

EXECUTIVE BENEFITS LEARNING SERIES

Nonqualified Deferred Compensation Plans: Accounting and Reporting Considerations

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September 2015



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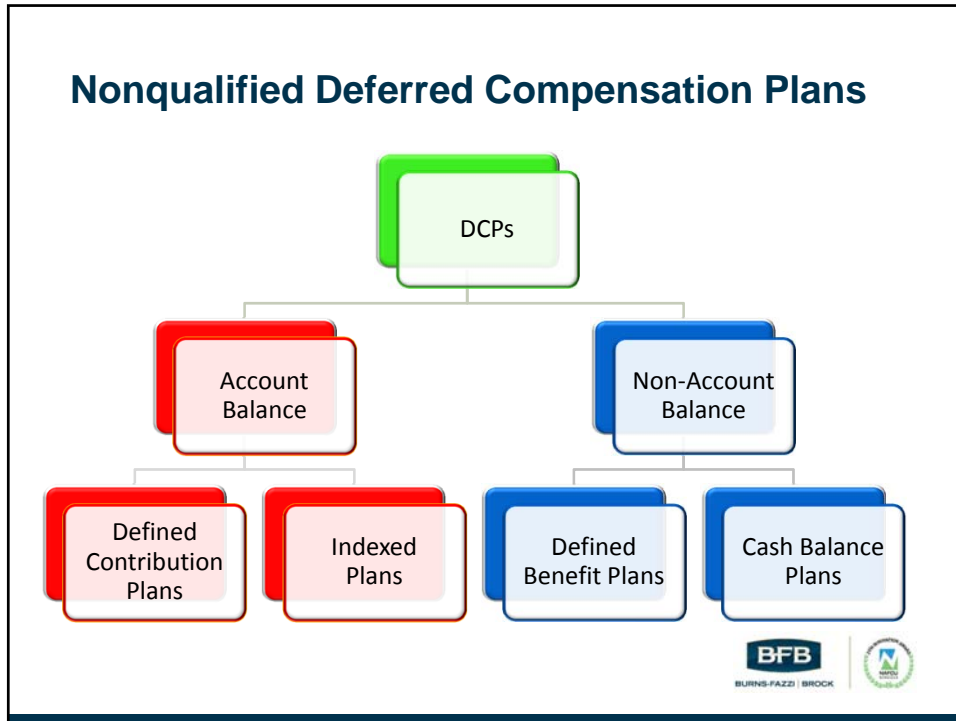
Agenda

- Welcome
- Nonqualified Deferred Compensation Plans (DCP)
- Funding Options
- Call Report Treatment
- IRS Form 990 Reporting
- Q & A



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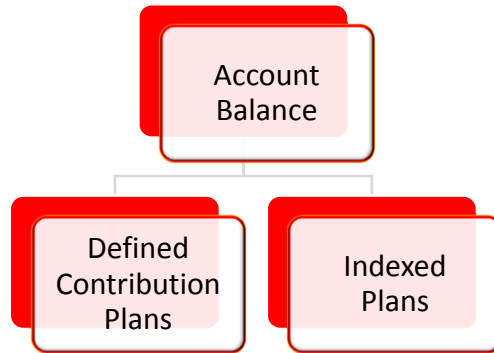


DCP Taxation

Taxation of DCP benefits to the executive is not impacted by whether the DCP is an account balance or non-account balance plan.

- 457(b) plans limit annual contributions (\$18,000 in 2015) and contain other restrictions on distributions. Benefits are always 100% vested, and are not taxed until received.
- 457(f) plans are not subject to IRS limits on contributions or benefits. Benefits are taxed upon vesting, even if the benefits are not paid until a later year.

Account Balance Plans



Account Balance Plans

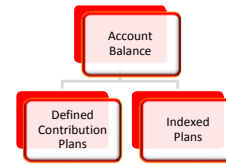
Defined Contribution Plans



- Credit union makes a contribution each year
- Contribution can be a dollar amount or percentage of salary stated in the plan document, or a discretionary amount determined on an annual basis
- Contributions credited with earnings based on set interest rate or allocation among investment options
- $\text{Account Balance} = \text{Contributions} + \text{Interest}$
- $\text{Benefit} = \text{Account Balance}$, paid upon meeting pre-determined age and/or service requirements



Account Balance Plans

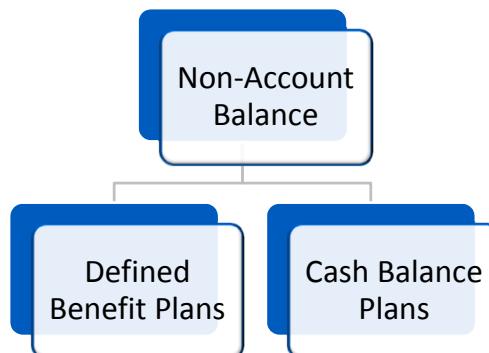


Indexed Plans

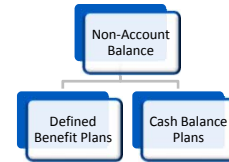
- Credit union invests a principal amount
- Principal investment generates earnings
- Principal investment is not part of benefit
- Account Balance = Earnings (or portion of earnings) on principal investment
- Benefit = Account Balance, paid upon meeting pre-determined age and/or service requirements



Non-Account Balance Plans



Non-Account Balance Plans

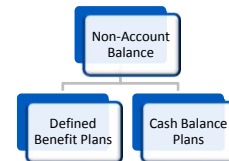


Defined Benefit Plans

- Promised benefit is defined as a formula or fixed amount
- Benefit is paid by the credit union (i.e. vested) upon meeting stated age and/or service requirements



Non-Account Balance Plans



Cash Balance Plans

- Promised benefit is defined as a stated account balance
- Account Balance = Stated contributions + stated Interest generally intended to target a certain benefit amount
- Benefit = Account Balance, paid upon meeting pre-determined age and/or service requirements



DCP Accounting Requirements

Income Statement

- Annual accrual is an expense that is reflected on the income statement

Balance Sheet

- Accrued balance is a liability on the balance sheet



Funding Options

NCUA Regulation § 701.19(c) governs investments held to fund employee benefit plan obligations.

Under this provision, a credit union may hold otherwise impermissible investments if the investment is “directly related” to the credit union’s obligations or potential obligations under an employee benefit plan.

Employee benefit obligations include:

- Defined benefit plan liabilities
- 401(k) match contributions
- Employer-paid life insurance expenses
- Employer-paid health insurance expenses
- Employer-paid long- and short-term disability expenses
- Nonqualified plan expenses



Funding Options

Types of assets held to fund benefit plan obligations vary, but the most prevalent include:

- Life insurance policies
- Annuities
- Mutual funds



Funding Options

What is the role of the funding assets?

- Primarily, assets provide earnings to offset benefit expenses
- Assets may determine the amount of benefits payable
- Assets may be the source of cash to pay benefits



Funding Options

Examples of assets acquired to fund DCPs

1. General asset purchased to offset benefit expenses:

- Credit union invests in an asset, such as life insurance, that is projected to produce annual income
- Annual income offsets the annual benefit expense
- Benefit is not connected to the asset
- Credit union may liquidate the asset to pay the benefit, or may continue to hold it to fund other benefit obligations



Funding Options

Examples of assets acquired to fund DCPs (continued)

2. Related to a Defined Contribution Plan:

- Contributions are credited with earnings based on executive allocation among certain fund options
- Credit union separately allocates its asset consistent with the executive's allocation
- Executive benefit is based on performance of selected fund options
- Credit union may liquidate the asset to pay the benefit, or continue to hold it to fund other benefit obligations



Funding Options

Examples of assets acquired to fund DCPs (continued)

3. Related to an Indexed Plan:

- Credit union deposits the principal amount into the asset, typically an insurance policy or a mutual fund
- Executive benefit is the value of the asset in excess of the credit union's principal
- When benefits are due, credit union generally withdraws the value in excess of the credit union's principal and pays this amount to the executive
- Credit union may then liquidate the remaining asset, or continue to hold it to fund other benefit obligations



Funding Options – Accounting

Income Statement

- Annual asset increase is a gain that is reflected on the income statement
 - Annual asset decrease is a loss

Balance Sheet

- Value is an asset on the balance sheet



Call Report Treatment

Credit unions with \$10 million or more in assets are required to use generally accepted accounting principles (GAAP) in reporting DCPs on the Call Report. GAAP treatment of DCPs is determined under:

- Accounting Principles Board Opinion No. 12 (“APB 12”), *Omnibus Opinion—1967*, as amended by Statement of Financial Accounting Standards No. 106 (“SFAS 106”) *Employers’ Accounting for Postretirement Benefits Other Than Pensions* (ASC 710)
- FASB Technical Bulletin No. 85-4 (“FTB 85-4”) *Accounting for Purchases of Life Insurance* (ASC 325-30)
- Statement of Financial Accounting Standards No. 115 (“SFAS 115”) *Accounting for Certain Investments in Debt and Equity Securities* (ASC 320-10-25)



Call Report Treatment

GAAP treats DCPs and their funding as follows:

1. The cost of the benefits must be accounted for over the service period during which the benefits are earned. The service period ends on the date the executive is fully eligible for the benefits.”



Call Report Treatment

GAAP treatment of DCPs and funding...

2. The accounting must be in a “systematic and rational manner.”



Call Report Treatment

GAAP treatment of DCPs and funding...

3. Because any assets the credit union holds in connection with the DCP are general assets to which the executive has no preferred claim, the asset is reported separately from the liability (i.e., offsetting is not allowed).



Call Report Treatment

GAAP treatment of DCPs and funding...

4. The asset value of life insurance the credit acquires to informally fund the deferred compensation obligation is the policy's cash surrender value.



Call Report Treatment



Interagency Advisory on Accounting for Deferred Compensation Agreements and Bank-owned Life Insurance (the "Advisory")

- Additional guidance from banking regulators
- Advisory explains how indexed plans should be reported on the Call Report
- NCUA was not party to the Advisory, so Advisory does not directly apply to credit unions.
- Advisory does, however, illustrate how GAAP applies to indexed plans





Example: Reporting DCP Benefit Liability

DCP – Q3 2015 CALL REPORT						
Event	Impact	Account	Amount	Form	Line	Acct Code
Adopting a new DCP, adding a participant, or increasing a benefit	Increase liabilities	Accounts Payable and Other Liabilities	GAAP expense	Fin Cond	9	825
	Increase expenses	Total Employee Compensation and Benefits	GAAP expense	Inc & Exp	20	210
Growth (reduction) in accrued benefits	Increase (decrease) liabilities	Accounts Payable and Other Liabilities	GAAP amount change	Fin Cond	9	825
	Increase (decrease) expenses	Total Employee Compensation and Benefits	GAAP amount change	Inc & Exp	20	210
Paying a benefit	Decrease asset	Cash on Hand (or other asset as applicable)	Payment	Fin Cond	1	730A
	Decrease liabilities	Accounts Payable and Other Liabilities	Payment	Fin Cond	9	825
Forfeited benefit (e.g., participant terminates prior to vesting)	Decrease liabilities	Accounts Payable and Other Liabilities	GAAP liability	Fin Cond	9	825
	Decrease expenses	Total Employee Compensation and Benefits	GAAP expense	Inc & Exp	20	210

Example: Reporting Life Insurance

LIFE INSURANCE HELD TO FUND DCP – Q3 2015 CALL REPORT						
Event	Impact	Account	Amount	Form	Line	Acct Code
Paying premiums	Change assets	Decrease in Cash on Hand	Premium paid	Fin Cond	1	730A
		Increase in All Other Assets	Premium paid	Fin Cond	32c	009C
	Special insurance reporting	Increase in Other Insurance	Premium paid	Sch B	20c.ii	789E2
Growth (reduction) in policy cash surrender value	Increase (decrease) income	Other Operating Income	Amount of change	Inc & Exp	13	659
	Increase (decrease) assets	All Other Assets	Amount of change	Fin Cond	32c	009C
	Special insurance reporting	Increase (decrease) in Other Insurance	Amount of change	Sch B	20c.ii	789E2
Cash value withdrawals (to pay benefits or otherwise)	Change assets	Increase in Cash on Hand	Withdrawal amount	Fin Cond	1	730A
		Decrease in All Other Assets	Withdrawal amount	Fin Cond	32c	009C
	Special insurance reporting	Decrease in Other Insurance	Withdrawal amount	Sch B	20c.ii	789E2
Insurance proceeds received upon death of insured	Change assets	Increase in Cash on Hand	Proceeds	Fin Cond	1	730A
		Decrease in All Other Assets	Policy book value	Fin Cond	32c	009C
	Increase income	Other Operating Income	Excess proceeds	Inc & Exp	13	659
	Special insurance reporting	Decrease in Other Insurance	Book value	Sch B	20c.ii	789E2

Example: Reporting Mutual Funds

MUTUAL FUNDS HELD TO FUND DCPs – Q3 2015 CALL REPORT

Event	Impact	Reporting	Amount	Form	Line	Acct Code
Buying mutual funds	Change assets	Decrease in Cash on Hand	Cost	Fin Cond	1	730A
		Increase in All Other Investments	Cost	Fin Cond	12	766
	Special asset reporting	Increase in Other Investments	Cost	Sch B	20b	789D
Growth (reduction) in mutual fund value	Increase (decrease) income	Other Operating Income	Amount of change	Inc & Exp	13	659
	Increase (decrease) assets	All Other Investments	Amount of change	Fin Cond	12	766
	Special insurance reporting	Increase (decrease) in Other Investments	Amount of change	Sch B	20b	789D
Liquidating mutual funds	Change assets	Increase in Cash on Hand	Proceeds	Fin Cond	1	730A
		Decrease in All Other Investments	Proceeds	Fin Cond	12	766



DCP Impact on IRS Form 990

Form 990 is filed annually by state-chartered credit unions

- Part VII and Schedule J relate to reporting of executive compensation
 - Part VII requires disclosure of basic compensation information for certain key and highest compensated employees
 - Schedule J requires certain details related to compensation and benefits



DCP Impact on Form 990

Form 990 Part VII

- Column (F) - other compensation – requires reporting of five specific items, irrespective of amount and vesting status, two of which are related to DCPs:
 1. Tax-deferred employer contributions to a nonqualified plan, and
 2. Annual increase or decrease in the actuarial value of benefits under a nonqualified defined benefit plan



DCP Impact on Form 990

Form 990 Schedule J

- DCP accruals reported in column (F) of Part VII are also reported in column (C) of Schedule J
- In addition, the entire benefit payment is reported in Column (B)iii in the year paid

Column	Content
(B)(i)	Base compensation reported on the W-2
(B)(ii)	Bonus and incentive compensation reported on the W-2
(B)(iii)	Other compensation reported on the W-2
(C)	Retirement and other deferred compensation
(D)	Nontaxable benefits
(E)	Total of the above
(F)	Compensation reported as deferred in prior Form 990s



DCP Impact on Form 990

Form 990 reporting requirements result in “double-reporting” of DCP benefits

- As benefits accrue, the annual accrual is reported in column (F) of Part VII, and in column C of Schedule J
- When benefits are paid, the total payment is reported in column (B)(iii) of Schedule J

This “double-reporting” may be misleading. To ensure clarity regarding the amount of the benefit, in the year of a benefit payment, the credit union should report how much of the payment was reported on prior Forms 990 in column (F) of Schedule J



Conclusion

- Accounting implications to the credit union’s income statement and balance sheet should be understood for existing DCPs and should be analyzed for any new plans being considered
- Credit unions should be aware of the appropriate reporting of assets held to fund employee benefits on Call Report Schedule B
- State-chartered credit unions should understand the double-reporting of DCPs on IRS Form 990, so that any questions or concerns that are raised by members can be answered with an accurate explanation



Questions?

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Next Webinar – October 21, 2015
Executive Benefits: Pitfalls to Avoid During Due Diligence

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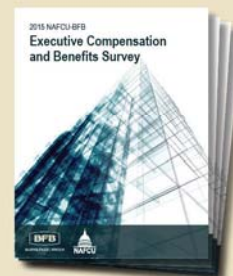
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- Investment products are not insured by the FDIC or any other federal government agency, or by any bank or bank affiliate.
- Investment products may be subject to investment risk, including possible loss of value.
- Withdrawals made from investment products during the first 15 years could result in unfavorable LIFO taxation under IRC Section 7702(f)(7) "force-out" rules. Withdrawals in excess of cost basis may be taxable. Lapsing a policy with an outstanding loan results in the loan, and any accrued interest, being treated as a distribution, which may be taxable. Modified Endowment Contracts ("MECs") are taxed differently and are not suitable for this program if surrenders or loans are anticipated. Please check policy illustrations to see if the policies being considered are MECs. Certain changes to a non-MEC policy could result in the policy becoming a MEC. Professional tax advisors should be consulted. Any loans, withdrawals or partial surrenders will reduce cash values and death benefits.
- Mutual Funds & Variable Universal Life Insurance Policies: Before investing, investors should carefully consider the investment objectives, risks, charges and expenses of the variable product and its underlying investment options. The current contract prospectus and underlying fund prospectuses provide this and other important information. Please contact your representative or the Company to obtain the prospectuses. Please read the prospectus carefully before investing or sending money.
- Past performance cannot predict future results. The purpose of this discussion outline is to present the issues and plan mechanics associated with a taxable investment and corporate owned life insurance financing strategy. The insurance products shown in this report are representative of the market and are based on a hypothetical investment yield which is not guaranteed.

DCPs – Q1 2015 CALL REPORT

Event	Impact	Account	Amount	Form	Line	Acct Code
Adopting a new DCP, adding a participant, or increasing a benefit	Increase liabilities	Accounts Payable and Other Liabilities	GAAP expense	Fin Cond	9	825
	Increase expenses	Total Employee Compensation and Benefits	GAAP expense	Inc & Exp	20	210
Growth (reduction) in accrued benefits	Increase (decrease) liabilities	Accounts Payable and Other Liabilities	GAAP amount change	Fin Cond	9	825
	Increase (decrease) expenses	Total Employee Compensation and Benefits	GAAP amount change	Inc & Exp	20	210
Paying a benefit	Decrease asset	Cash on Hand	Payment	Fin Cond	1	730A
	Decrease liabilities	Accounts Payable and Other Liabilities	Payment	Fin Cond	9	825
Participant forfeits benefit (e.g., early termination of employment)	Decrease liabilities	Accounts Payable and Other Liabilities	GAAP liability	Fin Cond	9	825
	Decrease expenses	Total Employee Compensation and Benefits	GAAP expense	Inc & Exp	20	210

LIFE INSURANCE HELD TO FUND DCPs – Q1 2015 CALL REPORT

Event	Impact	Account	Amount	Form	Line	Acct Code
Paying premiums	Change assets	Decrease in Cash on Hand	Premium paid	Fin Cond	1	730A
		Increase in All Other Assets	Premium paid	Fin Cond	32c	009C
	Special insurance reporting	Increase in Other Insurance	Premium paid	Sch B	20c.ii	789E2
Growth (reduction) in policy cash surrender value	Increase (decrease) income	Other Operating Income	Amount of change	Inc & Exp	13	659
	Increase (decrease) assets	All Other Assets	Amount of change	Fin Cond	32c	009C
	Special insurance reporting	Increase (decrease) in Other Insurance	Amount of change	Sch B	20c.ii	789E2
Cash value withdrawals (to pay benefits or otherwise)	Change assets	Increase in Cash on Hand	Withdrawal amount	Fin Cond	1	730A
		Decrease in All Other Assets	Withdrawal amount	Fin Cond	32c	009C
	Special insurance reporting	Decrease in Other Insurance	Withdrawal amount	Sch B	20c.ii	789E2
Insurance proceeds received at participant's death	Change assets	Increase in Cash on Hand	Proceeds	Fin Cond	1	730A
		Decrease in All Other Assets	Policy book value	Fin Cond	32c	009C
	Increase income	Other Operating Income	Excess proceeds	Inc & Exp	13	659
	Special insurance reporting	Decrease in Other Insurance	Book value	Sch B	20c.ii	789E2

MUTUAL FUNDS HELD TO FUND DCPs – Q1 2015 CALL REPORT

Event	Impact	Reporting	Amount	Form	Line	Acct Code
Buying mutual funds	Change assets	Decrease in Cash on Hand	Cost	Fin Cond	1	730A
		Increase in All Other Investments	Cost	Fin Cond	12	766
	Special asset reporting	Increase in Other Investments	Cost	Sch B	20b	789D
Growth (reduction) in mutual fund value	Increase (decrease) income	Other Operating Income	Amount of change	Inc & Exp	13	659
	Increase (decrease) assets	All Other Investments	Amount of change	Fin Cond	12	766
	Special insurance reporting	Increase (decrease) in Other Investments	Amount of change	Sch B	20b	789D
Liquidating mutual funds	Change assets	Increase in Cash on Hand	Proceeds	Fin Cond	1	730A
		Decrease in All Other Investments	Proceeds	Fin Cond	12	766

2015 Form 990
DCP Reporting

	Core Form		Schedule J						
	W-2 (Greater of Box 1 or Box 5) (D)	Estimate of Other Compensation (F)	W-2 Compensation			Deferred Compensation (C)	Nontaxable Benefits (D)	Total (E)	Deferred Comp on Prior Form 990s (F)
			Base Pay (B)(i)	Incentives (B)(ii)	Other (B)(iii)				
457(b) DCPs									
Employee Deferrals	√				√			√	
Employer Credits – Vested ¹⁵	√				√			√	
Employer Credits – Non-vested		√				√		√	
Previously Non-vested Employer Credits Vesting	√				√			√	√
Earnings or losses on Account – Vested									
Earnings or losses on Account – Non-vested									
Earnings or losses on Account – Previously non-vested earnings that vest during the year	√				√			√	
Distributions					√				√
457(f) DCPs									
Employer Credits – Vested (after-tax deferral)	√				√			√	
Employer Credits – Non-vested		√				√		√	
Employee Deferrals – Vested	√				√			√	
Employee Deferrals – Non-vested		√				√		√	
Vesting of previously Non-vested Credits/Deferrals	√				√			√	
Earnings on Account – Non-vested									
Earnings on Account – Vesting of previously non-vested earnings	√				√			√	
Earnings on Account – Vested earnings on vested principal									
Non-Account Balance Accruals (+ or -) – Vested	√				√	√		√	
Non-Account Balance Accruals (+ or -) – Non-vested		√				√		√	
Distributions ¹⁶	√				√			√	√