Employee benefit plans industry developments - 1998; Audit risk alerts

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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 and the AICPA Employee Benefit Plans Committee. It has not been approved, disapproved, or otherwise acted on by any senior technical committee of the AICPA. The AICPA staff wishes to thank the Office of the Chief Accountant of the U.S. Department of Labor Pension and Welfare Benefits Administration for contributing to this Audit Risk Alert.

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Industry and Economic Developments

As the need for individuals to provide for their own financial retirement increases, plan sponsors continue to offer 401(k) and other defined-contribution pension plans and to offer more investment options for participants. Currently, there is a trend toward bundled service providers and daily valuations. In the past, the trustee of a plan would differ from the recordkeeper of the plan. More and more, these services are being “bundled” and provided by one service provider. This allows plan participants to change their investments daily, by phone or via the Internet, with virtually no record of the changes being kept by the service provider or the plan. This increases the auditor’s reliance on the system and increases the need for reports based on Statement on Auditing Standards (SAS) No. 70, *Reports on the Processing of Transactions by Service Organizations* (AICPA, *Professional Standards*, vol. 1, AU sec. 324). See the “Audit Issues and Developments” section of this Audit Risk Alert for a further discussion on the trend toward daily valuation and the use of SAS No. 70 reports.

The Year 2000 (Y2K) Issue has become a prominent issue in the business community and has similarly caught the attention of the Department of Labor (DOL). On February 9, 1998, the DOL issued a news release warning plan administrators about the Y2K Issue and the need for immediate action. Assistant Secretary for Pension and Welfare Benefits Olena Berg reminded plan administrators and service providers of the need for action to address the looming Y2K software problem in order to protect workers’ benefits as the century turns. According to Berg, “Plan administrators and service providers cannot afford to gamble on a last-minute, technological fix. They must act now.” Plan administrators are responsible for assessing and remediating the effects of the Y2K Issue on the plan’s systems. Plan administrators are also responsi-
ble for considering the effects that other entities’ noncompliant systems may have on its operations and information system, including service provider systems. For a further discussion of Y2K, see the following section entitled, “Year 2000 Issue” of this Audit Risk Alert.

Perhaps a more immediate issue than the Y2K Issue is the advent of the European Monetary Unit (EMU), commonly referred to as the euro. On January 1, 1999, many European countries will adopt the euro as their common currency and will no longer use their national currencies (there will be a transition period during which national currencies and the euro will exist simultaneously). The national currencies will no longer be quoted, and conversions will have to be made through the euro. Plans that invest in foreign securities should be aware of this issue to ensure that their systems can adapt to the euro as well as the year 2000. In the beginning, systems will have to be able to handle national currencies as well as the euro for the transition period, and any system modifications or replacements would need to be in place and working before January 1, 1999.

**The Year 2000 Issue**

*What is the Year 2000 Issue and how will the arrival of the year 2000 affect employee benefit plan recordkeeping systems?*

The majority of computer programs in use today have been designed to store dates in a dd/mm/yy (date/month/year) format, that allows only two digits for each date component. For example, the date December 31, 1998, is stored in most computers as 12/31/98. Programming for dates in this manner rests on the assumption that the designation 98 refers to the year 1998. This long-standing practice of using two-digit year input fields was initially developed as a cost-saving technique, but will cause many computers to treat the entry 00 as 1900. As a result, such programs may recognize the date January 1, 2000 (01/01/00) as January 1, 1900! Unless remedied, significant problems relating to the integrity of all information based on time will then arise. To further complicate the issue, even if a plan’s computer software and hardware have been modified to resolve the problem, the entity may be affected by the computer systems of third-party data-processing services, third-party administrators, actuaries,
plan sponsors, or claims administrators that have not made such modifications.

Another shortcoming is that the algorithm used in some computers for calculating leap years is unable to detect that the year 2000 is a leap year. Therefore, systems that are not Y2K compliant may not register the additional day, and date calculations may be incorrect.

The Y2K Issue also may affect computer applications before January 1, 2000. Failures are expected to occur when systems attempt to perform calculations into the year 2000. In addition, some software programs use the year 1999 to mean something other than the date. As systems process information using these dates, they may produce erratic results or stop functioning.

Although auditors do not have a responsibility to detect current or future effects of the Y2K Issue on operational matters that do not affect the entity’s ability to prepare financial statements in accordance with generally accepted accounting principles (GAAP), or an other comprehensive basis of accounting (OCBOA), auditors should be aware that the Y2K Issue may affect a service organization’s computerized systems to provide services to employee benefit plans. This in turn may affect the ability of employee benefit plans to record, process, summarize, and report financial data. For example, a system unprepared for Y2K might fail to recognize when an active participant has attained normal retirement age under the plan to qualify for full vesting. Other areas related to age or service that could be affected include the following:

- Eligibility requirements
- Reinstatement of forfeited account balances
- Funding calculations and lump-sum distribution calculations
- Defined-contribution age or service allocations
- Nondiscrimination testing
- Start dates for required minimum distribution
- Employee stock ownership plan (ESOP) diversification rights
- Qualified domestic relations orders (QDROs)
• Early retirement supplements
• Post-retirement-medical benefits
• Funding assumptions for post-retirement benefits in a funded welfare plan
• Calculations based on the following Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards:
  – FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*
  – FASB Statement No. 87, *Employers' Accounting for Pensions*
  – FASB Statement No. 88, *Employers' Accounting for Settlement and Curtailments of Defined-Benefit Pension Plans and for Termination Benefits*
  – FASB Statement No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*
  – FASB Statement No. 112, *Employers' Accounting for Postemployment Benefits*

The AICPA's Audit Issues Task Force (AITF) of the Auditing Standards Board (ASB) issued or will be issuing the following interpretations regarding the Y2K Issue.

• Interpretations of AU section 312, *Planning and Supervision*, of the Statements on Auditing Standards. Issued in October 1997, the Interpretations explain the auditor’s responsibilities in regard to the Y2K Issue. The Interpretations address the following questions. (1) Does the auditor of financial statements have a responsibility to detect the Y2K Issue? (2) How does the Y2K Issue affect the planning for an audit of financial statements? (3) Under what circumstances is the Y2K Issue a reportable condition? The Interpretations were published in the January 1998 issue of the *Journal of Accountancy*.

• Interpretations of SAS No. 70, *Reports on the Processing of Transactions by Service Organizations*. Issued in December 1997, the Interpretations clarify the responsibilities of ser-
vice organizations and service auditors with respect to information about the Y2K Issue in a service organization's description of controls. The Interpretations appeared in the March 1998 issue of the *Journal of Accountancy*.

- Interpretations of SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*, vol. 1, AU section 341). Expected to be issued in the second quarter of 1998, the Interpretations will discuss the auditor's responsibilities when he or she believes there is substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time, and the conditions and events underlying that belief include conditions and events relating to the Y2K Issue.

SAS No. 83, *Establishing an Understanding With the Client* (AICPA, *Professional Standards*, vol. 1, AU sec. 310) requires auditors to obtain an understanding with the client regarding the service to be performed, including the objectives and limitations of an audit of financial statements (see the "New Auditing Pronouncements" section of this Audit Risk Alert). Auditors may wish to specifically address the Y2K Issue in connection with obtaining that understanding and may consider adding language such as the following to their engagement letter.

> Because many computerized systems use only two digits to record the year in date fields (for example, the year 1998 is recorded as 98), such systems may not be able to accurately process dates ending in the year 2000 and after. The effects of this issue will vary from system to system and may adversely affect a plan's operations as well as its ability to prepare financial statements.

An audit of financial statements conducted in accordance with generally accepted auditing standards is not designed to detect whether the plan's systems are year-2000-compliant. Further, we have no responsibility with regard to the plan's efforts to make its systems, or any other systems, such as those of the Plan's service providers or any other third parties, year-2000-compliant or provide assurance on whether the Plan has addressed or will be able to address all of the affected systems on a timely basis.
These are responsibilities of the Plan's management. However, for the benefit of management, we may choose to communicate matters that come to our attention relating to the Year 2000 Issue.

Because of the publicity that the Year 2000 Issue has received, some entities may decide to make disclosures regarding their systems' year 2000 readiness. Auditors should be extremely cautious about being associated with assertions that clients' systems are year 2000 compliant or guarantees that systems will become compliant by a specified date.

The auditor also may wish to consider whether year-2000-related problems should be highlighted in his or her management comment letters. For further discussion of the Y2K Issue including illustrative language that auditors may want to add to their management letters see the AICPA publication, *The Year 2000 Issue: Current Accounting and Auditing Guidance*. (This publication is available on the AICPA's web site, which is http://www.aicpa.org.)

Additional information relating to the Y2K Issue is available on the Internet at the following Web sites:

- Year 2000 Technical Audit Center page of AuditServe: http://www.auditserve.com
- AuditNet Year 2000 Resources for Auditors: http://users.aol.com/auditnet/y2kaudit.htm
- AICPA Web site: http://www.aicpa.org

**Executive Summary—Year 2000 Issue**

- Unless corrective actions are taken, the year 2000 may cause accounting and financial information systems to produce inaccurate date-related output.

- The AITF issued Interpretations to AU section 312, “Planning and Supervision,” of the Statements on Auditing Standards and SAS No. 70, *Reports on the Processing of Transactions by Service Organizations* and how they relate to the Y2K Issue.
• The AITF plans to issue Interpretations to SAS No. 59, *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern.*

• Auditors may wish to include references to the Y2K Issue in their engagement and management letters.

• The DOL is warning plan administrators about the Y2K Issue and the need for immediate action.

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**Regulatory and Legislative Developments**

**Regulatory Developments**

**Department of Labor Nonenforcement of GAAP Disclosures of Postretirement Benefit Obligations by Multiemployer Health and Welfare Benefit Plans**

On March 13, 1997, the DOL published in the *Federal Register* a notice and request for comment on an annual enforcement policy pursuant to which the DOL would not reject the Form 5500 annual report of a multiemployer welfare benefit plan filed for the 1996 and 1997 plan years solely because the accountant’s opinion accompanying such report is qualified or adverse due to a failure to comply with the financial statement disclosure requirements of AICPA Statement of Position (SOP) 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans.* The DOL has decided to extend its nonenforcement policy for the 1998 plan year while it considers the public comments it received. See the section entitled “Multiemployer Health and Welfare Benefit Plan Accounting for Postretirement Benefit Obligations” of this Audit Risk Alert for further discussion of this issue.

**Revision of the Form 5500 Series and Related Regulations Under the Employee Retirement Income Security Act of 1974**

On September 3, 1997, the DOL, the Internal Revenue Service (IRS), and the Pension Benefit Guaranty Corporation (PBGC) jointly published in the *Federal Register* a proposal aimed at streamlining and simplifying the Form 5500 Annual Report Series and reducing the filing burden for plan sponsors. The public was provided an opportunity to comment on the proposed changes and, on No-
nember 17, 1997, the DOL held a hearing at which eight witnesses testified before representatives from the DOL, the IRS, and the PBGC. The DOL is evaluating the oral and written comments received and expects the revised form to be in use for the 1999 filing year. In general, the AICPA supports the proposed revisions to the Form 5500 series and has issued a comment letter to the DOL.

Review of Financial Institution Certifications Obtained During Limited-Scope Audits

During 1997, the U.S. Department of Labor Pension and Welfare Benefits Administration (PWBA) conducted an informal review of financial certifications furnished in conjunction with limited-scope audits pursuant to the Employee Retirement Income Security Act of 1974 (ERISA) section 103(a)(3)(C). The scope of the PWBA's review included twelve individual master trust filings by three banks and one hundred individual plan filings and focused on assets for which fair value is not readily available (for example, real estate, limited partnerships, and nonpublicly traded securities). The review revealed the following:

1. Certifications frequently did not report assets at current value

2. Plan administrators frequently reported assets on the Form 5500 at the same value as that set forth in the certification, without regard to whether the assets had been valued at current value

3. In many instances, there was little or no documentation to support the values certified to by the financial institution or reported by the administrator

4. In many instances, assets were certified to and reported at cost for more than one year

5. The PWBA's review found that, although not required to unless the auditor becomes aware that such information is incorrect, incomplete, or otherwise unsatisfactory for the purpose of preparing the financial statements, the accountants accepted these certifications without further investigation.

In this regard, Paragraph 7.52 of the AICPA's Audit and Accounting Guide Audits of Employee Benefit Plans (the Guide), with conform-
ing changes as of May 1, 1998, states that although independent au-
ditors conducting limited-scope audits are not required to audit cer-
tain investment information, further investigation and testing are
required whenever the auditor becomes aware that such informa-
tion is incorrect, incomplete, or otherwise unsatisfactory for the
purpose of preparing financial statements. See the “Limited-Scope
Audit Exemption and Trustee Certifications” section of this Audit
Risk Alert for further discussion of trustee certifications.

Timeliness of Participant Contributions Remains an
Enforcement Initiative for the PWBA

The PWBA continues to focus on the timeliness of remittance of
particular contributions in contributory employee benefit plans.
Participant contributions are required to be remitted as soon as
they can reasonably be segregated from an employer's general as-
sets. A new DOL regulation, effective February 3, 1997, requires
employers who sponsor pension plans (both defined-benefit and
defined-contribution) to remit employee contributions as soon as
practicable, but in no event more than fifteen business days after
the month in which the participant contribution was withheld or
received by the employer.

The regulation establishes a procedure by which an employer may
obtain an extension of the fifteen business-day limit for an additional
ten business days. This regulation does not change the maximum pe-
riod for remittance of employee contributions to welfare plans: as
soon as practicable, but in no event more than ninety days after the
day the contribution was withheld or received by the employer.

Failure to remit or untimely remittance of participant contribu-
tions may constitute a prohibited transaction (either a use of plan
assets for the benefit of the employer or a prohibited extension of
credit) and, in certain circumstances, may constitute embezzle-
ment of plan assets. Additionally, such information should be
properly presented on the required Form 5500 supplemental
schedule of nonexempt transactions with parties in interest.

For questions or further information, contact the Office of Regu-
lations and Interpretations at the DOL at (202) 219-7461.
Pension Lump-Sum Payment Miscalculations

According to a recent audit of terminated fully funded pension plans by the PBGC, approximately 8 percent of employees in the audit sample who received lump-sum payments from their pensions in 1994 and 1995 were underpaid. The audit revealed that the most common reasons given for pension lump-sum payment miscalculations were interest rate and employee information errors. Because the pension laws are complex and lump-sum payments are growing, plan administrators and auditors should pay close attention to lump-sum payment calculations.

Paragraph 9.03 of the Guide states that auditors should “recompute benefits based on the plan instrument and related documents, option elected, and pertinent service or salary history” for a selected sample of participants receiving benefit payments. Plan administrators and auditors should also understand the methodology used to arrive at the calculation of lump-sum payments. This methodology should be stated in the pension plan instrument. Generally, the interest rates used must be no more than those published by the PBGC at any given point in time.

PWBA Review of Plan Audits and Related Peer Review Developments

The PWBA has established an ongoing quality review program to assess the quality of audit work performed by independent auditors in audits of plan financial statements that are required by 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. Because ERISA holds plan administrators responsible for assuring that plan financial statements are audited in accordance with generally accepted auditing standards (GAAS), deficient audit work can also expose plan administrators to significant penalties under ERISA Section 502(c)(2).

The PWBA continues its aggressive reporting compliance program to ensure that plan administrators comply with ERISA's reporting and disclosure requirements. The DOL's 1999 budget set
a major performance goal to report 3 percent or less deficiencies in Form 5500 filings and 12 percent or less in audit deficiencies.

The AICPA, working with the PWBA, has made a concerted effort to improve the guidance and training available to auditors of employee benefit plans. The AICPA self-regulatory teams continue to be concerned about deficiencies noted on audits of employee benefit plans, and practitioners need to understand that severe consequences including loss of membership in the AICPA, and loss of license can result from inadequate plan audits.

**PWBA Outreach and Customer Service Efforts**

The PWBA continues to encourage auditors and plan filers to call its Division of Accounting Services at (202) 219-8794 with ERISA-related accounting and auditing questions. Questions concerning the filing requirements and preparation of Form 5500 should be directed to the Division of Reporting Compliance at (202) 219-8770.

In addition to handling technical telephone inquiries, the PWBA is involved in numerous outreach efforts designed to provide information to practitioners to help their clients comply with ERISA's reporting and disclosure requirements. Questions regarding these outreach efforts should be directed to the Office of the Chief Accountant at (202) 219-8818. Practitioners and other members of the public may also wish to contact the PWBA at their Web site: http://www.dol.gov/dol/pwba. The Web site provides information on PWBA's organizational structure, current regulatory activities, and customer service and public outreach efforts.

**Delinquent Filer Voluntary Compliance Program**

In April 1995, the PWBA initiated an ongoing Delinquent Filer Voluntary Compliance (DFVC) program designed to encourage filer compliance by allowing plan administrators who failed to file or filed their Form 5500 Series annual reports late to apply for relief from full delinquency penalties. Auditors should be aware of this program if their clients' plan reports have not been filed or have been filed late and they qualify for this program.

Questions concerning the DFVC Program should be directed to the PWBA's Division of Reporting Compliance at (202) 219-8770.
Other Current Matters

**PWBA Proposed Rule on Claims Procedures for Employee Benefit Plans.** On September 8, 1997, the PWBA issued an information request in evaluating whether to amend its regulation that establishes minimum requirements for employee benefit plan claims procedures. The comment period ended on November 7, 1997, and at that time, the PWBA had received fifty-five written comments.

**Section 401(k) Plan Fees.** On November 12, 1997, the PWBA conducted a hearing on disclosure of Section 401(k) fees. The purpose of the hearing was to enable the DOL to hear comments on the issues of 401(k) fees and suggestions for solutions, as well as to determine whether plan sponsors are fulfilling their fiduciary obligations.

**PBGC Proposed Changes to Recovery of Pension Overpayments.** On December 18, 1997, the PBGC published a proposed rule that would change its recoupment regulation. The regulation has caused some participants of terminated pension plans who were initially overpaid by the PBGC to repay more than they owed to the agency.

**Harris Trust Regulations.** On December 22, 1997, the PWBA published a proposed rule aimed at clarifying the retroactive effect of a Supreme Court decision regarding an insurer's general account including assets of an employee benefit plan. The U.S. Supreme Court's 1993 ruling in *John Hancock Mutual Life Insurance Co. v. Harris Trust and Savings Bank* held that an insurer's general account includes plan assets to the extent it includes funds that are attributable to any nonguaranteed components of contracts with employee benefit plans. Because John Hancock's contract provided for a return that varied with the insurer's investment performance, the court determined that John Hancock held plan assets and was, therefore, a fiduciary with respect to those assets. Due to the retroactive effect of the 1993 decision, numerous transactions engaged in by insurance company general accounts may have violated ERISA. In 1995, the PWBA granted a class exemption providing retroactive relief for various transactions, but did not provide relief for transactions involving the
general internal operation of an insurance company general account. The PWBA's proposed rule states that when a plan acquires a transition policy issued by an insurer on or before December 31, 1998, which is supported by assets of the insurer's general account, the plan's assets include the policy but do not include any of the underlying assets of the insurer's general account if the insurer satisfies various other requirements set forth in the proposed regulation. Also set forth in the proposed regulation are various rules regarding disclosure responsibilities for insurers, certain termination procedures, insurer initiated amendments, prudence standards, and immunity from certain liability for transactions predating the enactment of the regulation.

Further information on any of the above topics can be found on the PWBA's Web site: http://www.dol.gov/dol/pwba.

Executive Summary—Regulatory Developments

• The DOL has extended its nonenforcement policy regarding the SOP 92-6 disclosure requirements for multiemployer health and welfare benefit plans for the 1998 plan year.
• The DOL, IRS, and PBGC have proposed revisions to the Form 5500 series.
• The PWBA conducted a review of financial institution certifications obtained during limited-scope audits.
• The PWBA continues to focus on the timeliness of the remittance of participant contributions.

Legislative Developments

Pension Audit Legislation

What is happening with the repeal of the limited-scope audit exemption?

Several bills aimed at repealing the limited-scope audit exemption that currently exists under Section 103(a)(3)(C) of ERISA are expected to be introduced in the 105th Congress. The DOL and the U.S. General Accounting Office (GAO) have recommended that Congress repeal the limited-scope audit exception that, according to the DOL, is utilized in about half of the approximately 70,000
audits of employee benefit plans subject to ERISA. The AICPA supports repeal of the limited-scope audit exemption. Further, the proposed legislation would require auditors to report certain significant events to the DOL and would establish additional educational and quality control review requirements for plan auditors. As of the date of this Audit Risk Alert, the following three bills have been introduced:

- H.R. 2290, Security and Enforcement Compliance for Retirement under ERISA (otherwise known as the Secure Act)
- S.14, Retirement Security Act of 1997

The DOL is also expected to have its recommendations introduced in proposed legislation. Pension audit legislation, if enacted, would be effective for plan years beginning after the date of enactment of the legislation.

Other Legislation Affecting Plans

_Pension Provisions of the Taxpayer Relief Act of 1997._ On August 5, 1997, the President signed the Taxpayer Relief Act of 1997. The law contains several pension-related provisions that—

- Establish a 10 percent limit on mandatory allocation of elective contributions to employer securities in a 401(k) account.
- Repeal the requirement that plan administrators file summary plan descriptions (SPD), summary material modifications (SMM), or updated SPDs with the DOL. The new law does not, however, relieve plan administrators from their obligation to furnish participants and beneficiaries with copies of these documents.
- Require the DOL and the U.S. Treasury to each issue guidance by December 31, 1998, on employers using new technologies for pension plans.
- Increase the excise tax on prohibited transactions from 10 to 15 percent.
• Clarify that ERISA does not preclude an ERISA-covered plan from offsetting a participant’s benefits against amounts owed to the plan due to the participant’s breach of a fiduciary duty.

• Protect plans from disqualification if they accept rollovers from an employee’s previous employer beginning in 1998.

• Raise the involuntary cashout limit from $3,500 to $5,000, without indexing.

*Mental Health Parity Act of 1996 (MHPA).* On December 22, 1997, the DOL, the Department of Health and Human Services, and the U.S. Treasury issued an interim final rule in which group plans, under certain conditions may exempt themselves from the parity provisions of MHPA. The interim final rule is effective for plan years beginning January 1, 1998.

*Health Insurance Portability and Accountability Act of 1996 (HIPAA).* On December 29, 1997, the PWBA, the IRS, and the Health Care Financing Administration jointly published interim final rules clarifying treatment by group health insurance plans of flexible spending accounts and nondiscrimination provisions of HIPAA.

*Savings Are Vital To Everyone’s Retirement (SAVER) Act.* On November 20, 1997, President Clinton signed the SAVER Act into law. This legislation promotes the need for personal retirement savings and directs the DOL, among other things, to conduct ongoing public education on saving for retirement through several initiatives.

*State-Registered Investment Advisors as Investment Managers Under ERISA.* On November 10, 1997, Public Law 105-72 (PL 105-72) was enacted to permit state registered investment advisors to obtain status as “investment managers” under ERISA Section 3(38) providing that they file with the DOL a copy of their most recently filed state registration form and any subsequent filings.

Further information regarding the preceding legislation can be obtained from the PWBA, U.S. Department of Labor, 200 Constitution Avenue, N.W., Room N-5625, Washington, DC 20210, (202) 219-8776 or on the Internet at http://www.dol.gov/dol/pwba.
Audit and Accounting Developments

Audit Issues and Developments

Multiemployer Health and Welfare Benefit Plan Accounting for Postretirement Benefit Obligations

Will the DOL reject an audit report qualified because the multiemployer plan did not adopt SOP 92-6?

Employee health and welfare benefit plans that prepare financial statements in accordance with GAAP must follow the accounting and reporting requirements set forth in chapter 4, “Accounting and Reporting by Employee Health and Welfare Benefit Plans,” of the AICPA Audit and Accounting Guide Audits of Employee Benefit Plans (the Guide), which incorporates the guidance of AICPA SOP 92-6, Accounting and Reporting by Health and Welfare Benefit Plans. SOP 92-6 is effective for all single-employer plans, and became effective for multiemployer plans for plan years beginning after December 15, 1995.

Among other requirements, SOP 92-6 requires plans that provide postretirement benefits to include in their financial statements the amount of the accumulated postretirement benefit obligation representing the actuarial present value of all future benefits attributed to plan participants' services rendered to date. Because accumulated benefit obligations are not reported on Form 5500 submitted to the DOL, plans adopting SOP 92-6 should include a note to their financial statements reconciling the amounts reported in the financial statements to amounts reported on Form 5500. See paragraphs 12.27 and A.51 of the Guide for further guidance on such reconciliations.

Accounting changes adopted to conform to the provisions of the SOP should be made retroactively. SAS No. 58, Reports on Audited Financial Statements (AICPA, Professional Standards, vol. 1, AU sec. 508), states that when there has been a change in accounting principles that has a material effect on the comparability of the plan's financial statements auditors should refer to the change in an explanatory paragraph of their report. Because ERISA requires comparative statements of net assets available for

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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.

As noted in the "Regulatory Developments" section of this Audit Risk Alert, the DOL will not enforce the postretirement benefit obligation disclosure requirements in SOP 92-6 for multiemployer health and welfare benefit plans for plan years 1996, 1997, and 1998. If a plan does not adopt all of the provisions of SOP 92-6, including presenting the postretirement benefit obligation amount in the statement of plan's benefit obligations and statement of changes in plan's benefit obligations, which is required to fairly present the plan's financial statements in conformity with GAAP, the auditor should consider the effect of this departure from GAAP on his or her report. SAS No.58 describes the circumstances that may require a qualified or adverse opinion when the financial statements contain a departure from GAAP (See AU sections 508.35–508.60). A qualified opinion is expressed when the auditor believes, on the basis of his or her audit, that the financial statements contain a departure from GAAP, the effect of which is material, and he or she has concluded not to express an adverse opinion. An auditor should express an adverse opinion when, in the auditor's judgment, the financial statements taken as a whole are not presented fairly in conformity with GAAP.

Over the past year, members of the AICPA Employee Benefit Plans Committee noted that when multiemployer plans did not adopt SOP 92-6 for postretirement benefit obligations, the postretirement benefit obligation amount was material enough that the financial statements taken as a whole were not fairly presented in conformity with GAAP and an adverse opinion was issued. The members of the Committee also noted that only in rare instances, such as if very few retirees remained in the plan, was a qualified opinion issued. Further, when the plan administrator did not quantify the amount of or change in the plan's postretirement benefit obligation, or in the absence of an actuarial determination, the committee members presumed the effects of the omission on the financial statements to be material.
If the auditor issues an adverse opinion on the plan's financial statements, the auditor cannot express an opinion on the supplemental schedules required by ERISA. An expression of an opinion on the supplemental schedules in those circumstances would be inappropriate because it may overshadow or contradict the adverse opinion on the plan's basic financial statements. See “Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents” (AICPA, Professional Standards, vol. 1, AU sec. 551.10.)

Executive Summary—Multiemployer Health and Welfare Benefit Plan Accounting for Postretirement Benefit Obligations

- The DOL will not enforce the postretirement benefit obligation disclosure requirements in SOP 92-6 for multiemployer health and welfare benefit plans for plans years 1996, 1997, and 1998.
- If a plan does not adopt all of the provisions of SOP 92-6, the auditor should consider the effect of this departure from GAAP on his or her report.
- If an adverse opinion is expressed because of a departure from GAAP, the auditor is precluded from issuing an opinion on the required supplemental schedules.

Trend Toward Daily Valuation and the Use of SAS No. 70 Reports

SAS No. 70, Reports on the Processing of Transactions by Service Organizations, provides, among other things, guidance on the factors an independent auditor should consider when auditing the financial statements of a plan that uses a service organization to process certain transactions. With the trend toward daily valuation of 401(k) plans, more benefit plans are using service providers to execute transactions and maintain accountability on behalf of the plan administrator. For example, outside service organizations such as recordkeepers, bank trust departments, insurance companies, and benefits administrators may keep records and process benefit payments. Often, the plan does not maintain independent accounting records of transactions executed by the service provider. For example, many plan sponsors no longer maintain participant enrollment forms detailing the contribution percentage and the allocation by
fund option, and this amount can be changed by telephone or Internet without any record. In these situations, the auditor may not be able to obtain a sufficient understanding of internal control relevant to transactions executed by the service organization to plan the audit and to determine the nature, timing, and extent of testing to be performed without considering those components of internal control maintained by the service organization. This understanding can be efficiently achieved by obtaining and reviewing a report prepared in accordance with SAS No. 70.

The auditor should read the entire SAS No. 70 document to determine what was reviewed and tested and over what period and whether there are any instances of noncompliance with the service organization's controls identified in either (1) the service auditor's report or (2) within the body of the document (where the results of testing are described). If the service organization's SAS No. 70 report identifies instances of noncompliance with the service organization's controls, the plan auditor should consider the effect of the findings on the assessed level of control risk for the audit of the plan's financial statements and, as a result, the plan auditor may decide to perform additional tests at the service organization or, if possible, perform additional audit procedures at the plan. In certain situations, the SAS No. 70 report may identify instances of noncompliance with the service organization's controls but the plan auditor concludes that no additional tests or audit procedures are required because the noncompliance does not affect the assessment of control risk for the plan.

1998 Audit and Accounting Guide Revisions

The following list summarizes some of the revisions included in the AICPA Audit and Accounting Guide Audits of Employee Benefit Plans with conforming changes as of May 1, 1998.

There are new sections on the following:

• 403(b) plans or arrangements.
• Auditing merging and terminating plans
• Auditing changes in service providers, forfeitures, and rollovers
The Guide has been updated to reflect the following:

- SAS No. 82, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 316), including a new appendix containing fraud risk factors specific to employee benefit plans.


**Limited-Scope Audit Exemption and Trustee Certifications**

*What is an auditor's responsibilities as they relate to trustee certifications? What are some red flags to watch for?*

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, such as a bank, trust company, or similar institution or an insurance company.

As noted in the “Regulatory Developments” section of this Audit Risk Alert, the PWBA identified numerous instances in which financial institution certifications did not report assets at current value, particularly assets for which fair value is not readily available, and plan administrators improperly reported on their Form 5500 the value reflected in the certification, rather than fair value. Paragraph 7.52 of the Guide states that while independent auditors conducting limited-scope audits are not required to audit certain investment information, further investigation and testing are required whenever the auditor becomes aware that such information is incorrect, incomplete, or otherwise unsatisfactory for the purpose of preparing financial statements.

Auditors may want to remind plan administrators of the need to ensure that assets of the plan are reported at current value, without regard to whether such assets were held and certified to by a...
financial institution, for purposes of the Form 5500. Red flags to look for include assets with values that do not change from year to year, and reliance on values certified to by financial institutions even though it is not clear from the certification that the value reported in the certification is current value.

In addition to the items noted by the DOL, certifications often contain a computerized signature on a computer-generated report of plan investment information. This provides plans and auditors with little or no assurance that the information has been carefully checked by an appropriate official of the financial institution. Also, financial institutions are increasingly adding caveats to the certifications that for all intents and purposes reduces or invalidates the assurances that the certifications are to provide.

**OCBOA Financial Statement Disclosures**


The Interpretation applies to cash, modified cash, and income tax basis presentations. It addresses the summary of significant accounting policies; disclosures for financial statement items that are the same as or similar to those in GAAP statements; issues relating to financial statement presentation; and disclosure of matters not specifically identified on the face of the statements. The Interpretation contains examples of how OCBOA disclosures, including presentation, may differ from those in GAAP financial statements.

The Interpretation states that the discussion of the basis of accounting needs to include only the significant differences from GAAP and that quantifying differences is not required.

If cash, modified cash, or income tax basis financial statements contain elements, accounts, or items for which GAAP would re-
quire disclosure, the statements either should provide the relevant GAAP disclosure or provide information that communicates the substance of that disclosure. Qualitative information may be substituted for some of the quantitative information required in a GAAP presentation. GAAP disclosure requirements that are not relevant to the measurement of the element, account, or item need not be considered.

Cash, modified cash, and income tax statements should comply with GAAP requirements that apply to the presentation of financial statements or provide information that communicates the substance of those requirements. The substance of GAAP presentation requirements may be communicated using qualitative information and without modifying the financial statement format. Several examples illustrate how this guidance may be applied.

Finally, if GAAP would require disclosure of other matters such as contingent liabilities, going concern, and significant risks and uncertainties, the auditor should consider the need for that same disclosure or disclosure that communicates the substance of those requirements. Such disclosures need not include information that is not relevant to the basis of accounting.

When a defined-benefit health and welfare plan prepares its financial statements in accordance with GAAP, paragraph 4.18 in the Guide requires that the financial statements disclose information about the plan's benefit obligations as of the end of the year and significant changes in the obligations during the year. When such a plan prepares its financial statements on the cash or modified cash basis of accounting, this Interpretation generally requires that the statements either provide the relevant disclosures that would be required for a GAAP presentation or provide information that communicates the substance of those disclosures. As noted in paragraph 4.05 in the Guide, it is appropriate to disclose information about the plan's benefit obligations that would be required for a GAAP presentation. Nevertheless, disclosure of information that communicates the substance of those requirements is also appropriate. That may result in substituting qualitative information for some of the more detailed quantitative information required for a GAAP presentation. For example, if the plan is unable to sepa-
rate health claims payable from death and disability benefits payable, a disclosure such as the following may be appropriate.

The $1,200,000 currently payable to or for participants, beneficiaries, and dependents primarily relate to health claims payable.

As noted in paragraph 13.23 in the Guide, if the plan's cash or modified cash basis financial statements do not disclose either the form or the substance of the information about the benefit obligation that would be required for a GAAP presentation, the auditor should express a qualified or adverse opinion.

Executive Summary—OCBOA Financial Statement Disclosures


New Auditing Pronouncements

**SAS No. 82, Consideration of Fraud in a Financial Statement Audit.** In February 1997, the ASB issued SAS No. 82, *Consideration of Fraud in a Financial Statement Audit*, which describes the auditor's responsibilities relating to fraud in a financial statement audit and provides guidance on what should be done to meet those responsibilities. SAS No. 82 supersedes SAS No. 53, *The Auditor's Responsibility to Detect and Report Errors and Irregularities* (AICPA, *Professional Standards*, vol. 1, AU sec. 316), and is effective for audits of financial statements for periods ending on or after December 15, 1997 with early application permitted. See Chapters 5, 6, 12, and Appendix K in the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans*, with conforming changes as of May 1, 1998 for further guidance on SAS No. 82.

**SAS No. 83, Establishing an Understanding With the Client.** In October 1997, the ASB issued SAS No. 83, *Establishing an Understanding With the Client*. The Statement—

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• Requires the practitioner to establish an understanding with the client that includes the objectives of the engagement, the responsibilities of management and the auditor (including any supplemental schedules accompanying the basic financial statements), and any limitations of the engagement.

• Requires the practitioner to document the understanding with the client in the workpapers, preferably through a written communication with the client.

• Provides guidance for situations in which the practitioner believes that an understanding with the client has not been established.

The Statement also identifies specific matters that ordinarily would be addressed in the understanding with the client, and other contractual matters an auditor might wish to include in the understanding. SAS No. 83 is effective for engagements for periods ending on or after June 15, 1998, with early application permitted. See chapter 5, "Planning," in the Guide for further guidance on SAS No. 83, including an illustrative engagement letter.

SAS No. 84, Communications Between Predecessor and Successor Auditors. In October 1997, the ASB issued SAS No. 84, Communications Between Predecessor and Successor Auditors (AICPA, Professional Standards, vol. 1, AU sec. 315). This Statement provides guidance on communications between predecessor and successor auditors when a change of auditors is in process or has taken place. The Statement—

• Expands the required communications with the predecessor auditor before the successor auditor accepts an engagement to include inquiries about communications made by the predecessor auditor to audit committees or others with equivalent authority and responsibility as described in SAS No. 82, SAS No. 54, Illegal Acts by Clients (AICPA, Professional Standards, vol. 1, AU sec. 317), and SAS No. 60, Communication of Internal Control Related Matters Noted in an Audit (AICPA, Professional Standards, vol. 1, AU sec. 325), and any other reasonable inquiries that the successor auditor may wish to ask the predecessor auditor.
- Clarifies the successor auditor's responsibility with respect to obtaining sufficient competent evidential matter used in analyzing the impact of the opening balances on the current year financial statements and consistency of accounting principles as a matter of professional judgment.

- Expands the working papers ordinarily made available to the successor auditor by the predecessor auditor to include documentation of planning, internal control, audit results and other matters of continuing audit significance.

- Provides communication guidance when possible misstatements are discovered in financial statements reported on by a predecessor auditor.

- Introduces an illustrative client consent and acknowledgment letter and an illustrative successor auditor acknowledgment letter. A predecessor auditor may conclude that obtaining written communications from both the former client and the successor auditor will allow greater communication between both parties and greater access to the working papers than would be the case in the absence of such communications.

SAS No. 84 is effective with respect to acceptance of an engagement after March 31, 1998, with early application permitted.

**SAS No. 85, Management Representations.** The ASB issued SAS No. 85, *Management Representations* in November 1997. The Statement provides appropriate guidance regarding written management representations to be obtained by an auditor as part of an audit performed in accordance with generally accepted auditing standards. The Statement—

- Clarifies the requirement for an auditor to obtain written representations for all financial statements and periods covered by the auditor's report.

- Includes a representation made by management that states that it is management's belief that the financial statements are fairly presented in conformity with generally accepted accounting principles.
Includes a list of updated specific representations to be obtained from management that are consistent with representations obtained in current practice. Such representations include information concerning fraud as referred to in SAS No. 82 and significant estimates and material concentrations known to management that are required to be disclosed in accordance with Statement of Position 94-6, Disclosure of Certain Significant Risks and Uncertainties.

States that the auditor ordinarily should obtain a representation letter tailored to cover representations relating to the financial statements unique to the entity's business or industry and includes a listing of additional representations that may be appropriate in certain situations.

SAS No. 85 will be effective for audits of financial statements for periods ending on or after June 30, 1998. See Chapter 12, “Other Auditing Considerations,” in the Guide for further guidance on SAS No. 85, including an illustrative management representation letter.

Executive Summary—New Auditing Pronouncements

New auditing standards include the following:

- SAS No. 82, Consideration of Fraud in a Financial Statement Audit
- SAS No. 83, Establishing an Understanding with the Client
- SAS No. 84, Communications Between Predecessor and Successor Auditors
- SAS No. 85, Management Representations

Accounting Issues and Developments

Proposed Statements of Position

The AICPA Employee Benefit Plans Committee currently has three Statement of Position (SOP) projects under way. In March 1998, the FASB cleared for exposure a proposed SOP to provide guidance on the accounting for and disclosure of 401(h) features of both defined benefit pension plans and health and welfare benefit plans. The Committee is currently addressing FASB comments on a proposed SOP on accounting for and reporting of certain employee benefit plan investments, including addressing
the need for the disclosures required in paragraph 3.28k of the Guide. The third proposed SOP on the accounting for and reporting on certain health and welfare benefit plan transactions is delayed pending resolution of certain issues with the DOL. These two proposed SOPs are expected to be released for exposure by the end of 1998.

Executive Summary—Proposed Statements of Position

Proposed SOPs include the following:

- **Accounting For and Disclosure of 401(h) Features of Both Defined Benefit Pension Plans and Health and Welfare Benefit Plans** (cleared for exposure, March 1998)

- **Accounting For and Reporting of Certain Employee Benefit Plan Investments** (expected to be released for exposure by the end of 1998)

- **Accounting For and Reporting on Certain Health and Welfare Benefit Plan Transactions** (expected to be released for exposure by the end of 1998)
## IRS Limits on Benefits and Compensation

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AICPA Order Department  
Products Available:  
Audit and Accounting Guide: *Audits of Employee Benefit Plans*  
Checklists and Illustrative Financial Statements:  
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*Defined Contribution Plans*  
*Employee Health and Welfare Benefit Plans*  
*Health and Welfare Benefit Plans*  
Self-study CPE courses:  
*Audits of Employee Benefit Plans*  
*Employee Benefit Plans I: Accounting Principles*  
*Employee Benefit Plans II: Audit Considerations* | (800) 862-4272 (phone)  
(800) 862-4272  
http://www.aicpa.org |
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Pension and Welfare Benefits Administration:  
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Division of Accounting Services  
Division of Reporting Compliance  
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