Employee benefit plans industry developments - 1999; Audit risk alerts

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Employee Benefit Plans Industry Developments—1999

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

This Audit Risk Alert is intended to provide auditors of financial statements of employee benefit plans with an overview of recent 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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Employee Benefit Plans
Industry Developments—1999

Industry Developments

What are the current industry conditions employee benefit plans are facing?

This year saw a continued emphasis on individuals providing for their own financial retirement. The number of investment choices offered by 401(k) plans continues to grow. More and more 401(k) plans offer employer stock as an option, and with the stock market as favorable as it has been, employer stock accounts for a large portion of many 401(k) plans. However, in light of the volatility of financial markets, auditors should continue to be particularly sensitive to concerns about the valuation of plan investments—especially derivative products— and the adequacy of related disclosures.

Many plans are now offering their participants online access to their 401(k) plans either through the Internet or Intranet. A 1998 survey performed by Merrill Lynch found that 12 percent of companies are now using a Web site for communications relating to employees' retirement plans. This is up from 8 percent a year earlier. Making access to retirement plans easier encourages employees to take advantage of these savings plans. Online access enables plan participants to review their accounts and change their investment elections at any time, even from home. Such an environment is a good vehicle for educating participants and allows them to perform such tasks as:

• Daily transfers
• Loans modeling and initiation, including review and approval of loan
• Statements on demand
• Salary deferral changes
• Enrollment
• Retirement remodeling
• Confirming balances

Because plan participants can change their investments daily, by phone, or via Internet or Intranet sites, daily valuations of such plans are becoming more commonplace. More and more these services are being “bundled” and provided by one service provider. These service providers 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. In fact, many plan sponsors no longer maintain records such as participant enrollment forms detailing the contribution percentage and the allocation by fund option, and this amount can be changed by telephone or online without any record. In these situations, the auditor may not be able to obtain a sufficient understanding of internal controls 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. This understanding can be efficiently achieved by obtaining and reviewing a report prepared in accordance with Statement on Auditing Standards (SAS) No. 70, Reports on the Processing of Transactions by Service Organizations (AICPA, Professional Standards, vol. 1, AU sec. 324).

The auditor should read the entire SAS No. 70 document to determine the scope of the engagement (the applications covered), the period covered, the tests performed, and the results of the
tests, including instances of noncompliance. This information can be found in the auditor’s report and in the body of the document (where the tests and 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 for 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.

If during the planning phase of an audit, a SAS No. 70 report is not available from the service provider, the user auditor should consider information available at the user organization about the controls at the service organization (for example, user manuals, system overviews, technical manuals, and so on). If the user auditor concludes that the available information is not adequate to obtain a sufficient understanding of the service organization’s controls to plan the audit, consideration should be given to having the auditor and plan sponsor call the service provider directly and ask specific questions that will enable the auditor to document his or her understanding of the internal controls at the service provider. The auditor may also consider confirming certain parameters, such as copayment deductibles, directly with the service provider.

Further, when SAS No. 70 reports are not available auditors may consider confirming directly with participants—

- Specific changes made to their elections throughout the year.
- Year-end balances.

Auditors may be able to obtain printouts of the daily activity from the service provider throughout the year to confirm directly with the participants. Auditors should keep in mind that in the
daily valuation environment, many service providers are on the
cash basis and auditors should be alert to accrual basis adjustments,
for example, contributions receivable reconciliation between the
recordkeeper and the trustee.

Year 2000 Issue

What is the Year 2000 Issue and how will it affect your audits?

As we move closer to the year 2000, the Year 2000 Issue becomes
more critical for auditors. Problems resulting from the millen­
nium bug may have significant effects on clients currently, which
auditors will need to address. One of the many issues discussed
regarding the Year 2000 Issue is that the year 2000 is a leap year.
Systems that are not year-2000-ready may not register the addi­
tional day, thus producing incorrect results for date-related calcula­
tions. In addition, certain year 2000 problems may occur in 1999.
For example, some software programs may have assigned special
meanings to entries date-coded as “XX/XX/99” to allow for the
testing of software modifications. Therefore actual transactions
using such dates may not be processed correctly or may stop
functioning. Failures may also take place in 1999 when systems
perform calculations into or beyond the year 2000.

Unless these year 2000 problems are remedied, significant prob­
lems relating to the integrity of electronically processed informa­
tion based on time may occur. To further complicate the issue,
even if a plan's computer software and hardware have been modi­
fied 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 adminis­
trators that have not made such modifications. The Year 2000
Issue may affect the ability of a service organization’s computer­
ized 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 sys­
tem unprepared for the year 2000 might fail to recognize when
an active participant has attained normal retirement age to qual­
ify for full vesting under the plan. 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
• Postretirement medical benefits
• Funding assumptions for postretirement benefits in a funded welfare plan
• Benefit calculations based on relevant Financial Accounting Standards Board (FASB) Statements

It is the responsibility of an entity’s management—not the auditor—to assess and remediate the effects of the Year 2000 Issue on an entity’s systems. Under generally accepted auditing standards (GAAS), the auditor has a responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. Thus, the auditor’s responsibility relates to the detection of material misstatement of the financial statements being audited, whether caused by the Year 2000 Issue or by some other cause.

Auditing guidance relating to the Year 2000 Issue has been developed by the Audit Issues Task Force (AITF) of the Auditing Standards Board (ASB). The AITF has issued the following auditing Interpretations:

• Interpretation No. 4, “Audit Considerations for the Year 2000 Issue,” of AU section 311, *Planning and Supervision* (AICPA, *Professional Standards*, vol. 1, AU sec. 9311.38), discusses the auditor’s responsibility for the Year 2000 Issue,
how it affects planning for an audit of financial statements conducted in accordance with GAAS, and in what circumstances the Year 2000 Issue may result in a reportable condition under SAS No. 60, *Communication of Internal Control Related Matters Noted in an Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 325).

- Interpretation No. 3, "Responsibilities of Service Organizations and Service Auditors With Respect to Information About the Year 2000 Issue in a Service Organization's Description of Controls," of SAS No. 70 (AICPA, *Professional Standards*, vol. 1, AU sec. 9324.19), addresses the responsibilities of service auditors with respect to information about the Year 2000 Issue in a service organization's description of controls.


Auditors should be aware of the auditing and accounting issues that arise from the Year 2000 Issue, including audit planning, going-concern issues, establishing an understanding with the client, impairment, revenue and expense recognition, and disclosure. A more comprehensive discussion of this topic can be found in *Audit Risk Alert—1998/99*.

**Department of Labor (DOL) Issues Guidance on Year 2000 Compliance**

*What guidance has the DOL issued regarding the Year 2000 Issue?*

On December 14, 1998, the U.S. DOL Pension and Welfare Benefits Administration (PWBA) issued a press release addressing concerns about fiduciary liability and the year 2000 computer problem. To help the employee benefit industry understand these issues, the PWBA released sample questions used by its investigators to evalu-
ate year 2000 compliance in the course of investigations of benefit plans across the United States. This release was in response to hundreds of inquiries from concerned employee benefit plan administrators and trustees and from their service providers who want to know what information the PWBA is seeking from the plans to show they are working to solve their internal computer problems and to avert any potential disruption in service to their participants and beneficiaries. Like most business operations, employee benefit plans rely on computers to perform critical operations such as benefit calculations and payments. The sample fiduciary questions have been reprinted in appendix B, “Sample Fiduciary Questions Regarding The Year 2000 Problem,” of this Audit Risk Alert and are available on the PWBA’s Web site: http://www.dol.gov/dol/pwba.

Earlier in 1998, the PWBA issued two news releases emphasizing that plans need to address year 2000 issues relating to their own computer systems. In addition, the agency widely distributed a Year 2000 Issue pamphlet on commonly asked questions and answers. “PWBA Year 2000 Questions and Answers” is reprinted in appendix C of this Audit Risk Alert and is also available on the PWBA’s Web site: http://www.dol.gov/dol/pwba. The pamphlet concentrates on the fiduciary liability of plan officials and service providers in addressing the Year 2000 Issue in connection with any computer systems their plans utilize.


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 Audit Issues Task Force has issued Interpretations providing guidance to auditors on the Year 2000 Issue.

• Several auditing and accounting issues arise from the Year 2000 Issue, including audit planning, going-concern issues, establishing
an understanding with the client, impairment, and disclosure. A more comprehensive discussion of this topic can be found in *Audit Risk Alert—1998/99*.

- The Pension and Welfare Benefits Administration (PWBA) of the DOL has issued guidance for plan administrators and service providers regarding the Year 2000 Issue, including posting Sample Fiduciary Questions and Qs&As on its Web site. Such guidance has also been reprinted in appendixes B and C of this Audit Risk Alert.

**Regulatory Developments**

*When will the DOL reject an annual report of a multiemployer health and welfare benefit plan, qualified due to a failure to comply with the requirements of SOP 92-6?*

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

On November 25, 1998, the PWBA announced that it will not adopt a proposed nonenforcement policy affecting Form 5500s filed by multiemployer health and welfare benefit plans. Accordingly, annual reports of multiemployer health and welfare benefit plans filed for plan years commencing on or after January 1, 2000, will be subject to rejection by the PWBA if there is any material qualification in the accountant’s opinion accompanying the annual report due to a failure to comply with the requirements of Statement of Position (SOP) 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans*.

To ensure that multiemployer health and welfare plans have an adequate opportunity to prepare their financial recordkeeping and other related systems to comply with SOP 92-6, the PWBA also stated that these plans may continue to rely on its previously announced interim nonenforcement relief for their 1999 Form 5500 reports. It is important to point out, however, that SOP 92-6 requires restatement of prior period financial statements only if they are presented together with the current year’s financial statements. Therefore, when SOP 92-6 is adopted for plan year 2000, it will be necessary to restate the 1999 statement of net assets to
comply with the provisions of SOP 92-6. Plan administrators should consider engaging an actuary in 1999 to perform the calculations for the 1999 plan year. Plan administrators who rely on the interim relief must, however, comply with the AICPA's pre-SOP 92-6 requirements in their financial statement treatment of the matters now covered by SOP 92-6. See the section entitled "Multiemployer Health and Welfare Benefit Plan Accounting for Postretirement Benefit Obligations" in this Audit Risk Alert for further discussion of this issue.

Update on the Proposed Revisions of the Form 5500 Series

When will the new Form 5500 become effective?

On June 23, 1998, the DOL, Internal Revenue Service (IRS), and Pension Benefit Guaranty Corporation (PBGC) submitted the new Form 5500 to the Office of Management and Budget (OMB) for approval under the Paperwork Reduction Act. The submission to OMB followed the completion of the agencies' evaluation of more than sixty public comments and a day of testimony from employer groups, employee representatives, financial institutions, service organizations, and others, on the Form streamlining proposal that was published in the Federal Register in September 1997. Following OMB's review and approval of the new data collection form, the final computer-scannable forms that will be mandatory for 1999 plan year filings and electronic filing options will be developed and published in the Federal Register. The Form 5500 Annual Return/Report is used by more than 800,000 pension, welfare, and fringe benefit plans that file information with the federal government. The new Form 5500 is intended to streamline the report and the methods by which it is filed and processed. The proposal was patterned after tax returns familiar to individuals and corporate taxpayers—a simple, one-page main form with basic information and a checklist that guides each filer to the more detailed schedules that are applicable to the filer's specific type of plan.

Since the Employee Retirement Income Security Act of 1974 (ERISA) requires the attachment of several schedules to the Form 5500, auditors should be aware of several changes. The most notable changes follow.
Information on Which Auditors Are Required to Report

- Schedule G (Financial Transaction Schedules)—As a result of a planned shift to computer-scannable forms, the use of this schedule will be mandatory for reporting loans, leases, and fixed income obligations in default or uncollectible, and prohibited transactions.

- Schedule of Assets Held for Investment Purposes and Schedule of Reportable Transactions—Plans that have assets held for investment purposes and reportable transactions will continue to complete these schedules. While no mandatory form is required for this information, the instructions provide the format for the schedules. Auditors should note:
  - Historical cost information is no longer required on the Schedule of Assets Held for Investment Purposes for participant-directed investments.
  - Participant or beneficiary-directed transactions are no longer required to be taken into account for purposes of preparing the Schedule of Reportable Transactions.
  - In a plan's initial year, the 5 percent threshold for the schedule of reportable transactions is based on the end-of-year balance of the plan's assets.

Changes to Other Schedules

- Schedule A (Insurance Information)—Information required by this schedule will now be permitted to be reported on an insurance contract or policy year basis.

- Schedule C (Service Provider Information)—This schedule will be limited to the top forty paid service providers and will require explanations of service provider terminations for only accountants and enrolled actuaries. In addition, this schedule eliminates the requirement to identify plan trustees annually.

- Schedule D (Direct Filing Entity[DFE]/Participating Plan Information)—This schedule was created as part of an overall effort to make the Form 5500 the standardized reporting
format for all filers. It was also part of the proposal to standardize the way information is filed about insurance company pooled separate accounts (PSAs), bank common or collective trusts (CCTs), master trust investment accounts (MTIAs), 103-12 investment entities (103-12 IEs) and group insurance arrangements (GIAs).

- **Schedule H (Financial Information for Large Plans and DFEs)**—This schedule contains the financial information formerly contained in the Form 5500 and a series of questions regarding activities of the plan. Additional guidance has been provided on reporting “deemed distributions” of participant loans, “corrective distributions” from pension plans and “incurred but not reported” (IBNR) claims for welfare plans.

The DOL is simultaneously developing a new computerized system to process the Form 5500 (the ERISA Filing Acceptance System or “EFAST”) to reduce government and filer costs associated with filing, receiving, and processing annual reports. The new computerized system will simplify and expedite the receipt and processing of the Form 5500 by relying on computer-scannable forms and electronic filing technologies.

On December 10, 1998, the DOL published in the *Federal Register* a notice proposing amendments to ERISA’s reporting and disclosure regulations. These amendments would make technical and conforming changes to the regulations necessary to implement the revised Form 5500 Series. Among other changes, the proposed regulatory amendments would update the references in sections of ERISA to reflect the new structure of the Form 5500 Series:

- **Section 2520.103** provides for special reporting rules for plans that participate in a master trust. The proposed amendments do not change the information required to be reported regarding the master trust, but rather establish the Form 5500 Series as the standard reporting format for master trusts.

- **Section 2520.103-12** provides an exemption and an alternative method of reporting for plans investing in certain investment entities, the assets of which are deemed to include
plan assets under Section 2520.103-101. The proposed amendments do not change the information required to be reported by the 103-12 investment entity, but rather establish the Form 5500 Series as the standard reporting format.

- Section 2520.103-5 implements Section 103(a)(2) of ERISA, which deals with insurance carriers or other organizations that provide some or all of the benefits under a plan or hold plan assets, and banks or similar institutions that hold plan assets. In the case of CCTs or PSAs, the proposed amendments would require that such CCTs or PSAs notify their participating plans of whether or not they intend to file a Form 5500 as a new direct filing entity, and to furnish the plan administrators with the information about the assets held by such CCTs or PSAs needed by the plan administrators to satisfy their obligations under Title I of ERISA.

**PWBA Review of Plan Audits**

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 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 contained a major performance goal that no more than 12 percent of 1999 plan year audits would contain deficiencies with professional and regulatory standards and that no more than 3 percent of Form 5500 filings would contain reporting and disclosure deficiencies. During 2001, the PWBA plans to conduct a nationwide study to once again assess the quality of employee benefit plan audits and evaluate compliance with its goal.
AICPA Peer Review Developments

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 can result from inadequate plan audits, including loss of membership in the AICPA and loss of license. Some common recurring deficiencies noted by the AICPA Peer Review Board in its review of employee benefit plans follow:

- Inadequate testing of participant data
- Inadequate testing of investments
- Failure to understand testing requirements on a limited-scope engagement
- Inadequate or no documentation of the auditor's understanding of internal control
- Inadequate consideration of prohibited transactions
- Incomplete description of the plan and its provisions
- Inadequate or missing disclosures related to investments
- Inadequate or missing disclosures related to participant data
- Failure to properly report on or include the required supplemental schedules required by ERISA and DOL

The AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans* provides guidance concerning areas where the Peer Review Board noted deficiencies.

In 1998 the AICPA Peer Review Board revised Interpretation No. 2, *Engagement Selection in On-Site Peer Reviews*. This Interpretation now requires that, among other types of engagements, an employee benefit plan engagement subject to ERISA be selected for review in an on-site peer review. The Interpretation states that

   Regulatory and legislative developments have made it clear that there is a significant public interest in, and a higher risk
associated with, audits conducted pursuant to the Employee Retirement Income Security Act of 1974 (ERISA). Therefore, if a firm performs the audit of one or more entities subject to ERISA, at least one such audit engagement conducted pursuant to ERISA should be selected for review.

Standards for Performing and Reporting on Peer Reviews (AICPA, Professional Standards, vol. 2, PR sec. 17,661, and Peer Review Program Manual, PRP sec. 3100.48) states that the AICPA Peer Review Board, by Interpretations, can require specific types of engagements to be selected for review.

Timeliness of Participant Contributions Remains an Enforcement Initiative for the PWBA

The PWBA continues to focus on the timeliness of remittance of participant 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 assets. A DOL regulation 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 period for remittance of employee contributions to welfare plans, that is, 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 contributions 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 embezzlement of plan assets. Additionally, such information should be properly presented on the required Form 5500 supplemental
schedule of nonexempt transactions with parties-in-interest. GAAS requires that the auditor's report on financial statements included in an annual report filed with the DOL cover the information in the required supplementary schedules when they are presented along with the basic financial statements. If the auditor concludes that the plan has entered into a prohibited transaction, and the transaction has not been properly disclosed in the required supplementary schedule, the auditor should (a) express a qualified opinion or an adverse opinion on the supplementary schedule if the transaction is material to the financial statements, or (b) modify his or her report on the supplementary schedule by adding a paragraph to disclose the omitted transaction if the transaction is not material to the financial statements. See chapter 11, "Party in Interest Transactions," of the AICPA Audit and Accounting Guide Audits of Employee Benefit Plans for further discussion of prohibited transactions.

For questions or further information, contact the Office of Regulations and Interpretations at the DOL at (202) 219-7461.

**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 its 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.

Questions concerning the DFVC Program should be directed to the PWBA's Division of Reporting Compliance at (202) 219-8770. Practitioners and other members of the public may also wish to contact the PWBA at its Web site: http://www.dol.gov/dol/pwba.

PWBA Proposed Rule on Claims Procedures for Employee Benefit Plans

On September 9, 1998, the PWBA published a proposed rule to ensure plan participants a timely, fair internal review when they have a grievance against their health plan and an expedited review for urgent claims. On February 16-18, 1999, PWBA held public hearings to address the over 600 comment letters received from the public. One area of agreement was that the new rules should be rewritten to make a distinction between services that must be pre-authorized and claims that are paid after services have been provided.

In addition, the PWBA published an interim amendment to its rules relating to the way health care plans explain coverage required by the Newborns' and Mothers' Health Protection Act of 1996. The interim amendment tells providers to disclose that a mother and baby may be discharged earlier than the minimum time an insurance plan must cover. Generally a health plan or health insurance issuer may not restrict benefits for any hospital stay to less than forty-eight hours for most deliveries and ninety-six hours for a cesarean section. What may not have been clear in plan disclosures was that an attending provider (such as a physician or licensed nurse midwife) may discharge them sooner, although only after consultation with the mother.
Section 401(k) Plan Fees
On July 1, 1998, the DOL released “A Look at 401(k) Plan Fees,” a 19-page, educational booklet to help consumers understand the fees and expenses associated with 401(k) plan accounts. The booklet answers commonly asked questions regarding plan fees and expenses, highlights the most common fees, and encourages participants to make informed investment decisions, consider fees as one of several factors when making a decision, compare all services received with the total cost, and realize that cheaper is not necessarily better. The booklet is available from the PWBA's Publication Hotline at (800) 998-7542 and on the PWBA's Web site at: http://www.dol.gov/dol/pwba. In addition, the PWBA is making available on its Web site the results of recent research on the subject. “Study of 401(k) Plan Fees and Expenses” examines current practices relating to which fees and expenses are paid by employers sponsoring 401(k) plans and which are paid by employees participating in the plan.

National Summit on Retirement Savings
The first National Summit on Retirement Savings, called for by the Savings Are Vital to Everyone's Retirement Act of 1997 (SAVER Act) was held on June 4-5, 1998, in Washington, DC. The Summit was co-hosted by the President and the congressional leadership in the House and Senate. The SAVER Act calls for a second Summit in 2001 and a third in 2005.

The purpose of the Summit was to increase public awareness of the importance of retirement planning and to identify ways to promote greater retirement savings by all Americans. The final report on the 1998 National Summit on Retirement Savings was published on September 3, 1998, and may be found on the PWBA's Web site at: http://www.dol.gov/dol/pwba.

Health Benefits Education Campaign
On December 16, 1998, the DOL launched a national health benefits education campaign designed to help millions of working Americans understand their medical benefits when they experience changes in life and work—such as marriage, childbirth,
job layoff, or retirement. Seventy public and private organizations have joined this education campaign and will help distribute three new brochures to advise workers and spouses covered by employer-sponsored health plans.


DOL Announces Procedure for State-Registered Investment Advisers to Obtain ERISA Investment Manager Status

On January 14, 1998, the DOL announced a new procedure that state-registered investment advisers must follow in order to obtain investment manager status under federal pension law. Under Public Law 105-72, signed into effect on November 10, 1997, state-registered investment advisers seeking investment manager status under ERISA must file with the DOL a copy of their most recently filed state registration form and any subsequent filings. Generally, the new filing requirement applies to investment advisers who manage less than $25 million and who are required to register under state law. Advisers who are required to register in multiple states need only provide the department a copy of the registration form filed in the state where they maintain their principal office and place of business.

Investment advisers could initially file their registration forms with the department any time prior to November 10, 1998, to satisfy the new requirement for ERISA investment manager status. Any subsequent filings with the state should be filed with the department at the same time. The PWBA has prepared a brief on the new filing requirement. Copies may be obtained by calling the DOL’s Publication Hotline at (800) 998-7542. This brief, along with other publications concerning ERISA provisions that may be applicable to investment advisers, is also available on the PWBA’s Web site at: http://www.dol.gov/dol/pwba/public/pubs/brief2.htm.
DOL Proposes Rule on Electronic Communications and Recordkeeping by Employee Benefit Plans

On January 29, 1999, the DOL issued proposed regulations addressing electronic communications of certain information by employee benefit plans and minimum standards for maintenance and retention of employee benefit records in electronic form.

The proposed rule on electronic communications expands to pension and other welfare plans the existing “safe harbor” for group health plans using electronic media to furnish summary plan descriptions and summaries of material modifications to plan participants. The proposal also would expand the “safe harbor” to cover summary annual reports. In addition, the proposed rule would provide minimum standards regarding the use of electronic media for the maintenance and retention of records under ERISA.

Executive Summary—Regulatory Developments

• The PWBA announced that it will not adopt a proposed nonenforcement policy affecting Form 5500s filed by multiemployer health and welfare benefit plans. Accordingly, annual reports of multiemployer health and welfare benefit plans filed for plan years commencing on or after January 1, 2000, will be subject to rejection by the PWBA if there is any material qualification in the accountant’s opinion accompanying the annual report due to a failure to comply with the requirements of SOP 92-6.

• Since SOP 92-6 requires restatement of prior period financial statements, plan administrators should consider engaging an actuary in 1999 to perform the calculations for the 1999 plan year as the actuarial amounts will be needed for the financial statements issued for plan year 2000.

• Pending approval from the OMB, the new Form 5500 schedules will become effective for the 1999 plan year filings.

• The AICPA Peer Review Board revised Interpretation No. 2, Engagement Selection in On-Site Peer Reviews. This Interpretation requires that, among other types of engagements, an employee benefit plan engagement subject to ERISA be selected for review in an on-site peer review.
Legislative Developments

What should you know about the legislative proposal “The ERISA Enforcement Improvement Act of 1999”?

Pension Audit Legislation

The Administration has developed a legislative proposal, “The ERISA Enforcement Improvement Act of 1999,” aimed at improving the quality and integrity of employee benefit plans. The proposal includes:

1. Retaining the limited-scope audit provision in lower risk circumstances where:
   a. At least 95 percent of a plan’s assets have a “readily ascertainable market value”;
   b. The regulated financial institution certifies to statements as “complete and accurate” and to the “current value” of each asset at the end of the plan year;
   c. Within an eighteen-month period preceding the certification, the financial institution receives a GAAS report from an independent qualified public accountant (IQPA), which comments on the adequacy of the internal controls of the financial institution (or affiliates) pertaining to the execution, maintenance of accountability, recording, and processing of transactions related to plan or participant recordkeeping;
   d. The certified information is considered part of the plan’s annual report; and
   e. The IQPA providing the certification satisfies the requirements of the proposal’s enhanced auditor qualifications.

2. Enhancing ERISA’s auditor qualifications by requiring IQPAs to undergo periodic external quality control reviews and complete continuing professional educational training related to employee benefit plan matters;
3. Requiring speedy reporting of serious ERISA violations and imposing substantial civil penalties on plan administrators and IQPAs who fail to comply with the notification provisions; and

4. Making 502(l) penalties discretionary. Section 502(l) penalties are mandatory civil penalties paid by plan fiduciaries that apply to amounts paid under “settlement agreements” or court orders in cases where the Secretary of Labor is a party.

Audit Developments

What information should an audit report include when SOP 92-6 is first adopted and the updated report on prior period financial statements has a different opinion from the opinion previously expressed?

Multiemployer Health and Welfare Benefit Plan Accounting for Postretirement Benefit Obligations

Employee health and welfare benefit plans that prepare financial statements in accordance with generally accepted accounting principles (GAAP) must follow the accounting and reporting requirements set forth in chapter 4, “Accounting and Reporting by Health and Welfare Benefit Plans,” of the AICPA Audit and Accounting Guide Audits of Employee Benefit Plans, which incorporates the guidance of AICPA SOP 92-6. 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. Accounting changes adopted to conform to the provisions of the SOP should 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.2

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, 1998, and 1999. However, annual reports of multiemployer health and welfare benefit plans filed for plan years beginning on or after January 1, 2000, will be subject to rejection if there is any material qualification in the accountant’s opinion accompanying the annual report due to a failure to comply with the requirements of SOP 92-6. Since SOP 92-6 requires restatement of prior period financial statements, plan administrators should consider engaging an actuary in 1999 to perform the calculations for the 1999 plan year as the actuarial amounts will be needed for the financial statements issued on the year 2000.

SAS No. 58, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 508.68-.69), provides guidance when an auditor has previously qualified his opinion or expressed an adverse opinion on financial statements of prior periods because of a departure from GAAP and the prior period financial statements are restated in the current period to conform with GAAP. SAS No. 58 requires the auditor’s updated report on the financial statements of the prior period to indicate that the statements have been restated and to express an unqualified opinion with respect to the restated financial statements. Further, when the updated report has a different opinion from the opinion previously expressed on the prior period financial statements, the auditor should disclose all the substantive reasons for the different opinion in a separate explanatory paragraph(s) preceding the opinion paragraph of his or her report. The explanatory paragraph(s) should disclose—

2. If accounting changes were necessary to conform to the provisions of Statement of Position (SOP) 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans*, that fact should be disclosed when financial statements for the year in which the SOP is first applied are presented either alone or with financial statements of prior years.
1. The date of the auditor’s previous report.
2. The type of opinion previously expressed.
3. The circumstances or events that caused the auditor to express a different opinion.
4. That the auditor’s updated opinion on the financial statements of the prior period is different from his or her previous opinion on those statements.

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.3 SAS No. 58 describes the circumstances that may require a qualified or adverse opinion when the financial statements contain a departure from a generally accepted accounting principle (see AICPA, Professional Standards, vol. 1, AU sec. 508.35.60). 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 two years, 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.

3. The AICPA Employee Benefit Plans Committee currently has a proposed SOP on certain health and welfare benefit plan transactions that is awaiting FASB clearance for exposure. Among other things, this proposed SOP would allow the information about benefit obligations to be presented in a note to the financial statements. See the “Proposed Statements of Position for Employee Benefit Plans” section of this Audit Risk Alert for a further discussion of this proposed SOP.
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 SAS No. 29, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*, vol. 1, AU sec. 551.10).

**1999 Audit and Accounting Guide Revisions**

The following list summarizes some of the revisions that will be included in the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans* (the Guide), with conforming changes as of May 1, 1999.

There are new sections on the following:

- Auditing changes in actuaries
- Auditing self-directed accounts

The Guide has been updated to reflect FASB Statement No. 133.

The SOP *Accounting For and Reporting of Postretirement Medical Benefit (401(h)) Features of Defined Benefit Pension Plans* will be included in the Guide.

**Accounting Developments**

*What new accounting standards that affect employee benefit plans have been proposed or issued recently?*
New FASB Pronouncements

FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities

In June 1998, the FASB issued Statement No. 133, Accounting for Derivative Instruments and Hedging Activities (FASB, Current Text, vol. 1, sec. D50). FASB Statement No. 133 establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. FASB Statement No. 133 applies to employee benefit plans. As such, certain investments held by plans will fall under this statement. Paragraph 43 of FASB Statement No. 133 provides specific guidance to entities that do not report earnings, such as defined benefit pension plans. Paragraphs 44 through 47 of FASB Statement No. 133 set forth the disclosure requirements.

FASB Statement No. 133 is effective for all fiscal quarters of fiscal years beginning after June 15, 1999. Initial application of FASB Statement No. 133 should be as of the beginning of an entity’s fiscal quarter; on that date, hedging relationships must be designated anew and documented pursuant to the provisions of the Statement. Earlier application of all of the provisions of FASB Statement No. 133 is encouraged, but it is permitted only as of the beginning of any fiscal quarter that begins after issuance of the Statement. FASB Statement No. 133 should not be applied retroactively to financial statements of prior periods.

New AICPA Statements of Position

Statement of Position Accounting For and Reporting of Postretirement Medical Benefit (401(h)) Features of Defined Benefit Pension Plans

As of April 1999, the SOP Accounting For and Reporting of Postretirement Medical Benefit (401(h)) Features of Defined Benefit Pension Plans was due to be released shortly. This SOP amends chapters 2 and 4 of the AICPA Audit and Accounting Guide Audits of Employee Benefit Plans (the Guide), and specifies the accounting for and disclosure of 401(h) features of defined benefit pension plans, by both defined benefit pension plans and health and welfare benefit plans.

The SOP requires—

1. Defined benefit pension plans to record assets held in a 401(h) account related to health and welfare plan obligations for retirees as both assets and liabilities on the face of the statement of net assets available for pension benefits in order to arrive at net assets available for pension benefits.

2. 401(h) account assets used to fund health and welfare benefits, and the changes in those assets, to be reported in the financial statements of the health and welfare benefit plan. Benefit obligations related to the 401(h) account are also required to be reflected in the health and welfare plan financial statements.

3. Defined benefit pension plans to disclose the fact that the assets are available only to pay retirees' health benefits.

4. Health and welfare benefit plans to disclose in the notes to the financial statements the fact that retiree health benefits are funded partially through a 401(h) account of the defined benefit pension plan.

The SOP is effective for financial statements for plan years beginning after December 15, 1998, with earlier application encouraged. Accounting changes adopted to conform to the provisions of this SOP should be made retroactively.

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Proposed Statements of Position for Employee Benefit Plans

The AICPA Employee Benefit Plans Committee currently has two SOP projects underway.

Accounting and Reporting for Certain Employee Benefit Plan Investments and Other Disclosure Matters

The first proposed SOP, Accounting and Reporting for Certain Employee Benefit Plan Investments and Other Disclosure Matters, was cleared for exposure by the FASB at the February 24, 1999, meeting pending certain changes. This SOP was discussed at the March 8-9, 1999, AcSEC meeting for final clearance for exposure. The exposure draft is expected to be released in the second quarter 1999. This proposed SOP amends chapters 3 and 4 of the AICPA Audit and Accounting Guide Audits of Employee Benefit Plans (the Guide), SOP 94-4, Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans, and SOP 92-6. This proposed SOP simplifies disclosures for certain investments and would supersede AICPA Practice Bulletin (PB)12, Reporting Separate Investment Fund Option Information of Defined Contribution Pension Plans.

Specifically this proposed SOP—

1. Revises Guide paragraphs 3.28k and 3.28l and supersedes PB 12 to eliminate the required disclosures by defined contribution pension plans for participant-directed investment programs.

2. Revises Guide paragraph 3.20 to eliminate the required disclosures by defined contribution pension plans to present plan investments by general type in the statement of net assets available for benefits for participant-directed investment options.

3. Revises Guide paragraph 3.28g to require identification of those investments that represent 5 percent or more of net assets available for benefits that are nonparticipant-directed for defined contribution pension plans.
4. Revises SOP 94-4 paragraph 15, SOP 92-6 paragraph 58, and Guide paragraphs 3.28p and 4.57 to eliminate the required disclosures by investment fund option for defined contribution pension and health and welfare plans relating to benefit responsive investment contracts.

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

Accounting For and Reporting on Certain Health and Welfare Benefit Plan Transactions

The second proposed SOP, on the accounting for and reporting on certain health and welfare benefit plan transactions, was discussed at the January 1999 AcSEC meeting and was cleared for exposure pending FASB clearance. The exposure draft is expected to be released for exposure in the second quarter of 1999. This proposed SOP amends chapter 4 of the AICPA Audit and Accounting Guide Audits of Employee Benefit Plans, and SOP 92-6. This proposed SOP revises the standards for measuring, reporting, and disclosing estimated future postretirement benefit payments that are to be funded partially or entirely by plan participants. It specifies the presentation requirements for benefit obligation information and establishes standards of financial accounting and reporting for certain postemployment benefits provided by health and welfare benefit plans. Specifically, it allows information about the benefit obligations to be presented in a separate statement, combined with other information in a financial statement, or presented in a note to the financial statements. The proposed SOP also clarifies the measurement date for benefit obligations and clarifies the identification of 5 percent investment disclosures.

The provisions of this proposed SOP would be effective for financial statements for plan years beginning after December 15, 2000, with earlier application encouraged. Financial statements for prior
plan years are required to be restated to comply with the provi-
sions of this proposed SOP.

Note: Practitioners should note that the purpose of AICPA expo-
sure drafts is to solicit comments from preparers, auditors, users of
financial statements, and other interested parties. They are nonau-
thoritative and cannot be used as a basis for changing GAAP.

Executive Summary—Proposed Statements of Position

• *Accounting and Reporting for Certain Employee Benefit Plan Investments and Other Disclosure Matters* (expected to be released for exposure by the second quarter 1999)

• *Accounting For and Reporting on Certain Health and Welfare Benefit Plan Transactions* (expected to be released for exposure by the second quarter 1999)

Professional Ethics Division Interpretations and Rulings

Omnibus Proposal of Professional Ethics Division Interpretations and Rulings

On February 18, 1999, the AICPA Professional Ethics Executive Committee adopted, with modification, most of the proposals from the November 1998 exposure draft *Omnibus Proposal of Professional Ethics Division Interpretations and Rulings*. In particular, the Professional Ethics Executive Committee has adopted revisions of Interpretation 101-3 under Rule 101, *Independence* (AICPA, *Professional Standards*, vol. 2, ET sec. 101.05), to address the various types of other services that a member may perform for an attest client in today's practice environment and the impact of such services on the member's independence. The proposal sets forth general principles that the member should consider in evaluating the effect on independence of performing a service, and provides examples of general activities that would be considered to impair independence. Specifically, the proposed revision to Interpretation 101-3 sets forth specific examples of when independence is and is not impaired when performing various benefit plan administration services. This interpretation is scheduled to be
published in the May 1999 *Journal of Accountancy*. The interpretation can also be found on the AICPA Web site at http://www.aicpa.org. It is important to point out that, for ERISA engagements, the DOL has separate independence standards which may be more restrictive than those of the AICPA. See paragraph A.79 in appendix A of the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans* for a listing of the DOL’s independence standards.

**AICPA Services**

For a complete listing of AICPA services see *Audit Risk Alert—1998/99* (product no. 022223).

**Related AICPA Publications**

- AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans* (012339)
- AICPA Practice Aid *Financial Statement Reporting and Disclosure Practices for Employee Benefit Plans* (Offering the same kind of powerful help AICPA's *Accounting Trends and Techniques* does, this comprehensive practice aid illustrates a wide range of employee benefit plan financial statement disclosures and auditor's reports for both full-scope and limited-scope audits.) (008725)
- *Checklists and Illustrative Financial Statements for*—
  - Defined Benefit Pension Plans (008720)
  - Defined Contribution Pension Plans (008735)
  - Health and Welfare Benefit Plans (008721)
- "A Wake-Up Call"—An Employee Benefit Plan Audit Video (013800)

**National Conference**

Each spring the AICPA sponsors a National Conference on Employee Benefit Plans that is specifically designed to update auditors,
plan administrators, and industry or plan sponsors on various topics including recent and proposed employee benefit plan legislative and regulatory issues, and significant accounting, auditing, and tax developments. The 2000 National Conference on Employee Benefit Plans will be held May 7-10, 2000, at the Hilton Walt Disney World, Orlando, Florida. Information on the conference may be obtained by calling the AICPA Conferences Division at (201) 938-3556.

**Continuing Professional Education**

The AICPA offers the following self-study courses (also available in group study form):

- *Audits of Employee Benefit Plans*
- *Audits of 401(k) Plans*

For group study courses, visit the AICPA Web site, at http://www.aicpa.org/store/csearch.htm, for a current schedule of where these courses are offered, or call your state society for complete details. Registration for all group study courses is done through your state CPA society.

**Order Information**

Copies of AICPA publications referred to in this document may be obtained by calling the AICPA Order Department at (888) 777-7077 or faxing a request to (800) 362-5066. Copies of FASB publications referred to in this document may be obtained directly from the FASB by calling the FASB Order Department at (203) 847-0700, ext. 10.

**Accounting and Auditing Technical Hotline and Ethics Hotline**

The AICPA Technical Hotline answers members’ inquiries about accounting, auditing, attestation, compilation, and review services. Members of the AICPA's Professional Ethics Team answer inquiries concerning independence and other behavioral issues related to the application of the AICPA Code of Professional Conduct. To reach either hotline, call (888) 777-7077.
World Wide Web Site

The AICPA has a home page on the World Wide Web. "AICPA Online," the Web site (URL or uniform resource locator: http://www.aicpa.org), offers CPAs the unique opportunity to stay abreast of developments in accounting and auditing, including exposure drafts. The home page is updated daily. The Web site includes In Our Opinion, the newsletter of the AICPA Audit and Attest Standards Team. The newsletter provides valuable and timely information on technical activities and developments in auditing and attestation standard setting.

This Audit Risk Alert replaces Employee Benefit Plans Industry Developments—1998.

The AICPA is currently offering a new CD-ROM product, entitled reSource: AICPA's Accounting and Auditing Literature. This CD-ROM enables subscription access to the following AICPA Professional Literature products in a Windows format: Professional Standards, Technical Practice Aids, and Audit and Accounting Guides (available for purchase as a set which includes all twenty-five Guides and the related Audit Risk Alerts, or as individual publications). This dynamic product allows you to purchase the specific titles you need, and includes hypertext links to references within and between all products. To order any publications included on the CD-ROM, call (888) 777-7077.

Practitioners Publishing Company (PPC) and the AICPA are currently offering publications issued by PPC, the AICPA, and the FASB on one CD-ROM disk, entitled The Practitioner's Library—Accounting and Auditing. The FASB publications include Original Pronouncements, Current Text, Emerging Issues Task Force Abstracts, and FASB Implementation Guides; and the AICPA publications include Professional Standards, Technical Practice Aids, Audit and Accounting Guides, and Peer Review Program Manual. The disk also contains eighteen PPC engagement manuals. The disk may be customized so that purchasers pay for and receive only selected segments of the material. For more information about this product call (800) 323-8724.
The Audit Risk Alert *Employee Benefit Plans Industry Developments* is published annually. As you encounter audit and industry issues that you believe warrant discussion in next year's Alert, please feel free to share them with us. Any other comments that you have about the Alert would also be greatly appreciated. You may email them to ldelahanty@aicpa.org or write to:

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201 Plaza Three  
Jersey City, NJ 07311-3881
## APPENDIX A

### IRS Limits on Benefits and Compensation

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FICA Taxable Wage Base

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The guidance issued to PWBA’s field offices states that Year 2000 reviews will be conducted in all new and ongoing civil investigations. The attached list of sample fiduciary questions was provided to the field offices to assist the staff in the initial stages of conducting those reviews. In addition, the guidance provides that a Y2K warning will be issued in those cases where a determination is made that a plan fiduciary has failed to take appropriate measures to protect the interests of the plan and its participants and beneficiaries from the potential harm posed by the Year 2000 problem. The issuance of a warning is intended to place the plan fiduciary on notice of his or her obligation and to encourage voluntary compliance in addressing the Year 2000 issue. Regardless of whether a warning is received by an individual fiduciary, however, in those cases where plan fiduciaries fail to act prudently in performing their plan duties and plan participants and beneficiaries are adversely affected, appropriate enforcement action may be pursued.

A. Plan’s Internal Computer Operations

1. Provide the name, position title, and telephone number of the person in your organization responsible for addressing the Year 2000 compliance of the plan’s computer system.

2. If applicable, provide the name and telephone number of the person or entity hired to address the Year 2000 compliance of the plan’s computer system. Provide a copy of the service contract.

* These sample questions were issued by the U.S. Department of Labor Pension and Welfare Benefits Administration (PWBA) to help the employee benefit industry understand these issues.
3. If applicable, describe how the plan's Year 2000 service provider was selected and what information was reviewed in the course of the selection process.

4. What stages have been completed in addressing the Year 2000 problem (e.g., inventory development, assessment, remedial action, testing, contingency planning)?

5. If applicable, provide a copy of the strategy or planning document addressing how Year 2000 compliance will be ensured with respect to plan operations.

6. Has an inventory of plan-related computer information systems been developed for purposes of assessing Year 2000 compliance? Please provide a copy.

7. Has a Year 2000 compliance assessment been conducted? Please provide a copy.

8. What information has been reviewed by the plan fiduciaries regarding the plan's Year 2000 compliance?

9. What corrective measures have been identified to date? What remedial action, if any, has been taken? By whom? How much did it cost?

10. Who determined the remedial actions to be taken by the plan? What information provided the basis for the decision?

11. Has the plan been "certified" as Year 2000 compliant? If so, please explain and provide a copy of the certification.

12. Has a testing schedule been devised for the plan's computer systems? Who will perform the test?

13. Has a contingency plan been devised in the event critical computer operations are disrupted? If so, provide a copy.

14. What information has been provided, or will be provided, to plan participants regarding the Year 2000 problem?

15. Who is responsible for paying the costs of addressing the Year 2000 problem?
**B. External Computer Operations of Plan Service Providers**

1. Has the plan compiled a list of service providers for purposes of determining Year 2000 compliance? Has the plan determined which of these providers renders essential or critical services? Provide a copy of the list.

2. Provide the name and telephone number of the plan fiduciary responsible for hiring the plan service providers.

3. Has the plan notified service providers of its expectations regarding Year 2000 compliance? If so, provide a copy of the notification.

4. Have contracts between the plan and its service providers been amended to address the plan's expectations regarding Year 2000 compliance? If so, provide copies of the contract amendments.

5. Has each plan service provider been contacted to determine their Year 2000 compliance? If so, please provide copies of the information requested and obtained from the service providers.

6. Has the plan fiduciary reviewed documentation from plan service providers regarding their Year 2000 compliance? If so, what information was reviewed and what action was taken by the plan fiduciary to ensure the plan's interests, and those of participants and beneficiaries, were protected?

7. Were any concerns expressed by the plan regarding the service provider's Year 2000 compliance? If so, what were those concerns and what actions were taken to address them?

8. What action has the plan taken to ensure that the remedial measures required to bring the service provider's computer system into Year 2000 compliance have been or will be implemented?

9. Has the plan determined that the service provider has scheduled or conducted testing of its computer systems for purposes of determining Year 2000 compliance?
10. Has the plan obtained documentation describing the service provider's contingency plan or the measures the service provider intends to implement in the event essential plan operations are disrupted due to a Year 2000 problem?

C. Plan Sponsor's Computer System

1. Has the plan obtained appropriate and timely information from the plan's sponsor regarding the Year 2000 compliance of its computer system?

2. Has the plan's fiduciary considered the potential impact of a Year 2000 problem in the plan sponsor's computer system in developing the plan's contingency plan?

D. Investigations Focused on Financial Institutions (banks, insurance companies, brokers, investment managers, etc.)

1. Identify the types of services provided to ERISA-covered employee benefit plans (e.g., trustee services, banking, brokerage, investment management, record keeping). Describe the measures that have been taken to ensure that all such services have been evaluated for Year 2000 compliance.

2. If the financial institution is subject to regulation by a federal, state or other regulatory agency, what actions were taken to comply with that agency's requirements?

3. Has any governmental agency (state or federal) or other independent organization reviewed the company's computer operations for Year 2000 compliance? If so, identify the agency or agencies. If any report was produced and provided to the institution, please provide a copy.

4. What actions have been taken by the financial institution to ensure that its service providers and vendors are Year 2000 compliant (e.g., have investment managers checked on the Year 2000 compliance of their brokers)?

E. Investment-Related Issues

1. If the fiduciary makes investment decisions on behalf of the plan, what specific procedures are followed to determine that the investments are Year 2000 compliant?
2. If the plan offers investment options in connection with individually directed accounts under section 404(c) of ERISA, has the plan fiduciary taken appropriate steps to ensure that the investment options and related information systems are Year 2000 compliant?

3. If a plan has delegated investment responsibility or authority, in whole or in part, to an investment manager or other fiduciary, what procedures has the fiduciary implemented to monitor that fiduciary’s investment decisions in connection with the Year 2000 problem?

4. In selecting, hiring, and retaining an investment adviser or manager, has the plan fiduciary obtained and reviewed appropriate information aimed at determining that investment decisions are made with consideration of Year 2000 compliance?
APPENDIX C

PWBA Year 2000 Questions and Answers*

Q. What is the Year 2000 problem and how does it affect employee benefit plans?

A. The Year 2000 (Y2K) problem arises when a computer performing date-dependent computations or operations produces erroneous results because its system recognizes years only by the last two digits, causing a “00” entry to be read as the year “1900” rather than “2000.” Because the computer systems, both hardware and software, produced in the past have commonly used the two-digit date designation, virtually all businesses are now faced with the enormous task of determining the extent to which their systems will be affected by the Year 2000 problem. Computer systems that are found to have a problem must be converted to a compliant format, i.e., a format that reflects the correct date. As a general matter, the conversion process is recognized as both time-consuming and expensive.

Like most business operations, employee benefit plans rely on computers for most of their critical operations such as benefit calculations and payments. The Year 2000 problem may affect these operations in serious and potentially unpredictable ways. For example, assume a plan provides that an employee becomes eligible to participate in the plan at age 21 with one year of service. For a participant born in 1979 and employed beginning in December 1998, on January 1, 2000, the plan’s computer system may miscalculate eligibility by showing the employee as minus 21 years of age and as having worked minus 99 years.

In addition, the Y2K problem is an issue for all of the businesses that provide critical services to employee benefit plans, such as banks, insurance companies, actuarial firms and invest-

* Written and produced by the Pension and Welfare Benefits Administration, July 1998.
ment management companies. The extent to which these businesses are affected by the Year 2000 problem could have serious consequences for their client plans.

Q. What is a plan fiduciary's potential liability under the Employee Retirement Income Security Act (ERISA) with respect to the Year 2000 problem?

A. As stated in the Department of Labor's February 9, 1998, press release, plan fiduciaries, such as plan administrators and trustees, are responsible for ensuring that plans and their participants and beneficiaries are protected. Such protection includes the establishment and implementation of a prudent procedure for ensuring that the plans' own computers, and, to the extent possible, those of the plans' service providers, are Year 2000 compliant. ERISA establishes comprehensive standards to govern fiduciary conduct. Among other things, a plan fiduciary must discharge his or her duties with respect to a plan solely in the interest of the plan's participants and beneficiaries. In addition, a plan fiduciary must discharge those duties with "the care, skill, prudence and diligence under the circumstances then prevailing that a prudent person acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims." A fiduciary's failure to comply with ERISA's fiduciary responsibility requirements may result in personal liability for losses incurred by a plan or its participants and beneficiaries.

Q. What constitutes a prudent procedure for ensuring Year 2000 compliance?

A. Because the Year 2000 problem could have a substantial impact on plan investments, benefit payments and other essential plan operations, plan fiduciaries are responsible for establishing and implementing a strategy to evaluate and ensure Year 2000 compliance. Because of the complex and technological nature of this problem, however, plan fiduciaries may choose to hire outside consultants and experts to inventory, review, assess, convert and test the computer systems re-
In addition to addressing the Year 2000 problem as it relates to computer systems under their control, plan fiduciaries have an obligation to determine whether the plan's critical operations will be endangered by the computer systems of unrelated service providers, such as third party administrators. In this regard, plan fiduciaries have an obligation to obtain information sufficient to evaluate each service provider's Year 2000 compliance and to monitor that compliance to ensure the plan's interests are protected.

Because of the pervasive nature of the Year 2000 problem, it may not be possible to prevent a disruption of computer operations. In recognition of that possibility, a plan fiduciary must determine how best to protect the plan and its participants and beneficiaries through the establishment of a contingency plan that will be implemented in the event the plan's essential operations are affected.

Q. To what extent are plan fiduciaries responsible for Year 2000 problems that are caused by unrelated plan service providers?

A. Plan fiduciaries are responsible for obtaining in a timely fashion appropriate information to evaluate the Year 2000 compliance of all of the plan's service providers and determining what action is appropriate to ensure that the interests of the plan and its participants and beneficiaries are protected. In addition, when selecting service providers, plan fiduciaries should include Year 2000 compliance as another factor to be considered. Finally, the plan fiduciary is responsible for monitoring the service provider's operations to ensure ongoing compliance and protection of the plan's interests.

Q. Can the plan be charged for the costs associated with the Year 2000 problem?

A. ERISA provides that reasonable expenses relating to the administration of an employee benefit plan may be charged to
the plan. Also, the plan document should identify which costs may be charged to the plan. The issue of whether the cost of ameliorating the Year 2000 problem of a specific plan may be passed through depends on the terms of the plan document and whether the cost constitutes a reasonable administrative expense related to the plan.

For example, Company Y is a manufacturer and offers its employees a 401(k) plan through payroll deductions. Y has determined that its computerized payroll system is not Year 2000 compliant and large portions of its complex software system must be converted. As a general matter, Y is responsible for the costs of achieving Year 2000 compliance for its corporate payroll system. However, because the plan document permits charging the plan reasonable administrative fees, that portion of the cost relating directly to the plan's administration may be charged to the plan.

Q. **Is the Department planning to implement an enforcement initiative with respect to the Year 2000 problem?**

A. The Department's Pension and Welfare Benefits Administration (PWBA) investigators have already begun addressing the Year 2000 problem in the course of new and ongoing investigations. In those cases where plan fiduciaries have failed to act prudently in performing their plan duties and plan participants and beneficiaries have been adversely affected, appropriate enforcement action will be determined and pursued.

Q. **What should a plan administrator disclose about the plan's year 2000 activities to participants and beneficiaries?**

A. The Department strongly encourages plan administrators to disclose to their participants and beneficiaries the extent of the plan's Y2K preparedness. The administrator is encouraged to inform participants and beneficiaries as to the steps being taken to ensure the Y2K issue does not interrupt the operation of the plan or participants' and beneficiaries' access to their individual accounts.
Administrators are recommended to inform their participants and beneficiaries about:

- The plan's current level of readiness
- The strategy for bringing the plan's systems into Y2K compliance
- A timetable for when the critical systems will become Y2K compliant
- The level of compliance for service provider companies
- Possible effect on the participants and their beneficiaries should the plan become impaired in any way due to Y2K problems
- Any contingency, or backup, plans that have been devised in the event the plan is not Y2K compliant in time.

Q. Are plan auditors, as part of their current engagements, required to detect potential record keeping problems associated with the year 2000?

A. No. It is the plan administrator's responsibility for assessing and remedying any problems associated with the Y2K problem. Under generally accepted auditing standards (GAAS), the auditor does not have a responsibility to determine the effects of the Y2K issue on operational matters that do not affect the plan's ability to prepare financial statements for other than the year being audited.

SAS No. 83, Establishing an Understanding With the Client, requires auditors to obtain an understanding with the client regarding the services to be performed. This understanding is usually documented in an engagement letter addressed to the plan administrator and signed by the auditor. The Department of Labor encourages plan administrators to have language in engagement letters in order to clarify the auditor's responsibilities regarding the Y2K issue. This should minimize any confusion surrounding the auditor's duties and responsibilities. Engagement letters also should clarify how auditors intend to exercise their discretion to
communicate matters that come to their attention relating to the Y2K issue in management letters or otherwise.

Q. What information will be disclosed to the plan administrator by the plan's auditor relative to the Y2K problem?

A. In general, the auditor is only obligated to list current system failures as reportable conditions and is not obligated to forecast future system failures. Therefore, the plan administrator cannot rely upon the plan's auditor to comment on potential record keeping problems regarding the Y2K issue that may arise in the future. Plan auditors are extremely cautious about being associated with any assertions that their clients' systems are Year 2000 compliant. The plan auditor's responsibility is limited to planning and performing an audit with the goal of obtaining reasonable assurance about whether the financial statements are free of material misstatement. The auditor is also responsible for reporting significant problems to the plan's management if such problems exist during the period being audited. The auditor's focus is on the current period, not future periods. Therefore, even in the event of an auditor becoming aware that in some period after the period being audited, the Y2K issue could adversely affect the plan's ability to process financial information, this potential future problem does not constitute a reportable condition in the current year.

Q. What assurances will the Reports on the Processing of Transactions by Service Organizations (commonly referred to as SAS No. 70 reports) provide to plan administrators and their auditors regarding the Y2K issue?

A. None. The Reports on the Processing of Transactions by Service Organizations (SAS No. 70 reports) are typically prepared by a service organization's independent auditors. These reports can provide a level of assurance to plan administrators and auditors regarding the system of internal controls in place at the service organization. Because these reports deal with a historical perspective, they do not provide assurances for prospective periods regarding deficiencies which may affect those future
periods (such as the Y2K issue). Accordingly, plan administra-
tors and auditors should not expect the Reports on the Pro-
cessing of Transactions by Service Organizations to provide
any assurance on the organization’s Y2K compliance.

Q. Whom should I call if I have questions about how to address the
Year 2000 problem?

A. The Department of Labor is not in a position to provide
guidance regarding the technical issue of how to resolve the
Y2K problem. However, a large amount of information on
the topic is available through the Internet. Some useful Web-
sites include:

• **Federal Financial Institutions Examination Council (FFIEC)**—www.ffiec.gov—which provides a list of resources
(bank association Websites and documents) useful to federa-
ally supervised financial institutions as well as trade groups,
vendors and companies providing services to institutions.

• **American Institute of Certified Public Accountants (AICPA)**—www.aicpa.org—which also has established
hyperlinks to many private-sector and governmental Web-
sites where helpful resources are identified.

• **The Small Business Administration (SBA)**—www.sba.gov/
y2k/—which offers specific assistance to the small business
owner on the Y2K problem.

• **Office of the Comptroller of the Currency (OCC)**—
www.occ.ustreas.gov—which regulates and supervises
national banks to ensure a safe, sound and competitive
national banking system.

• **General Accounting Office (GAO)**—www.gao.gov—
which even includes an auditor’s checklist for the com-
puter crisis.

• **Securities and Exchange Commission (SEC)**—www.sec.
gov—which is responsible for administering the federal secu-
rities laws designed to protect investors in securities markets
that operate fairly and ensure that investors have access to
disclosure of all material information concerning publicly traded securities.

- **Information Technology Association of America (ITAA)**—[www.itaa.org/year2000.htm](http://www.itaa.org/year2000.htm)—which is a trade association representing the interests of the information technology industry.

- **General Services Administration (GSA)**—[www.itpolicy.gsa.gov/mks/yr2000/y2khome.htm](http://www.itpolicy.gsa.gov/mks/yr2000/y2khome.htm)—which contains information about planning, testing and contingency policy and also links to hundreds of private and public sites that offer advice and examples.

(The Pension and Welfare Benefits Administration, while providing a direct linkage to these resources, neither guarantees or assumes responsibility for the information provided by these Websites.)

**Q.** *Whom should I call if I have questions about my potential fiduciary liability?*

**A.** If you have questions regarding your potential fiduciary liability, you may contact the Pension and Welfare Benefits Administration’s Regional or District Office nearest you. A list of the agency’s field offices follows:

- Atlanta Regional Office: (404) 562-2156
- Boston Regional Office: (617) 565-9600
- Chicago Regional Office: (312) 353-0900
- Cincinnati Regional Office: (606) 578-4680
- Dallas Regional Office: (214) 767-6831
- Detroit District Office: (313) 226-7450
- Kansas City Regional Office: (816) 426-5131
- Los Angeles Regional Office: (626) 583-7862
- Miami District Office: (954) 424-4022
- New York Regional Office: (212) 399-5191
• Philadelphia Regional Office: (215) 596-1134
• San Francisco Regional Office: (415) 975-4600
• St. Louis District Office: (314) 539-2693
• Seattle District Office: (206) 553-4244
• Washington, D.C. District Office: (202) 254-7013
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<tr>
<td>American Institute of Certified Public Accountants</td>
<td>Order Department Harborside Financial Center, 201 Plaza Three, Jersey City, NJ 07311-3881 (888) 777-7077</td>
<td>24 Hour Fax Hotline (201) 938-3787</td>
<td><a href="http://www.aicpa.org">http://www.aicpa.org</a></td>
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<td>Financial Accounting Standards Board</td>
<td>Order Department P.O. Box 5116 Norwalk, CT 06856-5116 (203) 847-0700, ext. 10</td>
<td>24 Hour Fax-on-Demand (203) 847-0700, menu item 14</td>
<td><a href="http://www.fasb.org">http://www.fasb.org</a></td>
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<td>Division of Reporting Compliance</td>
<td>Form 5500 preparation and filing requirements (202) 219-8770</td>
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<td>Office of Regulations and Interpretations</td>
<td>(202) 219-7461</td>
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