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Employee Benefit Plans Industry Developments—1994

Complement to AICPA Audit and Accounting Guide
Audits of Employee Benefit Plans

American Institute of Certified Public Accountants

NOTICE TO READERS

This audit risk alert is intended to provide auditors of financial statements of employee benefit plans with an overview of recent economic, industry, regulatory, and professional developments that may affect the audits they perform. This document has been prepared by the AICPA staff. It has not been approved, disapproved, or otherwise acted on by a senior technical committee of the AICPA.

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The staff of the AICPA is grateful to the members of the AICPA Employee Benefit Plans Committee for their contribution to this document.

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Employee Benefit Plans Industry Developments—1994

Industry and Economic Developments

The road to economic recovery appears to hold a number of obstacles that are likely to significantly affect employee benefits plans and their financial statements. Chief among the concerns is the sensitivity of many plans to interest rates and interest rate fluctuations.

The Impact of Interest Rate Fluctuations

Investment Policy. As interest rates fell to historically low levels over the past year, a number of pension plan administrators and investment managers adopted increasingly more aggressive investment strategies—directing an increasingly larger proportion of plan investments into higher yielding and frequently higher risk investment vehicles. These investments included derivative products such as futures, options, and swap contracts; securities lending arrangements; so-called junk bonds; real estate and specialized real estate investment securities; and global securities. As the long-awaited economic recovery unfolds and interest rates begin to climb, the quality and value of many of these plan investments may continue to be called into question. In light of the volatility of financial markets, auditors should continue to be particularly sensitive to concerns about the valuation of plan investments and the adequacy of related disclosures. Auditors of plans with significant investments in contracts with financial institutions need to consider the financial stability of the issuing companies (particularly those with significant holdings in high-risk investments) and their ability to fulfill their contractual obligations.

Funded Status. Changes in interest rates can also have a significant effect on the funded status of defined benefit pension plans. Lower interest rates may cause plans to decrease assumed rates of return used in actuarial calculations, resulting in increases in the actuarial present value of accumulated plan benefits. As a result, when rates are relatively low, many defined benefit pension plans that historically have been well funded may no longer be so as large increases in the actuarial present value of accumulated plan benefits erode their overfunded status.

Fluctuations in interest rates may prompt plans to reassess the reasonableness of the interest rate assumptions inherent in the actuarial determination of plan data. Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 35, *Accounting and Reporting by Defined Benefit Pension Plans,* stipulates that assumed rates of return used to determine the actuarial present value of accumulated plan benefits shall reflect the "expected rates of return during the periods for which payment of benefits is expected to be deferred and shall be consistent with returns realistically achievable on the types of assets held by the plan and the plan's investment policy." The Statement also stipulates that expected rates of inflation used in estimating automatic cost-of-living adjustments should be consistent with the assumed rates of return. Auditors should carefully consider whether the rates of return and rates of inflation assumed by the plan's actuaries are reasonable and should question rates that appear to be out of line with those that they believe are realistically achievable. Statement on Auditing Standards (SAS) No. 57, *Auditing Accounting Estimates* (AICPA, *Professional Standards,* vol. 1, AU sec. 342), provides auditors with guidance on obtaining and evaluating sufficient competent evidential matter to support significant accounting estimates in audits of financial statements.

Funding Problems. Significant underfunding of many defined benefit pension plans is causing increasing concern in both the public and private sectors. Recent estimates indicate that state and local governmental pension plans across the country are underfunded by more than $125 billion, prompting speculation that public pension fund underfunding will be the next century's equivalent of today's "health care crisis." In addition, the funding problems at the Pension Benefit Guaranty Corporation (PBGC) continue to cause concern about its ability to meet its obligation to guarantee benefits under defined benefit pension plans in the private sector. The PBGC's growing deficit coupled with the substantial additional risk of insuring underfunded plans that are sponsored by financially troubled companies are major sources of this concern. Many of the already underfunded plans have granted enhanced pension benefits in conjunction with work force or salary reduction programs, thereby causing them to fall even further behind in funding. There is still speculation that a taxpayer bailout of the PBGC may be necessary. Congress has taken steps to attempt to improve the situation and is currently considering legislation that includes a number of provisions aimed at strengthening the financial condition of underfunded defined benefit pension plans in general, and the PBGC in particular.

AICPA Recommendations. Many participants of underfunded defined benefit pension plans do not realize that some or all of their pension bene-

fits may be at risk if the plan sponsor fails. In April 1993, the AICPA submitted to the Labor–Management Relations Subcommittee of the House of Representatives a statement that proposed specific measures to correct a shortfall in the information about their defined benefit pension plans that participants need to help them plan for their retirement. The AICPA recommended the following reforms to improve disclosures to plan participants:

1. The U.S. Department of Labor (DOL) should enhance and expand the information required in the Summary Annual Report to include fundamentals, such as how much the plan has promised to pay participants (in other words, the accumulated plan benefits), whether the plan is currently funded to make good on those commitments, whether plan benefits are insured by the government's PBGC, and the quality of the plan's investments.
2. The DOL should monitor compliance to ensure that plan participants receive the Summary Annual Report.
3. The DOL should ensure that every individual member of multiemployer pension plans (for example, union-sponsored plans) has access to information on how much benefits he or she has earned.
4. The DOL should shorten the time allowed for plans to notify employees of major plan changes to no more than ninety days.
5. The FASB should require that defined benefit pension plans prominently disclose the total accumulated plan benefits in the financial statements.
6. Congress should require pension plans to have full scope audits.

In December 1993, the DOL issued a Request for Information (RFI) intended to assist its evaluation of the extent to which the current disclosure requirements serve to assure that participants and beneficiaries are provided with useful and timely information about their plans and the extent to which the current requirements need to be updated. Auditors should be alert for any regulatory or legislative proposals that may result from the RFI.

Regulatory and Legislative Developments

Regulatory Developments

PWBA Review of Plan Audits. During 1993, the DOL Pension and Welfare Benefits Administration (PWBA) continued to implement its quality review program for audits required by the Employee Retirement Income Security Act of 1974 (ERISA). Practitioners deemed by the PWBA to have

performed significantly substandard audit work are referred to either state licensing boards or the AICPA Professional Ethics Division for further investigation. As of December 31, 1993, 46 referrals had been made to state licensing boards and 200 referrals had been made to the AICPA Professional Ethics Division; of these the Professional Ethics Division has resolved 148 cases. Of these resolved cases, 49 were referred to the AICPA's Trial Board, 73 resulted in letters of recommended corrective action, nine were found to contain no deficiencies, and 17 were closed for other reasons. Common deficiencies noted in the referrals included—

- Inadequate or no audit program or planning.
- Inadequate or no understanding of the internal control structure.
- Inadequate or no documentation supporting the audit work performed.
- Deficiencies in the auditor's report.
- Deficiencies in the note disclosures.

As part of its quality review program, the PWBA also performs on-site reviews of independent auditor's working papers. As of December 31, 1993, one hundred thirty-five such reviews had been performed. Professional work deemed significantly deficient by the PWBA as a result of its reviews is referred to the AICPA Professional Ethics Division or to appropriate state boards of accountancy. Because ERISA places the responsibility for seeing that plans' financial statements are audited on plan administrators, deficient audit work can expose plan administrators to significant penalties under ERISA section 502(c)(2).

PWBA Reporting Compliance Program. In addition to its quality review program for ERISA audits, the PWBA has an aggressive reporting compliance program to ensure that plan administrators comply with ERISA's reporting requirements. Through 1993, the PWBA has rejected over 2,700 filings and imposed over $50 million in civil penalties under ERISA section 502(c)(2), which provides for penalties of up to one thousand dollars per day against plan administrators who fail to file acceptable annual reports on a timely basis.

In December 1992, PWBA concluded a grace period program designed to encourage late filers and nonfilers to submit required annual report filings to the DOL. This program resulted in the submission of over 40,000 additional filings and the collection of approximately 40 million dollars in civil penalties.

The PWBA continues to actively identify and target both late filers and nonfilers. Over 1,400 late filers and nonfilers have been identified and assessed over nine million dollars in late filing and nonfiling penalties.

The PWBA encourages practitioners to urge their clients to file any delinquent annual report filings. The following penalties may be assessed against late filers or nonfilers:

- *Late Filers*—Plan administrators who voluntarily file annual reports for 1988 and subsequent reporting years after the due date will be considered late filers. They may be assessed $50 a day, per plan, for the period for which they failed to file.
- *Nonfilers*—Plan administrators who fail to file required reports and are subsequently identified by the PWBA will be considered nonfilers. They may be assessed a penalty of $300 per day, per plan, with the penalty continuing to accrue up to $30,000 per year for each plan year until a filing is submitted.

Form 5500 Reporting Requirements. The instructions to the 1992 Form 5500 indicated that use of the Schedule G, Financial Schedules, by plans answering "yes" to Items 27a through 27f on the 1993 Form 5500, would be optional for the 1992 plan year and mandatory for the 1993 plan year. Because a number of service providers may be unable to modify their computerized recordkeeping systems in time to provide plan administrators with the required information in the format prescribed by Schedule G for the 1993 plan year filings, mandatory use of Schedule G has been deferred. The PWBA has indicated that it will not reject Form 5500 Annual Return/Report filings for the 1993 plan year solely because of a failure to file required financial schedules in accordance with the format prescribed by Schedule G. However, plan auditors and administrators should be aware that while the use of the Schedule G *form* is optional, the *information* required by that schedule still must be included in the filings.

Extension of Enforcement Policy. The PWBA's Technical Release 92-1 provides interim relief from the trust and certain annual reporting requirements, including the audit requirements, of ERISA for so-called cafeteria plans (described in section 125 of the Internal Revenue Code). Interim relief was originally to expire on December 31, 1993. However, the PWBA has determined that relief should remain in effect until the adoption of final regulations addressing the trust and reporting requirements of Title I of ERISA for welfare plans that receive participant contributions. Plan auditors should be alert for the issuance of such regulations.

Reporting Participant Loans. The DOL requires that loans to participants of plans that offer such a feature (for example, 401(k) or annuity plans) be included as investments on Form 5500 and disclosed in the Schedule of Assets Held for Investment Purposes. Loans that meet the requirements of the DOL's regulations under ERISA section 408(b)(1) may be aggregated and presented with a general description of terms and interest rates. The

DOL may reject filings that do not properly disclose participant loans on the Schedule of Assets Held for Investment Purposes.

Contributions of Property. The Supreme Court recently ruled *(Commissioner v. Keystone Consolidated Industries Inc.)* that the contribution of property to a defined benefit pension plan by the plan's sponsoring employer is a prohibited transaction under Section 4975(c)(1)(A) of ERISA.

In light of this ruling, the Internal Revenue Service is looking at plans with significant amounts of employer assets for possible prohibited transactions and examining whether plan assets are being appropriately valued. Paragraphs 11.09 through 11.16 of the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans* provide auditors with guidance regarding the course of action that they should take when, as part of an audit, they become aware that prohibited transactions, such as contributions of property by plan sponsors, may have occurred. Auditors should also be alert for any guidance issued by the DOL in this area.

Legislative Developments

Pension Reform. Recently, attention has been focused on underfunded retirement plans and how the PBGC's growing accumulated deficit will affect its ability to meet its obligation to guarantee employees' benefits under most private sector defined benefit pension plans. H.R. 3396, The Retirement Protection Act of 1993, was introduced in Congress in October 1993 in response to these concerns. The bill is intended to increase the security of the pension system and improve the PBGC's ability to meet its obligations to plan participants. It would modify existing rules to encourage employers to more fully fund their defined benefit pension plans and would amend various qualification requirements, including minimizing the ability of sponsors of underfunded plans to select interest and mortality assumptions for purposes of calculating their minimum contributions, imposing substantial limitations on the ability to cross-test defined contribution plans (for example, age-weighted profit-sharing plans) and modifying the interest and mortality assumptions used for calculating lump sum distributions from defined benefit plans. Auditors should be aware that such changes could, among other things, affect a plan's tax qualification status, which may have a direct and material effect on the plan's financial statements, as described in SAS No. 54, *Illegal Acts by Clients* (AICPA, *Professional Standards,* vol. 1, AU sec. 317), and should be alert for any new developments in this area.

ERISA Audit Improvement Act. Congress is being asked to consider the ERISA Audit Improvement Act, the objective of which is, among other things, to improve ERISA provisions with respect to the audits of the financial statements of employee benefit plans.

If enacted, the Act would repeal the limited scope audit exemption and mandate external quality control reviews every three years for public accountants who conduct ERISA audits. The Act would also require qualified public accountants to report directly to the Secretary of Labor certain events that come to their attention during the audit.

Auditors should be aware that this Act could substantially change the way benefit plan audits are conducted and could significantly affect their audit practice. Auditors should be alert to any new developments in this area.

Audit and Accounting Developments

Audit Issues

Derivatives and Other High-Risk Investments. In response to low interest rates and in an attempt to earn higher yields, a number of investment managers have revised their investment strategies. Generally, the changes involve the purchase of more complex financial instruments that can involve a substantial risk of loss. Investors in such instruments should have the expertise necessary to understand and manage the related risks. As discussed below, auditors should also be familiar with such instruments and the associated risks. One class of these instruments—derivatives—requires particular attention.

Derivatives are complex financial instruments whose values depend on the values of one or more underlying assets or financial indexes. Derivatives generally fall into at least two categories, as follows:

- Asset-backed securities that include mortgage-backed securities, interest-only and principal-only strips, and tranches of collateralized mortgage obligations
- Off-balance-sheet instruments such as forward contracts, interest-rate and currency swaps, futures, options, and other financial contracts

By reconfiguring cash flows associated with underlying assets, an issuer can create asset-backed securities that meet the needs of and are attractive to various potential users or investors by isolating, enhancing, or diluting one or more of credit, liquidity, interest-rate, and other risks inherent in the underlying cash flows. For example, through mortgage-backed securities, the issuer can enhance the marketability of underlying mortgage loans by spreading liquidity and credit risk across broad pools, or by providing a higher yield to those users willing to accept a higher concentration of the risks associated with specific collateral cash flows. Similarly, users find certain derivatives attractive because they can pur-

chase the risks and rewards they desire most, or can synthetically create a security with the desired risk and reward characteristics.

Accounting for derivatives is complex. Given the constant innovation and complexity of derivatives, accounting literature does not explicitly cover some derivatives, however, several related projects are under way.

The innovative and complex nature of such investment vehicles may significantly increase audit risk. For example, as more and more financial institutions enter the markets for such instruments, their profitability may diminish. Traders may attempt to compensate for the diminution by increasing the volume of transactions involving such instruments or by further customizing products. An increase in volume may be accompanied by trading with counterparties that have higher credit risk. Customizing transactions may increase valuation difficulties. The propriety of the methods used to account for transactions involving sophisticated financial instruments and to determine their value should be carefully considered. Understanding the substance of transactions in such instruments is important in determining the propriety of their accounting treatment. In some circumstances, auditors may find it helpful to consult with experts. SAS No. 22, *Planning and Supervision* (AICPA, *Professional Standards,* vol. 1, AU sec. 311) requires that an auditor understand the events, transactions, and practices that, in the auditor's judgment, may have a significant effect on the financial statements. Accordingly, auditors of the financial statements of users and issuers of derivatives should be aware of the various risks involved with derivatives and in planning the audit should consider—

- The nature and extent of the use of derivatives.
- The level of expertise of the plan's investment managers in monitoring, evaluating, and accounting for derivatives.
- The policies and procedures established for investment in high-risk derivatives and the degree of oversight by the plan administrator.
- The involvement of specialists in valuing derivatives.

The auditor should consider the work of any specialist used in valuing derivatives when auditing complex derivatives. See guidance in SAS No. 11, *Using the Work of a Specialist* (AICPA, *Professional Standards,* vol. 1, AU sec. 336).

Reporting on Supplemental Schedules. The AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans* includes guidance on reporting on supplemental schedules that are required by the DOL's Rules and Regulations for Reporting and Disclosure under ERISA. The report on supplemental information that is prescribed in the Guide for use when a

full scope audit has been performed differs from that to be used when a limited scope audit has been performed. Some auditors are confused about the differences in these reports. According to the Guide, when an audit in accordance with generally accepted auditing standards (GAAS) (in other words, a full scope audit) has been performed, the auditor's report on the supplemental schedules need not state that the schedules comply with the DOL filing requirements. However, when a limited scope audit has been performed, the Guide states that the auditor's report includes the auditor's opinion as to whether the *form and content* of the information included in the financial statements and DOL schedules is presented in compliance with the DOL's rules and regulations under ERISA. In either case, when the auditor concludes that the supplemental schedules do not contain all required information or contain information that is inaccurate or is inconsistent with the financial statements, the auditor should consider either adding an explanatory paragraph to the report on the schedules or expressing a qualified or adverse opinion on the supplemental schedules. The Guide contains a table that illustrates the report modifications that an auditor might consider to be necessary when a schedule, or information thereon, is omitted or when information included in a schedule is materially inconsistent with the financial statements.

Limited Scope Audit Exemption. ERISA section 103(a)(3)(C) allows auditors to limit the scope of their testing of investment information prepared and certified by a qualified trustee or custodian. A number of auditors, however, have assumed that the exclusion applies to investment information other than that certified by a qualified trustee or custodian or to other noninvestment information (for example, benefit payments, employer/employee contributions, and receivables). Auditors should be aware that the scope limitation and the corresponding limitation of the auditor's work extends *only* to investments and related investment activity certified by the qualified trustee or custodian. Plan investments not held by a qualified trustee or custodian, and *all* noninvestment related information should be subjected to the same audit procedures as for a full scope audit. The auditor's responsibilities in limited scope engagements are discussed in detail in paragraphs 7.45 and 7.46, *Audits of Employee Benefit Plans.*

Review of Form 5500. Plans that meet certain criteria are required to file audited financial statements along with Form 5500. When audited financial statements are filed along with a plan's Form 5500, the auditor should read the Form 5500 and consider whether it is materially inconsistent with the financial statements that are to be included in the filing. See paragraph 12.12, *Audits of Employee Benefit Plans.*

Auditors may encounter situations in which the financial statements and auditor's report are issued for purposes other than ERISA filings prior to the completion of the Form 5500. In such situations, the auditor should inform the plan administrator that the financial statements and auditor's report are not to be attached to the Form 5500 filing without the auditor's review of the filing on Form 5500. See paragraphs 12.15 and 12.16, *Audits of Employee Benefit Plans* for guidance on the auditor's responsibility when reports are issued prior to the Form 5500 filing.

Reporting on Fund Information. Requirements for presenting information related to separate investment fund options of defined contribution plans are described in paragraph 3.23(k), *Audits of Employee Benefit Plans.* When the required information on separate investment options is presented on the face of the financial statements, the auditor's measure of materiality remains that with respect to the financial statements taken as whole, rather than each investment fund option. Paragraph 13.36 of the Guide contains an auditor's report on the financial statements of a savings plan containing separate investment fund option information, filed with Form 5500, which illustrates the appropriate reporting in such a situation.

Audit Development

SAS on Service Organizations. In April 1992 the AICPA Auditing Standards Board issued SAS No. 70, *Reports on the Processing of Transactions by Service Organizations* (AICPA, *Professional Standards,* vol. 1, AU sec. 324), which is effective for service auditor's reports dated after March 31, 1993. SAS No. 70 supersedes SAS No. 44, *Special-Purpose Reports on Internal Accounting Control at Service Organizations.* SAS No. 70 provides guidance to auditors of financial statements of entities that use service organizations, such as bank trust departments, that provide investment or administrative services to employee benefit plans.

When an organization uses a service organization, transactions that affect the user organization's financial statements are subjected to policies and procedures that may be physically and operationally separate from the user organization. Consequently, the internal control structure of a user organization may include a component that is not directly under the control and monitoring of the user organizations management. For this reason, planning the audit may require that a user auditor gain an understanding of policies and procedures at the service organization that may affect the user organization's financial statements. If control policies and procedures at a service organization have a significant effect on assertions in a user organization's financial statements, the user organization's auditor may find a service auditor's report helpful in gaining an understanding of an entity's internal control structure and in assessing control risk.

Many bank trustees are on a calendar year and, consequently, obtained special-purpose reports in accordance with SAS No. 44 prior to March 31, 1993, for use by auditors in audits of 1992 plan financial statements. Auditors should be aware that such reports are not acceptable for use by auditors in audits of 1993 plan financial statements. Trustees should engage auditors to prepare service auditors' reports that are prepared in accordance with SAS No. 70 for use by plan auditors in audits of 1993 plan financial statements.

Auditors should also be aware that although a service auditor's report on policies and procedures placed in operation at the service organization may be helpful in providing a sufficient understanding to plan the audit, the auditor should not rely on such a report to justify a reduction of the assessed level of control risk below the maximum. If the auditor plans to use a service auditor's report to reduce the assessed level of control risk, he or she should obtain a service auditor's report on policies and procedures placed in operation that includes tests of operating effectiveness.

The AICPA is also preparing an auditing procedures study (APS) that provides assistance to user auditors as well as service auditors in the implementation of SAS No. 70.

Accounting Issue

Paragraph 3.23(m) of the Guide requires that the plan disclose the amounts of assets that have been allocated to participants who have withdrawn from the plan as of year end, but for which disbursement of those funds from the plan has not yet been made. The amount should be disclosed in the notes to the financial statements. It should not be classified as a liability in the statement of net assets available for benefits. When evaluating the adequacy of disclosures in this area, auditors should be aware that for plans filing under the alternative method, the DOL requires that these amounts be reported as liabilities on Form 5500, which will require a reconciling note in the plan's financial statements as described in paragraphs A.41 and A.42(c) of the Guide.

Accounting Developments

Valuation of Insurance and Investment Contracts. The FASB has issued FASB Statement No. 110, *Reporting by Defined Benefit Pension Plans of Investment Contracts,* which is an amendment to FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans.* FASB Statement No. 110 requires fair-value reporting for all investment contracts held by defined benefit pension plans. However, it permits the continued use of contract value for insurance contracts as defined in FASB Statement No. 60, *Accounting and Reporting by Insurance Enterprises,* as well as deposit admin-

istration and immediate participation guarantee contracts entered into before March 20, 1992. FASB Statement No. 110 is effective for fiscal years beginning after December 15, 1992.

In September 1993, the AICPA's Employee Benefit Plans Committee issued an exposure draft proposed statement of position (SOP), *Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined Contribution Pension Plans,* that, in final form, will provide guidance on how those plans should report investment contracts issued by insurance companies, banks, thrift institutions, and others. In addition, the proposed SOP would provide guidance for determining the fair value of investment contracts held by all types of plans. The proposed SOP may substantially change the way certain investment contracts are reported. Auditors should be alert for final guidance in this area.

Reporting Investment Contracts Issued by Troubled Insurance Companies. The Guide currently permits the reporting of investment contracts issued by insurance companies that are held by health and welfare plans and defined contribution pension plans at the value, determined on Schedule A, Insurance Information, of Form 5500, that is contract value. In the current economic environment, certain of these contracts may have been issued by what are now troubled insurance companies. In these cases, the auditor should be aware that continuing to carry the assets at contract value may not be appropriate, because the plan may not recover the entire contractual amount. When addressing problem contracts, auditors should consider the guidance in FASB Statement No. 5, *Accounting for Contingencies.*

Fair Value Disclosures. FASB Statement No. 107, *Disclosures about Fair Value of Financial Instruments,* requires all entities to disclose, within the body of the financial statements or in the accompanying notes, the fair value of financial instruments, both assets and liabilities recognized and not recognized in the statement of financial position, for which it is practicable to estimate fair value. Generally, financial instruments of an employee benefit plan other than insurance contracts as defined in FASB Statement No. 110, are included in the scope of FASB Statement No. 107 and are subject to the disclosure requirements of paragraphs 10–14 of the Statement.

An entity also should disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments. Since these disclosures are made by defined benefit pension plans in accordance with FASB Statement No. 35, as amended, and by defined contribution plans in accordance with the provisions of the Guide, the disclosure requirements of FASB Statement No. 107 typically will be met by complying with FASB Statement No. 35, as amended, or the Guide, as appropriate.

Health and Welfare Benefit Plans. In August 1992, the AICPA Employee Benefit Plans Committee issued SOP 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans.* The SOP clarifies several accounting and reporting requirements set forth in chapter 4 of the Guide and updates the Guide to incorporate new statements issued by the FASB. Significant changes include clarification of—

- The objective of financial reporting by defined benefit health and welfare plans.
- How defined benefit health and welfare plans, both single-employer and multiemployer, should account for and report benefit obligations, including postretirement obligations.
- The requirement to recognize claims incurred but not reported.
- The stipulation that benefit obligations should not include death benefits actuarially expected to be paid during participants' period of active service.
- The distinction between defined contribution health and welfare plans and defined benefit health and welfare plans.
- The requirement that the current insurance premium rates used in determining the obligation for accumulated eligibility credits should generally consider mortality rates and the probability of employee turnover.

SOP 92-6 is effective for audits of single-employer plans with more than five hundred participants for plan years beginning after December 15, 1992; for audits of single-employer plans with no more than five hundred participants for plan years beginning after December 15, 1994; and for audits of multiemployer plans for plan years beginning after December 15, 1995. When a plan adopts the SOP, the plan must adopt it in its entirety. Accounting changes adopted to conform to the provisions of the SOP shall be made retroactively. Because ERISA requires comparative statements of net assets available for plan benefits, it will be necessary to restate the prior year's statement of net assets in the year of adoption in an ERISA audit to comply with the provisions of the SOP. In addition, because accumulated benefit obligations are not reported on Form 5500, plans adopting SOP 92-6 for the 1993 plan year should include a note to their financial statements reconciling the amounts reported in the financial statements to amounts reported on Form 5500, as described in paragraphs A.41 and A.42(c) of the Guide.

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This audit risk alert supersedes *Employee Benefit Plans Industry Developments—1993.*

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Auditors should also be aware of the economic, regulatory, and professional developments that may affect the audits they perform as described in *Audit Risk Alert—1993*, which may be obtained by calling the AICPA Order Department at the number below and requesting publication number 022099.

Copies of AICPA publications referred to in this document may be obtained by calling the AICPA Order Department at (800) TO–AICPA. Copies of FASB publications may be obtained directly from the FASB by calling the FASB Order Department at (203) 847–0700, ext. 10.