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AALU Bulletin No: 06-119

October 9, 2006

Subject:    **FASB Ratifies EITF Consensuses on (1) Split-Dollar Life Insurance/Post-Retirement Liability and (2) Capitalization of Assets under FASB Technical Bulletin 85-4**

Major References: [\*Minutes of September 20, 2006 FASB Meeting: Ratification of EITF Consensuses and Tentative Conclusions \(September 26, 2006\)\*](#)

Related Reports: 06-107, 06-103, 06-75, 06-73, 06-71, 06-46, 06-40

MDRT Information Retrieval Index Nos.: 300.00; 6800.00

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*At a recent meeting, the Financial Accounting Standards Board ("FASB"), as anticipated, ratified consensuses that the Emerging Issues Task Force ("EITF") had reached on two issues of interest to the life insurance industry: (1) EITF Issue 06-4 "Accounting for Deferred Compensation and Post-Retirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements" and (2) EITF Issue 06-5 "Accounting for Purchases of Life Insurance -- Determining the Amount that Could Be Realized in Accordance with FASB Technical Bulletin 85-4 (Accounting for Purchases of Life Insurance)." As previously reported here, AALU and others had urged both the FASB and the EITF not to adopt these consensuses. (See our Bulletins Numbers 06-107, 06-103, 06-75, 06-73, 06-71, 06-46, and 06-40.) Staff of the EITF plan to issue final versions of these Issues on or before the EITF's next scheduled meeting in November. The consensus on Issue 06-5 will take effect for fiscal years beginning after December 15, 2006. The consensus on Issue 06-4 will apply to fiscal years beginning after December 15, 2007.*

A.    *Issue 06-4*

## 1. *Substantive Rules*

Issue 06-4 interprets the FASB's Statement of Financial Accounting Standard No. 106 *Employers Accounting for Post-Retirement Benefits other than Pensions* ("FAS 106") and *Opinion 12* of the former Accounting Principles Board ("APB 12"). In general, FAS 106 and APB 12 require an employer to accrue expenses and anticipated liabilities of benefits that the employer has obligated itself to provide to employees once they retire. The accruals must be based on the anticipated present value of the benefits. FAS 106 applies when the benefits are provided pursuant to a plan; APB 12 applies when no plan is deemed to exist. The accrued expenses affect the amount of net income the employer reports on its income statement; the accrued liabilities appear on the employer's balance sheet.

Under Issue 06-4, an employer must accrue these amounts even when it has arranged to provide them through an endorsement split-dollar life insurance arrangement. The FASB and the EITF rejected arguments by AALU and numerous other commenters that (i) an endorsement split-dollar arrangement shifts the liability from the employer or (ii) the arrangement effectively settles the liability. The amounts that must be accrued depend on the substantive agreement between the employer and the employee. During the FASB's and EITF's deliberations concerning this issue, some confusion was expressed concerning the amounts that must be discounted to present value. (See our Bulletin No. 06-107.) According to the minutes of the last FASB meeting, its staff plans to "create a communication strategy" to provide affected entities the appropriate information.

Practically from the beginning of its deliberations on Issue 06-4, the EITF determined that the issue solely involves endorsement split-dollar policies. The FASB meeting of September 20, however, has recently suggested that the EITF review, at its scheduled November meeting, the accounting for collateral assignment split-dollar arrangements. AALU will follow any relevant developments.

## 2. *Effective Date and Transition*

The EITF had proposed that Issue 06-4 apply to fiscal years beginning after December 15, 2006. Numerous public comments to the FASB identified potential economic hardships and implementation issues associated with that proposed effective date. Based on public comments received, the FASB voted to make the final consensus effective for fiscal years beginning after December 15, 2007, although earlier application is permitted. Entities must recognize the effects of applying the consensus through either (a) a change in accounting principle reflected as a "cumulative-effect adjustment" to retained earnings or to other components of equity or net assets as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods.

## B. *Issue 06-5*

### 1. *Substantive Rules*

Issue 06-5 interprets FASB Technical Bulletin 85-4 *Accounting for Purchases of Life Insurance* ("FTB 85-4") issued in 1985. This pronouncement applies to all entities that purchase life insurance (other than life settlement contracts) in which the entity is either the owner or beneficiary of the contract. FTB 85-4 addresses the amount at which the entity should record the policy as an asset on its balance sheet. Under the basic rule, the entity should record the "amount that could be realized" under the contract.

At a minimum, the amount that could be realized includes a policy's cash surrender value as of the date of the balance sheet. Issue 06-5 addresses two associated issues:

- (1) Should the recorded amount also include additional amounts (beyond basic cash surrender value) included in the contractual terms of a policy? Such amounts may include, for example, experience reserve account balances and recovered deferred acquisition costs.
- (2) Should the asset include an incremental amount available if the policyholder surrenders all policies or certificates simultaneously rather than individually? Such additional amounts may take the form of, for example, a waiver of surrender charges.

Like the proposed version, the final consensus takes the position that the amount recorded under FTB 85-4 generally should include the amounts described in (1) above but generally not in (2) above (unless all policies or certificates are required to be surrendered as a group).

At its September meeting, the EITF discussed the effect of delays in receiving recoverable amounts. It determined that fixed amounts described in (1) above recoverable in periods beyond one year from the surrender of the policy should be discounted to their present values in accordance with APB Opinion 21 *Interest on Receivables and Payables*. However, the EITF decided that the basic cash surrender value component should not be discounted even when there exist contractual restrictions on the ability to surrender a policy or the timing of surrender. The FASB ratified these decisions, although one of its member disagreed with the decision to not discount the cash surrender value component.

## **2. *Effective Date and Transition***

The FASB agreed with the EITF that the final consensus should take effect for fiscal years beginning after December 15, 2006. Entities may apply the consensus for earlier periods for which they have not yet issued interim or annual financial statements. Entities must recognize the effects of applying the consensus through either (a) a change in accounting principle reflected through a "cumulative-effect adjustment" to retained earnings or to other components of equity or net assets as of the beginning of the year of adoption or (b) a change in accounting principle through retrospective application to all prior periods.

## **C. *Next Steps***

The minutes of the FASB's September meeting suggest that a separate communication may be issued concerning Issue 06-4. AALU believes that this communication may seek to clarify confusion expressed over how to determine amounts that an employer must record as expenses and liabilities. The communication also may reflect concerns expressed by the FASB that "smaller affected entities" may not understand the nature of the change that Issue 06-4 requires.

AALU will report any remaining developments concerning Issue 06-4 or Issue 06-5.

Any AALU member who wishes to obtain a copy of the minutes of the FASB's meeting of September 20, 2006 may do so through the following means: (1) use hyperlink above next to "Major References," (2) log onto the AALU website at [AALU.org](http://AALU.org), enter the *Member Portal* and select *Current Washington Report* for linkage to source material or (3) email Jeff Lavine at [lavine@aalu.org](mailto:lavine@aalu.org) and include a reference to the *Washington Report*.

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