Accounting guidelines – IRC Section 457(f) retirement plans

The accounting for Internal revenue Code Section 457(f) (IRC Section 457(f)) retirement plans is generally made up of two separate categories of entries:

1) **First set of entries.** To account for the deferred compensation as compensation expense and to record the deferred compensation account(s) as a liability.
2) **Second set of entries.** To account for the informal financing of the deferred compensation plan liability using mutual funds or variable corporate-owned life insurance (variable COLI).

Following is a general discussion of the applicable accounting principles. Please keep in mind that the organization should determine, in consultation with its accountant or advisors, the accounting treatment that will be used for financial reporting.

GAAP guidelines

The Financial Accounting Standards Board (FASB) is responsible for establishing non-governmental U.S. Generally Accepted Accounting Principles (GAAP). Effective for accounting periods ending after September 15, 2009, the FASB Accounting Standards Codification (ASC Codification) is the single source of authoritative U.S. GAAP. For convenience, these accounting guidelines include both pre- and post-codification references to GAAP.

Expense and liability

The IRC Section 457(f) plan accounts are a contractual obligation from the organization to pay the plan participants in the future and are treated as a long-term liability. This benefit is recognized over the vesting period. This IRC Section 457(f) plan liability is accounted for under "Compensation – General" at **ASC 710-10-25 (APB 12)**.

Organization-owned mutual funds

If mutual funds are used to informally finance the IRC Section 457(f) plan, **ASC 958-320-25 (SFAS 124)** entitled "Not-For-Profit Entities, Investments – Debt and Equity Securities" states that debt and equity securities that are classified as *available-for-sale* securities should be reported at their *fair market value* with all unrealized gains (losses) accounted for as current income. The sample guidelines assume the use of the fair value method.

Life insurance

If corporate owned life insurance is used to informally finance the IRC Section 457(f) plan, **ASC 325-30-35 (TB 85-4 and EITF 06-5)** entitled "Investments in Insurance Contracts" should be your reference.

Expense and liability (Compensation-General ASC 710-10-25 / APB 12)

Expense and liability entries	Balance sheet		Income statement	
	Debit (DR)	Credit (CR)	Debit (DR)	Credit (CR)
1. Creating the deferred compensation account				
Deferred compensation expense			$100,000	
Deferred compensation liability		$100,000		
2. Crediting earnings to the deferred compensation account				
Deferred compensation expense			$8,000	
Deferred compensation liability		$8,000		
3. Distributing the deferred comp liability account to the plan participant and closing the account				
Deferred compensation liability	$108,000			
Cash		$108,000		

(1) The employer recognizes this benefit over the vesting period. Above $100,000 of deferred compensation is recognized that creates a deferred compensation liability account.

(2) Accounting for the earnings credited to the deferred compensation account, assuming a hypothetical 8% rate of return. This cost may be partially or fully offset by the earnings in an underlying asset used to informally finance the plan.

(3) Paying out the plan participant with cash and closing out the deferred compensation liability account.

Accounting for the unrealized gains on tax-exempt organization-held investments
(ASC 958-320-25 / FAS 124)

Tax-exempt organization taxable investment entries	Balance sheet DR	Balance sheet CR	Income statement DR	Income statement CR
1. Purchase of mutual fund(s) to informally finance 457(f) plan liability account				
Mutual fund(s)	$100,000			
Cash		$100,000		
2. Mutual fund(s) *realized* earnings				
Mutual fund(s)	$5,000			
Other investment income				$5,000
3. Mutual fund(s) *unrealized* earnings				
Mutual fund(s)	$3,000			
Other investment income				$3,000
4. Sell mutual fund(s) & close account				
Cash	$108,000			
Mutual fund(s)		$108,000		

For organizations, both realized and unrealized earnings are recognized in the income statement

(1) The organization purchases mutual funds.

(2) The mutual fund(s) increases $8,000 of which 25% ($2,000) was realized interest, dividend and capital gains distributions and of which 50% of the undistributed gains ($3,000) was realized capital gains due to rebalancing.

(3) The mutual fund(s) increases $8,000 of which $3,000 was unrealized gain (increase in NAV).

(4) The organization sells the mutual fund(s), deposits proceeds into cash.

Accounting for investments in life insurance

(Investments in insurance contracts ASC 325-30-35 / TB 85-4 and EITF 06-5)

Life insurance entries	Balance sheet		Income statement	
	DR	CR	DR	CR
1. Organization pays premium into insurance contract				
COLI asset (CSV)	$100,000			
Cash		$100,000		
2. Adjustment to cash surrender value (CSV) in the insurance contract				
Premium expense			$3,000	
COLI asset (CSV)		$3,000		
3. Partial withdrawal of CSV (surrender or loan) and deposit into cash				
Cash	$10,000			
COLI asset (CSV)		$10,000		
4. Plan participant dies at end of year one with $1,000,000 of death benefit				
Cash	$1,000,000			
Nontaxable life insurance proceeds				$913,000
COLI asset (CSV)		$87,000		

(1) The organization pays the premium into the life corporate-owned life insurance (COLI) contract.

(2) The change during any accounting period in cash surrender value (CSV) is an adjustment to the corporate-owned life insurance asset and to premium expense. This change could be a debit or credit depending on charges/earnings in the life insurance policy(s).

(3) The organization can withdraw cash from the CSV in the form of a surrender or loan to pay a deferred compensation benefit to a plan participant.

(4) When the plan participant dies, the organization receives the death benefit proceeds and recognizes the income (the difference between the death benefit and the CSV).

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