ESOP BRIEF #16

ESOP Accounting

By The ESOP Association

This issue brief describes common accounting practices for non-leveraged and leveraged ESOPs.

Non-Leveraged ESOPs

Accounting for non-leveraged ESOPs is relatively simple. For a contribution to a non- leveraged ESOP either stock or cash, the plan sponsor receives a tax deduction equal to its ESOP contribution expense.

If a company makes a $100,000 cash contribution in a given year, which the plan uses to buy 1,000 shares of stock for $100 per share, the appropriate journal entry would debit ESOP contribution expense and credit cash for $100,000. If the company contributes stock to the ESOP instead of cash, the ESOP contribution expense will equal the fair market value of the stock on the date of transfer. If the company contributed $1,000 shares of stock valued at $100, with a par value of $10, the appropriate journal entry would debit ESOP contribution expense for $100,000 and credit common stock for $10,000 and paid-in capital for $90,000.

The footnotes to the company's financial statements should disclose the company's funding policy for the ESOP, and the groups covered by the ESOP, as well as the amounts contributed to it and charged to expense during the accounting period covered by the statements.

Leveraged ESOPs

Accounting for a leveraged ESOP:

- Debt of an ESOP should be recorded as a liability in the financial statements of the employer when the debt is covered by either a guarantee of the employer or a commitment by the employer to make contributions to the ESOP sufficient to meet the debt service requirements. This liability should be reduced as the ESOP makes payments on the debt.
- The offsetting debit to this liability should be accounted for as a reduction of shareholders' equity, regardless of whether new shares are issued to the ESOP or the ESOP purchases shares from existing shareholders. This is normally done through an equity contra account. An increase in shareholders' equity is reported only as the debt which financed that increase is reduced. Thus, the liability and equity contra accounts associated with the ESOP are reduced in symmetry as the ESOP debt is repaid.
- The amount contributed to the plan each year to reduce the loan balance should be charged to compensation expense based on the fair market value of the shares the year they are released from the suspense account. The interest element of the contribution, however, should be separately identified and charged instead as an interest expense.
- Shares of an ESOP should be treated as outstanding shares when determining earnings per share only when the shares have been released and allocated to participant accounts. Dividends paid on shares held by the plan should be charged to retained earnings.
- The plan sponsor should disclose the debt's terms and interest rate, and any other significant information concerning the guarantee, in its financial statements' footnotes.

A company which bought $100,000 of stock (1000 shares at $100 per share, $10 per share par value) for an ESOP with an ESOP loan would debit cash and the equity contra account for $100,000, while crediting a guaranteed indebtedness liability account for $100,000 and crediting common stock for $10,000 and paid-in capital for $90,000.

The number of outstanding shares will increase only as shares are released from the expense account. The plan sponsor will debit $20,000 compensation expense each year at the fair market value of the shares released. (Note, for stock acquired before December 15, 1992, the value of the stock shares when acquired is the compensation expense measure, not fair market value.) The equity contra account (which may be called "Unearned Compensation") is reduced by the $20,000 principal payment with a credit, while the company's indebtedness is reduced by $20,000 with a debit.

This review of SOP 93-6 is necessarily brief, and only a general overview. In more detail is The ESOP Association's publication ESOP Accounting Standards, which sells for $10.00 for member of the Association. Please seek professional advice and service when reviewing SOP 93-6 in detail.

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