

**Emerging Issues Task Force
Agenda Committee Report
November 22, 2005**

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Emerging Issues Task Force Agenda Committee Decisions on Proposed Issues

1. Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Split-Dollar Life Insurance Arrangements

Companies purchase life insurance for various reasons that may include protecting against the loss of "key" employees, funding deferred compensation and postretirement benefit obligations, and providing an investment return. Split-dollar life insurance is an arrangement in which the employer and an employee split the premiums and share the cash surrender value and/or death benefits of the insurance policy. For example, the employer and employee may share the cost of the premiums, or the employer may pay all of the premiums, and at the death of the insured employee, the proceeds of the policy are split between the employer and the employee's estate or beneficiaries. There currently appears to be diversity in practice in accounting for certain aspects of split-dollar life insurance arrangements as a number of questions have been raised.

Questions about the accounting for split-dollar life insurance arrangements relate to both asset and liability recognition. Certain issues associated with the recognition and measurement of the life insurance asset for split-dollar arrangements were recently considered by the EITF Agenda Committee in two separate potential new issues.¹ Those agenda requests illustrate the diversity that has developed in practice in accounting for split-dollar life insurance. For both requests, the Agenda Committee noted that the issues might be addressed by the Board and they did not add those issues to the EITF's agenda. At its October 19, 2005 meeting, the Board asked the FASB staff to develop a formal agenda request on issues related to asset recognition and measurement under the guidance in FASB Technical Bulletin No. 85-4, *Accounting for Purchases of Life Insurance*. The FASB staff is expected to request, in early 2006, that the Board add a project to the FASB's agenda.

Diversity in practice also exists with respect to the recognition of liabilities and compensation costs for split-dollar life insurance arrangements. This diversity in practice is evidenced by the

¹ The Agenda Committee considered (1) "Accounting for Endorsement Split-Dollar Life Insurance Arrangements," in February 2004 and (2) "Accounting for Purchases of Life Insurance—Determining the Amount that Could be Realized in Accordance with FASB Technical Bulletin No. 85-4," in October 2005.

Agenda Committee's consideration in February 2004 of a potential new issue entitled, "Accounting for Postretirement Cost of Insurance Charges in Modified Endowment Contracts." The Agenda Committee did not add this issue to the EITF's agenda and noted that postretirement arrangements should be accounted for separately from life insurance arrangements. However, diversity continues to exist regarding the accounting for obligations under split-dollar life-insurance arrangements.

The following sections provide background information on the common types of split-dollar life insurance arrangements and the accounting literature that may be applicable to those arrangements.

Types of Split-Dollar Life Insurance Arrangements

Split-dollar life insurance may be structured in a number of different ways, which adds to the complexity of the accounting. The two most common types are:

1. Endorsement Split-Dollar Policies – An employer purchases a life insurance policy to insure the life of an employee. The employer enters into a separate agreement that splits the policy's premium and/or policy benefits between the employer and the employee. The employer owns the policy, controls all rights of ownership, and may terminate the benefits promised to the employee if the employee departs the company prior to retirement. The employer endorses a portion of the death benefit to the employee (the employee designates a beneficiary for this portion of the death benefit). Upon the death of the employee, the employee's beneficiary receives the designated portion of the death benefits and the employer receives the remainder of the death benefits.

The employee's portion of the death benefits commonly is based on one of the following:

- a. Amounts that exceed the gross premiums paid by the employer
- b. Amounts that exceed the sum of the gross premiums paid by the employer plus an additional fixed or variable investment return on those premiums
- c. Amounts equal to a multiple of the employee's base salary at retirement or death (for example, twice the employee's base salary).

2. Collateral Assignment Split-Dollar Policies – An employer purchases a life insurance policy to insure the life of an employee and transfers ownership of the policy to the employee. The employee (or the employee's estate or trust) owns the insurance policy and controls all rights of ownership. The employer usually pays all or a substantial part of the premium. The employee (or the employee's estate or trust) irrevocably assigns a portion of the death benefits to the employer as collateral for the employer's interest in the policy. Amounts due to the employer vary but, typically, the employer is entitled to receive a

portion of the death benefit equal to the premiums paid by the employer or premiums paid plus an additional fixed or variable return on those premiums. Upon retirement, the employee may have an option to buy the employer's interest in the insurance policy.

These basic arrangements often include additional provisions. For example, under an endorsement type policy, the employer may be required to provide life insurance coverage to a specific employee for a specified period. These split-dollar arrangements may include an *option-to-purchase* provision and/or a *comparable-coverage* provision. Under an option-to-purchase provision, the employer is required to offer the insured employee the option to purchase the policy before the employer could sell, surrender, or otherwise transfer the policy. The employee's purchase price often is the current cash surrender value of the policy. Under a comparable-coverage provision, the employer is required to maintain comparable coverage for the insured employee if the employer decides to switch the policy to a different carrier. These provisions provide the employee with the security that benefits will continue and the employer with the ability to switch insurance carriers and to realize the cash surrender value of a policy.

Additionally, payments of insurance premiums may take a number of different forms including the payment of a single premium or a series of future payments.

Accounting Literature – Life Insurance

In 1984, the AICPA released Issues Paper, "Accounting for Key-Person Life Insurance,"² which acknowledged that there were questions about the accounting for the deferred compensation elements of life insurance arrangements. However, that Issues Paper did not provide specific guidance on the accounting for the deferred compensation and postretirement benefit aspects of split-dollar life insurance arrangements. Additionally, the Issues Paper specifically noted that the normal methods of accounting for deferred compensation arrangements may not be appropriate for "complex" split-dollar arrangements.

In 1985, the FASB issued Technical Bulletin 85-4, which provides guidance on the accounting for the investment in life insurance (the asset) and requires that the amount that could be realized under the insurance contract as of the date of the financial statements be reported as an asset.

² This Issues Paper was the predecessor and was used as the basis for the conclusions, of Technical Bulletin 85-4.

Additionally, the change in the cash surrender or contract value during the period is an adjustment of premiums paid in determining the expense or income recognized for the period. Although footnote 1 in Technical Bulletin 85-4 acknowledges that life insurance may be purchased to fund deferred compensation arrangements or postemployment death benefits, it does not address the recognition of compensation costs associated with those benefits.

Accounting Literature – Deferred Compensation and Postretirement Benefits

Although neither of the following is specific to split-dollar life insurance arrangements, APB Opinion No. 12, *Omnibus Opinion – 1967*, provides guidance on the accounting for deferred compensation contracts with individual employees if those contracts, taken together, do not constitute a plan and FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*, provides guidance on the accounting for postretirement benefits that are part of a plan for retirees, but are not part of a pension plan.

Opinion 12 requires deferred compensation costs to be recognized over the service period in a systematic and rational manner. At the end of the service period (the full eligibility date as defined in Statement 106³), the accrued amount should equal the then present value of the benefits expected to be provided to the employee and the employee's beneficiaries. For example, future payments, including death benefits, to be paid to the employee and the employee's beneficiaries should be accrued over the service period such that a liability at the end of the service period exists in the amount of the present value of those payments.

Under Statement 106, an entity should recognize and measure the obligation for postretirement benefits based on the actuarial present value of all future benefits attributed to an employee's service rendered to that date (Statement 106 provides measurement guidance). Statement 106 requires an employer to attribute the costs of those postretirement benefits over the required service period.

³ FAS 106 defines *full eligibility date* as "the date at which the employee has rendered all the service necessary to have earned the right to receive all of the benefits expected to be received by the employee (including any beneficiaries and dependents expected to receive benefits)."

Statement 106 provides guidance on the treatment of insurance contracts, which are defined as contracts in which an insurance company unconditionally undertakes a legal obligation to provide specified benefits to specific individuals in return for a fixed premium. Paragraph 67 of Statement 106 states that benefits covered by insurance contracts shall be excluded from the accumulated postretirement benefit obligation, unless the contract contains a participation right (as defined in Statement 106). Additionally, paragraph 70 of Statement 106 states that the cost of postretirement benefits attributed to service in the current period should be the cost of purchasing the insurance coverage.

Accounting Issue and Alternatives

As noted above, there is diversity in the accounting for the deferred compensation and postretirement benefit aspects of split-dollar life insurance arrangements. Some believe that Opinion 12 or Statement 106 (if the arrangement is part of a plan, Statement 106 would be applicable, and Opinion 12 would be applicable otherwise) should be applied and that a liability for the future death benefit (or the future cost of insurance premiums, depending on the substance of the benefit communicated to the employee) should be recognized. However, some believe that the employer's obligation to provide the death benefit is effectively settled when the insurance policy is purchased and, therefore, no liability for the future benefit should be recognized.

Others believe that the recognition and measurement of a liability depends on the type of arrangement—that is, whether it is an endorsement-type arrangement or a collateral-type arrangement. For collateral-type arrangements, the employee owns the policy and the premiums paid by the employer are effectively advances (loans) to the employee; therefore, some believe that there is no obligation to recognize a liability for either the death benefit or the future premium payments.

Issue: The employer's accounting for the deferred compensation or postretirement benefit aspects of a split-dollar life insurance arrangement.

View A: An employer always should recognize a liability for the payment of future death benefits associated with a split-dollar life insurance arrangement in accordance with Opinion 12 or Statement 106, as applicable.

View B: An employer should recognize a liability for the future death benefits in accordance with Opinion 12 or Statement 106 only if it owns and controls the life insurance policy (for example, an endorsement-type arrangement).

View C: An employer should recognize a liability for future benefits or premiums based on the substantive agreement with the employee, regardless of the type of arrangement (collateral or endorsement). If the arrangement is to provide a death benefit, the employer should recognize a liability for the future death benefit in accordance with Opinion 12 or Statement 106. If the arrangement is to provide funds to the employee to purchase a life insurance policy, the employer should recognize a liability for the future premium payments in accordance with Opinion 12 or Statement 106. If the arrangement is to provide the employee with the investment value of the policy, the employer should recognize a liability based on the value of the benefit in accordance with Opinion 12 or Statement 106.

View D: An employer should recognize the change in the cash surrender value or contract value (the life insurance asset) during the period as an adjustment to the premiums paid in accordance with Technical Bulletin 85-4. No liability recognition is required because the purchase of the insurance effectively settles the obligation.

Agenda Committee Decisions: *The Agenda Committee decided to add this Issue to the EITF Agenda.*

Criteria for Adding Items to the EITF Agenda

1. Does the issue have widespread relevance?

This issue has widespread relevance. Small and mid-sized companies use split-dollar life insurance arrangements as investment vehicles and to compensate employees. Although particularly common in banking, split-dollar life insurance arrangements also are used by entities in other industries.

2. Is there significant diversity in practice?

There is significant diversity in practice. Questions about the accounting for split-dollar life insurance arrangements have arisen in practice and those questions have resulted in diversity in practice. That diversity is evidenced by the recent potential new issues considered by the Agenda Committee, which have focused on the accounting for the asset and specific arrangement terms. However, the diversity in practice also relates to the recognition of liabilities and compensation costs. Guidance from the EITF could eliminate the current diversity in practice and improve financial reporting.

3. Is there conflicting guidance in existing GAAP?

There is no conflicting guidance existing in GAAP; however, there are differing views about the application of GAAP.

4. Is it likely the EITF will be able to resolve the issue in less than one year?

The EITF will resolve the issue in less than one year.

5. Is the issue related to a current FASB project? If so, is there a pressing need to provide related guidance on a more timely basis than that expected from the FASB's activities?

This issue does not relate to a current FASB project. The Board asked the FASB staff to develop a formal agenda request on issues related to the guidance in Technical Bulletin 85-4. It is expected that the agenda request will address only asset recognition and measurement. Accordingly, this potential issue does not address the same issues that the Board may consider.

6. Is it reasonably likely that the FASB would conclude that only one answer is acceptable?

There may be alternative views that Board members could find acceptable.

7. Is there an opportunity through addressing the issue to converge U.S. practices with international practices?

There currently is not a direct conflict within existing U.S. GAAP and international practices.

2. Reconsideration of EITF Issue No. 04-6, "Accounting for Stripping Costs Incurred during Production in the Mining Industry"

Paragraph 4 of Issue 04-6 defines the production phase of a mine as the period beginning "when saleable minerals are extracted (produced), regardless of the level of production or revenues."

A number of mining companies, however, believe that development of a mine is substantially complete when removal of overburden and other waste materials has been completed, which often involves removal of incidental mineral material when gaining access to the primary deposit. These mining companies believe that the production phase cannot commence until the activities required to access the mineral deposit, including the removal of overburden and waste material that contains incidental mineral material, are completed.

These mining companies believe that the consensus in Issue 04-6 regarding the definition of the development phase of a mine is inconsistent with FASB Statement No. 34, *Capitalization of Interest Cost*, because Issue 04-6 takes a very narrow view of how development phase is interpreted while Statement 34 takes a much broader view. Statement 34 states that interest costs should be capitalized during the entire period required to get an asset ready for its intended use and clarifies that the activities necessary to get the asset ready are to be construed broadly.

In addition, coal mining companies believe that ARB 43 is the most appropriate model for attributing stripping costs to the coal inventory extracted because there is a uniform mineral dispersion directly associated with stripping efforts. However, the consensus in Issue 04-6 would require the advance stripping costs to be recognized prior to the extraction of the associated coal inventory, which would be contradictory to ARB 43.

The mining companies (including the coal mining companies) also point to the preliminary consensus reached by the Emerging Issues Committee of the Canadian Institute of Chartered Accountants in CICA Draft Abstract D56, *Accounting for Stripping Costs in the Mining Industry*, as another example of the inconsistencies between Issue 04-6 and Statement 34 or ARB 43. In D56, the Committee agreed that "stripping costs should be capitalized if the stripping activity can be shown to represent a betterment to the mineral property" which "occurs when the

stripping activity permits an increase in the output of the mine in future periods through providing access to additional sources of reserves that will be produced in future periods."

The FASB staff notes that the comment period for D56 concluded on November 15, 2005.

Lastly, these mining companies believe that under Issue 04-6, differing interpretations of "inventory produced (that is, extracted)" are occurring, which will result in diversity in practice, and therefore believe additional clarification is necessary. These companies point to the different storage methods used as well as certain legal restrictions on storage of "inventory produced."

The FASB staff has attached one of the original agenda requests related to this issue (see Exhibit 1, which is provided as a separate file).

Accounting Issues

Issue 1: Whether the EITF intended to modify the guidance provided in Statement 34 or in ARB 43.

Issue 2: In light of the recent preliminary consensus reached by the Emerging Issues Committee of the CICA and the consequential potential diversity between U.S. GAAP and International Accounting Standards, whether the EITF should reconsider its consensus for Issue 04-6.

Issue 3: Whether the EITF should further clarify the term "inventory produced."

Agenda Committee Decisions: *The Agenda Committee decided to not add this Issue to the EITF Agenda. However, the Agenda Committee agreed with the FASB staff that the production period does not yet commence if only incidental mineral material has been removed. Therefore, the FASB staff will clarify the language in Issue 04-6 to address the removal of overburden and waste that includes incidental mineral material.*

Criteria for Adding Items to the EITF Agenda

1. Does the issue have widespread relevance?

This issue has widespread relevance within the mining industry.

2. Is there significant diversity in practice?

When Issue 04-6 becomes effective, a number of mining companies believe that the interpretation of inventory produced will result in diversity in practice.

3. Is there conflicting guidance in existing GAAP?

Some mining companies argue that Issue 04-6 creates conflicting guidance in GAAP between Issue 04-6 and Statement 34 and ARB 43 (coal companies).

4. Is it likely the EITF will be able to resolve the issue in less than one year?

The EITF could resolve these issues in less than one year.

5. Is the issue related to a current FASB project? If so, is there a pressing need to provide related guidance on a more timely basis than that expected from the FASB's activities?

This issue does not relate to a current FASB project.

6. Is it reasonably likely that the FASB would conclude that only one answer is acceptable?

There may be alternative views that Board members could find acceptable.

7. Is there an opportunity through addressing the issue to converge U.S. practices with international practices?

The recent consensus reached in Issue 04-6 could result in diversity in practice between Canadian GAAP and U.S. GAAP, pending the final consensus in the Draft Abstract D56. The consensus could also result in diversity in practice between U.S. GAAP and International Accounting Standards.

Decision to Cancel the January 6, 2006 EITF Meeting

The Agenda Committee agreed with the EITF Chairman's recommendation to cancel the January 6, 2006 EITF meeting due to an insufficient number of agenda items. The next scheduled meeting of the EITF is March 15-16, 2006.

Status of Open Issues and Agenda Committee Items

The following represents the FASB staff's assessment of the status and immediate plans with respect to the open Issues on the Task Force's agenda. The Issues on the proposed agenda for the next meeting are considered either high priority issues or issues on which meaningful progress can be made within the staff's given complement of resources. The staff's prioritization of issues is based primarily on the FASB staff's understanding of the level of diversity in practice created by each respective Issue, the financial reporting implications of that diversity, the current interaction, if any, of the Issues with active Board projects, and current resource availability among the staff (with respect to both time and relevant technical expertise).

Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	EITF Liaison	FASB Staff	Immediate Plans	Due Date - Next Deliverable
05-1	Accounting for the Conversion of an Instrument That Becomes Convertible upon the Issuer's Exercise of a Call Option	11/04	3/05, 6/05, 9/05	3/06	Graziano	Oakley/ Sarno	The FASB staff will prepare an Issue Summary for the next meeting.	Next EITF meeting
05-H	Accounting for Payments Made by a Service Provider to Equipment Manufacturers and/or Retailers/Resellers of Specialized Equipment That Is Necessary for a Customer to Receive a Service from the Service Provider	10/05	N/A	03/06	Hauser	Cosper/ Beswick	The FASB staff will prepare an Issue Summary for the next meeting.	Next EITF meeting
06-A	Accounting for the Deferred Compensation and Postretirement Benefit Aspects of Split-Dollar Life Insurance Arrangements	11/05	N/A	03/06	TBD	Moss/ Trench	The FASB staff will prepare an Issue Summary for the next meeting.	Next EITF meeting

Other EITF Issues including Inactive Issues Pending Developments in Board Projects							
Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	FASB Staff	Immediate Plans	Due Date - Next Deliverable
00-18	Accounting Recognition for Certain Transactions involving Equity Instruments Granted to Other Than Employees	5/00	7/00, 7/01, 11/01, 1/02, 3/02	NA	Sarno	Pending further progress on Phase II of the Board's share-based payments project.	NA
	<i>The remaining issue in Issue 00-18 is Issue 3: For transactions that include a grantee performance commitment, how the grantee should account for the contingent right to receive, upon performing as specified in the arrangement, grantor equity instruments that are the consideration for the grantee's future performance. The Task Force asked the FASB staff to focus on improving the guidance (originally from Issue 96-18) used to determine the date at which a commitment for counterparty performance to earn the equity instruments is reached.</i>						
00-27	Application of EITF Issue No. 98-5, "Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios," to Certain Convertible Instruments	5/00	11/00, 1/01	Not scheduled	Richards	Pending further progress on Phase II of the Board's liabilities and equity project.	N/A

Other EITF Issues including Inactive Issues Pending Developments in Board Projects							
Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	FASB Staff	Immediate Plans	Due Date - Next Deliverable
02-D	The Effect of Dual-Indexation both to a Company's Own Stock and to Interest Rates and the Company's Credit Risk in Evaluating the Exception under Paragraph 11(a)(1) of FASB Statement No. 133, <i>Accounting for Derivative Instruments and Hedging Activities</i>	3/02	N/A	Not scheduled	Jacobs	Pending further progress on Phase II of the Board's liabilities and equity project.	N/A
03-15	Interpretation of Constraining Conditions of a Transferee in a Collateralized Bond Obligation Structure	11/02	N/A	Not scheduled	Lusniak	Pending developments in the Board's project on QSPE's and reconsideration by the FASB staff as to the extent of the issue.	N/A

Other EITF Issues including Inactive Issues Pending Developments in Board Projects							
Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	FASB Staff	Immediate Plans	Due Date - Next Deliverable
03-17	Subsequent Accounting for Executory Contracts That Have Been Recognized on an Entity's Balance Sheet	5/03	11/03	Not scheduled	Moss	Issue addresses the amortization of a recognized executory contract that has periods of both positive and negative cash flows. This issue is pending the Board's consideration of how the factors in paragraph 11(d) of Statement 142 should be evaluated in determining the useful life of an intangible asset (formerly EITF Issue 03-9).	N/A
04-7	Determining Whether an Interest Is a Variable Interest in a Potential Variable Interest Entity	5/04	6/04, 9/04, 11/04, 3/05	Not scheduled	Belcher	At its March 30, 2005 meeting, the Board agreed to add a project to provide guidance on the variability that should be considered when determining whether an interest is a variable interest. The FASB staff will ask the Task Force to remove this Issue from its agenda at a future meeting.	N/A

Other EITF Issues including Inactive Issues Pending Developments in Board Projects							
Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	FASB Staff	Immediate Plans	Due Date - Next Deliverable
05-4	The Effect of a Liquidated Damages Clause on a Financial Instrument Subject to EITF Issue No. 00-19, "Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock"	2/05	6/05, 9/05	N/A	Thuener/ Jacobs/ Richards	Pending further progress on a DIG Issue for determining whether a registration rights agreement is a derivative	March 2006 Meeting Materials

Issues Pending Further Consideration by the Agenda Committee							
Issue No.	Description	Date Added	Date(s) Discussed	Next Meeting	FASB Staff	Immediate Plans	Due Date - Next Deliverable
N/A	Application of EITF Issue No. 99-20, "Recognition of Interest Income and Impairment on Purchased and Retained Beneficial Interests in Securitized Financial Assets," When a Special-Purpose Entity Holds Equity Securities and Whether an Investment That Is Redeemable at the Option of the Investor Should Be Considered an Equity Security or Debt Security	9/00	N/A	Not scheduled	Jacobs	Pending consideration of an FASB project that may address the measurement of beneficial interests in securitized financial instruments.	Pending developments in a Board project