

Interpretation of the Emerging Accounting Issues Working Group
INT 04-20: EITF 01-8: Determining whether an Arrangement Contains a Lease

ISSUE NULLIFIED BY SSAP NO. 22

INT 04-20 Dates Discussed

December 5, 2004; March 13, 2005

INT 04-20 References

SSAP No. 22—Leases (SSAP No. 22)

SSAP No. 86—Accounting for Derivative Instruments and Hedging, Income Generation, and Replication (Synthetic Asset) Transactions (SSAP No. 86).

INT 04-20 Issue

1. *EITF No. 01-8, Determining Whether an Arrangement Contains a Lease* (EITF 01-8) originated to provide guidance in determining whether an energy-related contract should be considered a lease subject to the requirements of *FASB Statement No. 13, Accounting for Leases* (Statement 13 or FAS 13), which is adopted with modification in *SSAP No. 22—Leases* (SSAP No. 22). The EITF subsequently expanded it to address all arrangements, not just those involving energy-trading contracts.
2. The Issue is how to determine whether an arrangement contains a lease that is within the scope of SSAP No. 22.
3. In applying this Issue, 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.

INT 04-20 Discussion

4. Per EITF 01-8, the consensus on the Issue is as follows:
 8. The evaluation of whether an arrangement contains a lease within the scope of Statement 13 should be based on the substance of the arrangement using the following guidance.

Property, Plant, or Equipment

 9. Property, plant, or equipment, as used in Statement 13, includes only land and/or depreciable assets. 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.
 10. 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.

11. 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.

Right to Use Property, Plant, or Equipment

12. 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.

Reassessment of the Arrangement

13. The Task Force reached a consensus that the assessment of whether an arrangement contains a lease should be made at inception of the arrangement based on all of the facts and circumstances. A reassessment of whether the arrangement contains a lease after the inception of the arrangement shall be made only if (a) there is a change in the contractual terms, (b) a renewal option is exercised or an extension is agreed to by the parties to the arrangement, (c) there is a change in the determination as to whether or not fulfillment is dependent on specified property, plant, or equipment, or (d) there is a substantial physical change to the specified property, plant, or equipment. A reassessment of an arrangement should be based on the facts and circumstances as of the date of reassessment, including the remaining term of the arrangement. Changes in estimate (for example, the estimated amount of output to be delivered to the purchaser or other potential purchasers) would not trigger a reassessment. The following more fully describes the conclusions of the Task Force in that regard.

- a. Change in contractual terms. The arrangement should be reassessed under the Consensus Guidance in this Issue if the contractual arrangement among the parties involved changes, unless the change only renews or extends the arrangement.

- b. Renewal or extension. A renewal or extension of the arrangement that does not include modification of any of the terms in the original arrangement prior to the end of the term of the original arrangement should be evaluated under the Consensus Guidance in this Issue only with respect to the renewal or extension period. The accounting for the remaining term of the original arrangement should continue without modification. The exercise of a renewal option that was included in the lease term at the inception of the arrangement would not be considered a renewal for the purpose of reevaluating the arrangement.
- c. Dependency upon specific property, plant, or equipment. A change in the determination as to whether or not fulfillment is dependent on specified property, plant, or equipment requires a reassessment of the arrangement under the Consensus Guidance in this Issue to determine whether the arrangement contains a lease on a prospective basis. ...
- d. Physical change to specific property, plant, or equipment. A substantial physical change to the specified property, plant, or equipment requires a reassessment of the arrangement under the Consensus Guidance in this Issue to determine whether the arrangement contains a lease on a prospective basis. For purposes of determining if a physical change to the specified property, plant, or equipment gives rise to a reassessment, increases or decreases in productive capacity that result from adding or subtracting a physically distinct unit of property, plant, or equipment should be ignored if fulfillment of the arrangement is dependent upon a distinct unit of property, plant, or equipment that remains unchanged. ...

14. The Task Force reached a consensus that 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. [Omitted as not applicable to statutory accounting]
- d. [Omitted as not applicable to statutory accounting]
- e. 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.
- f. 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.

- g. [Omitted as not applicable to statutory accounting]
- h. [Omitted as not applicable to statutory accounting]

Multiple Element Arrangements That Contain a Lease

15. 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 Statement 13 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 Statement 13 shall be accounted for in accordance with other applicable generally accepted accounting principles. For purposes of applying Statement 13, 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, consistent with the guidance in paragraph 4.a. of Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables."

- 5. The working group reached a consensus to adopt the EITF 01-8, with modification as follows:
 - a. Change references to FAS 13 to SSAP 22.
 - b. Change references to FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities* to SSAP No. 86.
 - c. Remove references to capital and sales-type leases as these are not applicable to statutory accounting principles.

INT 04-20 Status

- 6. No further discussion is planned.