APPLIED KNOWLEDGE | ACCOUNTING GUIDELINES

Accounting for company stock in a deferred compensation plan

Accounting Standards Codification (ASC) 710-10-25-15 (EITF 97-14) (Deferred Compensation – Rabbi Trust) , issued on July 23, 1998, addresses the subject of accounting for nonqualified deferred compensation plans where assets are held and invested in a Rabbi Trust. The most significant impact of EITF 97-14 concerns accounting for company stock held in Rabbi Trusts.

Before EITF 97-14, it wasn't clear how companies should account for company stock held in a Rabbi Trust. Three "styles" of accounting were used.

- Companies treated Rabbi Trust holdings as assets on their books. The assets, including company stock, were "marked to market" and therefore would offset changes in the value of the deferred compensation plan accounts.
- Companies treated company stock held in the Rabbi Trust as Treasury Stock, an offset to equity. Treasury stock isn't "marked to market". Since no offset to changes in value in the deferred compensation plan liability account is available, some companies argued that the value of company stock in the deferred compensation plan liability account shouldn't be "marked to market" either and didn't recognize those changes.
- Companies didn't consolidate the Rabbi Trust into their financial reporting. The assets held by the Rabbi Trust and the corresponding deferred compensation plan liability were "off balance sheet".

EITF 97-14 clarifies the accounting for company stock in Rabbi Trusts, although the result may be seen as undesirable for companies wishing to mirror movements in deferred compensation plan accounts by holding assets in trust. The conclusions:

- The accounts of the Rabbi Trust **must be consolidated** with the company's accounts in the financial statements. Separate reporting **isn't** permitted.
- Company stock held by a Rabbi Trust must be accounted for "in a manner similar to" **Treasury Stock** in the company's financial statements (a separate component of Stockholders Equity, not an asset). Changes in fair value of the Treasury Stock **aren't** recognized.
- Any other "diversified" assets held in the Rabbi Trust are accounted for using Financial Instruments ASC 825-10-25 (FAS 159).
- If diversification in the deferred compensation plan account **isn't permitted** and the obligation in the account **must be settled only in company stock**, changes in the fair value of the deferred compensation plan obligation to the participant **shouldn't** be recognized.

- If diversification in the deferred compensation plan is **permitted** and/or the obligation to the plan participant may be **settled in cash or stock**, any changes in the value of the deferred compensation plan obligation should be **recognized in current company income or expense**.

This results in an undesirable situation for most companies. Under EITF 97-14, if company stock is held in a Rabbi Trust, and the plan participant is allowed to diversify and/or take settlement in cash, the company **isn't permitted to recognize changes** in the value of the asset (the company stock in the Rabbi Trust) but **must recognize changes** in the fair market value of the deferred compensation plan obligation to the participant. As a result, if the value of the company stock increases, the company must recognize the increase in the plan liability but may not recognize the increase in the value of the company stock in the Rabbi Trust.

BB10921-05 | 05/2023 | 2889041-052023| ©2023 Principal Financial Services, Inc.