RA Bench

Accounting for Deferred Compensation Plans

Non-qualified deferred compensation (NQDC) is a technique for providing meaningful benefits for senior executives, selected key employees, and others. A non-qualified deferred compensation plan is a contract, most commonly between an employer and an employee to delay the receipt of compensation in order to defer the employee's taxation on that income to a future year. These plans can be created as a stand alone plan, as a 401(k) mirror or excess plan, or as an integral part of a bonus plan.

A deferred compensation plan is disclosed in a public company's proxy statement. A narrative description of the plan is required in the first year of the plan only. The Summary Compensation Table lists the salary, bonus other annual compensation, long term compensation and other compensation. The earnings on deferred compensation should be listed in the table and if necessary described below the summary table.

Annual Compensation				All Other Compensation *
Name & Position	Year	Salary	Bonus	
Mary CEO	2003	$700,000	$1,000,000	$130,000
Joe COO	2003	$500,000		$80,000

* Includes the value of insurance premiums paid of $4,000 for supplemental life insurance on the lives of Mary and Joe

Accounting for an investment in life insurance

Under FASB-Technical Bulletin 85-4, life insurance contracts (including variable universal life contracts), should be aggregated to Cash Surrender Value and booked on the Balance Sheet as an "Other Asset" and as "Cash Value Increase (or Loss)" to offset "Premium Expense" on the Balance Sheet. The increase (or decrease) of cash value in the contracts must be expensed in the Income Statement for the accounting period.

Accounting for assets acquired by the company in connection with a deferral plan.

Generally speaking, as assets of the company such assets will reflect upon the company's Balance Sheet as "Other Assets" as the "Cash Account" is reduced, and gains or losses will be reflected in the Income Statement for the accounting period. The company will reflect "Investment Expense" and "Investment Increase (or Loss)" as a contra expense, which will then be netted to produce "Net Investment Expense" on the Income Statement for the accounting period. However, the differences in particular asset types should be noted.

What is the GAAP accounting for benefits in a nonqualified plan in the company's financial statements?

Based upon GAAP, defined contribution deferred compensation plans for a select group is typically accounted for under APB-12, as amended by SFAS-106 (outlining calculation) and SFAS-132 (governing disclosure). Under this set of principles, the company should: account for the arrangements individually on an accrual basis following the terms of the plan; accrue the cost of these benefits in a systematic and rational manner over the period of an employee's service, which usually means adding plan deferrals, the "Service Cost", to any gain or loss credited to a participant's account, the "Interest Cost" during the accounting period, and accrue these amounts such that the aggregate amount accrued by the date of distribution to a participant, the "full eligibility date", shall equal the present value of all the benefits expected to be paid.

What is the GAAP accounting for mutual funds in connection with a deferral plan?

Under SFAS-115, mutual funds should be treated as "available for sale" since re-allocation of a participant's account may require re-allocation in the supporting mutual funds. As such, each fund would be valued on the Balance Sheet at its fair value and any increase (or decrease) in fair value booked to the Income Statement for the accounting period.

What is the income tax accounting for a nonqualified deferral plan?

The benefit plan and the supporting assets must be accounted for separately as follows:

The employer is taxed upon a participant's deferral amounts not paid currently as compensation, but receives a deferred tax deduction, which it then takes when the benefits are paid out and not at the time the deferral amounts are contributed into a trust or investment asset. As owner of any assets acquired in connection with a plan, the employer will be taxed on any earnings and interest on such assets if and as they become taxable.

RA Bench, Inc. | 1301 Fifth Avenue Suite 3330 | Seattle, Washington 98101 | 206.682.7803 | www.rabench.com