

TEXAS STATEWIDE TELEPHONE COOPERATIVE, INC.

LIFE INSURANCE FOR DIRECTORS



Presented by Wade Wilson, C.P.A.
Bolinger, Segars, Gilbert & Moss, L.L.P.
8215 Nashville Ave. ; Lubbock, Texas 79423
806-747-3806 www.bsgm.com



WHY PROVIDE LIFE INSURANCE FOR DIRECTORS?

- To insure the Company against the loss of a director.
- To provide a deferred compensation arrangement for the director.
- A combination of insuring the Company and providing a deferred compensation arrangement for the Director.

Types of Split Dollar Policies

- Endorsement
 - The **Company** owns and controls the policy.
- Collateral Assignment
 - The **employee** owns and controls the policy

3

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ENDORSEMENT TYPE POLICIES

- DIVERSITY IN PRACTICE
 - Prior to the issuance of EITF Issue No. 06-04 there was diversity in practice primarily in accounting for the deferred compensation and postretirement aspects of endorsement split-dollar insurance arrangements.
 - The standard is effective after 12/15/07.

4

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ENDORSEMENT TYPE POLICIES

Typical Policy Attributes

- Pays a single premium at inception of the policy.
- Enters a separate agreement that splits the policy benefits between the employer and the employee/director.
- The employer owns the policy, controls all rights of ownership, and may terminate the policy (and, in turn, the promised benefits).

5

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ENDORSEMENT TYPE POLICIES

Typical Policy Attributes

- The employer endorses a portion of the death benefits to the employee/director's designated beneficiary.
- Upon death of the insured the employee/director's beneficiary typically receives the designated portion of the death benefits directly from the insurance company and the employer receives the remainder.

6

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ENDORSEMENT TYPE POLICIES

Directors Portion of the Proceeds

- Commonly based on one of the following:
 1. Excess of policy proceeds over gross premiums paid by the employer.
 2. Excess of policy proceeds over gross premiums paid by the employer and an additional return on those premiums.
 3. Face amount of the death benefit under the policy, less the cash surrender value.
 4. A multiple of the insured's base salary.

7

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ENDORSEMENT TYPE POLICIES

Accounting Issue

- Whether the postretirement benefit associated with the benefit is effectively settled in accordance with SFAS 106 upon entering into such an arrangement.

8

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ENDORSEMENT TYPE POLICIES

EITF Consensus

- An employer should recognize a liability for future benefits (if, in substance, a postretirement benefit plan exists) or (if the arrangement is, in substance, an individual deferred compensation contract).

9

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ENDORSEMENT TYPE POLICIES

EITF Consensus

- For example, if the employer has effectively agreed to maintain a life insurance policy during the employee/director's retirement, the cost of the insurance policy during post retirement should be accrued.

10

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ENDORSEMENT TYPE POLICIES

EITF Consensus

- Similarly, if the employer has agreed to provide a death benefit, the employer should accrue, over the service period, a liability for the present value of the future death benefit.

ENDORSEMENT TYPE POLICIES

Each Case May be Different

- Issues to consider:
 - Will the benefit be provided in the event of default by the insurance company? If not it would indicate that the postretirement benefit is a promise to maintain a life policy during retirement.
 - Is the death benefit explicitly tied to an insurance policy? If not, the benefit is the death benefit.

ENDORSEMENT TYPE POLICIES DEFINITIONS

- Cash Surrender Value (CSV) – the amount of cash that may be realized by the owner upon surrender of the contract.
- Surrender Charge – A contractual fee imposed when a policy is surrendered.

13

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EXAMPLE

- FACTS
 - Purchase a \$100,000 life insurance
 - Death Benefit = \$100,000 plus premiums
 - Employer owns the policy and rights
 - Employer makes single premium of \$30,000
 - Annual insurance cost \$2,000
 - Director has no interest the cash value
 - Cash value equals the cash surrender value and is \$29,500 at the end of the period

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14

EXAMPLE

- **FACTS – Continued:**
 - The Company and director enter into a split-dollar agreement
 - Execute policy endorsement naming the beneficiary and amount of the benefit (this agreement binds the insurance company)
 - Benefit = Death Benefit less cumulative premiums.
 - If policy is surrendered, the policy terminates and the company has no further liability to the director.

EXAMPLE

- **FACTS – Continued:**
 - Upon death of the insured, the insurance company will make the respective death benefit payment directly to the director's beneficiary and to the employer.
 - The policy remains a general asset of the employer, fully subject to the claims of creditors.

JOURNAL ENTRIES

	<u>Account</u>	<u>Dr.</u>	<u>Cr.</u>
CSV of Life Insurance Contract	1410.000	\$30,000	
Cash in Bank	1120.000		\$30,000
To record the purchase of single premium life insurance contract.			

	<u>Account</u>	<u>Dr.</u>	<u>Cr.</u>
Gen & Admin – Executive – Dir	6720.000	\$2,000	
CSV of Life Insurance Contracts	1410.000		\$2,000
To record the annual cost of insurance.			

JOURNAL ENTRIES

	<u>Account</u>	<u>Dr.</u>	<u>Cr.</u>
CSV of Life Insurance Contract	1410.000	\$1,500	
Gen & Admin – Executive – Dir	6720.000		\$1,500
To adjust the asset account to equal the cash surrender value at period end. (\$30,000 -2,000+1,500 = \$29,500 = CSV)			

Note:

The insurance company is liable to pay the Company and the insured's beneficiary. Therefore the Company would only record increases in the cash surrender value to the point that the CSV = the total amount that the Company would receive from the insurance company in the event of death. If the insurance company pays the entire death proceeds to the Company, the Company should record the entire CSV and any amounts greater than what will be retained by the Company should be recorded as a liability to the insured's beneficiary.

JOURNAL ENTRIES

	<u>Account</u>	<u>Dr.</u>	<u>Cr.</u>
Cash in Bank	1120.000	\$30,000	
CSV of Life Insurance Contract	1410.000		\$29,500
Nonopr Inc & Expense – Gain on Life Insurance	7300.000		500

To record the receipts from the insurance company upon death of the insured.

Note:

The insurance Company is liable to separately pay the Company and the insured's beneficiary. The beneficiary will receive (\$100,000 face value plus cumulative premiums paid of \$30,000 = \$130,000 less amount paid to the Company of \$30,000 for a net of \$100,000).

EXAMPLE

- **FACTS – Continued:**
 - Now assume that the policy endorsement agreements calls for a benefit to the director in the amount of \$60,000 which vest evenly over a five year period. The benefit will be paid by the Company.
 - The director dies at the end of the second period.
 - The CSV = \$31,000 at time of death.

JOURNAL ENTRIES

	<u>Account</u>	<u>Dr.</u>	<u>Cr.</u>
Accrued Deferred Comp – Dir	4300.000		\$24,000
Gen & Admin – Executive – Dir	6720.000	\$24,000	

To record the vested portion of the deferred compensation agreement to the director. (\$60,000/5x2=\$24,000)

	<u>Account</u>	<u>Dr.</u>	<u>Cr.</u>
Cash in Bank	1120.000	\$130,000	
CSV of Life Insurance Contract	1410.000		\$31,000
Nonopr Inc & Expense – Gain on Life Insurance	7300.000		99,000

To record the receipts from the insurance company upon death of the insured.

JOURNAL ENTRIES

	<u>Account</u>	<u>Dr.</u>	<u>Cr.</u>
Cash in Bank	1120.000		\$24,000
Accrued Deferred Comp – Dir	4300.000	\$24,000	

To record the payment of the benefit to the directors beneficiary upon death of the insured.

Note:

The insurance Company is not liable to separately pay the insured's beneficiary. Therefore the Company is liable for the amount due to the beneficiary.

Other Considerations

- If the Company is liable to continue paying life insurance premiums after the director retires, then it has a postretirement liability that should be recorded. (In our example the Company will be reimbursed through the death benefits the offsetting journal entry account would be to account 1438 – Deferred Charges since future premiums are expected to be recovered)

Other Considerations

- In most cases directors serve until death or are defeated in an election. Depending on the Company's director tenure policies and past experience, it may be argued that it is impossible to determine a projected retirement date for directors.

IRS Considerations

- It is **very important** that the insured **not** have the ability to control or alter the plan pay out in any way. If the insured has this ability it will likely trigger immediate income recognition to the insured for purposes of reporting to the IRS.

QUESTIONS

