Accounting guidelines for Deferred Compensation – Select Reward plans

The accounting principles that apply to this deferred comp plan are outlined below. Based on the plan design of this deferred comp benefit, the actual payment of the benefit requires the key employee to complete the service period. A number of factors, such as employment termination or death, may impact whether the participant is able to complete the service period and receive the benefit payment. Under normal accounting contingency rules, the contingency must be probable and reasonably estimated before a liability is booked. Another consideration for your tax advisors would be whether the present value is material to the company's financial statements. Decisions regarding the booking of the liability and the proper amount should be reviewed with your corporate financial officers and your professional tax advisors.

With for-profit employers, if the employer and their tax advisors choose to book the liability, the accounting for this deferred comp plan is made up of two separate categories of entries:

- The first set of entries is to account for deferred comp as a compensation expense and to record the deferred comp account(s) as a liability.
- The second set of entries is to account for the informal financing of the deferred comp plan using life insurance policies.

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

GAAP provides the methods to calculate the liability associated with promising a deferred comp benefit.

Deferred comp plan accounts are contractual obligations from the employer to pay the key employee(s) in the future and is treated as a long-term liability. This plan liability is accounted for under "Compensation-General" at ASC 710-10-25 (APB 12).

Income taxes (SFAS 109)

In this plan, the employer can also offer a pre-retirement death benefit to the key employee through an endorsement split dollar or death benefit only arrangement. If the employer’s tax advisor does record a liability, the corresponding tax impact should also be recorded based on ASC 740-10-25 (SFAS 109). The employer would record a deferred tax asset to reflect the future deduction of the plan benefit. However, each employer should consult with their tax advisor on best practices in this regard.

Life insurance

Under this type of arrangement, the employer owns the contract, pays the premium, and records the policy as a corporate-owned asset according to ASC 325-30-35 (TB 85-4). In this plan, the employer can also offer a pre-retirement death benefit for the key employee through an endorsement split dollar or death benefit only arrangement. (Please see BB12712) for journal transaction examples for this feature.)

The employer must meet the notice and consent requirements of IRC Section 101(j). Each year the company must file a completed IRS form 8925 and include its employer-owned life insurance policies.

This hypothetical example is for illustrative purposes only.

Journal transaction example

1. The company sets up a deferred comp liability account based on a defined contribution design, and debits a deferred comp expense account, which may be calculated based on the cash surrender value of the insurance contract.*
2. After the key employee completes the service period, the company pays the lump-sum bonus to the key employee equal to the deferred comp account balance, which may be calculated based on the cash value of the life insurance policy with cash ($300,000 in the example below) and the payment is currently deductible for tax purposes.
3. The company pays $20,000 in life insurance premium out of company cash flow.
4. The cash surrender value (CSV) is accounted for as an asset and offsets the life insurance premium expense.

	Balance Sheet		Income Statement	
Informal financing with life insurance	Debit	Credit	Debit	Credit
1. Creating the deferred comp account Deferred comp wage expense			$18,791	
Deferred comp liability		$18,791		
2. Payment of reward bonus Deferred comp liability	$300,000			
Cash		$300,000		
3. Company pays premium into insurance contract Life insurance premium expense			$20,000	
Cash		$20,000		
4. Cash surrender value (CSV) in the insurance contract Life insurance CSV	$18,791			
Life insurance premium expense				$18,791

*For plans with a defined benefit design (or a fixed amount), a simple present value calculation could be reported as the liability.

Principal®

principal.com