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Accounting for and reporting of certain defined contribution plan investments and other disclosure matters : amendment to the AICPA audit and accounting guide, Audits of employee benefit plans; Statement of position 99-3;

American Institute of Certified Public Accountants. Accounting Standards Executive Committee

STATEMENT OF POSITION 99-3

AICPA

AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

September 15, 1999

Accounting for and Reporting of Certain Defined Contribution Plan Investments and Other Disclosure Matters

Amendment to the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans*

Issued by the
Accounting Standards Executive Committee

NOTE

Statements of Position on accounting issues present the conclusions of at least two-thirds of the Accounting Standards Executive Committee, which is the senior technical body of the Institute authorized to speak for the Institute in the areas of financial accounting and reporting. Statement on Auditing Standards No. 69, *The Meaning of* Present Fairly in Conformity With Generally Accepted Accounting Principles *in the Independent Auditor's Report*, identifies AICPA Statements of Position that have been cleared by the Financial Accounting Standards Board as sources of established accounting principles in category *b* of the hierarchy of generally accepted accounting principles that it establishes. AICPA members should consider the accounting principles in this Statement of Position if a different accounting treatment of a transaction or event is not specified by a pronouncement covered by rule 203 of the AICPA Code of Professional Conduct. In such circumstances, the accounting treatment specified by the Statement of Position should be used, or the member should be prepared to justify a conclusion that another treatment better presents the substance of the transaction in the circumstances.

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SUMMARY

This Statement of Position (SOP) amends chapters 3 and 4 of the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans* (the Guide). This SOP amends SOP 94-4, *Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined Contribution Plans*, and SOP 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans*. This SOP simplifies disclosures for certain investments and supersedes AICPA Practice Bulletin 12, *Reporting Separate Investment Fund Option Information of Defined-Contribution Pension Plans*.

This SOP—

- Amends paragraph 3.20 of the Guide to eliminate the previous requirement for a defined contribution plan to present plan investments by general type for participant-directed investments in the statement of net assets available for benefits.
- Amends paragraph 3.28(k) and supersedes paragraph 3.28(l) of the Guide and supersedes Practice Bulletin 12 to eliminate the requirement for a defined contribution plan to disclose participant-directed investment programs and to eliminate the requirement to disclose the total number of units and the net asset value per unit during the period, and at the end of the period, by defined contribution pension plans that assign units to participants.
- Amends paragraph 3.28(g) of the Guide to require a defined contribution plan to identify nonparticipant-directed investments that represent 5 percent or more of net assets available for benefits.
- Amends paragraphs 3.28(p) and 4.57 of the Guide, paragraph 53 of SOP 92-6, and paragraph 15 of SOP 94-4 to eliminate the requirement for defined contribution plans, including both health and welfare benefit plans and pension plans, to disclose benefit-responsive investment contracts by investment fund option.

- Replaces exhibits E-1 through E-5 in the Guide.

This SOP is effective for financial statements for plan years ending after December 15, 1999. Earlier application is encouraged for fiscal years for which annual financial statements have not been issued. If the previously required "by-fund" disclosures are eliminated, the reclassification of comparative amounts in financial statements for earlier periods is required.

FOREWORD

The accounting guidance contained in this document has been cleared by the Financial Accounting Standards Board (FASB). The procedure for clearing accounting guidance in documents issued by the Accounting Standards Executive Committee (AcSEC) involves the FASB reviewing and discussing in public board meetings (1) a prospectus for a project to develop a document, (2) a proposed exposure draft that has been approved by at least ten of AcSEC's fifteen members, and (3) a proposed final document that has been approved by at least ten of AcSEC's fifteen members. The document is cleared if five of the seven FASB members do not object to AcSEC undertaking the project, issuing the proposed exposure draft or, after considering the input received by AcSEC as a result of the issuance of the exposure draft, issuing the final document.

The criteria applied by the FASB in its review of proposed projects and proposed documents include the following.

1. The proposal does not conflict with current or proposed accounting requirements, unless it is a limited circumstance, usually in specialized industry accounting, and the proposal adequately justifies the departure.
2. The proposal will result in an improvement in practice.
3. The AICPA demonstrates the need for the proposal.
4. The benefits of the proposal are expected to exceed the costs of applying it.

In many situations, the clearance of the proposed project and proposed documents by the FASB reflect suggested changes to the proposed items.

Accounting for and Reporting of Certain Defined Contribution Benefit Plan Investments and Other Disclosure Matters

Introduction

1. The primary objective of a **defined contribution plan's**[1] financial statements is to provide information that is useful in assessing the plan's present and future ability to pay benefits. This objective is consistent with the objectives of a pension plan's financial statements as stated in Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*. The primary users of a defined contribution plan's financial statements are the plan sponsor(s), plan participants, and the following governmental regulators: the U.S. Department of Labor (DOL), the Internal Revenue Service (IRS), and the Securities and Exchange Commission (SEC). For employee benefit plans that are subject to the Employee Retirement Income Security Act (ERISA), many of the disclosures in a plan's financial statements are provided in order to comply with certain regulatory requirements. For substantially all plans, the financial statement information is reported to the regulatory agencies on Form 5500, Annual Return/Report of Employee Benefit Plans, which includes financial statements and supplemental schedules (for example, plan investments and reportable transactions).

2. Paragraph 3.28(k) of the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans* (the Guide) established requirements for separately reporting information about participant-directed **investment fund options** within defined contribution plans. AICPA Practice Bulletin 12,

1. Terms defined in the glossary are set in boldface type the first time they appear in this SOP.

Reporting Separate Investment Fund Option Information of Defined-Contribution Pension Plans, clarified the reporting requirements set forth in paragraph 3.28(k). Plans that provide participant-directed investment programs were required to disclose amounts relating to each such program as a separate fund, either in columnar form in the financial statements or in the related disclosures, or through separate financial statements for each investment fund option.

3. Statement of Position (SOP) 94-4, *Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined Contribution Plans*, paragraph 15; paragraphs 3.28(p) and 4.57 of the Guide; and SOP 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans* (SOP 92-6, as amended by SOP 94-4[2]), paragraph 53, required defined contribution pension and **health and welfare benefit plans** to disclose the following information relating to **benefit-responsive investment contracts** in the aggregate by investment fund option:

   - The average yield for each period for which a statement of net assets available for benefits is presented
   - The crediting interest rate as of the date of each statement of net assets available for benefits presented
   - The amount of valuation reserves recorded to adjust contract amounts
   - The fair values of benefit-responsive investment contracts reported at contract value, in accordance with FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments*, as amended

4. Paragraph 3.28(l) of the Guide required defined contribution pension plans that assign units to participants to disclose "the total number of units and the net asset value per unit during the period (for example, monthly or quarterly, depending on the plan's provisions for calculating the unit values) and at the end of the period."

2. The original paragraph 53 of SOP 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans*, has been renumbered to paragraph 58 by the issuance of SOP 94-4, *Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans.* The amended SOP can be found in the AICPA Technical Practice Aids series, sec. 10,530.

5. Paragraph 3.20 of the Guide required defined contribution plans to present plan investments in the statement of net assets available for benefits by general type.

6. Paragraph 3.28(g) of the Guide requires identification of investments that represent 5 percent or more of the net assets available for benefits.

Scope

7. Paragraphs 8 through 12 of this SOP apply to all defined contribution plans with participant-directed investment programs. Paragraphs 13 and 14 of this SOP apply to all defined contribution health and welfare benefit plans with benefit-responsive investment contracts.

Conclusions

Defined Contribution Plans

Presentation in Defined Contribution Plan Financial Statements of Information About Investments, Participant-Directed Investment Programs, and Units of Participation

8. A defined contribution plan that provides participant-directed investment programs is no longer required to disclose amounts relating to those individual programs as a separate fund in the financial statements in columnar form, or in the related disclosures, or by separate financial statements for each program as required by Practice Bulletin 12. However, if a defined contribution plan provides for both participant-directed and nonparticipant-directed[3] investment programs, the plan should disclose information

3. If a plan offers a program that is both participant- and nonparticipant-directed, and if the participant-directed and nonparticipant-directed amounts cannot be separately determined, the plan will be deemed to be nonparticipant-directed for purposes of this disclosure. For example, an employer-sponsored plan offers six investment fund options, one of which is a stock fund that includes only the employer's stock. Employees at their discretion may invest their contributions in any or all of the six options. However, the employer's contribution to the plan (for example, the company match) is automatically invested in the employer's stock fund. The stock fund is considered to be nonparticipant-directed for purposes of this disclosure if the employee and the employer amounts cannot be separately determined.

in the financial statements about the net assets and significant components of the changes in net assets relating to the nonparticipant-directed program with such reasonable detail, either in the financial statements or the accompanying notes, as is necessary to identify the types of investments and changes therein.

9. Defined contribution plans are not required to present participant-directed plan investments in the statement of net assets available for benefits by general type as required by paragraph 3.20 of the Guide. Participant-directed plan investments may be shown in the aggregate, as a one-line item, in the statement of net assets available for benefits. The presentation of nonparticipant-directed investments in the statement of net assets available for benefits or in the notes should be detailed by general type, such as registered investment companies (also known as mutual funds), government securities, short-term securities, corporate bonds, common stocks, mortgages, loans to participants, and real estate. The presentation should indicate whether the fair values of the investments have been measured by quoted market prices in an active market or were determined otherwise.

10. In addition to the current requirement to identify those investments that represent 5 percent or more of net assets available for benefits, defined contribution plans should specifically identify those investments that represent 5 percent or more of net assets available for benefits that are nonparticipant-directed.

11. Defined contribution plans no longer need to disclose, by investment fund option, the information on benefit-responsive investment contracts as required by paragraph 15 of SOP 94-4, paragraphs 3.28(p) and 4.57 of the Guide, and paragraph 53[4] of SOP 92-6. However, the disclosures set forth in SOP 94-4, paragraph 15; the Guide, paragraphs 3.28(p) and 4.57 (bullet 17); and SOP 92-6, paragraph 53 (as amended by SOP 94-4[4]), are still required in the aggregate.

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4. The original paragraph 53 of SOP 92-6 has been renumbered to paragraph 58 by the issuance of SOP 94-4. The amended SOP can be found in the AICPA Technical Practice Aids series, sec. 10,530.

12. Defined contribution plans (participant-directed and nonparticipant-directed) that assign units to participants are not required to disclose the total number of units and the net asset value per unit during the period, and at the end of the period as required by Guide paragraph 3.28(l).

Defined Contribution Health and Welfare Benefit Plans

13. Defined contribution health and welfare benefit plans no longer need to disclose the information on benefit-responsive investment contracts by investment fund option, as required by paragraph 15 of SOP 94-4, paragraphs 3.28(p) and 4.57 of the Guide, and paragraph 53[5] of SOP 92-6. However, the disclosures set forth in SOP 94-4, paragraph 15; the Guide, paragraphs 3.28(p) and 4.57 (bullet 17); and SOP 92-6, paragraph 53 (as amended by SOP 94-4[5]), are still required in the aggregate.

14. In addition to the disclosures listed in paragraph 13, defined contribution health and welfare benefit plans should specifically identify those investments that represent 5 percent or more of net assets available for benefits.

Amendments to the Guide

15. In paragraph 3.09 and footnote 6, the phrase "when they are due" is deleted.

16. In paragraphs 3.11 and 4.20, the phrase "when due" is deleted.

17. Paragraph 3.20 is replaced with the following.

> Participant-directed plan investments may be shown in the aggregate, as a one-line item, in the statement of net assets available for benefits. The presentation of nonparticipant-directed investments in the statement of net assets available for benefits or in the notes should be detailed by general type, such as registered investment companies (also known as mutual funds), govern-

5. The original paragraph 53 of SOP 92-6 has been renumbered to paragraph 58 by the issuance of SOP 94-4. The amended SOP can be found in the AICPA Technical Practice Aids series, sec. 10,530.

ment securities, short-term securities, corporate bonds, common stocks, mortgages, loans to participants, and real estate. The presentation should indicate whether the fair values of the investments have been measured by quoted market prices in an active market or were determined otherwise.

18. In paragraph 3.28(g), the following is added after the first sentence:

    If any of those investments are nonparticipant-directed, they should be identified as such.

19. Paragraph 3.28(k) is replaced with the following:

    If a defined contribution plan provides for participant-directed and nonparticipant-directed investment programs, the plan should disclose information in the financial statements about the net assets and significant components of the changes in net assets relating to the nonparticipant-directed program with such reasonable detail, either in the financial statements or accompanying notes, as is necessary to identify the types of investments and changes therein.

    A plan provides for participant-directed investment programs if it allows participants to choose among various investment alternatives. The available alternatives are usually pooled fund vehicles, such as registered investment companies or commingled funds of banks, that provide varying kinds of investments—for example, equity funds and fixed income funds. The participant may select among the various available alternatives and periodically change that selection.

20. Paragraph 3.28(l) is eliminated.

21. In paragraph 3.28(p), the phrase "by investment option" is deleted.

22. In the seventeenth bullet of paragraph 4.57, the phrase "by investment option" is deleted.

23. Exhibits E-1 through E-5 in the Guide are superseded by the illustrative financial statements and disclosures in appendix B of this SOP.

24. The terms "benefit-responsive investment contract" and "investment fund option," as defined in the glossary of this SOP, are added to the glossary of the Guide.

Amendments to SOP 94-4

25. In paragraph 15, the phrase "by investment option" is deleted.

26. In paragraph 17(g)(o), the phrase "by investment option" is deleted.

27. In paragraph 17(l)(i), the phrase "by investment option" is deleted.

28. In the first bullet of paragraph 18(e), the phrase "by investment option" is deleted.

Amendment to SOP 92-6

29. In the sixteenth bullet of paragraph 53[6] (which was added by SOP 94-4), the phrase "by investment option" is deleted.

Practice Bulletin 12

30. This SOP supersedes AICPA Practice Bulletin 12, *Reporting Separate Investment Fund Option Information of Defined-Contribution Pension Plans.*

Effective Date and Transition

31. This SOP is effective for financial statements for plan years ending after December 15, 1999. Earlier application is encouraged for fiscal years for which annual financial statements have not been issued. If the previously required "by-fund" disclosures are eliminated, the reclassification of comparative amounts in financial statements for earlier periods is required.

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6. The original paragraph 53 of SOP 92-6 has been renumbered to paragraph 58 by the issuance of SOP 94-4. The amended SOP can be found in the AICPA Technical Practice Aids series, sec. 10,530.

APPENDIX A

Background Information and Basis for Conclusions

A.1 The Accounting Standards Executive Committee (AcSEC) considered whether the disclosures required by paragraph 3.28(k) of the Guide should be made by a defined contribution plan for its participant-directed investment programs. Paragraph 3.28(k) of the Guide, as clarified by Practice Bulletin 12, required all plans that provide participant-directed investment fund options to disclose the options separately and show in the financial statements amounts relating to each individual investment fund option, either in columnar format on the face of the financial statements, in the related notes to the financial statements, or in separate financial statements for each option. Practice Bulletin 12 clarified that paragraph 3.28(k) requires plans to disclose information about the net assets and significant components of changes in net assets for each participant-directed investment fund option.

A.2 Since the issuance of Practice Bulletin 12, there has been an increase in the number of investment programs offered to participants of defined contribution plans. At the same time, financial information about many investment fund options has become widely available, often with more frequency than the issuance of plan financial statements. For example, certain daily business publications and information services, such as Bloomberg Pricing Service and Interactive Data Corporation, provide financial information about investment fund options. In addition, financial information is publicly available for many investment fund options throughout the year, including upon request from fund distributors and the Securities and Exchange Commission (SEC). In each instance, participants and other interested parties are provided with financial information that is similar in many respects to the information required to be disclosed under paragraph 3.28(k) of the Guide. In addition, plan participants receive information about the plan in the form of at least annual (often quarterly) individual single-employer account statements and summary annual reports. Also, plan administrators and the trustees regularly provide plan participants with information on the investment fund options, such as prospectuses on mutual funds, or provide copies of the individual account statements on a quarterly basis.

A.3 The primary objective of a defined contribution plan's financial statements is to provide information that is useful in assessing the plan's present and future ability to pay benefits. That objective is fulfilled, in part, when the plan's financial statements provide information that is relevant and timely and the benefit of doing so justifies the cost. In view of the fact that plan participants now have available from other sources financial information about many participant-directed investment fund options, in many cases more timely and frequently than plan financial statements (for example, daily valuations), AcSEC believes that the benefit of plans presenting certain disclosures required by Guide paragraphs 3.28(k) and 3.28(l) for defined contribution plans is diminished. Furthermore, the periodic per unit net asset value disclosure is not a meaningful disclosure in the current plan investment environment because of the increased frequency of measuring unit values (that is, daily valuations), and plan participants generally receive more timely investment information from their individual participant statements. AcSEC believes that continuing to require those disclosures under these circumstances would impose an increasing compliance burden on plans, the cost of which would grow increasingly difficult to justify as more investment programs are offered to participants. Consequently, AcSEC has concluded that certain disclosures required by paragraphs 3.28(k) and 3.28(l) should not be required for defined contribution plans. Paragraph 3.28(k) is amended to reflect this conclusion and to reflect certain other disclosure requirements carried forward from Practice Bulletin 12, which is superseded by this SOP. Paragraph 3.28(l) is eliminated from the Guide.

A.4 The U. S. Department of Labor (DOL) is a primary user of a defined contribution plan's financial statements, and many of the disclosures in a plan's financial statements are provided in order to comply with certain regulatory requirements. Although this SOP eliminates the Guide paragraph 3.28(k) requirement to disclose amounts relating to individual participant-directed investment programs, it still requires that information about nonparticipant-directed investment programs in the aggregate be disclosed. This SOP also amends paragraph 3.20 of the Guide to require a defined contribution plan to present in the financial statements or accompanying notes plan investments by general type for only nonparticipant-directed investments. In addition, this SOP adds to the existing Guide paragraph 3.28(g) requirements to identify those investments that represent 5 percent or more of net assets available for benefits that are nonparticipant-directed. The DOL has advised that disclosure of information about nonparticipant-directed investment programs in the aggregate is useful in its regulation of defined contribution plans. In addition, AcSEC believes disclosure of such information is useful in providing information about plan resources and how the plan trustee's stewardship responsibility for those resources has been discharged.

A.5 SOP 94-4, paragraph 15, and the Guide, paragraphs 3.28(p) and 4.57, required defined contribution plans to disclose certain aggregate information about benefit-responsive investment contracts by investment option. Furthermore, SOP 94-4, paragraph 15; the Guide, paragraph 4.57; and SOP 92-6, paragraph 53 (as amended by SOP 94-4), required defined contribution health and welfare plans to disclose certain aggregate information about fully benefit-responsive investment contracts by investment option. AcSEC believes that disclosure of this information by investment option should not be required, and elimination of this disclosure is consistent with the elimination of certain Guide paragraph 3.28(k) disclosures. However, disclosure of this information in the aggregate is still required. Consequently, SOP 94-4, paragraph 15; paragraphs 3.28(p) and 4.57 of the Guide; and SOP 92-6, paragraph 53, are amended.

A.6 This document was exposed for public comment for a period of sixty days. Certain respondents to the exposure draft believed that paragraph 3.20 of the Guide should not be amended. Paragraph 3.20 of the Guide required defined contribution plans to present plan investments detailed by general type in the statement of net assets available for benefits. AcSEC believes including participant-directed investments by general type in the financial statements for a defined contribution plan does not provide useful information in assessing the plan's present and future ability to pay benefits, nor does AcSEC believe it provides useful information to evaluate the trustee's stewardship responsibilities over those assets. Consequently, AcSEC has concluded that a defined contribution plan may present participant-directed plan investments in the aggregate, as a one-line item, on the statement of net assets available for benefits without detailing them by general type.[7] In addition, as mentioned in paragraph A.4, AcSEC believes the disclosure of nonparticipant-directed investment information by general type is useful in providing information about plan resources and how the plan trustee's stewardship responsibility for those resources has been discharged.

A.7 AcSEC decided to permit, but not require, early application of this SOP in plan financial statements for a fiscal year for which annual financial statements have not been issued. AcSEC believes that requiring entities that may adopt the SOP early to reclassify amounts in the financial statements when by-fund disclosures are eliminated will improve comparability.

7. Form 5500, item 31, requires investments to be detailed by general type.

APPENDIX B

Illustrative Financial Statements and Disclosures of a Defined Contribution Plan With Participant-Directed and Nonparticipant-Directed Investment Programs

B.1 This Appendix illustrates certain applications of the provisions of this SOP that apply to the annual financial statements of a defined contribution plan with participant-directed and nonparticipant-directed investments. These illustrative financial statements and disclosures supersede exhibits E-1 through E-5 in the Guide.

XYZ Company 401(k) Plan
Statements of Net Assets Available for Benefits

	December 31, 20X1	December 31, 20X0
Assets:		
Investments (See Note C)	$9,177,000	$7,995,000
Receivables:		
Employer contribution	14,000	10,000
Participant contributions	52,000	50,000
Total receivables	66,000	60,000
Total assets	9,243,000	8,055,000
Liabilities:		
Accounts payable	10,000	20,000
Accrued expenses	15,000	-
Total liabilities	25,000	20,000
Net assets available for benefits	$9,218,000	$8,035,000

See accompanying notes to the financial statements.

XYZ Company 401(k) Plan
Statement of Changes in Net Assets Available for Benefits

	Year Ended December 31, 20X1
Additions:	
Additions to net assets attributed to:	
Investment income:	
Net appreciation in fair value of investments (see Note C)	$ 279,000
Interest	439,000
Dividends	165,000
	883,000
Less investment expenses	(50,000)
	833,000
Contributions:	
Participant	900,000
Employer	699,000
	1,599,000
Total additions	2,432,000
Deductions:	
Deductions from net assets attributed to:	
Benefits paid to participants	1,144,000
Administrative expenses (see Note F)	105,000
Total deductions	1,249,000
Net increase	1,183,000
Net assets available for benefits:	
Beginning of year	8,035,000
End of year	$9,218,000

See accompanying notes to financial statements.

A. Description of Plan

The following description of the XYZ Company ("Company") 401(k) Plan (Plan) provides only general information. Participants should refer to the Plan agreement for a more complete description of the Plan's provisions.

1. *General.* The Plan is a defined contribution plan covering all full-time employees of the Company who have one year of service and are age twenty-one or older. It is subject to the provisions of the Employee Retirement Income Security Act (ERISA).
2. *Contributions.* Each year, participants may contribute up to 12 percent of pretax annual compensation, as defined in the Plan. Participants may also contribute amounts representing distributions from other qualified defined benefit or defined contribution plans. Participants direct the investment of their contributions into various investment options offered by the Plan. The Plan currently offers two mutual funds and an insurance investment contract as investment options for participants. The Company contributes 25 percent of the first 6 percent of base compensation that a participant contributes to the Plan. The matching Company contribution is invested directly in XYZ Company common stock. Additional profit sharing amounts may be contributed at the option of the Company's board of directors and are invested in a portfolio of investments as directed by the Company. Contributions are subject to certain limitations.
3. *Participant Accounts.* Each participant's account is credited with the participant's contribution and allocations of (a) the Company's contribution and (b) Plan earnings, and charged with an allocation of administrative expenses. Allocations are based on participant earnings or account balances, as defined. The benefit to which a participant is entitled is the benefit that can be provided from the participant's vested account.
4. *Vesting.* Participants are vested immediately in their contributions plus actual earnings thereon. Vesting in the Company's contribution portion of their accounts is based on years of continuous service. A participant is 100 percent vested after five years of credited service.
5. *Participant Loans.* Participants may borrow from their fund accounts a minimum of $1,000 up to a maximum of $50,000 or 50

percent of their account balance, whichever is less. The loans are secured by the balance in the participant's account and bear interest at rates that range from 6 percent to 10 percent, which are commensurate with local prevailing rates as determined quarterly by the Plan administrator.

6. *Payment of Benefits.* On termination of service due to death, disability, or retirement, a participant may elect to receive either a lump-sum amount equal to the value of the participant's vested interest in his or her account, or annual installments over a ten-year period. For termination of service for other reasons, a participant may receive the value of the vested interest in his or her account as a lump-sum distribution.

B. Summary of Accounting Policies

Use of Estimates
The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

Investment Valuation and Income Recognition
The Plan's investments are stated at fair value except for its benefit-responsive investment contract, which is valued at contract value (Note E). Quoted market prices are used to value investments. Shares of mutual funds are valued at the net asset value of shares held by the Plan at year end.

Purchases and sales of securities are recorded on a trade-date basis. Dividends are recorded on the ex-dividend date.

C. Investments

The following presents investments that represent 5 percent or more of the Plan's net assets.

	December 31, 20X1	December 31, 20X0
XYZ Company common stock, 400,000 and 390,000 shares, respectively	$ 470,000*	$ 420,000*
ABC Corporation common stock, 390,000 and 380,000 shares, respectively	490,000*	450,000*
Prosperity Investments Common Stock Fund, 226,250 and 200,000 shares, respectively	2,262,500*	2,000,000*
Prosperity Investments Balanced Fund, 40,000 and 210,000 shares, respectively	1,422,000	2,100,000
Investment Contract with National Insurance Company, #2012A, matures 12/31/X5 (Note E)	1,500,000	650,000

*Nonparticipant-directed

During 20X1, the Plan's investments (including gains and losses on investments bought and sold, as well as held during the year) appreciated in value by $279,000 as follows:

Mutual funds	$ 229,000
Common stock	30,000
Corporate bond	30,000
U.S. Government Securities	(10,000)
	$ 279,000

D. Nonparticipant-Directed Investments

Information about the net assets and the significant components of the changes in net assets relating to the nonparticipant-directed investments is as follows:

	December 31, 20X1	December 31, 20X0
Net Assets:		
Common stock	$ 960,000	$ 870,000
Mutual funds	2,262,500	2,000,000
Corporate bonds	307,500	255,000
U.S. Government Securities	225,000	120,000
	$3,755,000	$3,245,000

	Year ended December 31, 20X1
Changes in Net Assets:	
Contributions	$ 699,000
Dividends	165,000
Net appreciation	60,000
Benefits paid to participants	(280,000)
Transfers to participant-directed investments	(134,000)
	$ 510,000

E. Investment Contract with Insurance Company

In 20X0, the Plan entered into a benefit-responsive investment contract with National Insurance Company (National). National maintains the contributions in a general account. The account is credited with earnings on the underlying investments and charged for participant withdrawals and administrative expenses. The contract is included in the financial statements at contract value as reported to the Plan by National. Contract value represents contributions made under the contract, plus earnings, less participant withdrawals and administrative expenses. Participants may ordinarily direct the withdrawal or transfer of all or a portion of their investment at contract value.

There are no reserves against contract value for credit risk of the contract issuer or otherwise. The average yield and crediting interest rates were approximately 8 percent for 20X1 and 20X0. The crediting interest rate is based on a formula agreed upon with the issuer, but may not be less than 4 percent. Such interest rates are reviewed on a quarterly basis for resetting.

F. Related-Party Transactions

Certain Plan investments are shares of mutual funds managed by Prosperity Investments. Prosperity Investments is the trustee as defined by the Plan and, therefore, these transactions qualify as party-in-interest transactions. Fees paid by the Plan for the investment management services amounted to $105,000 for the year ended December 31, 20X1.

G. Plan Termination

Although it has not expressed any intent to do so, the Company has the right under the Plan to discontinue its contributions at any time and to terminate the Plan subject to the provisions of ERISA. In the event of Plan termination, participants would become 100 percent vested in their employer contributions.

H. Tax Status

The Internal Revenue Service has determined and informed the Company by a letter dated August 30, 1986, that the Plan and related trust are designed in accordance with applicable sections of the Internal Revenue Code (IRC). Although the Plan has been amended since receiving the determination letter, the Plan administrator and the Plan's tax counsel believe that the Plan is designed and is currently being operated in compliance with the applicable requirements of the IRC.

GLOSSARY

Defined contribution plan. A plan that provides an individual account for each participant and provides benefits that are based on (a) amounts contributed to the participant's account by the employer or employee, (b) investment experience, and (c) any forfeitures allocated to the account, less any administrative expenses charged to the plan.

Benefit-responsive investment contract. A contract between an insurance company, a bank, a financial institution, or any financially responsible entity and a plan that provides for a stated return on principal invested over a specified period and that permits withdrawals at contract value for benefit payments, loans, or transfers to other investment options offered to the participant by the plan. Participant withdrawals from the plan are required to be at contract value.

Health and welfare benefit plan. A plan that provides the following:

1. Medical, dental, visual, psychiatric, or long-term health care; severance benefits; life insurance; accidental death or dismemberment benefits
2. Unemployment, disability, vacation or holiday benefits
3. Apprenticeships, tuition assistance, day-care, housing subsidies, or legal services benefits

Investment fund option. An investment alternative provided to a participant in a defined contribution plan. The alternatives are usually pooled fund vehicles, such as registered investment companies (meaning, mutual funds), commingled funds of banks, or insurance company pooled separate accounts providing varying kinds of investments, for example, equity funds and fixed income funds. The participant may select from among the various available alternatives and periodically change that selection.

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