Accounting for Life Insurance Contracts with Cash Surrender Value – Background Information and Basis for Conclusions

Accounting Guideline AcG-21

FOREWORD

In September 2024, the Accounting Standards Board (AcSB) released ACCOUNTING GUIDELINE AcG-21, *Accounting for Life Insurance Contracts with Cash Surrender Value* in Part II of the CPA Canada Handbook – Accounting. The AcSB has approved for publication the contents of this document setting out its rationale for the Guideline.

Background Information and Basis for Conclusions documents are sources of generally accepted accounting principles, as described in GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section 1100 in Part II of the Handbook. These documents are intended to help readers understand how the AcSB reached its conclusions, but they do not include explanations of requirements or guidance on the application of the relevant Section or Accounting Guideline.

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INTRODUCTION

1 This document summarizes considerations that the AcSB deemed significant in reaching its conclusions as it developed AcG-21, *Accounting for Life Insurance Contracts with Cash Surrender Value* in Part II of the CPA Canada Handbook. This document sets out the reasons the Board undertook the project to develop the Guideline, the process of research and deliberation, the key decisions made and the principal reasons for adopting the positions taken and rejecting others. Individual Board members gave some factors greater weight than other ones.

2 Nothing in this document is to be taken as overriding the requirements of the Handbook. However, the discussion may help readers understand how the AcSB developed AcG-21 and the Board's intent with respect to interpreting and applying this Guideline.

BACKGROUND

3 During 2017 and 2018, the AcSB heard through consultations with its Private Enterprise Advisory Committee and Not-for-Profit Advisory Committee (Advisory Committees) that there was diversity in practice related to accounting for life insurance contracts with cash surrender value. Some enterprises did not recognize an asset for cash surrender value because FINANCIAL INSTRUMENTS, Section 3856, specifically scopes out insurance contracts, including the cash surrender value of a life insurance policy. Other enterprises recognized an asset for cash surrender value based on the conclusion that it is an economic resource controlled by the entity and therefore meets the definition of an asset in FINANCIAL STATEMENT CONCEPTS, paragraphs 1000.24-27. In February 2022, in light of feedback from its Advisory Committees, the AcSB approved a project to develop guidance on accounting for life insurance contracts with cash surrender value.

4 The AcSB sought feedback from its Advisory Committees to better understand existing practice and challenges related to accounting for the cash surrender value in life insurance contracts. The AcSB also considered other standard setters' work. Under IFRS® Accounting Standards, no prescriptive guidance is available for such contracts. Under U.S. generally accepted accounting principles, the amount that could be realized under the insurance contract is reported as an asset and the change in cash surrender value reported as an adjustment to premiums paid or recognized as income.

5 Based on this research, the AcSB identified the following issues with accounting for life insurance contracts with cash surrender value:

(a) *Cash surrender value meets the definition of an asset:* Section 3856 scopes out life insurance contracts with cash surrender value. However, some preparers concluded that cash surrender value meets the definition of an asset since the owner of the policy controls when the cash surrender value is realized. This resulted in diversity in practice as to recognition of cash surrender value as an asset.

(b) *Measurement of cash surrender value asset:* Cash surrender value was often measured at the cash surrender amount, which is the amount that would be received upon termination of the policy prior to the death of the insured. This measurement is inconsistent with guidance in Section 3856 that requires initial measurement of financial instruments acquired in an arm's length transaction at fair value.

(c) *Presentation of insurance premiums and change in cash surrender value:* When an enterprise purchases a life insurance policy with cash surrender value, the insurance company allocates part of the premium payment to cost of insurance and the remainder to cash surrender value. The enterprise then earns investment income on the amounts allocated to cash surrender value. The policy holder cannot always identify the cost of the insurance portion of the premium. This resulted in diversity in practice for the recognition of insurance expense and change in cash surrender value in the income statement.

6 After considering its Advisory Committees' advice, the AcSB approved a project with the following objectives:

(a) address the diversity in practice related to recognition and measurement of cash surrender value as an asset;

(b) address issues related to presentation of policy premiums and change in cash surrender value; and

(c) develop disclosure requirements that provide decision-useful information to users.

7 In November 2023, the AcSB issued its Exposure Draft, "Accounting for Life Insurance Contracts with Cash Surrender Value." In developing the proposals, the Board sought its Advisory Committees' advice. These Advisory Committees include financial statement users, auditors and preparers, with a range of backgrounds and experience from across Canada. Advisory Committee members include representatives from organizations of differing sizes and in a variety of industries.

8 The AcSB received eight comment letters and 135 survey responses from interested and affected parties from across Canada. Respondents generally supported the proposals in the Exposure Draft. However, respondents provided feedback on the proposed accounting guideline and suggested changes to some of the proposals. The specific issues addressed in this project, including the comments received on the Exposure Draft and any changes made in response to those comments, are highlighted in the subsequent sections.

APPLICABILITY TO NOT-FOR-PROFIT ORGANIZATIONS (NFPOS)

9 NFPOs apply Part II of the Handbook to the extent that Part II standards address topics not addressed in Part III of the Handbook. AcG-21 addresses the specific topic of life insurance contracts with cash surrender value, which is not addressed in Part III of the Handbook. Therefore, NFPOs are required to apply the Guideline. Accordingly, while

developing the Guideline, the AcSB consulted its Not-for-Profit Advisory Committee on any unique considerations for NFPOs applying this Guideline (See "Contributed insurance contracts.")

EFFECTS ANALYSIS

10 AcG-21 aims to:

(a) enhance the relevance and usefulness of financial information by:

(i) improving consistency of recognition, measurement and presentation; and

(ii) requiring disclosure of information that will provide decision-useful information; and

(b) reduce the cost of preparing financial statements by providing clear guidance on when to recognize cash surrender value as an asset and how to measure the amount.

Recognition and measurement of cash surrender value as an asset

11 AcG-21 is not expected to change current practice for many enterprises that already recognize life insurance contracts with cash surrender value. The AcSB heard from its Advisory Committees that many entities that recognize cash surrender value as an asset measure the asset at the amount that would be realized on termination of the insurance policy prior to the death of the insured.

12 The AcSB acknowledges that AcG-21 will result in changes for enterprises that currently do not recognize cash surrender value as an asset or that measure cash surrender value at an amount other than the cash surrender amount, such as fair value or amortized cost. The Board thinks recognizing cash surrender value as an asset when an enterprise is the owner and beneficiary of the insurance contract accurately reflects the asset controlled by the enterprise.

13 The AcSB's view is that measurement at the amount that would be received upon termination of the insurance contract provides the most useful information to users without adding undue cost to preparers. For entities not currently recognizing cash surrender value in accordance with AcG-21, some additional costs may be associated with implementing and applying these requirements. However, the Board heard that cash surrender value is often readily available via the entity's insurance provider and therefore the Board does not expect significant costs associated with this requirement. Recognition of this asset provides important liquidity information to financial statement users, and therefore the Board thinks the benefit of recognizing this asset outweighs the cost.

Presentation and disclosure

14 The AcSB acknowledges that AcG-21 will result in a reallocation in the income statement for enterprises that currently report policy payments and change in cash surrender value at gross amounts. However, these proposals will not result in a change to net income or retained earnings for most enterprises. The Board thinks that providing guidance on presentation and disclosure for life insurance contracts with cash surrender value will reduce diversity in practice and support consistency of financial reporting. Also, the Board thinks users will benefit from better transparency and consistency in the financial statements.

Conclusion on effects analysis

15 Having considered the effects of AcG-21, as discussed above, the AcSB thinks this Guideline will improve financial reporting of private enterprises and NFPOs.

PURPOSE AND SCOPE

16 The AcSB sought to clarify the accounting for cash surrender value, including recognition of cash surrender value as an asset and measurement. The Board also sought to clarify the presentation of income or expense from insurance contracts with cash surrender value.

17 The AcSB considered whether guidance on accounting for cash surrender value could be provided within an existing Handbook Section, such as Section 3856, or whether the guidance should be provided in a separate Section or Accounting Guideline. Although cash surrender value may meet the definition of a financial instrument, the Board was concerned that amending Section 3856 would create application challenges as the recognition and measurement of cash surrender value would be inconsistent with the existing recognition and measurement guidance for financial instruments. As a result, the Board chose to provide guidance in an Accounting Guideline.

18 The AcSB developed AcG-21 to address the issues identified with accounting for life insurance contracts with cash surrender value, as noted in paragraph 6 of the Basis for Conclusions. Specifically, the Guideline addresses recognition and measurement of cash surrender value as an asset, presentation of life insurance policy premiums and change in cash surrender value, and disclosures that provide decision-useful information to users. The Board concluded that addressing these issues in a Guideline limited to life insurance contracts that include cash surrender value, from the policy owner's perspective, would limit the risk of unintended consequences on other parts of Part II and Part III.

19 The AcSB considered whether the Guideline's scope should include non-life insurance contracts that may include cash surrender value. The Board heard that there is diversity in practice for accounting for cash surrender value in a life insurance contract due to the scope exclusion in paragraph 3856.03(d). The Board had not heard that there are challenges or diversity in practice related to accounting for non-life insurance contracts. Also, the Board thought that expanding the scope to include non-life insurance products could result in preparers applying the Guideline to amounts that are not cash surrender value, such as potentially refundable premiums or the prepaid portion of insurance expense. Additionally, the Board chose to limit the Guideline's scope to life insurance policies issued by a regulated insurance

provider to avoid introducing confusion about accounting for other types of insurance products or amounts that are not life insurance.

RECOGNITION

Cash surrender value asset

20 The AcSB concluded that cash surrender value in a life insurance policy meets the definition of an asset because:

(a) the cash surrender value provides a future cash flow that the enterprise can access at any time;

(b) the enterprise can control access to the cash surrender value in that only the enterprise can access the cash flow; and

(c) the transaction giving rise to the right to the benefit occurred when the enterprise purchased the policy or received an existing policy (as a transfer from the owner or as a contribution).

21 The AcSB considered whether it would be possible to limit the Guideline's scope to only life insurance policies where the entity will receive the cash surrender value upon death of the insured. The Board determined that this would require preparers to analyze each insurance contract to determine whether cash surrender value is paid or forfeited on death. The Board thought this analysis may be unnecessarily complex and difficult to perform for many entities.

22 The AcSB determined that requiring the policy owner to also be the beneficiary will ensure that cash surrender value is only recognized as an asset when the owner is guaranteed to receive the cash surrender value, including on the death of the insured. This limitation will also reduce complexity to preparers by eliminating the need to analyze insurance policies to determine the disposition of cash surrender value on the death of the insured.

23 Some Exposure Draft respondents suggested that AcG-21 should also include guidance on recognition of life insurance and other insurance contracts that meet the definition of an asset. The AcSB concluded that insurance contracts that do not include a cash surrender value component would not result in an asset as the enterprise would not control access to the death benefit or policy face value. Consistent with this analysis, the Board decided not to expand the Guideline's scope to include insurance policies that do not include cash surrender value.

MEASUREMENT

24 The AcSB considered the following alternative bases under which cash surrender value could be measured:

(a) cost (either the total premiums paid or the premiums component specific to the cash surrender amount);

(b) fair value; or

(c) cash surrender amount.

25 The AcSB considered whether the initial cost of the asset could be the total insurance premiums paid. Alternatively, the cost could be the amounts contributed by the policy owner less the portion specific to the cost of insurance. Based on consultation with the Advisory Committees, the Board heard that the enterprise may not have the information readily available to determine the contributed amounts for the insurance versus the cash surrender value. As a result, the Board determined that using cost as the measurement basis for the asset would be unfeasible. Additionally, the Board heard that cost would not provide decision-useful information as it would not reflect the cash flows received on termination and lending decisions are generally based on the cash surrender amount.

26 The AcSB considered whether cash surrender value could be measured at fair value. The Board noted that determining fair value of cash surrender value could require a complex analysis of underlying assumptions about future cash flows and discount rates applied to the future death benefit. The Board thought fair value would not be relevant to users of financial statements, particularly lenders that do not rely on the fair value of the contract in their lending decisions as lending is generally based on a percentage of the cash surrender amount, and fair value would not reflect the cash flows that would be received on termination. Therefore, the Board concluded that measuring fair value of cash surrender value would not justify the cost and complexity of determining fair value.

27 The AcSB considered whether cash surrender value could be measured at the cash surrender amount specified in the insurance contract or provided by the insurance provider. Cash surrender amount represents the amount that the policy holder would receive if the policy were terminated prior to the death of the insured. The Board noted that this amount is typically readily available from the insurance provider and the amount can be verified with minimal effort or cost. Also, the Board identified that this amount provides the most decision-useful information as lending decisions are generally based on a percentage of the cash surrender amount.

28 The AcSB concluded that cash surrender value should be measured at the cash surrender amount. The Board observed that measurement at cash surrender amount is consistent with the concept of measurement in FINANCIAL STATEMENT CONCEPTS, paragraph 1000.49(b), as cash surrender value is the realizable value.

29 Most Exposure Draft respondents agreed with the AcSB's proposal to measure cash surrender value at the realizable amount. However, some Exposure Draft respondents suggested allowing an option to measure cash surrender value at fair value. These respondents noted that fair value measurement would be consistent with measurement of financial instruments in Section 3856 and contributions accounted for in accordance with CONTRIBUTIONS – REVENUE RECOGNITION, Section 4410.

30 The AcSB considered whether an option to measure at fair value would provide decision-useful information. As noted in paragraphs 25-27 above, the Board heard that lending decisions are generally based on the cash surrender amount and

not fair value. Additionally, the fair value of a contribution can be equivalent to the realizable value or replacement cost of the contributed item on the contribution date. The Board thought that measurement of contributions of life insurance policies to a NFPO at cash surrender amount would be consistent with measurement of contributions at realizable value.

31 Additionally, the AcSB determined that allowing an accounting policy choice for measurement of cash surrender value would result in a loss of comparability between entities, as similar entities would measure the same asset at different amounts. There would also be a loss of comparability against entities in other jurisdictions that require measurement at the realizable amount.

32 Consistent with this analysis, the AcSB concluded that measurement at cash surrender amount would provide the most decision-useful information.

33 Several Exposure Draft respondents requested clarification on whether subsequent measurement occurred on the policy anniversary date or the entities' reporting date. The AcSB agreed that clarification was needed and decided to revise the measurement paragraph to include that subsequent measurement occurs at each reporting date.

PRESENTATION

Change in cash surrender value and policy premiums

34 The AcSB considered the following presentation methods for change in cash surrender value and insurance premiums:

(a) presenting change in cash surrender value as income and policy premiums as insurance expense at gross amounts;

(b) presenting the net of insurance policy premiums and change in cash surrender value as insurance expense. When change in cash surrender value exceeds policy premiums, the enterprise would report a net credit in insurance expense; and

(c) presenting the net of insurance policy premiums and change in cash surrender value as other income when the net amount is a credit and as an expense when the net amount is a debit.

35 The AcSB heard that presenting policy premiums and change in cash surrender value at gross amounts overstates insurance expense. A portion of the policy payment may be allocated to cash surrender value by the insurance provider; therefore, the policy payment is not entirely an expense. Similarly, presentation at gross amounts would overstate change in cash surrender value as the change consists of investment income earned and contributions from policy premiums.

36 The AcSB heard that presenting a net amount in insurance expense is reasonable in the early years of the insurance contract when premiums exceed the change in cash surrender value. However, in later years of the contract, the change in cash surrender value often exceeds the premiums paid resulting in a net credit. The Board concluded that presenting a credit to insurance expense in periods when change in cash surrender value exceeds policy premiums would be confusing to users.

37 Based on this information, the AcSB decided to require recognition of policy premiums and change in cash surrender value on a modified net basis. Under this method, the net of policy premiums and change in cash surrender value is reported as income when the amount is a net credit and as an expense when the amount is a net debit. The Board thinks this method avoids the confusion created by presenting a credit to insurance expense while also eliminating the concern that recognizing change in cash surrender value and policy premiums at gross amounts may overstate income and expense.

38 Most Exposure Draft respondents agreed with the AcSB's proposal to present change in cash surrender value and policy payments on a net basis. However, some respondents suggested that presenting policy payments at gross amounts provides useful information about cash outflows and the obligations to maintain the insurance policy. The Board heard that financial statement users who are interested in this information are typically able to request details of policy payments. The Board therefore concluded that disclosure or presentation of policy payments would result in additional administrative burden to many enterprises whose users would not benefit from the added disclosure and decided not to require disclosure of policy payments.

Classification

39 The AcSB considered whether preparers would benefit from guidance on classification of cash surrender value as either a current or long-term asset. The Board determined that classification would depend on whether the policy owner intends to maintain or terminate the policy. The Board heard that guidance in CURRENT ASSETS AND CURRENT LIABILITIES, Section 1510, can be applied to cash surrender value when determining classification in the balance sheet. As a result, the Board concluded it is not necessary to provide guidance on classification of the asset as preparers will apply judgment and consider the circumstances and intention for each policy when determining the appropriate classification of a cash surrender value asset.

40 Several Exposure Draft respondents suggested that guidance on classification of change in cash surrender value and policy premiums in the income statement and statement of cash flows would improve consistency of financial reporting. The Board determined that cash flow and income statement presentation would be dependent on the specific facts and circumstances for each policy and each entity. Entities using insurance policies as an investment would likely consider payments and redemptions to be investing activities in the statement of cash flows and other income in the

income statement. Conversely, entities that purchase insurance as a condition of financing may consider the payments to be operating or financing activities. Additionally, the entity's use of insurance may change over time.

41 Consistent with this analysis, the AcSB decided not to provide guidance on cash flow or income statement classification to allow entities to choose the presentation that best reflects their use of insurance. The Board determined that this solution is consistent with other standards in Part II and Part III, as most standards do not provide prescriptive guidance on income statement or cash flow presentation.

Disclosure

42 The AcSB heard that life insurance contracts with cash surrender value are often not visible in the financial statements. The Board also heard that users will often request specific details of insurance policies when relevant to their decisions. Based on this feedback, the Board developed disclosures that will alert users' attention to the existence of life insurance policies with cash surrender value and provide decision-useful information without being onerous to preparers.

43 The AcSB heard that entities often combine cash surrender value with investments or other assets, and policy premiums and changes in cash surrender value with other income or insurance expense. The Board considered whether requiring separate presentation of the face of the balance sheet for cash surrender value, and on the face of the income statement for the net of policy premiums and change in cash surrender value, would provide decision-useful information. The Board heard that disclosing these amounts would be useful for trending analysis. However, the Board observed that entities are not required to present other similar amounts (e.g., insurance expense) separately on the face of the financial statements. Therefore, it would not be appropriate to require separate presentation of these amounts. To ensure that users can identify the location of these amounts in the financial statements, AcG-21 requires disclosure of the captions including these amounts in the financial statements, if not presented separately.

44 The AcSB considered whether disclosure of the amounts of transactions affecting cash surrender value during the period would provide useful information for trending and comparison purposes. The change in cash surrender value may include:

(a) the portion of policy premiums allocated to cash surrender value by the insurance provider;

(b) investment gains and losses on cash surrender value; and

(c) acquisitions of new insurance policies and terminations of existing policies.

45 To provide information on the transactions that contribute to the change in cash surrender value, the AcSB proposed to require disclosure of the amounts of acquisitions and terminations of life insurance policies with cash surrender value during the period. The Board thought this disclosure would help users understand the enterprise's transactions and how they contributed to the change in the cash surrender value balance.

46 Exposure Draft respondents noted that disclosure of the amounts of acquisitions and terminations of life insurance policies with cash surrender value during the period would not provide additional decision-useful information as these amounts would be included in other areas of the financial statements. For example, terminations would appear in the statement of cash flows and contributions would appear in revenue of NFPOs and in equity of for-profit entities. Respondents thought that the cost and complexity of this disclosure would outweigh the benefit. In consideration of this feedback, the AcSB decided to not require disclosure of the amounts of acquisitions and terminations of life insurance policies with cash surrender value during the period.

47 The AcSB considered whether disclosing the measurement basis of cash surrender value would provide useful information for readers to understand the financial statements. AcG-21 requires cash surrender value to be measured at the cash surrender amount and does not provide options or alternative measurement bases. The Board concluded that disclosure of the measurement basis would not provide decision-useful information since all cash surrender value assets will be measured in the same way.

EFFECTIVE DATE

48 The Exposure Draft proposed that AcG-21 would be effective for fiscal years beginning on or after January 1, 2025. The AcSB thought that this would allow sufficient time for preparers to implement the Guideline based on the understanding that the proposed accounting treatment was consistent with current practice for many entities. Some Exposure Draft respondents noted that the proposed effective date would not provide sufficient time for preparers to obtain information necessary to implement the Guideline retrospectively, and for users to understand the Guideline. In response to these concerns, the Board decided to defer the effective date of AcG-21 by one year to fiscal years beginning on or after January 1, 2026.

TRANSITION

49 The Exposure Draft proposed that the Guideline be applied retrospectively to insurance policies that exist and have a cash surrender value on or after the beginning of the earliest period presented in the financial statements in which the enterprise first applies the Guideline. The AcSB thought that applying the proposed Guideline would result in improvements to financial reporting and that retrospective application would be useful since it would provide comparable information for the prior period. The Majority of Exposure Draft respondents agreed with this proposal.

CONSEQUENTIAL AMENDMENTS

First-time adoption

50 Exposure Draft respondents suggested that preparers would benefit from allowing the transition relief in AcG-21 to be applied on a first-time adoption of Part II or Part III of the Handbook. The AcSB acknowledged that this transition relief would benefit preparers and provided consequential amendments to FIRST- TIME ADOPTION, Section 1500, and FIRST-TIME ADOPTION BY NOT-FOR-PROFIT ORGANIZATIONS, Section 1501, to allow application of the AcG-21 transition provisions on a first-time adoption.

Business combinations and combinations between NFPOs

51 The AcSB decided to make consequential amendments to BUSINESS COMBINATIONS, Section 1582, and COMBINATIONS BY NOT-FOR-PROFIT ORGANIZATIONS, Section 4449, to provide an exception to the requirement to measure identifiable assets at their acquisition-date fair values for cash surrender value. These amendments require measurement of cash surrender value at the carrying amount recognized in the balance sheet of the transferred business. The Board thought this exception will eliminate challenges resulting from initial measurement at fair value when cash surrender value is subsequently measured at the cash surrender amount.

Contributed insurance contracts

52 NFPOs often receive donations of life insurance policies with cash surrender value as part of planned giving initiatives. The AcSB heard that there was diversity in practice, as some NFPOs recognize a contribution when the ownership of the life insurance policy is transferred to the NFPO while others recognize a contribution only upon receipt of the death benefit.

53 As discussed above, the AcSB concluded that cash surrender value that meets the requirements of AcG-21 is an asset. Accordingly, contributions of such policies should be recognized on the date the donor transfers ownership of the policy to the NFPO. To remove ambiguity and ensure guidance is consistently applied, the Board decided to make a consequential amendment to Section 4410 to allow an exception to the requirement to measure contributions at fair value when a NFPO receives a contribution of a life insurance policy with cash surrender value. The Board determined that this exception will eliminate challenges that would result from initial measurement at fair value when cash surrender value is subsequently measured at the cash surrender amount.

EXPOSURE FOR COMMENT

54 After resolving the issues arising from the exposure-draft process, the AcSB considered, as part of its due process, whether the revisions to the proposals should be exposed for comment.

55 The revisions have been highlighted in the relevant sections throughout this Basis for Conclusions. These revisions are clarifications based on feedback received from interested and affected parties. Other than clarifications already highlighted in this document, only minor drafting changes were made. Therefore, the AcSB decided there was no need for re-exposure.