2000

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Employee Benefit Plans Industry Developments—2000

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

This document has been prepared by the AICPA staff. 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 members of the 1998–1999 AICPA Employee Benefit Plans Committee; Richard M. Steinberg, former committee member; Wendalyn Frederick, technical manager, AICPA Professional Standards and Services; and The Office of Chief Accountant, Pension and Welfare Benefits Administration of the U.S. Department of Labor for their contributions to this Audit Risk Alert.


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Employee Benefit Plans

Industry Developments—2000

Introduction

What is the purpose of this Audit Risk Alert?

This Audit Risk Alert is intended to help you expand your knowledge and understanding of the employee benefit plan industry and the related regulatory environment, as well as to help you plan and perform your employee benefit plan audits. The Alert addresses current industry developments and emerging practice issues and provides information on current auditing and accounting developments. Armed with a sound understanding of these areas allows you to, among other things, perform your audits in a more efficient and effective manner, and to deliver greater value to your clients through audit and related services.

Industry Developments

Twenty-Fifth Anniversary of ERISA

September 2, 1999, marked the twenty-fifth anniversary of the enactment of ERISA—the Employee Retirement Income Security Act. Signed into law by President Gerald R. Ford, ERISA represented a landmark federal statute aimed at protecting the retirement and certain health and welfare benefits of American workers. When ERISA became effective, there were only 270,000 pension plans covering some 42 million participants. These plans had $225 billion in assets. Twenty-five years later, 700,000 pension plans hold more than $4.3 trillion of retirement assets that are owed to 90 million participants nationwide. The Department of Labor (DOL) also assures that 6 million health and welfare plans deliver benefits to 150 million participants and their families.

The DOL's Pension and Welfare Benefits Administration (PWBA) has evolved to meet the ongoing economic and market trends
that affect the financial viability of these plans. In meeting its mission, PWBA uses a philosophy of "prudent" regulation, targeted enforcement, and expeditious service to workers as its guideposts in administering plans under its jurisdiction during good and bad economic times. In the early 1980s, the PWBA started a new program to handle individual problems encountered by participants in obtaining pension, health, and other benefits. The Division of Technical Assistance and Inquiries was created in the national office to address this public need that workers get clear information about their rights and benefits. Today there are dedicated benefit advisers in each field office handling more than 150,000 inquiries annually. Benefit advisers are a valuable complement to the investigative staff because cases involving potential violations that affect classes of participants may be identified from complaints received from the public. Since October 1994, the PWBA has answered more than 625,000 public inquiries and recovered $147 million in pension benefits for individual participants. This money was returned to participants as a lump-sum payment or increased benefits. For the same period, the PWBA's enforcement program recovered approximately $1.71 billion for plans so that these plans would have the money to pay promised benefits to participants and their families.

In an effort to increase public awareness about job-based pension and health benefits, the PWBA launched the national pension education campaign in July 1995 and the national health benefits education campaign in December 1998. These campaigns have resulted in tangible information products (such as booklets, public service announcements, and interactive Web sites) and greater access to a variety of public and private resources to help workers understand their benefits and how to preserve their rights to those benefits. The DOL's publications hotline ((800) 998-7542) serves the public and private partners in the two campaigns. To date, more than 5 million publications have been distributed nationwide providing valuable information to the PWBA's various constituencies. The PWBA's Web site, http://www.dol.gov/dol/pwba, offers informational material as well as interactive sites to help workers, employers, and the benefit community make informed decisions about pension and health benefit programs.
Trends in 401(k) Plans

What are the current trends in 401(k) plans?

A recent survey of 401(k) sponsors was performed to “collect and present information and insights on key aspects of 401(k) plan design, investments, education, communication, and administration.” Based on key findings of the survey, the number of investment options being offered continues to increase. Other continuing trends include daily valuing of fund balances, allowing participants to transfer existing balances daily between investment funds, and the use of the Internet. The survey, in part, showed that—

- 78 percent of eligible employees participated in their company’s 401(k) plan.
- The average number of investment options available for 401(k) contributions is up from eight in 1997 to eleven in 1999.
- 89 percent of plans perform daily valuations of fund balances. This is up from 71 percent in 1997.
- Plans allowing participants to transfer existing balances between investment funds on a daily basis is up from 64 percent in 1997 to 86 percent.
- 55 percent of plans provide their participants with Internet access to their 401(k) plan information, with another 27 percent planning to provide such access within the next eighteen months. Sixty-two percent of plans are using the Internet for employee investment education. This is up from 20 percent in 1997.
- There is a gradual trend toward payment of expenses from plan assets.

See the “Audit Developments” section of this Audit Risk Alert for further discussion of certain of these trends.

1. Survey was performed by Hewitt Associates, LLC, in 1999.
AICPA Establishes Employee Benefit Plan Expert Panel

With the elimination of the AICPA Employee Benefit Plans Committee, how will the AICPA identify industry-specific business reporting issues and liaise with the DOL?

As part of its effort to revamp the Institute’s volunteer structure, the Board of Directors has approved the establishment of expert panels that focus on identifying industry-specific business reporting issues with an emphasis on audit and accounting. Panels are being established in areas in which membership and the public have a high stake and in which the AICPA can add significant value. Initially, the AICPA will establish seven panels; employee benefit plans will be one of these.

The panels will enable standard setters, such as the AICPA Accounting Standards Executive Committee (AcSEC), the AICPA Auditing Standards Board (ASB), the Financial Accounting Standards Board (FASB), and the Governmental Accounting Standards Board (GASB), to continue to leverage the AICPA membership’s industry expertise, as well as provide a means for the profession to liaise with outside groups, such as regulators. In addition, the panels are designed to broaden the AICPA’s activities beyond those that were traditionally undertaken by committees, to help achieve the Vision, and complement the work of the Group of 100. The AICPA has begun implementing the new structure.

The AICPA will continue to use the task force model identified by the Board of Directors in July 1999, with the panels identifying projects and then handing them off to task forces. The AICPA will draw

2. The initial seven panels include Biotechnology and Pharmaceuticals, Computer Auditing and Electronic Delivery, High Technology, Employee Benefit Plans, Financial Services, Health Care, and Government/Not-for-Profit.

3. The Vision is the result of a collaborative, grassroots effort supported by the AICPA and state CPA societies to strategically determine the future of the profession.

4. The Group of 100 is a cross-functional group of members representing all areas of the profession. The group consists of CPAs from various segments of the profession and other business professionals who will identify and rank according to priority those critical emerging issues to be addressed. Once consensus on the most significant issues is reached, the top issues will be presented to a smaller team of volunteers and senior AICPA staff, which will be responsible for rationalizing and evaluating proposals, approving action plans, establishing task forces and budgets, setting priorities, and allocating resources accordingly.
talent from the broad and deep expertise of the membership to undertake the projects, as well as serve on the panels. The AICPA will develop a database of member expertise to help facilitate that process. You can apply for expert panel service by visiting the AICPA Web site at http://www.aicpa.org, clicking on “Find Out About Volunteer Central,” and following the directions on that site. Task force opportunities will be announced on the Web site and through other means. For more information, contact Arleen Thomas, vice president, Professional Standards and Services, at (212) 596-6115 or athomas@aicpa.org, or Joel Tannenbaum, technical manager, Accounting Standards, at (212) 596-6164 or jtanenbaum@aicpa.org.

PWBA Issues Final Rule on Assets Held in Insurance Company General Accounts

On January 5, 2000, the DOL published a final rule to provide guidance on how insurance companies manage pension assets held in their general accounts. Federal pension law generally does not consider assets of insurance company general accounts as including plan assets subject to ERISA. However, the 1993 Supreme Court ruling in the Harris Trust case concluded that plan investments in certain insurance contracts could result in an insurer holding plan assets. In such cases, insurance companies become fiduciaries subject to ERISA's rules. On July 12, 1995, the DOL granted a class exemption giving insurance companies conditional relief for transactions between their general accounts and companies that had preexisting relationships with investing plans. This class exemption will continue to provide limited relief for insurers who choose not to comply with the final rule. The final rule provides a broad safe harbor by stating that insurance companies would not be deemed fiduciaries under ERISA by virtue of plan investments in certain general account policies that were issued by an insurer on or before December 31, 1998. To come within the safe harbor, insurance companies must—

- Disclose to plan clients the method by which expenses and income are allocated to the contract.
- Allow plans to terminate or discontinue a policy upon ninety days notice to the insurer and to elect either a lump-sum pay-
out without penalty or annual installment payments over a ten-year period with interest.

- Give plans written notice of certain amendments sixty days before their taking effect.

**Regulatory Developments**

**Revision of the Form 5500 Series**

*Are you using the new Form 5500?*

On February 2, 2000, the DOL, Internal Revenue Service (IRS), and the Pension Benefit Guarantee Corporation (PBGC) announced the adoption of a substantially revised and improved Form 5500, Annual Return/Report of Employee Benefit Plan, for use by more than 800,000 pension and welfare benefit plans that file information with the federal government. The agencies have replaced Form 5500, Form 5500-C, and Form 5500-R with a single Form 5500 to be used by all filers. This new streamlined form applies to plan years beginning on or after January 1, 1999, and comprises a simple main form with basic identifying information and a checklist that guides each filer to more detailed schedules applicable to the filer’s specific type of plan. (See appendix B of this Audit Risk Alert for a quick reference chart for filing the new Form 5500. See appendix C for an example of the new main Form 5500, and see appendix D for examples of certain of the supplemental schedules required by the regulations.)

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).** Starting in 1999, large plans and certain direct filing entities (DFEs) must use

5. Direct filing entities (DFEs) include bank common or collective trusts (CCTs), and insurance company pooled separate accounts (PSAs) that choose to file information on behalf of their participating plans; master trust investment accounts (MTIAs); investment entities filing under 29 CFR 2520.103-12 (103-12 IEs); and group insurance arrangements (GIAs) filing under 29 CFR 2520.103-2 and 104-43.
this schedule to report loans, leases, and fixed income obligations in default or uncollectible, and nonexempt transactions.

• Schedule of Assets Held for Investment Purposes at End of Year and Schedule of Reportable Transactions. Large plan filers and certain DFEs that have assets held for investment purposes at the end of the year and reportable (5 percent) transactions are required to complete these forms. Computer-scannable forms will not be required; however, they must be prepared in accordance with the instructions to the Form 5500. Auditors should note the following.

  – Historical cost information is no longer required on the Schedule of Assets Held for Investment Purposes at End of Year 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 accountants and enrolled actuaries only. In addition, this schedule eliminates the requirement to identify plan trustees annually.

• Schedule D (Direct Filing Entity/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.

- **Schedule I (Small Plan Information).** This schedule combines information that was previously reported on Form 5500C/R. The same level of information is required each year.

- **Schedule R (Retirement Plan Information) and Schedule T (Qualified Pension Coverage Information).** These schedules replace items 15 through 21 on the 1998 Form 5500.

**Related Regulations Under ERISA**

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. Among other changes, the proposed regulatory amendments would update the references in sections of ERISA to reflect the new structure of the new Form 5500:

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

- 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 a CCT or PSA, the proposed amendments would require that such CCT or PSA notify its participating...
plans of whether or not it intends to file a Form 5500 as a direct filing entity, and to furnish the plan administrator with the information about the assets held by such CCT or PSA, respectively, needed by the plan administrator to satisfy its obligations under Title I of ERISA.

- Section 2520.103-12 provides an exemption and 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 would not change the information required to be reported by the 103-12 investment entity, but rather would establish the Form 5500 Series as the standard reporting format.

The comment period ended on February 8, 1999, and the DOL expects to issue final regulations in the spring of 2000.

**New “EFAST” Computerized Filing System**

**How do you file the new Form 5500?**

Beginning July 1, 2000, the DOL will take over the processing responsibilities for the Form 5500 and Form 5500-EZ from the IRS. The DOL has developed a new computerized system that will simplify and expedite the receipt and processing of the Form 5500 by relying on computer-scannable forms and electronic filing technologies. This system, called the ERISA Filing Acceptance System (EFAST), will reduce government and filer costs associated with filing, receiving, and processing annual reports.

EFAST will process the new 1999 Form 5500 in two computer-scannable formats: machine print and hand print (the questions are the same, only the appearance is different). Except for those who file electronically, use of computer-scannable forms is mandatory for 1999 plan year reports, which generally will be due starting in July, 2000.6

6. To help filers make the transition to the new EFAST system, the PWBA will not reject, during the first processing year of the new EFAST system, any 1999 annual return/report filing solely because it was submitted in whole or in part on a unofficial computer generated version of the 1999 hand-print form. However, certain minimum standards must be met. See the questions and answers on the EFAST Web site (www.efast.dol.gov) for more information on this topic.
Help Desk—The PWBA, IRS, and PBGC are granting a two-and-one-half month extension of the deadline for filing 1999 Form 5500 Series returns/reports under EFAST. The three agencies agreed to grant transition-year relief from the requirement to file an IRS Form 5558 (Application for Extension of Time to File Certain Employee Plan Returns) to obtain that extension. Specifically, the deadline for filers whose 1999 Form 5500 Series would be due on or before July 31, 2000, will be extended to October 16, 2000, without filers having to file a Form 5558. (This automatic extension cannot be extended further by filing a Form 5558. Filers whose normal due date is after July 31, 2000, and who are otherwise eligible to use the Form 5558, must still file the Form 5558 to secure a two-and-one-half month extension.)

Filers can choose a machine print format that uses computer software to complete the Form 5500. The machine print forms can be filed electronically, or they may be printed out on computer printers and mailed to the DOL’s processing center in Lawrence, Kansas. The printed form will include a computer-scannable two-dimensional bar code on the bottom of each page for expedited processing. Plans interested in using the machine print version of the Form 5500 will need to use EFAST-approved software. Those wishing to file the 1999 Form 5500 or 5500EZ electronically must have the individual who will sign the filing apply for an electronic signature by submitting a completed Form EFAST-1.7

Help Desk—Advance copies of the Form EFAST-1 and instructions are available for viewing and downloading from the EFAST Web page at http://www.efast.dol.gov or from the “What’s new” area on the PWBA’s home page at http://www.dol.gov/dol/pwba. Check the DOL’s EFAST Web site at www.efast.dol.gov for more information regarding the machine print forms and electronic filing.

When plan annual reports are filed electronically, the DOL encourages attachments to the electronic form (for example, certain applicable supplemental schedules) to be submitted in a single Adobe Portable Document format (PDF); however, data

7. Also, companies, trades, businesses, or other persons applying for codes to be EFAST transmitters or software developers must submit the Form EFAST-1 signed by an authorized person.
can be submitted in a single file or multiple files in any of the following formats:

- ASCII/EBCIDIC Character (text) format
- Microsoft Word Document format
- Corel Wordperfect Document format
- Adobe Portable Document format (PDF)
- Hypertext-Markup Language (HTML) format
- Microsoft Excel format
- Lotus 1-2-3 format

Filers can also choose a hand print format to complete their Form 5500 by hand or typewriter. However, the hand print format can be filed only by mail (including certain private delivery services) to the DOL's processing center in Lawrence, Kansas. The hand print version of the Form 5500 uses special paper and special green ink that enables EFAST to scan hand and typewritten entries. Accordingly, hand print filers must file using the original hand print form. Filings made using photocopies of the hand print version may be subject to rejection by the DOL.8

Help Desk—Green ink forms will be available in the Form 5500 package mailed by the IRS and will also be available twenty-four hours a day, seven days a week, by calling (800) TAX-FORM ((800) 829-3676).

Small Plan Security Proposal

On December 1, 1999, the DOL published a notice of proposed rulemaking to improve the security of more than $300 billion in assets held in private-sector pension plans maintained by small businesses. In recent years, considerable public attention has focused on the potential vulnerability of small plans to fraud and abuse. A widely publicized case involved theft of more than $1 million from the Emergi-Lite, Inc., retirement plan by the plan's third-party administrator. Approximately $2.5 million was recovered in that case for the former employees as a result of the DOL's efforts. Although such circumstances are rare, the DOL decided

8. See footnote 6.
it was appropriate to propose steps to strengthen the security of pension assets and the accountability of persons handling those assets. Currently, pension plans with fewer than 100 participants are exempt from the requirement to have an independent qualified public accountant conduct an annual audit of the plan's financial statements. The proposed rule would add new conditions to the audit waiver. Under the proposal, small pension plans would not be required to have an annual audit if they—

- Hold at least 95 percent of plan assets with certain financial institutions—such as banks, mutual fund companies, insurance companies, or registered broker-dealers—or obtain additional fidelity bonding where 95 percent of the assets are not held with certain financial institutions.
- Disclose in the summary annual report (SAR) furnished to participants each year the names of the financial institutions holding plan assets, and the amounts held and the name of the surety companies issuing the fidelity bonds.
- Include in the SAR a notice informing participants and beneficiaries of their right to review or receive free of charge copies of asset statements of institutions' holding plan assets and evidence of any required bond, as well as a notice of their right to contact the department if the statements or evidence of bonding are not made available.

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

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

On November 25, 1998, the PWBA announced that it will not adopt a proposed nonenforcement policy affecting Form 5500s filed by multiemployer welfare benefit plans. Accordingly, annual reports of multiemployer 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 accoun-
tant'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 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 if they are presented together with the current year's financial statements. Because ERISA requires comparative statements of net assets available for plan benefits, 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 92-6.9 Plan administrators should consider engaging an actuary now 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.

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.

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.

9. 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.
Statement on Auditing Standards (SAS) No. 58, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 508.68 and .69), provides guidance on when an auditor has previously qualified his or her 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 opinion with respect to the restated financial statements. Further, when the updated report has an opinion different 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—

a. The date of the auditor’s previous report.

b. The type of opinion previously expressed.

c. The circumstances or events that caused the auditor to express a different opinion.

d. 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 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.10

10. In March 2000 the AICPA Accounting Standards Executive Committee issued an exposure draft of a proposed SOP on certain health and welfare benefit plan transactions. 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 section “Exposure Draft—Proposed Statement of Position to Amend SOP 92-6” of this Audit Risk Alert for a further discussion of this proposed SOP.
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 (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 few years, members of the AICPA Employee Benefit Plans Committee¹¹ 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 SAS No. 29, Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents (AICPA, Professional Standards, vol. 1, AU sec. 551.10).

¹¹ See the section titled “AICPA Establishes Employee Benefit Plan Expert Panel” for a discussion of the new volunteer structure at the AICPA.
PWBA Review of Plan Audits

When does the PWBA plan to conduct its next nationwide study to assess the quality of employee benefit 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 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. A major performance goal of the DOL is that no more than 12 percent of 1999 plan year audits contain deficiencies with professional and regulatory standards and that no more than 3 percent of Form 5500 filings 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. Accordingly, 1999 plan audits are of particular importance because 1999 is the year the PWBA's study will use to gauge the improvements made by the profession to strengthen the quality of employee benefit plan audits.

Section 401(k) Plan Fees

Investment expenses in defined contribution plans, particularly 401(k) plans, normally include administrative fees (such as record-keeping, voice response systems, daily valuations, and legal, trustee, and accounting services); investment fees (such as management fees which are normally a percentage of the assets invested, and sales charges or loads which are transaction charges); and additional fees (such as loan initiation charges). Some of these expenses are netted against investment earnings (for example, investment man-
agement fees), while others are charged as administrative expenses that are then allocated proportionately to participant accounts or charged as a flat fee per participant. These fees may be “bundled” when all such services are provided by one service provider, or “unbundled” when more than one service provider is utilized. Additionally, the nature of the investment vehicle may modify the types of expenses encountered. For example —

- Mutual funds will often have sales charges (such as front-end load—paid when you invest in a fund—or back-end load, which is more like an early redemption fee, based on the actual time the fund was held). Mutual funds may also charge rule 12b-1 fees, which are fees paid from plan assets for commissions to brokers, advertising or other promotional costs, and service provider fees. A “no-load” fund will indicate that there are no sales charges; however, there could still be 12b-1 fees.

- Collective investment funds offered by banks and trust companies do not have sales charges; however, they do have investment management and administrative fees.

- Pooled guaranteed investment contracts offered primarily by insurance companies have investment management and administrative expenses.

- Variable annuity contracts offered by insurance companies normally “wrap” an annuity contract around investment options, such as mutual funds. Participants invest in these investment options. In addition, these arrangements include insurance elements, such as interest return guarantees, death benefits, and annuity features. Expenses include investment management and administrative expenses. Expenses may also include: surrender or transfer charges upon withdrawal before the contract expires; and insurance-related charges that could include sales charges, costs of issuing contracts, and mortality risk charges.

If amounts of administrative or investment expenses are significant to the plan, auditors should consider whether the financial statements have appropriate footnote disclosure.
401(k) Fee Disclosure Tools

On July 15, 1999, the DOL joined representatives of the American Bankers Association (ABA), the American Council of Life Insurance (ACLI), and the Investment Company Institute (ICI) to release new 401(k) fee disclosure tools. These new tools will help employers—especially small employers—understand the investment fees and expenses which are charged to 401(k) retirement plans. The "401(k) Plan Fee Disclosure Form" features a flexible format that employers can use in whole or in part, depending on the type of plan investments and services. In addition, the form provides employers with a handy way to make cost-effective decisions and compare the investment fees and administrative costs of competing providers of plan services. The 401(k) fee form contains basic information employers may use in calculating and accounting for the total costs of operating a plan. It contains—

- An overview of the purpose of the form and general description on calculating 401(k) fees.
- A schedule that summarizes the total plan fees and expenses.
- Additional schedules providing information on investment product fees and estimates, plan administration expenses, one-time start-up and conversion expenses, and service provider termination expenses.

Also, a new DOL pamphlet, A Look at 401(k) Fees for Employers, highlights the overall obligations employers must fulfill in operating a plan. The pamphlet, which employers may use in conjunction with the form, describes the various fiduciary standards employers must comply with under federal pension law. The pamphlet lists ten basic questions employers should answer in considering fees and expenses paid for services. This includes employers' obligation to assure that fees paid by 401(k) plans are reasonable.

Help Desk—Both the form and publication are available through the DOL's Web site at http://www.dol.gov/dol/pwba or at any of the following Web sites: http://www.abacom, http://www.acli.com, or http://www.ici.org. The public can also obtain this material from the American Bankers Association at (800) 338-0626.
Consideration of Materiality

The DOL has taken enforcement action against plans that have failed to properly maintain participant account records, resulting in the recalculation of misstated participant accounts and payment of additional benefits. Plan administrators should evaluate the effects of recorded and unrecorded misstatements on participant account balances. Plan auditors should consider discussing with and advising plan administrators of such responsibilities.

SAS No. 89, *Audit Adjustments* (AICPA, *Professional Standards*, vol. 1, AU sec. 310, 333, and 380), establishes audit requirements designed to encourage client management to record financial statement adjustments aggregated by the auditor and to clarify management's responsibilities for the disposition of financial statement misstatements brought to its attention. SAS No. 89 was issued in December 1999 and is effective for audits of financial statements for periods beginning on or after December 15, 1999, with earlier adoption permitted. (See the "New Auditing Pronouncements" section of this Audit Risk Alert for a summary of SAS No. 89.)

Materiality—SEC Staff Bulletin No. 99

Although most employee benefit plans are not subject to the Securities and Exchange Commission (SEC), Staff Accounting Bulletin (SAB) No. 99, *Materiality*, provides interesting and useful insights by reaffirming the concepts of materiality as expressed in the accounting and auditing literature as well as in long-standing case law. SAB No. 99 addresses the application of materiality thresholds to the preparation and audit of financial statements filed with the SEC.

The SAB draws heavily on the existing auditing and accounting literature on materiality and makes some important statements. These statements include the following:

- Registrants and auditors may not rely solely on a numerical threshold to determine what is material.

12. Staff Accounting Bulletins are not rules or interpretations of the Securities and Exchange Commission; they represent interpretations and practices followed by staff of the Office of the Chief Accountant and the Division of Corporation Finance in administering the disclosure requirements of the federal securities laws.
• The materiality of misstatements discovered in the financial reporting and auditing processes must be considered both individually and in the aggregate.

• Intentional misstatements that are not material are inappropriate and may be unlawful. (The SAB addresses the evaluation of misstatements discovered in the financial reporting and auditing processes and does not affect the auditor's consideration of materiality in planning the audit.)

Registrants and their auditors are urged to read the SAB fully and carefully.

Help Desk—The full text of the SAB can be viewed at the SEC Web site, http://www.sec.gov/rules/acctreps/sab99.htm. Additional sources of guidance on materiality evaluation include Practice Alert 94-1, Dealing With Audit Differences, issued by the Professional Issues Task Force (PITF) of the AICPA SEC Practice Section Executive Committee (the Alert is available on the AICPA's Web site at http://www.aicpa.org), and a white paper on materiality developed by a task force of the five largest accounting firms (this paper also is available on the AICPA's Web site).

Timeliness of Remittance 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. DOL regulations require employers that sponsor pension plans (both defined benefit and defined contribution) to remit employee contributions as soon as practicable, but in no event later 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: as soon as practicable, but in no event later 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 supplemental schedule, the auditor should (a) express a qualified opinion or an adverse opinion on the supplemental schedule if the transaction is material to the financial statements or (b) modify his or her report on the supplemental 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 the Office of the Chief Accountant (OCA), 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 OCA’s help desk 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. This year, the DOL's outreach efforts will concentrate on the new Form 5500 and the EFAST processing system. In addition to once again participating in the AICPA's National Conference on Employee Benefit Plans, the PWBA will partner with the International Foundation of Employee Benefit Plans and several state CPA societies to conduct a series of Form 5500 workshops in about fifteen major cities throughout the country. These workshops are designed to provide benefit plan professionals with a comprehensive review of the new Form 5500, an introduction to the new EFAST processing system, and information regarding electronic filing. For a schedule of these upcoming events, members should contact the Office of the Chief Accountant at (202) 219-8818 or consult the PWBA's Web site at www.dol.gov/dol/pwba. The Web site also provides information on the 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 help desk at (202) 219-8770.

**Other Current Matters**

**Voluntary Fiduciary Correction Program**

In response to requests from the employee benefits community for a formal program that would reduce the risk of enforcement actions and the imposition of the section 502(1) penalty, the PWBA published a notice adopting the Voluntary Fiduciary Correction Program (VFCP). The VFCP is an enforcement program designed to encourage self-correction of certain violations of ERISA. The
VFCP lays out procedures, the types of transactions covered by the program, and acceptable corrective actions that do not require consultation or negotiation with the DOL.

Help Desk—For further information regarding the VFCP, visit the PWBA Web site at http://www.dol.gov/dol/pwba. Questions about the application process should be directed to PWBA regional offices.

New Form M-1 for Multiple Employer Welfare Arrangements
On March 16, 2000, the PWBA published a new Form M-1 annual report for multiple employer welfare arrangements (MEWAs). Generally MEWAs are arrangements that offer medical benefits to the employees of two or more employers, or to their beneficiaries. These arrangements may not include plans that are established or maintained under collective bargaining agreements, by a rural electric cooperative, or by a rural telephone cooperative association. Under the new reporting requirement, the one-page Form M-1 is generally required to be filed once a year. The first year, the form is generally due May 1, 2000, but administrators can request an automatic sixty-day extension to July 1, 2000. The next filing would then not be due until March 1, 2001, and on every March 1 thereafter.

Help Desk—For more information on the new Form M-1 visit the PWBA Web site (which includes commonly asked questions regarding filing the Form M-1) at http://www.dol.gov/dol/pwba. The PWBA has created a good faith safe harbor under which M-1 filings due in the year 2000 will not be assessed penalties in cases where there has been a good faith effort to comply with the filing requirements. To help filers, the PWBA is publishing a guide for completing the Form M-1. The guide is available at the PWBA Web site or by calling the PWBA toll-free publication hotline at (800) 998-7542. Plan administrators may also contact the PWBA with any questions or for assistance in completing the new report by calling (202) 219-8818.

Executive Summary—Regulatory Developments
• The new Form 5500 has been adopted by the DOL, IRS, and PBGC for plan years beginning on or after January 1, 1999. Make sure you are filing the correct Form 5500.
• The DOL will take over processing responsibilities for the Form 5500 from the IRS. The new filing system, EFAST (the ERISA Filing Acceptance System), will process the new 1999 Form 5500. Either the form must be filed electronically or a computer scannable form (machine print or hand print) must be mailed to the DOL's processing center in Lawrence, Kansas.

• The PWBA, IRS, and PBGC are granting a two-and-one-half month extension of the deadline for filing 1999 Form 5500 Series returns/reports under EFAST.

• The PWBA will not adopt the 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.

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

Legislative Developments

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—

• Retaining the limited-scope audit provision in lower risk circumstances where—
  – At least 95 percent of a plan's assets have a "readily ascertainable market value."
  – 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.
Within an eighteen-month period preceding the certification, the financial institution receives a GAAS report (for example, SAS No. 70 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.

The certified information is considered part of the plan's annual report.

The IQPA providing the certification satisfies the requirements of the proposal's enhanced auditor qualifications.

- Enhancing ERISA's auditor qualifications by requiring IQPAs to undergo periodic external quality control reviews and to complete continuing professional educational training related to employee benefit plan matters.
- 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.
- 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 to which the Secretary of Labor is a party.

Audit Developments

Cash Balance Plans

What are cash balance plans and how do you audit them?

A number of companies have switched recently from traditional pension plan formulas to "cash balance" plans, leaving many workers confused and concerned about how this change will affect their retirement benefits. "The trend to convert long-standing pension plans to something new has upset workers and we've been hearing
from them,” Secretary of Labor Alexis M. Herman said. “The first step is to provide enough information so they can understand cash balance plans well enough to ask the hard questions about how the change will affect them.”

Help Desk—To help sort through the confusion, the PWBA has posted a publication to its Web site titled Cash Balance Plans: Questions and Answers that explains the differences between the cash balance method of determining pension benefits and the more traditional defined benefit plans and 401(k) plans. The questions and answers can be found in appendix E of this Audit Risk Alert and on the PWBA’s Web site, http://www.dol.gov/dol/pwba.

Traditional defined benefit pension plans provide benefits that are defined in terms of a percentage of final average compensation or career average compensation, or as a flat dollar benefit per year of service. Recently, new types of benefit formulas, including cash balance plans and pension equity plans, have become more popular.

A cash balance plan is a special form of career average compensation plan. Typically a cash balance defined benefit pension plan maintains hypothetical “accounts” for participants. The employer credits participants’ “accounts” with a certain number of dollars each plan year, and promises earnings at a specified rate. Interest on the “account” balance is credited at a stated rate, which may be different from the plan’s actual rate of investment return. The interest rate may be modified prospectively, so long as there are no reductions in the participant’s benefit accrued to date. The formula for determining the amount to be credited to participants’ “accounts” can be varied from year to year, if the employer properly amends the plan prior to the beginning of the year and complies with notice requirements under ERISA. A change in interest rate would also require a plan amendment and compliance with notice requirements under ERISA. The principal advantage to participants of a cash balance plan is the ability to watch their hypothetical “account balances” grow (similar to a defined contribution pension plan) while providing certainty as to the interest to be credited. The participants bear no investment risk. The employer bears the risk that the plan’s actual rate of return may fall
below the stated rate of interest to be credited to participants’ accounts. Additionally, if a vested participant terminates or retires, the lump sum payment equals the hypothetical “account balance”; in a traditional plan a participant would not be able to compute the lump sum he or she is entitled to.

A pension equity plan is a defined benefit pension plan that has many of the advantages of the cash balance plan but the benefit formula is similar to a final pay program rather than a career average cash balance program. Under this arrangement, a participant is credited with “points” based on age, service, or both. On termination of employment, a participant’s final average compensation is multiplied by his or her accumulated points to determine a hypothetical account balance. This balance normally may be distributed as a lump sum or converted to an annuity.

When auditing benefit obligation information of cash balance plans or pension equity plans, auditors should follow the audit guidance for auditing plan obligations in chapter 10, “Auditing Participant Data and Plan Obligations,” of the Guide. Although the benefit formula of a cash balance plan or a pension equity plan is different from that of a traditional defined benefit pension plan, the audit procedures to be performed on the benefit obligation information would be the same as those for a traditional defined benefit pension plan.

**Disclosure of Nonexempt Transactions and SAS No. 82**

SAS No. 82, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1, AU sec. 316) describes the auditor’s responsibilities relating to fraud in a financial statement audit and provides guidance on what should be done to meet those requirements.

In circumstances where an auditor has determined that there is evidence that fraud may exist, paragraph 40 of SAS No. 82 (AU sec. 316.40) states that disclosure of possible fraud to parties other than the client’s senior management and its audit committee ordinarily is not part of the auditor’s responsibility and ordinarily would be precluded by the auditor’s ethical or legal obligations of
confidentiality unless the matter is reflected in the auditor's report. The auditor should recognize, however, that a duty to disclose outside the entity may exist when an entity must comply with certain legal and regulatory requirements. Auditors should be aware that certain instances of fraud may give rise to nonexempt transactions under ERISA and DOL regulations. DOL regulations require that nonexempt transactions be disclosed on Schedule G of the 1999 Form 5500, and reported on by the plan's auditor.

COSO's Fraud Research Report

Fraudulent Financial Reporting: 1987–1997, An Analysis of U.S. Public Companies, released in March 1999 by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), provides an analysis of fraudulent financial reporting investigated by the SEC. COSO's stated intent in issuing this report was to foster a better understanding of the nature and causes of financial statement fraud, thus guiding future efforts to combat the problem.

By examining incidents of fraudulent financial reporting from the SEC Accounting and Auditing Enforcement Releases (AAERs) issued from January 1987 through December 1997, this report provides some valuable insights into financial reporting fraud by identifying who commits the fraud, what kind of fraud is committed, and the implications to auditors. You may find these insights to be useful in helping to better understand, and fulfill, certain requirements of SAS No. 82. For example, armed with an understanding of the environment in which fraud is commonly perpetrated, the methods typically used to carry out fraud, and the financial statement accounts most often affected, you may find that you are better equipped to assess the risk of material misstatement due to fraud on the audit engagements you perform.

13. Because potential conflicts with the auditor's ethical and legal obligations for confidentiality may be complex, the auditor may wish to consult with legal counsel before discussing such matters with parties outside the client.
Help Desk—See Audit Risk Alert—1999/2000 (Product No. 022250kk) for a more in-depth discussion of this report, including some of the report's significant findings. The complete report, Fraudulent Financial Reporting: 1987–1997, An Analysis of U.S. Public Companies (Product No. 990036kk), can be obtained by calling the AICPA order department (Member Satisfaction) at (888) 777-7077. The price is $20 for members.

The COSO fraud report and recent highly publicized instances of fraudulent financial reporting serve as reminders to auditors of the need to remain alert to possible instances of fraudulent activity and to maintain an appropriate attitude of professional skepticism. A number of prominent fraud cases have involved either management fraud or deliberate deceit by management in working with their auditors. Some of the more common audit issues identified in recent litigation related to fraudulent financial reporting included the following:

- A willingness by the auditor to accept management's representations without corroboration
- Allowing the client to unduly influence the scope of auditing procedures
- The failure to identify risky situations or ignoring identified audit risks by not applying professional skepticism and revising auditing procedures appropriately

Help Desk—For additional guidance on SAS No. 82, you may wish to refer to the AICPA Practice Aid Considering Fraud in a Financial Statement Audit: Practical Guidance for Applying SAS No. 82 (Product No. 008883kk), which walks the practitioner through the issues likely to be encountered in applying the SAS to audits and provides valuable tools, such as sample documentation. The self-study course Consideration of Fraud in a Financial Statement Audit: The Auditor's Responsibilities under SAS No. 82 (Product No. 732045kk) also provides additional guidance. In addition, the AICPA publication Audit Issues in Revenue Recognition (Product No. 022506kk) provides a valuable look at problematic revenue recognition issues discussed from the auditor's perspective.
The Use of Electronic Means and the Daily Valuing of Transactions

With the increased use of the telephone and electronic means, such as the Internet or an intranet, participants have direct access to the service organization, enabling them to change their investments as frequently as on a daily basis. Often, the plan sponsor does not maintain independent accounting records of transactions initiated through these means.

When planning the audit, auditors should consider making inquiries of plan management as to the frequency at which transactions are processed and valued (for example, daily) and whether the plan allows participants to initiate transactions by telephone or electronic means. SAS No. 47, Audit Risk and Materiality in Conducting an Audit, as amended by SAS No. 82 (AICPA, Professional Standards, vol. 1, AU sec. 312), provides guidance on the auditor’s consideration of audit risk and materiality when planning or performing an audit of financial statements in accordance with GAAS. SAS No. 47, as amended, provides that the determination of the scope of the auditing procedures is directly related to the consideration of audit risk and indicates that the risk of material misstatement of the financial statements due to fraud is part of audit risk. Transactions initiated by telephone or electronic means (such as the Internet or an intranet) is one area identified as presenting particular audit risk when auditing employee benefit plans. The service provider may be able to provide detailed transaction reports at the plan or participant level, such as telephone or electronic transaction reports, trade batch reports, distribution summaries, loan ledgers, or details of purchases, sales, and dividends posted to individual accounts. When testing benefit payments when disbursements are initiated by telephone or electronic means (such as the Internet or an intranet), auditors should consider confirming disbursements directly with participants or comparing disbursements to a transaction report, if one is maintained. When participants make contribution or investment elections by telephone or electronic means (such as the Internet or an intranet), auditors should consider confirming contribution percentage and source (pretax or post-tax) and investment election directly with the participant or compare to a
transaction report, if one is maintained. Auditors should determine that contributions are properly classified and invested according to the participants' investment elections.

Because of the predominance of plan provisions that permit transactions to be processed and valued as frequently as on a daily basis, the determination of the value of plan assets on the dates throughout the year in which the plan permits transactions is important. Where an investment option in a defined contribution plan contains "hard to price” investments, such as limited partnerships, periodic valuation is more difficult. Failure to properly value plan assets on the date of a participant-directed transaction can result in such transactions being executed at inappropriate amounts and consequently either an understatement or overstatement of plan assets and distributions. For testing investment transactions when plans are valued daily, auditors should consider comparing the initiated trade to the detail recordkeeping activity. (When a plan is valued daily, a single trade is usually executed at the close of business based on information provided by the recordkeeper. The trade represents the net of all participant-directed activity for that day.)

**Soft Dollars**

*What are soft dollars?*

In connection with the execution of trades to buy and sell securities held as plan assets, the plan or in certain instances participants pay for such execution costs. These investment costs are usually reported net of investment earnings. Often, the investment manager(s) of the plan receives "soft dollars" from the broker who executes the trades. These soft dollars are monies rebated or "credit" given for the payment of brokerage firm services, other than trade execution, from the commissions generated from the investment trades. These other services are primarily for research, products, and services (such as publications, consulting fees, and research analysis reports).

If soft dollar arrangements exist, auditors should consider whether such amounts have been used in accordance with the investment management arrangement. Auditors should inquire of plan man-
agement whether management has obtained and reviewed a copy of the investment manager's Form ADV.\(^{14}\)

**Auditing Multiemployer Plans**

When auditing participant data in a multiemployer benefit plan, the auditor is often unable to directly test payroll records. Plan sponsors or trustees may engage the employer's auditor, other outside auditors, in-house compliance personnel, or others to perform agreed-upon procedures to test the completeness of employer contributions. The employer payroll procedures should be designed to test that all employees working for a contributing employer performing covered work ("covered work" is defined under the collective bargaining agreement) have been properly reported and that any subcontracting work performed on behalf of a contributing employer is also being reported. The auditor performing the payroll procedures will typically issue an agreed-upon procedures report in accordance with Statement on Standards for Attestation Engagements (SSAE) No. 4, *Agreed-Upon Procedures Engagements* (AICPA Professional Standards, vol. 1, AT sec. 600).

**Help Desk**—For further guidance on auditing multiemployer plans, see the AICPA's new Practice Aid, *Auditing Multiemployer Plans*. This brand new publication provides guidance on unique issues regarding the accounting, auditing, and reporting on financial statements of various types of multiemployer employee benefit plans. This nonauthoritative Practice Aid is designed to complement the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans*. There are chapters on SOP 92-6 application, investments, employer payroll audits, internal control testing, the new Form 5500, and more. Also included are illustrative financial statements for various types of multiemployer employee

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14. Form ADV is required under the Investment Advisers Act of 1940 and includes a description of—

- The products (research and services).
- Whether clients may pay commissions greater than those obtainable from other broker-dealers in return for products (research and services).
- Whether research is used to service all accounts or just those accounts paying for it.
- Any procedures that the adviser used in the last fiscal year to direct client transactions to a particular broker in return for products, research, and services received.
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, particularly when held by outside parties
- Inadequate disclosures related to participant-directed investment programs
- 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
- Failure to properly report on a DOL limited-scope audit
- Improper use of limited-scope exemption because financial institution did not qualify for such an exemption
- Inadequate or missing disclosures related to participant data

15. Taken from the 1998/1999 AICPA Peer Review Board Oversight Task Force Report and Comments.
• Failure to properly report on or include the required supplemental schedules relating to 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.

**New Auditing Pronouncements**

*What new auditing pronouncements have been issued recently?*

**SAS No. 88, Service Organizations and Reporting on Consistency**


• Clarify the applicability of SAS No. 70 by stating that the SAS is applicable if an entity obtains services from another organization that are part of the entity’s information system. It also provides guidance on the types of services that would be considered part of an entity’s information system.

• Revise and clarify the factors a user auditor should consider in determining the significance of a service organization’s controls to a user organization’s controls.

• Clarify the guidance on determining whether information about a service organization’s controls is necessary to plan the audit.

• Clarify that information about a service organization’s controls may be obtained from a variety of sources.

• Change the title of SAS No. 70 from *Reports on the Processing of Transactions by Service Organizations* to *Service Organizations*.

- Conform the list of changes that constitute a change in the reporting entity (AU sec. 420.07) to the guidance in paragraph 12 of Accounting Principles Board (APB) Opinion No. 20, Accounting Changes.

- Clarify that the auditor need not add a consistency explanatory paragraph to the auditor’s report when a change in the reporting entity results from a transaction or event.

- Eliminate the requirement for a consistency explanatory paragraph in the auditor’s report if a pooling of interests is not accounted for retroactively in comparative financial statements.

- Eliminate the requirement to qualify the auditor’s report and consider adding a consistency explanatory paragraph to the report if single-year financial statements that report a pooling of interests do not disclose combined information for the prior year.

All of the amendments contained in SAS No. 88 were effective upon issuance.

**SAS No. 89, Audit Adjustments**

In December 1999, the AICPA ASB issued SAS No. 89, Audit Adjustments (AICPA, Professional Standards, vol. 1, AU sec. 310, 333, and 380), which amends three SASs to establish audit requirements designed to encourage client management to record financial statement adjustments aggregated by the auditor. It also clarifies management’s responsibility for the disposition of financial statement misstatements brought to its attention. SAS No. 89 amends SAS No. 83, Establishing an Understanding With the Client (AICPA, Professional Standards, vol. 1, AU sec. 310); SAS No. 85, Management Representations (AICPA, Professional Standards, vol. 1, AU sec. 333); and SAS No. 61, Communication
With Audit Committees (AICPA, Professional Standards, vol. 1, AU sec. 380), as follows:

- SAS No. 83 is amended to include in the understanding with the client, management's responsibility for determining the appropriate disposition of financial statement misstatements aggregated by the auditor. Specifically, SAS No. 89 adds the following to the list of matters that generally are included in the understanding with the client:
  - Management is responsible for adjusting the financial statements to correct material misstatements and for affirming to the auditor in the representation letter that the effects of any uncorrected misstatements aggregated by the auditor during the current engagement and pertaining to the latest period presented are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

- SAS No. 85 is amended to require that the management representation letter include an acknowledgment by management that it has considered the financial statement misstatements aggregated by the auditor during the current engagement and pertaining to the latest period presented, and has concluded that any uncorrected misstatements are immaterial, both individually and in the aggregate, to the financial statements taken as a whole. It also requires that a summary of the uncorrected misstatements be included in or attached to the representation letter.

- SAS No. 61 is amended to require the auditor to inform the audit committee about uncorrected misstatements aggregated by the auditor during the current engagement and pertaining to the latest period presented, whose effects management believes are immaterial, both individually and in the aggregate, to the financial statements taken as a whole.

These amendments are effective for audits of financial statements for periods beginning on or after December 15, 1999, with early adoption permitted.
SAS No. 90, Audit Committee Communications

SAS No. 90, Audit Committee Communications (AICPA, Professional Standards, vol. 1, AU sec. 380 and 722), also issued in December 1999, amends SAS No. 61 and SAS No. 71, Interim Financial Information (AICPA, Professional Standards, vol. 1, AU sec. 722). SAS No. 90 is in response to the recommendations numbered 8 and 10 of the report of the Blue Ribbon Committee on Improving the Effectiveness of Corporate Audit Committees, which suggest changes to GAAS.

Among other things, the amendment to SAS No. 61 requires an auditor to discuss with the audit committees of SEC clients certain information relating to the auditor's judgments about the quality, not just the acceptability, of the company's accounting principles and underlying estimates in its financial statements. It also encourages a three-way discussion among the auditor, management, and the audit committee. This amendment is effective for audits of financial statements for periods ending on or after December 15, 2000, with earlier application permitted.

The amendment to SAS No. 71 clarifies that the accountant should communicate to the audit committee or be satisfied, through discussions with the audit committee, that matters described in SAS No. 61 have been communicated to the audit committee by management when they have been identified in the conduct of interim financial reporting. This amendment also requires the accountant of an SEC client to attempt to discuss with the audit committee the matters described in SAS No. 61 prior to the filing of the Form 10-Q. This amendment is effective for reviews of interim financial information for interim periods ending on or after March 15, 2000, with earlier application permitted.

Auditing Interpretations

Interpretation, “Reference to Country of Origin in the Auditor’s Standard Report,” to AU section 508, Reports on Audited Financial Statements

The AICPA issued an Interpretation, “Reference to Country of Origin in the Auditor’s Standard Report,” to AU section 508. This
interpretation states that a U.S. auditor may include a reference, in the auditor's standard report, to the country of origin of the accounting standards used to prepare the financial statements or of the auditing standards the auditor followed in performing the audit. Pursuant to the interpretation, an auditor may replace the phrase "generally accepted auditing standards" with "auditing standards generally accepted in the United States of America" and "generally accepted accounting principles" with "accounting principles generally accepted in the United States of America." This issue was raised because oftentimes financial statements prepared in conformity with accounting principles established in the United States and audited in accordance with standards issued by the AICPA are increasingly available beyond U.S. borders.


Executive Summary—New Auditing Pronouncements

- SAS No. 88, Service Organizations and Reporting on Consistency—issued in December 1999 and was effective upon issuance.

- SAS No. 89, Audit Adjustments—issued in December 1999 and is effective for audits of financial statements for periods beginning on or after December 15, 1999, with earlier adoption permitted.

- SAS No. 90, Audit Committee Communications—issued in December 1999. The amendment to SAS No. 61 is effective for audits of financial statements for periods ending on or after December 15, 2000, with earlier application permitted. The amendment to SAS No. 71 is effective for reviews of interim financial information for interim periods ending on or after March 15, 2000, with earlier application permitted.

New AICPA Statements of Position for Employee Benefit Plans

SOP 99-2, *Accounting for and Reporting of Postretirement Medical Benefit (401(h)) Features of Defined Benefit Pension Plans*

SOP 99-2 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.

SOP 99-2 requires—

1. Defined benefit pension plans to record the aggregate amount of net 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 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 401(h) account 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 by a restatement of financial statements for prior periods.

SOP 99-3, Accounting for and Reporting of Certain Defined Contribution Plan Investments and Other Disclosure Matters

SOP 99-3 amends chapters 3 and 4 of the AICPA Audit and Accounting Guide Audits of Employee Benefit Plans; SOP 94-4, Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined- Contribution Pension Plans; and SOP 92-6, Accounting and Reporting by Health and Welfare Benefit Plans. This SOP simplifies disclosures for certain investments and supersedes AICPA Practice Bulletin 12, Reporting Separate Investment Fund Option Information of Defined- Contribution Pension Plans (PB 12).

SOP 99-3—

1. Amends paragraph 3.20 of the Guide to eliminate the previous requirement for a defined contribution plan to present plan investments by general type for participant-directed investments in the statement of net assets available for benefits.

2. Amends paragraph 3.28(k) and supersedes paragraph 3.28(l) of the Guide and supersedes PB 12 to eliminate the requirement for a defined contribution plan to disclose participant-directed investment programs and to eliminate the requirement to disclose the total number of units and the net asset value per unit during the period, and at the end of the period, by defined contribution pension plans that assign units to participants.

3. Amends paragraph 3.28(g) of the Guide to require a defined contribution plan to identify nonparticipant-directed investments that represent 5 percent or more of net assets available for benefits.

4. Amends paragraphs 3.28(p) and 4.57 of the Guide, paragraph 53 of SOP 92-6, and paragraph 15 of SOP 94-4 to eliminate the requirement for defined contribution plans, including both health and welfare benefit plans and pension plans, to disclose benefit-responsive investment contracts by investment fund option.
5. Replaces exhibits E-1 through E-5 in the Guide.

SOP 99-3 is effective for financial statements for plan years ending after December 15, 1999. Earlier application is encouraged for fiscal years for which annual financial statements have not been issued. If the previously required “by-fund” disclosures are eliminated, the reclassification of comparative amounts in financial statements for earlier periods is required.


**Exposure Draft—Proposed Statement of Position to Amend SOP 92-6**

In March 2000 the AICPA Accounting Standards Executive Committee issued an exposure draft for a proposed SOP, Accounting for and Reporting of Certain Health and Welfare Benefit Plan Transactions. This proposed SOP would amend chapter 4 of the AICPA Audit and Accounting Guide Audits of Employee Benefit Plans, and SOP 92-6. It would revise the standards for measuring, reporting, and disclosing estimated future postretirement benefit payments that are to be funded partially or entirely by plan participants. It would specify the presentation requirements for benefit obligation information and establish standards of financial accounting and reporting for certain postemployment benefits provided by health and welfare benefit plans. Specifically, it would allow 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 would also clarify the measurement date for benefit obligations and 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 would be required to be restated to comply with the provisions of this proposed SOP.
Help Desk—The comment period for this exposure draft ends June 22, 2000. This exposure draft is available to download as an Adobe Portable Document Format (PDF) file from the AICPA Web site, http://www.aicpa.org.

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

New FASB Pronouncements

This section presents brief summaries of recently issued Financial Accounting Standards Board (FASB) accounting pronouncements that may affect employee benefit plans. The summaries are for informational purposes only and should not be relied on as a substitute for a complete reading of the applicable standard.

FASB Statement No. 135, Recession of FASB Statement No. 75 and Technical Corrections

FASB Statement of Financial Accounting Standards No. 135, Recession of FASB Statement No. 75 and Technical Corrections, rescinds FASB Statement No. 75, Deferral of the Effective Date of Certain Accounting Requirements for Pension Plans of State and Local Governmental Units. GASB Statement No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, was issued November 1994 and establishes financial reporting standards for defined benefit pension plans and for the notes to the financial statements of defined contribution plans of state and local governmental entities. FASB Statement No. 75 is, therefore, no longer needed. FASB Statement No. 135 also amends FASB Statement No. 35, Accounting and Reporting by Defined Benefit Pension Plans, to exclude from its scope plans that are sponsored by and provide benefits for the employees of one or more state or local governmental units.

This Statement also amends other existing authoritative literature to make various technical corrections, clarify meanings, or describe applicability under changed conditions. FASB Statement No. 135
is effective for financial statements issued for fiscal years ending after February 15, 1999. Earlier application is encouraged.

**FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities,¹⁶ as amended by FASB Statement No. 137, Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133**

In June 1998, the FASB issued Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*. 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, as amended by FASB Statement No. 137, is effective for all fiscal quarters of fiscal years beginning after June 15, 2000. Initial application of FASB Statement No. 133, as amended, 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, as amended, 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, as amended, should not be applied retroactively to financial statements of prior periods.

Executive Summary—New FASB Pronouncements

• FASB Statement No. 135, Rescission of FASB Statement No. 75 and Technical Corrections.

• FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended by FASB Statement No. 137, Accounting for Derivative Instruments and Hedging Activities—Deferral of the Effective Date of FASB Statement No. 133.

Audit and Accounting Guide Revisions as of May 1, 2000

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, 2000.

There are new sections on the following:

• Cash balance plans
• Multiemployer plans

The Guide has been updated to reflect the issuance of the following pronouncements:

• SOP 99-2, Accounting for and Reporting of Postretirement Medical Benefit (401(h)) Features of Defined Benefit Pension Plans
• SOP 99-3, Accounting for and Reporting of Certain Defined Contribution Plan Investments and Other Disclosure Matters
• SAS No. 88, Service Organizations and Reporting on Consistency
• SAS No. 89, Audit Adjustments
• SAS No. 90, Audit Committee Communications

The Guide has also been updated to reflect the issuance of the new streamlined Form 5500. To order this Guide see the "Order Information" section of this Alert (Product No. 012340kk).
Independence

AICPA Professional Ethics Division Interpretations and Rulings

Ethics Interpretations and rulings are promulgated by the executive committee of the Professional Ethics division of the AICPA to provide guidelines on the scope and application of ethics rules but are not intended to limit such scope or application. Publication of an Interpretation or ethics ruling in the *Journal of Accountancy* constitutes notice to members. A member who departs from Interpretations or rulings shall have the burden of justifying such departure in any disciplinary hearing.

Help Desk—It is important to point out that, for ERISA engagements, the DOL has separate independence standards that may be more restrictive than those of the AICPA. See paragraph A.85 in appendix A of the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans*, with conforming changes as of May 1, 2000, for a listing of the DOL's independence standards.


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, “Performance of Other Services,” of ET section 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 revision 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 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 was published
in the May 1999 *Journal of Accountancy*. The Interpretation can also be found on the AICPA Web site at http://www.aicpa.org.

**Ruling No. 111 Under Rule of Conduct 101: Employee Benefit Plan Sponsored by Client**

The Professional Ethics Executive Committee has adopted a new ethics ruling under the Code of Professional Conduct (AICPA, *Professional Standards*, vol. 2, ET sec. 191.222-223) to provide guidance to AICPA members who provide professional services, such as asset management or investment services, to employee benefit plans sponsored by attest clients. The committee believes that such services generally would impair a member's independence with respect to the benefit plan, however, would only impair independence with respect to the client sponsor in certain circumstances. The committee also believes it is appropriate to differentiate between defined benefit and contribution plans. Specifically, the member's independence would be considered impaired with respect to the client sponsor of a defined benefit plan if the assets under management or in the custody of the member are material to the plan or the client sponsor. On the other hand, independence would not be impaired with respect to the sponsor of a defined contribution plan provided the member does not make any management decisions or perform management functions on behalf of the client sponsor or have custody of the sponsor's assets. This ruling was published in the April 2000 *Journal of Accountancy*. The Interpretation can also be found on the AICPA Web site at http://www.aicpa.org.

**Help Desk**—It is important for you to monitor the activities of the Professional Ethics Executive Committee because it may issue Interpretations, ethics rulings, or both, that may be relevant to your engagements. See the *Audit Risk Alert—1999/2000* (Product No. 022250kk) for a summary of the committee's 1999 activities. For full information about the Interpretations and rulings, visit the Professional Ethics Team Web page at http://www.aicpa.org/members/div/ethics/index.htm. You can also call the Professional Ethics Team at (888) 777-7077, menu option 2, followed by menu option 2.
Recent Exposure Drafts

Practitioners should note that the purpose of exposure drafts is to solicit comments from preparers, auditors, users of financial statements, and other interested parties. They are nonauthoritative and cannot be used as a basis for changing GAAS or GAAP. The following is a listing of some of the more significant exposure drafts outstanding at the time we went to press that may effect employee benefit plans.


ASB Exposure Drafts

An exposure draft for a proposed SAS, Auditing Financial Instruments (to supersede SAS No. 81, Auditing Investments), was issued June 10, 1999. The proposed SAS would provide updated guidance on planning and performing auditing procedures for financial statement assertions about financial instruments (including derivatives). The proposed SAS—

- Indicates that an auditor may require special skill or knowledge to plan and perform auditing procedures for certain assertions about financial instruments.
- Provides guidance on inherent risk considerations for assertions about financial instruments.
- Provides guidance on control risk considerations for assertions about financial instruments.
- Provides guidance on auditing considerations related to the initial designation of a financial instrument as a hedge and the continued application of hedge accounting.
- Indicates that a service organization's services may affect the nature, timing, and extent of the auditor's substantive tests.
• Provides guidance on substantive tests an auditor might perform when auditing valuation assertions that are dependent on management's intent and ability.

• Provides guidance on designing substantive tests of valuation assertions based on cost, an investee's financial results, amounts due under contract, and fair value.

The ASB also is developing an Audit Guide that will provide guidance on how to apply the proposed SAS to assertions about specific types of financial instruments and assertions based on specific accounting requirements. The ASB plans to issue the SAS and the Audit Guide at approximately the same time and to periodically update the Audit Guide to address new accounting and auditing pronouncements and new financial instruments.

AcSEC Exposure Drafts

Proposed SOP, Accounting for and Reporting of Certain Health and Welfare Benefit Plan Transactions

In March 2000 the AICPA AcSEC issued an exposure draft for a proposed SOP, Accounting for and Reporting of Certain Health and Welfare Benefit Plan Transactions. See the section “Exposure Draft—Proposed Statement of Position to Amend SOP 92-6” of this Audit Risk Alert for a summary of this exposure draft.

AICPA Services

For a complete listing of AICPA services see Audit Risk Alert—1999/2000 (Product No. 022250kk).

Related AICPA Publications

• AICPA Audit and Accounting Guide Audits of Employee Benefit Plans, with conforming changes as of May 1, 2000 (Product No. 012340kk)

• UPDATED! AICPA Practice Aid Financial Statement Reporting and Disclosure Practices for Employee Benefit Plans, Second Edition (Offering the same kind of powerful help AICPA's Accounting Trends and Techniques does, this com-
prehensive Practice Aid illustrates a wide range of employee benefit plan financial statement disclosures and auditors' reports for both full-scope and limited-scope audits. The Practice Aid has been updated to include SOP 99-2 and SOP 99-3 and the new Form 5500 schedules. This publication will be available summer 2000—Product No. 006608kk.)

- **NEW!** AICPA Practice Aid *Auditing Multiemployer Plans* (This brand new publication provides guidance on unique issues regarding the accounting, auditing, and reporting on financial statements of various types of multiemployer employee benefit plans. This nonauthoritative Practice Aid is designed to complement the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans*. There are chapters on SOP 92-6 application, investments, employer payroll audits, internal control testing, the new Form 5500, and more. Also included are illustrative financial statements for various types of multiemployer employee benefit plans. This publication will be available summer 2000—Product No. 006603kk.)

- **Checklists and Illustrative Financial Statements for**—
  - *Defined Benefit Pension Plans* (008758kk)
  - *Defined Contribution Pension Plans* (008759kk)
  - *Health and Welfare Benefit Plans* (008760kk)

- **"A Wake-Up Call"**—An Employee Benefit Plan Audit Video (013801kk)

**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 2001 National Conference on Employee Benefit Plans will be held May 21–23, 2001, in Washington, D.C. For a conference brochure, please call (888) 777-7077 and request brochure G50038, or for more information, visit the AICPA Web site at www.aicpa.org.
Continuing Professional Education

The AICPA offers the following self-study courses:

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

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—1999.
The AICPA CD-ROM product, titled reSource: AICPA's Accounting and Auditing Literature, 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 that includes all twenty-five Guides and the related 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, titled The Practitioner's Library—Accounting and Auditing. The FASB publications include Original Pronouncements, Current Text, Emerging Issues Task Force Abstracts, and FASB Implementation Guides; 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 Audit Risk Alert, please feel free to share them with us. Any other comments that you have about the Audit Risk Alert would also be greatly appreciated. You may email these comments to ldelahanty@aicpa.org or write to:

Linda C. Delahanty
AICPA
Harborside Financial Center
201 Plaza Three
Jersey City, NJ 07311-3881
### IRS Limits on Benefits and Compensation

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<td>Social Security Tax</td>
<td>6.20%</td>
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# APPENDIX B*

## Quick Reference Chart for Filing the New Form 5500

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<td>Must complete if plan has insurance contracts.</td>
<td>Must complete if plan has insurance contracts.</td>
<td>Must complete if plan has insurance contracts.</td>
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<td>Schedule B (Actuarial Information)</td>
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<td>Not required.</td>
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<td>Schedule C (Service Provider Information)</td>
<td>Must complete if service provider was paid $5,000 or more and/or an accountant or actuary was terminated.</td>
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<td>Must complete if service provider was paid $5,000 or more and/or an accountant or actuary was terminated.</td>
<td>Not required.</td>
<td>MTIAs, GIAs and 103-12 IEs must complete Part I if service provider paid $5,000 or more. GIAs and 103-12 IEs must complete Part II if accountant was terminated.</td>
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<td>Schedule D (DFE/Participating Plan Information)</td>
<td>Must complete Part I if plan participates in a CCT, PSA, MTIA, or 103-12 IE.</td>
<td>Must complete Part I if plan participates in a CCT, PSA, MTIA, or 103-12 IE.</td>
<td>Must complete Part I if plan participates in a CCT, PSA, MTIA, or 103-12 IE.</td>
<td>Must complete Part I if plan participates in a CCT, PSA, MTIA, or 103-12 IE.</td>
<td>All DFEs must complete Part II, and DFEs that invest in CCT, PSA, or 103-12 IE must also complete Part I.</td>
</tr>
<tr>
<td>Schedule E (ESOP Information)</td>
<td>Must complete if ESOP.</td>
<td>Must complete if ESOP.</td>
<td>Not required.</td>
<td>Not required.</td>
<td>Not required.</td>
</tr>
<tr>
<td>Schedule G (Financial Schedules)</td>
<td>Must complete if Schedule H, lines 4b, 4c, or 4d are &quot;Yes.&quot;³</td>
<td>Not required.</td>
<td>Must complete if Schedule H, lines 4b, 4c, or 4d are &quot;Yes.&quot;³</td>
<td>Not required.</td>
<td>MTIAs, GIAs and 103-12 IEs must complete if Schedule H, lines 4b, 4c, or 4d are &quot;Yes.&quot;³</td>
</tr>
<tr>
<td>Schedule H (Large Plan and DFE Financial Information)</td>
<td>Must complete.</td>
<td>Not required.</td>
<td>Must complete.⁴</td>
<td>Not required.</td>
<td>All DFEs must complete Parts I, II, &amp; III. MTIAs, 103-12 IEs, and GIAs must also complete Part IV.</td>
</tr>
</tbody>
</table>
### Quick Reference Chart for Filing the New Form 5500 (continued)

<table>
<thead>
<tr>
<th>Large Pension Plan</th>
<th>Small Pension Plan</th>
<th>Large Welfare Plan</th>
<th>Small Welfare Plans</th>
<th>DFE²</th>
<th>Fringe Benefit Plans</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Schedule R</strong> (Retirement Plan Information)</td>
<td>Must complete unless plan is neither a defined benefit plan nor subject to Code section 412 or ERISA section 302 and no benefits were distributed during the plan year.</td>
<td>Must complete unless plan is neither a defined benefit plan nor subject to Code section 412 or ERISA section 302 and no benefits were distributed during the plan year.</td>
<td>Not required.</td>
<td>Not required.</td>
<td>Not required.</td>
</tr>
<tr>
<td><strong>Schedule SSA</strong> (Statement Identifying Separated Participants With Deferred Vested Benefits)</td>
<td>Must complete if plan had separated participants with deferred vested benefits to report.</td>
<td>Must complete if plan had separated participants with deferred vested benefits to report.</td>
<td>Not required.</td>
<td>Not required.</td>
<td>Not required.</td>
</tr>
<tr>
<td><strong>Schedule T</strong> (Qualified Pension Plan Information)</td>
<td>Must complete if qualified plan unless permitted to rely on coverage testing information for prior year.</td>
<td>Must complete if qualified plan unless permitted to rely on coverage testing information for prior year.</td>
<td>Not required.</td>
<td>Not required.</td>
<td>Not required.</td>
</tr>
<tr>
<td>Accountant's Report</td>
<td>Must attach.</td>
<td>Not required.</td>
<td>Must attach.</td>
<td>Not required.</td>
<td>Must attach for a GIA or 103-12 IE.</td>
</tr>
</tbody>
</table>
1. This chart provides only general guidance. Not all rules and requirements are reflected. Refer to specific Form 5500 instructions and regulations for complete information.

2. DFE (Direct Filing Entity) includes: bank common or collective trusts (CCTs) and insurance company pooled separate accounts (PSAs) (29 CFR 2520.103-3 and 103-4) that choose to file information on behalf of their participating plans; master trust investment accounts (MTIAs) (29 CFR 2520.103-1(e); investment entities filing under 29 CFR 2520.103-12 (103-12 IEs); and group insurance arrangements (GIAs) filing under 29 CFR 2520.103-2 and 104-43.

3. Schedules of assets and reportable (5%) transactions also must be filed with the Form 5500 if Schedule H, lines 4i or 4j are "Yes," but use of scannable form not required.

4. Unfunded, fully insured and combination unfunded/insured welfare plans covering fewer than 100 participants at the beginning of the plan year that meet the requirements of 29 CFR 2520.104-20 are exempt from filing an annual report. Such a plan with 100 or more participants must file an annual report, but is exempt under 29 CFR 2520.104-44 from the accountant's report requirement and completing Schedule H, but MUST complete Schedule G, Part III, to report any nonexempt transactions.
APPENDIX C

New Form 5500—Main Form

The Form 5500 displayed on the next three pages is for illustrative purposes only and cannot be filed with the DOL. See the sections “Revision of the Form 5500 Series” and “New “EFAST” Computer Filing System” of this Audit Risk Alert for information on how to obtain copies of the Form 5500 and how to file.
# Form 5500

**Annual Return/Report of Employee Benefit Plan**

This form is required to be filed under sections 104 and 4065 of the Employee Retirement Income Security Act of 1974 (ERISA) and sections 6038C, 6047(b), 6057(b), and 6058(a) of the Internal Revenue Code (the Code). Complete all entries in accordance with the instructions to the Form 5500.

## Part I: Annual Report Identification Information

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>This return/report is for:</td>
<td></td>
</tr>
<tr>
<td>(1)</td>
<td>a multiemployer plan;</td>
<td></td>
</tr>
<tr>
<td>(2)</td>
<td>a single-employer plan other than a multiemployer plan;</td>
<td></td>
</tr>
<tr>
<td>(3)</td>
<td>a multiple-employer plan;</td>
<td></td>
</tr>
<tr>
<td>(4)</td>
<td>a DFE (collectively bargained plan);</td>
<td></td>
</tr>
</tbody>
</table>

| B | This return/report is: |   |
| (1) | the first return/report filed for the plan; |   |
| (2) | an amended return/report; |   |
| (3) | the final return/report filed for the plan; |   |
| (4) | a short plan year return/report (less than 12 months); |   |

| C | If the plan is a collectively-bargained plan, check here |   |

| D | If you filed for an extension of time to file, check the box and attach a copy of the extension application |   |

## Part II: Basic Plan Information

**Purpose**

- Enter all requested information.

<p>| | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>1a</td>
<td>Name of plan</td>
<td></td>
</tr>
<tr>
<td>1b</td>
<td>Three-digit plan number (IPN)</td>
<td></td>
</tr>
<tr>
<td>1c</td>
<td>Effective date of plan (mo., day, yr.)</td>
<td></td>
</tr>
</tbody>
</table>

| 2a | Plan sponsor's name and address (employer, if for a single-employer plan) |   |
| 2b | Employer Identification Number (EIN) |   |
| 2c | Sponsor's telephone number |   |
| 2d | Business code (see instructions) |   |

---

Caution: A penalty for the late or incomplete filing of this return/report will be assessed unless reasonable cause is established.

Under penalties of perjury and other penalties set forth in the instructions, I declare that I have examined this return/report, including accompanying schedules, statements and attachments, and to the best of my knowledge and belief, it is true, correct, and complete.

---

Signature of plan administrator  
Date  
Typed or printed name of individual signing as plan administrator

Signature of employer/plan sponsor/DFE  
Date  
Typed or printed name of individual signing as employer, plan sponsor or DFE as applicable

For Paperwork Reduction Act Notice and OMB Control Numbers, see the instructions for Form 5500.
<table>
<thead>
<tr>
<th>3a</th>
<th>Plan administrator’s name and address (if same as plan sponsor, enter “Same”)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>3b</td>
<td>Administrator’s EIN</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>3c</td>
<td>Administrator’s telephone number</td>
</tr>
</tbody>
</table>

4. If the name and/or EIN of the plan sponsor has changed since the last return/report filed for this plan, enter the name, EIN and the plan number from the last return/report below:

<table>
<thead>
<tr>
<th>a</th>
<th>Sponsor’s name</th>
</tr>
</thead>
<tbody>
<tr>
<td>b</td>
<td>EIN</td>
</tr>
<tr>
<td>c</td>
<td>PN</td>
</tr>
</tbody>
</table>

5. Preparer information (optional)  
   a. Name (including firm name, if applicable) and address

| b | EIN                                                                             |
| c | Telephone no.                                                                   |

6. Total number of participants at the beginning of the plan year

<table>
<thead>
<tr>
<th>Total number of participants</th>
<th>6</th>
</tr>
</thead>
</table>

7. Number of participants as of the end of the plan year (welfare plan complete only lines 7a, 7b, 7c, and 7d)

<table>
<thead>
<tr>
<th>Line</th>
<th>Description</th>
<th>7a</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Active participants</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Retired or separated participants receiving benefits</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Other retired or separated participants entitled to future benefits</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total. Add lines 7a, 7b, and 7c</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Deceased participants whose beneficiaries are receiving or are entitled to receive benefits</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Number of participants with account balances as of the end of the plan year (only defined contribution plans complete this item)</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Number of participants that terminated employment during the plan year with accrued benefits that were less than 100% vested</td>
<td></td>
</tr>
<tr>
<td></td>
<td>If any participant(s) separated from service with a deferred vested benefit, enter the number of separated participants required to be reported on Schedule SSA (Form 5500)</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>7a</th>
</tr>
</thead>
<tbody>
<tr>
<td>Pension benefits (check box if the plan provides pension benefits and enter the applicable pension feature codes from the List of Plan Characteristics Codes (printed in the instructions))</td>
<td></td>
</tr>
<tr>
<td>Welfare benefits (check box if the plan provides welfare benefits and enter the applicable welfare feature codes from the List of Plan Characteristics Codes (printed in the instructions))</td>
<td></td>
</tr>
<tr>
<td>Fringe benefits (check box if the plan provides fringe benefits)</td>
<td></td>
</tr>
</tbody>
</table>

8a Plan funding arrangement (check all that apply)

| (1) | Insurance                                                                 |
| (2) | Section 412(i) insurance contracts                                         |
| (3) | Trust                                                                     |
| (4) | General assets of the sponsor                                             |

FILING

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0 2 9 9 0 0 0 2 I 1 N

68
<table>
<thead>
<tr>
<th>Schedules attached (Check all applicable boxes and, where indicated, enter the number attached. See instructions.)</th>
</tr>
</thead>
<tbody>
<tr>
<td>a Pension Benefit Schedules</td>
</tr>
<tr>
<td>(1)</td>
</tr>
<tr>
<td>(2)</td>
</tr>
<tr>
<td>If a Schedule T is not attached because the plan is relying on coverage testing information for a prior year, enter the year.</td>
</tr>
<tr>
<td>(3)</td>
</tr>
<tr>
<td>(4)</td>
</tr>
<tr>
<td>(5)</td>
</tr>
<tr>
<td>b Financial Schedules</td>
</tr>
<tr>
<td>(1)</td>
</tr>
<tr>
<td>(2)</td>
</tr>
<tr>
<td>(3)</td>
</tr>
<tr>
<td>(4)</td>
</tr>
<tr>
<td>(5)</td>
</tr>
<tr>
<td>(6)</td>
</tr>
<tr>
<td>(7)</td>
</tr>
<tr>
<td>c Fringe Benefit Schedule</td>
</tr>
<tr>
<td></td>
</tr>
</tbody>
</table>

**PURPOSES**

**DO NOT USE FOR FILING**

029900031C
The new 1999 Form 5500 continues to require that certain supplemental schedules be attached to the annual Form 5500 filing. The information reported in these schedules have not changed from prior years. However, reporting has now been standardized so some of these schedules are now required to be reported on Schedule G, Financial Transactions Schedules, of Form 5500 as noted in this appendix.

Help Desk—The following footnotes apply to the schedules in this appendix, as noted.

* Cost or Cost of asset refers to the original or acquisition cost of the asset. The DOL generally will accept any clearly defined and consistently applied method of determining historical cost that is based on the initial acquisition cost of the asset (e.g., first in-first out or average cost). The use of revalued cost (the fair value of the asset at the beginning of the current plan year) for these schedules is not acceptable.

++ Current value means fair market value where available. Otherwise, it means the fair value as determined in good faith under the terms of the plan by a trustee or a named fiduciary, assuming an orderly liquidation at the time of the determination.

The following schedule is the "Schedule of Assets Held for Investment Purposes at End of Year." In column (a), place an asterisk (*) on the line of each identified person known to be a party in interest to the plan. The schedule must use the format shown here and be clearly labeled "Schedule of Assets Held for Investment Purposes at End of Year."
Note 1: Participant loans may be aggregated and presented with a general description of terms and interest rates.

Note 2: In column (d), cost information may be omitted with respect to participant or beneficiary directed transactions under an individual account plan.

The following schedule is the “Schedule of Investment Assets Both Acquired and Disposed of Within the Plan Year” (see 2520.103-11). This schedule must be clearly labeled “Schedule of Investment Assets Both Acquired and Disposed of Within the Plan Year” and must use the following format:

<table>
<thead>
<tr>
<th>(a) Identity of issue, borrower, lessor or similar party</th>
<th>(b) Description of investment including maturity date, rate of interest, collateral, par, or maturity value</th>
<th>(c) Costs of acquisitions</th>
<th>(d) Proceeds of dispositions</th>
</tr>
</thead>
</table>

Note: In column (c), cost information may be omitted with respect to participant or beneficiary directed transactions under an individual account plan.

The following schedule is the “Schedule of Reportable Transactions.” This schedule must be clearly labeled “Schedule of Reportable Transactions” and must use the following format:

<table>
<thead>
<tr>
<th>(a) Identity of party involved</th>
<th>(b) Description of asset (include interest rate and maturity in case of a loan)</th>
<th>(c) Purchase price</th>
<th>(d) Selling price</th>
<th>(e) Lease rental</th>
<th>(f) Expense incurred with transaction</th>
<th>(g) Cost of asset</th>
<th>(h) Current value of asset on transaction date</th>
<th>(i) Net gain or (loss)</th>
</tr>
</thead>
</table>

Note: Participant- or beneficiary-directed transactions under an individual account plan should not be taken into account for purposes of preparing this schedule. The current value of all assets of the plan, including those resulting from participant direction, should be included in determining the 5 percent figure for all other transactions.
The following schedule is the "Schedule of Loans or Fixed Income Obligations in Default or Classified as Uncollectible." This schedule is now required to be reported in Schedule G, Part I, of the Form 5500. In column (a), place an asterisk (*) on the line of each identified person known to be a party in interest to the plan. Include all loans that were renegotiated during the plan year. Also, explain what steps have been taken or will be taken to collect overdue amounts for each loan listed. The following are the headings of Schedule G, Part I:

<table>
<thead>
<tr>
<th>(a)</th>
<th>(b) Identity and address of obligor</th>
<th>(c) Original amount of loan</th>
<th>(d) Principal</th>
<th>(e) Interest</th>
<th>(f) Unpaid balance at end of year</th>
<th>(g) Detailed description of loan including dates of making and maturity, interest rate, the type and value of collateral, any renegotiation of the loan and the terms of the renegotiation and other material items</th>
<th>(h) Principal</th>
<th>(i) Interest</th>
</tr>
</thead>
</table>

The next schedule is the "Schedule of Leases in Default or Classified as Uncollectible." This schedule is now required to be reported in Schedule G, Part II, of the Form 5500. In column (a), place an asterisk (*) on the line of each identified person known to be a party in interest to the plan. The following are the headings of Schedule G, Part II:

<table>
<thead>
<tr>
<th>(a)</th>
<th>(b) Identity of lessor/lessee</th>
<th>(c) Relationship to plan, employer, employee organization or other party-in-interest</th>
<th>(d) Terms and description (type of property, location and date it was purchased, terms regarding rent, taxes, insurance, repairs, expenses, renewal options, date property was leased)</th>
<th>(e) Original cost</th>
<th>(f) Current value at time of Lease</th>
<th>(g) Gross rental receipts during the plan year</th>
<th>(h) Expenses paid during the plan year</th>
<th>(i) Net Receipts</th>
<th>(j) Amount in arrears</th>
</tr>
</thead>
</table>

The last schedule is the schedule "Nonexempt Transactions." This schedule is now required to be reported in Schedule G, Part III of the Form 5500. The following are the headings of Schedule G, Part III:
| (a) Identity of party involved | (b) Relationship to plan, employer or other party-in-interest | (c) Description of transactions including maturity date, rate of interest, collateral, par or maturity value | (d) Purchase price | (e) Selling price | (f) Lease rental | (g) Expenses incurred in connection with transaction | (h) Cost of asset* | (i) Current value of asset** | (j) Net gain or (loss) on each transaction |
Cash Balance Plans Questions & Answers

U.S. Department of Labor
Pension and Welfare Benefits Administration

November 1999

If your company is converting its traditional pension plan benefit formula to a new cash balance pension plan benefit formula, you may have some questions about how this change will affect you. The following are responses to some of the most often asked questions. These responses are designed to provide general information and are not legal interpretations of ERISA or the Internal Revenue Code.

1. What is a cash balance plan?

There are two general types of pension plans—defined benefit plans and defined contribution plans. In general, defined benefit plans provide a specific benefit at retirement for each eligible employee, while defined contribution plans specify the amount of contributions to be made by the employer toward an employee's retirement account. In a defined contribution plan, the actual amount of retirement benefits provided to an employee depends on the amount of the contributions as well as the gains or losses of the account.

A cash balance plan is a defined benefit plan that defines the benefit in terms that are more characteristic of a defined contribution plan. In other words, a cash balance plan defines the promised benefit in terms of a stated account balance.
2. How do cash balance plans work?

In a typical cash balance plan, a participant's account is credited each year with a "pay credit" (such as 5 percent of compensation from his or her employer) and an "interest credit" (either a fixed rate or a variable rate that is linked to an index such as the one-year treasury bill rate). Increases and decreases in the value of the plan's investments do not directly affect the benefit amounts promised to participants. Thus, the investment risks and rewards on plan assets are borne solely by the employer.

When a participant becomes entitled to receive benefits under a cash balance plan, the benefits that are received are defined in terms of an account balance. For example, assume that a participant has an account balance of $100,000 when he or she reaches age 65. If the participant decides to retire at that time, he or she would have the right to an annuity. Such an annuity might be approximately $10,000 per year for life. In many cash balance plans, however, the participant could instead choose (with consent from his or her spouse) to take a lump sum benefit equal to the $100,000 account balance.

In addition to generally permitting participants to take their benefits as lump sum benefits at retirement, cash balance plans often permit vested participants to choose (with consent from their spouses) to receive their accrued benefits in lump sums if they terminate employment prior to retirement age.

Traditional defined benefit pension plans do not offer this feature as frequently.

If a participant receives a lump sum distribution, that distribution generally can be rolled over into an IRA or to another employer's plan if that plan accepts rollovers.

The benefits in most cash balance plans, as in most traditional defined benefit plans, are protected, within certain limitations, by federal insurance provided through the Pension Benefit Guaranty Corporation.
3. How do cash balance plans differ from traditional pension plans?

While both traditional defined benefit plans and cash balance plans are required to offer payment of an employee's benefit in the form of a series of payments for life, traditional defined benefit plans define an employee's benefit as a series of monthly payments for life to begin at retirement, but cash balance plans define the benefit in terms of a stated account balance. These accounts are often referred to as "hypothetical accounts" because they do not reflect actual contributions to an account or actual gains and losses allocable to the account.

4. How do cash balance plans differ from 401(k) plans?

Cash balance plans are defined benefit plans. In contrast, 401(k) plans are a type of defined contribution plan.

There are four major differences between typical cash balance plans and 401(k) plans.

a. Participation. Participation in typical cash balance plans generally does not depend on the workers contributing part of their compensation to the plan; however, participation in a 401(k) plan does depend, in whole or in part, on an employee choosing to make a contribution to the plan.

b. Investment Risks. The investments of cash balance plans are managed by the employer or an investment manager appointed by the employer. The employer bears the risks and rewards of the investments. Increases and decreases in the value of the plan's investments do not directly affect the benefit amounts promised to participants. By contrast, 401(k) plans often permit participants to direct their own investments within certain categories. Under 401(k) plans, participants bear the risks and rewards of investment choices.

c. Life Annuities. Unlike many 401(k) plans, cash balance plans are required to offer employees the ability to receive their benefits in the form of lifetime annuities.
d. **Federal Guarantee.** Since they are defined benefit plans, the benefits promised by cash balance plans are usually insured by a federal agency, the Pension Benefit Guaranty Corporation (PBGC). If a defined benefit plan is terminated with insufficient funds to pay all promised benefits, the PBGC has authority to assume trusteeship of the plan and to begin to pay pension benefits up to the limits set by law. Defined contribution plans, including 401(k) plans, are not insured by the PBGC.

5. *Is there a federal pension law that governs these plans?*

Yes. Federal law, including the Employee Retirement Income Security Act (ERISA), the Age Discrimination in Employment Act (ADEA), and the Internal Revenue Code (IRC), provides certain protections for the employee benefits of participants in private sector pension and health benefit plans.

If your employer offers a pension plan, the law sets standards for fiduciary responsibility, participation, vesting (the minimum time a participant must generally be employed by the employer to earn a legal right to benefits), benefit accrual and funding. The law also requires plans to give basic information to workers and retirees. The IRC establishes additional tax qualification requirements, including rules aimed at ensuring that proportionate benefits are provided to a sufficiently broad-based employee population.

The Department of Labor, the Equal Employment Opportunity Commission (EEOC), and the IRS/Department of the Treasury have responsibilities in overseeing and enforcing the provisions of the law. Generally, the Department of Labor focuses on the fiduciary responsibilities, employee rights, and reporting and disclosure requirements under the law, while the EEOC concentrates on the portions of the law relating to age discriminatory employment practices. The IRS/Department of the Treasury generally focuses on the standards set by the law for plans to qualify for tax preferences.
6. *Are there requirements that apply if my employer converts my current plan to a cash balance plan?*

Yes; however, employers are not required to establish pension plans for their employees because the private pension system is voluntary. In addition, employers are allowed substantial flexibility in deciding whether to terminate or amend their existing plans. Therefore, employers generally may change by plan amendment their traditional pension plans and the benefit formulas they use.

Federal law does place restrictions on plan changes, including amendments that convert a traditional pension plan formula to a cash balance plan formula. For example, a plan amendment cannot reduce benefits that participants have already earned. Advance notification to plan participants is required if, as a result of the amendment, the rate that plan participants may earn benefits in the future is significantly reduced. Additionally, there are other legal requirements that have to be satisfied, including prohibitions against age discrimination.

7. *Can my benefits earned under the plan be reduced when the plan benefit formula is converted to a cash balance plan formula?*

No. While employers may amend their plans to reduce the rate at which future benefits are earned, they generally are prohibited from reducing the benefits that participants have already earned. In other words, an employee generally may not receive less than his or her accrued benefit under the plan formula at the effective date of the amendment. For example, assume that a plan's benefit formula provides a monthly pension at age 65 equal to 1.5 percent for each year of service multiplied by the monthly average of a participant's highest three years of compensation, and that the plan is amended to convert its benefit formula to a cash balance plan formula. If a participant has completed 10 years of service at the time of the amendment, the participant will have the right to receive a monthly pension at age 65 equal to 15 percent of the monthly average of the
participant’s highest three years of compensation when the plan amendment is effective. This benefit (including related early retirement benefits) is protected by law and cannot be reduced.

8. **What happens to the assets in a plan when an employer converts its traditional defined benefit plan formula to a cash balance plan formula?**

When an employer amends its plan to convert the plan’s traditional defined benefit plan formula to a cash balance plan formula, the plan’s assets remain intact and continue to back the pension benefits under the plan. Employers cannot remove funds from the plan, unless the plan has been terminated and has assets remaining after payment of all of the benefits under the plan.

9. **Is it possible that I will not accrue any additional benefits under the cash balance plan formula?**

In some cases, when your traditional plan formula is changed to a cash balance plan formula, the benefit earned under the old formula may exceed the amount determined to be your benefit under the cash balance plan formula. In this situation, you might not earn any additional benefits until your benefit under the cash balance plan formula exceeds the benefit you had earned under the old formula. This is commonly referred to as “wear away.” There are legal requirements that have to be satisfied with respect to benefit accruals, including prohibition against age discrimination. “Wear away” is one of the issues being closely studied by the EEOC, IRS and the Department of Labor.

10. **How am I affected if I leave my job at a company that just changed its pension plan from a traditional defined benefit formula to a cash balance plan formula?**

If you have worked long enough to be vested under the plan, you should receive the sum of (1) the accrued benefit under the formula in effect before the amendment, and (2) any additional benefits (see response to question 9 above)
you earned under the plan formula in effect after the amendment. However, you may have to wait until a retirement age under the plan to receive your benefit.

11. Is my employer required to give me a choice of remaining under the old formula rather than automatically switching me to the new formula?

Neither ERISA nor the IRC requires employers to give employees the choice of remaining in the old formula. Employers have several options, including:

a. Allowing employees to remain under the old formula, while restricting new hires to the new formula;
b. Stipulating that certain employees who have reached a specific length of service or who have reached a certain age may choose to stay with the old formula; and,
c. Providing no choice, replacing the old formula and applying the new formula to all participants.

The law permits employers to have such flexibility, but whatever option applies has to satisfy legal requirements. For example, the option may not violate prohibitions against discrimination on the basis of age.

Under each of these options, benefits already earned by the participants, as of the effective date of the amendment that converts the old formula to a cash balance formula, may not be reduced.

12. If my employer gives me a choice of staying with the old formula or converting to the new cash balance plan formula, how do I make the right choice?

The right choice for you and your family may be affected by a wide range of factors. For example, in making this choice you should take into account your retirement expectations, when you intend to begin receiving your benefits, and the chance that your needs might change.

In analyzing any choice presented under your plan, you will want to compare all the terms and options available to
you under the cash balance package with those currently available to you. It is important for you to consider each option under each plan formula.

You will also want to consider the specifics of your retirement benefit, such as how your accrued benefit (including the value of any early retirement subsidy) is defined under each formula, the current value of your accrued benefit under each formula, and its value as an annuity at normal retirement age, or as a lump sum distribution. You may also want to take into account how your choice will affect survivor benefits.

You should also compare the value of other related benefits that may be offered under either choice. For instance, some traditional pension plans provide for an offset or subsidy if you retire prior to the age at which your Social Security benefits commence, or offer credit for service also covered by a disability benefit plan.

In making your decision, you should pay attention to any time limits that may apply and any waivers you may be requested to sign. Finally, you need to consider how long you have been with your employer and whether or not you expect to stay employed with your current employer or change jobs in the future.

You may want to consult a professional advisor for assistance in making your choice.

13. What information is my employer required to give me to explain the new cash balance plan formula, and when should I receive this information?

Many employers voluntarily provide helpful information about these conversions in advance of the change becoming effective. Make sure you have all the information that the employer has provided. If you are still not sure if you have enough information to understand the plan change, you have a right to contact your plan administrator and ask for more information or help in understanding the change and any choices you have in conjunction with the change.
Plan administrators are required to give at least 15 days’ advance notice of plan amendments that significantly reduce the rate at which plan participants earn benefits in the future.

After the plan is amended, the plan administrator is required to provide all plan participants with a Summary of Material Modifications to the plan or a revised Summary Plan Description. This document will summarize the changes to your plan.

In addition, under the Age Discrimination in Employment Act (ADEA), an employer requiring an employee to sign a waiver of rights and claims when choosing between plans is required to provide enough information to enable the employee to make a knowing and voluntary decision to waive ADEA rights. In most cases, an employee must be given at least 21 days to sign the waiver and at least 7 days to revoke the agreement.

14. Will the conversion of my pension plan formula have an effect on my retiree health benefits?

Generally, pension plans and health plans are operated independently and are administered separately. If you have questions about your health benefits you should contact your health plan administrator. Be aware that, like pension plans, many health plans can be amended or terminated.

15. What should I do if I believe my benefits under the old formula have been inappropriately reduced or that my rights have been violated?

You should immediately contact the plan administrator and discuss your concerns. Be sure to review your individual benefit statement or the information used to calculate your benefit to determine if it is correct—such as employment date, length of service, and salary.

If your concerns are not adequately addressed, or you still have questions about your situation, you should contact one of our benefit advisors, located in 15 field offices nationwide.
In addition, employees who believe that they have been subject to discriminatory treatment because of their age, race, color, religion, sex, national origin, or disability may file a charge of discrimination with the Equal Employment Opportunity Commission (EEOC).

There are strict time limits for filing such a charge.
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<td>Form 5500 preparation and filing requirements (202) 219-8770</td>
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<td>Office of Regulations and Interpretations</td>
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