Statutory Issue Paper No. 106

Real Estate Sales – An Amendment to SSAP No. 40—Real Estate Investments

STATUS
Finalized September 12, 2000

Current Authoritative Guidance for Real Estate Sales: SSAP No. 40R
This issue paper may not be directly related to the current authoritative statement.

Original SSAP from Issue Paper: SSAP No. 77

Type of Issue:
Common Area

SUMMARY OF ISSUE

1. Current statutory accounting guidance for Real Estate is provided in *SSAP No. 40—Real Estate Investments* (SSAP No. 40). SSAP No. 40 adopted *FASB Statement No. 66, Accounting for Sales of Real Estate* (FAS 66), with modification to paragraph 9 to indicate that only letters of credit from institutions listed by the Securities Valuation Office shall be included in determining the buyer's initial investment. Although FAS 66 states that it is applicable to all sales of real estate, it does not explicitly define real estate or identify the real estate transactions to which it is specifically applicable.

2. Paragraph 1 of *FASB Statement No. 66, Accounting for Sales of Real Estate*, states, "This Statement establishes standards for recognition of profit on all real estate sales transactions without regard to the nature of the seller's business." *FASB Interpretation No. 43, Real Estate Sales an interpretation of FASB Statement No. 66* (FIN 43) clarifies that the phrase "all real estate sales" to include sales of real estate with property improvements or integral equipment that cannot be removed and used separately from the real estate without incurring significant costs. *FASB Emerging Issues Task Force No. 00-13, Determining Whether Equipment is "Integral Equipment" Subject to FASB Statements No. 66 and No. 98* (EITF 00-13) adds guidance relative to the definition of integral equipment.

3. The purpose of this issue paper is to adopt FIN 43 and EITF 00-13 which is consistent with the Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy (Statement of Concepts).

SUMMARY CONCLUSION

4. This issue paper supersedes paragraphs 16 and 17 of SSAP No. 40. The following guidance shall be followed when accounting for the sales of real estate.

5. Recognition of profit on sales of real estate investments shall be accounted for in accordance with *FASB Statement No. 66, Accounting for Sales of Real Estate* (FAS 66), except as modified in paragraph 6 of this statement, *FASB Emerging Issues Task Force No. 87-9, Profit Recognition on Sales of Real Estate with Insured Mortgages or Surety Bonds* (EITF 87-9), *FASB Emerging Issues Task Force No.* 87-29, *Exchange of Real Estate Involving Boot* (EITF 87-29), *FASB Interpretation No. 43, Real Estate Sales an interpretation of FASB Statement No. 66* (FIN 43) and *FASB Emerging Issues Task Force No. 00-13, Determining Whether Equipment is "Integral Equipment" Subject to FASB Statements No. 66 and No. 98*. This issue paper applies to all sales of real estate including real estate with property improvements or integral equipment. The terms "property improvements" and "integral equipment" refer to any physical structure or equipment attached to the real estate that cannot be removed and used separately without incurring significant costs, such as an office building. Profit shall be recognized in full when real estate is sold, provided (a) the profit is determinable, that is, the collectibility of the sales price is reasonably

assured or the amount that will not be collectible can be estimated, and (b) the earnings process is virtually complete, that is, the seller is not obliged to perform significant activities after the sale to earn the profit. Unless both conditions exist, recognition of all or part of the profit shall be postponed. Profit shall not be recognized by the full accrual method until all of the following criteria are met:

a. A sale is consummated;

b. The buyer's initial and continuing investments are adequate to demonstrate a commitment to pay for the property;

c.

Real Estate Sales – An interpretation of

4. In the first sentence of paragraph 38 of Statement 66, the phrase property improvements is interpreted to include both property improvements and integral improvements (to conform that paragraph to the scope clarification provided by this Interpretation).

10. EITF 00-13 provides the following guidance:

1. With the issuance of Interpretation 43, which concludes that sales of integral equipment are within the scope of Statement 66, determining whether equipment constitutes "integral equipment" has taken on increased importance as that determination now affects whether the detailed guidance in Statement 66 should be applied to a transfer of equipment. Further, the appropriateness of sales-type lease classification by lessors for leases involving equipment is also impacted by the determination of whether the equipment to be leased is "integral equipment." In addition, that determination is important for reaching a conclusion as to whether Statement 98, with its more stringent provisions, applies to a sale-leaseback transaction.

2. Integral equipment is defined in Interpretation 43 as "any physical structure or equipment attached to the real estate that cannot be removed and used separately without incurring significant cost." The authoritative pronouncements governing the accounting for leasing transactions and sales of real estate do not provide any guidance for interpreting the phrase "cannot be removed and used separately without incurring significant cost," and, as a result, there may be diversity in practice with respect to determining what constitutes "integral equipment" for the purpose of applying Statements 13, 66, and 98.

3. This issue is how the determination of whether equipment is integral equipment should be made.

EITF 00-13 DISCUSSION

4. The Task Force agreed that the phrase "cannot be removed and used separately without incurring significant cost" contains two distinct concepts: (a) the ability to remove the equipment without incurring significant cost and (b) the ability of a different entity to use the equipment at another location without significant diminution in utility or value. The Task Force reached a consensus that the determination of whether equipment is integral equipment should be based on the significance of the cost to remove the equipment from its existing location (which would include the cost of repairing damage done to the existing location as a result of the removal),

removal. The estimated cost to ship and reinstall the equipment at a new site (estimated as of the beginning of the lease term) is $85,000. For this example, assume that the equipment would have the same fair value (installed) to the seller and a potential buyer. Therefore, there is no diminution in fair value of the equipment beyond the discount a purchaser would presumably require to cover the cost to ship and reinstall the equipment.

In accordance with this consensus, Company A would assess whether or not the production equipment is integral equipment as follows ($80,000 + $85,000) ÷ $1,075,000 = 15.3 percent. Because the cost of removal combined with the diminution in value exceeds 10 percent of the fair value (installed) of the production equipment, the cost to remove the equipment and use it separately is deemed to be significant. Therefore, the production equipment is integral equipment.

RELEVANT LITERATURE

Statutory Accounting

- Statutory Accounting Principles Statement of Concepts and Statutory Hierarchy
- *SSAP No. 40—Real Estate Investments*

Generally Accepted Accounting Principles

- *FASB Interpretation No. 43, Real Estate Sales, an interpretation of FASB Statement No. 66*
- *FASB Statement No. 66, Accounting for Sales of Real Estate*
- *FASB Emerging Issues Task Force No. 00-13, Determining Whether Equipment is "Integral Equipment" Subject to FASB Statements No. 66 and No. 98*

State Regulations

- No additional guidance obtained from state statutes or regulations.

