

# INITIATIVE

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## Accounting for Corporate Life Insurance

When a life insurance policy is acquired by a corporation, it is important to properly record the purchase, the premium payments and any build up of contract cash surrender value ("CSV") in the books of the corporation.

The International Financial Reporting Standards (IFRS) and Accounting Standards for Private Enterprises are silent as to the financial reporting of corporate owned life insurance. Guidance in respect of accounting for a life insurance policy can be taken from the United States, where the financial accounting standards board has released a statement in this regard. The following are examples of how to account for corporate owned life insurance policies.

### During the Life Time of the Life Insured

There are essentially three components to the accounting treatment during the insured's lifetime:

1. The CSV of the life insurance policy is an asset that is recorded on the balance sheet ("B/S") of the company. The amount recorded varies from year to year as the CSV of the policy increases or decreases.
2. The payment of the policy premium will be reflected on the B/S of the company as a reduction in cash.
3. The increase in the CSV and the payment of the policy premium are reflected in the company's income statement ("I/S") on a net basis (see example below). If the premium paid is greater than the increase in CSV for the year, the difference between the two is recorded as an insurance expense on the I/S. If the premium paid is less than the increase in the CSV, the difference is recorded as an insurance gain.

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The Initiative is a monthly case study and information brief for distribution partners of The Empire Life Insurance Company (Empire Life). Details are edited to illustrate relevant financial, tax & estate planning principles, generally using the Federal context. This material is current to the year and month of issue (Vol. yy, No. mm) but is not a tax or legal opinion. Retained professional advice should be engaged in relation to any actual Client matters.

The Sales, Tax, Estate Planning, Underwriting & Product (STEPUP) team provides broker support, including seminar education, advanced concept illustrations & Client case consultations.

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It is important to note that the insurance expense does not generally qualify as a deduction in the calculation of the company's taxable income. Conversely, the amount recorded as an insurance gain on the I/S is not included in the company's income for tax purposes. Any amount on the company's financial statements ("F/S") that are not taxable or tax deductible will be adjusted for tax purposes when the corporate income tax return is prepared.

The following numerical examples illustrate this accounting treatment for a \$1,000,000 corporate owned life insurance policy. There is a \$10,000 annual premium payable for 10 years, after which the policy is paid up.

CSV	Year 1	\$3,000
	Year 2	\$8,000
	Year 9	\$98,000
	Year 10	\$110,000
	Year 11	\$115,000

**Year 1 accounting entries:**

Debit	CSV (B/S)	\$3,000
Debit	Insurance Expense (I/S)	\$7,000
Credit	Bank (B/S)	\$10,000

To record premium payment in year one and recognize yearend CSV of \$3,000.

**Year 2 accounting entries:**

Debit	CSV (B/S)	\$5,000
Debit	Insurance Expense (I/S)	\$5,000
Credit	Bank (B/S)	\$10,000

To record premium payment in year two and increase in CSV of \$5,000 (\$8,000 less \$3,000). The premium paid is greater than the increase in CSV for the year so the difference between the two is recorded as an insurance expense on the I/S.

**Year 10 accounting entries:**

Debit	CSV (B/S)	\$12,000
Credit	Insurance Gain (I/S)	\$2,000
Credit	Bank (B/S)	\$10,000

To record premium payment in year ten and increase in CSV of \$12,000 (\$110,000 less \$98,000). The premium paid is less than the increase in the CSV for the year. In this situation, the difference between the two is recorded as an insurance gain on the I/S.



From year eleven onwards, the policy would be paid up and no amount would be drawn on the bank. However, accounting entries could still be made based on the change in cash value over the fiscal period.

In order to enhance the value of information provided by a company's financial statements, notes are usually added to explain significant accounting policies and other information on the financial statements. The actual cash value of the corporate owned life insurance policy as well as the death benefit and other pertinent information could be disclosed in a note to the financial statements.

### On the Death of the Life Insured

On the death of the life insured, the company receives the proceeds of the life insurance policy. The proceeds received replace the life insurance asset recorded on the B/S. The excess proceeds are recorded as a mortality gain on the I/S. This amount is not included in the calculation of taxable income since insurance proceeds are tax-free.

### Example

Year 10 CSV (As recorded on the books of the company)	\$110,000
Life insurance proceeds received	\$1,000,000

The receipt of the life insurance proceeds will create cash in the company equal to the benefit received.

The CSV of the life insurance policy is no longer an asset, so its balance must be removed from the B/S.

The entry is balanced by recording a mortality gain on the I/S of the company.

Debit	Bank	\$1,000,000
Credit	Investment in Life Insurance	\$110,000
Credit	Mortality Gain	\$890,000

To record life insurance proceeds received in year of death (year 10).

It should be noted that the mortality gain is not a taxable amount but rather a method by which the accountant can record the difference between life insurance proceeds received and the asset value recorded on the company's books.