2004

Employee benefit plans industry developments - 2004; Audit risk alerts

American Institute of Certified Public Accountants
Employee Benefit Plans Industry Developments — 2004

Strengthening Audit Integrity
Safeguarding Financial Reporting
Employee Benefit Plans Industry Developments — 2004

Strengthening Audit Integrity
Safeguarding Financial Reporting
Notice to Readers

This Audit Risk Alert, prepared by the AICPA staff, is intended to provide auditors of financial statements of employee benefit plans with an overview of recent economic, industry, regulatory, and professional developments that may affect the audits they perform.

This publication is an Other Auditing Publication as defined in Statement on Auditing Standards (SAS) No. 95, Generally Accepted Auditing Standards (AICPA, Professional Standards, vol. 1, AU sec. 150). Other Auditing Publications have no authoritative status; however, they may help the auditor understand and apply the SASs.

If an auditor applies the auditing guidance included in an Other Auditing Publication, he or she should be satisfied that, in his or her judgment, it is both appropriate and relevant to the circumstances of his or her audit. This publication was reviewed by the AICPA Audit and Attest Standards staff and published by the AICPA and is presumed to be appropriate. This document has not been approved, disapproved, or otherwise acted on by a senior technical committee of the AICPA.

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Technical Manager
Accounting and Auditing Publications

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Acknowledgments

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Employee Benefit Plans Industry Developments—2004

How This Alert Helps You

This Audit Risk Alert is intended 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, accounting, and regulatory developments. Being armed with a sound understanding of these areas allows you, among other things, to perform your audits in a more efficient and effective manner, and to deliver greater value to your clients through audit and related services.

Industry and Economic Developments

The need for individuals to plan for their own retirement is critical as fewer individuals look toward Social Security to carry them through retirement. This section discusses the industry and economic environment, and other issues facing employee benefit plans today.

The AICPA Establishes the Employee Benefit Plan Audit Quality Center

Financial statement audits of employee benefit plans represent a critical portion of the many audits performed by CPAs each year. Employee benefit plan audits include audits of defined benefit, defined contribution, and health and welfare benefit plans subject to the Employee Retirement Income Security Act of 1974 (ERISA) under the regulatory authority of the U.S. Department of Labor (DOL).

The AICPA is committed to helping its members achieve the highest standards in performing quality employee benefit plan audits. To help CPAs meet the challenges inherent in audits in this unique and complex area, the AICPA launched the Employee Benefit Plan Audit Quality Center (the Center), a firm-
based voluntary membership center for accounting firms that audit employee benefit plans.

The Center's primary purpose is to promote the quality of employee benefit plan audits. To meet this overall goal, the Center will:

- Create a community of firms that demonstrate a commitment to employee benefit plan audit quality
- Serve as a comprehensive resource provider for member firms
- Provide information about the Center's activities to other employee benefit plan stakeholders
- Raise awareness about the importance of employee benefit plan audits

The Center can help accounting firms demonstrate their commitment to employee benefit plan audit quality and assist in applying a set of best practices.

The Center will offer resources to enhance the quality of audits of employee benefit plans, by providing:

- A single point of access to the latest developments in accounting, auditing, and DOL rules and regulations
- Periodic updates on current issues through conferences and Webcasts
- Vehicles for member interaction and information sharing
- The voice for Center members to the DOL

**Membership Requirements**

To be eligible to be a member of the Center, a firm must:

- Designate an audit partner\(^1\) to have firm-wide responsibility for the quality of the firm's ERISA employee benefit plan audit practice. *(Effective at admission date.)*

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1. An audit partner refers to an individual who is legally a partner, owner, or shareholder in a CPA firm or a sole practitioner and who performs audit services, concurring reviews (if applicable), or consultations on technical or industry-specific issues with respect to audit clients of the firm. Such individual should be party to any partnership, ownership, or shareholder agreement of a CPA firm.
• Have all audit partners of the firm residing in the United States and eligible for AICPA membership be members of the AICPA.2 (Effective at admission date.)

• Establish a program to ensure that all ERISA employee benefit plan audit engagement personnel possess current knowledge, appropriate to their level of involvement in the engagement, of applicable professional standards, rules, and regulations for ERISA employee benefit plan audits. Such knowledge may be obtained from on-the-job training or training courses or both. For an individual signing audit opinions and an individual managing ERISA employee benefit plan audit engagements, the individual must complete a minimum of eight hours of employee benefit plan-specific continuing professional education (CPE) within the three-year period (or within the firm's or individual's most recent CPE period ending within the three-year period) prior to signing an ERISA employee benefit plan audit opinion or managing3 an ERISA employee benefit plan audit engagement. Thereafter, the individual must have a minimum of eight hours of employee benefit plan-specific CPE every three years (or within the firm's or individual's CPE period covering a three-year period) where an individual continues in this capacity for ERISA employee benefit plan audits. (Program must be in place at admission; CPE requirement must be met in the firm's or individual's first CPE cycle ending after January 1, 2005.)

• Establish policies and procedures specific to the firm's ERISA employee benefit plan audit practice to comply

2. Member firms must use best efforts to ensure compliance with this membership requirement. Best efforts include (a) annually advising each audit partner that AICPA membership is mandatory, and (b) taking appropriate corrective action in the event that the firm detects noncompliance. In addition, while only audit partners residing in the United States and eligible for AICPA membership must be members of the AICPA, member firms must encourage all other firm professionals who are eligible for membership in the AICPA to enroll as individual AICPA members.

3. Individuals managing the audit engagement are professional employees who have either continuing responsibility for the overall planning and supervision of the engagement or the authority to determine that an engagement is complete subject to final partner approval if required.
with the applicable professional standards and Center membership requirements. These policies and procedures must be documented and appropriately communicated. *(Effective on or before December 31, 2004.)*

- In addition to meeting the quality control standards requirement for monitoring, establish annual internal inspection procedures that include a review of the firm’s ERISA employee benefit plan audit practice by individuals possessing current experience and knowledge of the accounting and auditing practices specific to ERISA employee benefit plan audits. The engagements inspected should be representative of the firm’s ERISA employee benefit plan practice considering the number and different types of plan audits (for example, defined benefit, defined contribution, health and welfare, multiemployer, employee stock ownership plans [ESOPs], limited, and full scope) and the various locations at which those audits are performed. The internal inspection should include reviewing the firm’s compliance with the Center membership requirements. The internal inspection reports specific to the ERISA engagements should be made available to the firm’s peer reviewer. *(Effective for firm monitoring performed beginning after January 1, 2005.)*

- Make publicly available information about its most recently accepted peer review as determined by the Executive Committee.* *(Effective at admission date.)*

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4. The Executive Committee has determined that Center member firms are required to make publicly available the following information, if applicable, relative to the firm’s peer review:
   - Peer review report
   - Letter of comment, if applicable
   - Letter of response, if applicable
   - Letter signed by the reviewed firm indicating that the peer review documents have been accepted with the understanding that the firm agrees to take certain actions, if applicable
   - Letter notifying the firm that certain required actions have been completed, if applicable, and
   - Letter notifying the firm that the peer review has been accepted
• Have its ERISA employee benefit plan audits selected as part of the firm's peer review reviewed by individuals employed by a Center member firm. *(Effective for peer reviews commencing on or after January 1, 2005.)*

• Periodically file with the Center information about the firm and its ERISA employee benefit plan audit practice, and agree to make such information available for public inspection, as determined by the Executive Committee.5

• Pay dues as established by the Executive Committee.

• Comply with additional requirements as may be established by the Executive Committee and approved by the AICPA Board of Directors.

**Economic Environment**

In planning their audits, auditors need to understand the economic conditions facing the industry in which the client operates. Economic activities relating to such factors as interest rates, consumer confidence, overall economic expansion or contraction, inflation, and the labor market are likely to have an impact on the entity being audited.

**A Growing and Strengthening U.S. Economy**

In the fourth quarter of 2003, the U.S. economy expanded at a 4 percent growth rate, a sharp decline from the astonishing 8.2 percent pace it gained in the third quarter of 2003, but still considered a healthy pace. The 2003 strong growth was fueled by consumer spending (aided by the President's tax cuts), business

5. The Executive Committee has determined that Center member firms are required to file with the Center the following information:
• Firm name and address
• Whether the firm is a member of the CPCAF and/or PCPS
• Name and contact information of the designated audit partner with firm-wide responsibility for the quality of the firm's ERISA employee benefit plan audit practice
• Name and contact information of the firm's designated Center contact administrator (if different from designated person above)
• Total number of CPAs in owner's group, CPAs in firm, professional staff, and firm personnel
• Approximate number of ERISA employee benefit plan audits (that is, 1-5, 6-25, 26-50, 51-100, 101-500, or over 500)
spending, defense expenditures, and good corporate profits. For all of 2003, the gross domestic product rose 3.1 percent, a good indication that the economy is strong and getting stronger. In 2003, Wall Street enjoyed these positive economic indicators, as the stock markets rallied and posted gains not seen since June 2002. In addition, a weak U.S. dollar is helping to improve export sales and lessen the trade deficit.

U.S. corporations have reduced excess inventory levels and unproductive assets while increasing productivity and competitiveness. Corporate profits are improving and global economic growth appears to be gaining steam.

The Unemployment Picture
The U.S. unemployment rate fell to 5.7 percent in December 2003 and then to 5.6 percent in January 2004, its lowest level in more than two years, indicating a continued slow recovery to the labor market.

Interest Rates
The Federal Reserve has made a commitment to keep its interest rate target at a 45-year low of 1 percent for many more quarters. Interest rates on mortgages and other borrowings continue to remain low.

Risks to the Economy
Although the economy is growing at a strong pace and promising signs about the job market exist, some Americans are still struggling to make debt payments. The lingering effects of a weak job market and a flood of personal bankruptcy filings continue to paint a picture of poor consumer credit quality. High levels of personal debt, suppressed wage growth, and a lack of job creation could eventually cause consumers to curtail their spending and, consequently, slow economic expansion. Moreover, the weak U.S. dollar could contribute to higher interest rates which, in turn, could cause foreign investment and the key U.S. housing market to weaken.
Mutual Fund Industry Abuses and Related Guidance Issued by the Department of Labor

On September 3, 2003, the New York State Attorney General filed a complaint alleging the existence of illegal trading schemes that cost mutual fund investors billions of dollars annually. This investigation focuses on two types of trading practices known as late trading and market timing. According to the complaint, late trading involves purchasing mutual fund shares at the 4:00 p.m. price after the market closes. It is more common with international funds because of the timing of the market closings. Late trading is prohibited by the New York Martin Act, other state laws, and Securities and Exchange Commission (SEC) regulations because it allows a favored investor to take advantage of post-market-closing events not reflected in the share price set at the close of the market.

Market timing is an investment technique involving short-term, “in and out” trading of mutual fund shares that have a detrimental effect on long-term shareholders. Market timing is not illegal but is considered improper when a mutual fund’s prospectus says that the practice is discouraged or prohibited.

In December 2003, the SEC issued proposed new rules and rule amendments to prevent late trading abuses, and new rules and form amendments to curb market timing abuses. The new rules and form amendments under consideration to prevent market timing abuses include, among others, rule and form amendments that would require explicit disclosure in fund offering documents of market timing policies and procedures. Such disclosures would emphasize the obligation of funds to fair value their securities under certain circumstances to minimize market timing arbitrage opportunities. The proposed rules are available on the SEC Web site at www.sec.gov.

Late trading and market timing may affect benefit plans in two ways. First, plan sponsors have a fiduciary duty to select prudent investments and investment options for participants. It could be considered a fiduciary breach if it was determined the plan sponsor was not prudent in selecting a mutual fund as a plan investment that had losses due to market timing or late trading.
Second, amid rampant publicity about market timing in mutual funds, some benefit plan sponsors have determined that certain plan participants in participant-directed defined contribution plans have been engaging in market timing, potentially raising expenses for all participants. Many benefit plans do not have any formal policies restricting market timing. Because investment purchases and sales processing is often outsourced to outside service providers, plan sponsors may believe it is not their responsibility to monitor for market timing. Also, the trades are difficult to identify because individual participant buys and sells are often bundled before being sent to the fund. Nevertheless, plan sponsors have a fiduciary duty to be on the watch for such transactions and could be liable for potential losses incurred by participants.

The existence of enforcement actions alleging violations of laws and regulations could raise reporting and auditing implications for benefit plans. Plan investors in funds where late trading or improper trading by market timers was permitted may seek compensation for losses resulting from the dilution of fund gains. Also, as a result of these investigations, there may be greater scrutiny of investment policies and trading procedures by the plan sponsor. Plan sponsors may respond to information about a fund’s illegal or improper trading by redeeming shares in these funds, or opt for other investments or investment options for participants. Also, in response to increased scrutiny, sponsors may be reexamining their market timing policies and procedures, or may charge redemption fees to discourage market timers.

According to the AICPA Audit and Accounting Guide Employee Benefit Plans, with conforming changes as of March 1, 2004 (EBP Guide) (paragraph 7.15), one of the objectives of auditing procedures applied to benefit plan investments is to provide the auditor with a reasonable basis for concluding whether investment transactions are initiated in accordance with the established investment policies of the plan. As part of a full scope audit, auditors should review relevant plan documents such as the latest plan agreement, investment adviser agreements, and investment policy statement. Auditing procedures for investments (EBP Guide paragraph 7.16) also include inquiring of the plan admin-
istrator or other appropriate parties if they are aware of any situation where the plan's investments or other transactions violate applicable laws or regulations. The auditor should consider whether management has identified any noncompliance with the stated investment restrictions and test the compliance with the restrictions to the extent considered necessary. A benefit plan sponsor's failure to comply with its stated investment restrictions may be considered a possible illegal act that may have an indirect effect on the financial statements of the plan.

The auditor of an employee benefit plan should be aware of the possibility that violations of laws and regulations may have occurred. If specific information that provides evidence concerning the existence of possible violations affecting the financial statements comes to the auditor's attention, the auditor should apply auditing procedures specifically directed to ascertaining whether a violation has occurred (see Statement on Auditing Standards [SAS] No. 54, Illegal Acts by Clients, AICPA, Professional Standards, vol. 1, AU. sec. 317.07).

Labor Department Issues Guidance on Fiduciary Duties in Response to Mutual Fund Abuses

On February 17, 2004, the Employee Benefit Security Administration (EBSA) announced guidance on the duties of employee benefit plan fiduciaries in light of alleged abuses involving mutual funds. There are approximately 730,000 private sector pension plans, covering 102 million individuals, protected by the fiduciary responsibility provisions of ERISA. These plans hold more than $1.1 trillion of assets invested in mutual funds and similar pooled investment vehicles, representing more than 30 percent of all pension plan investments.

The guidance addresses the obligations of fiduciaries to review their mutual fund and pooled investment fund investments with respect to reported and potential late trading and market-timing abuses. The guidance also provides examples of steps that fiduciaries can take to deal with market-timing concerns within their own plans without losing the protections of section 404(c) of ERISA. This guidance comes as federal and state investigations of
late trading and market-timing abuses involving mutual funds have raised a number of questions about what steps fiduciaries should take with respect to their plans' mutual fund investments and other similar types of investments.

In addition, the EBSA is conducting reviews of mutual funds, similar pooled investment funds, and service providers for such funds to determine whether there have been any violations of ERISA. As with EBSA's investigations involving corporate fraud and similar misconduct, these investigations are being coordi­nated with other federal agencies through President Bush's Corporate Fraud Task Force.

The guidance is available on EBSA's Web site at www.dol.gov/ebsa under Compliance Assistance.

The Sarbanes-Oxley Act of 2002

On July 30, 2002, President Bush signed into law the Sarbanes-Oxley Act of 2002 (the Act). The Act dramatically affects the accounting profession and affects not just the largest accounting firms, but any CPA actively working as an auditor for a publicly traded company or any CPA working in the financial management area of a public company. The Act contains some of the most far reaching changes that Congress has ever introduced to the business world. Although most of the provisions of this legislation are specific to auditors of public companies, even practitioners not performing audits may be affected by the Act. Therefore, all CPAs should become familiar with the provisions of the Act and the Public Company Accounting Oversight Board (PCAOB).

Major provisions impacting employee benefit plans that file Form 11-K include the following.

- Auditors of public companies are required to register with the PCAOB. This includes auditors of employee benefit plans whose plan sponsors file annual reports on Form 11-K with the SEC.

- Auditor independence
Help Desk—It should be noted that independence would be impaired if an auditor prepares financial statements for a client that are filed with the SEC.

- Section 201—Services Outside the Scope of Practice of Auditors—The independence provisions of the Act and the SEC rules prohibit a registered firm from performing specified non-audit services for audit clients that file with the SEC. Nonaudit services are services other than those provided in connection with an audit or a review of the financial statements.

- Section 202—Pre-Approval Requirements—The rule requires an audit committee to establish policies and procedures for the pre-approval of services to be provided by the auditor. Pre-approval policies and fee disclosures are effective for fiscal years ending after December 15, 2003.

- Section 203—Audit Partner Rotation—To maintain independence, partners must rotate after serving for five consecutive years and are subject to a five-year “time out” period after the rotation. This requirement also includes concurring review partners and extends to both Form 11-Ks as well as other benefit plans if there is a Form 11-K filing.

- Section 204—Auditor Reports to Audit Committees—Auditors are currently required to communicate specified matters related to the conduct of an audit to those who have responsibility for oversight of the financial reporting process, which is often the sponsor’s audit committee. SAS No. 61, Communication With Audit Committees (AICPA, Professional Standards, vol. 1, AU sec. 380), as amended, and S-X Rule 2-07 communications need to be completed prior to the issuance of the audit report and filing of the Form 11-K.6

6. Only the Securities and Exchange Commission (SEC) required communication needs to be completed prior to the issuance of the Form 11-K. Other SAS No. 61 communications may occur at various times in compliance with Statement on Auditing Standards (SAS) No. 61, Communication With Audit Committees (AICPA, Professional Standards, vol. 1, AU sec. 380), as amended.
• Corporate Responsibility
  - Section 302—*Corporate Responsibilities for Financial Reports*—Requires a certification of the financial statements and other financial information. This requirement does not apply to annual reports on Form 11-K.
  - Many issuers included section 906 certifications with Forms 11-K filed during the past year in light of uncertainty over the scope of the statutory language and informal suggestions by the SEC that it would be appropriate to do so. Based upon discussions currently with the SEC, section 906 does not apply to Form 11-K filings. Plan sponsors should consult with their SEC counsel.

• Management Assessment of Internal Controls
  - Section 404—Requires each issuer that files periodic reports with the SEC to (1) establish and maintain a system of internal control over financial reporting, (2) include in its annual report a report by management on the system of internal controls, and (3) accompany the report with an attestation report on the system of internal controls. Based upon discussions with the SEC, section 404 is not applicable to Form 11-K. Plan sponsors should consider consulting with their SEC counsel.

• Additional Requirements
  - *Proposed Auditing Standard No. 1*—Reference in auditor’s report to Auditing Standard No. 1—*References in Auditors’ Reports to the Standards of the Public Company Accounting Oversight Board.* The proposed standard requires registered public accounting firms to indicate in their auditor’s reports that the engagement was performed pursuant to “the standards of the Public Company Accounting Oversight Board (United States).” On April 4, 2004, this PCAOB standard was filed with the SEC with a 21-day comment period. See the SEC’s Web site for further developments.
Consider including a reference in the management representation letter that the PCAOB fees have been paid, if applicable.

**Investments and Reporting of Certain Investments on Form 5500**

Pension funds, especially those with large investment portfolios, are more frequently investing in limited partnership private equity funds, which may include hedge funds. These pooled investment funds are lightly regulated and not readily marketable, unlike registered investment funds, commonly known as mutual funds. Auditors should take special care in identifying when a plan invests in a limited partnership because it is not uncommon for such investments to be classified incorrectly (for example, as a registered investment company or other type of fund) on the schedule of investments provided by the custodian or trustee.

This trend of investing in limited partnerships and the recent scrutiny of accounting and disclosure of limited partnership investments in corporate financial statements have precipitated an issue about what employee benefit plan financial statements should disclose regarding a plan's investments in limited partnerships.

The EBP Guide does not specifically address financial statement or Form 5500 reporting requirements for limited partnerships. Employee benefit plan financial statements report investments at fair value, which would include investments in limited partnerships. Such investments are generally not consolidated or accounted for on the equity method, as they might be in the plan sponsor's financial statements.

Other required disclosures for limited partnership investments are those applicable under AICPA Statement of Position (SOP) 94-6, *Disclosure of Certain Significant Risks and Uncertainties*. SOP 94-6 requires disclosures about certain significant estimates and current vulnerability due to certain concentrations.

Consideration should be given to including the following disclosures:
• Description of the plan’s ownership interests in the limited partnerships and a summary of investments owned by the partnership and the corresponding risk. A riskier, more aggressive investment would warrant consideration of additional disclosure.

• If a related-party relationship exists, the names of the other partners in the plan’s partnership and their relationship to the plan.

• Methodology in which the partnerships allocate gains, losses, and expenses between the plan and the other partners.

• Related-party transactions with parties in interest related to the limited partnerships (including investment management fees paid).

• Additional capital commitment requirements.

• Valuation methodology.

Paragraph 7.59 of the EBP Guide addresses auditing procedures for limited partnerships when performing full scope audits. Auditors should take special care in performing limited scope audit procedures on limited partnership investments, as often the certifying entity does not have timely or accurate information regarding the amount and valuation of the plan's investment in the limited partnership. Although the auditor is not required to audit certain investment information when the limited scope audit exemption is applicable, further investigation and testing are required whenever the auditor becomes aware that such information is incorrect, incomplete, or otherwise unsatisfactory for the purpose of reporting on the financial statements (see paragraph 7.64 of the EBP Guide.) In addition, oftentimes the financial statements or appraisal prepared for limited partnerships do not have the same year end as the plan. The financial statements or appraisal need not cover the exact period covered by the plan's financial statements; they should, however, be sufficiently recent to satisfy the plan auditor. Auditors may wish to consider additional auditing procedures to address the gap in reporting, such as (1) requesting monthly financial activity of the partnership since
the financial statement or valuation date and performing substantive analytics, (2) inquiring of the investment adviser regarding monthly valuation procedures and any unusual investment activity changes which would result in significant changes in market value, and (3) evaluating the need for additional evidence to determine the fair value of the investments.

103-12 Entities
How a plan reports investments on Schedule H to the Form 5500 depends on the nature of the underlying assets of the investments and whether the plan sponsor elects to file directly with the DOL.

DOL regulation 29 CFR 2520.103-12 provides an alternative method of reporting for plans that invest in an entity, other than a master trust investment account (MTIA), common/collective trust (CCT), or pooled separate account (PSA), whose underlying assets include "plan assets" (within the meaning of DOL regulation 29 CFR 2510.2-101) of two or more plans that are not members of a related group of employee benefit plans. Making this determination can be complicated and may necessitate legal or other specialized industry consultation.

Generally a 103-12 entity will operate based on its legal structure (according to its operating agreements) in the form of a financial services product such as a trust or a limited partnership. Typically audited financial statements are required by the entity's operating agreement and are prepared in accordance with generally accepted accounting principles (GAAP) in a format following industry standards consistent with the entity's operations. For example, a 103-12 entity that operates as a limited partnership would prepare financial statements in accordance with GAAP for limited partnerships.

A 103-12 entity is required to file the following (see paragraph A.56 of the EBP Guide):

- Form 5500
- Schedule A, "Insurance Information"
- Schedule C, "Service Provider Information," Part I and II
• Schedule D, “DFE/Participating Plan Information,” Part II
• Schedule G, “Financial Transaction Schedules”
• Schedule H, “Financial Information” (including the Schedule of Assets (Held at End of Year))
• A report of the independent qualified public accountant (IQPA)

Often the format of the financial statement schedules (for example, the Schedule of Assets) for the 103-12 entity prepared in accordance with industry standards is not consistent with the format of the schedules as required by Form 5500 instructions. Form 5500 requirements should be considered when reporting on additional information schedules to be attached to the 103-12 entity’s financial statements filed with the Form 5500.

Direct Filing Entity (DFE) Enforcement Activities

The EBSA has an ongoing program to review the accuracy and completeness of Form 5500 filings made by DFEs. The agency has identified numerous technical deficiencies in DFE filings. In particular, the instructions are not followed properly. Several of the more common errors include:

• Incorrect completion of Schedule D, Part II, Information on Participating Plans (to be completed by DFEs). The schedule is either not completed at all; fails to provide all of the participating plans employer identification numbers and three-digit plan numbers; or discloses participating plan information on an attachment in place of completing the schedule.

• The failure of DFE investment information on Schedule H, Part I to reconcile with Schedule D, Part I.

• DFEs completing items on Schedule H that relate only to plan filings.

Enforcement letters have been sent to DFE filers requesting that the filings be corrected. Failure to correct the DFE filing may
subject the participating plans’ filings to rejection and further enforcement action by the EBSA.

DFE filers are encouraged to carefully read and follow the instructions to the Form 5500 regarding completion of the necessary schedules and information. Questions concerning completion of the Form 5500 may be directed to the EBSA “Help Desk” toll-free at (866) 463-3278.

**Health and Welfare Benefit Plans—COBRA**

Many health and welfare plans are required to provide continuation of benefits upon termination of employment through the Consolidated Omnibus Budget Reconciliation Act (COBRA). This continuation of benefits may be considered a postemployment or postretirement obligation, depending upon the terms of participation. In accordance with SOP 01-2, *Accounting and Reporting by Health and Welfare Benefit Plans*, the benefit obligation associated with COBRA would be equal to the actuarial present value of the cost of such benefits, less the present value of expected participant contributions for such benefits. Many plans require that participants pay the estimated full cost of health benefits provided under COBRA. In such situations, the net cost to the plan sponsor for such benefits is zero, and thus the plan would not recognize an obligation. If the plan sponsor subsidizes the cost of health benefits under COBRA, an obligation should be recognized by the plan to the extent that all criteria required by Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 112, *Employers’ Accounting for Postemployment Benefits*, FASB Statement No. 106, *Employers’ Accounting for Postretirement Benefits Other Than Pensions*, or both, are satisfied.

In many cases, the collection of COBRA contributions and payment of COBRA benefits are performed by third-party administrators. The administration of these features should be understood so that accounting for all COBRA activity is included in the financial statements of the plan. In the event that benefits provided by COBRA are self-insured, the obligation for claims incurred but not reported should include COBRA participants.
Proposed Rules on Notices for COBRA Continuation Health Care Coverage

On May 28, 2003, the DOL published in the *Federal Register* proposed rules clarifying the requirements for notices under COBRA for employees, employers, and plan administrators. The proposal provides guidance and model notices for workers and family members to continue their group health care coverage.

Under COBRA, most group health plans must give employees and their families the opportunity to elect a temporary continuation of their group health coverage when coverage would otherwise be lost for reasons such as termination of employment, divorce, or death. COBRA requires that certain notices be given before individuals can elect COBRA coverage. The plan administrator must give employees and spouses a general notice explaining COBRA when the employees and spouses first become covered under the plan. When an event occurs that would trigger a right to elect COBRA coverage, either the employer or the employee and his or her family members must notify the plan of the event. Finally, when the plan receives this notice, the plan must notify individuals of their COBRA rights and allow them to elect continuation coverage.

A fact sheet and further information on the proposal are available on EBSA’s Web site at www.dol.gov/ebsa under Fact Sheets.

**Outsourcing of Certain Administrative Functions**

Employee benefit plan sponsors have typically used third-party service providers in some capacity to assist in administering their plans. Many plan sponsors are increasingly turning to outsourcing as a way to reduce costs and increase efficiencies of administering employee benefit plans. Examples include recordkeeping and/or benefit payments or claims processed by outside service organizations, such as bank trust departments, data processing service bureaus, insurance companies, and benefits administrators.

Many plan sponsors and their employees may not be familiar with their fiduciary responsibilities regarding employee benefit plans. Auditors should refer plan sponsors to their plan legal
counsel for interpretations of specific actions and how these may or may not be in accordance with their fiduciary responsibilities.

SAS No. 70, *Service Organizations* (AICPA, *Professional Standards*, vol. 1, AU sec. 324), as amended, provides, among other things, guidance on the factors an independent auditor should consider when auditing the financial statements of a plan that uses a service organization to process certain transactions. Often, the plan does not maintain independent accounting records of transactions executed by the service provider. For example, many plan sponsors no longer maintain participant enrollment forms detailing the contribution percentage and the allocation by fund option; these amounts can be changed by telephone or over the Internet without any record at the plan sponsor. In these situations, the auditor may not be able to obtain a sufficient understanding of internal control relevant to transactions executed by the service organization to plan the audit and to determine the nature, timing, and extent of testing to be performed without considering those components of internal control maintained by the service organization. This understanding can be efficiently achieved by obtaining and reviewing a report prepared in accordance with SAS No. 70, if available. If a SAS No. 70 report is not available, see paragraph 6.14 of the EBP Guide for guidance.

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

The plan auditor should also read the description of controls to determine whether complementary user organization controls are required (for example, at the plan sponsor level) and whether they are relevant to the service provided to the plan. If they are relevant to the plan, the plan auditor should consider such information in planning the audit. The plan auditor should consider the need to document and test such user organization controls. While the plan sponsor may have outsourced administrative functions to a third party, the plan sponsor still has a fiduciary duty to monitor the activities of the third party. Examples of such monitoring controls, which should be considered in planning and performing the audit, may include:

- Review of third-party service provider's SAS No. 70 report
- Fluctuation analysis or reasonableness review of periodic third-party service provider reports with reconciliations with and comparisons to client data
- Predetermined communication, escalation, and "follow up" procedures in the event of an issue or problem
- Periodic review of financial and control measures included in the third-party service provider contract
- On-site visits to the third-party service provider
- Annual reassessment of effectiveness of the third-party service provider relationship

**What If the Service Organization Uses Another Service Organization to Perform Certain Functions?**

A service organization may use another service organization to perform functions or processing that is part of the plan's information system as it relates to an audit of the financial statements. The subservice organization may be a separate entity from the service organization or may be related to the service
organization. To plan the audit and assess control risk, the plan auditor may need to consider controls at the service organization and also may need to consider controls at the subservice organization, depending on the functions each performs. For further guidance on subservice organizations, see paragraph 6.17 of the EBP Guide and Chapter 5 in the AICPA Audit Guide Service Organizations: Applying SAS No. 70, as Amended (product no. 012772kk).

What If the Service Organization Has Internal Control Reports Other Than a SAS No. 70 Report?

Service Organizations may receive various reports on internal control. The independent auditor may only rely on internal control reports issued by service organizations under SAS No. 70 and accompanied by an opinion from an independent public accounting firm. A type 1 SAS No. 70 report may be relied upon in connection with gaining an understanding of the plan's control environment. Only a type 2 SAS No. 70 report may be relied upon to reduce the scope of substantive testing by the independent accountant. Other internal control reports provided by service organizations may not be relied upon by the independent auditor. Such other reports may include:

- SysTrustSM reports
- Transfer agent internal control reports filed with the SEC under the Securities Exchange Act of 1934 (1934 Act) rule 17Ad-13
- Broker-dealer internal control reports filed with the SEC under the 1934 Act rule 17a-5
- SAS No. 70 reports accompanied by an opinion from an entity that is not a licensed public accounting firm

7. This is typically a restricted-use report and is not intended to be and should not be used by anyone other than the specified parties.
8. Same as footnote 7.
Regulatory Developments

2003 Form 5500 Series and Guidance on Filing Requirements

The Department of Labor (DOL), Internal Revenue Service (IRS), and the Pension Benefit Guaranty Corporation (PBGC) have released the 2003 Form 5500 return/reports, schedules, and instructions to be used by employee benefit plans for plan year 2003 filings. The IRS has also released the Form 5500-EZ return and instructions to be used by certain one-participant retirement plans for plan year 2003 filings.

The agencies have also released tips to avoid common filing errors and frequently asked questions (FAQs) for small pension plans that use the audit exception to assist filers in complying with their reporting obligations. The tips and FAQs will help plans avoid basic filing errors and explain the conditions that small pension plans must meet to be eligible for a waiver of the annual audit requirement. The FAQs also include model summary annual report language for the required participant notice under the small plan audit exception. This guidance may be found in Appendixes D and E of this Audit Risk Alert and on the EBSA Web site at www.dol.gov/ebsa.

The Form 5500 and Form 5500-EZ for plan year 2003 are essentially unchanged from 2002. Certain modifications have been made to reflect changes in the law or regulations, to improve forms processing, and to clarify the instructions. The modifications to the Form 5500 Annual Report for 2003 include the following:

- Form 5500—The instructions add two plan characteristic codes to lines 8a and 8b: Code 3I on employer contributions to pension plans invested and held in employer securities, and code 4U for certain collectively bargained welfare benefit plans under the Internal Revenue Code (IRC)

- Schedule B—The instructions for line 4a, Quarterly Contributions, are modified for new plans; the instructions for line 8c and the Schedule of Active Participant Data are
modified to incorporate average cash balance account data; and on line 9l(2), the current liability full funding limitation is now based on 170 percent of the current liability

- Schedule E—Line 1 is a modification of the former line 17 regarding subchapter S corporation ESOPs
- Schedule H—Line 3 is reordered to clarify the reporting of information concerning the report of the IQPA
- Reporting delinquent participant contributions. Schedule H and Schedule I—Information concerning delinquent participant contributions reported on line 4a is no longer required to be reported again on line 4d (or Schedule G) (See the section “Timeliness of Remittance of Participant Contributions Remains an Enforcement Initiative for the EBSA” of this Audit Risk Alert for further guidance.)

- Schedule SSA—The instructions alert filers that nonstandard printouts will no longer be allowed to report separated vested participants on the 2004 forms.

Help Desk—Filers should note that, beginning this year, the Forms 5500 and 5500-EZ booklets with the official handprint forms and instructions will not be automatically mailed to filers of record. A postcard will be mailed instead to remind filers of the filing obligation.

The official government printed forms are available by calling (800) TAX-FORM (800-829-3676). Information copies of the forms, schedules, and instructions are available on EBSA's Web site at www.efast.dol.gov. Filers should monitor the EFAST Web site for information on approved software vendors when completing 2003 Forms 5500 by computer and for electronic filing options. Filers may contact the EFAST Help Line for general assistance by calling (866) 463-3278.

2003 Form M-1 for Multiple Employer Welfare Arrangements

On February 11, 2004, the DOL published in the Federal Register the 2003 Form M-1 annual report for multiple employer welfare arrangements (MEWAs). MEWAs are arrangements that offer
medical benefits to the employees of two or more employers or to their beneficiaries.

New Electronic Filing Option
The DOL has authority under the Health Insurance Portability and Accountability Act (HIPAA) to require reporting of information about MEWAs. Administrators generally must file the one-page Form M-1 once a year. While the 2003 Form M-1 has few changes from the 2002 form, this year, for the first time, filers can fill out and submit their filings via the Internet.

The annual filing date for the Form M-1 is March 1 of each year. However, in order to encourage the use of the new electronic filing option, the department has decided to extend this year's normal filing deadline from March 1 to May 1, 2004. In addition, administrators can request an automatic 60-day extension, which has also been extended from May 1 to July 1, 2004.

Beginning March 1, 2004 the online filing system will be available on EBSA's Web site, allowing filers to complete the form and submit it at no cost. The online form can be completed in multiple sessions and can be printed for the filer's records. The Web site includes a user manual, frequently asked questions, and a link to submit questions electronically. Online filing is an example of President Bush's E-Government initiative, which uses improved technology to make it easier for citizens and businesses to interact with the government.

Help Desk—To use the online filing process, go to www. askebsa.dol.gov/mewa/. Technical assistance for the online filing system is also available by calling (202) 693-8600. Information about the Form M-1 and how to fill it out is available on the Web site or by calling (202) 693-8360.

Paper copies of the form can be obtained by calling EBSA's toll-free number at (866) 444-EBSA (3272) or downloading at www.dol.gov/ebsa and clicking on the "Forms/Doc Requests" section.
Department of Labor’s EXPRO Program

The Employee Retirement Income Security Act (ERISA) allows the DOL to grant exemptions from all or any part of the restrictions imposed by ERISA’s prohibited transaction provisions. Prohibited Transaction Exemption (PTE) 96-62, known as “EXPRO,” provides an expedited process for parties to seek authorization from the DOL to engage in certain prohibited transactions. The exemption applies to certain prospective transactions between employee benefit plans and parties in interest where such transactions are specifically authorized by the DOL and are subject to terms, conditions, and representations that are substantially similar to exemptions previously granted by the DOL. The exemption affects plans, participants, and beneficiaries of such plans and certain persons engaging in such transactions.

PTE 96-62 requires that applicants demonstrate to the DOL that their proposed transactions are substantially similar to transactions in at least two exemptions previously granted by the department within five years of their submission. PTE 96-62 was amended in July 2002 to provide applicants with more cases on which to base their transactions. The amendment to EXPRO also provided applicants with an alternate method of satisfying the program’s requirements—instead of having to cite as substantially similar two individual exemptions granted by the DOL within the previous five years, applicants may cite one individual exemption granted within the past 10 years and a transaction “authorized” under the EXPRO exemption within the past five years.

Nearly 250 EXPRO transactions have been authorized. EXPRO has significantly reduced the number of individual exemptions relating to routine transactions, thus allowing applicants to receive exemptions in a more timely fashion and often saving them the cost of going through the more formal process to obtain an exemption.

For more information about EXPRO and the transactions authorized under the program, visit EBSA’s Web site at www.dol.gov/ebsa.
Small Pension Plan Security Regulation

Historically, pension plans with fewer than 100 participants have been exempt from the requirement to have an independent audit of the plan's financial statements. In recent years, however, considerable public attention has focused on the potential vulnerability of small plans to fraud and abuse. Although such circumstances are rare, the DOL decided it was appropriate to strengthen the security of pension assets and the accountability of persons handling those assets.

Accordingly, on October 19, 2000, the DOL published a final rule designed to safeguard small pension plan assets by adding new conditions to the audit waiver requirement that focus on persons who hold plan assets, enhanced disclosure to participants and beneficiaries, and improved bonding requirements. The audit requirement for health and welfare plans is not affected by this regulation.

Under the regulation, the administrator of an employee pension benefit plan that is required to complete Schedule I of the Form 5500 is not required to engage an independent auditor provided:

- At least 95 percent of the assets of the plan constitute "qualifying plan assets" or

- Any person who "handles" assets of the plan that do not constitute qualifying plan assets is bonded in accordance with section 412 of ERISA and DOL regulation 29 CFR 2580.412-6;

  and

- Certain required disclosures are made in the plan's Summary Annual Report.

According to the DOL, the vast majority of the assets of small plans are "qualifying plan assets." The DOL believes the plans that do not meet the 95 percent threshold will opt for the less expensive bonding alternative to avoid an independent audit of the plan's financial statements.
Definition of Qualifying Plan Assets

For purposes of this regulation, the term “qualifying plan assets” means:

• Qualifying employer securities, as defined in section 407(d)(5) of ERISA and the regulations issued thereunder

• Any loan meeting the requirements of section 408(b)(1) of ERISA and the regulations issued thereunder

• Any assets held by any of the following institutions:
  – A bank or similar financial institution as defined in section 2550.408b-4(c);
  – An insurance company qualified to do business under the laws of a state;
  – An organization registered as a broker-dealer under the Securities Exchange Act of 1934; or
  – Any other organization authorized to act as a trustee for individual retirement accounts (IRAs) under section 408 of the IRC.

• Shares issued by an investment company registered under the Investment Company Act of 1940

• Investment and annuity contracts issued by any insurance company qualified to do business under the laws of a state

• In the case of an individual account plan, any assets in the individual account of a participant or beneficiary over which the participant or beneficiary has the opportunity to exercise control and with respect to which the participant or beneficiary is furnished, at least annually, a statement from a regulated financial institution describing the assets held (or issued) by such institution and the amount of such assets

Disclosure Requirements

The exemption from the audit requirement for small pension plans is further conditioned on the disclosure of certain informa-
tion to participants and beneficiaries. Specifically, the summary annual report (SAR) of a plan electing the waiver must include, in addition to any other required information:

- Except for certain qualifying plan assets, the name of each regulated financial institution holding (or issuing) qualifying plan assets and the amount of such assets reported by the institution as of the end of the plan year (see question 6 in Appendix E of this Audit Risk Alert)

- The name of the surety company issuing the bond, if the plan has more than 5 percent of its assets in nonqualifying plan assets

- A notice indicating that participants and beneficiaries may, upon request and without charge, examine or receive copies of evidence of the required bond and statements received from the regulated financial institutions describing the qualifying plan assets

- A notice stating that participants and beneficiaries should contact the regional office of the EBSA if they are unable to examine or obtain copies of the regulated financial institution statements or evidence of the required bond, as applicable

In response to a request from any participant or beneficiary, the administrator, without charge to the participant or beneficiary, must make available for examination, or upon request furnish copies of, each regulated financial institution statement and evidence of any bond required.

**Effective Date**

This rule is effective as of the first plan year beginning after April 27, 2001.

**Help Desk**—Plan auditors should advise their small plan clients that they must indicate on Schedule I, item 4k, whether they are able to claim a waiver of the audit requirement.
New Frequently Asked Questions

The EBSA has received a variety of questions on how to determine whether a small plan has met the conditions for the audit waiver. Accordingly, the agency has created a document to answer frequently asked questions about the audit waiver requirements under the amended regulation. These FAQs may be found in Appendix E of this Audit Risk Alert and at the EBSA's Web site at www.dol.gov/ebsa/faqs. Additionally, questions concerning this guidance may be directed to the EFAST Help Line at (866) 463-3278. The EFAST Help Line is available Monday through Friday from 8:00 am to 8:00 pm, Eastern Time.

DOL Voluntary Fiduciary Correction Program

The EBSA has authority to bring civil enforcement actions and assess monetary penalties for violations of ERISA. On March 15, 2000, the DOL adopted the Voluntary Fiduciary Correction Program (VFCP) to help plan officials quickly and completely correct certain employee benefit plan violations.

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 department.

Any plan official, sponsoring employer, or parties to affected transactions may apply to the appropriate EBSA regional office to voluntarily correct violations covered by the program. In order to qualify, applicants must have fully undone any prohibited transactions, restored any losses and profits with interest, paid any expenses associated with correcting the transactions, and distributed any supplemental benefits owed to eligible participants and beneficiaries. In addition, a notice must be given to participants advising them of corrected violations.

The transactions eligible (a total of 15 specific transactions) for the VFCP include:

- Delinquent participant contributions
- Certain prohibited loans
• Loans with inadequate collateral or security
• Certain improper sales or purchases, including prohibited transactions
• Improper valuation of assets that affect benefit calculations
• Payment of excessive or duplicative fees

Applicants who fully comply with all of the terms and procedures of the VFCP will receive a “No-Action Letter” from EBSA and will not be subject to penalties. The EBSA does, however, reserve the right to conduct investigations to determine truthfulness, completeness, and whether full correction was made.

Applicants who fail to fully correct fiduciary violations will be rejected and become subject to enforcement action and civil penalties. In addition, persons involved in pending investigations or criminal violations cannot take advantage of the program.

Help Desk—Information regarding the VFCP is available on the EBSA’s Web site at www.dol.gov/dol/ebsa. Persons should telephone the EBSA regional office in their area with any questions about the application process. These telephone numbers may be found on the EBSA’s Web site, http://askebsa.dol.gov/.

DOL Guidance on Claims Regulation

On November 21, 2000, the DOL published a final regulation in the Federal Register that sets new standards for processing benefit claims of participants and beneficiaries who are covered under employee benefit plans governed by the ERISA. The regulation may be found at the DOL’s Web site at www.dol.gov/ebsa/regs/fedreg/final/2000029766.htm.

The new claims procedure regulation applies to certain plans for new claims filed on or after January 1, 2002, and applies to group health plans on the first day of the first plan year beginning on or after July 1, 2002, but not later than January 1, 2003. The claims procedure regulation changes the minimum procedural requirements for the processing of benefit claims for all employee benefit plans covered under ERISA, although the changes are minimal for pension and welfare benefits plans other than those that pro-
vide group health and disability benefits. The regulation substantially changes the procedures for benefit determinations for group health and disability benefit claims. Among other things, it creates new procedural standards for initial and appeal-level decisions, new time frames for decision-making, and new disclosure rights for claimants.

In response to many questions, the DOL has also published guidance, in a Q&A format, to assist plans in bringing their benefit processing systems into timely compliance with the requirements of the claims regulation. This guidance answers many of the frequently asked questions about the application of the claims regulation to group health and disability benefit plans. To the extent that the provisions of the regulation apply to other types of plans, the Q&A guidance applies to those plans also. The DOL anticipates providing additional guidance in the form of additional questions and answers, advisory opinions, or information letters as may be necessary to facilitate implementation of the requirements of the regulation. The FAQs may be obtained on the Internet at www.dol.gov/dol/ebsa or by calling the DOL toll-free at (800) 998-7542 to obtain free printed copies.

EBSA Review of Plan Audits

The EBSA continues its ongoing review program to assess the quality of ERISA audits. EBSA staff review audit reports that are attached to Form 5500 filings as well as conduct on-site reviews of audit work papers.

The EBSA is in the process of concluding and drafting the findings of a nationwide study involving the on-site review of statistically-selected sets of audit work papers for ERISA employee benefit plan audits. The primary objective of this review is to assess the level and quality of audits of ERISA employee benefit plans filed with the DOL, and compare the results to those of a similar study performed for the year 1996. At the time of the writing of this Audit Risk Alert, the EBSA report had not been released. When available, further information related to the audit quality study may be found at the EBSA Web site at www.dol.gov/dol/ebsa.
Help Desk—Recognizing the critical importance of improving the quality of ERISA employee benefit plan audits, the AICPA has created the Employee Benefit Plan Audit Quality Center to promote and improve the quality of such audits. See the section “The AICPA Establishes the Employee Benefit Plan Audit Quality Center” of this Audit Risk Alert for further information.

**EBSA Outreach and Customer Service Efforts**

The EBSA continues to encourage auditors and plan filers to call its Division of Accounting Services at (202) 693-8360 with ERISA-related accounting and auditing questions. Questions concerning the filing requirements and preparation of Form 5500 should be directed to the EBSA’s EFAST Help Desk at its toll-free number, (866) 463-3278.

In addition to handling technical telephone inquiries, the EBSA is involved in numerous outreach efforts designed to provide information to practitioners to help their clients comply with ERISA’s reporting and disclosure requirements. The agency’s outreach efforts continue to focus on plan audit quality, the current Form 5500, the EFAST Processing System, and other agency-related developments. Questions regarding these outreach efforts should be directed to the Office of the Chief Accountant at (202) 693-8360. Practitioners and other members of the public may also wish to contact the EBSA at its Web site at www.dol.gov/dol/ebsa. The Web site also provides information on EBSA’s organizational structure, current regulatory activities, and customer service and public outreach efforts.

**Delinquent Filer Voluntary Compliance Program**

The Delinquent Filer Voluntary Compliance (DFVC) Program is designed to encourage plan administrators to file overdue annual reports by paying reduced penalties. Established in 1995 and revised in March 2002, the program offers incentives for delinquent plan administrators to voluntarily comply with ERISA’s annual reporting requirements.
Program Eligibility
Eligibility in the DFVC Program continues to be limited to plan administrators with filing obligations under Title I of ERISA who comply with the provisions of the program and who have not been notified in writing by the DOL of a failure to file a timely annual report under Title I of ERISA. Form 5500-EZ filers and Form 5500 filers for plans without employees (as described in 29 CFR 2510.3-3(b) and (c)) are not eligible to participate in the DFVC Program because such plans are not subject to Title I.

Program Criteria
Participation in the DFVC Program is a two-part process. First, file with EBSA a complete Form 5500 Series Annual Return/Report, including all schedules and attachments, for each year relief is requested. Special simplified rules apply to "top hat" plans and apprenticeship and training plans. Second, submit to the DFVC Program the required documentation and applicable penalty amount. The plan administrator is personally liable for the applicable penalty amount, and, therefore, amounts paid under the DFVC Program shall not be paid from the assets of an employee benefit plan.

Penalty Structure
Per day penalty. The basic penalty under the program is $10 per day for delinquent filings.

Per filing cap. The maximum penalty for a single late annual report is $750 for a small plan (generally a plan with fewer than 100 participants at the beginning of the plan year) and $2,000 for a large plan.

Per plan cap. This cap is designed to encourage reporting compliance by plan administrators who have failed to file an annual report for a plan for multiple years. The "per plan" cap limits the penalty to $1,500 for a small plan and $4,000 for a large plan regardless of the number of late annual reports filed for the plan at the same time. There is no "per administrator" or "per sponsor" cap. If the same party is the administrator or sponsor of several
plans required to file annual reports under Title I of ERISA, the maximum applicable penalty amounts would apply for each plan.

Small plans sponsored by certain tax-exempt organizations. A special “per plan” cap of $750 applies to a small plan sponsored by an organization that is tax-exempt under IRC section 501(c)(3). The $750 limitation applies regardless of the number of late annual reports filed for the plan at the same time. It is not available, however, if as of the date the plan files under the DFVC Program there is a delinquent annual report for a plan year during which the plan was a large plan.

“Top hat” plans and apprenticeship and training plans. The penalty amount for “top hat” plans and apprenticeship and training plans is $750.

Internal Revenue Service and Pension Benefit Guaranty Corporation Participation

Although the DFVC Program does not cover late filing penalties under the IRC or Title IV of ERISA, the IRS and PBGC agreed to provide certain penalty relief for delinquent Form 5500s filed for Title I plans where the conditions of the DFVC Program have been satisfied.

Questions about the DFVC Program should be directed to EBSA by calling (202) 693-8360. For additional information about the Form 5500 Series, visit the EFAST Internet site at www.efast.dol.gov, or call the EBSA Help Desk toll-free at (866) 463-3278.

DOL Issues Final Rules on Disclosure of Pension Plan “Blackout Periods”

On January 24, 2003, the DOL published final rules implementing a new federal law requiring 401(k) plans to give workers 30-day advance notice of “blackout periods” when their rights to direct investments, take loans, or obtain distributions are suspended. Blackout periods typically occur when plans change recordkeepers or investment options, or add participants due to corporate merger or acquisition.
On July 30, 2002, President Bush signed the Sarbanes-Oxley Act of 2002, giving the Secretary of Labor authority to promulgate rules and a model notice implementing the blackout notice provisions. The act requires that participants and beneficiaries be given a 30-day advance notice of a blackout period. When a blackout period affects a plan that includes employer stock as an investment option, the plan must also notify the corporate issuer of the employer stock so that corporate insiders are aware that they may not trade employer securities or exercise options during the blackout. The law is effective for blackout periods occurring on or after January 26, 2003.

Under these rules, 401(k) plan administrators must provide blackout notices that contain the reasons for the blackout, a description of the workers' rights that will be suspended, the start and end dates of the blackout period, and a statement advising workers to evaluate their current investments based on their inability to direct or diversify assets during the blackout period.

Failure or refusal to provide the required notice may result in civil penalties of up to $100 per day per participant.

The rules may be viewed at www.dol.gov/ebsa under Laws and Regulations.

**Fiduciary Responsibility Under ERISA Automatic Rollover Safe Harbor**

On March 2, 2004, the DOL announced a proposed rule that provides guidance on how employers and financial institutions can implement the new requirement that retirement plan distributions between $1,000 and $5,000 be automatically rolled over into an individual retirement plan unless the worker directs otherwise. By following the terms of the regulation, employers will meet their fiduciary responsibility for choosing the IRA or annuity provider and investment of the funds.

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) requires that certain distributions of retirement plan benefits of $1,000 to $5,000 be automatically rolled over into an individual retirement plan when a separated worker fails
to elect a distribution method. The proposed regulation protects retirement plan fiduciaries from liability under ERISA by providing a safe harbor in connection with two aspects of the automatic rollover process—the selection of an institution to provide the individual retirement plans and the selection of investments for such plans.

In order to obtain relief under the safe harbor, plan fiduciaries must satisfy certain conditions. Among others, these relate to the types of institutions that are qualified to offer individual retirement plans, the investment products in which funds can be invested, and the limitations on the fees and expenses that may be assessed against the individual retirement plan funds.

The DOL is also proposing a class exemption. The proposed exemption would enable certain plan sponsors to use their own services and products in connection with rollovers from their own retirement plan.

Further information and the text of the proposed regulation are available on the EBSA Web site at www.dol.gov/ebsa under Proposed Rules.

**EBSA's Orphan Plan Project**

EBSA has an ongoing enforcement project aimed at locating pension plans, particularly 401(k) plans, which have been abandoned by fiduciaries through death, neglect, bankruptcy, or incarceration and to determine if a fiduciary could be located to perform fiduciary functions such as terminating the plan, distributing the plan's assets, and filing appropriate financial reporting forms such as the final annual report.

In the event that no fiduciary is located, EBSA takes an active role in the appointment of an independent fiduciary so that participants and beneficiaries can receive their earned benefits. The orphan plan initiative assists at-risk populations, specifically those participants who are in danger of losing some or all of their retirement savings. In many orphan plan situations, fiduciaries have deserted the plan and effectively abdicated their responsibilities. As a result, participants are unable to exercise any rights they
may have under the plan; plan assets are not being actively managed; individual participant accounts may not be credited accurately; and reports required to be filed are not prepared.

EBSA works with other federal agencies including the IRS and PBGC to help both individuals and financial institutions who may wind up as caretakers of orphan plans by default by streamlining the process of plan termination and distribution of assets.

EBSA is also reviewing the recommendations of an ERISA Advisory Council report on orphan plans. The agency is hoping to accomplish many of the objectives laid out by the Advisory Council through the regulatory process rather than legislation. A proposed regulation would establish procedures and standards for distributing benefits from individual account plans that have been abandoned by their fiduciaries. EBSA is working with the IRS to address the tax issues that arise in these cases as well.

Information regarding this national enforcement project may be found on the EBSA’s Web site at www.dol.gov/ebsa.

The DOL Continues to Issue New Field Assistance Bulletins

In the course of audits and investigations by EBSA field enforcement staff, difficult legal issues often arise. In an effort to provide the regional office staff with prompt guidance, EBSA has developed a vehicle for communicating technical guidance from the national office. Field Assistance Bulletins (FAB) ensure that the law is applied consistently across the various regions. They also provide the regulated community with an important source of information about the agency’s views on technical applications of ERISA. All FABs are posted on EBSA’s Web site and available to the public.

Compliance assistance is a top DOL priority, and the FABs are the next step in EBSA’s continuing compliance assistance program to educate and assist employers, plan officials, service providers, and others in achieving and maintaining compliance with ERISA. FABs are available at www.dol.gov/ebsa under Compliance Assistance. The following is a summary of FABs that have been issued:
• *Field Assistance Bulletin 2002-1*—Addresses the fiduciary considerations involved with the refinancing of an ESOP loan under section 408(b)(3) of ERISA.

• *Field Assistance Bulletin 2002-2*—Addresses whether the trustees of two related multiemployer plans were subject to ERISA's fiduciary standards when they amended the plan's trust agreements.

• *Field Assistance Bulletin 2002-3*—Addresses the fiduciary considerations regarding the use of agreements in which the service provider retains the “float” on plan assets.

• *Field Assistance Bulletin 2003-1*—Addresses the issue of whether corporate directors and officers may be denied participant loans that might violate securities laws when ERISA requires that such loans be made available to all participants on a reasonably equivalent basis.

• *Field Assistance Bulletin 2003-2*—Considers the application of EBSA's participant contribution requirements to multiemployer defined contribution pension plans.

• *Field Assistance Bulletin 2003-3*—Addresses the issue of which rules apply to how expenses are allocated among plan participants in a defined contribution pension plan.

**Timeliness of Remittance of Participant Contributions Remains an Enforcement Initiative for the EBSA**

The EBSA continues to focus on the timeliness of remittance of participant contributions in contributory employee benefit plans. Participant contributions are plan assets on the earliest date that they can reasonably be segregated from the employer's general assets, but in no event later than (1) for pension plans, the 15th business day of the month following the month in which the participant contributions are withheld or received by the employer, and (2) for welfare plans, 90 days from the date on which such amounts are withheld or received by the employer.
Reporting of Late Remittances

Failure to remit or untimely remittance of participant contributions constitutes a prohibited transaction under ERISA section 406, regardless of materiality. Such transactions constitute either a use of plan assets for the benefit of the employer or a prohibited extension of credit. In certain circumstances, such transactions may even be considered an embezzlement of plan assets.

Information on all delinquent participant contributions should be reported on line 4a of either Schedule H or Schedule I of the Form 5500 regardless of the manner in which they have been corrected. In addition, plan administrators should correct the prohibited transaction with the IRS by filing a Form 5330 and paying any applicable excise taxes.

Beginning with the 2003 Form 5500, information on delinquent participant contributions is no longer required to also be reported on line 4d of Schedule G. For large plans that are subject to the audit requirement:

- Delinquent participant contributions reported on line 4a that constitute prohibited transactions (excluding those that have been corrected under the VFCP and for which the conditions of PTE 2002-51 have been satisfied, as described below) should be reported on a separate supplemental schedule to be attached to the Form 5500 and reported on by the IQPA.

- ERISA and DOL regulations require additional information to be disclosed in supplemental schedules. Some of this information is required to be covered by the auditor’s report. SAS No. 29, Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents (AICPA, Professional Standards, vol. 1, AU sec. 551), as amended, provides guidance on the form and content of reporting when the auditor submits a document containing information accompanying 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 (1) express a qualified opinion or an adverse opinion on the supplemental schedule if the transaction is material to the financial statements or (2) 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 EBP Guide for further discussion of prohibited transactions.

Plan officials faced with remitting delinquent participant contributions should consider applying to the DOL's Voluntary Fiduciary Correction Program (VFCP). Plans that fully comply with the program, including satisfaction of the conditions of Prohibited Transaction Exemption (PTE) 2002-51:

- Will receive a "No-Action Letter" issued by the DOL that provides for no imposition of section 502(l) penalties
- Receive relief from the excise tax provisions of the Internal Revenue Code
- Continue to report the occurrence and amount of the corrected delinquent remittances on line 4a of either Schedule H or Schedule I (but not on line 4d or Schedule G)
- Are not required to report such transactions as supplemental information if the plan is required to be audited since the transactions are not considered to be prohibited transactions

The EBSA's Web site, www.dol.gov/ebsa, contains useful information about the VFCP, including a Fact Sheet, a FAQ section, and a Sample No-Action Letter.

**Reporting of Delinquent Loan Repayments**

Generally speaking, participant loan repayments are not subject to the DOL's participant contribution regulation (29 C.F.R. sec. 2510.3-102). Accordingly, their delinquent remittance is not reported on line 4a of either Schedule H or Schedule I. However, delinquent remittance of participant loan repayments is a prohibited transaction.
In Advisory Opinion 2002-2A, the DOL concluded that, while not subject to the participant contribution regulation, participant loan repayments paid to or withheld by an employer for purposes of transmittal to an employee benefit plan are sufficiently similar to participant contributions to justify, in the absence of regulations providing otherwise, the application of principles similar to those underlying the final participant contribution regulation for purposes of determining when such repayments become assets of the plan. Specifically, the Advisory Opinion concluded that participant loan repayments paid to or withheld by an employer for purposes of transmittal to the plan become plan assets as of the earliest date on which such repayments can reasonably be segregated from the employer's general assets.

Delinquent forwarding of participant loan repayments is eligible for correction under the VFCP and PTE 2002-51 on terms similar to those that apply to delinquent participant contributions.

For questions or further information, contact the Office of Regulations and Interpretations at the DOL at (202) 693-8500 or the EBSA's Web site at www.dol.gov/ebsa.

Audit Issues

Auditing Health and Welfare Plans

In recent years, health and welfare plans have become more complex, more expensive, and more difficult to administer. Health care inflation, particularly in the area of prescription drugs, is rampant with no apparent end in sight, and the ultimate impact of the recent Medicare prescription benefit legislation is yet to be determined. The administration of health claims has always been complicated and now new requirements for more timely claims processing, appeal decisions, and the privacy requirements under HIPAA have added to these complexities. Due to the intricacies in the health care industry and the sheer magnitude of the dollars involved, trustees, administrators, and others involved have been and continue to be concerned with health and welfare fraud. SAS No. 99, Consideration of Fraud in a Financial Statement Audit (AICPA, Professional Standards, vol. 1, AU sec. 316), is the pri-
mary source of authoritative guidance about an auditor's responsibilities concerning the consideration of fraud in a financial statement audit.

When using standard audit programs for employee benefit plans, those programs should be tailored to the unique nature of health and welfare plans. The following paragraphs describe certain of these unique areas and include suggested audit procedures.9

**Understanding Health and Welfare Plans**

Before performing a health and welfare plan audit, it is critical for the auditor to establish a clear understanding of the plan. The audit requirement is of the plan, not the trust. Therefore, before conducting each audit, the auditor needs to understand the benefits offered by the plan. For those benefits offered, the auditor should consider the following:

- Which benefits are insured versus self-insured
- For self-insured benefits—who the providers are and the elements of the contractual arrangement with the plan
- For self-insured claims—how the various claims are administrated and adjudicated, and how fees are charged
- What information systems are used to support the plan operations, and which of those are in-house systems or outsourced

When answering these questions, the auditor should consider the responses with regard to all covered participants (that is, active, COBRA, retirees, and so on). Understanding areas such as the various benefits offered, the providers, and the control environment are key to developing the audit approach and the sampling methodology.

**Rebates Receivable**

If there are rebates receivable from a service provider, those rebates should be examined to determine if the correct amount for the ap-

9. Some of the audit procedures noted may be more than what is required by generally accepted auditing standards (GAAS).
appropriate periods of time has been reflected in the proper period. In addition, the auditor should gain an understanding of the service contracts and apply procedures to determine if all rebates have been received by the plan. These include rebates from prescription drug programs or excess premiums paid over claims incurred under certain contractual arrangements with insurance companies.

**Contracts With Benefit Service Providers**

For any contracts the plan has with a benefit service provider, the reconciliation of the amounts due to or from the benefit service provider should be examined to determine if the amounts are appropriate. Any amounts due from the benefit provider should be classified as a receivable in the statement of net assets, and amounts due to the provider would normally be shown in the financial statements with the other benefit obligations of the plan.

**Claims Payable and Incurred But Not Reported (IBNR)**

Plan auditors should be aware of industry trends for purposes of assessing the reasonableness of significant estimates, including incurred but not reported (IBNR) claims. The obligation established for IBNR may be declining for plans that do not cover retirees. Often a large component of the amount calculated for IBNR is for prescription drugs. Information technology advances by prescription benefit managers and dispensing pharmacies has led to a reduction of the time between the dispensing date and the billing date to the plan. This would cause IBNR to decrease. If the plan has retirees, the IBNR obligation may still be increasing because of coordination issues with insurance carriers.

**Accumulated Eligibility Credits**

Many plans cover participants when they are terminated or otherwise unemployed. Single employer plans often cover up to 30 days after employment ends. Multiemployer plans can cover up to 60 days or longer after employment ends. In the construction industry where work is seasonal, hour banks are often used to provide insurance coverage for the months when the participant does not work. If the plan permits accumulated eligibility credits, there should be an obligation calculated for those credits. The au-
ditor should determine whether the plan provides for accumulated eligibility credits and should determine if the obligation has been properly calculated and disclosed in the financial statements in accordance with paragraph 23 of SOP 01-2.

**Actuarial Data and Census Information**

The actuarial data and census information furnished by the health and welfare plan sponsor to the actuary, especially when the plan covers retirees, is as important as the data used in a defined benefit pension plan. The auditor should gain assurance through confirmation or other audit procedures to ensure that the actuarial data and census information furnished to the actuary is complete and accurate.

**Allocation of Expenses**

In multiemployer plans or large employers, the health and welfare plan often shares office space, employees, and other expenses with the sponsoring organization or with other plans. The allocation of expenses shared by these organizations should be made on a logical and systematic basis. No plan should pay more than its fair share of expenses. The auditor should review the allocation to ensure that it is reasonable and current. An allocation methodology calculation that is over three years old could be outdated and may need to be revised.

**HIPAA Privacy Concerns**

Auditors must have access to claims information as part of their normal audit process to render an opinion on the health and welfare plan's financial statements. Most claims processors have required signed business associate agreements with the auditors, allowing the auditors access to claim information for the plan. A third-party administrator acting as a claims processor may still limit access to claim files because claims information for other plans is stored in the same area. Auditors should also exercise caution regarding the contents and retention practices of their client files to ensure compliance with the business associate agreement.
SAS No. 70 Concerns

Many health and welfare plans utilize the services of outside claims processors or of third-party administrators (TPA) who process claims. A typical audit procedure utilized in this situation is for the auditor to obtain a type 2 SAS No. 70 report from the service provider or the TPA. A type 2 SAS No. 70 report can be used to reduce the amount of detailed substantive testing. (See the “Analytical Procedures” section of this Audit Risk Alert for a discussion of analytical procedures used as substantive tests.)

About Health and Welfare Claims

The auditor should have a basic understanding of the plan and have the skill and knowledge to test that claims are being properly adjudicated. It is not expected that the auditor would have the knowledge of a skilled billing claims specialist or a skilled medical specialist when claims are processed by a TPA. The auditor should be aware, however, of the typical problems that a health and welfare plan might experience when processing claims. These problems may include:

- Unbundling (charging for performance of multiple procedures when only one procedure was performed)
- Upcoding (charging for a higher level of service than the procedure actually performed)
- Fictitious services by service providers
- Performance of unnecessary services
- Duplicate claims
- Duplicate coverage
- Kickbacks
- Nontransmittal of rebates and discounts
- Abuse
- Ineligibility
The auditor should be aware of any processing problems with claims that the plan is encountering and should discuss with the plan administrator and others what the plan is doing to confront these issues. See Appendix C of this Audit Risk Alert for claims testing information.

What types of errors does the auditor find in testing health and welfare claims? The errors typically found include:

1. **Eligibility.** Testing for eligibility is relatively straightforward. Most problems with eligibility relate to a participant who terminates and whose eligibility ceased before the date of service for which the claim was filed.

2. **Wrong individual.** The claim was paid for the wrong person. This occurs when two or more participants have the same or similar names. Claims are also paid for the wrong family member.

3. **Other errors** in the diagnosis code, the CPT/HCPCS\(^{10}\) code, or errors in the information in the claims form.

### The Health Insurance Portability and Accountability Act

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) established standards for the privacy and protection of individually identifiable electronic health information as well as administrative simplification standards. HIPAA includes protection for those who move from one job to another, who are self-employed, or who have preexisting medical conditions, and places requirements on employer-sponsored group health plans, insurance companies, and health maintenance organizations.

In December 2000 the final rules on standards for privacy of individually identifiable health information were published in the *Federal Register*. The rules include standards to protect the privacy of individually identifiable health information. The rules (applicable...

\(^{10}\) Physicians' Current Procedural Terminology (CPT) is a listing of descriptive terms and identifying five-digit codes for reporting medical services and procedures. The Health Care Financing Administration (HCFA) developed level II and level III codes in its Healthcare Common Procedure Coding System (HCPCS codes) to bill for supplies and services not covered by a CPT code (level I).
able to health plans, health care clearinghouses, and certain health care providers) present standards with respect to the rights of individuals who are the subjects of this information, procedures for the exercise of those rights, and the authorized and required uses and disclosures of this information. These are the first-ever national standards to protect medical records and other personal health information.

Privacy Concerns

In response to this regulation, many claim processors have updated and instituted a variety of confidentiality, indemnification, or business associates agreements to protect their organizations when third parties request claim information. In certain instances the auditor has been willing to sign such contracts but the third-party administrator has interpreted the new HIPAA regulations to not allow outside auditors access to the detailed claims information. However, some believe that as long as the health information is protected by a privacy contract signed by the auditor, the third-party administrator should provide access to a plan's claim information to enable the auditor to perform an audit of the plan's financial statements to be attached to the Form 5500 filing with the DOL.

If asked to sign such confidentiality, indemnification, or business associates agreements, auditors need to take special care in reviewing these agreements. Often the auditor may not agree with certain language in the agreement, resulting in delays in the audit while mutually agreeable language is determined. Many of the representations are very broad. The agreements generally require that the auditor hold the claim processor harmless from any actual or threatened action arising from the release of information without limitation of liability. In addition, the agreements may require the auditor to hold the client harmless as well. This last indemnification will most likely contradict provisions in the engagement letter between the auditor and the client. Auditors need to keep in mind that the testing of claims at a third-party administrator could be delayed as a result of the request to sign such an agreement and should plan the timing of the audit accordingly. Before entering into any confidentiality agreements, the agree-
ment should be reviewed by the auditor's legal counsel. If the auditor is unable to obtain access to records as a result of not signing a confidentiality agreement, or a third-party administrator's refusal to provide access under any circumstances, a scope limitation could result.

On February 20, 2003, the security rules under HIPAA were finalized. The rules are effective for most health plans on April 21, 2005 (small health plans, as defined, will have until April 21, 2006, to comply).

**Consideration of Fraud in Employee Benefit Plan Engagements**

SAS No. 99, *Consideration of Fraud in a Financial Statement Audit*, is the primary source of authoritative guidance about an auditor's responsibilities concerning the consideration of fraud in a financial statement audit. SAS No. 99 establishes standards and provides guidance to auditors in fulfilling their responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud. SAS No. 99 was effective for audits of financial statements for periods beginning on or after December 15, 2002.

**Practical Guidance**

The AICPA Practice Aid *Fraud Detection in a GAAS Audit, Revised Edition* (Fraud Practice Aid, product no. 006615kk) provides a wealth of information and can help in complying with the provisions of SAS No. 99. Moreover, this Practice Aid will assist auditors in understanding the requirements of SAS No. 99 and whether current audit practices effectively incorporate these requirements. This Practice Aid is an *Other Auditing Publication* as defined in SAS No. 95, *Generally Accepted Auditing Standards* (AICPA, *Professional Standards*, vol. 1, AU sec. 150). Other auditing publications have no authoritative status; however, they may help the auditor understand and apply SASs.

The Practice Aid states that the changes in SAS No. 99 required more work in every audit in both identifying and responding to
the risk of material misstatement due to fraud. Changes effected by SAS No. 99 include:

- A required brainstorming session among the audit team members to discuss the potential for material misstatement due to fraud.
- An increased emphasis on inquiry as an audit procedure that increases the likelihood of fraud detection.
- Expanded use of analytical procedures to gather information used to identify risks of material misstatement due to fraud.
- The consideration of other information, such as client acceptance and continuance procedures, during the information-gathering phase.
- Expanded guidance on evaluating information obtained and identifying the risks that may result in a material misstatement due to fraud.
- The presumption that improper revenue recognition is a fraud risk in all entities. For employee benefit plans, this risk is primarily related to investment income resulting from inappropriate investment valuation. For multiemployer plans, the auditor should consider whether employers are motivated to understate the employer contributions due.
- Mandate of certain audit responses on every audit engagement. These responses are designed to specifically address the risk of management override over internal controls.
- Requirements for the auditor to take into account an evaluation of the entity’s programs and controls that address the identified fraud risks.

The Importance of Exercising Professional Skepticism

Because of the characteristics of fraud, the auditor’s exercise of professional skepticism is important when considering the risk of material misstatement due to fraud. Professional skepticism is an attitude that includes a questioning mind and a critical assess-
ment of audit evidence. The auditor should conduct the engagement with a mindset that recognizes the possibility that a material misstatement due to fraud could be present, regardless of any past experience with the entity and regardless of the auditor’s belief about management’s honesty and integrity. Furthermore, professional skepticism requires an ongoing questioning of whether the information and evidence obtained suggests that a material misstatement due to fraud has occurred.

The Required Brainstorming Session

According to the Fraud Practice Aid, there are two primary objectives of the brainstorming session. The first objective is that the engagement team should gain a good understanding of:

- Information that experienced team members have about their experiences with the client
- How fraud might be perpetrated and concealed at the entity
- The procedures the team might perform to detect any material misstatement that results

The second objective is to set the proper “tone at the top” for conducting the audit. The senior members of the team need to convey the need to conduct the audit utilizing a proper level of professional skepticism and to remind everyone on the team that the possibility of fraud does exist in every engagement. See the Fraud Practice Aid for further guidance.

Underfunded Pension Plans

Many companies across all industries are facing a mounting crisis—underfunded pension plans. Simply put, many companies have defined benefit plans in which the obligations owed to retirees exceed the assets in the plans. These companies are faced with making large contributions to those plans to meet legal requirements and make up the shortfall. The current shortfall in many of the nation’s pension plans may become a major crisis. So many pension plans are failing that the PBGC, the agency that insures and bails out corporate pension plans, is facing growing deficits and an increasingly precarious financial position.
Reasons for the Pension Plan Shortfalls
The volatility in pension costs results from changes in the discount rates, changes in the fair value of plan assets, and differences between actual and anticipated experience of the plan. Although the market has improved in recent months, there has been an increase in underfunded plans due to declines in the discount rate and the decline in prior year's stock market results.

Impact on Plan Sponsor
The impact on a plan sponsor's financial statements has been an increase in pension expense and in many cases the need to record an additional minimum liability in accordance with FASB Statement No. 87, Employers' Accounting for Pensions. Accordingly, information about pension costs has received increased attention. In an effort to provide the public with better and more complete information about pensions, the FASB reissued Statement No. 132, Employers' Disclosures about Pensions and other Postretirement Benefits (revised 2003) (FASB Statement No. 132R). Although FASB Statement No. 132R is not new, it has been amended to require companies to provide more details about their plan assets, benefit obligations, cash flows, benefit costs, and other relevant information. The additional disclosures are effective for fiscal years beginning after December 15, 2003, and quarters beginning after the same date.

Cash-Balance Plan Developments to Watch
Many companies have switched their defined benefit plans to cash-balance plans. Now two federal court rulings have cast serious doubt on the future viability of cash-balance plans. The courts declared that the companies violated age discrimination laws and miscalculated payouts. These rulings are being appealed. If the appeals fail, cash-balance plans may become illegal and abandoned by companies. The FASB is undertaking a project to specifically define cash-balance plans. After the definition project is complete, which is expected by the end of 2004, the FASB will address related measurement issues.
Congress continues to debate and reconcile the replacement of the 30-year Treasury rate used for purposes of defined benefit plan funding. A temporary rate expired at the end of 2003. Emerging Issues Task Force (EITF) Issue No. 03-4, *Determining the Classification and Benefit Attribution Method for a 'Cash Balance' Pension Plan*, contains some accounting guidance on these plans, but the Issue is still open and only parts of it have been ratified.

**Common Audit Concerns**

The following lists specific areas often overlooked and which auditors should pay particular attention to when auditing employee benefit plans.

**Eligible Compensation**

Plan documents specify the various aspects of compensation (for example, base wages, overtime, and bonuses) that are considered in the calculation of plan contributions for defined contribution plans and in the determination of benefits in a defined benefit plan. Testing of payroll data should address the determination of eligible compensation for individual employees and comparison of the definition of eligible compensation used in the calculation to the plan document. Since this process is generally not included in the payroll testing of the plan sponsor or in type 2 SAS No. 70 reports, a comparison of eligible compensation per the plan document to eligible compensation used in plan operations is required.

**Payroll Data**

Reliance is often placed on testing of payroll performed in conjunction with a corporate audit; however, these procedures, which generally include only high level analytics with limited or no documentation of the control environment or performance of substantive procedures, are not sufficient to satisfy the payroll testing requirements. Often payroll processing is outsourced to an outside service provider that may have a SAS No. 70 type 1 report, which provides a description of procedures and controls, but does not have a SAS No. 70 type 2 report, which also in-
cludes testing of the procedures and controls, and can be used to reduce the scope of substantive testing. Paragraph 10.05 of the EBP Guide describes procedures the auditor should consider to test payroll in conjunction with the plan audit.

Service Organizations and SAS No. 70 Reports
Most employee benefit plans use service organizations (for example, bank trustees, insurance companies, or benefits administrators) to process transactions and maintain plan records. Often SAS No. 70 type 2 reports are obtained and used by the auditor to reduce the amount of substantive testing required. Auditors often do not perform or document their evaluations of the extent of the evidence provided by the report regarding the effectiveness of controls for particular financial statement assertions and of its effect on audit strategy, including determination of the nature, timing, and extent of substantive tests for particular audit objectives. An evaluation of user organization controls that are contemplated in the design of the service organization’s controls and recommended in the service organization’s description of controls in the SAS No. 70 report should also be performed.

For service organizations that do not issue a current type 2 SAS No. 70 report, the working papers should contain sufficient documentation of the auditor’s understanding of the control environment at the service organization and the results of the auditor’s evaluation of the effectiveness of control policies and procedures sufficient to support the planned reliance approach. See Chapter 6 of the EBP Guide for further discussion of internal controls.

Understanding Investments
Plan investments represent the majority of assets held by a benefit plan. Benefit plans invest in a wide variety of investments and investment vehicles, some of which are not easily identified by review of the investment trust statements. It is important for auditors to gain an understanding of the types of investments the plan holds to determine the proper auditing procedures and accounting and reporting implications. This understanding can be obtained through (1) discussions with plan management,
investment advisers, or custodian or trustees, and (2) reviews of investment agreements, minutes of investment committee meetings, and other documentation. Chapter 7 of the EBP Guide provides a description of various investments and related audit procedures. (See the “Investments” section of this Audit Risk Alert for further guidance.)

Limited Versus Full-Scope Audits
Under DOL regulations, certain assets held by a bank, trust company, or similar institution or by a regulated insurance company and related investment information do not have to be audited provided the institution certifies the information. All noninvestment activity of the plan such as participant allocations, contributions, benefit payments, and expenses are subject to audit. See EBP Guide paragraphs 7.63 and 13.26 for limited scope procedures and reporting.

Allocation Testing for Defined Contribution Plans
One of the objectives of auditing procedures applied to individual participant accounts of a defined contribution plan is to provide the auditor with a reasonable basis for concluding whether net assets and transactions have been properly allocated to participant accounts in accordance with the plan documents. Each type of participant account activity during the year (for example, contributions, income allocations, expense allocations, and forfeiture allocations) should be taken into consideration in the determination of auditing procedures. In a limited scope audit, the allocation of investment income to individual accounts is not certified by the trustee or custodian and must be tested by the auditor, taking into consideration reliance on a SAS No. 70 type 2 report, if available. See Chapter 10 of the EBP Guide for further discussion of auditing participant data.

Self-Directed Investments—The DOL’s Alternative Method of Reporting Participant-Directed Brokerage Window Investments
Plan sponsors of participant-directed defined contribution plans continue to allow participants to expand their control over in-
vestment decisions, through self-directed investments, sometimes referred to as self-directed brokerage accounts. These features allow participants to select any investment they choose without oversight from the plan administrator or investment committee. The only limitation is the availability of the desired investment through the plan's service provider, which generally is a securities broker-dealer or is a broker-dealer that has an alliance with the plan's service provider. The self-directed feature is often in addition to a more traditional array of risk diverse mutual funds and other investment option choices. Often plan sponsors may charge participants' fees to provide this investment feature and may also require a minimum balance to be invested.

While self-directed accounts should be viewed as individual investments for auditing and reporting purposes, the instructions to Form 5500, Schedule H, “Financial Information,” permit aggregate reporting of certain self-directed accounts (also known as participant-directed brokerage accounts) on the Form 5500 and related schedule of assets.

For Form 5500 reporting, investments made through participant-directed brokerage accounts may be reported as a single line item on the Schedule H of the Annual Return/Report Form 5500 rather than by type of asset on the appropriate line item for the asset category (in Parts I and II of Schedule H), for example, common stocks and mutual funds, provided the assets are not:

- Loans
- Partnership or joint-venture interests
- Real property
- Employer securities

11. This is different from participant-directed investment fund options. Participant-directed investment fund options allow the participant to select from among various available alternatives and to periodically change that selection. The alternatives are usually fund vehicles, such as registered investment companies (that is, mutual funds); commingled funds of banks; or insurance company pooled separate accounts providing varying kinds of investments, for example, equity funds and fixed income funds.
• Investments that could result in a loss in excess of the account balance of the participant or beneficiary who directed the transaction

This Form 5500 reporting creates an issue with investment reporting in plan financial statements because GAAP requires certain reporting and disclosures. The following table summarizes the differences between the Form 5500 alternative reporting for participant-directed brokerage account investments and GAAP that may raise issues for auditors when obtaining brokerage window investment information.

<table>
<thead>
<tr>
<th>Form 5500—Alternative Reporting</th>
<th>GAAP—Required Reporting and Disclosures</th>
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<tr>
<td>• Certain investments and related income (see above) made through participant-directed brokerage accounts may be shown as single line items on Schedule H.</td>
<td>• Identification of investments representing 5 percent or more of plan net assets in the plan's footnotes. (See paragraph 3.28g of the EBP Guide.)</td>
</tr>
<tr>
<td>• Certain investments listed on the Schedule of Assets (Held at End of Year) may be shown as a single line item.</td>
<td>• Reporting of investment income, exclusive of changes in fair value, in the statement of changes in net assets or the footnotes. (See paragraph 3.28b of the EBP Guide.)</td>
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<td></td>
<td>• Reporting of net appreciation/depreciation by investment type in the plan's footnotes. (See paragraph 3.25a of the EBP Guide.)</td>
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In addition, plan auditors may experience difficulty in obtaining brokerage window investment information by individual investment categories (such as common stocks and mutual funds) and brokerage window investment income (such as net appreciation/depreciation by type) from plan service providers. In plans subject to the limited scope audit provisions of ERISA, the investment certification may provide investment amounts only in total, not for the individual investments. However, brokerage window investments are not considered a fund or a pooled separate account subject to other reporting requirements. Individual investment information is needed by plan administrators and auditors for the valuation of investment assets in the plan and for audit testing.
and disclosure purposes in accordance with GAAP and GAAS. Therefore, it is important for plan administrators, recordkeepers, and service providers to maintain these records for audit and financial reporting purposes.

Help Desk—Auditors should note that when a SAS No. 70 report is available, often it does not cover the self-directed investments.

This alternative method of reporting participant-directed brokerage window investments does not relieve fiduciaries from their obligation to prudently select and monitor designated plan investment options and brokers.

**Analytical Procedures**

SAS No. 56, *Analytical Procedures* (AICPA, *Professional Standards*, vol. 1, AU sec. 329), as amended, provides guidance on the use of analytical procedures and requires the use of analytical procedures in the planning and overall review stages of all audits.

Analytical procedures are used for the following purposes:

1. To assist the auditor in planning the nature, timing, and extent of other auditing procedures
2. As a substantive test to obtain evidential matter about particular assertions related to account balances or classes of transactions.
3. As an overall review of the financial information in the final review stage of the audit.

Analytical procedures should be applied to some extent for the purposes referred to in 1 and 3 above for all audits of financial statements made in accordance with GAAS. In addition, in some cases analytical procedures can be more effective or efficient than tests of details for achieving particular substantive testing objectives.

**Analytical Procedures in Planning the Audit**

For planning purposes, these procedures should focus on (1) enhancing the auditor's understanding of the plan and the transac-
tions and events that have occurred since the last audit date, and (2) identifying areas that may represent specific risk relevant to the audit. These procedures can help to identify such things as the existence of unusual transactions and events, and amounts, ratios, and trends that might indicate matters that have financial statement and audit planning ramifications.

The following are examples of analytical procedures that the auditor may find useful in planning an audit of an employee benefit plan:

- Comparison of investment balances and rates of return with prior-period amounts.
- Analysis of changes in contributions and benefit payments during the current period based on statistical data (for example, number of participants eligible to receive benefits in the current period, number of terminations).

Analytical Procedures Used as Substantive Tests

The auditor’s reliance on substantive tests to achieve an audit objective related to a particular assertion may be derived from tests of details, from analytical procedures, or from a combination of both. The decision about which procedures to use to achieve a particular audit objective is based on the auditor’s judgment on the expected effectiveness and efficiency of the available procedures.

The auditor considers the level of assurance, if any, he or she wants from substantive testing for a particular audit objective and decides, among other things, which procedure, or combination of procedures, can provide that level of assurance. For some assertions, analytical procedures are effective in providing the appropriate level of assurance. For other assertions, however, analytical procedures may not be as effective or as efficient as tests of details in providing the desired level of assurance.

The expected effectiveness and efficiency of an analytical procedure in identifying potential misstatements depends on, among other things, (1) the nature of the assertion, (2) the plausibility and predictability of the relationship, (3) the availability and reli-
ability of the data used to develop the expectation, and (4) the precision of the expectation.

Documentation of Substantive Analytical Procedures

When an analytical procedure is used as the principal substantive test of a significant financial statement assertion, the auditor should document all of the following:

1. The expectation, where that expectation is not otherwise readily determinable from the documentation of the work performed, and factors considered in its development

2. Results of the comparison of the expectation to the recorded amounts or ratios developed from recorded amounts

3. Any additional auditing procedures performed in response to significant unexpected differences arising from the analytical procedure and the results of such additional procedures

See SAS No. 56, as amended (AU sec. 329), for further guidance.

Examples of Analytical Procedures Used as Substantive Tests in Employee Benefit Plan Engagements

- Investments. Investments balances may fluctuate during the year based on changes in (1) investment strategy resulting from management decisions (or resulting from participant decisions in the case of a defined contribution participant directed plan), (2) market trends, or (3) other plan changes (for example, merger or termination). Once the auditor understands what type of changes have occurred, an expectation can be developed.

Review market trends for similar types of investments and determine expectations based on plan activity (level of contributions or distributions) taking into account plan changes.

Oftentimes the recordkeeper or investment manager prepares quarterly investment return reports which can be used to assist in developing an expectation. In addition, bench-
marks for yields and total return can be obtained for asset classes or specific investments (for example mutual funds).

- **Participant contributions.** Review the prior year Form 5500 to determine the participant headcount in the plan. Obtain the total contribution balance for the prior year, and divide this amount by the participant headcount to determine an average participant contribution amount for the prior year. Determine (1) the growth or decline of participants for the current year, (2) changes in contribution rates (for example plan amendments and so on), and (3) pay increases. Calculate current year contribution amount using last year's average contribution amount and this year's headcount taking into account any changes in contribution rates or pay increases.

**Participant Contributions Example:**

Prior year headcount per the Form 5500 = 130 people

Prior year participant contributions balance = $401,828

Prior year “average” participant contribution = $401,828/130 = $3,091

Per discussion with management, during the current year, due to significant layoffs in the Company, only 50 people remain actively contributing in the Plan. No pay increases took effect during the year. Therefore, we would expect total participant contributions to be:

$3,091 \times 50 \text{ people} = $154,549 \text{ expected contribution}

Oftentimes the recordkeeper prepares quarterly reports which include headcount and contribution rate information which can be used to assist in developing an expectation.

- **Claims.** Determine number of claimants receiving claims in the prior year and the average claim per participant. Determine the number of claims during the year. Apply the average claim per participant to the expected number of claimants taking into account plan amendments, individual large claims, stop loss insurance coverage, or the health care cost trend rate increase.
Oftentimes the TPA prepares quarterly reports which include headcount and claim information which can be used to assist in developing an expectation.

- **Payroll.** Develop an expectation for current year gross wages using prior year gross wages taking into account change in number of employees, average percentage pay increases, and addition and termination of highly compensated employees.

**Limited-Scope Audits**

ERISA section 103(a)(3)(c) allows the plan administrator to instruct the auditor not to perform any auditing procedures with respect to investment information prepared and certified by a bank or similar institution or by an insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency which acts as trustee or custodian. The election is available, however, only if the trustee or custodian certifies both the *accuracy* and *completeness* of the information submitted. Certifications that address only accuracy or completeness, but not both, do not comply with the DOL regulation, and therefore are not adequate to allow plan administrators to limit the scope of the audit. This *limited-scope* audit provision does not apply to information about investments held by a broker-dealer or an investment company. However, some broker-dealers and investment companies have established separate trust companies that will provide a limited-scope certification. The DOL has noted instances where limited-scope audits were performed when the financial institution did not qualify.

In addition, if a limited-scope audit is to be performed on a plan funded under a master trust arrangement or other similar vehicle, separate individual plan certifications from the trustee or the custodian should be obtained for the allocation of the assets and the related income activity to the specific plan.

The limited-scope exemption applies only to the *investment* information certified by the qualified trustee or custodian, and does not extend to participant data, contributions, benefit payments,
or other information whether or not it is certified by the trustee or custodian. Thus, except for the investment-related functions performed by the trustee or custodian, an auditor conducting a limited-scope audit would need to include in the scope of the audit functions performed by the plan sponsor or other third-party service organizations, such as third-party welfare plan claims administrators or third-party savings plan administrators, if circumstances necessitate. The nature and scope of testing will depend on a variety of factors including the nature of the functions being performed by the third-party service organization, whether a SAS No. 70 report that addresses areas other than investments is available, if deemed necessary, and, if so, the type of report and the related results. (See Chapter 6 of the EBP Guide for a discussion of SAS No. 70.) The limited-scope audit exemption is implemented by 29 CFR 2520.103-8 of the DOL’s Rules and Regulations for Reporting and Disclosure under ERISA. The limited-scope exemption does not exempt the plan from the requirement to have an audit. Guidance on the auditor’s report and responsibilities for this type of limited-scope audit is provided in paragraphs 7.63 and 13.25 through 13.29 in the Guide. Exhibit 5-1 in the Guide summarizes the conditions that generally allow for limited-scope audits in decision tree format.

Help Desk—Auditor’s should note that often the certification does not cover participant loans.

**EBSA Guidance on Insurance Company Demutualizations**

During the past few years there have been a number of insurance companies that have demutualized resulting in the insurance contract policyholder receiving demutualization proceeds. On February 15, 2001, EBSA issued a letter regarding alternatives available under the trust requirement of Title I of ERISA with respect to receipt by policyholders of demutualization proceeds belonging to an ERISA-covered plan in connection with the proposed plan of demutualization of an insurance company (the Company).
In its letter, the DOL noted that the application of ERISA's trust requirements would depend on whether demutualization proceeds received by a policyholder constitute plan assets. The DOL stated that, in the case of an unfunded or insured welfare plan in which participants pay a portion of the premiums, the portion of the demutualization proceeds attributable to participant contributions must be treated as plan assets. In the case of a pension plan, or where any type of plan or trust is the policyholder or where the policy is paid for out of trust assets, the DOL stated that all of the proceeds received by the policyholder in connection with the demutualization would constitute plan assets.

Auditors should take care to identify those plans with contracts with insurance companies that have demutualized and ensure that the proceeds are properly recorded as plan assets. Plan sponsors may not be familiar with EBSA's letter regarding alternatives available with respect to receipt by policyholders of demutualization proceeds. In addition, it has been noted that demutualization proceeds are oftentimes deposited into a separate account or trust and may be overlooked in financial reporting for the plan.

**Reporting of Participant Loans on Defined Contribution Plan Master Trust Form 5500 Filings**

The face of Schedule H Form 5500 instructs master trust investment accounts not to complete line 1c(8) participant loans. In practice, many master trusts for defined contribution plans include participant loans as part of their master trust agreement. However, even though these loans may be included as part of the master trust agreement, the Form 5500 instructs the preparer not to include them as part of the master trust assets. Thus, the plan's financial statements would require a supplemental schedule, Schedule of Assets (Held at End of Year), to report participant loans as a nonmaster trust investment. The plan's Form 5500 filing would require the participant loans to be broken out separately from the investment in the master trust on the Schedule H.
Investments

Understanding Investments

Plan investments represent the majority of assets held by a benefit plan. This section helps you gain an understanding of typical investments found in employee benefit plans.

Definitions of Investments

The following list includes investments as defined by the instructions to the Form 5500.

- **Master trust.** A trust for which a regulated financial institution (bank, trust company, or similar financial institution that is regulated, supervised, and subject to periodic examination by a state or federal agency) that serves as trustee or custodian and in which assets of more than one plan sponsored by a single employer or by a group of employers under common control are held.

- **Common/collective trust.** A trust maintained by a bank, trust company, or similar institution, which is regulated, supervised, and subject to periodic examination by a state or federal agency, for the collective investment and reinvestment of assets contributed thereto from employee benefit plans maintained by more than one employer of controlled group of corporations.

- **Pooled separate account.** An account maintained by an insurance carrier, which is regulated, supervised and subject to periodic examination by a state agency, for the collective investment and reinvestment of assets contributed thereto from employee benefit plans maintained by more than one employer of controlled group of corporations.

- **103-12 Entity.** An entity that is not a master trust, common/collective trust, or pooled separate account whose underlying assets include “plan assets” within the meaning of 29 CFR 2510.3-101 of two or more plans that are not members of a related group of employee benefit plans.
• *Registered investment company.* An investment firm which is registered with the SEC and complies with certain stated legal requirements for the collective investment and reinvestment of assets contributed thereto from investors (employee benefit plans and nonemployee benefit plans).

What Are Derivatives? How Do I Audit Them?

Many plan sponsors continue to turn to derivatives as tools to manage the risk stemming from fluctuations in foreign currencies, interest rates, and other market risks, or as speculative investment vehicles to enhance earnings. Derivatives get their name because they derive their value from movements in an underlying\(^{12}\) such as changes in the price of a security or a commodity. Examples of common derivatives include call options, forward foreign exchange contracts, futures contracts, put options, and synthetic guaranteed investment contracts (GICs). Employee benefit plans that use derivatives to manage risk are involved in hedging activities. Hedging is a risk alteration activity that attempts to protect the employee benefit plan against the risk of adverse changes in the fair values or cash flows of assets, liabilities, or future transactions. SAS No. 92, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* (AICPA, Professional Standards, vol. 1, AU sec. 332), provides guidance on auditing investments in debt and equity securities; investments accounted for under Accounting Principles Board (APB) Opinion No. 18, *The Equity Method of Accounting for Investments in Common Stock*; and derivative instruments and hedging activities. Paragraph 7.55 of the EBP Guide discusses the objectives of auditing procedures applied to derivative instruments and related transactions. Paragraph 7.56 discusses the auditing procedures to be applied to derivative instruments and hedging activities.

The unique characteristics of derivatives instruments and securities, coupled with the relative complexity of the related account-

\(^{12}\) Paragraph 2.09 of the Audit Guide *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* defines an underlying as a specific interest rate, security price, commodity price, foreign exchange rate, index of prices, or rates, or other variable. An underlying may be a price or rate of an asset or liability, but it is not the asset or liability itself.
ing guidance, may require auditors to obtain special skills or knowledge to plan and perform auditing procedures. SAS No. 92 is intended to alert auditors to the possible need for such skill or knowledge. Also, see the AICPA Audit Guide *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* for further guidance on auditing such instruments (product no. 012520kk).

Help Desk—Chapter 3 of the AICPA Audit and Accounting Guide *Investment Companies* includes brief descriptions of certain financial instruments that may be helpful when such investments are used by employee benefit plans. Some derivative financial instruments commonly found in employee benefit plans include call options, forward foreign exchange contracts, futures contracts, put options, and synthetic guaranteed investment contracts (GICs). (For more information regarding current accounting and financial reporting for synthetic GICs, see paragraphs 7.45 and 7.47 of the EBP Guide.)

**AICPA Peer Review Developments—Recurring Deficiencies Found in Employee Benefit Plan Audits**

The AICPA, working with EBSA, 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\(^\text{13}\) in its review of employee benefit plans include:

- Inadequate testing of participant data
- Inadequate testing of investments, particularly when held by outside parties

\(^\text{13}\) Taken from the *AICPA 2002/2003 Peer Review Board Oversight Task Force Report and Comments.*
• Inadequate disclosures related to participant-directed investment programs
• Failure to understand testing requirements on a limited-scope engagement
• 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 the financial institution did not qualify for such an exemption
• Inadequate or missing disclosures related to participant data
• Failure to properly report on and/or include the required supplemental schedules relating to ERISA and the DOL

The EBP Guide provides guidance concerning areas where the Peer Review Board noted deficiencies.

**New Auditing and Attestation Guidance**

Presented below is a list of auditing and attestation pronouncements and other guidance issued since the publication of last year’s Alert. For information on auditing and attestation standards and other guidance issued subsequent to the writing of this Alert, please refer to the AICPA Web site at www.aicpa.org/members/div/auditstd/technic.htm and to the PCAOB Web site at www.pcaobus.org (public company audits only). You may also look for announcements of newly-issued standards in *The CPA Letter*, the *Journal of Accountancy*, and the quarterly electronic newsletter, “In Our Opinion,” issued by the AICPA’s Auditing Standards team and available at www.aicpa.org.
<table>
<thead>
<tr>
<th>SAS No. 101</th>
<th>Auditing Fair Value Measurements and Disclosures</th>
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<tr>
<td>SOP 03-2</td>
<td>Attest Engagements on Greenhouse Gas Emissions Information</td>
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<td>(Not applicable to attest engagements on public companies)</td>
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<tr>
<td>Attest Interpretation No. 5 of Chapter 1, “Attest Engagements,” of Statement on Standards for Attestation Engagements (SSAE) No. 10: Attestation Standards: Revision and Recodification (Not applicable to attest engagements on public companies)</td>
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<tr>
<td>“Attest Engagements on Financial Information Included in XBRL Instance Documents”</td>
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<tr>
<td>PCAOB Rule 3100T (Applicable to public company audits only)</td>
<td>All registered public accounting firms are required to adhere to the PCAOB's auditing and related professional practice standards in connection with the preparation or issuance of any audit report for an issuer and in their auditing and related attestation practices</td>
</tr>
<tr>
<td>PCAOB Rule 3200T (Applicable to public company audits only)</td>
<td>In connection with the preparation or issuance of any audit report, a registered public accounting firm and its associated persons shall comply with generally accepted auditing standards as described in SAS No. 95 as in existence on April 16, 2003</td>
</tr>
<tr>
<td>PCAOB Rule 3300T (Applicable to public company audits only)</td>
<td>In connection with an engagement (1) described in the Auditing Standard Board’s (ASB’s) SSAE No. 10, and (2) related to the preparation or issuance of audit reports for issuers, a registered public accounting firm and its associated persons shall comply with the SSAEs and related interpretations and SOPs as in existence on April 16, 2003</td>
</tr>
<tr>
<td>PCAOB Rule 3400T (Applicable to public company audits only)</td>
<td>A registered public accounting firm and its associated persons shall comply with quality control standards as described in (1) the ASB’s Statements on Quality Control Standards as in existence on April 16, 2003, and (2) the AICPA SEC Practice Section’s Requirements of Membership (d), (f) (first sentence), (l), (m), (n)(1), and (o) as in existence on April 16, 2003</td>
</tr>
<tr>
<td>PCAOB Rule 3500T (Applicable to public company audits only)</td>
<td>Interim Ethics Standards</td>
</tr>
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For summaries of the above standards and other guidance, visit the applicable Web site. To obtain copies of AICPA standards and other guidance, contact the Service Center Operations at (888) 777-7077 or go online at www.cpa2biz.com.

**Accounting Developments**

**Sale of Real Estate Investments Held by Employee Benefit Plans**

TPA 6930.05—Sale of Real Estate Investments Held by Employee Benefit Plans and Discontinued Operations

*Inquiry:* Many employee benefit plans invest directly in real estate (for example, a building) that generates rental income and operating expenses for the plan. Generally, these plans are defined benefit plans but certain defined contribution plans may also hold these investments.

Paragraph 41 of FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, provides that a “component of an entity” comprises operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity. A component of an entity may be a reportable segment or an operating segment, a reporting unit, a subsidiary, or an asset group.

Paragraph 42 of FASB Statement No. 144 provides that the results of operations of a component of an entity that either has been disposed of or is classified as held for sale shall be reported in discontinued operations in accordance with paragraph 43 of FASB Statement No. 144 if both of the following are met:

- The operations and cash flows of the component have been (or will be) eliminated from the ongoing operations of the entity as a result of the disposal transaction and
• The entity will not have any significant continuing involvement in the operations of the component after the disposal transaction.

Paragraph 43 of FASB Statement No. 144 states that in a period in which a component of an entity either has been disposed of or is classified as held for sale, the income statement of a business enterprise (or statement of activities of a not-for-profit organization) for current and prior periods shall report the results of operations of the component, including any gain or loss recognized in accordance with paragraph 37 of FASB Statement No. 144, in discontinued operations.

Because employee benefit plans are not specifically scoped out of FASB Statement No. 144, if an employee benefit plan invests in real estate that generates rental income and operating expenses for the plan and then sells that property, is the sale of the real estate investment considered a discontinued operation of the plan?

Reply: No. For many entities, after evaluating the conditions in paragraph 42 of FASB Statement No. 144, an investment in real estate (such as a building) that generates rental income and operating expenses would be considered to meet the definition of a “component of an entity” (as defined in FASB Statement No. 144) and, therefore, any gains or losses relating to the disposal of that “component” would be reported in discontinued operations. However, employee benefit plan financial statements show financial status or net assets available for benefits and changes in financial status or net assets available for benefits. Because they do not show a statement of operations or activities, there is no reason to distinguish between continuing and discontinued operations. Rather, real estate in an employee benefit plan should be treated as an investment carried at fair value and the related income/expenses and net appreciation/depreciation should be included in the statement of changes in financial status or statement of changes in net assets available for benefits. No distinction should be made between continuing and discontinued operations.
Contributions Receivable

Contributions Receivable—Defined Benefit Pension Plans

Many times the funding of the final and possibly additional contributions for defined benefit plans occurs after a plan's year end. Auditors are often unsure of how to treat contributions made after the plan's year end but prior to the filing of the plan's Form 5500. Plan sponsors have until the date the plan sponsor's tax return is due to make contributions and apply them to the previous year.

Guidance for contributions receivable can be found in Chapter 2 and paragraph 8.05 in Chapter 8 of the EBP Guide. Based on this guidance, determining how to treat contributions made after the plan year is as follows: (1) Inquire of the plan sponsor to understand the timing of any additional contributions anticipated to be made after the plan year end that will be included on the plan sponsor's tax return for the year under audit. (2) Prior to issuing the auditor's report, obtain the Form 5500 Schedule B from the actuary to ensure that the contributions reported on Schedule B agree to the amount included in the plan's financial statements and Schedule H. This practice will, in many instances, result in filing the Form 5500 after September 15 for calendar year-end defined benefit pension plans.

In the event that the financial statements and related Form 5500 were already filed and the plan sponsor elects to make an additional contribution related to the year under audit, this additional contribution should be treated as a subsequent event. A footnote should be added to the financial statements including information reconciling the contributions per the financial statements to the Form 5500. The Form 5500 should then be amended and refiled. The auditor's opinion should be dual dated for the subsequent event. Financial statements should not be restated unless an error has occurred. For further guidance, see the EBP Guide paragraphs 12.30 and 12.31.

Contributions Receivable—Health and Welfare Plans

Health and Welfare plans typically pay claims on a pay-as-you-go-basis. Based on this funding policy, a receivable for incurred
but not reported (IBNR) claims is generally not recorded. IBNR claims are an estimate and are not paid until submitted. An argument could be made for recording a receivable for claims payable and premiums payable since these amounts are known and are short-term in nature.

**New Accounting Pronouncements and Other Guidance**

Presented below is a list of accounting pronouncements and other guidance issued since the publication of last year’s Alert. For information on accounting standards issued subsequent to the writing of this Alert, please refer to the AICPA Web site at www.aicpa.org, and the FASB Web site at www.fasb.org. You may also look for announcements of newly issued standards in *The CPA Letter* and the *Journal of Accountancy*.

<table>
<thead>
<tr>
<th>Standard Title</th>
<th>Description</th>
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<tbody>
<tr>
<td>FASB Statement No. 132 (Revised 2003)</td>
<td><strong>Employers’ Disclosures about Pensions and Other Postretirement Benefits</strong></td>
</tr>
<tr>
<td>FASB Interpretation No. 46 (Revised December 2003)</td>
<td><strong>Consolidation of Variable Interest Entities, An Interpretation of ARB No. 51</strong></td>
</tr>
<tr>
<td>SOP 03-1</td>
<td><strong>Accounting and Reporting by Insurance Enterprises for Certain Nontraditional Long-Duration Contracts and for Separate Accounts</strong></td>
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<td>SOP 03-3</td>
<td><strong>Accounting for Certain Loans or Debt Securities Acquired in a Transfer</strong></td>
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<tr>
<td>SOP 03-4</td>
<td><strong>Reporting Financial Highlights and Schedule of Investments by Nonregistered Investment Partnerships: An Amendment to the Audit and Accounting Guide Audits of Investment Companies and AICPA Statement of Position 95-2, Financial Reporting by Nonpublic Investment Partnerships</strong></td>
</tr>
<tr>
<td>SOP 03-5</td>
<td><strong>Financial Highlights of Separate Accounts: An Amendment to the Audit and Accounting Guide Audits of Investment Companies</strong></td>
</tr>
</tbody>
</table>

For summaries of the above standards and other guidance, visit the applicable Web site. To obtain copies of AICPA standards and other guidance, contact the Service Center Operations at (888) 777-7077 or go online at www.cpa2biz.com.
Audit and Accounting Guide Revisions as of March 1, 2004

The following list summarizes some of the revisions included in the EBP Guide, with conforming changes as of March 1, 2004.

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

- FASB Statement No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities
- SAS No. 101, Auditing Fair Value Measurements and Disclosures (AICPA, Professional Standards, vol. 1, AU sec. 328)

Help Desk—To order the EBP Guide, call the Service Center Operations at (888) 777-7077 or go to www.cpa2biz.com and order product no. 012594kk.

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 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. For full information about Interpretations and rulings, visit the Professional Ethics Team Web page at 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. 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.89 in Appendix A of the EBP Guide for a listing of the DOL's independence standards.

The AICPA has published a new risk alert *Independence and Ethics Alert—2003/04* (product no. 022474kk). See this alert for further guidance on ethics and independence matters.

**On the Horizon**

Auditors should keep abreast of auditing and accounting developments and upcoming guidance that may affect their engagements. You should check the appropriate standard-setting Web sites (listed below) for a complete picture of all accounting and auditing projects in progress. Presented below is brief information about certain projects that are expected to result in final standards in the near future. Remember that exposure drafts are nonauthoritative and cannot be used as a basis for changing GAAP or GAAS.

The following table lists the various standard-setting bodies' Web sites, at which information may be obtained on outstanding exposure drafts, including downloading a copy of the exposure draft. These Web sites contain much more in-depth information about proposed standards and other projects in the pipeline.

<table>
<thead>
<tr>
<th>Standard-Setting Body</th>
<th>Web Site</th>
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<tbody>
<tr>
<td>AICPA Auditing Standards Board (ASB)</td>
<td><a href="http://www.aicpa.org/members/div/auditsd/drafts.htm">www.aicpa.org/members/div/auditsd/drafts.htm</a></td>
</tr>
<tr>
<td>(Note that new standards issued by the ASB apply to nonpublic companies or nonissuers.)</td>
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<tr>
<td>AICPA Accounting Standards Executive Committee (AcSEC)</td>
<td><a href="http://www.aicpa.org/members/div/acctstd/edo/index.htm">www.aicpa.org/members/div/acctstd/edo/index.htm</a></td>
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<td>AICPA Professional Ethics Executive Committee (PEEC)</td>
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<tr>
<td>Public Company Accounting Oversight Board (PCAOB)</td>
<td><a href="http://www.pcaob.us.org">www.pcaob.us.org</a></td>
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</tbody>
</table>
Help Desk—The AICPA’s standard-setting committees publish exposure drafts of proposed professional standards exclusively on the AICPA Web site. The AICPA will notify interested parties by e-mail about new exposure drafts. To be added to the notification list for all AICPA exposure drafts, send your e-mail address to service@aicpa.org. Indicate “exposure draft e-mail list” in the subject header field to help process your submission more efficiently. Include your full name, mailing address, and, if known, your membership and subscriber number in the message.

Auditing Pipeline—Nonpublic Companies

Note: The proposed standards discussed in this section would not apply to audits of public companies.

Proposed SAS, Communication of Internal Control Related Matters Noted in an Audit

This proposed SAS would supersede SAS No. 60, Communication of Internal Control Related Matters Noted in an Audit (AICPA, Professional Standards, vol. 1, AU sec. 325), and significantly strengthen the quality of auditor communications of such matters in audits of nonpublic companies.

New Framework for the Audit Process

The ASB has issued a suite of seven proposed SASs relating to the auditor’s risk assessment process. The ASB believes that the requirements and guidance provided in the proposed SASs, if adopted, would result in a substantial change in audit practice and in more effective audits. The primary objective of the proposed SASs is to enhance the auditor’s application of the audit risk model in practice by requiring:

- A more in-depth understanding of the entity and its environment, including its internal control, that would better enable the auditor to identify the risks of material misstatement in the financial statements and any steps the entity is taking to mitigate them.
• A more rigorous assessment of the risks of material misstatement of the financial statements based on that understanding.

• A better linkage between the assessed risks of material misstatement and the nature, timing, and extent of audit procedures performed in response to those risks.

The exposure draft consists of the following proposed SASs:

• Amendment to Statement on Auditing Standards No. 95, Generally Accepted Auditing Standards

• Audit Evidence, which will supersede SAS No. 31, Evidential Matter (AICPA, Professional Standards, vol. 1, AU sec. 326), as amended

• Audit Risk and Materiality in Conducting an Audit, which will supersede SAS No. 47, as amended, of the same title (AICPA, Professional Standards, vol. 1, AU sec. 312)

• Planning and Supervision, which will supersede SAS No. 1, Codification of Auditing Standards and Procedures (AICPA, Professional Standards, vol. 1, AU sec. 310, "Appointment of the Independent Auditor"), as amended, and SAS No. 22, Planning and Supervision (AICPA, Professional Standards, vol. 1, AU sec. 311), as amended

• Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (Assessing Risks)

• Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained, which will supersede SAS No. 45, Omnibus Statement on Auditing Standards—1983, and, together with the proposed SAS, Assessing Risks, will supersede SAS No. 55, Consideration of Internal Control in a Financial Statement Audit (AICPA, Professional Standards, vol. 1, AU sec. 319), as amended

• Amendment to SAS No. 39, Audit Sampling (AICPA, Professional Standards, vol. 1, AU sec. 350)
You should keep abreast of the status of these projects and exposure drafts inasmuch as they will substantially affect the audit process. More information can be obtained on the AICPA's Web site at www.aicpa.org.

Auditing Pipeline—Public Companies

PCAOB Auditing Standard No. 1, References in Auditors’ Reports to the Standards of the Public Company Accounting Oversight Board

In December 2003 the PCAOB adopted its first auditing standard. This standard requires the auditors’ reports on engagements conducted in accordance with PCAOB standards to include a reference that the engagement was performed in accordance with the standards of the PCAOB. This standard will not take effect unless approved by the SEC.

PCAOB Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction with an Audit of Financial Statements

In March 2004 the PCAOB approved an auditing standard for audits of internal control over financial reporting. This standard addresses both the work that is required to audit internal control over financial reporting and the relationship of that audit to the audit of the financial statements. This standard will not take effect unless approved by the SEC.

Proposed Rule Regarding Certain Terms Used in Auditing and Related Professional Practice Standards

This proposed rule would set and define the terminology the PCAOB will use in its standards to describe the obligations those standards impose on registered public accounting firms and their associated persons. See the PCAOB Web site for information about this proposed rule.

Proposed Auditing Standard on Audit Documentation

This proposed standard would establish general requirements for documentation the auditor should prepare and retain in connection with any engagement conducted in accordance with audit-
ing and related professional practice standards set by the PCAOB. The proposed standard would supersede SAS No. 96, *Audit Documentation* (AICPA, *Professional Standards*, vol. 1, AU sec. 339), and amend SAS No. 1 (AU sec. 543, “Part of Audit Performed by Other Independent Auditors,” as amended), for audits of public entities only. See the PCAOB Web site for information about this proposed standard.

**Accounting Pipeline**

**Proposed FASB Statement, Qualifying Special-Purpose Entities and Isolation of Transferred Assets—An amendment of FASB Statement No. 140**

This proposed Statement would amend and clarify FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, in several ways. A final Statement is expected to be issued during the first quarter of 2004. See the FASB Web site at www.fasb.org/draft/ed_qspe.pdf for complete information.

**Proposed Amendment to FASB Concepts Statement No. 6 to Revise the Definition of Liabilities—An amendment of FASB Concepts Statement No. 6**

This proposed amendment to FASB Concepts Statement No. 6, *Elements of Financial Statements—a replacement of FASB Concepts Statement No. 3*, would revise the definition of liabilities to also include as liabilities certain obligations that require or permit settlement by issuance of the issuer’s equity shares and that do not establish an ownership relationship. A final Statement is expected to be issued in the third quarter of 2004.

**Proposed Statement of Position, Accounting for Certain Costs and Activities Related to Property, Plant, and Equipment, and Proposed FASB Statement, Accounting in Interim and Annual Financial Statements for Certain Costs and Activities Related to Property, Plant, and Equipment—An Amendment of APB**
Opinions No. 20 and No. 28 and FASB Statements No. 51 and No. 67, and a Rescission of FASB Statement No. 73

Principally, the proposed FASB Statement would amend FASB Statement No. 67, Accounting for Costs and Initial Rental Operations of Real Estate Projects, to exclude from its scope the accounting for acquisition, development, and construction costs of real estate developed and used by an entity for subsequent rental activities. The accounting for those costs would be subject to the guidance in the proposed SOP. It also would amend APB Opinion No. 28, Interim Financial Reporting, to require that those costs that the proposed SOP would require be expensed as incurred on an annual basis also be expensed as incurred in interim periods. A final SOP is expected to be issued during the fourth quarter of 2004.

Help Desk—See the Audit Risk Alert—2003/04 for additional proposed standards.

International Accounting Standards

The International Accounting Standards Committee (IASC) was formed in 1973 and is an independent, private sector body. The objective of the IASC is to harmonize the accounting principles for financial reporting around the world. The IASC publishes the International Accounting Standards.

Employee Benefit Plan-Related Standards

The following are employee benefit plan-related standards:

- International Accounting Standard (IAS) No. 19, Employee Benefits, addresses postemployment benefits including pensions.

- IAS No. 26, Accounting and Reporting by Retirement Benefit Plans, addresses the accounting and reporting by retirement benefit plans. It establishes separate standards for reporting by defined benefit plans and by defined contribution plans.
In June 2002 the IASB agreed to add a limited convergence project on postemployment benefits to its agenda. The purpose of this project is to build on the principles that are common to most existing national standards on postemployment benefits and to seek improvements to IAS No. 19 in certain specific areas.

Help Desk—For further information regarding the IASC and its standards visit its Web site at www.iasb.org.uk.

Resource Central

Employee benefit plan-related educational courses, Web sites, publications, and other resources available to CPAs

Related Publications

The following are some of the AICPA publications that deliver valuable guidance and practical assistance as potent tools to be used on your employee benefit plan engagements.

- AICPA Audit and Accounting Guide Employee Benefit Plans, with conforming changes as of March 1, 2004 (product no. 012594kk).

- Accounting Trends & Techniques—Employee Benefit Plans (product no. 006611kk). Offering the same kind of powerful help that the AICPA's Accounting Trends and Techniques does, this comprehensive book illustrates a wide range of employee benefit plan financial statement disclosures and auditors' reports for both full-scope and limited-scope audits. The publication also includes a chapter dedicated to illustrative management letters and management letter comments.

- AICPA Practice Aid Auditing Multiemployer Plans (product no. 006603kk). This publication provides guidance on unique issues regarding the accounting, auditing, and reporting on financial statements of various types of multi-employer employee benefit plans.
• Checklists and Illustrative Financial Statements for:

  - Defined Benefit Pension Plans (008993kk). The 2004 checklist will be available this summer (product no. 008994kk).
  - Defined Contribution Pension Plans (009003kk). The 2004 checklist will be available this summer (product no. 009004kk).
  - Health and Welfare Benefit Plans (009013kk). The 2004 checklist will be available this summer (product no. 009014kk).
  - Governmental Employee Benefit Plans (published February 2004, product no. 009043)

• "A Wake-Up Call," an employee benefit plan audit video (013801kk).

AICPA's reSOURCE Online Accounting and Auditing Literature

Get access—anytime, anywhere—to the AICPA's latest Professional Standards, Technical Practice Aids, Audit and Accounting Guides, Audit Risk Alerts, and Accounting Trends & Techniques. To subscribe to this essential service, go to CPA2biz.com.

reSOURCE CD-ROM

The AICPA is currently offering a CD-ROM product entitled reSOURCE: AICPA's Accounting and Auditing Literature. This CD-ROM enables subscription access in Windows format to AICPA Professional Literature products, namely, Professional Standards, Technical Practice Aids, and Audit and Accounting Guides (available for purchase as a set that includes all Guides and the related Audit Risk Alerts, or as individual publications). This dynamic product allows you to purchase the specific titles you need and includes hypertext links to references within and between all products.
Conferences

National Conference on Employee Benefit Plans

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 2005 National Conference on Employee Benefit Plans will be held May 16-18, 2005, in Las Vegas, Nevada. For a conference brochure, please call (888) 777-7077, and request brochure G50038; for more information, visit the Web site at www.cpa2biz.com/conferences.

Education Courses

The AICPA has developed a number of continuing professional education (CPE) courses that are valuable to CPAs working on employee benefit plan engagements. Those courses include:

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

Online CPE

AICPA InfoBytes, offered exclusively through CPA2Biz, is AICPA’s flagship online learning product. Selected as one of Accounting Today’s top 100 products for 2003, AICPA InfoBytes now offers a free trial subscription to the entire product for up to 30 days. AICPA members pay $149 ($369 nonmembers) for a new subscription and $119 ($319 nonmembers) for the annual renewal. Divided into one- to two-credit courses that are available 24/7, AICPA InfoBytes offers hundreds of hours of learning in a wide variety of topics. To register or learn more, visit http://cpa2biz.com.

CPE CD-ROM

AICPA’s Standards Update and Implementation Guide (formerly The Practitioner’s Update) (product no. 738462kk) CD-ROM helps you keep on top of the latest standards. Issued twice a year, this
cutting-edge course focuses primarily on new pronouncements that will become effective during the upcoming audit cycle.

**Service Center Operations**

To order AICPA products, receive information about AICPA activities, and find help on your membership questions, call the AICPA Service Center Operations at (888) 777-7077.

**Hotlines**

**Accounting and Auditing Technical Hotline**
The AICPA Technical Hotline answers members' inquiries about accounting, auditing, attestation, compilation, and review services. Call (888) 777-7077.

**Ethics Hotline**
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. Call (888) 777-7077.

**Web Sites**

**AICPA Online and CPA2Biz**
AICPA Online offers CPAs the unique opportunity to stay abreast of matters relevant to the CPA profession. AICPA Online informs you of developments in the accounting and auditing world as well as developments in congressional and political affairs affecting CPAs. In addition, CPA2Biz.com offers all the latest AICPA products, including Audit Risk Alerts, Audit and Accounting Guides, *Professional Standards*, and CPE courses.

**Other Helpful Web Sites**
Further information on matters addressed in this Audit Risk Alert is available through various publications and services offered by a number of organizations. Some of those organizations are listed in the table at the end of this Alert.
This Audit Risk Alert replaces *Employee Benefit Plans Industry Developments—2003*.

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 e-mail 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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<sup>1</sup> Catch-up contributions for individuals over age 50 increased from $1,000 in 2002 to $2,000 in 2003 and to $3,000 in 2004.
The following questions and answers have been developed by the members of the Employee Benefit Plans Audit Guide Revision Task Force. They include frequently asked questions encountered by the task force members on accounting, auditing, and regulatory matters.

1. Can the plan sponsor accept a certification from the plan's recordkeeper if the recordkeeper certifies the investment information to be complete and accurate on behalf of the plan's trustee/custodian as "agent for"?

A. According to the U.S. Department of Labor (DOL), such a certification generally would be acceptable if there is in fact a legal arrangement between the trustee and the recordkeeper to be able to provide the certification on the trustee's behalf. Care should be taken by the plan administrator to obtain such legal documentation. Additionally the plan auditor might consider adding wording to the standard limited scope report to include reference to such an arrangement. Sample language might include the following: "any auditing procedures with respect to the information described in Note X, which was certified by ABC, Inc., the recordkeeper of the Plan as agent for XYZ Bank, the trustee of the Plan, . . . We have been informed by the plan administrator that the trustee holds the Plan's investment assets and executes investment transactions. The plan administrator has obtained a certification from the agent on behalf of the trustee, as of and for the year ended December 31, 20XX, that the information provided to the plan administrator by the agent for the trustee is complete and accurate." The third paragraph of the report should also be modified.

2. Is it permissible to perform a limited scope audit on a portion of the plan's investments but not all (some investments
did not meet the DOL 29 CFR 2520.103-8 criteria for a limited scope audit)? If yes, what form does the auditors' report take?

A. Yes, it is permissible to perform a limited scope audit on only a portion of a plan's investments and audit the remaining investments. The auditors' report is the same as that used for a limited scope audit. However, the note that is referenced in the auditor report should clearly identify the investments that were not audited.

3. Under Form 5500 (Schedule H, Part IV, line 4j), there is a special rule whereby transactions under an individual account plan that a participant directs should not be taken into account for purposes of preparing the Schedule of Reportable Transactions. What about situations where an individual account plan is participant-directed but has certain transactions that appear to be nonparticipant-directed (for example, "pass through" account for contributions)?

A. If the plan is an individual account plan and the overall structure of the plan is participant-directed, "pass through" account transactions would not be required to be included on the Schedule of Reportable Transactions. Another example would be a participant-directed individual account plan that liquidates its investment options as a result of a plan termination, merger, or change in service provider. Often such changes result in the plan sponsor directing the plan trustee to liquidate the current balance in the participant-directed investment options into a short-term fund before the transfer to new investment options. Such transactions would not be required to be included on the Schedule of Reportable Transactions.

4. What are the general conditions requiring an audit of pension plan financial statements?

A. An audit generally is required if the plan is covered under Title I of the Employee Retirement Income Security Act of 1974 (ERISA) and there are over 100 participants as of the beginning of the plan year. Exhibit 5-2 in Chapter 5 of the
AICPA Audit and Accounting Guide Employee Benefit Plans, with conforming changes as of March 1, 2004 (the EBP Guide) provides guidance on determining who is considered a participant. In addition, DOL regulations permit plans that have between 80 and 120 participants at the beginning of the plan year to complete the Form 5500 in the same category ("large plan" or "small plan") as was filed in the previous year.

5. What audit procedures should be performed on material plan mergers into a plan? What audit procedures are required when the prior plan was audited? What if the prior plan was never audited?

A. If the prior plan was audited, the auditor should obtain the audited financial statements to ensure that the balance transferred from the prior plan financial statements reconciles to the balance that is reflected on the new plan's financial statements. Also, the auditor will generally perform procedures to ensure that a sample of participant accounts were properly set up under the new plan. In addition to the participant level testing, if the prior plan was not audited, the auditor will generally perform audit procedures to determine that the equity that is transferred from the prior plan is reasonable based upon an analysis of historical activity. (Other audit procedures relating to plan mergers can be found in paragraphs 12.13 through 12.16 of the EBP Guide.)

6. When a plan operates in a decentralized environment, what additional audit procedures should be considered?

A. The auditor should consider the controls at each decentralized location as well as the overall mitigating controls that may be performed on a centralized basis. Taking into consideration the materiality of the activity at each decentralized location, the auditor may choose to expand participant level and substantive testing to incorporate these decentralized locations.
7. When the majority of a plan's assets are held in a master trust, but the plan has investments outside of the master trust, what are the requirements for the supplemental schedules?

A. The Form 5500 instructions exclude master trust assets from the supplemental schedule reporting requirements. However, any assets held outside the master trust must be reported on the supplemental schedules. When calculating the 5 percent threshold for disclosing reportable transactions, the current value of master trust assets is subtracted from the beginning of the year net asset balance.

8. Is the master trust required to be audited?

A. While the DOL does not require the master trust to be audited, the plan administrator normally engages an auditor to report only on the financial statements of the individual plans. If the master trust is not audited, the plan auditor should perform those procedures necessary to obtain sufficient audit evidence to support the financial statement assertions as to the plan's investments or qualify or disclaim his or her report.

9. Is a certification at the master trust level acceptable under DOL regulation 2520.103-8?

A. If a limited scope audit is to be performed on a plan funded under a master trust arrangement or other similar vehicle, the DOL requires separate individual plan certifications from the trustee or the custodian regarding the allocation of the assets and the related income activity to the specific plan.

10. Should noninterest-bearing cash be included as an asset on the supplemental schedule of assets (held at end of year)?

A. Generally, only assets held for investment are included on the supplemental schedule of assets (held at end of year); thus noninterest-bearing cash would not be included. Interest-bearing cash accounts would be included on the supplemental schedule.
11. Can immaterial investments be netted together as "other" on the supplemental schedule of assets (held at end of year)?

A. No, each investment must be separately listed on the supplemental schedule.

12. What is the auditor's responsibility for detecting nonexempt transactions resulting from participant contributions that are not remitted to the plan within the guidelines established by DOL regulations?

A. An audit performed in accordance with generally accepted auditing standards (GAAS) cannot be expected to provide assurance that all party-in-interest transactions will be discovered. Nevertheless, during the audit the auditor should be aware of the possible existence of party-in-interest transactions. During the planning phase of the audit, the auditor should inquire about the existence of any party-in-interest or nonexempt transactions. If any issues relating to late remittances are brought to the auditor's attention, the auditor may consider obtaining a schedule of employee contributions detailing payroll withholding date and date of deposit to the plan. A sample of deposits can then be traced to the supporting payroll register and wire transfer advice or check. Further, the auditor should have the client include in the management representation letter a representation that there are no party-in-interest transactions that have not been disclosed in the supplemental schedules.

13. If a nonexempt transaction related to the above is noted, is materiality of the transaction taken into consideration in determining the need for the supplemental schedule of nonexempt transactions?

A. There is no materiality threshold for the inclusion on the supplemental schedule. All known events must be reported.

14. When is a plan subject to the requirements of the Securities Act of 1933, thus requiring a Form 11-K filing under the Securities Exchange Act of 1934?
A. Section 3(a)(2) of the Securities Act of 1933 provides exemptions from registration requirements for defined benefit plans and defined contribution plans not involving the purchase of employer securities with employee contributions. All other plans are subject to the requirements, provided they are both voluntary and contributory. (For further guidance, see paragraph 12.24 of the EBP Guide.) Advice of counsel should be obtained to determine if the registration requirements apply to the plan.

15. In a defined contribution plan, can investments be shown as a one-line item on the financial statements?

A. Participant-directed plan investments may be shown in the aggregate, as a one-line item in the statement of net assets available for benefits. The presentation of nonparticipant-directed investments in the statement of net assets available for benefits or in the notes should be detailed by general type, such as registered investment companies, government securities, corporate bonds, common stocks, and so on.

16. If investments are shown as a one-line item in a defined contribution plan, what disclosures are required?

A. The presentation should indicate whether the fair values of the investments have been measured by quoted market prices in an active market or were determined otherwise. Investments that represent 5 percent or more of the net assets available for benefits should be separately identified. If any of those investments are nonparticipant-directed, they should be identified as such. Listing all investments in the schedule of assets (held at end of year) required by ERISA does not eliminate the requirement to include this disclosure in the financial statements.

17. Are participant loans considered an investment on the face of the financial statements or as a loan receivable?

A. Loans are considered an investment for reporting purposes.

18. Should the benefits paid per the statement of changes in net assets available for plan benefits agree to the benefits paid in
the statement of changes in accumulated plan benefits for a defined benefit pension plan?

A. The benefits paid should be the same on both statements. If differences are noted, the issue should be resolved with the actuary to determine whether payments recorded by the plan or used by the actuary require adjustment.

19. Is the schedule of 5 percent reportable transactions required for defined benefit plans?

A. As defined benefit plans generally are not participant-directed, the reportable transactions schedule would be required.

20. When does a health and welfare plan require an audit?

A. A health and welfare plan is required to have an audit when the plan has more than 100 participants at the beginning of the plan year (this can be expanded to 120 if the 80-to-120-participant rule applies) and the plan is funded. According to DOL Regulation 2520.104-44, the existence of a separate fund or account for the plan by the employer or a third-party administrator (TPA) can cause the requirement that funds be paid directly from the general assets of the sponsor not to be met. For example, if a separate account is maintained that would be deemed to be a trust under state law, the related plan would be deemed to be funded under ERISA. It is not always easy to determine when a plan is considered funded. The auditor may wish to consult with legal counsel, plan actuaries, or the DOL to determine if a plan meets the definition of funded.

21. Are participants counted the same way for pension plans and health and welfare benefit plans?

A. Participants for health and welfare plans are employees who are eligible and have elected coverage under the plan.

22. If participants are contributing toward the health and welfare benefits, is an audit required?
A. According to DOL Technical Releases 88-1 and 92-1, participant contributions to a welfare plan that has an Internal Revenue Code (IRC) section 125 cafeteria plan feature do not have to be held in trust. If contributions are not through a section 125 plan and they are not used for the payment of insurance or health maintenance organization (HMO) premiums, generally, they will be required to be held in trust. If the plan is funded voluntarily or as required by DOL regulation, then the plan would require an audit.

23. If a plan offers several benefits under the plan document, and only medical is funded through the voluntary employees’ beneficiary association (VEBA) trust, what is the audit requirement?

A. The reporting entity and thus the audit requirement is of the entire plan; not the trust. All benefits covered by the plan should be included in the audited financial statements.

24. If a VEBA trust is used as a pass-through for claims payment during the year, but there are no monies in the VEBA trust at year end, is an audit of the plan required?

A. If a plan is deemed to be funded for a part of a plan year, the entire plan year is subject to the audit requirement. All plan activity for the entire year would have to be included in the audited financial statements.

25. If multiple plans use a VEBA trust, can an audit be performed at the VEBA trust level?

A. The audit requirement is of the plan, not the trust. Each plan would require a separate audit if it individually met the audit requirement (see previous question). The auditor may be engaged to audit the VEBA trust in order to assist with the plan level allocation reporting, but this would not fulfill the plan level audit requirement.

26. Does the funding of a health and welfare benefit plan though a 401(h) account, when the plan was otherwise unfunded, cause the plan to require an audit?
A. If the plan was otherwise unfunded, the 401(h) account association will not cause the health and welfare benefit plan to be considered funded for audit determination purposes.

27. What responsibility does the auditor have in testing plan qualification tests (for example, ACP and ADP) prepared by a client’s third-party administrator?

A. An audit in accordance with generally accepted auditing standards (GAAS) is not designed to ensure compliance with all legislative and regulatory provisions. However, plans must be designed and comply with certain operating tests in order to maintain their qualified status. If specific information comes to the auditor’s attention that provides evidence concerning the existence of possible violations affecting the financial statements, the auditor should apply auditing procedures specifically directed to ascertaining whether a violation has occurred. The auditor is also expected to inquire of, and obtain representation from, management concerning compliance with laws and regulations and the prevention of violations that may cause disqualification.

28. If the plan fails its 20X0 discrimination test and has to return employee contributions in 20X1 should “Excess Contribution Payable” liability be shown on the 20X0 financial statement?

A. Yes, the financial statements should reflect a liability for excess contributions payable on the financial statements if the amount is material to the financial statements.

29. What alternate audit procedures should be done to test participants’ investment allocation of deferral contributions where no documentation exists (participants can change deferrals and allocation of such online or via phone)?

A. Where participants make contributions or investment elections by telephone or electronic means (such as the Internet), consider confirming contribution percentage, source, and investment election directly with the participant or compare to a transaction report, if one is maintained. Al-
ternatively, if the service provider has a type 2 SAS No. 70 report\(^1\) that provides evidence that the service auditor has tested investment allocations, the auditor may place some reliance on the SAS No. 70 report to reduce (not eliminate) substantive testing.

30. For a DOL-limited scope audit, is it necessary to test the allocation of investment earnings at the participant account level?

A. The testing of allocation of investment earnings at the participant level is part of the participant data testing and is recommended for a limited scope audit.

31. I understand that brokerage accounts can be listed on one line item on the Form 5500. Can they be listed on one line item on the supplemental schedules to the financial statements or do the individual underlying investments have to be listed?

A. As described in the Form 5500 instructions, individually directed brokerage accounts may be listed as one line item on the statement of net assets available for benefits and on the supplemental schedule of assets, provided the investments are not loans, partnerships or joint-venture interests, real property, employer securities, or investments that could result in a loss in excess of the account balance of the participant or beneficiary who directed the transaction. However, the notes to the financial statements must disclose any individual investment that is over 5 percent of net assets available for benefits at the end of the year. In addition, the investment income for individually directed brokerage accounts may be shown as one line item in the Form 5500; however, the financial statements must separate interest and dividends from net appreciation (depreciation) in fair value on the statement of changes in net assets available for benefits and disclose net appreciation (depreciation) by type of investment in the notes to the financial statements.

\(^1\)Statement on Auditing Standards (SAS) No. 70, Service Organizations (AICPA, Professional Standards, vol. 1, AU sec. 324), as amended.
32. When a defined benefit plan has a 401(h) account and the assets of the 401(h) account are commingled in a master trust, are the required master trust disclosures included in the defined benefit plan or the health and welfare plan?

A. Since the 401(h) assets legally belong to the defined benefit plan, the master trust disclosures should be included in the defined benefit plan's financial statements.
There are three sources that the auditor may need to consult when testing claims. They are the sources that contain CPT codes, HCPCS codes, and ICD-9 codes.

Physicians' Current Procedural Terminology (CPT) is a listing of descriptive terms and identifying five-digit codes for reporting medical services and procedures. The purpose of CPT is to provide a uniform language that accurately describes medical, surgical, and diagnostic services and thereby serves as an effective means for reliable nationwide communications among physicians, patients, and third parties. In addition, for use in federal programs (Medicare and Medicaid), CPT is used extensively throughout the United States as the preferred system of coding and describing health care services.

CPT does not contain all the codes needed to report medical services and supplies. The Health Care Financing Administration (HCFA) developed level II and level III codes which are published as HCPCS (Healthcare Common Procedure Coding System) codes for supplies and services not covered by a CPT code (level I). These codes cover such items as durable medical equipment, ambulance services, and various drugs.

The International Classification of Diseases, Ninth Edition, Clinical Modifications (ICD-9-CM) is published by the United States government and is the classification employed for cause-of-death coding. The ICD-9 coding system is recommended for use in all clinical settings and is required for reporting diagnoses and diseases to the U.S. Public Health Service.

If medical claims are not submitted electronically, they are submitted on one of two types of forms. All hospital bills, both outpatient and inpatient, are submitted on a form UB92. All other bills are submitted on a form HCFA 1500.
The U.S. Department of Labor (DOL), Pension Benefit Guar­

ty Corporation (PBGC), and the Internal Revenue Service (IRS) have compiled the following practical, common sense tips for some of the most frequently occurring Form 5500 filing problems. The tips are intended to reduce the number of basic filing errors encountered when processing the Form 5500 and Form 5500-EZ returns, and also help filers avoid getting EFAST correspondence regarding these basic mistakes. Filers may obtain more information in the DOL’s Trouble Shooter’s Guide to Filing the ERISA Annual Report (Form 5500), which is available on the DOL Internet site at www.dol.gov/ebsa. Also, filers with questions can call the EFAST Help Line at (866) 463-3278.

1. Important Reminder for Fringe Benefit Plans

The IRS reminds employers that they no longer have to file an annual Form 5500 and Schedule F for so-called “pure fringe ben­

efit plans.”

Employers who in the past filed Form 5500 and the Schedule F (Fringe Benefit Plan Annual Information Return), solely to meet the reporting requirements of Internal Revenue Code (IRC) section 6039D (“fringe benefit plans”), should file neither Form 5500 nor Schedule F. In fact, the Schedule F has been eliminated and the Form 5500 has been modified so fringe benefit plan information cannot be reported.

Fringe benefit plans are often associated with ERISA group health plans and other welfare benefit plans. The IRS announce­

ment regarding fringe benefit plans does not cover these associ­

ated welfare plans. But, in many cases, a Form 5500 was not required for the welfare plan because it was exempt from filing a
Form 5500 report under Department of Labor regulations. For example, fully insured or unfunded welfare plans covering fewer than 100 participants at the beginning of the plan year are eligible for a filing exemption. Unless exempt, however, ERISA welfare plans must still file in accordance with the Form 5500 instructions on welfare plan filing requirements.


2. The Form 5500 Must Be Properly Signed and Dated

Failure to sign the form is the number one reason filers receive correspondence from the government regarding their Form 5500 or Form 5500-EZ. Filers should make sure they have the proper signatures and dates on the Form 5500, Form 5500-EZ, and any attached schedules that require a signature (Schedules B, P and SSA).

The type of plan or DFE filing the Form 5500 determines who is required to sign the form. Filers should consult Section 4 of the Instructions for Form 5500, under the heading “How to File,” for information on who is required to sign the return/report.

It is important to remember that, for those filings submitted electronically, the plan must keep in its records an original copy of the Form 5500 filing with all required signatures.

3. The Form 5550 Must Have the Proper EIN and Plan Number (PN)

It is critical that the Employer Identification Number (EIN) used to identify the “plan sponsor” be the same year to year when completing line 2b of the Form 5500 or Form 5500-EZ. Switching EINs without reporting the change on line 4 of the Form 5500 or Form 5500-EZ will disrupt proper processing of the form and cause the generation of correspondence with the filer. Also, the same EIN must go on line D of all the attached schedules (except Schedule P which reports the EIN of the plan’s employee benefit trust(s) or custodial account(s)).
A multiple-employer plan or plan of a controlled group of corporations should select one of the participating employers to list as the plan sponsor and use that employer’s EIN on line 2b. If the plan sponsor is a group of individuals (for example, a board of trustees of a collectively bargained plan) a single EIN should be obtained and used for the group. In the case of a Form 5500 filed for a Direct Filing Entity (DFE), use the EIN assigned to the CCT, PSA, MTIA, 103-12 IE or GIA.

The three-digit plan number (PN), in conjunction with the EIN, is used as a unique 12-digit number to identify the plan or DFE. Although EINs are obtained from the IRS, the plan sponsor/employer or plan administrator assigns the PN. Also, once a three-digit plan number and EIN combination is used for one plan or DFE, it cannot be used for any other plan or DFE, even after the plan or DFE terminates.

Plan administrators, plan sponsor/employers, and DFE sponsors should assign PNs as follows. Plans providing pension benefits (such as profit-sharing or money purchase plans) should be assigned plan numbers starting with 001, and consecutive numbers should be assigned to other pension plans (for example, 002, 003, 004, and so on). The sponsor of an MTIA, CCT, PSA or 103-12 IE filing as a DFE should also start with number 001, and consecutive numbers should be assigned to other DFEs of the sponsor. Welfare plans and group insurance arrangements (GIAs) filing as DFEs should be assigned plan numbers starting with 501, and consecutive numbers should be assigned to other welfare plans and GIAs (for example, 501, 502, 503, and so on). 888 or 999 should not be used as PNs.

Filers should consult the Form 5500 filing instructions for line 1b and 2b in Section 6, “Line-by Line Instructions”, for additional information on EINs and PNs. The instructions for line 2b include information on how to obtain EINs from the IRS.

4. The Form 5500 Filing May Not Be for a Period Greater Than 12 Months

The time period entered in Part I of the Form 5500 may not be greater than 12 months. If the plan year is a calendar year (Janu-
ary 1 through December 31), the spaces provided for dates in Part I may be left blank. If the plan or DFE is not reporting on a calendar year basis, but instead is using a fiscal year, then the 12-month (or shorter) fiscal year period should be inputted in the spaces provided. Example: fiscal year beginning 07/01/2003 and ending 06/30/2004.

Filers should make certain there is no gap between the ending date of their previous year’s Form 5500 and the beginning date of the current year’s form. Special care should be taken if filing a Form 5500 for a short plan year (a plan or DFE year of less than 12 months). For instance, if a plan or DFE changes from a calendar year to a noncalendar fiscal year, the beginning date entered on the “short plan year” Form 5500 should be one day after the ending date of the previous year’s Form 5500, and the ending date should be one day before the beginning date entered on the next year’s Form 5500. In addition, line B(4) should be checked on the short plan year Form 5500. The Form 5500 filing instructions, Section 4 (“How to File” and “Change in Plan Year”) contains additional information.

Finally, the plan year beginning and ending date on all attached Schedules (except Schedule P) must match the plan year beginning and ending dates on Part I of the Form 5500.

5. Use a Proper Business Code When Completing Line 2d of the Form 5500

On Form 5500, line 2d, filers should enter a valid business code that best describes the nature of the plan sponsor’s business.

The only business codes that are valid for use in answering line 2d are listed in the Form 5500 filing instructions section marked “Codes for Principal Business Activity.” If more than one employer and/or employee organization is involved, the business code for the main business activity of the employers and/or employee organizations should be entered.

Business codes may change from year to year. Therefore, the business code used for a previous year's filing may not be a valid busi-
ness code for the current year filing. Filers should select the appropriate business code from the Form 5500 filing instructions section marked "Codes for Principal Business Activity" (for example, if filing a 2002 Form 5500, the business code you select should be one of the business codes from the 2002 instructions).

6. Use the Correct Plan Characteristics Codes on Line 8 of the Form 5500

On Form 5500, line 8, filers must check box A and/or B to indicate if the plan is providing pension benefits and/or welfare benefits.

After indicating which benefits are being provided by checking box A and/or B, filers must enter the plan characteristics codes in the space provided beneath boxes A and/or B. These codes describe the type of pension and/or welfare benefits provided and other features of the plan. A list and description of the plan characteristics codes is in Section 6 of the Instructions for Form 5500.

An individual account pension plan like a money purchase plan or profit-sharing plan (including a 401(k) arrangement) should enter on Form 5500 line 8 the appropriate " Defined Contribution Pension Features" and "Other Pension Benefit Features" codes that are listed in the Form 5500 instructions. Individual account plans would not normally enter codes for "Defined Benefit Pension Features," such as 1A, 1B, or 1C.

7. Properly Identify the Funding and Benefit Arrangements on Line 9 of the Form 5500

Filers should indicate all the proper funding and benefit arrangements on Form 5500, lines 9a and 9b. The "Funding Arrangement" is the method used for the receipt, holding, investment, and transmittal of plan assets prior to the time the plan actually provides benefits. The "Benefit Arrangement" is the method by which the plan provides benefits to participants.

Filers should remember to indicate all the applicable funding and benefit arrangements. The responses on lines 9a and 9b are cross-
referenced against information on Schedules H, I, and/or A, as appropriate. Be careful to attach the appropriate financial or insurance schedule (H, I, A) that corresponds to the benefit and funding arrangements you indicate. For instance, if “Trust” is indicated as an arrangement, then a Schedule H or I (as appropriate) should be submitted with the Form 5500. Likewise if “insurance” is indicated as a funding and/or benefit arrangement, a Schedule A should be filed with Form 5500 for any insurance contract with a contract or policy year that ended with or within the plan year.

Filers should refer to the Form 5500 filing instructions, Section 6, “Line-by-Line Instructions,” for a description of the funding and benefit arrangements.

8. File All the Required Schedules and Attachments With Your Form 5500

Filers should make sure they file all the required schedules and attachments with their Form 5500. The Form 5500 instructions in Section 5, under the heading “What to File,” break down filing requirements based on type of filer (large plan, small plan, pension plan, welfare plan, or DFE), and include a Quick Reference Chart that lists each of the Form 5500 schedules and identifies who has to file them.


The information entered in the checklist on line 10 of the Form 5500 must match schedules that are submitted with the Form 5500. If a box is checked indicating that a schedule is attached, the schedule must be submitted with the Form 5500.

When filing Schedules A, P, or T, special care should be taken to enter the total number of each schedule filed in the spaces provided on line 10.
10. File the Appropriate Financial Information Schedule (H or I) With Your Form 5500

Filers should make sure to file the proper Financial Information Schedule with their Form 5500. The Schedule H is for “large plan” filers (generally plans with 100 or more participants at the beginning of the plan year) and all DFEs. The Schedule I is for “small plan” filers (generally plans with fewer than 100 participants at the beginning of the plan year).

If a Form 5500 is filed as a “small plan” last year and the number of plan participants is fewer than 121 at the beginning of this plan year, the plan administrator may continue to file Schedule I as a “small plan” under the “80-120 Participant Rule.” This rule allows plans with between 80 and 120 participants at the beginning of the plan year to file the Form 5500 in the same category (“large plan” or “small plan”) as the prior year filing. Please consult Section 5 of the Instructions for Form 5500 under the “What to File” heading for more information on the “80-120 Participant Rule.”

Certain Code section 403(b) retirement arrangements, IRA pension plans, fully insured pension plans, and insured, unfunded, or combination insured/unfunded welfare plans do not have to file Schedule H or I. Please consult Section 5, under the heading “Limited Pension Plan Reporting” and “Welfare Benefit Plan Filing Requirements” in the Instructions for Form 5500 for additional information and eligibility requirements.

When filing Schedule H or I, filers should make certain that all required information provided is accurate and complete. Make sure the spaces on the asset/liability and income/expense statements (lines 1 and 2) on the Schedule H and I that require a total from the lines above are completed accurately.

Schedule H

If Schedule H is filed, Part III of the schedule, regarding the independent qualified public accountant’s (IQPA) report and opinion, must be completed. The report of the IQPA identified on line 3 must be attached to the Form 5500 unless line 3d(1) or 3d(2), (3b(1) or 3b(2) on 2002 and prior year forms) is checked.
Plans filing Schedule H must answer all items in Part IV, lines 4a through 4k and line 5a. Check either “yes” or “no” as appropriate, and, where applicable, enter the dollar amounts or other information that is required. Not responding or indicating “n/a” to an item may cause the filing to be rejected.

MTIAs, 103-12 IEs, and GIAs should leave Schedule H, lines 4a, 4e, 4f, 4g, 4h, 4k, and 5 blank; 103-12 IEs also do not complete 4j.

Schedule I

When filing Schedule I, filers should ensure that the amounts entered on Part I, lines 3a through 3g (Specific Assets of the Plan) are the year-end values for the assets. The purchase price for an asset that was purchased during the plan year is not necessarily the year-end value. Also, if the plan sold an asset reportable on lines 3a through 3g during the plan year, a “0” should be entered on the appropriate line in the amount column if there were no other asset values to report on that line.

The amounts entered on Schedule I, Line 3f, “Loans (other than to participants),” should be the value of the loans that are an asset of the plan. Loans are assets to be reported on line 3f if the plan loaned the amounts (other than participant loans) or purchased loans originated by a third party. Do not include amounts the plan borrowed; amounts the plan owes should be reported as a liability on Schedule I, line 1b.

Plans completing Schedule I must answer all items in Part II, lines 4a through 4k and line 5a. Check either “yes” or “no” as appropriate, and, where applicable, enter the dollar amounts or other information that is required. Not responding or indicating “n/a” to an item may cause the filing to be rejected.

11. Do Not Submit Loose Schedules or Attachments

The Form 5500 must be submitted in its entirety with all required schedules and attachments (including the report of the IQPA, if applicable).
Loose schedules and attachments filed without a completed Form 5500 or amended Form 5500 will not be considered filed or processed. However, government, church, or other plans that elect voluntarily to file the Schedule SSA are not required to attach the schedule to a Form 5500 but must check box 1b on the Schedule SSA. See the Schedule SSA instructions for more information.

Hand print and machine print forms generated by EFAST approved software will not be processed if they are printed out blank, or with limited information, and then completed by pen or typewriter. Only official hand print paper forms printed by the IRS are allowed to be completed by pen or typewriter.

12. Follow the Proper Procedures When Filing an Amended Form 5500

If the amended return/report is filed electronically, filers should submit a completed and dated Form 5500 with electronic signature (check box B(2) in Part I to indicate it is an amended return/report), and resubmit all schedules and attachments, including those that are not being amended.

If the amended return/report is submitted in paper form, submit a new completed, signed, and dated Form 5500 (check box B(2) in Part I) and attach only the schedules or attachments that are being changed from the prior filing. Do not attach schedules and attachments that are not being changed. Do not attach schedules where only attachments are being amended. Identify only the schedules that are being amended on line 10 of Form 5500. If only attachments are being amended, do not identify any schedules on line 10 of Form 5500.

When submitting a corrected Form 5500 in response to correspondence from EBSA regarding processing of a return/report, filers should not check box B(2) on the Form 5500.
APPENDIX E

Frequently Asked Questions on the Small Pension Plan Audit Waiver Regulation

1. What is the Small Pension Plan Audit Waiver Regulation?

The Department of Labor's (DOL's) regulation at 29 CFR 2520.104-46 establishes conditions for small employee benefit plans (generally those with fewer than 100 participants) to be exempt from the general requirement under Title I of the Employee Retirement Income Security Act (ERISA) that plans be audited each year by an independent qualified public accountant (IQPA) as part of the plan's annual report (Form 5500).

The DOL amended the regulation in October 2000 to impose additional conditions for small pension plans to be exempt from the annual audit requirement. The purpose of the new conditions is to increase the security of assets in small pension plans by improving disclosure of information to participants and beneficiaries and, in certain instances, requiring enhanced fidelity bonds for persons who handle plan funds. The amendments went into effect beginning in 2001.

The Employee Benefits Security Administration (EBSA) has received a variety of questions on how to determine whether a small plan has met the conditions for the audit waiver. The purpose of this document is to answer frequently asked questions about the audit waiver requirements under the amended regulation. Questions concerning this guidance may be directed to the EFAST Help Line at (866) 463-3278. The EFAST Help Line is available Monday through Friday from 8:00 am to 8:00 pm, Eastern Time.
2. Eligible Pension Plans

2a. What pension plans are eligible for an audit waiver under the Small Pension Plan Security Amendments?

Pension plans with fewer than 100 participants at the beginning of the plan year are eligible if they meet the conditions for an audit waiver under 29 CFR 2520.104-46.

2b. Can a plan that utilizes the "80-120 Participant Rule" to file as a small plan claim the audit waiver?

Yes. All Schedule I filers that meet the conditions of the audit waiver are eligible. If the plan meets the conditions of the "80-120 Participant Rule," it may file as a small plan and attach Schedule I instead of Schedule H to its Form 5500. Under the 80-120 Participant Rule, if the number of participants covered under the plan as of the beginning of the plan year is between 80 and 120, and a small plan annual report was filed for the prior year, the plan administrator may elect to continue to file as a small plan.

2c. Does the plan have to tell participants, beneficiaries, and the DOL if it is claiming the audit waiver? If so, how?

Yes. The plan administrator must disclose that it is claiming the waiver by checking “yes” on line 4k of Schedule I of the Form 5500 filed for the plan.

2d. Does a small pension plan that does not meet the audit waiver conditions need to file Schedule H instead of Schedule I?

No. Small pension plans that cannot claim the audit waiver may still file Schedule I, but must attach the report of an IQPA to their Form 5500. They also do not need to include schedules of assets held for investment, a schedule of reportable transactions, the Schedule C, or Schedule G.
2e. If a small plan elects to file as a large plan pursuant to the 80-120 Participant Rule, can it still claim the small pension plan audit waiver?

No. Only plans filing as small plans can rely on the small pension plan audit waiver.

2f. If the plan previously did not have to include an audit with its annual report filing because it met another ERISA exception to the audit requirement, does it now have to meet the conditions under 29 CFR 2520.104-46?

No. If a plan meets another exception to the IQPA audit requirement, for example, if it is a small pension that is not required to complete Schedule I (such as a plan using an Internal Revenue Code [IRC] section 403(b) annuity arrangement that is exempt from the audit requirement under 29 CFR 2520.104-44) it does not have to meet the audit waiver requirements in 29 CFR 2520.104-46.

3. General Conditions for Audit Waiver

3a. What are the requirements for the audit waiver?

In addition to being a small pension plan filing the Schedule I, there are three basic requirements for a small pension plan to be eligible for the audit waiver:

First, as of the last day of the preceding plan year at least 95 percent of a small pension plan's assets must be "qualifying plan assets" or, if less than 95 percent are qualifying plan assets, then any person who handles assets of a plan that do not constitute "qualifying plan assets" must be bonded in an amount at least equal to the value of the "non qualifying plan assets" he or she handles.

Second, the plan must include certain information (described below) in the summary annual report (SAR) furnished to participants and beneficiaries in addition to the information ordinarily required.
Third, in response to a request from any participant or beneficiary, the plan administrator must furnish without charge copies of statements the plan receives from the regulated financial institutions holding or issuing the plan's "qualifying plan assets" and evidence of any required fidelity bond.

3b. What are qualifying plan assets?

"Qualifying plan assets" are:

Any asset held by certain regulated financial institutions (see the next question);

Shares issued by an investment company registered under the Investment Company Act of 1940 (for example mutual fund shares);

Investment and annuity contracts issued by any insurance company qualified to do business under the laws of a state;

In the case of an individual account plan, any assets in the individual account of a participant or beneficiary over which the participant or beneficiary has the opportunity to exercise control and with respect to which the participant or beneficiary is furnished, at least annually, a statement from a regulated financial institution describing the plan assets held or issued by the institution and the amount of such assets;

Qualifying employer securities, as defined in ERISA section 407(d)(5); and

Participant loans meeting the requirements of ERISA section 408(b)(1), whether or not they have been deemed distributed.

3c. Which financial institutions are "regulated financial institutions" for purposes of the audit waiver conditions?

Only the following institutions are "regulated financial institutions" for purposes of the audit waiver conditions:

Banks or similar financial institutions, including trust companies, savings and loan associations, domestic building and loan associations, and credit unions;
Insurance companies qualified to do business under the laws of a state;

Organizations registered as broker-dealers under the Securities Exchange Act of 1934;

Investment companies registered under the Investment Company Act of 1940; or

Any other organization authorized to act as a trustee for individual retirement accounts under IRC section 408.

3d. If more than 5 percent of the plan’s assets are nonqualifying, does that mean that the plan must be audited?

Not necessarily. If the plan obtains bonding in accordance with the provisions of the regulation and otherwise meets the waiver requirements, it can still claim the audit waiver.

3e. What are the basic decisions that must be made to determine whether a small pension plan may claim the audit waiver?

Administrators can use the decision tree found in Exhibit 5-4 of the EBP Guide for guidance.

4. Qualifying Plan Assets

4a. How do I calculate the percentage of “qualifying plan assets” for my plan?

All plan assets that must be reported on the Form 5500 Schedule I, line 1a, column (b) for the end of the prior plan year must be included in the calculation of “qualifying” and “nonqualifying” plan assets. The calculation must be made as soon as the information regarding the plan’s assets at the close of the preceding plan year practically can be ascertained. This generally will be much sooner than the due date for filing the Form 5500 for that preceding plan year.
4b. How is the percentage of “qualifying plan assets” determined for initial plan years?

In the initial plan year, the plan administrator may rely on estimates. The administrator should follow a similar method to the one described in 29 CFR 2580.412-15 for estimating the amount required for the ERISA section 412 fidelity bond for an initial plan year. For example, if a plan will be investing exclusively in assets that meet the definition of “qualifying plan assets,” for example, insurance contracts and mutual fund shares, bonding in addition to that required under section 412 would not be necessary to meet the first condition for claiming the audit waiver.

4c. When a new plan is initially funded through the transfer of assets from a predecessor plan, how is the percentage of “qualifying plan assets” determined for the initial plan year?

You should make the determination by treating the new plan as not having a preceding reporting year and use the assets actually transferred from the predecessor plan to determine whether the new plan meets the 95 percent percentage condition for “qualifying plan assets.”

4d. Does the type of account the plan has with a “regulated financial institution” matter in determining whether assets are “qualifying plan assets”?

Generally, the account must be a trust or custodial account. For example, plan assets held in bank custodial, common or collective trust, or separate trust accounts are qualifying plan assets. In addition, securities held by a broker-dealer for the plan in an omnibus account are qualifying plan assets. Checking and savings accounts that create a debtor-creditor relationship between the plan and the bank are also “qualifying plan assets” for purposes of the audit waiver conditions.

4e. If I put plan assets in a bank safe deposit box, can I treat those assets as “qualifying plan assets”?

No. Plan assets put in a safe deposit box with a bank are not qualifying plan assets.
4f. Can assets in individual participant accounts be treated as qualifying plan assets if the individual account statements from the regulated financial institutions are mailed by affiliates of the regulated financial institutions, other unaffiliated service providers, or the plan administrator?

Yes. The account statements must be statements of the regulated financial institution, but the institution's regular distribution systems may be used to transmit the statements to participants and beneficiaries. For example, a statement prepared by the regulated financial institution, on the institution's letterhead including contact information that a participant could use to confirm the accuracy of the information in the statement with the regulated financial institution could be given to the plan administrator for distribution to the plan participants and beneficiaries. However, a statement prepared by the plan administrator, even if based on data from the regulated financial institution, would not meet the audit waiver condition.

5. Fidelity Bonding For Nonqualifying Assets

5a. What type of fidelity bond is needed to meet the audit waiver conditions if more than five percent of its assets are nonqualifying assets?

Persons that handle nonqualifying assets must be covered by a fidelity bond or bonds that meet the requirements of section 412 of ERISA, except that the bond amount must be at least equal to 100 percent of the value the nonqualifying plan assets the person handles. Persons handling nonqualifying plan assets can rely on normal rules and exemptions under section 412 in complying with the audit waiver's enhanced bonding requirement. For example, if the only nonqualifying assets that a person handles are not required to be covered under a standard ERISA section 412 bond (for example, employer and employee contribution receivables described in 29 CFR 2580.412-5) that person would not need to be covered under an enhanced bond for a plan to be eligible for the audit waiver.
5b. If the plan has more than 5 percent of its assets in nonqualifying plan assets, does the enhanced bond have to cover all the nonqualifying assets or only those in excess of the 5 percent threshold?

All the nonqualifying assets, not just a selection that represent the excess over 5 percent, are subject to the enhanced bond requirement.

5c. Can the plan satisfy the audit waiver bonding requirement by having persons who handle the nonqualifying plan assets get their own bond?

Yes. The person handling the nonqualifying plan assets can obtain his or her own bond. Also, a company providing services to the plan can obtain a bond covering itself and its employees that handle nonqualifying plan assets. The bond has to meet the requirements under section 412, such as the requirements that the plan be named as an insured, that the bond not include a deductible or similar feature, and that the bonding company be on the U.S. Department of the Treasury's Circular 570 list of approved surety companies. [www.fms.treas.gov/c570/c570.html]

5d. Can the plan's section 412 fidelity bond be used to satisfy the bonding requirements for an audit waiver?

Section 412 of ERISA provides that persons that handle plan funds or other property generally must be covered by a fidelity bond in an amount no less than 10 percent of the amount of funds the person handles, and that in no case shall such bond be less than $1,000 nor is it required to be more than $500,000. In some cases, 100 percent of the value of nonqualifying plan assets may be less than 10 percent of the value of all of the plan funds a person handles. Under those circumstances, the section 412 bond covering the person will satisfy the audit waiver condition because the amount of the bond will be at least equal to 100 percent of the nonqualifying plan assets handled by that individual.

For example, a person may handle a total of $1 million in plan funds, but only $50,000 are nonqualifying plan assets. In that case, the ERISA section 412 bond covering the person should be
equal to or greater than $100,000, which would be more than the value of the nonqualifying assets the person handles. For that person, the ERISA section 412 bond would also satisfy the audit waiver enhanced bonding requirement.

Even where the amount of an existing section 412 bond is insufficient to meet the audit waiver requirement, plan administrators may want to consider increasing the coverage under the section 412 bond rather than getting a new fidelity bond.

6. Summary Annual Report (SAR) Disclosures

6a. What information must be included in the SAR for the plan to be eligible for the audit waiver?

The plan administrator must include the following additional information in the SAR furnished to participants and beneficiaries to be eligible for the small pension plan audit waiver:

Except as noted in the following question below, the name of each regulated financial institution holding or issuing “qualifying plan assets” and the amount of such assets reported by the institution as of the end of the plan year;

The name(s) of the surety company issuing enhanced fidelity bonding, if the plan has more than 5 percent of its assets in “non-qualifying plan assets”;

A notice indicating that participants and beneficiaries may, upon request and without charge, examine or receive from the plan copies of evidence of the required bond and copies of statements from the regulated financial institutions describing the “qualifying plan assets”; and

A disclosure stating that participants and beneficiaries should contact the DOL’s Employee Benefits Security Administration (EBSA) regional office if they are unable to examine or obtain copies of the regulated financial institution statements or evidence of the required bond.
6b. Do the enhanced SAR disclosure requirements apply to all “qualifying plan assets”?

No. The enhanced SAR disclosure is not required for the following qualifying plan assets:

Qualifying employer securities as defined in section 407(d)(5) of ERISA and the regulations issued thereunder;

Participant loans meeting ERISA section 408(b)(1) and the regulations issued thereunder; and,

In the case of an individual account plan, any assets in the individual account of a participant or beneficiary over which the participant or beneficiary has the opportunity to exercise control provided the participant or beneficiary is furnished, at least annually, a statement from an eligible regulated financial institution describing the assets held or issued by the institution and the amount of such assets.

6c. Do the enhanced SAR disclosure requirements apply even if 95 percent of the plan’s assets are “qualifying plan assets”?

Yes. Even if 95 percent of the plan’s assets are qualifying plan assets, to be eligible for the audit waiver, the SAR must include the required information on the regulated financial institutions holding or issuing the plan’s qualifying plan assets.

6d. Is there model language for the enhanced SAR requirements?

The regulations do not require that model language be used for the required enhanced SAR disclosures. Rather, as long as the SAR includes the required information, it will satisfy the audit waiver condition. The DOL did not issue model SAR disclosure text as part of the regulation because there are various ways that plans can satisfy the audit waiver conditions. Nonetheless, the following example may assist administrators in composing SAR disclosures for their plans that would satisfy the regulation. Plan administrators will need to modify the example to omit bonding or other information that is not applicable to their plan.

The following is model language for a notice:
The U.S. Department of Labor's regulations require that an IQPA audit the plan's financial statements unless certain conditions are met for the audit requirement to be waived. This plan met the audit waiver conditions for [insert year] and therefore has not had an audit performed. Instead, the following information is provided to assist you in verifying that the assets reported in the Form 5500 were actually held by the plan.

At the end of the [insert year] plan year, the plan had [include separate entries for each regulated financial institution holding or issuing qualifying plan assets]:

- [set forth amounts and names of institutions as applicable]
- [insert $ amount] in assets held by [insert name of bank],
- [insert $ amount] in securities held by [insert name of registered broker-dealer],
- [insert $ amount] in shares issued by [insert name of registered investment company],
- [insert $ amount] in investment or annuity contract issued by [insert name of insurance company]

The plan receives year-end statements from these regulated financial institutions that confirm the above information. [Insert as applicable:] The remainder of the plan's assets were (1) qualifying employer securities, (2) loans to participants, (3) held in individual participant accounts with investments directed by participants and beneficiaries and with account statements from regulated financial institutions furnished to the participant or beneficiary at least annually, or (4) other assets covered by a fidelity bond at least equal to the value of the assets and issued by an approved surety company.

Plan participants and beneficiaries have a right, on request and free of charge, to get copies of the financial institution year-end statements and evidence of the fidelity bond. If you want to examine or get copies of the financial institution year-end statements or evidence of the fidelity bond, please contact [insert mailing address and any other available way to request copies such as e-mail and phone number].
If you are unable to obtain or examine copies of the regulated financial institution statements or evidence of the fidelity bond, you may contact the regional office of the U.S. Department of Labor's Employee Benefits Security Administration (EBSA) for assistance by calling toll-free 1.866.444.EBSA (3272). A listing of EBSA regional offices can be found at www.dol.gov/ebsa. General information regarding the audit waiver conditions applicable to the plan can be found on the U.S. Department of Labor Web site at www.dol.gov/ebsa under the heading "Frequently Asked Questions."
Governmental Employee Benefit Plans

This section addresses audit and accounting issues unique to governmental employee benefit plans (governmental plans). Auditors of governmental plans should also see the AICPA Audit and Accounting Guides State and Local Governments (Non-GASB 34 Edition), and State and Local Governments (GASB 34 Edition) and the AICPA Audit Risk Alert State and Local Governmental Developments.

Help Desk—The accounting for many governmental plans is prescribed by Governmental Accounting Standards Board (GASB) standards, primarily GASB Statements No. 25, Financial Reporting for Defined Benefit Pension Plans and Note Disclosures for Defined Contribution Plans, and No. 26, Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans. The AICPA Audit and Accounting Guide Employee Benefit Plans (the EBP Guide) and related AICPA publications (such as this Audit Risk Alert, the Checklists, and Practice Aids listed in the “Related Publications” section of this Alert) are designed to address issues related to plans sponsored by commercial or not-for-profit private sector entities, and the accounting provisions in the EBP Guide do not apply to governmental plans. However, portions of those publications, including this Alert, may be useful to auditors of governmental plans. For example, auditors should consider referring to the EBP Guide for specific auditing considerations relating to governmental plans, such as

1. Governmental Accounting Standards Board (GASB) Statement No. 26, Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans, has been superseded by GASB Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans. See the “GASB Statement No. 43” section of this appendix for further information.
evaluating actuarial information. Although the audit objectives for governmental plans are similar to those for private-sector pension plans, the auditor should be aware that the Employee Retirement Income Security Act of 1974 (ERISA) does not apply to governmental entities. Instead, state and local laws and regulations govern the operations of governmental plans.

New and Proposed GASB Pronouncements

Help Desk—For further information on recent exposure drafts outstanding, visit the Web site http://accounting.rutgers.edu/raw/gasb/welcome.htm.

GASB Statement No. 40

In March 2003, the GASB issued its Statement No. 40, Deposit and Investment Risk Disclosures, an amendment of GASB Statement No. 3. The Statement amends GASB Statement No. 3, Deposits with Financial Institutions, Investments (including Repurchase Agreements), and Reverse Repurchase Agreements, and addresses additional risks to which governments are exposed.

GASB Statement No. 40 requires that state and local governments communicate key information about deposit and investment risks, as follows:

1. Investment credit risk disclosures, including credit quality information issued by rating agencies

2. Interest rate disclosures that include investment maturity information, such as weighted average maturities or specification identification of the securities

3. Interest rate sensitivity for investments that are highly sensitive to changes in interest rates (for example, inverse floaters, enhanced variable-rate investments, and certain asset-backed securities)

4. Foreign exchange exposures that would indicate the foreign investment’s denomination
GASB Statement No. 40 is effective for financial statements for periods beginning after June 15, 2004. Earlier application is encouraged.

Because of the potential complexity of governmental plans’ investment portfolios and operations, you should consider alerting your clients to the need to allow sufficient time to adopt appropriate reporting processes for GASB Statement No. 40.

GASB Statement No. 42

In November 2003, the GASB issued its Statement No. 42, Accounting and Financial Reporting for Impairment of Capital Assets and for Insurance Recoveries. The Statement requires governments to measure, recognize, and disclose the effects of capital asset impairment in their financial statements when it occurs. It also clarifies and establishes accounting requirements for insurance recoveries, including those associated with capital asset impairment. GASB Statement No. 42 is effective for financial statements for periods beginning after December 15, 2004, with earlier application encouraged.

GASB Statement No. 43

In April 2004, the GASB issued its Statement No. 43, Financial Reporting for Postemployment Benefit Plans Other Than Pension Plans. This Statement establishes accounting and financial reporting standards for plans that provide postemployment benefits other than pension benefits (known as other postemployment benefits or OPEB). As defined in GASB Statement No. 43, OPEB are (1) postemployment healthcare benefits and (2) other types of postemployment benefits (for example, life insurance) if provided separately from a pension plan. The provisions of the Statement apply if the OPEB plan is reported in the financial statements of a participating employer, plan sponsor, public employee retirement system (PERS), or other entity that administers the plan. GASB Statement No. 43 supersedes GASB Statement No. 26, Financial Reporting for Postemployment Healthcare Plans Administered by Defined Benefit Pension Plans, and amends various other GAAP requirements relating to the financial reporting for OPEB plans. The provisions of GASB Statement No. 43 are
effective in three annual phases based on the implementation phase of the employer (for single-employer plans) or of the largest participating employer in the plan (for multiple-employer plans) for purposes of applying GASB Statement No. 34, Basic Financial Statements—and Management’s Discussion and Analysis—for State and Local Governments. Specifically:

<table>
<thead>
<tr>
<th>If the sole or largest participating employer’s GASB Statement No. 34 phase was</th>
<th>The plan should apply GASB Statement No. 43 for periods beginning after</th>
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</thead>
<tbody>
<tr>
<td>Phase 1</td>
<td>December 15, 2005</td>
</tr>
<tr>
<td>Phase 2</td>
<td>December 15, 2006</td>
</tr>
<tr>
<td>Phase 3</td>
<td>December 15, 2007</td>
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</table>

Early implementation of GASB Statement No. 43 is encouraged. Further, a component unit should implement the requirements of GASB Statement No. 43 no later than the same year as its primary government. The GASB plans to soon issue a related Statement, Accounting and Financial Reporting by Employers for Postemployment Benefits Other Than Pensions, which establishes standards for accounting and financial reporting of OPEB costs and obligations by state and local governmental employers that offer OPEB and by plan sponsors. (See the following discussion on GASB Exposure Drafts.)

**GASB Technical Bulletin 2003-1**

In June 2003, the GASB staff issued Technical Bulletin (TB) 2003-1, Disclosure Requirements for Derivatives Not Reported at Fair Value on the Statement of Net Assets, to supersede GASB TB No. 94-1, Disclosures about Derivatives and Similar Debt and Investment Transactions. The TB applies to derivatives that are not reported at fair value on the statement of net assets. It provides an updated definition of derivatives and also provides disclosure requirements for the government’s objective for entering into the derivative and the derivative’s terms, fair value, associated debt, and risk exposures. The TB, which also discusses acceptable methods for determining fair value, became effective for financial statements for periods ending after June 15, 2003.
Although generally accepted accounting principles (GAAP) re-
quire governmental plans to report investments at fair value (and
thus they would not be subject to these disclosure requirements),
you should be alert to the possibility that your clients may have
liability strategies (such as interest rate swaps) involving deriva-
tives that may be subject to these disclosure requirements.

Help Desk—GASB publications can be ordered through the
GASB's Order Department at (800) 748-0659 or on its Web
site at www.gasb.org.

GASB Exposure Drafts

The GASB has outstanding exposure drafts (EDs) of two pro-
posed Statements that it plans to finalize before the end of 2004.

In August 2003, the GASB released the ED of a proposed State-
ment, Economic Condition Reporting: The Statistical Section. This
ED proposes to amend existing guidance for the presentation of
information in the statistical section of a comprehensive annual
financial report (CAFR). Its proposed effective date is for statisti-
cal sections prepared for periods beginning after June 15, 2005,
with earlier application encouraged.

In January 2004, the GASB released the ED of a proposed State-
ment, Accounting and Financial Reporting by Employers for Postem-
ployment Benefits Other Than Pensions, to establish standards for
the measurement, recognition, and display of OPEB expense or
expenditures and related liabilities in the financial reports of state
and local governments. The Statement would become effective in
three annual phases based on a government's implementation
phase for the purpose of GASB Statement No. 34 starting for pe-
riods beginning after December 15, 2006. Earlier application
would be encouraged.

Help Desk—If you are interested in tracking the progress of
the GASB's projects, look at the GASB Web site at www.gasb.
org. The GASB generally posts EDs on that site during the ex-
posure period.
Resources

See the “Information Resources” section of the AICPA Audit Risk Alert *State and Local Governmental Developments—2004* for a listing of resources for governmental entities, including governmental plans.
<table>
<thead>
<tr>
<th>Organization</th>
<th>General Information</th>
<th>Fax Services</th>
<th>Web Site Address</th>
</tr>
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<tbody>
<tr>
<td>American Institute of Certified Public Accountants</td>
<td>Order Department Harborside Financial Center 201 Plaza Three Jersey City, NJ 07311-3881 (888) 777-7077</td>
<td>24-Hour Fax Hotline (201) 938-3787</td>
<td><a href="http://www.aicpa.org">www.aicpa.org</a></td>
</tr>
<tr>
<td>Financial Accounting Standards Board</td>
<td>Order Department P.O. Box 5116 Norwalk, CT 06856-5116 (203) 847-0700, ext. 10</td>
<td>24 Hour Fax-on-Demand (203) 847-0700, menu item 14</td>
<td><a href="http://www.fasb.org">www.fasb.org</a></td>
</tr>
<tr>
<td>Public Company Accounting Oversight Board</td>
<td>1666 K Street, NW Washington DC 20006-2803 (202) 207-9100</td>
<td></td>
<td><a href="http://www.pcaobus.org">www.pcaobus.org</a> or <a href="http://www.pcaob.com">www.pcaob.com</a></td>
</tr>
<tr>
<td>Department of Labor Pension and Welfare Benefits Administration:</td>
<td></td>
<td></td>
<td><a href="http://www.dol.gov/dol/EBSA">www.dol.gov/dol/EBSA</a></td>
</tr>
<tr>
<td>Office of the Chief Accountant</td>
<td>(202) 693-8360</td>
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<tr>
<td>Division of Accounting Services</td>
<td>ERISA related accounting and auditing questions (202) 693-8360</td>
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<tr>
<td>Division of Reporting Compliance</td>
<td>Form 5500 preparation and filing requirements (202) 693-8560</td>
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<tr>
<td>Office of Regulations and Interpretations</td>
<td>(202) 693-8500</td>
<td></td>
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