sale-leaseback transactions. Assets that do not meet the definition of property, plant and equipment in paragraph 3 may only be used in sale-leaseback transactions as permitted practices with regulatory approval.

~~22.32.~~ A sale of property, plant or equipment that is accompanied by a leaseback of all or any part of the property, plant or equipment for all or part of its *remaining* economic life shall be accounted for by the buyer-lessor and seller-lessee as a purchase and operating lease and a sale and an operating lease, respectively, unless the sale-leaseback includes sale of nonadmitted assets to a related party. If the transaction involves a sale of nonadmitted assets to a related party, the transaction shall be accounted for by the deposit method detailed in paragraph 3748.

~~23. — When applying sale-leaseback accounting, the sale and gains and losses thereon, shall be recognized in accordance with paragraphs 2 and 3 of FASB Statement No. 28, Accounting for Sales with Leasebacks (refer to Exhibit A, paragraphs 46-49), except for sale-leaseback transactions involving real estate that are settled entirely in cash.~~

~~27.33.~~ Sale-leaseback accounting shall be used by a seller-lessee only if a sale-leaseback transaction includes all of the following:

- a. A normal leaseback ~~as described in paragraph 44.~~ is a lessee-lessor relationship that involves active use of the property by the seller-lessee in consideration for payment of rent, including contingent rentals that are based on future operations of the seller-lessee. The phrase active use of the property by the seller-lessee refers to use of the property during the lease term in the seller-lessee's trade or business, provided that subleasing of the leased property is minor.
- ~~b. — Payment terms and provisions that adequately demonstrate the buyer-lessor's initial and continuing investment in the property (refer to Exhibit A, paragraphs 50-58).~~
- ~~c. — Payment terms and provisions that transfer all of the other risks and rewards of ownership as demonstrated by the absence of any other continuing involvement by the seller-lessee described in paragraphs 31-33 of this section and paragraphs 25-39 and 41-43 of FAS 66~~
- ~~d.~~ b. Admitted assets, if the buyer-lessor is a related party, or either admitted or nonadmitted assets if the buyer-lessor is not a related party. For purposes of this paragraph, related parties include those identified in SSAP No. 25 and entities created for the purpose of buying and leasing nonadmitted assets for the reporting entity and/or its affiliates.

34. Under sale-leaseback accounting, any profit ~~or loss~~ on the sale shall be deferred and amortized in proportion to the related gross rental charged to expense over the lease term, with the exception of a sale of real estate settled entirely in cash.

~~24.35.~~ A sale of real estate, settled entirely in cash, that is accompanied by a leaseback of all or any part of the property, plant or equipment for all or part of its remaining economic life shall be accounted for by



the buyer-lessor and seller-lessee as a purchase and operating lease and a sale and an operating lease, respectively. The sale and gain ~~or loss~~ shall be recognized directly to special surplus funds and subsequently amortized to unassigned funds (surplus) over the lease term.

### Deposit Method and Financing Method

36. The deposit method is used when the transaction involves a sale-leaseback of nonadmitted assets to a related party. To the extent that leases between related parties are, in substance, arms-length transactions the guidance in this statement shall be applied. The determination of whether related party leases qualify as arms-length transactions is addressed in SSAP No. 25.

37. If a sale-leaseback transaction is accounted for by the deposit method, lease payments decrease and collections on the buyer-lessor's note, if any, increase the seller-lessee's deposit account. The sale-leaseback assets identified in paragraph 31 and any related debt continue to be included in the seller-lessee's balance sheet, and the seller-lessee continues to depreciate the sale-leaseback assets. A seller-lessee that is accounting for any transaction by the deposit method shall recognize a loss if at any time the net carrying amount of the sale-leaseback assets exceeds the sum of the balance in the deposit account, the fair value of the unrecorded note receivable and any debt assumed by the buyer.

38. If a sale-leaseback transaction is accounted for by the deposit method and then subsequently qualifies for sales recognition under paragraph 33, the transaction is accounted for using sale-leaseback accounting, and the gain or loss is recognized in accordance with the provisions of paragraph 34 of this statement. In addition, the leaseback is classified and accounted for in accordance with this statement as if the sale had been recognized at the inception of the lease. The change in the related lease accounts that would have been recorded from the inception of the lease had the transaction initially qualified for sale-leaseback accounting is included in computing the gain or loss recognized in accordance with paragraph 34 of this statement.

39. A sale-leaseback transaction that does not qualify for sale-leaseback accounting nor the deposit method shall be accounted for by the financing method. Under this method the seller-lessee shall not derecognize the transferred asset and shall account for any amounts received as a financial liability and the buyer-lessor shall not recognize the transferred asset and shall account for the amounts paid as a receivable.

40. If a sale-leaseback transaction is reported as ~~under the~~<sup>a</sup> financing ~~method~~, lease payments, exclusive of an interest portion, decrease and collections on the buyer-lessor's note increase the seller-lessee's liability account with a portion of the lease payments being recognized under the interest method. The seller-lessee reports the sales proceeds as a liability, continues to report the sale-leaseback assets identified in paragraph 31 ~~real estate or the real estate and equipment~~ as an asset, and continues to depreciate the ~~property~~ sale-leaseback assets.

41. If a sale-leaseback transaction accounted for ~~under the~~<sup>a</sup> financing ~~method~~ subsequently qualifies ~~for sales recognition~~ under ~~this statement and SSAP No. 40R~~ paragraph 33, the transaction is then recorded using sale-leaseback accounting, and the cumulative change in the related balance sheet accounts is included in the computation of the gain recognized in accordance with the provisions of paragraph 34 of this statement. In addition, the leaseback is classified and accounted for as an operating lease as if the sale had been recognized at the inception of the lease. The change in the related lease accounts from the inception of the lease to the date the sale is recognized is included in the gain recognized in accordance with paragraph 34 of this statement.

~~30. — A sale leaseback transaction that does not qualify for sale leaseback accounting because of any form of continuing involvement by the seller-lessee other than a normal leaseback shall be accounted for by the deposit method or as a financing (refer to Exhibit A, paragraphs 42 and 45), whichever is appropriate under FAS 66. If the criteria of paragraph 27.d. is not met, the sale leaseback shall be accounted for by the deposit method under FAS 66. The provisions or conditions described in paragraphs~~

~~31-33 of this section are examples of continuing involvement for the purpose of applying paragraphs 26-33.~~

~~31. Paragraphs 25-39 and 41-43 of FAS 66 describe forms of continuing involvement by the seller-lessee with the leased property that result in the seller-lessee not transferring the risks or rewards of ownership to the buyer-lessee. Two examples of continuing involvement specified in those paragraphs that are frequently found in sale-leaseback transactions are provisions or conditions in which:~~

- ~~a. The seller-lessee has an obligation or an option<sup>2</sup> to repurchase the property or the buyer-lessee can compel the seller-lessee to repurchase the property.~~
- ~~b. The seller-lessee guarantees the buyer-lessee's investment or a return on that investment for a limited or extended period of time.~~

~~32. Other provisions or conditions that are guarantees and that do not transfer all of the risks of ownership shall constitute continuing involvement for the purpose of applying paragraphs 26-33 to sale-leaseback transactions and include, but are not limited to, the following:~~

- ~~a. The seller-lessee is required to pay the buyer-lessee at the end of the lease term for a decline in the fair value of the property below the estimated residual value on some basis other than excess wear and tear of the property levied on inspection of the property at the termination of the lease.~~
- ~~b. The seller-lessee provides nonrecourse financing to the buyer-lessee for any portion of the sales proceeds or provides recourse financing in which the only recourse is to the leased asset.~~
- ~~c. The seller-lessee is not relieved of the obligation under any existing debt related to the property.~~
- ~~d. The seller-lessee provides collateral on behalf of the buyer-lessee other than the property, directly involved in the sale-leaseback transaction, the seller-lessee or a related party to the seller-lessee guarantees the buyer-lessee's debt, or a related party to the seller-lessee guarantees a return of or on the buyer-lessee's investment.~~
- ~~e. The seller-lessee's rental payment is contingent on some predetermined or determinable level of future operations of the buyer-lessee.<sup>3</sup> 34. Generally, leveraged leases are those in which the lessor acquires, through the incurrence of debt (such that the lessor is substantially "leveraged" in the transaction), property, plant or equipment with the intentions to lease the asset(s) to the lessee. Leveraged leases are defined as those leases that meet the criteria set forth in paragraph 42.a-d. (and the related paragraphs to which 42 refers) of FASB Statement No. 13, Accounting for Leases (FAS 13). Leases which meet the preceding definition shall be accounted for in accordance with paragraphs 43-47 (and the related paragraphs to which 43-47 refer) of FAS 13. Pursuant to paragraph 46 of FAS 13, as updated by FSP FAS 13, any estimated residual value and all other important assumptions affecting estimated total net income shall be reviewed at least annually. The projected timing of income tax cash flows generated by the lease is an important assumption and shall be reviewed annually, or more frequently, if events or changes in~~

<sup>2</sup> A right of first refusal based on a bona fide offer by a third party ordinarily is not an obligation or an option to repurchase. An agreement that allows the seller-lessee to repurchase the asset in the event no third party offer is made is an option to repurchase.

<sup>3</sup> Paragraphs 26-33 distinguish between contingent rentals that are based on the future operations of the seller-lessee and those that are based on some predetermined or determinable level of future operations of the buyer-lessee.

~~circumstances indicate that a change in timing has occurred or is projected to occur. The lessor shall record its investment net of the nonrecourse debt. In cases where the asset being leased is a nonadmitted asset, any net leveraged lease asset shall be nonadmitted. However, leveraged leases involving commercial airplanes are admitted assets.~~

~~60. — The buyer's initial investment shall be adequate to demonstrate the buyer's commitment to pay for the property and shall indicate a reasonable likelihood that the seller will collect the receivable. Lending practices of independent established lending institutions provide a reasonable basis for assessing the collectibility of receivables from buyers of real estate. Therefore, to qualify, the initial investment shall be equal to at least a major part of the difference between usual loan limits and the sales value of the property.~~

~~61. — The buyer's continuing investment in a real estate transaction shall not qualify unless the buyer is contractually required to pay each year on its total debt for the purchase price of the property an amount at least equal to the level annual payment that would be needed to pay that debt and interest on the unpaid balance over no more than (a) 20 years for debt for land and (b) the customary amortization term of a first mortgage loan by an independent established lending institution for other real estate. For this purpose, contractually required payments by the buyer on its debt shall be in the forms specified in paragraph 51 as acceptable for an initial investment. Except as indicated in the following sentence, funds to be provided directly or indirectly by the seller (paragraph 52.c.) shall be subtracted from the buyer's contractually required payments in determining whether the initial and continuing investments are adequate. If a future loan on normal terms from an established lending institution bears a fair market interest rate and the proceeds of the loan are conditional on use for specified development of or construction on the property, the loan need not be subtracted in determining the buyer's investment.~~

~~62. — An agreement to sell property (usually land) may provide that part or all of the property may be released from liens securing related debt by payment of a release price or that payments by the buyer may be assigned first to released property. If either of those conditions is present, a buyer's initial investment shall be sufficient both to pay release prices on property released at the date of sale and to constitute an adequate initial investment on property not released or not subject to release at that time in order to meet the criterion of an adequate initial investment for the property as a whole.~~

~~63. — If the release conditions described in paragraph 55 are present, the buyer's investment shall be sufficient, after the released property is paid for, to constitute an adequate continuing investment on property not released in order to meet the criterion of an adequate continuing investment for the property as a whole (paragraph 54).~~

~~64. — If the amounts applied to unreleased portions do not meet the initial and continuing investment criteria as applied to the sales value of those unreleased portions, profit shall be recognized on each released portion when it meets the criteria in SSAP No. 40R, paragraph 19 as if each release were a separate sale.~~

### Leveraged Leases for Lessors

42. A lessor shall record its investment in a leveraged lease. Generally, leveraged leases are those in which the lessor acquires, through the incurrence of debt (such that the lessor is substantially “leveraged” in the transaction), property, plant or equipment with the intentions to lease the asset(s) to the lessee. The net of the balances of the following accounts as measured in accordance with this guidance shall represent the lessor’s initial and continuing investment in leveraged leases:

- a. Rentals receivable
- b. Investment-tax-credit receivable

- c. Estimated residual value of the leased asset
- d. Unearned and deferred income.

43. A lessor shall initially measure its investment in a leveraged lease net of the nonrecourse debt. The net of the balances of the following accounts shall represent the initial and continuing investment in leveraged leases:

- a. Rentals receivable, net of that portion of the rental applicable to principal and interest on the nonrecourse debt.
- b. A receivable for the amount of the investment tax credit to be realized on the transaction.
- c. The estimated residual value of the leased asset. The estimated residual value shall not exceed the amount estimated at lease inception except if the lease agreement includes a provision to escalate minimum lease payments either for increases in construction or acquisition cost of the leased property, plant or equipment or for increases in some other measure of cost or value (such as general price levels) during the construction or preacquisition period. In that case, the effect of any increases that have occurred shall be considered in the determination of the estimated residual value of the underlying asset at lease inception.
- d. Unearned and deferred income consisting of both of the following:
  - i. The estimated pretax lease income (or loss), after deducting initial direct costs, remaining to be allocated to income over the lease term.
  - ii. The investment tax credit remaining to be allocated to income over the lease term.

44. The investment in leveraged leases minus deferred taxes arising from differences between pretax accounting income and taxable income shall represent the lessor's net investment in leveraged leases for purposes of computing periodic net income from the leveraged lease. Given the original investment and using the projected cash receipts and disbursements over the term of the lease, the rate of return on the net investment in the years in which it is positive shall be computed. The rate is that rate that, when applied to the net investment in the years in which the net investment is positive, will distribute the net income to those years and is distinct from the interest rate implicit in the lease. In each year, whether positive or not, the difference between the net cash flow and the amount of income recognized, if any, shall serve to increase or reduce the net investment balance. The use of the term years is not intended to preclude application of the accounting prescribed in this paragraph to shorter accounting periods.

45. The pretax lease income (or loss) and investment tax credit elements shall be allocated in proportionate amounts from the unearned and deferred income included in the lessor's net investment. The tax effect of the pretax lease income (or loss) recognized shall be reflected in tax expense for the year. The tax effect of the difference between pretax accounting income (or loss) and taxable income (or loss) for the year shall be charged or credited to deferred taxes.

46. If, at any time during the lease term the application of the method prescribed in this section would result in a loss being allocated to future years, that loss shall be recognized immediately. This situation might arise in circumstances in which one of the important assumptions affecting net income is revised.

47. The projected timing of income tax cash flows generated by the leveraged lease is an important assumption and shall be reviewed annually, or more frequently, if events or changes in circumstances indicate that a change in timing has occurred or is projected to occur. The income effect of a change in the

income tax rate shall be recognized in the first accounting period ending on or after the date on which the legislation effecting a rate change becomes law.

48. The lessor shall record its investment net of the nonrecourse debt. In cases where the asset being leased is a nonadmitted asset, any net leveraged lease asset shall be nonadmitted. However, leveraged leases involving commercial airplanes are admitted assets.

~~35. This statement applies to arms length transactions. To the extent that leases between related parties are, in substance, arms length transactions the guidance in this statement shall be applied. The determination of whether related party leases qualify as arms length transactions is addressed in SSAP No. 25~~

## Disclosures

~~36.~~49. The following disclosures shall be made in the financial statements of lessees:

- a. A general description of the lessee's leasing arrangements including, but not limited to, the following:
  - i. Rental expense for each period for which an income statement is presented, with separate amounts for minimum rentals, contingent rentals, and sublease rentals. Rental payments under leases with terms of a month or less that were not renewed need not be included;
  - ii. The basis on which contingent rental payments are determined;
  - iii. The existence and terms of renewal or purchase options and escalation clauses; and
  - iv. Restrictions imposed by lease agreements, such as those concerning dividends, additional debt, and further leasing;
  - v. Identification of lease agreements that have been terminated early or for which the lessee is no longer using the leased property, plant or equipment benefits, and the liability recognized in the financial statements under these agreements.
- b. For leases having initial or remaining ~~noncancelable~~ lease terms in excess of one year:
  - i. Future minimum rental payments required as of the date of the latest balance sheet presented, in the aggregate and for each of the five succeeding years; and
  - ii. The total of minimum rentals to be received in the future under noncancelable subleases as of the date of the latest balance sheet presented.
- c. For sale-leaseback transactions:
  - i. A description of the terms of the sale-leaseback transaction, including future commitments, or obligations, ~~provisions, or circumstances that require or result in the seller lessee's continuing involvement~~; and
  - ii. For those accounted for as deposits, (a) the obligation for future minimum lease payments as of the date of the latest balance sheet presented in the aggregate and for each of the five succeeding years and (b) the total of minimum sublease rentals, if any, to be received in the future under noncancelable subleases in the aggregate and for each of the five succeeding years.

- iii. [For those accounted for using the financing method, it is required to disclose the information in i. as well as the financing obligation and lease liabilities.](#)

~~37.~~[50.](#) When leasing is a significant part of the lessor's business activities in terms of revenue, net income, or assets, the following information with respect to leases shall be disclosed in the financial statements:

- a. For operating leases:
- i. The cost and carrying amount, if different, of property, [plant or equipment](#) on lease or held for leasing by major classes of property, [plant or equipment](#) according to nature or function, and the amount of accumulated depreciation in total as of the date of the latest balance sheet presented;
  - ii. Minimum future rentals on noncancelable leases as of the date of the latest balance sheet presented, in the aggregate and for each of the five succeeding years;
  - iii. Total contingent rentals included in income for each period for which an income statement is presented; and
  - iv. A general description of the lessor's leasing arrangements.
- b. For leveraged leases:
- i. A description of the terms including the pretax income from the leveraged leases. For purposes of presenting the investment in a leveraged lease in the lessor's balance sheet, the amount of related deferred taxes shall be presented separately (from the remainder of the net investment);
  - ii. Separate presentation (from each other) shall be made of pretax income from the leveraged lease, the tax effect of pretax income, and the amount of investment tax credit recognized as income during the period; and
  - iii. When leveraged leasing is a significant part of the lessor's business activities in terms of revenue, net income, or assets, the components of the net investment balance in leveraged leases shall be disclosed.

~~38. — Companies shall disclose the effect on the balance sheet and the income statement resulting from a change in lease classification under paragraph 3, for leases that at inception would have been classified differently had the guidance in paragraph 3 been in effect at the inception of the original lease.~~

~~39.~~[51.](#) Refer to the Preamble for further discussion regarding disclosure requirements.

### Relevant Literature

[52. This statement rejects ASU 2016-02, Leases. For statutory accounting, leases are treated as operating leases for lessees and reject the treatment as financing leases specified in 842-10-25 and reject the recognition of the right to use assets and related liabilities. For statutory accounting, specific guidance is adopted on sale leaseback transactions, specific guidance from lessors, leveraged leases from sections 842-40 and 842-50, respectively. The financing method is rejected for statutory accounting but adopted for instances where a sale-leaseback transaction fails sale accounting. The guidance within INT 02-15: EITF 00-11: Lessors' Evaluation of Whether Leases of Certain Integral Equipment Meet the Ownership Transfer Requirements of FASB Statement 13 applied to leases with inception between January 1, 2003 and January 1, 2020. With adoption of substantive revisions to SSAP No. 22R this guidance is nullified.](#)

- a. Accounting Standards Codification (ASC) 420-10-25 paragraphs 11-13 and ASC 420-10-30 paragraph 8 regarding the recognition of costs to terminate an operating lease before the end of the term and costs that will continue to be incurred under the contract for its remaining term without economic benefit are adopted. Other provisions of ASC 420 are rejected in SSAP No. 24.
- b. ASU 2014-05, Service Concession Arrangements (Adopted with modification to only exclude service concession arrangements from the lease definition.)
- c. ASU 2017-10, Determining the Customer of the Operation Services (Adopted with modification to clarify the customer in the previously adopted service concession arrangement definition.)
- d. ASU 2018-01, Land Easement Practical Expedient for Transition to Topic 842 (Rejected in its entirety.)
- e. ASU 2018-10, Codification Improvements to Topic 842, Leases (Rejected in its entirety.)
- f. ASU 2018-11, Leases (Topic 842), Targeted Improvements (Rejected in its entirety.)
- g. ASU 2018-20, Leases (Topic 842), Narrow-Scope Improvements for Lessors (Rejected for statutory accounting, except for paragraph 842-10-15-(40-42) as it was modified by ASU 2018-20.)
- h. ASU 2019-01, Leases (Topic 842), Codification Improvements (Rejected in its entirety.)

~~40. — This statement rejects FASB 13, as amended and interpreted, except for certain of the guidance on operating leases, sale leaseback transactions and leveraged leases (i.e., paragraphs 15, 16.(b., c., d.), 19.(a., b.), 23.(b., c.), 36, 37, 39.c. and, 42-47). A complete list of all FASB Statements, Interpretations and Technical Bulletins adopted and rejected in this statement is as follows:~~

- a. ~~(Staff Note – a. through c. have been moved to paragraph 52.)~~
- b.
- c.
- d. ~~FASB Statement No. 13, Accounting for Leases, [paragraphs 15, 16.(b., c., d.), 19.(a., b.), 23.(b., c.), 36, 37, 39.c., 42-47 adopted; all other paragraphs rejected];~~
- e. ~~FASB Statement No. 22, Changes in the Provisions of Lease Agreements Resulting from Refundings of Tax Exempt Debt (an amendment of FASB Statement No. 13) [rejected in its entirety];~~
- f. ~~FASB Statement No. 23, Inception of the Lease (an amendment of FASB Statement No. 13) [paragraph 10 adopted; all other paragraphs rejected];~~
- g. ~~FASB Statement No. 27, Classification of Renewals or Extensions of Existing Sales Type or Direct Financing Leases (an amendment of FASB Statement No. 13) [rejected in its entirety];~~
- h. ~~FASB Statement No. 28, Accounting for Sales with Leasebacks (an amendment of FASB Statement No. 13) [adopted in its entirety, except guidance on capital leases is not applicable other than those leases that qualify as leveraged leases and modifications for sale leaseback transactions involving real estate settled entirely in cash];~~
- i. ~~FASB Statement No. 29, Determining Contingent Rentals (an amendment of FASB Statement No. 13) [paragraphs 8 and 11 adopted; all other paragraphs rejected];~~



~~j. — FASB Statement No. 98, Accounting for Leases:~~

- ~~• Sale-Leaseback Transactions Involving Real Estate~~
- ~~• Sales-Type Leases of Real Estate~~
- ~~• Definition of the Lease Term~~
- ~~• Initial Direct Costs of Direct Financing Leases~~

~~(an amendment of FASB Statements No. 13, 66 and 91 and a rescission of FASB Statement No. 26 and Technical Bulletin No. 79-11) (paragraphs 1-13, 17-22.a., b., d., and e. adopted, paragraph j. adopted with modification to exclude references to sales-type lease classification criterion, paragraphs 27, 30, 31, adopted with modification to reference applicable statements of statutory accounting principles and reject guidance associated with capital leases; all other paragraphs rejected);~~

~~k. — FASB Statement No. 109, Accounting for Income Taxes [paragraphs 256-258 adopted; all other paragraphs addressed in SSAP No. 101—Income Taxes (SSAP No. 101)];~~

~~l. — FASB Statement No. 145, Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13 and Technical Corrections [paragraph 9.c.c. adopted; all other paragraphs rejected];~~

~~m. — FASB Interpretation No. 19, Lessee Guarantee of the Residual Value of Leased Property (an interpretation of FASB Statement No. 13) [rejected in its entirety];~~

~~n. — FASB Interpretation No. 21, Accounting for Leases in a Business Combination (an interpretation of FASB Statement No. 13) [rejected in its entirety];~~

~~o. — FASB Interpretation No. 23, Leases of Certain Property Owned by a Governmental Unit or Authority (an interpretation of FASB Statement No. 13) [rejected in its entirety];~~

~~p. — FASB Interpretation No. 24, Leases Involving Only Part of a Building (an interpretation of FASB Statement No. 13) [rejected in its entirety];~~

~~q. — FASB Interpretation No. 26, Accounting for Purchase of a Leased Asset by the Lessee during the Term of the Lease (an interpretation of FASB Statement No. 13) [rejected in its entirety];~~

~~r. — FASB Interpretation 27, Accounting for a Loss on a Sublease (an interpretation of FASB Statement No. 13 and APB Opinion No. 30) [adopted in its entirety];~~

~~s. — FASB Technical Bulletin 79-10, Fiscal Funding Clauses in Lease Agreements [rejected in its entirety];~~

~~t. — FASB Technical Bulletin 79-12, Interest Rate Used in Calculating the Present Value of Minimum Lease Payments [rejected in its entirety];~~

~~u. — FASB Technical Bulletin 79-13, Applicability of FASB Statement No. 13 to Current Value Financial Statements [rejected in its entirety];~~

~~v. — FASB Technical Bulletin 79-14, Upward Adjustment of Guaranteed Residual Values [rejected in its entirety];~~

~~w. — FASB Technical Bulletin 79-15, Accounting for Loss on a Sublease Not Involving the Disposal of a Segment [adopted in its entirety];~~



- x. ~~FASB Technical Bulletin 79-16(R), Effect of a Change in Income Tax Rate on the Accounting for Leveraged Leases [adopted in its entirety];~~
- y. ~~FASB Technical Bulletin 79-17, Reporting Cumulative Effect Adjustment from Retroactive Application of FASB Statement No. 13 [rejected in its entirety];~~
- z. ~~FASB Technical Bulletin 79-18, Transition Requirement of Certain FASB Amendments and Interpretations of FASB Statement No. 13 [rejected in its entirety];~~
- aa. ~~FASB Technical Bulletin 85-3, Accounting for Operating Leases with Scheduled Rent Increases [adopted in its entirety];~~
- bb. ~~FASB Technical Bulletin 86-2, Accounting for an Interest in the Residual Value of a Leased Asset:~~
- ~~• Acquired by a Third Party or~~
  - ~~• Retained by a Lessor That Sells the Related Minimum Rental Payments~~
- ~~[adopted in its entirety];~~
- cc. ~~FASB Technical Bulletin 88-1, Issues Related to Accounting for Leases:~~
- ~~• Time Pattern of the Physical Use of the Property in an Operating Lease~~
  - ~~• Lease Incentives in an Operating Lease~~
  - ~~• Applicability of Leveraged Lease Accounting to Existing Assets of the Lessor~~
  - ~~• Money-Over-Money Lease Transactions~~
  - ~~• Wrap Lease Transactions~~
- ~~[paragraphs 1-12 adopted; all other paragraphs rejected];~~
- dd. ~~FASB Staff Position 13-2: Accounting for a Change or Projected Change in the Timing of Cash Flows Relating to Income Taxes Generated by a Leveraged Lease Transaction [adopted in its entirety];~~
- ee. ~~FASB Emerging Issues Task Force No. 85-16, Leveraged Leases [adopted in its entirety];~~
- ff. ~~FASB Emerging Issues Task Force No. 86-17, Deferred Profit on Sale-Leaseback Transaction with Lessee Guarantee of Residual Value [rejected in its entirety];~~
- gg. ~~FASB Emerging Issues Task Force No. 86-33, Tax Indemnifications in Lease Agreements [adopted in its entirety];~~
- hh. ~~FASB Emerging Issues Task Force No. 86-43, Effect of a Change in Tax Law or Rates on Leveraged Leases [adopted in its entirety];~~
- ii. ~~FASB Emerging Issues Task Force No. 87-7, Sale of an Asset Subject to a Lease and Nonrecourse Financing: "Wrap Lease Transactions" [rejected in its entirety];~~
- jj. ~~FASB Emerging Issues Task Force No. 87-8, Tax Reform Act of 1986: Issues Related to the Alternative Minimum Tax [Issue No. 10 adopted];~~

~~kk. — FASB Emerging Issues Task Force No. 88-10, Costs Associated with Lease Modification or Termination, previously adopted in its entirety in SSAP No. 22, has been nullified with the adoption of ASC 420-10-25 paragraphs 11-13 and ASC 420-10-30 paragraph 8;~~

~~ll. — FASB Emerging Issues Task Force No. 88-21, Accounting for the Sale of Property Subject to the Seller's Preexisting Lease [rejected in its entirety];~~

~~mm. — FASB Emerging Issues Task Force No. 89-16, Consideration of Executory Costs in Sale-Leaseback Transactions [adopted in its entirety];~~

~~nn. — FASB Emerging Issues Task Force No. 90-14, Unsecured Guarantee by Parent of Subsidiary's Lease Payments in a Sale Leaseback Transaction [adopted in its entirety];~~

~~oo. — FASB Emerging Issues Task Force No. 90-15, Impact of Nonsubstantive Lessors, Residual Value Guarantees, and Other Provisions in Leasing Transactions [rejected in its entirety];~~

~~pp. — FASB Emerging Issues Task Force No. 90-20, Impact of an Uncollateralized Irrevocable Letter of Credit on a Real Estate Sale Leaseback Transaction [adopted in its entirety];~~

~~qq. — FASB Emerging Issues Task Force No. 92-1, Allocation of Residual Value or First-Loss Guarantee to Minimum Lease Payments in Leases Involving Land and Building(s) [rejected in its entirety];~~

~~rr. — FASB Emerging Issues Task Force No. 93-8, Accounting for the Sale and Leaseback of an Asset That Is Leased to Another Party [adopted in its entirety];~~

~~ss. — FASB Emerging Issues Task Force No. 95-17, Accounting for Modifications to an Operating Lease That Do Not Change the Lease Classification [adopted in its entirety];~~

~~tt. — FASB Emerging Issues Task Force No. 96-21, Implementation Issues in Accounting for Leasing Transactions Involving Special Purpose Entities [rejected in its entirety];~~

~~uu. — FASB Emerging Issues Task Force No. 98-9, Accounting for Contingent Rent (adopted with modification);~~

~~vv. — FASB Emerging Issues Task Force No. 00-11, Lessors' Evaluation of Whether Leases of Certain Integral Equipment Meet the Ownership Transfer Requirements of FASB Statement 13 [adopted with modifications to GAAP references];~~

~~ww. — FASB Emerging Issues Task Force No. 08-3: Accounting by Lessees for Maintenance Deposits (adopted with modification) to require reimbursable deposits to be reflected as nonadmitted assets.~~

### Effective Date and Transition

53. This statement is effective for years beginning January 1, 2001. The substantive revisions documented in *Issue Paper No. 161—Leases* are effective for all new leases entered into, and for existing leases reassessed due to a change in terms and conditions under paragraph 11, on or after January 1, 2020. Earlier adoption is permitted. The guidance in paragraph 34 regarding commercial airplanes was originally contained within *INT 00-02: Accounting for Leveraged Leases Involving Commercial Airplanes Under SSAP No. 22—Leases* and was effective March 13, 2000. The guidance in paragraph 5 was originally contained within *INT 04-20: EITF 01-8: Determining Whether an Arrangement Contains a Lease* and was effective March 13, 2005. Guidance in paragraph 27 related to maintenance costs incurred by lessee was previously included within *INT 09-05: EITF 08-3: Accounting by Lessees for Maintenance Deposits* and was effective for periods beginning September 21, 2009. The guidance in paragraphs 17 and

18 was originally contained within INT 00-27: EITF 98-9: Accounting for Contingent Rent and was effective September 11, 2000.

~~41. — This statement is effective for years beginning January 1, 2001. The provisions of this statement shall be applied to all new leases entered into, or for existing leases which are renewed, on or after January 1, 2001. The guidance in paragraph 3 was originally contained within INT 02-15: EITF 00-11: Lessors' Evaluation of Whether Leases of Certain Integral Equipment Meet the Ownership Transfer Requirements of FASB Statement 13 and should be applied to (a) leases for which lease inception occurs after January 1, 2003, and (b) leases modified after January 1, 2003, that meet the criteria in paragraph 9 of FAS 13 to be considered as new agreements. The guidance in paragraphs 4-11 was originally contained within INT 04-20: EITF 01-8: Determining Whether an Arrangement Contains a Lease and was effective March 13, 2005. Guidance in paragraph 16 related to maintenance costs incurred by lessee was previously included within INT 09-05: EITF 08-3: Accounting by Lessees for Maintenance Deposits and was effective for periods beginning September 21, 2009. The guidance in paragraphs 17 and 18 was originally contained within INT 00-27: EITF 98-9: Accounting for Contingent Rent and was effective September 11, 2000. The guidance in paragraph 34 regarding commercial airplanes was originally contained within INT 00-02: Accounting for Leveraged Leases Involving Commercial Airplanes Under SSAP No. 22—Leases and was effective March 13, 2000.~~

## REFERENCES

### Relevant Issue Papers

- *Issue Paper No. 22—Leases*
- *Issue Paper No. 161—Leases*