



LETTER OF COMMENT NO. 100

August 4, 2006

Mr. Larry Smith, CPA
Technical Director-File Reference No. 1235-001
Financial Accounting Standards Board
401 Merritt 7
PO Box 5116
Norwalk, CT 06856-5116

Re: July 6, 2006 Draft Abstract of EITF Issue No. 06-4, *Accounting for Deferred Compensation and Postretirement Benefit Aspects of Endorsement Split-Dollar Life Insurance Arrangements*

Dear Mr. Smith:

One of the objectives that the Council of the American Institute of Certified Public Accountants (AICPA) established for the PCPS Executive Committee is to act as an advocate for all local and regional firms and represent those firms' interests on professional issues, primarily through the Technical Issues Committee (TIC). This communication is in accordance with that objective. These comments, however, do not necessarily reflect the positions of the AICPA.

TIC has reviewed the EITF Draft Abstract and is providing the following comments for your consideration.

GENERAL COMMENTS

TIC disagrees with the conclusions in the Draft Abstract that would require recognition of a liability for a postretirement death benefit obligation when the obligation is funded by an endorsement split-dollar policy. TIC believes the endorsement split-dollar policy, as described, effectively settles the employer's obligation to provide the death benefit to the key employee.





TIC sees no benefit to the proposed accounting for financial statement users based on the provisions of the typical endorsement split-dollar policy. Without potentially an unacceptable level of cost, TIC also foresees practical problems in obtaining the necessary information to record the liability and believes auditors may have difficulty obtaining sufficient evidential matter to audit the liability.

TIC also believes that the proposed accounting is one-sided in that the asset recognized would be limited to the cash surrender value of the policy rather than an amount that would more reliably measure the policy rights held by the insured.

TIC believes the controversy surrounding the settlement issue, coupled with insurance-related projects being considered by the IASB and the FASB, is cause for removing this issue from the EITF's agenda. The issue is not interpretative in nature and should not be resolved by the EITF. Accounting for the settlement of compensation arrangements funded by insurance contracts should be resolved as part of a larger project on insurance accounting.

If the FASB ratifies the tentative conclusions in the Draft Abstract, TIC strongly suggests that the final consensus include a clear explanation of the provisions in endorsement agreements that fail to meet the settlement criteria.

SPECIFIC COMMENTS

The Draft Abstract appears to be flawed in that the proposed accounting is based on the assumption that endorsement split-dollar policies cannot be used to settle a postretirement death benefit obligation. This conclusion is inconsistent with the terms of the typical policy as discussed in paragraph 2 of the Draft Abstract and in Exhibit 06-4A of the issues summary. As a general rule, the employer would never have to make a payment to the employee's beneficiary that would not be covered by the split-dollar policy. Further, the employer has no unconditional obligation to the employee or the employee's beneficiary if the policy is terminated by the employer. As a practical matter, policies that transfer all risk related to the postretirement feature of the policy to the insurance company should be considered settled.

Paragraph 4 of the EITF issues summary indicates that employers' responsibilities under these policies vary and can contain provisions that could be construed as a continuing employer obligation. However, these provisions are not explained in the Draft Abstract. For example, Paragraph 5 says:

The Task Force believed that the purchase of an endorsement type policy does not constitute a settlement since the policy does not qualify as non-participating because the policyholders are subject to the favorable and unfavorable experience of the insurance company.



The Draft Abstract doesn't explain why experience adjustments would represent an additional obligation by the employer to the employee, especially since the employer has no obligation to provide any portion of the actual death benefit (not covered by insurance). The participating feature would seem to be a premium adjustment between the insurance company and the employer or the insurance company and the employee, depending on the arrangement.

In reaching the conclusion that the insurance policy does not represent a settlement of the entity's liability to the employee, the EITF looked to the definition of *settlement (of a postretirement benefit plan)* in SFAS No. 106, *Postretirement Benefits Other Than Pensions*, paragraph 518. Under this definition, purchase of a participating contract, such as an endorsement policy, would not constitute a settlement.

TIC disagrees that participating contracts would prohibit settlement accounting in all cases. The definition in SFAS 106 is intended to apply to a plan with a number of participants where premium adjustments would be costly. Deferred compensation plans under APB Opinion No. 12, would involve few participants and experience adjustments would be negligible, if any. TIC is therefore concerned that the tentative conclusions in the Draft Abstract are too broad and should be modified based on the provisions of individual endorsement split-dollar policies. That is, settlement accounting may be justified for a deferred compensation plan accounted for under APB Opinion No. 12 that is funded by a typical endorsement policy (even with a participatory feature),, but SFAS 106 policies or policies with certain guarantees from the employer for continued coverage or additional indemnification may not.

The proposed accounting model is also flawed because it ignores the potential effect of purchases of life insurance on the asset side of the balance sheet. That is, the Draft Abstract requires recognition of the postretirement benefit obligation but ignores the asset for the *expected future death benefit to be received*. As a result, the employer would record compensation expense twice for the same obligation—once when the postretirement benefit obligation was established and again when the insurance premiums were paid.

TIC believes it is inappropriate to set GAAP for the accounting for compensation arrangements funded by life insurance benefits without also re-deliberating FASB Technical Bulletin (FTB) No. 85-4, *Accounting for Purchases of Life Insurance*, which limits asset recognition to the cash surrender value of the policy at the balance sheet date. The FTB prohibits asset recognition for either the premiums paid for the insurance (i.e., deposit accounting) or the value of the death benefit. TIC believes cash surrender value is not the appropriate measurement attribute for the death benefit to be received. TIC believes the FTB is out of date and should be added to a comprehensive project to address accounting for the purchase of insurance.



TIC members also anticipate difficulty in obtaining the required information to measure the proposed liability for many entities, and, even when available, the calculation of the liability may be unauditable. The insurance company would be a vital source for the amount of the actuarial obligation, which the insurer may or may not be willing to provide. The auditor could not blindly accept the calculation, if provided, from the insurer and generally would not have the ability to obtain sufficient audit evidence regarding the assumptions used and calculations generated by the insurer's computer model. If the auditor hires an expert, he or she would have to audit the amount independently rather than through the insurance company. TIC believes this cost would be too high considering that a funding mechanism exists for the obligation and the fact that most of the obligations established would be reversed to a settlement gain upon receipt of the insurance proceeds.

TIC noted that passionate arguments were presented in the EITF issues summary on both sides of the settlement question. As a result, TIC opposes changing the accounting by insured entities at this time, especially given the strong opinions on each side. Issues involving the transfer of insurance risk are currently under debate in the Invitation to Comment (ITC) on *Bifurcation of Insurance and Reinsurance Contracts for Financial Reporting*, and the IASB has a long-term project on its agenda that will address accounting for insurance contracts by policyholders.

The ITC suggests that finite risk contracts wouldn't be eligible for insurance accounting if significant risk has not been transferred to the insurance company. Similarly, the Draft Abstract negates the intent of an insurance contract when the insured is subject to continuing risk in deferred compensation agreements or postretirement benefit plans that are funded by endorsement split-dollar policies. Debate on the accounting for purchases of insurance contracts is just beginning in a public forum. Therefore, it would not be appropriate to issue an authoritative EITF standard based on principles underlying the purchase of insurance that are subject to change in the near-term.

If the FASB decides to ratify the tentative conclusions presented in this EITF issue, TIC recommends that the final consensus include a description of the specific features of endorsement split-dollar policies that represent continuing risk on the part of the employer and clarify whether all endorsement policies warrant the same accounting treatment.

Paragraph 4 of the EITF Issues Summary indicates that some arrangements include additional provisions that "provide the employee with the security that their benefits will continue." The Draft Abstract is unclear as to whether these are the only troublesome provisions in the policy and how they would affect the transfer of risk.

TIC appreciates the opportunity to present these comments on behalf of PCPS member firms. We would be pleased to discuss our comments with you at your convenience.





PCPS

PRIVATE COMPANIES PRACTICE SECTION

Sincerely,

Edward J. Knauf, Chair
PCPS Technical Issues Committee

cc: PCPS Executive and Technical Issues Committees

