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Subject: **FASB Invites Public Comments on Draft Abstract of EITF Issue 06-10 on Employers Accounting for Collateral Assignment Split Dollar Life Insurance Arrangements**

Major References: ***FASB Draft Abstract of Issue 06-10 - Accounting for Deferred Compensation and Post-Retirement Benefit Aspects of Collateral Assignment Split Dollar Life Insurance Arrangements (December 6, 2006)***

Prior Washington Reports: *06-144; 06-139; 06-134; 06-119; 06-107*

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Earlier this year, the Emerging Issues Task Force (EITF) of the Financial Accounting Standards Board (FASB) decided that employers must accrue expenses and anticipated liabilities of providing post-retirement benefits through endorsement split dollar life insurance arrangements. EITF Issue 06-4; see our Bulletin Nos. 06-119 and 06-144. At its meeting November 16, 2006 the EITF tentatively decided, subject to public comment and ratification by the FASB, that employers also should be required to accrue such expenses and liabilities for post-retirement benefits provided through collateral assignment split dollar life insurance arrangements. EITF Issue 06-10; see our Bulletin Nos. 06-134 and 06-139. The FASB has invited public comment on the accompanying Draft Abstract of Issue 06-10. Written comments must be submitted to the FASB by January 22, 2007.

Under Issue 06-10, the EITF seeks to resolve two separate but interrelated issues. The first issue affects an employer's income statement and the liability side of its balance sheet. The second issue affects the asset side of an employer's balance sheet. The Draft Abstract sets forth these issues as follows:

Issue 1 - Whether an entity should record a liability for the post-retirement benefit associated with a collateral assignment split dollar life insurance arrangement in accordance with either Statement 106 (if, in substance, a post-retirement benefit plan exists) or Opinion 12 (if the arrangement is, in substance, an individual deferred compensation contract) based on the substantive agreement with the employee (consistent with the consensus reached in Issue 06-04)

If this issue is answered affirmatively, an employer would debit deferred compensation expense and credit a post-retirement benefit obligation to record the anticipated future benefits payable to the employee. For discussion of the amounts to record, see our *Bulletin Nos. 06-107* and *06-144*.

Issue 2 - How an employer should recognize and measure the asset in a collateral assignment split dollar life insurance arrangement.

Under a collateral assignment split dollar (CASD) arrangement, an employer records an asset (receivable) representing amounts due it from the employee under the terms of the arrangement. Typically, the employer is entitled to receive some portion of the death benefit payable on the underlying life insurance policy. Issue 2 concerns the appropriate amount of the receivable.

The Draft Abstract memorializes decisions the EITF reached at its meeting November 16, 2006. See our *Bulletin No. 06-139*. These decisions represent the EITF's anticipated consensus subject to public comments and ratification by the FASB.

A. Issue 1: Should an employer record a liability for a post-retirement benefit associated with a CASD arrangement?

The EITF tentatively concluded that an employer should recognize a liability for the post retirement benefit related to a CASD arrangement based on the substantive agreement with the employee. This conclusion parallels the EITF's consensus with respect to endorsement split dollar life insurance arrangements that provide post-retirement benefits. See our *Bulletin No. 06-119*.

In the case of CASD arrangements, however, the EITF appears to acknowledge that in some situations an insurance contract may "settle" a post-retirement benefit. If a settlement occurs, then the employer does not have to record liabilities. In determining whether a post-retirement benefit has been settled by an insurance contract, an employer should evaluate all the available facts and circumstances and analyze "whether the employer remains subject to the risks or rewards associated with the underlying insurance contract (in the post-retirement period) that collateralizes the employer's asset." (In this context the "employer's asset" refers to the employer's receivable from the employee under the CASD arrangement; see discussion of Issue 2 below.) The Draft Abstract concludes that a settlement has not occurred in either of two situations:

- The employer's asset is collaterized by the employee's (or retiree's) underlying insurance contract; or
- The recourse nature of the employer's loan to the employee (represented by the employer's receivable from the employee) is not substantive

For purposes of these guidelines, the recourse nature of the loan is substantive if the employer has the intent and ability fully to recover amounts due under the CASD arrangement in the event of default by the insurer.

To illustrate this point the Draft Abstract provides the following example:

> For example, if the amounts due under a collateral assignment split dollar life insurance arrangement are full recourse to the employee (or retiree), but the employer does not intend to seek recovery beyond the life insurance policy, the full recourse collateral provisions of the arrangement would not be substantive and settlement of the post-retirement benefit would not have occurred.

B. Issue 2: How Should the Employer Recognize and Measure Its Asset?

After discussing various alternatives (see our *Bulletin No. 06-139*), the EITF tentatively concluded that an employer should recognize and measure its asset (receivable) based on the nature and a substance of the CASD arrangement. In other words, no "one size fits all" rule applies. Rather, the employer should assess (taking into account all available information) the future cash flows (if any) to which the employer is entitled under the arrangement and the employee's obligation and ability to repay the employer. The Draft Abstract provides the following example:

> For example, if the arrangement limited the amount the employer could recover to the amount of the cash surrender value of the insurance policy held by the employee (or retiree), and if the employer's loan to the employee (or retiree) is greater than the cash surrender value of the insurance policy, at the balance sheet date the employer's asset would be limited to the amount of the cash surrender value of the insurance policy. Conversely, if the arrangement required the employee to repay the employer irrespective of the amount of the cash surrender value of the insurance policy (and assuming the employee (or retiree) is an adequate credit risk), the employer should recognize the value of the loan (including accrued interest, if applicable) considering the guidance in Opinion 21.

In the foregoing example, "Opinion 21" refers to Accounting Principles Board Opinion 21. Under that pronouncement, receivables and payables due more than one year in the future generally must be discounted to their present value.

C. Effective Date and Transition

The EITF's consensus on Issue 06-10 would be effective for fiscal years beginning after December 15, 2007, with earlier application permitted. Employers would recognize the effects of applying the consensus in either of two ways: (a) a change in accounting principle through a cumulative-effect adjustment to retained earnings or to other components of equity or net assets in the statement of financial position (balance sheet) as of the beginning of the year, in which the consensus is adopted, or (b) a change in accounting principle through retrospective application to all prior periods. This effective date parallels that adopted for the EITF's consensus on Issue 06-04. See our *Bulletin No. 06-119*.

D. Next Steps

The FASB has requested written comments on the Draft Abstract by January 22, 2007. AALU and its Accounting Task Force anticipate submitting written comments and welcome your input. Staff will analyze and assimilate comments received. The EITF is scheduled to consider the comments at its meeting March 14-15, 2007.

Any AALU member who wishes to obtain a copy of FASB's Draft Abstract of EITF Issue 06-10 may do so through the following means: (1) use hyperlink above next to "Major References," (2) log onto the AALU website at www.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 and include a reference to this *Washington Report*.

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