Accounting trends & techniques, employee benefit plans : financial statement reporting and disclosure practices

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Accounting Trends & Techniques

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Financial Statement Reporting and Disclosure Practices


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PREFACE

ABOUT THIS EDITION OF *ACCOUNTING TRENDS & TECHNIQUES–EMPLOYEE BENEFIT PLANS*

This publication provides illustrative disclosures for financial statements of employee benefit plans. It has been issued by the Accounting and Auditing Publications group of the AICPA and is intended to provide practitioners with nonauthoritative practical guidance on such disclosures.

Background

The contents of this publication, its focus, and the way it has been presented was originally shaped by the members of the 1997–98 AICPA Employee Benefit Plans Committee, who recognized the need for disclosure guidance in the area of employee benefit plans.

This publication was originally issued as a Practice Aid titled *Financial Statement Reporting and Disclosure Practices for Employee Benefit Plans* and was reissued as a second edition in 2000. In 2003, this publication was updated and renamed *Accounting Trends & Techniques—Employee Benefit Plans*, with a second edition reissued in 2005. This revised third edition of the publication has been updated by the AICPA staff to include certain changes necessary because of the issuance of authoritative accounting and auditing pronouncements, Financial Accounting Standards Board (FASB) Accounting Standards Updates (ASUs), and other changes necessary to keep this publication current on industry and regulatory matters.

Relevant guidance contained in official pronouncements issued through March 1, 2010, has been considered in the development of this edition of the book. This includes relevant guidance issued up to and including the following:

- FASB ASU No. 2009-12, *Fair Value Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*
- Statement on Auditing Standards No. 120, *Required Supplementary Information* (AICPA, *Professional Standards*, vol. 1, AU sec. 558)

Users of this edition should consider guidance issued subsequent to those items in the preceding list to determine their effect on entities covered by this publication.

New for This Edition

Among other things, this edition has been updated to reflect illustrative disclosures, in accordance with FASB *Accounting Standards Codification* 820, *Fair Value Measurements and Disclosures.* This edition also includes illustrative disclosures to reflect FASB ASC 855, *Subsequent Events*; new illustrative auditor's reports for 403(b) plans; and new illustrative Form 5500 schedule H line 4a—Schedule of Delinquent Participant Contributions.

Note: This edition does not illustrate the required disclosures for FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133* (codified in FASB ASC 815, *Derivatives and Hedging*) due to the effective date. Also, the changes from FASB ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*, are not illustrated because those changes are not yet effective.

For information regarding the preceding pronouncements, refer to the AICPA Audit Risk Alert *Employee Benefit Plans Industry Developments—2010*.

Financial Statement Examples

The examples contained herein have been taken from (*a*) actual financial statements of audited pension plans that have been edited to protect confidentiality; (*b*) examples developed by the Employee Benefit Plans Committee and the AICPA Employee Benefit Plans Expert Panel; and (*c*) the AICPA Audit and Accounting Guide *Employee Benefit Plans (With Conforming Changes as of March 1, 2010)* (EBP guide). The entity names used in the examples are fictitious. Any resemblance or similarities to real companies are entirely coincidental and beyond the intent of the staff or committee.

Please note that all years have been changed to reflect the current year as 20X2 (with 20X1 as the prior year and 20X3 the succeeding year).

Organization

This publication is organized to be used as a reference tool based on disclosures for specific types of pension plans as follows:

- Section 1 contains illustrative disclosures specific to defined benefit pension plans.
- Section 2 contains illustrative disclosures specific to defined contribution pension plans.
- Section 3 contains illustrative disclosures specific to health and welfare benefit plans.
- Section 4 contains illustrative disclosures general to all types of plans, such as subsequent events, related parties, and tax status.
- Section 5 contains illustrative disclosures and auditor reports for limited scope audits.
- Section 6 contains illustrative auditor's reports for all types of pension plans.
- Section 7 contains illustrative Form 5500 supplemental schedules.
- Section 8 contains illustrative management letters and comments for all types of employee benefit plans.

This publication is not a substitute for the authoritative pronouncements. Users of this publication are urged to refer directly to applicable authoritative pronouncements, when appropriate.

These disclosures are intended as guidance only and should be tailored to the specific circumstances of each engagement. Although many of the disclosures contained herein are for single employer plans, many of the disclosures also pertain to multiemployer plans and should be modified appropriately. For further guidance on financial statement disclosures, see the EBP guide and the following AICPA financial statement disclosure checklists: *Checklists and Illustrative Financial Statements for Defined Contribution Pension Plans*, *Checklists and Illustrative Financial Statements for Defined Benefit Pension Plans*, and *Checklists and Illustrative Financial Statements for Health and Welfare Benefit Plans*.

Management Letter Comments (for Nonissuers)

Section 8 pertains to audits of nonissuers only.[1] AU section 325, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA *Professional Standards,* vol. 1), provides guidance to enhance your ability to identify and evaluate control deficiencies during an audit and then communicate to management and those charged with governance those deficiencies that you believe are significant deficiencies or material weaknesses.

AU section 325 states that deficiencies identified during the audit that, upon evaluation, are considered significant deficiencies or material weaknesses under this section should be communicated in writing to management and those charged with governance as a part of each audit, including significant deficiencies and material weaknesses that were communicated to management and those charged

[1] Subject to Securities and Exchange Commission (SEC) oversight, Section 103 of the Sarbanes-Oxley Act of 2002 (act) authorizes the Public Company Accounting Oversight Board (PCAOB) to establish auditing and related attestation, quality control, ethics, and independence standards to be used by registered public accounting firms in the preparation and issuance of audit reports, as required by the act or the rules of the SEC. Accordingly, public accounting firms registered with the PCAOB are required to adhere to all PCAOB standards in the audits of issuers, as defined by the act, and other entities when prescribed by the rules of the SEC. Generally, plans that are required to file Form 11-K would be considered issuers. For audits of issuers, such as Form 11-K audits, see the AICPA publication *PCAOB Standards and Related Rules,* and AU-P section 325, *Communications About Control Deficiencies in an Audit of Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, PCAOB Standards, Interim Standards), for guidance.

with governance in previous audits and have not yet been remediated. Significant deficiencies and material weaknesses that previously were communicated and have not yet been remediated may be communicated in writing by referring to the previously issued written communication and the date of that communication. If other matters are communicated orally, the auditor should document the communication.

Section 8 of this publication shows illustrative deficiencies that have been communicated to management on actual employee benefit plan audits to illustrate deficiencies noted and suggestions for improving operations of the plan. The illustrations in section 8 are control deficiencies that are not significant deficiencies or material weaknesses. AU section 325 provides guidance on how to assess whether control deficiencies are significant deficiencies or material weaknesses. When a written communication is issued to those charged with governance, these other matters may be communicated in the same letter or in a separate letter, as illustrated in section 8.

Significant Deficiencies (for Audits of Issuers Only, Such as Form 11-K Audits)

AU-P section 325, *Communications About Control Deficiencies in an Audit of Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, PCAOB Standards, Interim Standards), requires auditors to communicate in writing to management and the audit committee[2] all significant deficiencies and material weaknesses identified during the audit. The written communication should be made prior to the issuance of the auditor's report on the financial statements. The auditor's communication should clearly distinguish between those matters considered significant deficiencies and those considered material weaknesses.

The Form 5500 Series

In addition to the reporting requirements of generally accepted accounting principles, employee benefit plans may have reporting requirements under the Employee Retirement Income Security Act of 1974 (ERISA), as amended. The annual report to be filed for employee benefit plans generally is the Form 5500 series.

The U.S. Department of Labor (DOL) has released tips to avoid common filing errors. The tips will help plans avoid basic filing errors and can be found on the Employee Benefits Security Administration (EBSA) Web site at www.dol.gov/ebsa.

Small Pension Plan Audit Waiver

The DOL has released frequently asked questions (FAQs) for small pension plans that use the audit exception to assist filers in complying with their reporting obligations. The FAQs will help 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 on the EBSA Web site at www.dol.gov/ebsa.

Supplemental Schedules

Form 5500 requires that certain supplemental schedules be attached to the annual Form 5500 filing. Such schedules include the following:

- Schedule H, line 4a—Schedule of Delinquent Participant Contributions
- Schedule H, line 4i—Schedule of Assets (Held at End of Year)
- Schedule H, line 4i—Schedule of Assets (Acquired and Disposed of Within Year)
- Schedule H, line 4j—Schedule of Reportable Transactions[3]

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[2] For audits of public companies, such as Form 11-K audits, if no such committee exists with respect to the entity, all references to the audit committee in this standard apply to the entire board of directors of the entity.

[3] Participant- or beneficiary-directed transactions are not required to be taken into account for purposes of preparing the schedule of reportable transactions. In a plan's initial year, the 5 percent threshold for the schedule of reportable transactions is based on the end-of-year balance of the plan's assets.

The following schedules are required to be reported on Schedule G:

- Schedule G, Part I—Schedule of Loans or Fixed Income Obligations in Default or Classified as Uncollectible
- Schedule G, Part II—Schedule of Leases in Default or Classified as Uncollectible
- Schedule G, Part III—Nonexempt Transactions

Section 403(b) Retirement Plans

Beginning with 2009 Form 5500 filings, employee benefit plans under Section 403(b) of the Internal Revenue Code that are sponsored by charitable organizations and covered under ERISA will be subject to the same reporting and audit requirements that currently exist for Section 401(k) plans. Many plans will face significant challenges in establishing plan accounting records and proper controls; identifying all participant accounts to be included as plan assets; determining beginning account balances (that is, comparative balances also are required as of December 31, 2008, for calendar year plans); and obtaining other financial information to be included in the plan's financial statements. As a result, plan sponsors need to ensure they are prepared for how the new audit requirements will affect their plan. Discussions, tools, and resources regarding the new audit requirement for these Section 403(b) retirement plans can be found at www.aicpa.org/EBPAQC and the AICPA Audit Risk Alert *Employee Benefit Plans Industry Developments—2010*.

RECENT ACCOUNTING UPDATES

FASB ASC

On the effective date of FASB Statement No. 168, *The* FASB Accounting Standards Codification™ *and the Hierarchy of Generally Accepted Accounting Principles—a replacement of FASB Statement No. 162*, FASB ASC became the source of authoritative U.S. accounting and reporting standards for nongovernmental entities, in addition to guidance issued by the Securities and Exchange Commission (SEC). At that time, FASB ASC superseded all then-existing, non-SEC accounting and reporting standards for nongovernmental entities. Once effective, all other nongrandfathered, non-SEC accounting literature not included in FASB ASC became nonauthoritative. This change affects accountants and auditors alike.

Plan accounting may be found in the following sections of FASB ASC:

- FASB ASC 960, *Plan Accounting—Defined Benefit Pension Plans*
- FASB ASC 962, *Plan Accounting—Defined Contribution Pension Plans*
- FASB ASC 965, *Plan Accounting—Health and Welfare Benefit Plans*

Fair Value Measurements and Disclosures

In September 2006, FASB issued FASB Statement No. 157, *Fair Value Measurements*, which was codified in FASB ASC 820, to provide enhanced guidance for using fair value to measure assets and liabilities. This standard defines *fair value* and expands disclosures about fair value measurements. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances.

For plan assets and liabilities that are traded in active markets, fair value is determined based on quoted market prices. If quoted market prices for identical assets and liabilities are not available, the plan uses valuation techniques that should maximize the use of observable inputs (assumptions based on market data) and minimize the use of unobservable inputs. In measuring fair value, the plan should make adjustments for risks and uncertainties if a market participant would include such an adjustment in its pricing. FASB ASC 820 requires entities to make certain disclosures for each major category of assets and liabilities that are measured at fair value, including the level within the fair value hierarchy in which the fair value measurements fall, as discussed in FASB ASC 820-10-35. For disclosure requirements, refer to FASB ASC 820-10-50.

In October 2008, FASB issued FASB Staff Position (FSP) FAS 157-3, *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active*, to provide guidance in applying fair value in an illiquid or distressed market. FSP FAS 157-3 was codified in FASB ASC 820 and clarified the application of FASB ASC 820 in an inactive market and amended FASB ASC 820 to include an illustrative example.

In April 2009, FASB issued FSP FAS 157-4, *Determining Fair Value When the Volume and Level of Activity for the Asset or Liability Have Significantly Decreased and Identifying Transactions That Are Not Orderly*, which also was codified in FASB ASC 820. This FSP emphasizes that even if there has been a significant decrease in the volume and level of activity for the asset or liability, and regardless of the valuation technique(s) used, the objective of a fair value measurement remains the same. *Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction (that is, not a forced liquidation or distressed sale) between market participants at the measurement date under current market conditions.

See the "Fair Value Measurements" sections of chapters 2–4 of the AICPA Audit and Accounting Guide *Employee Benefit Plans* for further discussion. In addition, readers are encouraged to consult the entire section of FASB ASC 820.

FEEDBACK

We hope that you find this edition of *Accounting Trends & Techniques—Employee Benefit Plans* to be informative and useful. Please let us know. What features do you like? What do you think can be improved or added? We encourage you to give us your comments and questions about all aspects of this publication. Please direct your feedback to Diana Krupica, using the following contact information. All feedback is greatly appreciated and kept strictly confidential.

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TABLE OF CONTENTS

SECTION 1: DISCLOSURES SPECIFIC TO DEFINED BENEFIT PENSION PLANS

1. DESCRIPTION OF THE PLAN

1.01

Note X: Description of the Plan

The following brief description of the retirement income plan for certain salaried employees (plan) is provided for general information purposes only. Participants should refer to the plan document for more complete information.

a. *General*—The plan is a defined benefit pension plan covering certain salaried employees at divisions, plants, offices, or locations designated by Red Corporation. Red Corporation's Employee Benefit Plan Committee, its Central Retirement Committee, and the plan administrator control and manage the operation and administration of the plan. ABC Bank serves as the trustee of the plan and, together with several investment managers, manages a portion of the plan's investment assets. The plan's other investment assets consist of unallocated insurance contracts with National Insurance Company and United Insurance Company. The plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA), as amended.
b. *Pension benefits*—Participants generally become fully vested after 5 years of vesting service, as defined by the plan. There is no partial vesting of benefits. The plan provides for normal retirement benefits upon reaching age 65 and has provisions for early retirement benefits. The plan also provides for benefits upon meeting certain other preconditions. Upon retirement, the amount of benefits under the plan is the highest amount determined based upon three different computations: (1) the career earnings formula; (2) the alternate benefit formula; or (3) the minimum benefit formula, as provided by the plan. Under each benefit computation, the annual benefit is a percentage of earnings or average annual earnings multiplied or adjusted by years of credited service. Benefits are payable in the form of a joint and survivor annuity, a single life annuity, or other optional forms.

1.02

Note X: Plan Description

The following brief description of the C&H Company pension plan (plan) is provided for general information purposes only. Participants should refer to the plan agreement for more complete information.

1. *General*. The plan is a defined benefit pension plan covering substantially all employees of C&H Company (company). It is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA), as amended.
2. *Pension benefits*. Employees with 5 or more years of service are entitled to annual pension benefits beginning at normal retirement age (65), equal to 1 percent of their final 5-year average annual compensation for each year of service. The plan permits early retirement at ages 55–64. Employees may elect to receive their pension benefits in the form of a joint and survivor annuity. If employees terminate before rendering 5 years of service, they forfeit the right to receive the portion of their accumulated plan benefits attributable to the company's contributions. Employees may elect to receive the value of their accumulated plan benefits as a lump sum distribution upon retirement or termination, or they may elect to receive their benefits as a life annuity, payable monthly from retirement. For each employee electing a life annuity, payments will not be less than the greater of (*a*) the employee's accumulated contributions plus interest or (*b*) an annuity for 5 years.
3. *Death and disability benefits*. If an active employee dies at age 55 or older, a death benefit equal to the value of the employee's accumulated pension benefits is paid to the employee's beneficiary. Active employees who become totally disabled receive annual disability benefits that are equal to the normal retirement benefits they have accumulated as of the time they become disabled. Disability

benefits are paid until normal retirement age, at which time disabled participants begin receiving normal retirement benefits computed as though they had been employed to normal retirement age, with their annual compensation remaining the same as at the time they became disabled.

1.03

Note X: Description of the Plan

The XYZ Company pension plan (plan) is a multiple employer plan maintained by XYZ Company and GHI Company as a defined benefit pension plan. The plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA), as amended.

Employees eligible to participate in the plan are those employees of XYZ Company and GHI Company who are at least 21 years old.

The Pension Committee of XYZ Company is the plan administrator. Additional information concerning the plan and its provisions can be found in the summary plan description. A copy of that document can be obtained from the plan administrator through XYZ Company, 1 New York Plaza, New York, NY 10021.

1.04

[*For a supplemental defined benefit pension plan that integrates with a basic defined benefit pension plan.*]

Note X: Description of the Plan

The following brief description of the supplemental retirement plan for nonrepresented employees of Jaba Corporation (plan) is provided for general information purposes only. Participants should refer to the plan document for more complete information.

a. *General*—The plan is a defined benefit pension plan intended to supplement the amount of the retirement benefits payable under Jaba Corporation's (company's) basic retirement plan—the retirement plan for employees of Jaba Corporation (retirement plan)—to employees who are not represented by a collective bargaining agreement. The plan is administered by the company and provides for the establishment of a trust.

   Effective January 1, 20X0, a master trust arrangement was established for the plan and the retirement plan. Use of the master trust permits the commingling of plan assets and retirement plan assets for investment and administrative purposes. Although assets are commingled in the master trust, ABC Bank maintains supporting records for the purpose of allocating the net gain of the investment accounts to both plans.

   The plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA), as amended.

b. *Vesting and pension benefits*—The plan covers all full time employees of the company, except those covered under a collective bargaining agreement. Employees become fully vested in benefits after 5 years of credited service, as defined by the plan. The plan provides for regular retirement benefits upon reaching age 65 and has provisions for disability; early retirement; survivor; and other benefits, each of which reduces the regular benefit by an amount stated in the plan or determined by the plan's actuary. Annual benefits at retirement are based on compensation and years of continuous service, reduced by the amount of the pension payable under the company's basic retirement plan.

[*For a defined benefit pension plan that includes a medical benefit component (401(h) account).*]

1.05

Note X: Description of the Plan

The plan includes a medical benefit (health and welfare) component, in addition to the normal retirement benefits, to fund a portion of the postretirement obligations for retirees and their beneficiaries, in accordance with Internal Revenue Code (IRC) Section 401(h). A separate account has been established and maintained in the plan for the net assets related to the health and welfare component [401(h) account]. In accordance with IRC Section 401(h), the plan's investments in the 401(h) account may not be used for, or diverted to, any purpose other than providing health and welfare benefits for retirees and participants. Any assets transferred to the 401(h) account from the defined benefit pension plan in a qualified transfer of excess pension plan assets (and any income allocable thereto) that are not used during the plan year must be transferred out of the account to the pension plan. The related obligations for health and welfare benefits are not included in this plan's obligations in the statement of accumulated plan benefits but are reflected as obligations in the financial statements of the health and welfare benefit plan. Plan participants do not contribute to the 401(h) account. Employer contributions or qualified transfers to the 401(h) account are determined annually and are at the discretion of the plan sponsor.

1.06

Note X: 401(h) Account

Effective January 1, 20X0, the plan was amended to include a medical benefit component, in addition to the normal retirement benefits, to fund a portion of the postretirement obligations for retirees and their beneficiaries, in accordance with Internal Revenue Code (IRC) Section 401(h). A separate account has been established and maintained in the plan for the net assets related to the medical benefit component [401(h) account]. In accordance with IRC Section 401(h), the plan's investments in the 401(h) account may not be used for, or diverted to, any purpose other than providing health benefits for retirees and their beneficiaries. Any assets transferred to the 401(h) account from the defined benefit pension plan in a qualified transfer of excess pension plan assets (and any income allocable thereto) that are not used during the plan year must be transferred out of the account to the pension plan. The related obligations for health benefits are not included in this plan's obligations in the statement of accumulated plan benefits but are reflected as obligations in the financial statements of the health and welfare benefit plan. Plan participants do not contribute to the 401(h) account. Employer contributions or qualified transfers to the 401(h) account are determined annually and are at the discretion of the sponsor. Certain of the plan's net assets are restricted to fund a portion of postretirement health benefits for retirees and their beneficiaries, in accordance with IRC Section 401(h).

1.07

[*The following disclosure is for when a pension plan becomes a cash balance pension plan.*]

Note X (In Part): Description of the Plan

The plan is a noncontributory cash balance plan covering substantially all employees of ABC Inc. . . . Effective January 1, 20X2, a hypothetical account is maintained for each participant in which contributions are credited for the benefit of the individual. Participants who were actively employed on December 31, 20X1, were credited with a lump sum opening balance equivalent to the present value of accrued pension benefits under the plan's prior benefit provisions. For participants who were at least age 35 and had 10 or more years of service, transitional contributions ranging from 4 percent to 10 percent, based on age and years of service, will be made for up to 10 years.

1.08

[*The following disclosure is for a multiemployer collectively bargained defined benefit pension plan.*]

Note X: Description of the Plan

The following description of the Candlestick Union and Industry International pension plan (plan) provides only general information. Participants should refer to the trust agreement and summary plan description and rules and regulations for a more complete description of the plan's provisions.

a. *General*—The plan is a multiemployer collectively bargained defined benefit pension plan subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA), as amended. The plan operates as a trust to provide retirement benefits to retirees who, during active employment, were covered employees of participating employers under collectively bargained agreements with various local unions of the Candlestick, Wax Workers, and Wick Makers International Union.
b. *Administration of the trust*—The administration of the trust is the responsibility of the plan's board of trustees, which comprises union and employer trustees. The investments of the fund are managed by 10 investment advisors. ABC Deposit and Trust Company serves as the custodian of the plan's investments.

c. *Pension benefits*—Generally, participants with 5 or more years of vested service are entitled to annual pension benefits beginning at age 65. The plan permits early retirement at ages 55–64. The pension benefit amount varies depending on the benefit level in the collective bargaining agreement when employment is terminated, earned pension credits, retirement age, and certain participant elections.

Participants generally will receive benefits under one of several husband and wife options, which guarantee payment of benefits during the lives of both the participant and the participant's spouse, unless the participant, with spousal consent, elects the single life option. Alternatively, a participant may elect other options whereby pension payments are guaranteed for a certain period from the effective date of the pension, and if the pensioner dies prior to the end of the period, his or her beneficiary receives the remaining payments.

d. *Disability benefits*—Participants who become totally and permanently disabled, have at least 10 years of pension credit, and have been disabled for 6 months receive disability pension benefits that are equal to the normal retirement benefits they have accumulated as of the time they become disabled.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1.09

Note X (In Part): Summary of Significant Accounting Policies

c. *Actuarial present value of accumulated plan benefits—Accumulated plan benefits* are those future periodic payments, including lump sum distributions, that are attributable under the plan's provisions to the service employees have rendered. The actuarial present value of accumulated plan benefits has been determined by an independent actuary and is that amount that results from applying actuarial assumptions to adjust the accumulated plan benefits to reflect the time value of money (through discounts for interest) and the probability of payment (by means of decrements such as for death, disability, withdrawal, or retirement) between the benefit information date and the expected payment date. The effect of plan amendments on accumulated plan benefits is recognized during the year in which such amendments are adopted.

The significant actuarial assumptions used in determining accumulated plan benefits as of December 31, 20X2, are as follows:

Investment return	7.0%, compounded annually
Mortality	RP-2000 combined mortality table
Retirement	Average retirement age—61

The foregoing actuarial assumptions are based on the presumption that the plan will continue. If the plan were to terminate, different actuarial assumptions and other factors might be applicable in determining the actuarial present value of accumulated plan benefits.

1.10

Note X: Summary of Significant Accounting Policies

The following are the significant accounting policies followed by the plan:

1. *Basis of accounting.* The accompanying financial statements are prepared on the accrual basis of accounting.
2. *Use of estimates.* The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and changes therein; disclosure of contingent assets and liabilities; and the actuarial present value of accumulated plan benefits at the date of the financial statements. Actual results could differ from those estimates.

3. *Investment valuation and income recognition.* Investments are recorded at fair value. *Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See note E for a discussion of fair value measurements.

   Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the exdividend date. Net appreciation includes the plan's gains and losses on investments bought and sold, as well as held during the year.
4. *Actuarial present value of accumulated plan benefits. Accumulated plan benefits* are those future periodic payments, including lump sum distributions, that are attributable under the plan's provisions to the service employees have rendered. Accumulated plan benefits include benefits expected to be paid to (*a*) retired or terminated employees or their beneficiaries, (*b*) beneficiaries of employees who have died, and (*c*) present employees or their beneficiaries.

   Benefits under the plan are based on employees' compensation during their last five years of credited service. The accumulated plan benefits for active employees are based on their average compensation during the five years ending on the date as of which the benefit information is presented (the valuation date). Benefits payable under all circumstances—retirement, death, disability, and termination of employment—are included, to the extent they are deemed attributable to employee service rendered to the valuation date. Benefits to be provided via annuity contracts excluded from plan assets are excluded from accumulated plan benefits.

   The actuarial present value of accumulated plan benefits is determined by an actuary from the AAA Company and is that amount that results from applying actuarial assumptions to adjust the accumulated plan benefits to reflect the time value of money (through discounts for interest) and the probability of payment (by means of decrements such as for death, disability, withdrawal, or retirement) between the valuation date and the expected date of payment. The significant actuarial assumptions used in the valuations as of December 31, 20X2, and 20X1 were (*a*) life expectancy of participants (the RP 2000 Combined Mortality Table was used), (*b*) retirement age assumptions (the assumed average retirement age was 60), and (*c*) investment return. The 20X2 and 20X1 valuations included assumed average rates of return of 7 percent and 6.25 percent, respectively, including a reduction of 0.2 percent to reflect anticipated administrative expenses associated with providing benefits. The foregoing actuarial assumptions are based on the presumption that the plan will continue. Were the plan to terminate, different actuarial assumptions and other factors might be applicable in determining the actuarial present value of accumulated plan benefits.
5. *Payment of benefits.* Benefit payments to participants are recorded upon distribution.
6. *Subsequent events*. The plan has evaluated subsequent events through July 31, 20XX, the date the financial statements were available to be issued.

1.11

Note X (In Part): Summary of Significant Accounting Policies

d. *Use of estimates*—The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of plan assets and the actuarial present value of accumulated plan benefits at the date of the financial statements. Actual results could differ from those estimates.

1.12

Note X (In Part): Summary of Significant Accounting Policies

Net appreciation (depreciation) in fair value of investments. Net realized and unrealized appreciation (depreciation) is recorded in the accompanying financial statements as net appreciation (depreciation) in fair value of investments.

1.13

[*The following disclosure is for when a pension plan becomes a cash balance pension plan.*]

Note X (In Part): Summary of Significant Accounting Policies

Actuarial Present Value of Accumulated Plan Benefits

. . .Through December 31, 20X1, benefits under the plan were based on employee's years of credited service and the final average annual salary for a 3 consecutive year period, which results in the highest average within the last 10 plan years preceding the employee's retirement or termination of service. Effective January 1, 20X2, benefits under the plan are based on the participant's hypothetical account balance.

1.14

[*The following disclosure is for a multiemployer collectively bargained defined benefit pension plan.*]

Note X (In Part): Summary of Significant Accounting Policies

H. Allocation of Administration Expenses

Certain expenses incurred for the benefit of both the fund and the Candlestick Union and Industry benefits fund (benefits fund) are allocated to the respective funds based upon the following various factors:

- Rental and related expenses are allocated based upon the square footage of office space devoted to each fund.
- Payroll processing expenses are based on the number of employees of each fund.
- Administrative services, accounting, records processing, and electronic data processing expenses are allocated 60 percent to the fund and 40 percent to the benefits fund, based on management's estimation of utilization.
- Certain administrative expenses incurred by the fund for the processing of medical or death benefits, or both, to retirees are allocated to the benefits fund, based on management's determination of the expenses that relate to the processing of those benefits.

I. Employers' Withdrawal Liability

The fund complies with the provisions of the Multiemployer Pension Plan Amendments Act of 1980 that require imposition of withdrawal liability on a contributing employer that partially or totally withdraws from the fund. The trustees adopted the first alternative method set forth in ERISA Section 4211(c)(2) to allocate potential employers' liabilities. Basically, a portion of the fund's actuarially determined unfunded vested liability is allocated to a withdrawing employer in proportion to the employer's contributions in the 10 years before withdrawal compared with total employers' contributions during the same period.

1.15

[*The following disclosure is for a multiemployer collectively bargained defined benefit pension plan.*]

Note X: Termination Priorities

Benefits under the plan are insured by the Pension Benefit Guaranty Corporation (PBGC). In the event that the plan terminates, the net assets of the plan shall be allocated among the participants and beneficiaries, in accordance with the priorities mandated by ERISA. Whether a particular participant's accumulated plan benefits will be paid depends on both the priority of those benefits and the level of benefits guaranteed by the PBGC at that time. Some benefits may be fully or partially provided for by the then existing assets and the PBGC guaranty, but other benefits may not be provided for at all.

A full description of the defined benefit plan termination priorities is available in the summary plan description and rules and regulations.

3. INVESTMENTS

Practice Tip:

Financial Accounting Standards Board (FASB) Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133*, which was codified in FASB *Accounting Standards Codification* (ASC) 815, *Derivatives and Hedging*, expands the disclosure requirements in FASB ASC 815 about an entity's derivative instruments and hedging activities. It is effective for financial statements issued for fiscal years beginning after November 15, 2008. The disclosure provisions of this statement apply to employee benefit plan financial statements. The new guidance requires more robust qualitative disclosures and expanded quantitative disclosures. Such disclosures generally will need to be presented for every annual and interim reporting period for which a statement of net assets and a statement of changes in net assets are presented. Upon adoption, entities are encouraged, but not required, to provide comparative disclosures for earlier periods.

1.16

Note X: Investments

During 20X2 and 20X1, the plan's investments appreciated (depreciated) in fair value by $4,206,708 and $(449,844), respectively, as follows:

	Net Appreciation (Depreciation) in Fair Value	
	20X2	*20X1*
Collective investment trusts	$ 0	$(434,382)
Equity securities	3,880,090	152,126
Mutual funds	326,618	(167,588)
	$4,206,708	$(449,844)

1.17

Note X: Investments

The fair market values of individual assets that represent 5 percent or more of the plan's net assets as of December 14, 20X2, and 20X1 are as follows:

	20X2
ABC Bank money market, variable rate—4.87% as of December 14, 20X2	$2,438,340
National Life Insurance Company, group annuity contract No. 6455739, variable rate—5.5% as of December 14, 20X2	242,718
National Life Insurance Company, group annuity contract No. 6455744, variable rate—5.5% as of December 14, 20X2	933,536

	20X1
Cash surrender value of Prosperity Life Insurance policy	$946,908
National Life Insurance Company, group annuity contract No. 6455739, variable rate—5.25% as of December 14, 20X1	230,388
National Life Insurance Company, group annuity contract No. 6455744, variable rate—5.25% as of December 14, 20X1	886,510

1.18

[*The following disclosure is from a multiple employer plan.*]

Note X: Investments

The plan's investment in a commingled trust liquid reserve fund, which had a cost and fair value of $4,887,386, was the only investment held by the plan that exceeded 5 percent of the plan's net assets at March 31, 20X2.

The plan's investment in the 9.25 percent U.S. Treasury notes due May 15, 20X5, which had a cost of $4,641,446 and a fair value of $4,537,974, was the only investment held by the plan that exceeded 5 percent of the plan's net assets at March 31, 20X2.

During the years ended March 31, 20X2, and 20X1, the plan had net appreciation (depreciation) (including gains and losses on investments bought and sold, as well as held during the year) in the fair value of investments as follows:

	20X2	*20X1*
United States government and agency securities	$ 358,124	$ (48,452)
Municipal bonds	7,158	16,758
Corporate bonds	29,600	(56,760)
Convertible bonds	94,872	61,682
Foreign bonds	(240,488)	(136,126)
Asset-backed securities	(21,158)	3,984
Mortgage-backed securities	131,482	62,970
Common stocks	11,489,778	4,452,674
Preferred stocks	38,652	50,478
Mutual funds	119,590	—
Total	$12,007,610	$4,407,208

1.19

[*The following disclosure is for a multiemployer collectively bargained defined benefit pension plan.*]

Note X: Investments

Investments held at December 31, 20X2, and 20X1 are summarized as follows:

	Assets at Fair Value as of December 31, 20X2			
	Level 1	*Level 2*	*Level 3*	*Total*
Short term investments	$ 293,749,835	$ —	$ —	$ 293,749,835
U.S. government securities	302,667,460	—	—	302,667,460
Corporate bonds	486,299,471	85,018,445	35,736,108	607,054,024
Other bonds	—	78,335,920	25,264,906	103,600,826
Bond index fund	277,034,912	72,986,223	24,427,621	374,448,756
Stocks	2,252,828,064	—	—	2,252,828,064
Equity mutual funds	546,808,188	—	—	546,808,188
Real estate investment trusts	—	—	322,088,945	322,088,945
Mortgages	—	—	—	—
Private equity holdings	—	—	42,225,925	42,225,925
Guaranteed insurance contracts	—	—	351,673,350	351,673,350
Total assets	$4,159,387,930	$236,340,588	$801,416,855	$5,197,145,373

	Assets at Fair Value as of December 31, 20X1			
	Level 1	*Level 2*	*Level 3*	*Total*
Short term investments	$ 376,342,476	$ —	$ —	$ 376,342,476
U.S. government securities	588,109,934	—	—	588,109,934
Corporate bonds	376,056,938	61,940,577	20,281,985	458,279,500
Other bonds	—	146,378,888	61,576,521	207,955,409
Bond index fund	423,755,925	84,228,446	38,930,407	546,914,778
Stocks	2,271,647,515	—	—	2,271,647,515
Equity mutual funds	486,677,649	—	—	486,677,649
Real estate investment trusts	—	—	296,087,740	296,087,740
Mortgages	—	—	578	578
Private equity holdings	—	—	27,038,205	27,038,205
Guaranteed insurance contracts	—	—	306,275,730	306,275,730
Total assets	$4,522,590,437	$292,547,911	$750,191,166	$5,565,329,514

The fair values of investments that individually represent 5 percent or more of the fund's net assets available for benefits at December 31, 20X2, and 20X1 are as follows:

	20X2	*20X1*
U.S. Debt Bond Index Fund	$ 372,448,756	$ 546,914,778
Longview Collective Investment Fund	297,951,316	223,200,898
Guaranteed insurance contract	351,673,350	306,275,730
	$1,076,391,406	$1,022,073,422

During 20X2 and 20X1, the fund's investments (including investments bought, sold, and held during the year) appreciated (depreciated) in value as follows:

	20X2	*20X1*
U.S. government securities	$ 7,973,265	$ 31,832,147
Corporate bonds	54,045	(5,167,688)
Other bonds	(12,350,719)	12,192,326
Bond index fund	45,228,879	62,386,171
Stocks	(232,968,190)	(46,738,844)
Equity mutual funds	(89,873,376)	(52,619,285)
Real estate investment trusts	18,829,680	22,368,868
Guaranteed insurance contracts	23,966,295	6,275,730
Total	$(239,140,121)	$ 30,529,425

1.20

Note X: Securities Lending

The trustees of the plan have an agreement with the custodial bank for the plan authorizing the bank to lend securities held in the plan account to third parties. The bank must obtain collateral from the borrower in the form of cash, letters of credit issued by an entity other than the borrower, or acceptable securities. Both the collateral and the securities loaned are marked-to-market on a daily basis so that all loaned securities are fully collateralized at all times. In the event that the loaned securities are not returned by the borrower, the bank will, at its own expense, either replace the loaned securities or, if unable to purchase those securities on the open market, credit the plan account with cash equal to the fair value of the loaned securities.

The plan and the bank each receive a percentage of the net income derived from securities lending activities based on the type of securities. Income earned during 20X2 and 20X1 was $1,363,284 and $1,133,473, respectively, net of bank fees of $569,960 and $489,944, respectively.

Although the plan's securities lending activities are collateralized as previously described, they involve both market and credit risk. In this context, *market risk* refers to the possibility that the borrowers of securities will be unable to collateralize the loan upon a sudden material change in the fair value of the loaned securities or collateral. *Credit risk* refers to the possibility that counterparties involved in the securities lending program may fail to perform in accordance with the terms of their contracts.

The fair value of securities loaned by the plan is $138,000,000 at December 31, 20X2, and $112,000,000 at December 31, 20X1.

1.21

Note X: Securities Lending

The plan participates in a securities lending program with the trustee. The program allows the trustee to loan securities, which are assets of the plan, to approved brokers (borrowers). The trustee requires borrowers, pursuant to a security loan agreement, to deliver collateral to secure each loan. The collateral requires ranges between 102 percent and 100 percent of the fair value of U.S. securities borrowed and 105 percent for non-U.S. securities borrowed. The plan bears the risk of loss with respect to the unfavorable change in fair value of the invested cash collateral. However, the borrower bears the risk of loss related to the decrease in the fair value of the securities collateral and, therefore, will have to deliver additional securities to maintain the required collateral. In the event of default by the borrower, the trustee shall indemnify the plan by purchasing replacement securities equal to the number of unreturned loaned securities, or if replacement securities are not able to be purchased, the trustee shall credit the plan for the market value of the unreturned securities. In each case, the trustee would apply the proceeds from the collateral for such a loan to make the plan whole.

The fair value of the securities on loan to borrowers at December 31, 20X2, and 20X1 was $523,057,773 and $416,123,981, respectively. Cash collateral of $537,724,771 and $428,764,384 was received for securities on loan at December 31, 20X2, and 20X1, respectively, and was invested in the ABC Short Term Investment Fund, which is a fund affiliated with the trustee. Noncash collateral of $44,643,388 and $0 received for securities on loan at December 31, 20X2, and 20X1, respectively, consisted of U.S. Government Agency Securities held by the trustee on behalf of the plan. A portion of the income generated upon investment of cash collateral is remitted to the borrowers, and the remainder is allocated between the plan and the trustee in its capacity as a security agent. Securities lending income allocated to the plan amounted to $1,369,163 and $1,965,668 for 20X2 and 20X1, respectively. Security lending income allocated to the trustee amounted to $707,906 and $1,020,558 for 20X2 and 20X1, respectively.

1.22

Note X: Forward Exchange Contracts

The plan has entered into forward exchange contracts for nontrading purposes in order to reduce its exposure to fluctuations in foreign currency exchange on its portfolio holdings. Forward exchange contracts are valued at the forward rate and are marked-to-market quarterly. The change in market value is recorded by the plan as an unrealized gain or loss. When the contract is closed, the plan records a realized gain or loss equal to the difference between the value of the contract at the time that it was opened and the value of the contract at the time that it was closed.

The use of forward exchange contracts does not eliminate fluctuations in the underlying prices of the plan's investment securities, but it does establish a rate of exchange that can be achieved in the future. Although forward exchange contracts limit the risk of loss due to a decline in the value of the hedged currency, they also limit any potential gain that might result should the value of the currency increase. In addition, the plan could be exposed to risks if the counterparties to the contracts are unable to meet the terms of their contracts.

1.23

Note X: Derivative Policy

The plan enters into contractual arrangements classified as derivatives in carrying out its investment strategy, principally to (1) hedge a portion of the plan's portfolio to limit or minimize exposure to certain risks, (2) gain exposure to a market more rapidly or less expensively than could be accomplished through the use of the cash markets, and (3) increase investment returns by reducing the cost of structuring the portfolio or capturing value disparities between financial instruments. The plan utilizes both exchange traded investment instruments, such as equity and interest rate futures, options on futures, over-the-counter (OTC) options, and forward exchange contracts. Select major financial institutions are used in derivatives transactions. When engaging in OTC and forward exchange contracts, there is exposure to credit loss in the event of nonperformance by the counterparties to these transactions. The plan manages this exposure through credit approvals, limits, and monitoring procedures and, to the extent possible, by restricting the period over which unpaid balances are allowed to accumulate. Procedures are in place at the trustee to regularly monitor and report market and counterparty credit risks associated with these instruments. The plan does not anticipate nonperformance by counterparties to these contracts, and no material loss would be expected from any such nonperformance.

The following is a summary of the significant accounting policies associated with the plan's use of derivatives.

Forward Foreign Currency Exchange Contracts

A *forward foreign currency exchange contract* (forward currency contract) is a commitment to purchase or sell a foreign currency at a future settlement date and at a negotiated rate.

Forward currency contracts are utilized to hedge a portion of the currency exposure that results from the plan's holdings of equity and fixed income securities denominated in foreign currencies.

Forward currency contracts are marked-to-market at the prevailing forward exchange rate of the underlying currencies, and the difference between contract value and market value is recorded as unrealized appreciation (depreciation) in plan net assets. When the forward exchange contract is closed, the plan transfers the unrealized appreciation (depreciation) to a realized gain (loss) equal to the change in the value of the forward exchange contract when it was opened and the value at the time it was closed or offset. Sales and purchases of forward currency contracts having the same settlement date and broker are offset, and any gain (loss) is realized on the date of offset.

Certain risks may arise upon entering into a forward currency contract from the potential inability of counterparties to meet the terms of their contracts. Additionally, when utilizing forward currency contracts to hedge, the plan gives up the opportunity to profit from favorable exchange rate movements during the term of the contract.

A summary of open forward currency contracts at December 31, 20X2, is presented subsequently:

	Settlement Date	*Aggregate Face Value*	*Market Value*	*Unrealized Appreciation (Depreciation)*
Currency Purchased				
Australian dollar	2/05/20X3	$4,511,682	$4,754,242	$242,560
Swiss franc	1/05/20X3–1/30/20X3	892,795	1,003,949	111,154
Currency Sold				
Swiss franc	1/30/20X3–2/5/20X3	6,101,138	6,530,167	(429,029)
Euro	1/2/20X3–2/5/20X3	29,903,282	31,308,418	(1,405,136)

Future Contracts

A *future contract* is a contractual agreement to make or take delivery of a standardized quantity of a specified grade or type of commodity or financial instrument at a specified future date, in accordance with terms specified by a regulated future exchange.

The plan uses equity index and fixed income future contracts to manage exposure to the market. Buying futures tends to increase the plan's exposure to the underlying instrument. Selling futures tends to decrease the plan's exposure to the underlying instrument held or hedge the fair value of other fund investments. The plan does not employ leverage in its use of futures; thus, cash balances are maintained at a level at least equal to the contract value of the futures.

Future contracts are valued at the last settlement price at the end of each day on the exchange upon which they are traded. Upon entering into a future contract, the plan is required to deposit either in cash or securities an amount equal to a certain percentage of the nominal value of the contract (initial margin). Pursuant to the future contract, the plan agrees to receive from, or pay to, the broker an amount of cash equal to the daily fluctuation in the value of the future contract. Such receipts or payments are known as *variation margin*, which are settled daily and are included in the realized gains (losses) on future contracts. The plan will record a variation margin receivable or payable in the net assets for variation margins, which have not yet been paid at the end of the year.

Future contracts involve, to varying degrees, credit and market risks. The plan enters into future contracts on exchanges where the exchange acts as the counterparty to the transaction. Thus, credit risk on such transactions is limited to the failure of the exchange. The daily settlement on the future contracts serves to greatly reduce credit risk. Losses in value may arise from changes in the value of the underlying instrument or if there is an illiquid secondary market for the contracts. In addition, there is the risk that there may not be an exact correlation between a future contract and the underlying index or security.

At December 31, 20X2, U.S. government and agency securities with a par value of $26,757,397 were pledged as collateral for open equity index and fixed income future positions.

A summary of the open futures as of December 31, 20X2, is presented subsequently:

	Long Contracts		*Short Contracts*	
	Notional Amount	*Unrealized Gain (Loss)*	*Notional Amount*	*Unrealized Gain (Loss)*
S&P 500 Index	$ 111,500	$5,545,175	$ —	$ —
Euribor	18,000,000	45,310	(1,250,000)	$ —
U.S. 10-year Treasury	281,000,000	4,670,547	(25,200,000)	(268,107)

Options

An *option contract* is a contract in which the writer of the option grants the buyer of the option the right to purchase from (call option), or sell to (put option), the writer a designated instrument at a specified price within a specified period of time. Certain options, including options on indixes, will require cash settlement by the plan if the option is exercised. The plan may enter into put or call option contracts in order to hedge against potential adverse price movements in the value of the portfolio assets, as a temporary substitute for selling selected investments; to lock in the purchase price of a security or currency that it expects to purchase in the near future, as a temporary substitute for the purchase of selected investments; and to enhance potential gain. The plan does not employ leverage in its use of options; thus, cash balances are maintained at a level at least equal to the underlying index exposure of the option contracts.

When the plan purchases or writes an option, an amount equal to the premium paid or received by the plan is recorded as an asset or liability and is subsequently adjusted to the current market value of the option purchased or written. Options purchased or written are valued at the last sale price or, in the absence of a sale, the mean between the closing bid and asked prices or at the most recent asked price (bid for purchased options) if no bid and asked price are available. Over-the-counter (OTC) purchased or written options are valued using dealer supplied quotations. Gain and loss is recognized when the option contract expires or is closed.

If the plan writes a covered call option, the plan foregoes, in exchange for the premium, the opportunity to profit during the option period from an increase in the value of the underlying security above the exercise price. If the plan writes a put option, it accepts the risk of a decline in the value of the underlying security below the exercise price. OTC options have a risk of the potential inability of counterparties to meet the terms of their contracts. The plan's maximum exposure to purchased options is limited to the premium initially paid. In addition, certain risks may arise upon entering into option contracts prior to the expiration date, and a change in value of the option contract may not correlate exactly with changes in the value of the securities or currencies hedged.

The plan uses the following types of options: options on fixed income futures, options on equity indixes, options on foreign currencies, and options on equity securities.

A summary of open written options on fixed income futures as of December 31, 20X2, and 20X1 is presented subsequently:

	Call Options			
	20X2		*20X1*	
	Number of Contracts	*Market Value*	*Number of Contracts*	*Market Value*
LIBOR	631	$(2,145,614)	683	$(2,148,861)
Eurodollar futures	—	—	325	(475,313)

4. FAIR VALUE MEASUREMENTS

Practice Tip:

FASB ASC 820, *Fair Value Measurements and Disclosures*, provides enhanced guidance for using fair value to measure assets and liabilities. This standard defines *fair value* and expands disclosures about fair value measurements. In January 2010, FASB issued Accounting Standards Update (ASU) No. 2010–06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. ASU No. 2010–06 amends the disclosure requirements of FASB ASC 820 to require new disclosures regarding (*a*) transfers in and out of levels 1 and 2 and (*b*) activity in level 3 fair value measurements. ASU No. 2010–06 also provides amendments to FASB ASC 820 that clarify existing disclosures regarding (1) the level of disaggregation for each class of assets and liabilities and (2) disclosures about inputs and valuation techniques for fair value measurements that fall in either level 2 or level 3.

The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures regarding the rollforward of activity in level 3 fair value measurements, which are effective for fiscal years beginning after December 15, 2010, and interim periods within those fiscal years.

1.24

Note X (In Part): Fair Value Measurements

Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 820, *Fair Value Measurements and Disclosures*, establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820–10 are described as follows:

- Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the plan has the ability to access.
- Level 2 inputs to the valuation methodology include the following:
  — Quoted prices for similar assets or liabilities in active markets
  — Quoted prices for identical or similar assets or liabilities in inactive markets
  — Inputs other than quoted prices that are observable for the asset or liability
  — Inputs that are derived principally from, or corroborated by, observable market data by correlation or other means

  If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.
- Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets at fair value. There have been no changes in the methodologies used at December 31, 20X2, and 20X1.

- *C & H Company common stock*. Valued at the closing price reported on the New York Stock Exchange.
- *Guaranteed investment contract with the National Insurance Company (National)*. Valued at fair value by discounting the related cash flows based on current yields of similar instruments with comparable durations, considering the credit worthiness of the issuer (see note G). Funds under the guaranteed investment contract that have been allocated and applied to purchase annuities (that is, National is obligated to pay the related pension benefits) are excluded from the plan's assets.
- *Corporate bonds*. Certain corporate bonds are valued at the closing price reported in the active market in which the bond is traded. Other corporate bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings. When quoted prices are not available for

identical or similar bonds, the bond is valued under a discounted cash flows approach that maximizes observable inputs, such as current yields of similar instruments, but includes adjustments for certain risks that may not be observable, such as credit and liquidity risks.

- *U.S. government securities*. Valued at the closing price reported in the active market in which the individual security is traded.
- *Mortgages*. Valued on the basis of their future principal and interest payments discounted at prevailing interest rates for similar investments.
- *Real estate*. Valued on the basis of a discounted cash flow approach, which includes the future rental receipts, expenses, and residual values as the highest and best use of the real estate from a market participant view as rental property.

The preceding methods may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following table sets forth by level within the fair value hierarchy the plan's assets at fair value as of December 31, 20X2, and 20X1. The following table does not include the plan's interest in the C&H master trust because that information is presented in a separate table (see note F).

	Assets at Fair Value as of December 31, 20X2			
	Level 1	*Level 2*	*Level 3*	*Total*
C & H Company common stock	$ 690,000	$ —	$ —	$ 690,000
Guaranteed investment contract with National Insurance Company	—	—	1,000,000	1,000,000
Corporate bonds:				
Aaa credit rating	1,000,000	—	—	1,000,000
Aa credit rating	—	2,000,000	—	2,000,000
A credit rating	—	—	500,000	500,000
Total corporate bonds	1,000,000	2,000,000	500,000	3,500,000
U.S. government securities	350,000	—	—	350,000
Mortgages	—	480,000	—	480,000
Real estate	—	—	270,000	270,000
Total assets, excluding plan interest in C&H master trust, at fair value	$2,040,000	$2,480,000	$1,770,000	$6,290,000

	Assets at Fair Value as of December 31, 20X1			
	Level 1	*Level 2*	*Level 3*	*Total*
C & H Company common stock	$ 880,000	$ —	$ —	$ 880,000
Investment contract with National Insurance Company	—	—	890,000	890,000
Corporate bonds:				
Aaa credit rating	1,200,000	—	—	1,200,000
Aa credit rating	—	2,250,000	—	2,250,000
A credit rating	—	—	220,000	220,000
Total corporate bonds	1,200,000	2,250,000	220,000	3,670,000
U.S. government securities	270,000	—	—	270,000
Mortgages	—	460,000	—	460,000
Real estate	—	—	240,000	240,000
Total assets, excluding plan interest in C&H master trust, at fair value	$2,350,000	$2,710,000	$1,350,000	$6,410,000

Level 3 Gains and Losses

The following table sets forth a summary of changes in the fair value of the plan's level 3 assets for the year ended December 31, 20X2:

	Level 3 Asset			
	Guaranteed Investment Contract With the National Insurance Company	*Corporate Bonds*	*Real Estate*	*Total*
Balance, beginning of year	$ 890,000	$220,000	$240,000	$1,350,000
Realized gains (losses)	—	100,000	25,000	125,000
Unrealized gains (losses) relating to assets still held at the reporting date	40,000	(30,000)	(75,000)	(65,000)
Purchases, sales, issuances, and settlements (net)	70,000	210,000	80,000	360,000
Balance, end of year	$1,000,000	$500,000	$270,000	$1,770,000
The amount of total gains or losses for the period included in changes in net assets attributable to the change in unrealized gains or losses relating to assets still held at the reporting date	$ 40,000	$ (30,000)	$ (75,000)	$ (65,000)

Gains and losses (realized and unrealized) included in changes in net assets for the preceding period are reported in net appreciation in fair value of investments in the statement of changes in net assets available for benefits.

5. CONTRACTS WITH INSURANCE COMPANIES

1.25

Note X (In Part): Summary of Significant Accounting Policies

b. *Investments*—Plan assets are invested in an annuity guaranteed deposit contract, an international stock separate account, a fixed income separate account, an intermediate term income account, a Prosperity Investments Capital Growth Account, a Fiduciary International Equity Account, an Industrial Income Account, and a short term separate account with National Insurance Company. Investments, excluding the guaranteed deposit contracts, are valued at fair value as measured by the quoted market price on the last day of the plan year. Guaranteed deposit contract assets are maintained in the general investment fund, which is stated at contract value, which represents cost, plus interest income, less distributions for benefits and administrative expenses to date.

The plan's annuity guaranteed deposit contract was entered into prior to March 20, 1992. Such contract is permitted to be carried at contract value.

6. INTEREST IN MASTER TRUSTS

1.26

Note X: Interest in C&H Master Trust

A portion of the plan's investments are in the master trust that was established for the investment of assets of the plan and several other C&H Company sponsored retirement plans. Each participating retirement plan has an undivided interest in the master trust. The assets of the master trust are held by GLC Trust Company (trustee).

The value of the plan's interest in the C&H master trust is based on the beginning of year value of the plan's interest in the trust, plus actual contributions and allocated investment income, less actual distributions and allocated administrative expenses. At December 31, 20X2, and 20X1, the plan's interest in the net assets of the master trust was approximately 9 percent and 11 percent, respectively. Investment income and administrative expenses relating to the master trust are allocated to the individual plans based upon average monthly balances invested by each plan.

The following table presents the assets, including investments, of the master trust:

	For the Year Ended December 31	
	20X2	*20X1*
Common stocks	$11,900,000	$ 8,800,000
Corporate bonds	11,800,000	6,700,000
U.S. government securities	867,000	750,000
	24,567,000	16,250,000
Receivable for securities sold	433,000	659,091
	$25,000,000	$16,909,091
Plan interest in C&H master trust	$ 2,250,000	$ 1,860,000

Investment income for the master trust is as follows:

	For the Year Ended December 31	
	20X2	*20X1*
Net appreciation in fair value of investments:	$ 300,000	$ 200,000
Common stocks	200,000	200,000
Corporate bonds	300,000	200,000
U.S. government securities	800,000	600,000
Interest	400,000	300,000
Dividends	230,000	300,000
	$1,430,000	$1,200,000

The closing prices reported in the active markets in which the securities are traded are used to value the investments in the master trust. The following table sets forth by level within the fair value hierarchy the master trust's assets at fair value as of December 31, 20X2, and 20X1:

	Assets at Fair Value as of December 31, 20X2			
	Level 1	*Level 2*	*Level 3*	*Total*
Common stocks:				
Energy	$ 5,500,000	—	—	$ 5,500,000
Health care	3,750,000	—	—	3,750,000
Information technology	1,250,000	—	—	1,250,000
Consumer goods	900,000	—	—	900,000
Utilities	500,000	—	—	500,000
Total common stocks	11,900,000	—	—	11,900,000
Corporate bonds	11,800,000			11,800,000
U.S. government securities	867,000	—	—	867,000
Total assets at fair value	$24,567,000	—	—	$24,567,000

	Assets at Fair Value as of December 31, 20X1			
	Level 1	*Level 2*	*Level 3*	*Total*
Common stocks:				
Energy	$ 3,750,000	—	—	$ 3,750,000
Health care	3,000,000	—	—	3,000,000
Information technology	1,000,000	—	—	1,000,000
Consumer goods	750,000	—	—	750,000
Utilities	300,000	—	—	300,000
Total common stocks	8,800,000	—	—	8,800,000
Corporate bonds	6,700,000			6,700,000
U.S. government securities	750,000	—	—	750,000
Total assets at fair value	$16,250,000	—	—	$16,250,000

1.27

Note X: Contract With Insurance Company

In 20W8, the company entered into an investment contract with National Insurance Company (National) under which the plan deposits a minimum of $100,000 a year. National maintains the contributions in an unallocated fund to which it adds interest at a rate of 8 percent. The interest rate is guaranteed through 20X4 but is subject to change for each succeeding 5-year period. When changed, the new rate applies only to funds deposited from the date of change. At the direction of the plan's administrator, a single premium to buy an annuity for a retiring employee is withdrawn by National from the unallocated fund. Purchased annuities are contracts under which National is obligated to pay benefits to named employees or their beneficiaries. The premium rates for such annuities to be purchased in the future and maximum administration expense charges against the fund also are guaranteed by National on a 5-year basis.

The annuity contracts provide for periodic dividends at National's discretion on the basis of its experience under the contracts. Such dividends received by the plan for the year(s) ended December 31, 20X2 (and 20X1), were $25,000 (and $24,000, respectively). In reporting changes in net assets, those dividends have been netted against amounts paid to National for the purchase of annuity contracts.

7. PLAN AMENDMENTS

1.28

Note X: Subsequent Event

The plan was amended on April 1, 20X2, to increase the retirement benefit unit by $1 for all retirees and terminated and active participants, effective for all retirements after May 31, 20X2. Using the assumptions used to measure the accumulated plan benefits at December 31, 20X1, the amendment will increase the actuarial present value of accumulated plan benefits by $5,236,000, of which $2,262,000 relates to vested benefits of plan participants currently receiving benefits; $365,000 relates to vested benefits of other plan participants; and $2,609,000 relates to nonvested benefits.

1.29

Note X: Changes in the Plan

The plan was not amended during 20X2.

Effective January 15, 20X1, the plan was amended to provide full credited service for all layoff time accumulated through February 1, 20X1, for all employees on the plan's seniority list.

During 20X1, the plan was amended to increase the benefit unit per year of credited service for all retirements after February 1, 20X1, as follows:

	Benefit Unit Increased	
Effective Date	*From*	*To*
February 1, 20X1	$24.00	$25.00
January 1, 20X2	25.00	26.00
January 1, 20X3	26.00	27.00

For participants who retire after February 1, 20X1, with 25 or more years of credited service, the plan was amended to increase the monthly early retirement supplement benefit prior to age 62 from $450 to $550 per month.

For participants who retire after January 1, 20X0, with 30 or more years of credited service, the plan was amended to increase the total monthly early retirement benefit payable prior to age 62 to the following amounts:

Effective Date	*Total Monthly Benefit*
February 1, 20X1	$1,400
January 1, 20X2	1,500
January 1, 20X3	1,600

The plan's actuary estimates that amendments becoming effective subsequent to December 31, 20X1, will increase accumulated plan benefits by approximately $655,850.

1.30

Note X: Changes in the Plan

Effective January 1, 20X2, a subsidiary part of the plan, formerly known as the retirement income plan for certain salaried employees, was amended to include employees of the Toledo, Ohio, plant and to count vesting service for service before January 1, 20X2, and credited service beginning on that date.

Effective January 1, 20X2, a subsidiary part of the plan, formerly known as the retirement plan for represented hourly-rated employees of the Altoona, Pennsylvania, plant, was amended to increase the benefit unit per year of credited service for employees who elect to waive participation in the Altoona savings plan and to establish a lump sum retirement bonus in the year of retirement for participants retiring on or after January 1, 20X2, as follows:

	Benefit Unit		
Effective Date	*From*	*To*	*Retirement Bonus*
January 1, 20X2	$15.00	$15.50	$1,500
January 1, 20X3	15.50	16.00	2,000
January 1, 20X4	16.00	16.25	2,000
January 1, 20X5	16.25	16.50	2,000

Effective as of October 1, 20X1, a subsidiary part of the plan, formerly known as the hourly-rated employees' pension plan union, was amended for employees at the Hoboken and Hempstead plants to increase the monthly benefit unit per year of credited service and the 30 and out provision for those employees retiring after October 1, 20X2, from $25 to $30 and from $1,550 and $1,950, respectively. In addition, the plan was amended to include, for certain employees, credited service under the plan for those periods previously not credited because of layoff from the active payroll.

The same subsidiary part of the plan also was amended for retirements occurring on or after October 1, 20X2, to establish interim monthly supplement amounts for early retirements by participants with less than 30 years of credited service and temporary benefits payable until the earlier of age 61 and 1 month or payment of Social Security disability benefits. The monthly benefit per year of credited service used to calculate temporary benefits is $34, limited to a maximum of 30 years or a maximum monthly amount of $1,000.

Effective August 31, 20X1, the plan was amended to approve the merger of 32 retirement plans of Starfish Company, Inc., and its affiliates into the plan [see note X(b)].

Effective August 1, 20X1, the name of the plan was changed from the retirement plan for eligible employees on the salary and weekly payrolls of the Acme Section A Operations, Acme Section B Operations, and Acme Section C Operations to the Acme retirement plan for eligible employees.

Effective January 1, 20X1, the plan was amended to include as vesting service periods of service with companies that are members of the Vortex Operations contract and to permit payment of internal administrative and investment management expenses directly to the ongoing operations of the plan.

Effective January 1, 20X1, the plan was amended to allow retirees from the retirement income plan for certain salaried employees, now a subsidiary part of the plan, to participate in, and accrue benefits as members of, the Acme flexible work force.

1.31

Note X: Plan Amendment

Effective July 1, 20X2, the plan was amended to increase future annual pension benefits from 1.25 percent to 1.5 percent of final 5-year average annual compensation for each year of service, including service rendered before the effective date. The retroactive effect of the plan amendment, an increase in the actuarial present value of accumulated plan benefits of $2,410,000, was accounted for in the year ended December 31, 20X2. (The actuarial present value of accumulated plan benefits at December 31, 20X0, does not reflect the effect of that plan amendment. The plan's actuary estimates that the amendment's retroactive effect on the actuarial present value of accumulated plan benefits at December 31, 20X0, was an increase of approximately $1,750,000, of which approximately $1,300,000 represents an increase in vested benefits.)

1.32

[*The following disclosure is for when a defined benefit pension plan is amended to implement a voluntary early retirement window.*]

Note X (In Part): Description of the Plan

Effective July 27, 20X2, the plan was amended to implement a voluntary early retirement window policy. This amendment provided the opportunity for eligible participants to elect early retirement during the window period from July 27, 20X2, to September 10, 20X2. The early retirement benefit was equal to the unreduced accrued benefit at age 65, and the participants could opt to receive this benefit as a lump sum payment. In addition, participants who elected to retire early under this program will receive an additional $300 per month for the period from May 1, 20X2, until attainment of age 65. Benefit payments that resulted from the voluntary early retirement window policy approximated $6.6 million.

1.33

Note X: Plan Amendments

Effective January 1, 20X2, the plan was amended to provide a permanent monthly increase of $50 for all pensioners whose pension effective date was during 20X2.

Effective July 1, 20X2, if a participant dies before retirement, the surviving spouse may defer receipt of the pension until the date when the participant would have attained the age at which he or she could have received a golden 80, golden 90, or normal retirement age pension, provided that the participant earned at least 1 hour of pension credit on or after July 1, 20X1, and the participant (if alive) would have been otherwise qualified to receive such a pension.

The plan was amended effective January 1, 20X1, as follows:

1. For husband and wife pensions (the normal form of pension for a married participant) with an effective date on or after January 1, 20X1, there will be no reduction of benefits from the amount for a single pensioner during the participant's lifetime. Benefits paid to the surviving spouse upon the death of the participants will be reduced by one half.
2. For disability pensions with an effective date on or after January 1, 20X1, participants will be paid a benefit equal to the normal pension accrued.
3. A special pension benefit increase of $25 or $50 per month will be paid to each pensioner or beneficiary, in addition to his or her regular monthly benefits otherwise payable. The increase will apply to any pensioner, surviving spouse, and beneficiary who received a monthly pension check for December 20X0 or any month during calendar year 20X1 as follows:

Pension Effective Date	*Monthly Increase*
Prior to December 31, 19XX	$50
After December 31, 19XX, but before December 31, 20X0	25
After December 31, 20X0, but before December 31, 20X1	50

   This special increase is determined for the surviving spouse or beneficiaries of any deceased pensioner based on the original pension effective date, as previously shown, pursuant to a husband and wife pension, the 36-month guarantee benefit, or any optional form of benefit elected by the pensioner.
4. The threshold for the $25 supplements was lowered from the $600–$699 level to the $25–$699 level for those who otherwise qualify.

8. PLAN MERGERS AND ACQUISITIONS

1.34

Note X: Plan Merger (Midyear)

On June 15, 20Xl, ABC Co. was acquired by the plan sponsor, and its pension plan was merged with the XYZ pension plan. At the date of the merger, the ABC Co. plan's accumulated plan benefits and net assets available for benefits were as follows:

Actuarial present value of vested benefits	
Participants currently receiving benefits	$ 3,040,000
Other participants	8,120,000
	$11,160,000
Actuarial present value of nonvested benefits	2,720,000
Actuarial present value of accumulated plan benefits	$13,880,000
Net assets available for benefits (cash)	18,012,000
Excess of assets not available for benefits over actuarial present value of accumulated plan benefits	$ 4,132,000

1.35

Note X: Plan Merger (Year-End)

On December 31, 20X1, ABC Co.'s subsidiary pension plan was merged into this plan. On the date of the merger, ABC Co. plan's accumulated plan benefits and net assets available for benefits were as follows:

[*Present full statement of accumulated plan benefits and net assets available for plan benefits for ABC Co. at December 31, 20X1.*]

1.36

Note X (In Part): Description of the Plan

b. *Plan merger*—Effective August 31, 20X1, the plan merged with the following 8 qualified U.S. defined benefit pension plans:

   i. Retirement income plan for certain salaried employees
   ii. Salaried employees' retirement plan—Acme A Operations
   iii. Pension plan for salaried employees of Acme Corporation
   iv. Pension plan for represented hourly employees of Acme Corporation
   v. Pension plan for hourly employees of Acme Corporation
   vi. Acme D Operations contract retirement plan for eligible employees of Acme Corporation
   vii. Beta Company off-site retirement plan
   viii. Beta International Service Company retirement plan for operations and maintenance employees

   The preceding 8 Acme Co. pension plans had aggregate plan net assets of $7.2 billion at August 31, 20X1, and an aggregate present value of accumulated plan benefits at December 31, 20X0, of $6.6 billion [computed in accordance with Financial Accounting Standards Board Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*—see footnote 2(c)]. This merger does not affect participant pension benefits because the benefit provisions of the merged plans are incorporated into the plan.

1.37

Note X (In Part): Description of the Plan

c. *Plan merger*—Effective August 31, 20X1, Acme Co. merged 33 of its qualified U.S. defined benefit pension plans (including the plan) into one pension plan: the Acme retirement plan for eligible employees. This merger will not affect participant pension benefits because the benefit provisions of these plans will be incorporated into the merged pension plan. Acme management believes that the plan merger was a tax exempt transaction under the applicable provisions of the Internal Revenue Code and, therefore, is not subject to federal income taxes.

1.38

Note X: Subsequent Events—Merger of the Pension Plan

On July 6, 20X2 the Swordfish Company's board of directors approved the merger, effective August 31, 20X2, of Swordfish Company's 33 qualified U.S. defined benefit pension plans (including the plan) into one pension plan: the Swordfish Company retirement plan for eligible employees. This merger will not affect participant pension benefits because the benefit provisions of these plans will be incorporated into the merged pension plan. Swordfish Company management expects the merged pension plan to have net assets in excess of actuarially determined accrued liabilities and to be qualified under the Internal Revenue Code.

1.39

Note X (In Part): Description of the Plan

c. *Plan merger*—Effective December 31, 20X2, the plan was merged with the group employees' retirement plan—operations. The net assets of the plan were transferred to the group employees' retirement plan—operations on December 31, 20X2. Accordingly, all benefits earned under the plan and contributions due to the plan prior to December 31, 20X2, will be payable or receivable in accordance with the plan out of or into the group employees' retirement plan—operations. The management of the company believes that the plan merger was a tax exempt transaction under the applicable provisions of the Internal Revenue Code and, therefore, is not subject to federal income taxes.

1.40

Note X: Subsequent Events

Following the close of business on January 31, 20X3, ABC Corporation (company), the holding company for the association, acquired DEF Company (DEF), with DEF ultimately merging with and into the association.

Pursuant to the acquisition agreement, the company and the association agreed to amend the plan to provide, at their option, either (i) credit, for benefit accrual purposes, for each employee of DEF who will remain in the employ of the association following the acquisition, to the extent that such service would have been recognized for similar purposes under DEF's defined benefit plan (DEF plan) as in effect immediately prior to the acquisition, and to provide an offset to the accrued benefits provided under the DEF plan through the date of the acquisition or (ii) benefits for each employee of DEF who will remain in the employ of the association following the acquisition, which will equal the sum of the accrued benefits provided under the DEF plan through the date of the acquisition and such employee's accrued benefits under the benefit formula set forth in the plan for the period after the acquisition.

Following the acquisition, the DEF plan was merged into the plan, and the plan was amended to provide credit, for benefit accrual purposes, for each participant of DEF who remained in the employ of the association following the acquisition, to the extent that such service would have been recognized for similar purposes under the DEF plan as in effect immediately prior to the acquisition. Former DEF plan participants are eligible to receive a benefit, using the plan's benefit formula based on total service with the association and DEF, of not less than their accrued benefit under the DEF plan through the date of the acquisition. As a result of a merger of the plans on April 30, 20X3, 642 additional participants became enrolled in the plan and additional assets of $16,038,572 were acquired by the plan from the DEF plan. In addition, the actuarial present value of accumulated plan benefits for former DEF plan participants as of April 30, 20X3, was $11,671,200.

1.41

Note X (In Part): Plan Description

The following brief description of the Brown Company automobile plant pension plan for hourly employees (plan) is provided for general information purposes only. Participants should refer to the plan document for more complete information.

a. *General*—The plan is a noncontributory defined benefit plan that provides for pension and disability benefits covering substantially all of the hourly employees at the automobile plant of Brown Company. a subsidiary of Brown, Inc. (Brown). In January 20X2, Blue Company completed its acquisition of Brown and controls and manages the operation and administration of the plan. As of June 1, 20X2, the plan changed its trustee from XYZ Bank to ABC Bank. ABC Bank serves as the trustee of the plan and, together with several investment managers, manages the plan's investment assets. The plan is subject to the provisions of ERISA.

9. PLAN TERMINATIONS

1.42

Note X: Plan Termination

The plan sponsor froze the accrued benefits as of February 28, 20X1, and terminated the plan as of March 31, 20X1. Therefore, the accrued benefits of each participant became nonforfeitable to the extent then funded, and the net assets of the plan will be allocated, as prescribed by the terms and provisions of the plan in accordance with ERISA and its related regulations, generally, to provide the following benefits in the order indicated, subject to any required approval of the IRS and the Pension Benefit Guaranty Corporation (PBGC):

- Benefits attributable to employee contributions, if any, taking into account those paid out before termination.
- Annuity benefits former employees or their beneficiaries have been receiving for at least three years or that employees eligible to retire for that three-year period would have been receiving if they had retired with benefits in the normal form of annuity under the plan. The priority amount is limited to the lowest benefit that was payable (or would have been payable) during those three years. The amount is further limited to the lowest benefit that would be payable under plan provisions in effect at any time during the five years preceding plan termination.
- Other vested benefits insured by the PBGC (a U.S. governmental agency), up to the applicable limitations (discussed subsequently).
- All other vested benefits (that is, vested benefits not insured by the PBGC).
- All nonvested benefits.

Certain benefits under the plan are insured by the PBGC if the plan terminates. Generally, the PBGC guarantees most vested normal age retirement benefits, early retirement benefits, and certain disability and survivors pensions. However, the PBGC does not guarantee all types of benefits under the plan, and the amount of benefit protection is subject to certain limitations. Vested benefits under the plan are guaranteed at the level in effect on the date of the plan's termination. However, a statutory ceiling exists on the amount of an individual's monthly benefit that the PBGC guarantees. For plan terminations occurring during 20X2 and 20X1, that ceiling that is adjusted periodically was $X,XXX and $X,XXX per month, respectively. That ceiling applies to those pensioners who elect to receive their benefits in the form of a single life annuity and are at least 65 years old at the time of retirement or plan termination (whichever comes later). For younger annuitants or for those who elect to receive their benefits in some form more valuable than a single life annuity, the corresponding ceilings are actuarially adjusted downward. Benefit improvements, if any, attributable to plan amendments may not be fully guaranteed even though total benefit entitlements fall below the aforementioned ceilings. The PBGC guarantees XX percent of any benefit improvements that result in benefits below the ceiling each year following the effective date of the amendment. If the amount of the benefit increase below the ceiling also is less than $XXX, $XX of the increase (rather than XX percent) becomes guaranteed by the PBGC each year following the effective date of the amendment. As a result, only the primary ceiling would be applicable after the fifth year following the effective date of the amendment.

1.43

Note X: Plan Termination

On April 25, 20X2, the board of trustees expressed their intent to terminate the plan. Benefits will continue to accrue through June 1, 20X2, and all participants will be considered to be fully vested as of January 1, 20X2. Employees will receive a lump sum payment from the plan once Beta Company receives IRS approval to terminate the plan, and such employees may elect to have their lump sum payment rolled over into an Individual Retirement Account (IRA). If an employee retires during 20X2, he or she may elect to have his or her lump sum payment rolled over into an IRA. A new defined contribution plan will be made available to Beta Company employees in 20X2.

1.44

Note X: Plan Termination

Benefits were accrued through June 1, 20X2, and were considered to be fully vested for all participants, and no additional service was earned after June 1, 20X2. During May and June 20X2, the plan purchased annuity contracts from National Life Insurance Company amounting to $485,242 to provide benefits to current retirees of the plan. On August 1, 20X2, the plan was terminated. The remaining plan participants received a lump sum payment from the plan, and the final distributions were made from the plan on December 22, 20X2. Plan assets amounting to approximately $79,300 were reverted to ABC Company. On December 4, 20X2, ABC Company received IRS approval to terminate the plan. A new defined contribution plan was made available to ABC Company employees, effective July 1, 20X2.

1.45

Note X: Plan Termination

In the event the plan is terminated, the net assets of the plan will be allocated for payment of plan benefits to the participants in order of priority determined in accordance with ERISA, applicable regulations thereunder, and the plan document.

Certain benefits under the plan are insured by the Pension Benefit Guaranty Corporation (PBGC) if the plan terminates. Generally, the PBGC guarantees most vested normal age retirement benefits, early retirement benefits, and certain disability and survivor's pensions. However, the PBGC does not guarantee all types of benefits under the plan, and the amount of benefit protection is subject to certain limitations. Vested benefits under the plan are guaranteed at the level in effect on the date of the plan's termination, subject to a statutory ceiling on the amount of an individual's monthly benefit.

Whether all participants receive their benefits, should the plan be terminated at some future time, will depend on the sufficiency, at that time, of the plan's net assets to provide those benefits, the priority of those benefits to be paid, and the level and type of benefits guaranteed by the PBGC at that time. Some benefits may be fully or partially provided for by the then existing assets and the PBGC guaranty, but other benefits may not be provided for at all.

1.46

Note X: Plan Termination

In the event the plan terminates, the net assets of the plan will be allocated, as prescribed by ERISA and its related regulations, generally, to provide the following benefits in the order indicated:

a. Benefits attributable to employee contributions, taking into account those paid out before termination.

b. Annuity benefits that former employees or their beneficiaries have been receiving for at least three years or that employees eligible to retire for that three-year period would have been receiving if they had retired with benefits in the normal form of annuity under the plan. The priority amount is limited to the lowest benefit that was payable (or would have been payable) during those three years. The amount is further limited to the lowest benefit that would be payable under plan provisions in effect at any time during the five years preceding plan termination.
c. Other vested benefits insured by the Pension Benefit Guaranty Corporation (PBGC) (a U.S. government agency), up to the applicable limitations (discussed subsequently).
d. All other vested benefits (that is, vested benefits not insured by the PBGC).
e. All nonvested benefits.

Benefits to be provided via contracts under which National Insurance Company (see note G) is obligated to pay the benefits would be excluded for allocation purposes.

Certain benefits under the plan are insured by the PBGC if the plan terminates. Generally, the PBGC guarantees most vested normal age retirement benefits, early retirement benefits, and certain disability and survivor's pensions. However, the PBGC does not guarantee all types of benefits under the plan, and the amount of benefit protection is subject to certain limitations. Vested benefits under the plan are guaranteed at the level in effect on the date of the plan's termination. However, a statutory ceiling exists, which is adjusted periodically, on the amount of an individual's monthly benefit that the PBGC guarantees. For plan terminations occurring during 20X3, that ceiling is $X,XXX per month. That ceiling applies to those pensioners who elect to receive their benefits in the form of a single life annuity and are at least 65 years old at the time of retirement or plan termination (whichever comes later). For younger annuitants or for those who elect to receive their benefits in some form more valuable than a single life annuity, the corresponding ceilings are actuarially adjusted downward. Benefit improvements attributable to the plan amendment effective July 1, 20X2 (see note H), may not be fully guaranteed even though total benefit entitlements fall below the aforementioned ceilings. For example, none of the improvements would be guaranteed if the plan were to terminate before July 1, 20X3. After that date, the PBGC would guarantee 20 percent of any benefit improvements that resulted in benefits below the ceiling, with an additional 20 percent guaranteed each year the plan continued beyond July 1, 20X3. If the amount of the benefit increase below the ceiling also is less than $100, $20 of the increase (rather than 20 percent) becomes guaranteed by the PBGC each year following the effective date of the amendment. As a result, only the primary ceiling would be applicable after July 1, 20X7.

Whether all participants receive their benefits should the plan terminate at some future time will depend on the sufficiency, at that time, of the plan's net assets to provide for accumulated benefit obligations and also may depend on the financial condition of the plan sponsor and the level of benefits guaranteed by the PBGC.

1.47

Note X: Plan Termination

On November 15, 20X0, the trustees of the plan elected to terminate the plan, effective April 1, 20X1. The company applied for and received approval for the termination from the IRS. All participants became fully vested in their account balances and had the option of receiving a distribution (less applicable penalties and taxes), transferring their balance to another qualified fund, or transferring their balance to the company's profit sharing plan. All of the plan's assets were either distributed or transferred, as elected by each participant, by February 5, 20X2.

1.48

[*The following disclosure is for when a plan sponsor files for bankruptcy after year-end and announces that the plan will be terminated.*]

Note X: Subsequent Event and Plan Termination

On June 19, 20X3, ABC Company filed for Chapter 11 bankruptcy in the United States Bankruptcy Court for the District of Columbia. All of the company's assets were subsequently sold to XYZ Acquisition Company on October 28, 20X2. Participants have been notified that benefits under the plan have stopped accruing, effective November 30, 20X2. ABC Company also promptly notified participants of its intent to terminate the plan.

The following is a summary of how participants' claims are being satisfied during the termination process. The plan purchased a group annuity contract during 20X3 to fulfill the plan's obligation to retirees currently receiving benefits. In addition, terminated vested participants have been paid out by lump sum distributions. Management is in the process of paying benefits to active participants and believes the plan will have the necessary funds to fulfill its obligations under the plan. The plan will terminate upon making its final distribution.

1.49

[*The following disclosure is for a partial termination of a defined benefit pension plan as a result of terminating the employees of a division of the plan sponsor.*]

Note X: Partial Termination

During the year ended December 31, 20X2, the plan sponsor terminated the employees of the Widget Division. In aggregate, the termination represented a partial termination of the plan. As a result of this partial termination, all accumulated benefits of affected employees were fully vested as of June 15, 20X2, the date on which the employees were terminated.

[*The following disclosures are for a multiemployer collectively bargained defined benefit pension plan that is frozen regarding both benefits and participation.*]

1.50

Note X: Plan Termination

During the November 19W7 board of trustees meeting, the trustees adopted a plan amendment to cease the accrual of all future pension credits, with respect to covered employment on or after January 1, 19W8. To the extent that participants had accumulated benefits as of January 1, 19W8, those benefits were preserved in accordance with the terms of the plan. In addition, participants continued to earn vesting credit in accordance with the terms of the plan for as long as the employer continued to have an obligation to contribute to the plan under its collective bargaining agreement.

The trustees terminated the accrual of future pension credits for all covered employment, effective January 1, 19W8. Also, due to the Pension Benefit Guaranty Corporation (PBGC) funding requirements, effective October 1, 20X1, benefits will be limited to amounts guaranteed by the PBGC.

As of July 1, 19W8, the last employer required to contribute to the plan withdrew from the plan. This event is considered a mass withdrawal, and accordingly, the current trustees submitted a notice of termination to the PBGC.

1.51

Note Y: Employer Withdrawal Liability

DEF Company and GHI Corporation withdrew from the plan and agreed to pay a withdrawal liability of $470,676 and $725,948, respectively. Payments began on April 1, 19W9, for both employers, and payments are scheduled to end on October 1, 20Z6, for DEF Company and June 1, 20Y7, for GHI Corporation. The remaining balance is payable in equal quarterly installments for both employers. These payments are due quarterly and total $6,519 per quarter. The discounted present value of the amounts due to the plan as of September 30, 20X8, and 20X7 totaled $359,914 and $386,625, respectively, assuming a 6 percent discount factor. Because the likelihood of the payment by the employers is uncertain, the discounted present value of the amounts due to the plan from the employers has been fully reserved as of September 30, 20X8, and 20X7.

1.52

Note Z: Plan Amendment

During the year ended September 30, 20X7, the plan was amended to provide that if the Pension Benefit Guaranty Corporation (PBGC) provides financial assistance to the plan as a result of the plan's insolvency, benefits will be limited to the maximum amount guaranteed by the PBGC.

1.53

Note AA: Insolvency and the Pension Benefit Guaranty Corporation Funding

During the year ended September 30, 20X7, the plan prepared a notice of insolvency to the Pension Benefit Guaranty Corporation (PBGC). In connection with this notice, the plan submitted an application for financial assistance requesting that the PBGC provide supplemental funding for payment of benefits and reasonable administrative expenses incurred by the plan after the depletion of existing plan assets. Effective October 31, 20X7, the PBGC began providing financial assistance to the plan, and during the year ended September 30, 20X8, the plan received $227,500.

Amounts received from the PBGC are recognized as an addition to net assets in the period received. Supplemental funding provided by the PBGC is technically a loan, but due to the circumstances, repayment is considered no more than a contingency, and no liability has been recorded. The ability of the plan to continue operations and payment of benefits is dependent on the PBGC continuing to provide financial assistance.

10. OTHER

1.54

Note X: Funding Policy

The company's funding policy is to make quarterly contributions to the plan, as determined by the plan's independent actuary. No employee contributions are permitted. The company's contributions for 20X2 and 20X1 comply with the minimum funding requirements of ERISA.

1.55

[*The following disclosure is for a multiple employer plan.*]

Note X: Funding Policy

The sponsors' funding policy is to contribute funds to the trust for the plan, as necessary, to provide for current service and any unfunded projected benefit obligation over a reasonable period. To the extent that these requirements are fully covered by assets in the trust, the sponsors may elect not to make any contribution in a particular year. The sponsors did not make any contributions in the years ended March 31, 20X2, and 20X1. The plan met the minimum funding requirements of ERISA as of March 31, 20X2, and 20X1.

1.56

Note X: Funding Policy

As a condition of participation, employees are required to contribute 3 percent of their salary to the plan. Present employees' accumulated contributions at December 31, 20X2, and 20X1 were $2,575,000 and $2,325,000, respectively, including interest credit on an interest rate of 5 percent compounded annually. The company's funding policy is to make annual contributions to the plan in amounts that are estimated to remain a constant percentage of employees' compensation each year (approximately 5 percent for 20X2 [and 20X1]), such that, when combined with employees' contributions, all employees' benefits will be fully provided for by the time they retire. Beginning in 20X3, the company's contribution is expected to increase to approximately 6 percent to provide for the increase in benefits attributable to the plan amendment, effective

July 20X2 (see note H). The company's contributions for 20X2 [and 20X1] exceeded the minimum funding requirements of ERISA.

Although it has not expressed any intention to do so, the company has the right under the plan to discontinue its contributions at any time and to terminate the plan, subject to the provisions set forth in ERISA.

1.57

[*The following disclosure is for a multiple employer plan.*]

Note X: Benefits

Generally, pension benefits are computed based on 1 percent of credited annual earnings not in excess of Social Security covered earnings, plus 1.5 percent of credited annual earnings in excess of Social Security covered earnings, multiplied by years of credited service, subject to the minimum benefit, as defined. Participants become fully vested after 5 years of service.

If the total present value of a participant's retirement or deferred vested benefit is $5,000 or less, the pension committee, at its discretion, may direct that the benefit be paid in a lump sum.

1.58

[*The following disclosure is for a multiple employer plan.*]

Note X: Changes in Accumulated Plan Benefits

The following is a summary of the changes in the actuarial present value of accumulated plan benefits for, effectively, the years ended March 31, 20X2, and 20X1:

	20X2	*20X1*
Actuarial present value of accumulated plan benefits at beginning of year	$50,231,746	$45,056,224
Increase (decrease) attributable to		
Benefits accumulated	3,288,218	3,649,266
Increase for interest due to the decrease in the discount period	3,799,162	3,299,508
Benefits paid	(2,466,642)	(2,164,658)
Change in interest rate assumption	—	(1,425,916)
Effect of plan amendment related to compensation limits used in determining benefits	3,042	1,817,322
Net increase	4,623,780	5,175,522
Actuarial present value of accumulated plan benefits at end of year	$54,855,526	$50,231,746

1.59

[*The following disclosure is for a multiemployer collectively bargained defined benefit pension plan.*]

Note X: Actuarial Present Value of Accumulated Plan Benefits

As of January 1, 20X2, and 20X1, the actuarial present value of accumulated plan benefits is as follows:

	For the Year Ended December 31	
	20X2	*20X1*
Vested benefits		
Participants currently receiving payments	$2,970,816,755	$2,908,273,645
Other participants	1,951,089,163	1,803,090,548
	4,921,905,918	4,711,364,193
Nonvested benefits	356,111,006	310,414,350
Total actuarial present value of accumulated plan benefits—January 1, 20X2, and 20X1	$5,278,016,924	$5,021,778,543

The changes in the actuarial present value of accumulated plan benefits from the previous benefit information date were as follows:

	For the Year Ended December 31	
	20X2	20X1
Increase (decrease) attributable to		
Plan amendments and shifts in benefit levels	$ 43,887,845	$ 45,344,754
Benefits accumulated, net experience gain or loss or changes in data	152,794,088	140,870,057
Benefits paid	(399,871,629)	(394,896,490)
Interest	369,182,948	344,867,205
Changes in actuarial assumptions	90,245,129	73,461,356
Net increase (decrease)	256,238,381	209,646,882
Total actuarial present value of accumulated plan benefits—January 1, 20X1, and 20X0	5,021,778,543	4,812,131,661
Total actuarial present value of accumulated plan benefits—January 1, 20X2, and 20X1	$5,278,016,924	$5,021,778,543

As of January 1, 20X2, and 20X1, the fund's actuarially determined minimum funding standards account exceeded the minimum funding requirements of ERISA.

Significant assumptions and methods underlying the actuarial computations are as follows:

- Actuarial cost method—Entry age normal
- Net investment return—7.5 percent on all assets
- Mortality rates—1994 Group Annuity Mortality Static Table
- Employee turnover, all causes—Varying rates depending on age and sex
- Annual administrative expenses—$7,300,000 for 20X2 and $7,200,000 for 20X1
- Retirement age—Based on retirement probability for various age ranges for active employees and inactive vested employees, including a provision for retirement when age plus years of service equals 80 (golden 80 pension) or when age plus years of service equals 90 (golden 90 pension) under certain plans.
- Actuarial value of assets—Sum of actuarial value of total assets at the beginning of the year and the increase in cost value during the year, excluding realized and unrealized gains or losses, plus 20 percent of market value at the end of the year in excess of that sum, plus additional adjustments as necessary so that the final actuarial value of assets is within 20 percent of their market value.

Benefits paid during the years ended December 31, 20X1, and 20X0 included bonus payments to active retirees. The bonus amounts were based on the retirees' retirement dates and aggregated approximately $42,779,000 and $76,321,000 for 20X1 and 20X0, respectively.

1.60

[*The following disclosure is for a multiemployer collectively bargained defined benefit pension plan that is frozen regarding benefits and participation.*]

Note X: Actuarial Present Value of Accumulated Plan Benefits

Accumulated plan benefits are those future periodic payments, including lump sum distributions, that are attributable under the plan provisions to the service employees have rendered. Accumulated plan benefits include benefits expected to be paid to (*a*) retired or terminated employees or their beneficiaries, (*b*) beneficiaries of employees who have died, and (*c*) present employees or their beneficiaries. Benefits payable under all circumstances are included, to the extent they are deemed attributable to employee service rendered to the valuation date.

The actuarial present value of accumulated plan benefits is determined by the plan actuary and is that amount that results from applying actuarial assumptions to adjust the accumulated plan benefits to reflect the time value of money (through discounts for interest) and the probability of payment (by means of decrements such as for death or retirement) between the valuation date and the expected date of payment. Based on the Pension Benefit Guaranty Corporation requirements for terminated but not yet insolvent multiemployer defined benefit pension plans, an actuarial valuation was requested and completed as of October 1, 20X5, and the valuation is included in note 4. An actuarial valuation of accumulated benefits obligation was not performed as of October 1, 20X7. However, management is confident that the current accumulated obligation significantly exceeds the plan's net assets available to meet those obligations.

[*The following disclosures are for a multiemployer collectively bargained defined benefit pension plan when the actuary has determined that the plan is in critical or endangered status.*]

1.61

Note X: Pension Protection Act Filing of Critical Status

For the year ended December 31, 20X2, the plan was certified by its actuary to be in critical status, within the meaning of the Pension Protection Act of 2006 (PPA). Under the PPA, if a pension plan enters critical status, the trustees of the plan are required to adopt a rehabilitation plan and establish steps and benchmarks to improve the plan's funding status. The trustees adopted a rehabilitation plan, as required by the PPA, on April 14, 20X3. The rehabilitation plan requires specific pension contribution rate increases while not increasing current benefit formulas. In addition, as required by the PPA, certain benefits are reduced for participants whose employers fail to adopt the required contribution rate increases, as set forth in the rehabilitation plan, or agree to adopt the rehabilitation plan schedule (default schedule) that provides for pension contribution increases at lower rates than the plan's primary schedule. Benefit reductions generally include the elimination of early retirement benefits, postretirement death benefits, and future disability benefits.

1.62

Note X: Pension Protection Act Filing of Critical Status

Under ERISA, as amended by the Pension Protection Act of 2006 (PPA), on March 29, 20X1, the actuary of the plan certified that the plan is in critical status for the plan year beginning January 1, 20X1. Based on this critical status certification, the plan's board of trustees adopted a rehabilitation plan, effective November 25, 20X1, based on plan information as of January 1, 20X1, and on reasonable assumptions about how the plan's assets and liabilities will change in the coming years, particularly as a result of changes in the plan's investment returns, which are dependent on the financial markets.

The plan will make adequate progress, to the extent reasonable based on financial markets' activity and other relevant factors, toward enabling it to emerge from critical status by the end of its rehabilitation period. The trustees may set a later date if they determine, based on reasonable actuarial assumptions and upon the exhaustion of all reasonable measures, that the plan cannot reasonably be expected to emerge from critical status by the end of its rehabilitation period.

1.63

[*The following disclosure is for a multiemployer collectively bargained defined benefit pension plan.*]

Note X: Employers' Contribution Obligation Exemption

The plan's trustee voted to suspend each employer's obligation to contribute to the fund in 20X2 and 20X1 for six weeks beginning July 1. The contribution obligation resumed after the respective periods of suspension.

1.64

[*The following disclosure is for a multiemployer collectively bargained defined benefit pension plan.*]

Note X: Occupancy Expense and Lease Commitment

The plan and the benefit's fund jointly lease office space from the International Union. Their 5-year lease expired on December 31, 20X1, and they exercised their option to renew the lease for an additional 5-year term. As of December 31, 20X2, the plan's portion of the required minimum lease payments, representing 60 percent of the total obligation, is as follows:

20X3	$ 455,361
20X4	469,022
20X5	483,093
20X6	497,585
	$1,905,061

Occupancy expenses, including rent and utilities, for 20X2 and 20X1 were $448,850 and $461,164, respectively, and are included in administrative expenses.

1.65

[*For a defined benefit pension plan that includes a medical benefit component (401(h) account).*]

Note X: Reconciliation of Financial Statements to Form 5500

The following is a reconciliation of net assets available for pension benefits, per the financial statements, to Form 5500:

	For the Year Ended December 31	
	20X2	*20X1*
Net assets available for pension benefits, per the financial statements	$40,860,000	$39,550,000
Net assets held in 401(h) account included as assets in Form 5500	3,041,000	2,789,000
Net assets available for benefits, per Form 5500	$43,901,000	$42,339,000

The net assets of the 401(h) account included in Form 5500 are not available to pay pension benefits but can be used only to pay retiree medical benefits.

The following is a reconciliation of the changes in net assets, per the financial statements, to Form 5500:

	For the Year Ended December 31, 20X2		
	Amounts per Financial Statements	*401(h) Account*	*Amounts per Form 5500*
Net appreciation in fair value of investments	$ 430,000	$35,000	$ 465,000
Interest income	221,000	71,200	292,200
Employer contributions	679,000	50,000	729,000
Benefits paid to retirees	1,100,000	37,000	1,137,000
Administrative expenses	$ 60,000	$ 5,000	$ 65,000

1.66

[*For a defined benefit pension plan that includes a medical benefit component (401(h) account).*]

Note X: Reconciliation of Financial Statements to Form 5500

The following is a reconciliation of net assets available for pension benefits, per the financial statements, to Form 5500:

	For the Year Ended December 31	
	20X2	*20X1*
Net assets available for pension benefits, per the financial statements	$7,940,000	$7,180,000
Net assets held in 401(h) account included as assets in Form 5500	1,072,000	966,000
Net assets available for benefits, per Form 5500	$9,012,000	$8,146,000

The net assets of the 401(h) account included in Form 5500 are not available to pay pension benefits but can be used only to pay retiree health benefits.

The following is a reconciliation of the changes in net assets, per the financial statements, to Form 5500:

	For the Year Ended December 31, 20X2		
	Amounts per Financial Statements	*401(h) Account*	*Amounts per Form 5500*
Net appreciation in fair value of investments	$233,000	$10,800	$243,800
Interest income	293,000	80,200	373,200
Employer contributions	740,000	40,000	780,000
Benefits paid to retirees	740,000	10,000	750,000
Administrative expenses	$ 50,000	$15,000	$ 65,000

1.67

Note X: Information Concerning Plan Sponsor

The plan sponsor, ABC Company, filed for protection under Chapter 11 of the U.S. Bankruptcy Code on April 16, 20X1, and is currently operating under this protection. The company has drafted a reorganization plan and is currently awaiting confirmation of that plan. The plan sponsor will make the minimum contributions to the plan, if and when such contributions are necessary.

SECTION 2: DISCLOSURES SPECIFIC TO DEFINED CONTRIBUTION PENSION PLANS

1. DESCRIPTION OF THE PLAN

2.01

Note X: Description of the Plan

The following description of the Blue Company, Inc., cash or deferred retirement plan for represented employees (plan) provides only general information. For a more complete description of the plan's provisions, refer to the agreement governing the plan (plan agreement).

a. *General*—The plan was established as a result of a collective bargaining agreement (CBA) between Blue Company, Inc. (Blue), and the Group Union (GU) and replaces the benefits provided by the Group Council cash or deferred plan (prior plan). The plan was established on May 15, 20X1, and is subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended. The plan was adopted under the provisions of Internal Revenue Code (IRC) Section 401(a), with a cash or deferred arrangement qualified under IRC Section 401(k). Pursuant to the requirements of IRC Section 401(a)(27), the plan is also a profit sharing plan. The plan is a defined contribution plan that covers all active employees of Blue who are represented by a CBA.

   During 20X1, assets of $8,006,358 were transferred in from the prior plan. The assets transferred were attributable to employees who participated in the prior plan and were transferred to the plan on October 1, 20X1. Participants began contributing to the plan in September 20X1.

   The plan is administered by Blue and advised by a committee whose members are appointed by the board of directors of Blue (administration committee). The assets of the plan are held and invested by ABC Bank (trustee).

b. *Tax status of the plan*—Blue has filed for a determination letter from the IRS regarding the plan's qualification under IRC Section 401(a) and the related trust's tax-exempt status under the provisions of IRC Section 501(a). The administration committee believes that the plan is currently designed and is being operated in compliance with the applicable requirements of the IRC. The administration committee will make any changes deemed necessary to ensure that the plan is granted tax-exempt status.

c. *Amendment and termination of the plan agreement*—The plan agreement may be amended or terminated by Blue at any time, unless such amendment violates the CBA. No such termination is contemplated, but if it should occur, the assets of the plan shall be used to pay or provide for the payment of any and all obligations hereunder, in accordance with the provisions of the plan and the directions of the administration committee. No portion of the assets of the plan, directly or indirectly, shall revert to or accrue to the benefit of Blue. In addition, in the event of the termination or partial termination of the plan, all participants shall have a fully vested interest in all accrued benefits.

d. *Participation*—Eligibility in the plan includes all employees who were participants in the prior plan on May 15, 20X1. Any other represented employee of Blue may become a participant immediately after his or her employment date.

e. *Contributions and Blue matching*—Contributions to the plan include (i) salary reduction contributions authorized by participants, (ii) matching contributions made by Blue, (iii) nonelective contributions made by Blue, and (iv) participant rollovers from another qualified plan.

   Each participant may authorize Blue to contribute into the plan, on a pretax basis, up to 15 percent of his or her annual salary. The contribution is subject to IRC limitations.

   Participants must be employed on the last day of the plan year; complete 1,000 hours of service during the plan year; and be represented by the GU to receive matching contributions. Blue matching contributions are in the form of Blue stock calculated at $0.50 for each dollar contributed by the participant, up to a maximum of 5 percent of the participant's compensation that is elected to be deferred as a salary reduction contribution. Forfeitures are used to reduce matching contributions.

No nonelective contributions by Blue were made in 20X2 or 20X1.

f. *Vesting*—If the participant terminates employment prior to normal or early retirement age (65 or 55, respectively) for any reasons other than death or permanent disability, the portion of the matching contribution that is vested is as follows:

Years of Service	*Vesting Percentage*
Less than 3 years	0%
3 years or more	100%

Participants are fully vested at all times in all other contributions.

g. *Participants' accounts and benefits*—Individual accounts are maintained for each plan participant to reflect the participant's contributions and related matching contribution. Income and loss is allocated to the participants' accounts based on the ratio of the account balance of the individual participant to the aggregate of all account balances of all participants in the fund within the plan. Participants withdrawing from the plan receive their balance by (i) a transfer to another qualified plan, (ii) a transfer to an individual retirement account, or (iii) a lump sum distribution that is subject to a 20 percent income tax withholding.

h. *Loans*—The plan agreement specifies that in the event the administration committee decides to permit loans, it may authorize the trustee to make a loan to any participant, subject to certain limitations stipulated in the plan agreement. As of December 31, 20X2, and 20X1, the administration committee had not elected to grant loans to participants.

2.02

Note X: Description of the Plan

The following brief description of the Black Company 401(k) savings plan (plan) is provided for general information purposes only. Participants should refer to the plan document for more complete information.

a. *General*—The plan is a defined contribution savings plan established by Black Company (company) and is subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended. Participation in the plan is entirely voluntary. An eligible employee is any person employed by the company who is an employee at any of the following company divisions: Charcoal, Grey, Marble, Absolute, or Night, and an employee becomes eligible to participate in the plan on the first day of the quarter immediately following hire. The plan's retirement committee and plan administrator control and manage the operation and administration of the plan. The retirement committee has all powers necessary to carry out the provisions of the plan and to satisfy the requirements of any applicable law. Effective February 1, 20X2, the plan changed its custodial and recordkeeping functions from DEF Bank to ABC Bank. ABC Bank currently serves as the plan trustee.

b. *Contributions*—An eligible employee may become a participant in the plan by completing an enrollment form whereby the employee agrees to accept a specified reduction in salary or wage for each pay period in consideration of the company contributing such amount to the plan. Participants may elect to contribute between 1 percent and 15 percent of their compensation, excluding bonuses and commissions, to the plan each year. Such contributions are excluded from the participant's taxable income for federal income tax purposes until received as a withdrawal or distribution from the plan.

A participant may increase or decrease the amount of the salary or wage reduction on the first day of each plan quarter.

Each month, the company will make a matching contribution to each participant's account equal to 25 percent of the amount of the participant's contribution. The maximum contribution amount eligible to be matched is 5 percent of eligible compensation. The company matching contributions are allocated to participants' accounts on each monthly valuation date. Total participant contributions in any calendar year are limited to the applicable limit under Internal Revenue Code Section 402(g).

The plan also provides that certain limitations may be imposed on participants' contributions in order to comply with statutory requirements.

The participant contributions and the company matching contributions may be allocated to six mutual funds as the participant directs.

c. *Investment elections*—Each participant may direct that salary reduction contributions be invested in 1 or more of the 6 mutual funds. Allocations must be in increments of 5 percent of each contribution. A participant may change such allocation at any time directly with ABC Bank and may transfer all or a portion of the value of his or her account, in increments of 5 percent, among the 6 funds as often as once each calendar quarter. On each monthly valuation date, the investment earnings will be determined for each fund. A participant's share of these investment earnings for a month are determined based upon the participant's percentage of the total fund balance as of the previous monthly valuation date.
d. *Valuation*—All of a participant's salary reduction and matching contributions are credited to his or her account, as directed by the participant. The value of each of the separate funds is determined by ABC Bank on each monthly valuation date. ABC Bank then values and increases or decreases each participant's account to reflect his or her proportionate interest in each of the funds, as adjusted for fund activity, since the preceding valuation date.
e. *Vesting and distributions*—Participants' contributions are fully vested at all times. The matching contributions to each participant's account are subject to vesting requirements. The matching contributions vest according to the following schedule:

Completed Years of Service	*Percentage of Matching Contribution Vested*
Less than 2	0%
2 or more	100%

Amounts contributed through salary or wage reductions may be withdrawn by, or distributed to, a participant only upon (1) termination of employment or (2) attaining the age of $59\frac{1}{2}$. Withdrawals prior to attaining age $59\frac{1}{2}$ are not permitted, except in the event of retirement, disability, or as a hardship distribution. Upon proof, to the satisfaction of the plan administrator, of an immediate and heavy financial need, amounts contributed may be withdrawn for a hardship purpose. Certain income tax penalties may apply to withdrawals or distributions prior to age $59\frac{1}{2}$.

f. *Forfeitures*—When certain terminations of participation in the plan occur, the nonvested portion of the participant's account, as defined by the plan, represents a forfeiture. Forfeitures are utilized to reduce the company matching contributions for the plan year. However, if the participant is reemployed and fulfills certain requirements, as defined in the plan, the participant's account will be reinstated.
g. *Termination of the plan*—The company may terminate, amend, modify, or suspend the plan, in whole or in part, at any time. However, in any such event, the participants' rights to their accrued benefits are nonforfeitable.

2.03

Note X: Description of the Plan

The following description of the XYZ Company (company) 401(k) plan (plan) provides only general information. Participants should refer to the plan agreement for a more complete description of the plan's provisions.

1. *General*. The plan is a defined contribution plan covering all full time employees of the company who have 1 year of service and are age 21 or older. The plan is subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended.
2. *Contributions*. Each year, participants may contribute up to 12 percent of pretax annual compensation, as defined in the plan. Participants who have attained age 50 before the end of the plan year are eligible to make catch-up contributions. Participants also may contribute amounts representing distributions from other qualified defined benefit or defined contribution plans. Participants direct the investment of their contribution into various investment options offered by the plan. The plan currently offers various mutual funds and an insurance investment contract as investment options

for participants. The company contributes 25 percent of the first 6 percent of base compensation that a participant contributes to the plan. The matching company contribution is invested directly in company common stock. Additional profit sharing amounts may be contributed at the option of the company's board of directors and are invested in a portfolio of investments, as directed by the company. Contributions are subject to certain limitations.

3. *Participant accounts*. Each participant's account is credited with the participant's contribution and allocations of (*a*) the company's contribution and (*b*) plan earnings and is charged with an allocation of administrative expenses. Allocations are based on participant earnings or account balances, as defined. The benefit to which a participant is entitled is the benefit that can be provided from the participant's vested account.
4. *Vesting*. Participants are vested immediately in their contributions, plus actual earnings thereon. Vesting in the company's contribution portion of their accounts is based on years of continuous service. A participant is 100 percent vested after 5 years of credited service.
5. *Participant loans*. Participants may borrow from their fund accounts a minimum of $1,000 up to a maximum equal to the lesser of $50,000 or 50 percent of their account balance. The loans are secured by the balance in the participant's account and bear interest at rates that range from 6 percent to 10 percent, which are commensurate with local prevailing rates, as determined quarterly by the plan administrator. Principal and interest is paid ratably through monthly payroll deductions.
6. *Payment of benefits*. On termination of service due to death, disability, or retirement, a participant may elect to receive either a lump sum amount equal to the value of the participant's vested interest in his or her account or annual installments over a 10-year period. For termination of service for other reasons, a participant may receive the value of the vested interest in his or her account as a lump sum distribution.
7. *Forfeited accounts*. At December 31, 20X2, and 20X1, forfeited nonvested accounts totaled $7,500 and $5,000, respectively. These accounts will be used to reduce future employer contributions. Also, in 20X2, company contributions were reduced by $5,000 from forfeited nonvested accounts.

2.04

Note X: Description of Plan

The following description of the XYZ Company (company) profit sharing plan (plan) provides only general information. Participants should refer to the plan agreement for a more complete description of the plan's provisions.

1. *General*. The plan is a defined contribution plan covering all full time employees of the company who have 1 year of service and are age 21 or older. The plan is subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended.
2. *Contributions*. Each year, the company contributes to the plan 10 percent of its current profits before pension and profit sharing costs and income taxes. Additional amounts may be contributed at the option of the company's board of directors. Participants may contribute up to 10 percent of their annual wages before bonuses and overtime. Contributions are subject to certain limitations.
3. *Participant accounts*. Each participant's account is credited with the participant's contribution and an allocation of (*a*) the company's contribution, (*b*) plan earnings, and (*c*) forfeitures of terminated participants' nonvested accounts and is charged with an allocation of administrative expenses. Allocations are based on participant earnings or account balances, as defined. The benefit to which a participant is entitled is the benefit that can be provided from the participant's vested account.
4. *Vesting*. Participants are vested immediately in their voluntary contributions, plus actual earnings thereon. Vesting in the company contributions portion of their accounts plus earnings thereon is based on years of continuous service. A participant is 100 percent vested after 5 years of credited service.
5. *Payment of benefits*. On termination of service due to death, disability, or retirement, a participant may elect to receive an amount equal to the value of the participant's vested interest in his or her account in either a lump sum amount or in annual installments over a 10-year period. For termination

of service due to other reasons, a participant may receive the value of the vested interest in his or her account as a lump sum distribution.

6. *Forfeited accounts*. At December 31, 20X1, forfeited nonvested accounts totaled $10,000. These accounts will be reallocated to participants in the same manner as employer contributions.

2.05

Note X: Description of the Plan

The following description of the individual account retirement plan for bargaining unit employees in Alpha Company's (company's) profit sharing plan (plan) provides only general information. Participants should refer to the plan agreement for a more complete description of the plan's funding, vesting, and benefit provisions. A copy of this pamphlet is available at the company's corporate office.

a. *General*—The plan is a profit sharing plan that provides payments to eligible employees of the company at termination, retirement, death, or disability. All union employees of the company belonging to Local Lodge No. 220, District 67 of the International Association of Machinists and Automobile Workers are eligible for participation. The plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA), as amended.
b. *Company contributions*—The company contributes to each participant's account monthly based on hours actively worked and specific contribution rates, as defined in the plan document. Contributions also are made for each hour incurred for overtime, vacations, or holidays but exclude sick time for which the employee may be paid. Company contributions are allocated among the investment fund options that have been selected by each employee. Vesting in company contributions is on a graduated scale, with 100 percent vesting at 5 years. As a result of passage of the Pension Protection Act of 2006, all active participants in the plan as of January 1, 2007, now become 100 percent vested in the company contributions upon completion of 3 years of service (3-year cliff vesting).
c. *Forfeitures*—Amounts that are forfeited due to a participant's termination of employment prior to vesting in company contributions made on the participant's behalf are used to reduce the required company contribution in subsequent periods. In 20X2 and 20X1, forfeited nonvested amounts totaling $806 and $644, respectively, were used to reduce company contributions. Upon termination of the plan, all remaining forfeitures are to be allocated to the participant accounts.
d. *Employee contributions*—The plan allows for employee contributions based on hours actively worked and elected contribution rates. Electing to contribute is voluntary, and these contributions are immediately 100 percent vested. Participants may elect to have their contributions allocated in 1 percent increments to 1 or more of the investment fund options offered by the plan. Allocations among the investment accounts may be changed at the participant's discretion on a daily basis.
e. *Termination of the plan*—Although it has not expressed any intent to do so, the company has the right under the plan to discontinue its contributions at any time and to terminate the plan, subject to the provisions of ERISA. In the event of plan termination, participants would become 100 percent vested in their company contributions.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.06

Note X (In Part): Summary of Significant Accounting Policies

Basis of accounting. The financial statements of the plan are prepared on the accrual basis of accounting.

Investment contracts held by a defined contribution plan are required to be reported at fair value. However, contract value is the relevant measurement attribute for that portion of the net assets available for benefits of a defined contribution plan attributable to fully benefit responsive investment contracts because contract value is the amount participants would receive if they were to initiate permitted transactions under the terms of the plan. The statement of net assets available for benefits presents the fair value of the investment contracts, as well as the adjustment of the fully benefit responsive investment contracts from fair value to contract value. The statement of changes in net assets available for benefits is prepared on a contract value basis.

Use of estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

Investment valuation and income recognition. Investments are reported at fair value. *Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See note D for a discussion of fair value measurements.

Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the exdividend date. Net appreciation includes the plan's gains and losses on investments bought and sold, as well as held during the year.

Payment of benefits. Benefits are recorded when paid.

Operating expenses. All expenses of maintaining the plan are paid by the company.

Subsequent events. The plan has evaluated subsequent events through July 31, 20XX, the date the financial statements were available to be issued.

2.07

Note X (In Part): Summary of Significant Accounting Policies

Investment valuation and income recognition. Investments are recorded at fair value. *Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See note E for a discussion of fair value measurements.

Dividend income is accrued on the exdividend date.

Purchases and sales of securities are recorded on a trade-date basis. Realized gains and losses from security transactions are reported on the average cost method.

2.08

[*The following disclosure is for financial statements prepared on the modified cash basis of accounting*.]

Note X (In Part): Summary of Significant Accounting Policies

Accounting method. The accounts of the plan are maintained, and the accompanying financial statements have been prepared, on the modified cash basis. Investment income is recognized when received, disbursements are recognized when made, and contributions are accrued at year-end. Additionally, securities investments are reflected at fair value. Accordingly, the financial statements are not intended to present the net assets available for benefits and changes in net assets available for benefits of the plan in conformity with accounting principles generally accepted in the United States of America.

3. INVESTMENTS

2.09

Note X: Investments

The following table presents the individual investment securities that exceeded 5 percent of the plan's net assets available for benefits at December 31, 20X2, and 20X1:

	For the Year Ended December 31, 20X2		
	Number of Shares	*Net Value*	*Fair Value*
Prosperity Trust Company mutual funds:			
Balanced fund	1,706,096	34.00	$29,020,694
Stock fund	1,309,820	61.54	40,303,192
Equity fund	798,756	42.86	17,117,360
XYZ Company common stock*	500,000	20.22	10,110,000
ABC Company common stock*	200,000	10.00	$ 5,000,000

	For the Year Ended December 31, 20X1		
	Number of Shares	*Net Value*	*Fair Value*
Prosperity Trust Company mutual funds:			
Balanced fund	1,624,880	32.50	$26,406,800
Stock fund	1,438,772	61.84	44,478,420
Equity fund	745,996	41.07	15,450,116
XYZ Company common stock*	450,000	19.75	8,875,050
ABC Company common stock*	202,000	10.50	$ 4,750,000

* Nonparticipant directed.

During 20X2, the plan's investments (including gains and losses on investments bought and sold, as well as held during the year) appreciated in value by $1,003,000 as follows:

Mutual funds	$ 900,000
Bank collective investment funds	80,000
Common stock	60,000
U.S. government securities	(37,000)
	$1,003,000

2.10

Note X: Investments

The following presents investments that represent 5 percent or more of the plan's net assets:

	For the Year Ended December 31	
	20X2	*20X1*
XYZ Company common stock—400,000 and 390,000 shares, respectively	$ 470,000*	$ 420,000*
ABC Corporation common stock—390,000 and 380,000 shares, respectively	$ 490,000*	$ 490,000*
Prosperity Investments Common Stock Fund—226,250 and 200,000 shares, respectively	$2,262,500*	$2,000,000*
Prosperity Investments Balanced Fund—140,000 and 210,000 shares, respectively	$1,422,000	$2,100,000
Investment contract with National Insurance Company at contract value, which approximates fair value, #2012A, matures 12/31/X6 (see note E)	$1,500,000	$ 650,000

* Nonparticipant directed.

During 20X2, the plan's investments (including gains and losses on investments bought and sold, as well as held during the year) appreciated in value by $279,000 as follows:

Mutual funds	$229,000
Common stock	30,000
Corporate bonds	30,000
U.S. government securities	(10,000)
	$279,000

2.11

Note X: Nonparticipant-Directed Investments

Information about the net assets and significant components of the changes in net assets relating to the nonparticipant-directed investments is as follows:

	For the Year Ended December 31	
	20X2	*20X1*
Net assets:		
Investments:		
Common stock	$ 960,000	$ 870,000
Mutual funds	2,262,500	2,000,000
Corporate bonds	307,500	255,000
U.S. government securities	225,000	120,000
	$3,755,000	$3,245,000

	For the Year Ended December 31, 20X2
Changes in net assets:	
Contributions	$ 699,000
Dividends	165,000
Net appreciation	60,000
Benefits paid to participants	(280,000)
Transfers to participant-directed investments	(134,000)
	$ 510,000

4. FAIR VALUE MEASUREMENTS

Practice Tip:

Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 820, *Fair Value Measurements and Disclosures*, provides enhanced guidance for using fair value to measure assets and liabilities. This standard defines *fair value* and expands disclosures about fair value measurements. In January 2010, FASB issued Accounting Standards Update (ASU) No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. ASU No. 2010-06 amends the disclosure requirements of FASB ASC 820 to require new disclosures regarding (*a*) transfers in and out of levels 1 and 2 and (*b*) activity in level 3 fair value measurements. ASU No. 2010-06 also provides amendments to FASB ASC 820 that clarify existing disclosures regarding (1) the level of disaggregation for each class of assets and liabilities and (2) disclosures about inputs and valuation techniques for fair value measurements that fall in either level 2 or level 3.

The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures regarding the rollforward of activity in level 3 fair value measurements which are effective for fiscal years beginning after December 15, 2010 and interim periods within those fiscal years.

2.12

Note X: Fair Value Measurements

Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 820, *Fair Value Measurements and Disclosures*, establishes a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820-10 are described as follows:

- Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the plan has the ability to access.
- Level 2 inputs to the valuation methodology include the following:
  - — Quoted prices for similar assets or liabilities in active markets
  - — Quoted prices for identical or similar assets or liabilities in inactive markets
  - — Inputs other than quoted prices that are observable for the asset or liability
  - — Inputs that are derived principally from, or corroborated by, observable market data by correlation or other means

  If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.
- Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 20X2, and 20X1.

- *Common stocks, corporate bonds, and U.S. government securities*. Valued at the closing price reported on the active market on which the individual securities are traded.
- *Mutual funds*. Valued at the net asset value of shares held by the plan at year-end.
- *Participant loans*. Valued at amortized cost, which approximates fair value.
- *Guaranteed investment contract*. Valued at fair value by discounting the related cash flows based on current yields of similar instruments with comparable durations, considering the creditworthiness of the issuer (see note E).

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following table sets forth by level within the fair value hierarchy the plan's assets at fair value as of December 31, 20X2, and 20X1:

Practice Tip:

The following table illustrates certain of the disclosure requirements of FASB ASC 820. The disclosures illustrated subsequently of the nature and risks of securities, as required by FASB ASC 820-10-50, are included here for illustrative purposes and are not intended to represent the only way to disclose such information.

In addition, in January 2010, FASB issued Accounting Standards Update (ASU) No. 2010-06. FASB ASU No. 2010-06 amends the disclosure requirements of FASB ASC 820, including amendments regarding the level of disaggregation for each class of assets and liabilities. The following illustrative financial statements have not been amended to conform to FASB ASU No. 2010-06. These financial statements will be amended closer to the effective date of FASB ASU No. 2010-06.

	Assets at Fair Value as of December 31, 20X2			
	Level 1	*Level 2*	*Level 3*	*Total*
Mutual funds				
Index funds	$2,262,500	—	—	$2,262,500
Balanced funds	1,422,000	—	—	1,422,000
Growth funds	1,375,000	—	—	1,375,000
Fixed income funds	800,000	—	—	800,000
Other funds	25,000	—	—	25,000
Total mutual funds	5,884,500	—	—	5,884,500
Common stocks		—	—	
Industrials	384,000	—	—	384,000
Telecommunications	240,000	—	—	240,000
Consumer	192,000	—	—	192,000
Other	144,000	—	—	144,000
Total common stocks	960,000	—	—	960,000
Corporate bonds	307,500	—	—	307,500
U.S. government securities	225,000	—	—	225,000
Guaranteed investment contract	—	—	$1,515,000	1,515,000
Participant loans	—	—	300,000	300,000
Total assets at fair value	$7,377,000	—	$1,815,000	$9,192,000

	Assets at Fair Value as of December 31, 20X1			
	Level 1	*Level 2*	*Level 3*	*Total*
Mutual funds				
Index funds	$2,000,000	—	—	$2,000,000
Balanced funds	2,100,000	—	—	2,100,000
Growth funds	1,150,000	—	—	1,150,000
Fixed Income	400,000	—	—	400,000
Other funds	100,000	—	—	100,000
Total mutual funds	5,750,000	—	—	5,750,000
Common stocks				
Industrials	348,000	—	—	348,000
Telecommunications	217,500	—	—	217,500
Consumer	174,000	—	—	174,000
Other	130,500	—	—	130,500
Total common stocks	870,000	—	—	870,000
Corporate bonds	255,000	—	—	255,000
U.S. government securities	120,000	—	—	120,000
Guaranteed investment contract	—	—	$ 660,000	660,000
Participant loans	—	—	350,000	350,000
Total assets at fair value	$6,995,000	—	$1,010,000	$8,005,000

Level 3 Gains and Losses

The following table sets forth a summary of changes in the fair value of the plan's level 3 assets for the year ended December 31, 20X2.

	Level 3 Assets for the Year Ended December 31, 20X2	
	Guaranteed Investment Contract	*Participant Loans*
Balance, beginning of year	$ 660,000	$350,000
Realized gains (losses)	—	—
Unrealized gains (losses) relating to instruments still held at the reporting date	40,000	—
Purchases, sales, issuances, and settlements (net)	815,000	(50,000)
Balance, end of year	$1,515,000	$300,000
The amount of total gains or losses for the period included in changes in net assets attributable to the change in unrealized gains or losses relating to assets still held at the reporting date	$ 40,000	$ 40,000

Gains and losses (realized and unrealized) included in changes in net assets for the preceding period are reported in net appreciation in fair value of investments in the statement of changes in net assets available for benefits.

2.13

[*The following disclosure relates to self-directed assets when the self-directed assets are immaterial.*]

Note X: Investments

Participant contributions and investment earnings were directed by the individual plan participants to the following 9 investment choices offered under the plan: the Moon Common Share Fund; 7 mutual funds (Asset Manager, Big Stock, Retirement Government Money Market, U.S. Equity Index, Intermediate Bond, International Growth, and Income and Equity) managed by Star Investments; and Star Brokerage Link. Star Brokerage Link is a self-directed brokerage account through which participants are able to invest in a variety of securities, including stock, bonds, mutual funds, and certificates of deposit. Effective April 2, 20X2, the Moon Savings Plan began offering the following 12 investment choices: 7 Star-managed investment options, a 500 index and growth and income mutual funds, a growth-oriented mutual fund, a self-directed brokerage account, and the Moon Common Share Fund.

Investments at fair value are summarized as follows. Investments representing more than 5 percent of plan assets are listed separately.

	For the Year Ended December 31	
	20X2	*20X1*
Registered investment companies:		
Star Asset Manager	$ 5,723	$ 4,781
Star Growth	19,924	17,506
Star U.S. Equity Index	5,708	5,112
Star Equity	4,864	3,076
Other registered investment companies	4,512	3,723
Total registered investment companies	40,731	34,198
Star Brokerage Link	2,830	2,695
Moon Common Share Fund*	18,428	17,695
Participant loans receivable	1,500	1,313
Total investments	$63,489	$55,901

* Partially nonparticipant directed.

Investments Valuation
Plan investments held by Star Brokerage Link were stated at fair value. Fair value of shares of registered investment companies represented the net asset value of such shares as of the close of business at the end of the period. Fair value of Moon common shares were based on the last quoted market price as of the close of business at period-end. Fair value of the Star Brokerage Link Account assets, which consist primarily of registered investment companies, were determined using the methods previously stated. Participant loans were valued at their outstanding balances, which approximated fair value.

Net Appreciation (Depreciation)
Net appreciation (depreciation) by investment type is as follows:

Net depreciation in fair value of investments:	
Registered investment companies	(3,608)
Common shares of Moon	(1,695)
Star Brokerage Link	(544)
	(5,847)

Nonparticipant-Directed Investments

Information about the significant components of the changes in net assets relating to the nonparticipant-directed investments was as follows (in thousands):

	For the Year Ended December 31, 20X2
Moon Common Share Fund:	
Beginning of period	$14,643
Changes in net assets	
Contributions	$ 326
Net depreciation	(1,399)
Benefits paid to participants	(104)
End of period	$13,466

5. CONTRACTS WITH INSURANCE COMPANIES

2.14

Note X (In Part): Summary of Significant Accounting Policies

B. Summary of Accounting Policies

Use of Estimates and Basis of Accounting
The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates that affect the financial statements and accompanying notes. Actual results could differ from those estimates.

Investment contracts held by a defined contribution plan are required to be reported at fair value. However, contract value is the relevant measurement attribute for that portion of the net assets available for benefits of a defined contribution plan attributable to fully benefit responsive investment contracts because contract value is the amount participants would receive if they were to initiate permitted transactions under the terms of the plan. The statement of net assets available for benefits presents the fair value of the investment contracts, as well as the adjustment of the fully benefit responsive investment contracts from fair value to contract value. The statement of changes in net assets available for benefits is prepared on a contract value basis.

Investment Valuation and Income Recognition

The plan's investments are stated at fair value. Quoted market prices are used to value mutual funds. Shares of mutual funds are valued at the net asset value of shares held by the plan at year-end. Participant loans are valued at their outstanding balances, which approximate fair value. The fair value of the guaranteed investment contract is calculated by discounting the related cash flows based on current yields of similar instruments with comparable durations.

Purchases and sales of securities are recorded on a trade-date basis. Dividends are recorded on the exdividend date.

2.15

Note X: Guaranteed Investment Contract With Insurance Company

In 20X1, the plan entered into a benefit responsive investment contract with National Insurance Company (National). National maintains the contributions in a general account. The account is credited with earnings on the underlying investments and charged for participant withdrawals and administrative expenses. The guaranteed investment contract issuer is contractually obligated to repay the principal and a specified interest rate that is guaranteed to the plan. Because the guaranteed investment contract is fully benefit-responsive, contract value is the relevant measurement attribute for that portion of the net assets available for benefits attributable to the guaranteed investment contract. The guaranteed investment contract is presented on the face of the statement of net assets available for benefits at fair value, with an adjustment to contract value in arriving at net assets available for benefits. Contract value, as reported to the plan by National, represents contributions made under the contract, plus earnings, less participant withdrawals and administrative expenses. Participants may ordinarily direct the withdrawal or transfer of all or a portion of their investment at contract value.

There are no reserves against contract value for credit risk of the contract issuer or otherwise. The fair value of the investment contract at December 31, 20X2, and 20X1 was $1,515,000 and $660,000, respectively. The crediting interest rate is based on a formula agreed upon with the issuer, but it may not be less than 4 percent. Such interest rates are reviewed on a quarterly basis for resetting.

Certain events limit the ability of the plan to transact at contract value with the issuer. Such events include the following: (1) amendments to the plan documents (including complete or partial plan termination or merger with another plan); (2) changes to the plan's prohibition on competing investment options or deletion of equity wash provisions; (3) bankruptcy of the plan sponsor or other plan sponsor events (for example, divestitures or spin-offs of a subsidiary) that cause a significant withdrawal from the plan; or (4) the failure of the trust to qualify for exemption from federal income taxes or any required prohibited transaction exemption under the Employee Retirement Income Security Act of 1974, as amended. The plan administrator does not believe that any events that would limit the plan's ability to transact at contract value with participants are probable of occurring.

The guaranteed investment contract does not permit the insurance company to terminate the agreement prior to the scheduled maturity date.

	20X2	*20X1*
Average yields:		
Based on actual earnings	4.68%	4.90%
Based on interest credited to participants	4.68%	4.90%

6. EMPLOYER CONTRIBUTIONS

2.16

Note X: Matching Contributions

Effective January 1, 20X2, a matching contribution feature, which provides that the company will contribute $0.25 for every dollar of salary reduction contributions by a participant to his or her 401(k) account, up to a maximum of 6 percent of his or her eligible salary, was implemented by the plan.

The company will match up to an additional $0.25 on every dollar of eligible employee contributions as an annual performance matching contribution if the company achieves certain performance objectives established by the company's board of directors. The company is funding its match with contributions to a tandem leveraged employee stock ownership plan. See the following note X. In 20X2 and 20X1, these incentive goals were met, and an additional performance matching contribution was made to each participant's matching contribution account.

2.17

Note X (In Part): Description of the Plan

Contributions. An eligible employee may become a participant in the plan by completing an enrollment form whereby the employee agrees to accept a specified reduction in salary or wage for each pay period in consideration of Yellow Company contributing such amount to the plan. Participants may elect to contribute between 1 percent and 15 percent of their compensation, excluding bonuses and commissions, to the plan each year. Such contributions are excluded from the participant's taxable income for federal income tax purposes until received as a withdrawal or distribution from the plan. A participant may increase or decrease the amount of the salary or wage reduction on the first day of each plan quarter.

Each month, Yellow Company will make a matching contribution to each participant's account equal to 25 percent of the amount of the participant's contribution. The maximum contribution amount eligible to be matched is 5 percent of eligible compensation. The Yellow Company matching contributions are allocated to participants' accounts on each monthly valuation date. Total participant contributions in any calendar year are limited to the applicable limit under Internal Revenue Code Section 402(g). The plan also provides that certain limitations may be imposed on participant's contributions in order to comply with statutory requirements.

2.18

Note X (In Part): Description of the Plan

a. *Contributions*—Contributions under the plan may be made by both the participants and the corporation. A participant may elect to make pretax contributions of at least 1 percent of eligible annual compensation, up to a maximum percentage, as determined by the plan administrator. For 20X2, the maximum employee contribution permitted was $9,240, and the maximum corporation matching contribution was $5,000. Additionally, the plan document provides for voluntary after-tax contributions. Contributions are invested in 7 mutual funds at the discretion of the participants. Participants may transfer or redirect contributions monthly.

   The corporations may make contributions to the plan in amounts determined by the board of directors. Any such contributions are allocated to the participants' pretax account, as provided by the plan, and invested directly in corporation common stock. Dividends paid on the corporation common stock in 20X2 and 20X1 were $25,000 and $20,000, respectively; distributions of corporation common stock were $40,000 and $30,000, respectively; and transfers out to other investment options were $55,000 and $66,000, respectively. Contributions of $280,000 and $200,000 were made by the corporation in 20X2 and 20X1, respectively. See note X for additional information regarding the contributions made by the corporation.

7. INTEREST IN THE MASTER TRUST

2.19

Note X: Investment in the Master Trust

At June 30, 20X2, and 20X1, the plan's investment assets were held in a trust account at Prosperity and consisted of an interest in a master trust. The master trust also includes the investment assets of the retirement plan for hourly employees of the XYZ Company's Toledo, OH, division; Richmond, VA, division; and Louisville, KY, division.

The master trust was composed of the following investments at June 30, 20X2, and 20X1:

	20X2	*20X1*
Mutual funds	$ 690,526	$ 619,154
Short term investments	180,996	184,684
Common stock	491,606	392,412
Bank collective investment funds	749,326	595,618
Pooled separate insurance company accounts	864,098	707,742
Corporate bonds	528,592	555,816
Net assets	$3,505,144	$3,055,426

The net investment income of the master trust for the years ended June 30, 20X2, and 20X1 is summarized as follows:

	For the Year Ended June 30, 20X2			
	Interest	*Dividends*	*Net Appreciation (Depreciation)*	*Total*
Mutual funds	173,812	—	—	173,812
Short term investments	47,314	—	—	47,314
Common stock		17,596	14,817	32,413
Bank collective investment funds	—	—	47,692	47,692
Pooled separate insurance company accounts	—	—	58,593	58,593
Corporate bonds	—	—	57,622	57,622
Total	221,126	17,596	178,724	417,446

	For the Year Ended June 30, 20X1			
	Interest	*Dividends*	*Net Appreciation (Depreciation)*	*Total*
Mutual funds	206,119	—	—	206,119
Short term investments	67,565	—	—	67,565
Common stock	—	16,058	8,291	24,349
Bank collective investment funds	—	—	(59,511)	(59,511)
Pooled separate insurance company accounts	—	—	(42,008)	(42,008)
Corporate bonds	—	—	3,416	3,416
Total	273,684	16,058	(89,812)	199,930

The plan's interest in the master trust as a percentage of net assets of the master trust was 61.3 percent and 59.3 percent at June 30, 20X2, and 20X1, respectively.

2.20

[*The following disclosure is for when a defined contribution plan establishes a master trust midyear. Prior to the master trust being established, the plan held investments in its own related trust.*]

Note X (In Part): Summary of Significant Accounting Policies

Valuation of investments. The ABC Company, Inc. 401(k) master trust (master trust) was established October 1, 20X2, to hold the investment assets of plans sponsored by ABC Company, Inc. (company and plan sponsor). Investments, and the income therefrom, are allocated to participating plans based on each plan's participation in investment options within the master trust. Accordingly, the plan's investment gain for the year ended December 31, 20X2, includes its allocable share of the master trust's interest and dividends and net appreciation in fair value of mutual funds since October 1, 20X2.

Investments, other than the group annuity contract, held in the master trust after October 1, 20X2, and by the plan prior to the transfer of assets to the master trust are stated at fair value. The mutual funds are valued at quoted market prices, which represent the net asset value of underlying investments held by the mutual fund. Participant loans are valued at their outstanding balances, which approximate fair value.

2.21

[*The following disclosure is for when a defined contribution plan establishes a master trust midyear. Prior to the master trust being established, the plan held investments in its own related trust.*]

Note X: Interest in ABC Company 401(k) Master Trust

At December 31, 20X2, the plan's interest in the net assets of the master trust was approximately 52 percent. Investment income and expenses are allocated to the plan based upon its pro rata share in the net assets of the master trust.

The following table represents the value of investments held in the master trust at December 31, 20X2.

Investments at fair value as determined by quoted market prices:	
Mutual funds	$25,000,000
Investments at estimated fair value:	
Participant loans	1,000,000
	$26,000,000

Investment income for the master trust was as follows for the portion of the year ended December 31, 20X2, that the master trust was in existence:

Net appreciation in fair value of mutual funds	$2,400,000
Interest and dividends	580,000

8. PLAN AMENDMENTS

2.22

Note X (In Part): Description of the Plan

Plan amendment. Effective October 1, 20X2, the plan was amended and restated, and a new trustee, administrator, and custodian (trustee) of the plan was appointed. Plan assets transferred to the new trustee were transferred into funds comparable to those offered by the previous custodian. The conversion initiated a blackout period beginning October 1, 20XX, and continued through November 1, 20XX. During this period, funds could not be applied to the employee-selected funds with the trustee or withdrawn from the plan until the trustee had time to accurately complete the conversion. During this period, employee contributions continued to be made through payroll deductions, and the contributions were deposited and held in the equity fund until the completion of the blackout period. At the end of the blackout period, these funds were transferred to the new trustee and invested in funds, as requested by each participant.

2.23

Note X: Changes in the Plan

The plan had no significant amendments during the periods ended December 31, 20X1; December 31, 20X0; or November 30, 20X0, except for changing the plan year-end from November 30 to December 31, effective December 1, 20X0.

Effective October 1, 20X2, the name of the plan was changed to the Omega savings and investment plan for salaried employees. In addition, on October 1, 20X2, the plan was amended to provide for 4 investment funds in which participant contributions to the plan may be invested. Company contributions are invested in the stock fund, which invests in common stock of Omega Corporation. Effective October 1, 20X2, the plan also was amended to provide a variable company match ranging from 50 percent to 100 percent of a participant's contributions, provided that such amount does not exceed 6 percent of a participant's base compensation. The percentage match is determined based on the consolidated net sales growth of Omega Corporation. Company contributions, effective October 1, 20X2, are made in the form of cash or common stock, or any combination thereof.

9. PLAN MERGERS, ACQUISITIONS, AND SPIN-OFFS

2.24

Note X (In Part): Description of the Plan

a. *General*—The plan is a defined contribution plan covering substantially all employees of ABC Savings and Loan Association (association and plan administrator). The plan was established in March 20X0 and is subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended.

   After the close of business on January 31, 20X2, ABC Corporation, the holding company for the association, acquired DEF Company (DEF), with DEF ultimately merging with and into the association.

   Effective January 27, 20X2, DEF terminated the DEF 401(k) plan (the DEF plan). Upon termination of the DEF plan, all of its participants were immediately fully vested in the benefits provided pursuant to the DEF plan, and the trustee of the DEF plan was directed to distribute the assets of the DEF plan to the eligible participants.

   Pursuant to the terms of the plan, as amended, participants in the DEF plan who continued in the employ of the association following the acquisition of DEF were provided the opportunity to transfer the distributions (including loans) from the DEF plan to the plan. Distributions of $1,675,254, consisting of $1,467,746 in cash and $207,508 in loans, were transferred from the DEF plan to the plan during the first 5 months of 20X2. In addition, the plan was amended to provide service credit for eligibility and vesting for individuals employed by DEF as of the date of acquisition and who subsequently became employees of the association.

2.25

Note X: Subsequent Events

On January 1, 20X2, the plan was merged into the company's deferred compensation plan. Under the new consolidated plan, the three individual components (the deferred compensation plan, capital accumulation, and the employee savings plan) formerly comprising the two separate plans will be retained.

In addition, the plan changed its trustee from XYZ Bank to ABC Bank and its recordkeeper from DEF to GHI, effective January 1, 20X2. In April 20X2, GHI was acquired, and recordkeeping responsibilities were assumed by Alpha Bank and Trust Company.

2.26

[*The following disclosure is for a defined contribution plan that has been split into two plans (from the perspective of the original plan).*]

Note X (In Part): Description of the Plan

Plan split. Effective January 1, 20X2, the plan was split into two separate plans identical in all respects except in regard to participating employer locations and employee groups. The employees, excluding employees who satisfy the plan definition of *highly compensated employee* (HCE), at the following locations became eligible to participate in the supplemental plan rather than the plan: ABC Corporation, New York, NY; XYZ Tools, Miami, FL; Widget Plastics, Cincinnati, OH; and Typical Manufacturing, Lexington, KY. These participants were transferred, along with their corresponding assets of the plan, to the supplemental plan on January 1, 20X2. The participants who remain in the plan include employees of the following locations: ABC Forging, Minneapolis, MN; ABC Trucks, Troy, MI; Generic Products, Inc., Madison, WI; Common Components Mfg., Seattle, WA; and employees of any participating employer location who, on or after January 1, 20X2, qualified as HCEs.

2.27

[*The following subsequent event disclosure is when a decision has been made after the plan's year-end to merge a defined contribution plan into another defined contribution plan.*]

Note X: Subsequent Event

On May 14, 20X3, the board of directors of XYZ Company, as permitted by the plan document, made the decision to merge the XYZ Company 401(k) plan into the XYZ Company retirement income plan, effective June 30, 20X3.

2.28

[*The following disclosure is for a subsequent event change in plan sponsor.*]

Note X: Subsequent Event

Effective April 1, 20X3, ABC Company became the sponsor of the plan as part of an asset purchase agreement whereby ABC Company acquired the operating assets of XYZ Company.

2.29

[*The following disclosure is for a subsequent event change in plan year-end (assuming preceding fiscal year ending on March 31).*]

Note X: Subsequent Event

Effective July 1, 20X3, an amendment to the plan was adopted that will change the plan year to January 1 of each year through the following December 31.

10. PLAN TERMINATIONS

2.30

Note X: Plan Terminations

The company has reserved the right to terminate the plan or reduce or cease contributions at the discretion of the board of directors or to amend the plan at any time and in any respect. However, no such action may deprive any participant or beneficiary under the plan of any vested right.

2.31

Note X (In Part): Description of the Plan

Plan termination. In the event the plan is wholly or partially terminated or upon the complete discontinuance of contributions under the plan by any entity that is a part of the company, each participant's interest in his or her company account affected by such termination or discontinuance shall be nonforfeitable on the date of such termination or discontinuance. Any unallocated assets of the plan fund then held by the trustee shall be allocated among the appropriate company accounts and employee accounts of the participants and will be distributed in such a manner as the company may determine.

2.32

Note X: Subsequent Events—Plan Termination

Effective April 20X3, Dolphin, Inc., announced the termination of the plan and the intention to transfer existing account balances into successor plans. The hourly employees at the Columbus and Augusta, GA, and Mobile, AL, facilities of the Electronic Systems Division became eligible to participate in the Dolphin Corporation savings plan effective May 1, 20X3. The hourly employees at the Ames, Cedar Rapids, Dubuque, Des Moines, and Waterloo, IA, facilities of the Missile Division became eligible to participate in the new Dolphin Corporation retirement savings plan, effective June 1, 20X3.

2.33

Note X: Termination of the Plan

On June 1, 20X2, the company entered into an agreement providing for the sale of certain assets of Alpha Company (Alpha) to Beta Company (Beta), effective June 2, 20X2. As a result of this transaction, most participants in the plan terminated their employment with Alpha and commenced employment with Beta, and their plan accounts were transferred to the Beta employee retirement savings plan. Most of the remaining participants who terminated employment with Alpha and did not commence employment with Beta have had their plan accounts distributed during 20X2 in accordance with plan provisions. With respect to plan participants who are continuing employment with an affiliate of the company, their plan accounts were transferred to the Beta affiliate pension plan. The company has adopted amendments to the plan discontinuing all contributions as of June 2, 20X2, and terminated the Plan as of that date. The plan also was amended to include the transfer of remaining profit sharing plan participant accounts into the Beta plan as of May 31, 20X3. Transferred accounts will be treated in accordance with the Beta plan's provision concerning unclaimed benefits.

2.34

Note X (In Part): Description of the Plan

Plan termination. By action of its board of directors, Sample Company and its U.S. subsidiaries (company) terminated the plan on December 31, 20X1, and filed an application with the IRS for approval.

Once IRS approval has been received, the net assets will be distributed to participants. Participants will have a choice of options regarding these distributions. Participants may elect an annuity, lump sum payment, individual retirement account rollover, or direct transfer into one of the company's other plans.

11. EMPLOYEE STOCK OWNERSHIP PLANS

2.35

Note X: Plan Description and Basis of Presentation

The following brief description of the Sponsor Company employee stock ownership plan (ESOP plan) is provided for general information purposes only. Participants should refer to the plan agreement for complete information.

Sponsor Company (company) established the Sponsor Company stock ownership plan (plan), effective as of January 1, 20XX. As of January 1, 20XY, the plan was amended and operates, in relevant part, as a leveraged ESOP and is designed to comply with Internal Revenue Code (IRC) Section 4975(e)(7) and the regulations thereunder, as amended, and is subject to the applicable provisions of the Employee Retirement Income Security Act of 1974, as amended. The plan is administered by an Employee Benefits Administration Committee comprising up to three persons appointed by the company's board of directors. The trust department of an independent third party bank is the plan's trustee.

The plan purchased company common shares using the proceeds of a bank borrowing (see note 6) guaranteed by the company and holds the stock in a trust established under the plan. The borrowing is to be repaid over a period of 10 years by fully deductible company contributions to the trust fund. As the plan makes each payment of principal, an appropriate percentage of stock will be allocated to eligible employees' accounts, in accordance with applicable regulations under the IRC. Shares vest fully upon allocation.

The borrowing is collateralized by the unallocated shares of stock and is guaranteed by the company. The lender has no rights against shares once they are allocated under the ESOP. Accordingly, the financial statements of the plan for the years 20X2 and 20X1 present separately the assets and liabilities and changes therein pertaining to the following:

a. The accounts of employees with vested rights in allocated stock (allocated)
b. Stock not yet allocated to employees (unallocated)

Eligibility. Employees of the company and its participating subsidiaries generally are eligible to participate in the plan after 1 year of service, provided that they worked at least 1,000 hours during such plan year. Participants who do not have at least 1,000 hours of service during such plan year or are not employed on the last working day of a plan year generally are not eligible for an allocation of company contributions for such year.

Payment of benefits. No distributions from the plan will be made until a participant retires; dies (in which case, payment shall be made to his or her beneficiary or, if none, his or her legal representatives); or otherwise terminates employment with the company and its participating subsidiaries. Distributions are made in cash or, if a participant elects, in the form of company common shares, plus cash for any fractional share.

Under the provisions of the plan, the company is obligated to repurchase participant shares that have been distributed under the terms of the plan, as long as the shares are not publicly traded, or if the shares are subject to trading limitations. During 20X2, the company repurchased from participants 4,390 shares at prices determined from the independent appraisal.

Voting rights. Each participant is entitled to exercise voting rights attributable to the shares allocated to his or her account and is notified by the trustee prior to the time that such rights are to be exercised. The trustee is not permitted to vote any allocated share for which instructions have not been given by a participant. The trustee is required, however, to vote any unallocated shares on behalf of the collective best interest of plan participants and beneficiaries.

Termination. The company reserves the right to terminate the plan at any time, subject to plan provisions. Upon such termination of the plan, the interest of each participant in the trust fund will be distributed to such participant or his or her beneficiary at the time prescribed by the plan terms and the IRC. Upon termination of the plan, the Employee Benefits Administration Committee shall direct the trustee to pay all liabilities and expenses of the trust fund and to sell shares of financed stock held in the loan suspense account to the extent it determines such sale to be necessary in order to repay the loan.

Concentrations. Substantially all of the plan's assets are invested in the company's common stock.

Participant accounts. The plan is a defined contribution plan under which a separate individual account is established for each participant. Each participant's account is credited as of the last day of each plan year, with an allocation of shares of the company's common stock released by the trustee from the unallocated account and forfeitures of terminated participants' nonvested accounts. Only those participants who are eligible employees of the company as of the last day of the plan year will receive an allocation. Allocations are based on a participant's eligible compensation, relative to total eligible compensation.

Vesting. If a participant's employment with the company ends for any reason other than retirement, permanent disability, or death, he or she will vest in the balances in his or her account based on total years of service with the company. Participants vest 20 percent per year of service and are 100 percent vested after 5 years of service.

Put option. Under federal income tax regulations, the company stock that is held by the plan and its participants and is not readily tradable on an established market or is subject to trading limitations includes a put option. The *put option* is a right to demand that the company buy any shares of its stock distributed to participants for which there is no market. The put price is representative of the fair market value of the stock. The company can pay for the purchase with interest over a period of five years. The purpose of the put option is to ensure that the participant has the ability to ultimately obtain cash.

Diversification. Diversification is offered to participants close to retirement so that they may have the opportunity to move part of the value of their investment in company stock into investments that are more diversified. Participants who are at least age 55 with at least 10 years of participation in the plan may elect to diversify a portion of their account. Diversification is offered to each eligible participant over a 6-year period. In each of the first 5 years, a participant may diversify up to 25 percent of the number of post-1986 shares allocated to his or her account, less any shares previously diversified. In the sixth year, the percentage changes to 50 percent. Participants who elect to diversify receive a cash distribution.

Participant accounts and forfeitures. Employer contributions and plan forfeitures are allocated to each participant's account based upon the relation of the participant's compensation to total compensation for the plan year. Forfeitures of terminated nonvested account balances allocated to remaining participants at December 31, 20X2, and 20X1 totaled $4,203 and $3,097, respectively. Plan earnings are allocated to each participant's account based on the ratio of the participant's beginning of the year account balance to all participants' beginning of the year account balances.

2.36

Note X: Loan Payable (Employee Stock Ownership Plan)

In 20XX, the plan entered into an $80,000,000 term loan agreement with a bank. The proceeds of the loan were used to purchase the company's common stock. Unallocated shares are collateral for the loan. The agreement provides for the loan to be repaid over 10 years. The scheduled amortization of the loan for the next 5 years and thereafter is as follows: 20X3—$6,500,000; 20X4—$7,000,000; 20X5—$7,500,000; 20X6—$8,000,000; 20X7—$8,500,000; and thereafter—$31,470,900. The loan bears interest at the prime rate of the lender. For 20X2 and 20X1, the loan interest rate averaged 7.34 percent and 5.12 percent, respectively.

2.37

Note X: Subsequent Events

At December 31, 20X2, the plan had a net deficiency in assets of $750,000. The plan incurred unrealized depreciation in fair value of investments in 20X2 of $1,300,000, and the investments have continued to depreciate during 20X3. A valuation of the preferred stock subsequent to December 31, 20X2, estimates the total value of these investments to be $336,000. These factors raise substantial doubt about the plan's ability to continue as a going concern.

For the plan to remain viable, XYZ Company must pursue and obtain appropriate financing and eventually become profitable.

The financial statements do not include any adjustments that might result from the going concern consideration previously noted.

2.38

Note X: Employee Stock Ownership Plan and Note Payable to the Company

In December 20W0, Guppie, Inc. (Guppie), established an employee stock ownership plan to provide matching contributions under the plan. Guppie issued and sold 1,690,140 shares of Preference stock, Plan Series A, to the plan. As consideration for the stock, the plan issued a promissory note to Guppie valued at $59,999,970, with an interest rate of 8.25 percent.

Principal payments, due January 1, commenced in 20X0. Effective December 31, 20X0, the terms of the plan's promissory notes were amended to reflect a 35-year amortization period. The revised minimum loan amortization requirements for the next 5 years are as follows: 20X3—$324,026; 20X4—$350,758; 20X5—$379,696; 20X6—$411,022; 20X7—$411,022; and thereafter—$38,260,498. The company is obligated to make contributions in cash to the plan that, when aggregated with the plan's dividends, equal the amount necessary to enable the plan to make its regularly scheduled payment of principal and interest due on the note payable. This Preference stock represented an unallocated investment of the plan that the plan began to allocate to individual participant accounts beginning March 31, 20X0, as the promissory note was repaid. The Preference stock has an annual dividend rate of $2.50 per share, and at December 31, 20X2, and 20X1, each share of the Preference stock is redeemable for an equivalent share of common stock. Alternatively, the participant may elect to receive a cash distribution upon withdrawal from the plan.

12. OTHER

2.39

[*The following is for failure to remit participant contributions timely (a nonexempt transaction) when it is determined that this disclosure is material to the overall presentation of the financial statements.*]

Note X: Nonexempt Transaction

Participant contributions of $500,000 were withheld from participants' pay during the month of August 20X2 but were not remitted to the plan's trust within the time frame required by the Department of Labor under the plan asset rules. This constituted a $500,000 loan from the plan to the plan sponsor for the period from September 23, 20X2, to December 20, 20X2. The loan, plus interest of $10,100 (10 percent based on the yields earned by the plan's assets during the period), was remitted to the plan's trust on December 20, 20X2.

SECTION 3: DISCLOSURES SPECIFIC TO HEALTH AND WELFARE BENEFIT PLANS

1. DESCRIPTION OF THE PLAN

3.01

Note X: Description of the Plan

The following description of the Allied Industries health care benefit plan (plan) provides only general information. Participants should refer to the plan agreement for a complete description of the plan's provisions.

General. The plan provides health and other benefits covering all participants in the widgets industry in the Greater Metropolis area. The plan and related trust were established on May 8, 1966, pursuant to a collective bargaining agreement between the Allied Employers' Trade Association and the Allied Union, Local 802. It is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA), as amended.

Benefits. The plan provides health benefits (medical, hospital, surgical, major medical, and dental); life insurance coverage; long term disability benefits; and death benefits to full time participants (with at least 450 hours of work in the industry during a consecutive 3-month period) and to their beneficiaries and covered dependents. Retired employees are entitled to similar health benefits (in excess of Medicare coverage), provided that they have attained at least age 62 and have 15 years of service with participating employers before retirement.

The plan also provides health benefits to participants during periods of unemployment, provided that they have accumulated, in the current year or in prior years, credit amounts (expressed in hours) in excess of the hours required for current coverage. Accumulated eligibility credits equal to one year's coverage may be carried forward.

Health, disability, and death claims of active and retired participants, dependents, and beneficiaries are processed by the administrator group, but the responsibility for payments to participants and providers is retained by the plan.

In 20X2, the board of trustees amended the plan to increase the deductible under major medical coverage from $100 to $300 and to extend dental coverage to employees retiring after December 31, 20X3. The amendment will not affect participating employers' contributions to the plan in 20X3 under the current collective bargaining agreement.

Contributions. Participating employers contribute 5.5 percent of wages, pursuant to the current collective bargaining agreement between employers and the union (expiring February 19, 20X5). Employees may contribute specified amounts, determined periodically by the plan's actuary, to extend coverage to eligible dependents. The costs of the postretirement benefit plan are shared by the plan's participating employers and retirees. In addition to deductibles and copayments, participant contributions in the current (and prior, if applicable) year were as follows:

Participants Retiring	*20X1 Retiree Contribution*	*20X0 Retiree Contribution*
(1) Pre-19X0	(1) None	(1) None
(2) 19X0–X4	(2) Retirees contribute 20% of estimated cost of providing their postretirement benefits*	(2) Retirees contribute 20% of estimated cost of providing their postretirement benefits
(3) 19X5–X9	(3) Retirees pay the cost of providing their postretirement benefits in excess of $200 per month "cap" (approximately 60% of the estimated cost)	(3) Retirees pay the cost of providing their postretirement benefits in excess of $200 per month "cap" (approximately 50% of the estimated cost)
(4) 20X0 and after	(4) Retirees pay 100% of estimated cost of providing their postretirement benefits	(4) Retirees pay 100% of estimated cost of providing their postretirement benefits

* Excluding $15 per month per capita increase in 20X1 due to adverse claims experience in 20X0.

Other. The plan's board of trustees, as sponsor, has the right under the plan to modify the benefits provided to active employees. The plan may be terminated only by joint agreement between industry and union, subject to the provisions set forth in ERISA.

3.02

Note X: Description of the Plan

The International Plumbers Union XXX welfare fund was formed in 1952 under an agreement between the National Plumbers Contractor's Association, Inc., and the International Plumbers Union XXX. The current agreement provides, among other things, for employers of members of the union to contribute, on behalf of each member employed, based on employee classifications and work zones, to the fund on a weekly basis and to provide a written report. Details of this agreement can be obtained at the fund office.

The fund provides for accident, hospital, medical, surgical, disability, death, dental, optical, and prescription benefits for eligible members, as specified in the plan. All benefits are provided from the assets of the fund. All other pertinent information regarding the plan can be obtained at the fund office.

A favorable ruling dated August 1, 1989, has been obtained from the IRS regarding the merger of International Plumbers Union XXX vacation and paid holiday fund with the International Plumbers Union XXX welfare fund. As of September 30, 1989, the International Plumbers Union XXX vacation and paid holiday fund ceased to exist as an independent entity and became a part of the International Plumbers Union XXX welfare fund.

3.03

Note X: Description of the Plan

The following description of the XXX plan (the plan) provides only general information. Participants should refer to the plan document for a more complete description of the plan's provisions. XXX Company has the right to terminate, suspend, withdraw, or amend the plan in whole or in part at any time, subject to the provisions set forth in the Employee Retirement Income Security Act of 1974, as amended.

The plan was established as a welfare benefit plan to pay eligible health care, dental benefits, and employee assistance program services for eligible employees. At each annual enrollment, provisions, such as participant contribution rates, coverage, deductibles, copays, and out-of-pocket maximums, may change.

The plan is available to regular employees of the company, including participating subsidiaries or affiliates who are working full time or part time (regularly scheduled to work at least 20 hours per week). Coverage is continued for employees who are on approved short term disability leave or leave under the Family and Medical Leave Act of 1993. Former employees and their dependents are eligible for continued coverage for the number of months specified under the Consolidated Omnibus Budget Reconciliation Act of 1985, if they so elect. Temporary employees, leased workers, independent contractors, part time employees working less than 20 hours per week, and employees subject to a collective bargaining agreement that does not provide for the employee's participation are not eligible. Qualified dependents and spouses are eligible, as further described in the plan document. Coverage becomes effective depending on the classification of the employees as full or part time.

Plan participants and the company share the cost of coverage. Participants pay premiums (based on annually determined contribution rates) through payroll deductions. The company pays authorized benefits either from the Voluntary Employee Beneficiary Association Trust or from general corporate assets as claims are processed by the claims administrators. Additionally, the company pays a portion of monthly premiums to health maintenance organizations, preferred provider organizations, and point of service providers for employees who elected such coverage.

Participants are responsible for copayments, deductibles, and coinsurance amounts, if applicable and dependent on the level of coverage selected.

Administrative fees, such as administrative service fees, trustee fees, and investment management fees, are paid by the plan, as allowed by the plan document. All other expenses are paid by the company. The company also provides to the plan certain accounting services for which no allocation of costs have been made to the plan.

[*For a health and welfare benefit plan with a 401(h) (retiree medical) component.*]

3.04

Note X: Description of the Plan

The Lynntine Company pension plan (pension plan), a separate plan sponsored by the company, includes a medical-benefit (health and welfare) component, in addition to normal retirement benefits, to fund a portion of the postretirement obligations for retirees and their beneficiaries, in accordance with Internal Revenue Code (IRC) Section 401(h). A separate account has been established and maintained in the pension plan for such contributions. In accordance with IRC Section 401(h), the plan's investments in the 401(h) account may not be used for, or diverted to, any purpose other than providing health and welfare benefits for retirees and participants. The related obligations for health and welfare benefits are not included in the pension plan's obligations in the statement of accumulated plan benefits but are reflected as obligations in the financial statements of the plan.

3.05

Note X: 401(h) Account

Effective January 1, 20X0, the C&H Company pension plan (benefit plan) was amended to include a medical-benefit component, in addition to normal retirement benefits, to fund a portion of the postretirement obligations for retirees and their beneficiaries, in accordance with IRC Section 401(h). A separate account has been established and maintained in the benefit plan for such contributions. In accordance with IRC Section 401(h), the plan's investments in the 401(h) account may not be used for, or diverted to, any purpose other than providing health benefits for retirees and their beneficiaries. The related obligations for health benefits are not included in the benefit plan's obligations in the statement of accumulated plan benefits but are reported as obligations in the financial statements of the health and welfare benefit plan.

3.06

Note X: Description of the Plan

In connection with a negotiated contract, the supplemental unemployment benefit plan for employees of ABC Company established pursuant to agreement with United Workers of America (plan) provides for payment of supplemental unemployment benefits to covered employees who have completed 2 years of continuous service. Payments are made to (*a*) employees on layoff and (*b*) certain employees who work less than 32 hours in any week. The following description is provided for general information purposes. The plan document should be referred to for specific information regarding benefits and other plan matters.

2. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.07

Note X: Summary of Significant Accounting Policies

a. *Use of estimates*. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, benefit obligations, and changes therein; claims incurred but not reported; eligibility credits; claims payable; and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.
b. *Investment valuation and income recognition*. The plan's investments are recorded at fair value. *Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See note E for a discussion of fair value measurements.

Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the exdividend date. Net appreciation includes the plan's gains and losses on investments bought and sold, as well as held during the year.

c. *Postretirement benefits*. The amount reported as the postretirement benefit obligation represents the actuarial present value of those estimated future benefits that are attributed by the terms of the plan to employees' service rendered to the date of the financial statements, reduced by the actuarial present value of contributions expected to be received in the future from current plan participants. Postretirement benefits include future benefits expected to be paid to or for (1) currently retired or terminated employees and their beneficiaries and dependents and (2) active employees and their beneficiaries and dependents after retirement from service with participating employers. The postretirement benefit obligation represents the amount that is to be funded by contributions from the plan's participating employers and existing plan assets. Prior to an active employee's full eligibility date, the postretirement benefit obligation is the portion of the expected postretirement benefit obligation that is attributed to that employee's service in the industry rendered to the valuation date.

The actuarial present value of the expected postretirement benefit obligation is determined by an actuary and is the amount that results from applying actuarial assumptions to historical claims-cost data to estimate future annual incurred claims costs per participant and to adjust such estimates for the time value of money (through discounts for interest) and the probability of payment (by means of decrements such as those for death, disability, withdrawal, or retirement) between the valuation date and the expected date of payment.

For measurement purposes, a 9.5 percent annual rate of increase in the per capita cost of covered health care benefits was assumed for 20X3; the rate was assumed to decrease gradually to 8.0 percent for 20X8 and to remain at that level thereafter. These assumptions are consistent with those used to measure the benefit obligation at December 31, 20X2.

The following were other significant assumptions used in the valuations as of December 31, 20X2, and 20X1:

Weighted average discount rate	8.0%—20X2; 8.25%—20X1
Average retirement age	60
Mortality	RP-2000 combined mortality table

The foregoing assumptions are based on the presumption that the plan will continue. Were the plan to terminate, different actuarial assumptions and other factors might be applicable in determining the actuarial present value of the postretirement benefit obligation.

d. *Other plan benefits*. Plan obligations at December 31 for health claims incurred by active participants but not reported at that date, for accumulated eligibility of participants, and for future disability payments to members considered permanently disabled at December 31 are estimated by the plan's actuary, in accordance with accepted actuarial principles. Such estimated amounts are reported in the accompanying statement of the plan's benefit obligations at present value, based on an 8 percent discount rate. Health claims incurred by retired participants but not reported at year-end are included in the postretirement benefit obligation.

e. *Subsequent events*. The plan has evaluated subsequent events through July 31, 20XX, the date the financial statements were available to be issued.

3.08

Note X: Accounting Policies

The records of the International Plumbers Union XXX welfare fund are maintained on the accrual basis of accounting, except that benefit payments are recorded when paid (see note Y).

3.09

Note X: Summary of Accounting Policies

Basis of accounting. The financial statements of the plan are prepared under the accrual method of accounting.

Investment valuation and income recognition. Investments are reported at fair value. *Fair value* is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See note 5 for discussion of fair value measurements.

Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the exdividend date. Net appreciation includes the plan's gains and losses on investments bought and sold, as well as held during the year.

If available, quoted market prices are used to value investments.

Use of estimates. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

Benefit obligations. The plan's obligation for accumulated eligibility credits is discounted using a weighted average assumed rate of $7\frac{1}{2}$ percent.

Payment of benefits. Health claims and premiums are reported when paid. Any refunds due to overpayments, subrogation, or adjustments are recorded in the period received and are shown netted with benefit payments.

Prescription rebates. Prescription drug rebates are recorded in the period to which to the related claims were paid and are shown netted with benefit payments.

3. BENEFIT OBLIGATIONS

3.10

Note X (In Part): Summary of Significant Accounting Policies

d. *Postretirement benefit obligations*. The postretirement benefit obligations represent the actuarial present value of those estimated future benefits that are attributed to employee service rendered to September 30, 20X2, and 20X1. Postretirement benefits include future benefits to be paid to or for (1) currently retired or terminated employees and their beneficiaries and dependents and (2) active employees and their beneficiaries and dependents after retirement from service with Hoth Corporation. Prior to an active employee's full eligibility date, the postretirement benefit obligation is the portion of the expected postretirement benefit obligation that is attributed to that employee's service rendered to the valuation date.

The actuarial present value of the expected postretirement benefit obligation is determined by an actuary and is the amount that results from applying actuarial assumptions to historical claims-cost data to estimate future annual incurred claims costs per participant and to adjust such estimates for the time value of money (through discounts for interest) and the probability of payment (by means of decrements such as those for death, disability, withdrawal, or retirement) between the valuation date and the expected date of payment.

For measurement purposes, health care cost trend rates were 8 percent for 20X3, gradually decreasing to 5 percent in the year 20XX and remaining at that level thereafter. All of the assumptions in the 20X2 valuations are the same as in the previous valuation, except for assumptions relating to the compensatory health trend for 20X2 and the discount rate, which increased from 7.5 percent in 20X1 to 8 percent in 20X2.

The following were other significant assumptions used in the valuations as of September 30, 20X2, and 20X1:

i. Retirement rates vary by age or by age and service for various groups of employees and divisional locations.
ii. Mortality assumptions were primarily based on the UP-20X2 mortality table, with certain modifications made for various groups of employees and divisional locations.

The foregoing assumptions are based on the presumption that the plan will continue. Were the plan to terminate, different actuarial assumptions and other factors might be applicable in determining the actuarial present value of the postretirement benefit obligations.

e. *Other benefit obligations*. Benefit claims currently payable include the plan's liability for claims incurred as of September 30, 20X2, and 20X1 but not reported and the plan's liability for claims reported as of September 30, 20X2, and 20X1 but not yet processed. The plan's liability for claims incurred but not reported is estimated by the third party administrators utilizing actuarial methods that take into consideration prior claims experience and the expected time period from the date such claims are incurred to the date that the related claims are submitted and paid.

3.11

Note X: Benefit Obligations

The plan's excess of benefit obligations over net assets at September 30, 20X2, and 20X1 relates primarily to the postretirement benefit obligation, the funding of which is not covered by the contribution rate provided by the current funding vehicle. It is expected that the deficiency will be funded through future contributions from the plan sponsor and participants.

The weighted average health care cost trend rate assumption (see note D.) has a significant effect on the amounts reported in the accompanying financial statements. If the assumed rates increased by 1 percentage point in each year, they would increase the obligations as of September 30, 20X2, and 20X1 by $238,000,000 and $260,200,000, respectively.

3.12

Note X: Benefit Obligations

The plan's deficiency of net assets over benefit obligations at December 31, 20X2, and 20X1 relates primarily to the postretirement benefit obligation, the funding of which is not covered by the contribution rate provided by the current bargaining agreement. It is expected that the deficiency will be funded through future increases in the collectively bargained contribution rates.

The weighted average health care cost trend rate assumption [see note 2(B)] has a significant effect on the amounts reported in the accompanying financial statements. If the assumed rates increased by 1 percentage point in each year, they would increase the obligation as of December 31, 20X2, and 20X1 by $2,600,000 and $2,500,000, respectively.

3.13

Note X: Benefit Obligations

Plan benefit obligations of the company at December 31, 20X2, and 20X1 for health claims incurred by participants but not reported at that date are estimated by the company by analyzing claim lag studies. Such amounts are reported at an undiscounted amount because amounts typically are payable within one year. Any differences in the amounts estimated and actual amounts will be reported in future years.

Postemployment obligations consist mainly of coverage provided by the plan under the Consolidated Omnibus Budget Reconciliation Act of 1985. Participants contribute 102 percent of the expected cost of the obligation, as estimated by the plan administrator. Postemployment obligations have not been disclosed because the company cannot reasonably estimate the amounts; however, the company has determined that the obligation would be immaterial to the plan's financial statements, based on the participants covering the expected cost of such benefits.

Deficiencies, if any, in net assets over benefit obligations will be funded by the company as the benefits are paid to participants.

On December 8, 2003, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (act) for employers sponsoring postretirement health care plans that provide prescription drug benefits was signed into law. The act introduces a prescription drug benefit under Medicare, as well as a federal subsidy to sponsors of retiree health care benefit plans providing a benefit that is at least actuarially equivalent to Medicare Part D(1). Under the act, the Medicare subsidy amount is received directly by the plan sponsor and not the related plan. Further, the plan sponsor is not required to use the subsidy amount to fund postretirement benefits and may use the subsidy for any valid business purpose. The accumulated postretirement benefit obligation as of December 31, 20X2, and 20X1 and the changes in the accumulated benefit obligation for the year ended December 31, 20X2, do not reflect any amount associated with the Medicare subsidy because the plan is not directly entitled to the Medicare subsidy.

3.14

Note X: Funding and Operation of the Plan

Funding of the plan. Contributions funded by ABC Company, the plan's sponsor, pursuant to the plan, are invested in assets held in a trust fund (the fund). General Bank, the trustee of the fund (trustee), invests the fund's money as set forth in the plan's investment policy. Investments consist of money market funds and are reported in the accompanying financial statements at fair value. Interest income from investments is recognized when earned.

Administration. The ABC Company Benefit Plan Administrative Committee has responsibility for administering the plan. The ABC Company Benefit Plan Asset Review Committee has responsibility for the management and control of the assets of the trust.

Benefits under the plan. The plan provides for the payment of weekly and short-week supplemental unemployment benefits. The benefits payable are reduced by any state unemployment benefits or any other compensation received. Also, a waiting week benefit of $100 will be payable if a participant fails to receive a state unemployment benefit solely because of the state's waiting week requirement. Benefits paid for any week for which the employee received state unemployment benefits are limited to $180. Benefits paid for all other weeks are limited to $235. The plan provides for a possible reduction of weekly benefits for employees with less than 20 years of service, based upon a percentage determined, generally, by dividing the net assets of the plan, as defined in the plan document, by the maximum financing (see "ABC's obligations under the plan"). Employees earn one-half credit unit for each week in which hours are worked or, in some situations, in which hours are not worked (vacation, disability, serving on grievance committee, and so on), up to a maximum of 52 credit units for employees with less than 20 years of service and 104 credit units for employees with 20 or more years of service. Generally, 1 credit unit is canceled for each weekly benefit paid and one-half credit unit is canceled for each short-week benefit paid.

ABC's obligations under the plan. The maximum financing of the plan at any month end is the lesser of (*a*) the product of $0.40 and the number of hours worked by covered employees during the first 12 of the 14 months next preceding the first day of the month and (*b*) 100 times the sum of the monthly benefits paid for 60 of the preceding 62 months, divided by 60. ABC's monthly contribution to the plan is computed as the lesser of (i) the product of $0.175 and the number of hours worked by covered employees in the month and (ii) the amount that, when added to the net assets of the plan, as defined by the plan document, as of the end of the preceding month, will equal the maximum financing. In addition, ABC contributes an income security contribution of $0.25 per hour worked by covered employees in the month. In the event of a plan deficit, ABC intends to make sufficient contributions to fund benefits as they become payable.

The following tables present the components of the plan's benefit obligations and the related changes in the plan's benefit obligations:

Benefit Obligations

	For the Year Ended December 31	
	20X1	*20X0*
Accumulated eligibility credits and total benefit obligations	$1,107,777	$1,095,620

Changes in Benefit Obligations

	For the Year Ended December 31, 20X1
Benefit obligations, beginning of year	$ 1,095,620
Benefits earned	$ 1,390,330
Interest	77,287
Claims paid	(1,455,460)
Benefit obligations, end of year	$ 1,107,777

Plan expenses. ABC bears all administrative costs, except trustee fees, that are paid by the plan.

4. INVESTMENTS

3.15

Note X: Investments

The plan's investments are held by a bank-administered trust fund. During 20X2, the plan's investments (including investments bought, sold, and held during the year) appreciated in value by $300,000 as follows (all level 1 investments):

	20X2		*20X1*
	Net Increase (Decrease) in Value During Year	*Fair Value at End of Year*	*Fair Value at End of Year*
U.S. government securities	$200,000	$5,000,000	$4,000,000
Corporate bonds	—	2,000,000	1,600,000
Common stocks	100,000	1,000,000	600,000
	$300,000	$8,000,000	$6,200,000

The fair value of individual investments that represents 5 percent or more of the plan's net assets are as follows (all level 1 investments):

	20X2	*20X1*
Commonwealth Power Co., 9.0% bonds due 20Y4 ($500,000 face amount)	$475,000	$450,000
ABC Company common stock (2,000 shares)	500,000	450,000
U.S. Treasury bond, 8.5% due 20X7 ($360,000 face amount)	—	350,000

5. FAIR VALUE MEASUREMENTS

Practice Tip:

Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 820, *Fair Value Measurements and Disclosures*, provides enhanced guidance for using fair value to measure assets and liabilities. This standard defines *fair value* and expands disclosures about fair value measurements. In January 2010, FASB issued Accounting Standards Update (ASU) No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. ASU No. 2010-06 amends the disclosure requirements of FASB ASC 820 to require new disclosures regarding (*a*) transfers in and out of levels 1 and 2 and (*b*) activity in level 3 fair value measurements. ASU No. 2010-06 also provides amendments to FASB ASC 820 that clarify existing disclosures regarding (1) the level of disaggregation for each class of assets and liabilities and (2) disclosures about inputs and valuation techniques for fair value measurements that fall in either level 2 or level 3.

The new disclosures and clarifications of existing disclosures are effective for interim and annual reporting periods beginning after December 15, 2009, except for the disclosures regarding the rollforward of activity in level 3 fair value measurements, which are effective for fiscal years beginning after December 15, 2010, and interim periods within those fiscal years.

3.16

Note X: Fair Value Measurements

Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 820, *Fair Value Measurements and Disclosures*, provides a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820-10 are described as follows:

- Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the plan has the ability to access.
- Level 2 inputs to the valuation methodology include the following:
  - — Quoted prices for similar assets or liabilities in active markets
  - — Quoted prices for identical or similar assets or liabilities in inactive markets
  - — Inputs other than quoted prices that are observable for the asset or liability
  - — Inputs that are derived principally from, or corroborated by, observable market data by correlation or other means

  If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.
- Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 20X2, and 20X1.

- *U.S. government securities and common stock*. Valued at the closing price reported in the active market in which the individual security is traded.
- *Corporate bonds*. Certain corporate bonds are valued at the closing price reported in the active market in which the bond is traded. Other corporate bonds traded in the over-the-counter market and listed securities for which no sale was reported on the last business day of the plan year are valued at the average of the last reported bid and asked prices. For certain corporate bonds that do not have an established fair value, the plan's board of trustees has established a fair value based on yields currently available on comparable securities of issuers with similar credit ratings.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following table sets forth by level within the fair value hierarchy the plan's assets at fair value as of December 31, 20X2, and 20X1:

	Assets at Fair Value as of December 31, 20X2			
	Level 1	*Level 2*	*Level 3*	*Total*
U.S. government securities	$5,000,000	—	—	$5,000,000
Corporate bonds			—	
Aaa credit rating	250,000	—	—	250,000
Aa credit rating	—	$1,750,000	—	1,750,000
Total corporate bonds	250,000	1,750,000	—	2,000,000
Common stocks		—	—	
Consumer goods	450,000	—	—	450,000
IT	350,000	—	—	350,000
Other	200,000	—	—	200,000
Total common stocks	1,000,000	—	—	1,000,000
Total assets at fair value	$6,250,000	$1,750,000	—	$8,000,000

	Assets at Fair Value as of December 31, 20X1			
	Level 1	*Level 2*	*Level 3*	*Total*
U.S. government securities	$4,000,000	—	—	$4,000,000
Corporate bonds			—	
Aaa credit rating	225,000	—	—	225,000
Aa credit rating	—	$1,375,000	—	1,375,000
Total corporate bonds	225,000	1,375,000	—	1,600,000
Common stocks		—	—	
Consumer goods	270,000	—	—	270,000
IT	210,000	—	—	210,000
Other	120,000	—	—	120,000
Total common stocks	600,000	—	—	600,000
Total assets at fair value	$4,825,000	$1,375,000	—	$6,200,000

3.17

Note X: Fair Value Measurements

Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 820, *Fair Value Measurements and Disclosures*, provides a framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820-10 are described as follows:

- Level 1 inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the plan has the ability to access.
- Level 2 inputs to the valuation methodology include the following:
  - — Quoted prices for similar assets or liabilities in active markets
  - — Quoted prices for identical or similar assets or liabilities in inactive markets
  - — Inputs other than quoted prices that are observable for the asset or liability
  - — Inputs that are derived principally from, or corroborated by, observable market data by correlation or other means

If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

- Level 3 inputs to the valuation methodology are unobservable and significant to the fair value measurement.

The asset's or liability's fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 20X2, and 20X1.

The plan's investments consist of shares of a money market portfolio that is valued using amortized cost, which approximates fair value.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following table sets forth by level within the fair value hierarchy the plan's assets at fair value as of December 31, 20X2, and 20X1:

	Assets at Fair Value as of December 31, 20X2			
	Level 1	*Level 2*	*Level 3*	*Total*
Money market portfolio	$10,605	—	—	$10,605
Total assets at fair value	$10,605	—	—	$10,605

	Assets at Fair Value as of December 31, 20X1			
	Level 1	*Level 2*	*Level 3*	*Total*
Money market portfolio	$80,750	—	—	$80,750
Total assets at fair value	$80,750	—	—	$80,750

6. OTHER

3.18

Note X: Estimated Contractor Contributions Receivable

Included in estimated contractor contributions receivable is the amount of $192,900, which has been turned over to the fund's collection attorney for appropriate legal action. A reserve for uncollectible accounts has been set up for 20XX in the amount of $127,430 after discussion with the fund's collection attorney and union officials regarding the probability of collecting some of the older receivables that are in litigation or bankruptcy.

3.19

Note X: Risks and Uncertainties

The actuarial present value of postretirement benefit obligations is reported based on certain assumptions pertaining to interest rates, health care inflations rates, and employee demographics, all of which are subject to change. Due to uncertainties inherent in the estimations and assumptions process, it is at least reasonably possible that changes in these estimates and assumptions in the near term would be material to the financial statements.

3.20

[*For a health and welfare benefit plan with a 401(h) (retiree medical) component.*]

Note X: 401(h) Account

The following table presents the components of the net assets available for postretirement health and welfare benefits in the 401(h) account and the related changes in net assets:

Net Assets Available for Postretirement Health and Welfare Benefits in 401(h) Accounts

	For the Year Ended December 31	
	20X2	*20X1*
Investments at fair value:		
U.S. government securities	$ 90,000	$ 50,000
Money market fund	20,000	30,000
	110,000	80,000
Employer's contribution receivable	9,000	5,000
Accrued interest	2,000	4,000
	121,000	89,000
Accrued administrative expenses	(5,000)	(5,000)
Net assets available	$116,000	$ 84,000

Changes in Net Assets in 401(h) Account

	For the Year Ended December 31, 20X2
Net appreciation in fair value of investments:	
U.S. government securities	$ 10,000
Interest	5,000
Employer contributions	15,000
Health and welfare benefits paid to retirees	35,000
Administrative expenses	(10,000)
Net increase in net assets available	(8,000)
	$ 32,000

3.21

[*For a health and welfare benefit plan with a 401(h) (retiree medical) component.*]

Note X: 401(h) Account

A portion of the plan's obligations are funded through contributions to the C&H Company's pension plan, in accordance with Internal Revenue Code Section 401(h). The following table presents the components of the net assets available for such obligations and the related changes in net assets available:

Net Assets Available for Postretirement Health and Welfare Benefits in 401(h) Account

	For the Year Ended December 31	
	20X2	*20X1*
Investments at fair value:		
U.S. government securities	$ 140,000	$150,000
Money market fund	900,000	800,000
	1,040,000	950,000
Cash	20,000	10,000
Employer's contribution receivable	20,000	15,000
Accrued interest	7,000	6,000
Total assets	1,087,000	981,000
Accrued administrative expenses	(15,000)	(15,000)
Net assets available	$1,072,000	$ 966,000

Changes in Net Assets in 401(h) Account

	For the Year Ended December 31, 20X2
Net appreciation in fair value of investments:	
U.S. government securities	$ 10,800
Interest	80,200
	91,000
Employer contributions	40,000
Health and welfare benefits paid to retirees	(10,000)
Administrative expenses	(15,000)
Net increase in net assets available	$106,000

3.22

[*For a health and welfare benefit plan with a 401(h) (retiree medical) component.*]

Note X: Reconciliation of Financial Statements to Form 5500

The following is a reconciliation of net assets available for benefits at December 31, 20X2, and 20X1, per the financial statements, to Form 5500:

	20X2	*20X1*
Net assets available for benefits, per the financial statements	$4,321,000	$4,283,000
Claims payable	(31,000)	(28,000)
Claims incurred but not reported	(58,000)	(53,000)
Premiums payable	(17,000)	(15,000)
Net assets held in ABC Inc. pension plan 401(h) account	(145,000)	(132,000)
Net assets available for benefits, per Form 5500	$4,070,000	$4,055,000

The following is a reconciliation of claims paid, per the financial statements, to Form 5500 for the year ending December 31, 20X2:

Claims paid, per the financial statements	$220,000
Add: Amounts payable at December 31, 20X2	31,000
Less: Amounts payable at December 31, 20X1	(28,000)
Claims paid, per Form 5500	$223,000

The following is a reconciliation of premiums paid, per the financial statements, to Form 5500 for the year ending December 31, 20X2:

Premiums paid, per the financial statements	$174,000
Add: Amounts payable at December 31, 20X2	17,000
Less: Amounts payable at December 31, 20X1	(15,000)
Premiums paid, per Form 5500	$176,000

3.23

Note X: Reconciliation of the Financial Statements to Form 5500

The following is a reconciliation of net assets available for benefits, per the financial statements, to Form 5500:

Net assets available for benefits, per the financial statements	$ 9,557,000
Claims payable	(1,200,000)
Net assets held in defined benefit plan 401(h) account	(1,072,000)
Net assets available for benefits, per Form 5500	$ 7,285,000

The following is a reconciliation of claims paid, per the financial statements, to Form 5500:

Claims paid, per the financial statements	$16,770,000
Add: Amounts payable at December 31, 20X2	1,200,000
Less: Amounts payable at December 31, 20X1	(1,050,000)
Claims paid, per Form 5500	$16,920,000

The following is a reconciliation of total additions, per the financial statements, to Form 5500:

Total additions, per the financial statements	$18,941,000
Less: Net increase in 401(h) net assets available	(106,000)
Net additions, per Form 5500	$18,835,000

3.24

[*This disclosure is for a supplemental unemployment benefit plan in accordance with Statement of Position 01-2,* Accounting and Reporting by Health and Welfare Benefit Plans *(AICPA,* Technical Practice Aids*, ACC sec. 10,830).*]

Note X: Termination of the Plan

Under certain conditions, the plan may be terminated. Upon termination, the assets then remaining shall be subject to the applicable provisions of the plan then in effect and shall be used until exhausted to pay benefits to employees in the order of their entitlement.

SECTION 4: OTHER FINANCIAL STATEMENT DISCLOSURES

1. SUBSEQUENT EVENTS

4.01

Note X: Subsequent Events

On February 16, 20X3, the boards of directors of ABC Holdings, Inc. (Holdings); ABC Management, Inc. (Management); and ABC Operations Inc. (Operations) approved resolutions that resulted in the adoption of the ABC Holdings, Inc., profit sharing plan and trust by Management and Operations, which was renamed the plan ABC 401(k) profit sharing plan and trust (plan). Effective February 16, 20X3, all the employees of Holdings became employees of Management or Operations. The boards also approved the change in the signatory employer from Holdings to Operations.

On February 16, 20X3, the board of directors of Operations approved the merger of the ABC Operations money purchase pension plan and trust into the plan.

4.02

Note X: Subsequent Events

The plan changed the trustee to ABC Trust Company and adopted a new plan document that amends and restates the plan, effective June 1, 20X3. The company has not yet requested or received a determination letter for the new plan document. The company believes that the provisions under the new plan document are in compliance with the applicable requirements of the Internal Revenue Code.

4.03

Note X: Subsequent Events

Effective January 1, 20X3, the plan sponsor merged the plan into an existing plan sponsored by Acquiring Company and discontinued contributions to the plan, subject to the provisions of ERISA. As a result of this merger, net plan assets of $244,133,126 were transferred to Acquiring Company 401(k) plan & trust on February 12, 20X3.

4.04

Note X: Subsequent Events

On March 8, 20X3, the plan was amended to allow the transfer of the account balances of the ABC profit sharing plan and trust, which was terminated January 1, 20X2, into the plan. On March 19, 20X3, $2,828,654 was transferred to the plan.

On April 16, 20X3, an amendment to the plan changed the definition of an e*ligible employee*. An employee who has been employed for 90 days from the date of hire is considered an eligible employee, effective the first day of the month following the 90-day anniversary. This amendment was effective May 1, 20X3.

4.05

Note X: Subsequent Events

Effective April 20X3, the plan was amended to

- increase the maximum deferral percentage from 15 percent to 25 percent.
- simplify the loan interest rate to prime plus 1 percent.
- eliminate the requirement that the term of any plan loan shall not extend beyond the date on which a participant attains age 70.

4.06

Note X: Subsequent Events

Effective May 1, 20X3, the company changed its plan administrator and recordkeeper from ABC Trust Company to Blue, a service group within DEF Bank.

The investment options available to employees prior to May 1, 20X3, also were replaced with the following investment options:

- ABC Small Cap Value Fund
- ABC Small Company Fund
- ABC Funds EuroPacific Growth Fund
- ABC Growth Fund of America
- DEF S&P 500 Fund
- DEF Life Retirement Fund
- DEF Life 2010 Fund
- DEF Life 2020 Fund
- DEF Life 2030 Fund
- DEF Life 2040 Fund
- XYZ Stock Fund
- Atlantic Total Return Fund

4.07

Note X: Subsequent Events

Effective January 1, 20X3, the company adopted an amendment to the plan to, among other changes, provide for safe harbor provisions described in Internal Revenue Code (IRC) Section 401(k)(12). The plan will apply for a new determination letter from the IRS during 20X3 stating that the plan, as amended, is qualified under IRC Section 401(a). However, the plan administrator believes that the plan has been designed to comply with and is operating in accordance with the requirements of the IRC and, therefore, believes the plan is qualified and the related trust is exempt from taxation.

4.08

Note X: Subsequent Events

Effective June 25, 20X3, the ABC Corporation Retirement Savings Plan Committee temporarily suspended future investments in the ABC Corporation stock fund under the retirement savings plan until the company becomes current on its Securities and Exchange Commission filings. A notice to participants was distributed on June 25, 20X3.

4.09

Note X: Subsequent Event

Effective January 1, 20X2, assets of participants who are employees of Red Corporation and Green Filmworks, Inc., were spun off to a separate qualified plan.

Effective January 1, 20X2, the investments were transferred to ABC Bank. The funds are invested in the following investment options, as directed by the participants:

a. *Fund A*—This portfolio consists of common stock, bonds, and cash equivalents in an effort to generate a significant rate of capital growth over time.
b. *Fund B*—This portfolio consists of common stocks, bonds, and cash equivalents in an effort to generate a mix of some capital growth and some capital preservation.
c. *Fund C*—This option invests in a pooled investment trust fund. The fund comprises a diversified portfolio of guaranteed investment contracts and other stable value investments, such as certificates of deposit. The objective of this option is to generate a relatively high rate of interest while protecting against declines in market value.

4.10

Note X: Subsequent Event

On May 25, 20X3, DEF Corporation agreed to acquire from ABC Corporation its XYZ subsidiary. The effect this acquisition will have on the plan has not been determined.

4.11

Note X: Subsequent Event

On December 29, 20X2, the company's board of directors approved the merger of the plan, effective February 28, 20X3, into the ABC plan. As of the approval date, the plan was frozen, and the ABC plan assumed all the assets and liabilities of the plan.

On February 14, 20X3, plan participants' investment account balances were liquidated, and the cash and participant loans were transferred into the ABC plan. As a result of the merger, participants of the plan were allowed to participate in the ABC plan, effective January 1, 20X3.

4.12

Note X: Subsequent Event

During 20X3, the sponsoring employer amended and restated the plan and trust document, effective January 1, 1997, to incorporate provisions of the General Agreement on Tariffs and Trade, as part of the Uruguay Round Agreements Act (GATT); the Uniformed Services Employment and Reemployment Act of 1994 (USERRA); the Small Business Job Protection Act of 1996 (SBJA); and the Taxpayer Relief Act of 1997 (TRA), the set of laws known collectively as GUST, and the IRS Restructuring and Reform Act of 1998.

4.13

Note X: Subsequent Event

The company's board of directors voted on July 31, 20X2, to adopt a Section 401(k) safe harbor design for the plan, which means that the plan automatically complies with the nondiscrimination requirements of Internal Revenue Code Section 401. The company amended the plan for the 20X3 plan year. Effective January 1, 20X3, the company will provide for a fully vested 100 percent matching contribution on up to 5 percent of pay deferred by a participant, and eligible participants may begin participating in the plan on the first day of each plan quarter.

4.14

Note X: Subsequent Event

Subsequent to December 31, 20X2, conditions in the worldwide debt and equity markets have deteriorated significantly. These conditions have had a negative effect on the fair value of the plan's investments since December 31, 20X2. However, we are unable to quantify the exact effect on the plan.

4.15

Note X: Subsequent Events

On May 10, 20X3, a new agreement between the company and the XYZ Union was ratified, resulting in the following:

- For EYZ employees, all pension plan benefit accruals will cease as of December 31, 20X3.
- The plan is closed to any new XYZ employees as of December 31, 20X3.
- December 31, 20X3, will be the latest date as of which a participant's average final compensation shall be determined for such employees.

The expected effect on the accumulated plan benefits is immaterial and will be recognized in the January 1, 20X4, valuation.

2. RISKS AND UNCERTAINTIES

4.16

[*The following disclosure is from a defined contribution plan.*]

Note X: Risks and Uncertainties

The plan invests in various investment securities. Investment securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the statement of net assets available for benefits.

4.17

[*The following disclosure is from a health and welfare benefit plan.*]

Note X: Risks and Uncertainties

The plan invests in various investment securities. Investment securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statement of net assets available for benefits.

The actuarial present value of benefit obligations is reported based on certain assumptions pertaining to interest rates; health care inflation rates; and employee demographics, all of which are subject to change. Due to uncertainties inherent in the estimations and assumptions process, it is at least reasonably possible that changes in these estimates and assumptions in the near term would be material to the financial statements.

4.18

[*The following disclosure is from a defined benefit pension plan.*]

Note X: Risks and Uncertainties

The plan invests in various investment securities. Investment securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statement of net assets available for benefits.

Plan contributions are made, and the actuarial present value of accumulated plan benefits is reported, based on certain assumptions pertaining to interest rates; inflation rates; and employee demographics, all of which are subject to change. Due to uncertainties inherent in the estimations and assumptions process, it is at least reasonably possible that changes in these estimates and assumptions in the near term would be material to the financial statements.

4.19

Note X: Risks and Uncertainties

The plan's investments, in general, are subject to various risks, such as interest rate, credit, and overall market volatility risk. Additionally, the value, liquidity, and related income of the investment securities are sensitive to changes in economic conditions and may be affected by shifts in the market's perception of issuers and changes in interest rates. Certain investments (such as asset-backed securities, limited partnerships, and limited liability companies) are less liquid and may have restrictions on their sale. Forced liquidation, although not expected at this time, may affect the estimated value of such investments. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in the value of investments will occur in the near term and that such changes could materially affect the amounts reported in the statement of net assets available for benefits and the funded status of the plan.

4.20

[*The following disclosure is from a defined contribution pension plan that participates in a master trust.*]

Note X: Risks and Uncertainties

Through the master trust, the plan provided for various investment options in any combination of stocks, bonds, mutual funds, and other investment securities. Investment securities are exposed to various risks, such as interest rate, market, and credit risk. These risks can be adversely affected by shifts in the market's perception of the issuers, changes in interest rates, and global economic conditions. Due to the level of risk associated with certain investment securities and the level of uncertainty related to changes in the value of investment securities, it is at least reasonably possible that changes in risks in the near term would materially affect participants' account balances and the amounts reported in the statement of net assets available for benefits.

4.21

Note X (In Part): Summary of Significant Accounting Policies

h. *Use of Estimates*. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of net assets available for benefits and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of changes in net assets available for benefits during the reporting period. Actual results could differ from those estimates. Significant estimates primarily consist of the estimated fair market value of the plan's investment in a private limited partnership (see note Y).

4.22

Note X: Risks and Uncertainties

The plan utilizes various investment instruments that are exposed to various risks, such as interest rate, credit, and overall market volatility risk. Due to the level of risk associated with certain investment securities, it is reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the financial statements. The plan's investments are not insured or protected by the plan's trustee, the Pension Benefit Guaranty Corporation, or any other governmental agency; accordingly, the plan is subject to the normal investment risks associated with money market funds, mutual funds, stocks, bonds, and other similar types of investments.

4.23

Note X: Risks and Uncertainties

On June 1, 20X2, the company was notified by the Department of Labor that they were auditing the plan beginning on January 1, 2005, to the present date. Management is not aware of any matters that would affect the plan's financial statements, footnotes, or supplemental schedules; however, the final outcome of the audit is unknown at this time. The accompanying financial statements do not include any adjustments that might result from this uncertainty.

4.24

Note X: Risks and Uncertainties

On August 11, 20X1, the company and its domestic subsidiaries (collectively, filing entities) filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code (bankruptcy code) in the Alexandria

Division of the United States Bankruptcy Court for the Eastern District of Virginia (bankruptcy court). During the pendency of the Chapter 11 cases, the filing entities continued to operate their businesses under the jurisdiction of the bankruptcy court and in accordance with the applicable provisions of the bankruptcy code and orders of the bankruptcy court.

The filing entities emerged from bankruptcy protection under a bankruptcy court-approved plan of reorganization, which became effective on March 31, 20X2. Among other things, the plan of reorganization provided for full payment of all allowed administrative and priority claims and the distribution of new equity in the reorganized filing entities to a new investor; a guarantor of a new debt arrangement; certain lenders; management and labor unions; and unsecured creditors, in satisfaction of their allowed claims. Investors in equity of the filing entities immediately prior to their emergence from bankruptcy protection, including plan participants, were not entitled to any distribution under the plan of reorganization, and their shares of common stock were cancelled.

Although the filing entities emerged from bankruptcy protection in March 20X2, they have continued to incur losses from operations. Primary factors contributing to these losses include the continued downward pressure on industry pricing and significant increases in raw material prices. The pressure on industry pricing is resulting from the rapid growth of foreign competition and cheaper products. Given the filing entities continued operating losses, the filing entities are pursuing a transformation of their manufacturing plan to further reduce cost per unit produced. Key elements of this plan are included in the filing entities' Form 10-K filed for the year ended December 31, 20X2. Because the plan will require changes in the filing entities' collective bargaining agreements, there can be no assurance that the plan can be achieved. Although the filing entities' preference is to complete their transformation on a consensual basis, failure to achieve the planned competitive cost structure will force the filing entities to reexamine their strategic options, including, but not limited to, asset sales or a judicial restructuring.

The most recently issued independent auditors' reports on the financial statements of the filing entities for the year ended December 31, 20X2, contained an explanatory paragraph that discusses certain conditions that raise substantial doubt about the ability of the filing entities to continue as a going concern.

4.25

Note X: Concentration of Market Risk

As of December 31, 20X2, and 20X1, approximately 10 percent and 8 percent of the plan's assets were invested in ABC Learning, Inc., common stock, respectively. The underlying value of the growth fund is dependent on the performance of ABC Learning, Inc., and the market's evaluation of such performance. It is at least reasonably possible that changes in the fair value of ABC Learning, Inc., common stock in the near term could materially affect participants' account balances and the amounts reported in the statement of assets available for benefits and the statement of changes in assets available for benefits.

4.26

Note X: Concentration of Market Risk

The plan holds investments in the plan sponsor's common stock, as well as various mutual funds; accordingly, plan participants' accounts that hold shares of the plan sponsor's common stock are exposed to market risk in the event of a significant decline in the value of such stock.

For all mutual funds, refer to the specific fund's prospectus and annual report for a full description of each fund's investment holdings and significant concentrations of credit risk. The mutual fund prospectus and annual reports can be obtained by contacting the ABC, Inc., Retirement Savings and Investment Plan Participant Service Center.

4.27

Note X: Concentration of Investments

Included in investments at December 31, 20X2, and 20X1 are shares of the sponsor's common stock amounting to $2,309,186 and $1,055,422, respectively. This investment represents 45 percent and 37 percent of total investments at December 31, 20X2, and 20X1, respectively. A significant decline in the market value of the sponsor's stock would significantly affect the net assets available for benefits.

4.28

Note X: Concentration of Credit Risk

Financial instruments that potentially subject the plan to concentrations of credit risk consist principally of investment contracts with financial institutions. These investment contracts typically are uncollateralized contractual obligations under which the issuer agrees to pay a specific rate of interest for a fixed period of time and to repay principal at maturity. The investment contract fund seeks to place its contracts with high-credit quality institutions, limiting the amount of credit exposure to any one financial institution.

4.29

Note X: Concentration of Investments

Participant contributions in the plan sponsor stock fund led to concentrations of holdings in these accounts in excess of ERISA allowances. As a result, future contributions to these funds have been restricted.

4.30

Note X: Certain Significant Estimates

The plan sponsor is engaged in collective bargaining with the union representing plan participants. Among other things, the union has demanded that employees receive a significant increase in hourly wages. Management of the plan sponsor has offered a significant increase in pension benefits in lieu of granting the union's request for an increase in cash compensation. If accepted during the next year, the increase in pension benefits would significantly increase the present value of accumulated plan benefits.

4.31

Note X: Certain Significant Estimates

As part of an announced downsizing program, the plan sponsor intends to reduce employee headcount. Management will determine the number of employees to be terminated during the next year. It is reasonably possible that when that decision is made, it will result in some eligible employees receiving pension benefits sooner than expected and in an amount greater than originally projected, which would significantly increase the present value of accumulated plan benefits.

4.32

Note X: Current Vulnerability Due to Certain Concentrations

The plan holds several apartment buildings for investment purposes. The properties are located in a town that has only one significant employer. The employer announced this year that it is considering leaving the area, and it is reasonably possible that the company will do so within the next year, which would significantly affect the plan's future cash flows from rents and the value of the properties.

4.33

Note X: Current Vulnerability Due to Certain Concentrations

The plan holds investments in several high tech companies whose values have tended to fluctuate, based on market demand for their products and the market's reaction to competing investment products in that industry. Given the rapidly changing state of the high tech industry, it is reasonably possible that a significant decline in the fair value of those investments during the next year will occur, and therefore, it is reasonably possible that a change in the assumed rates of return used to calculate the present value of accumulated plan benefits would be needed.

3. COMMITMENTS AND CONTINGENCIES

4.34

Note X: Commitments and Contingencies

From 1997 to January 20X3, the plan sponsor failed to register, in compliance with applicable securities laws, shares of the plan sponsor's common stock transferred to participants in its 401(k) plan and the interests of those participants in that plan, which also may be deemed securities requiring registration. The plan sponsor intends to offer a 30-day right of rescission to those participants who received shares of its common stock in violation of applicable securities laws during the 2 years preceding the date of the rescission offer, the statute of limitations period that the plan sponsor believes may apply to claims for rescission under applicable state laws, or possibly a longer or shorter period.

Under the rescission offer, the participants will be entitled to require the plan sponsor to repurchase those shares at the price per share of the plan sponsor's common stock when the shares were transferred to the participant's account, plus interest at a rate to be determined.

Based upon the plan sponsor's preliminary investigation, the plan sponsor currently believes that approximately 22,000 shares of its common stock were transferred to 401(k) plan participants since January 1, 20X1, in violation of applicable securities laws and if subject to its rescission offer, would have an aggregate repurchase price of approximately $301,000, plus interest. The plan sponsor also may face fines and other penalties for its violation of applicable securities laws and may be required to offer rescission to participants who received shares of the plan sponsor's common stock prior to the 2-year period preceding the anticipated rescission offer.

In addition, applicable securities laws do not expressly provide that the plan sponsor's planned rescission offer will terminate a participant's right to rescind a sale of stock that was not properly registered. Accordingly, the plan sponsor may continue to have a contingent liability relating to the shares transferred to participants who do not accept the rescission offer, based upon the price per share of the plan sponsor's common stock when the shares were transferred to the participant's account.

4.35

Note X: Commitments and Contingencies

The parent has incurred continued operating losses since 20X1. As a result, on October 27, 20X2, the parent announced that it had retained legal and financial advisers to assist in its objective of restructuring the parent's capital structure. This initiative has resulted in a decision by the parent not to pay an $11.1 million interest payment due November 15, 20X2, on its 8.875 percent senior notes due 20Y2 (senior notes). Because the parent did not cure the nonpayment before the expiration of a 30-day grace period, the parent is in default under the senior notes indenture, which gives rise to cross-default provisions under certain other U.S. credit agreements. The parent continues to analyze its financial restructuring alternatives. The parent is continuing to hold discussions with financial and legal advisers to an ad hoc committee of holders of the senior notes and with other creditors.

In addition, on December 28, 20X2, the parent announced that it had received notice from the NASDAQ Listing Qualifications staff that the parent's common stock had closed below the minimum $1.00 per share requirement for continued inclusion under Marketplace Rule 4450(a)(5). If the parent cannot demonstrate compliance with the minimum bid price requirement rule or meet certain other requirements on or before June 6, 20X3, the NASDAQ Listing Qualifications staff will provide written notice that the parent's common stock will be delisted or moved to the NASDAQ SmallCap Market.

As a result of the preceding, the common stock of the parent has become extremely volatile and has experienced severe devaluation, particularly since December 31, 20X2. Although the Parent, Inc. common stock fund was closed to new investments as of October 15, 20X2, a balance of $449,354 was held in the parent's common stock as of December 31, 20X2. Since that date, the stock price has declined $1.56, or 87 percent, from $1.79 at December 31, 20X2, to $0.23 at May 28, 20X3.

Although the parent is in the process of restructuring, investments in its securities will be highly speculative. If the parent is unable to accomplish a financial restructuring outside the protection of bankruptcy laws, it may be forced to seek the protection of the bankruptcy laws. In that event, shares of the parent's common stock likely will have little or no value.

4. DERIVATIVES

Practice Tip:

FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133*, which was codified in FASB ASC 815, *Derivatives and Hedging*, expands the disclosure requirements in FASB ASC 815 about an entity's derivative instruments and hedging activities. It is effective for financial statements issued for fiscal years beginning after November 15, 2008. The disclosure provisions of this statement apply to employee benefit plan financial statements. The new guidance requires more robust qualitative disclosures and expanded quantitative disclosures. Such disclosures generally will need to be presented for every annual and interim reporting period for which a statement of net assets and a statement of changes in net assets are presented. Upon adoption, entities are encouraged, but not required, to provide comparative disclosures for earlier periods.

4.36

Note X: Financial Investments With Off-Balance Sheet Risk

As of and during the years ended December 31, 20X3, and 20X2, the plan held no direct investments in derivatives.

4.37

Note X (In Part): Summary of Significant Accounting Policies

e. *Derivative financial instruments*—The master trust makes use of several investment strategies involving limited use of derivative investments. The master trust's management, as a matter of policy and with risk management as their primary objective, monitors risk indicators, such as duration and counter-party credit risk, both for the derivatives themselves and the investment portfolios holding the derivatives. Investment managers are allowed to use derivatives for such strategies as portfolio structuring, return enhancement, and hedging against deterioration of investment holdings from market and interest rate changes. Derivatives also are used as a hedge against foreign currency fluctuations. The master trust's management does not allow investment managers for the master trust to use leveraging for any investment purchase. Derivative investments are stated at estimated fair market values, as determined by quoted market prices. Gains and losses on such investments are included in the net appreciation (depreciation) of the master trust.

4.38

Note X: Derivative Financial Instruments

The plan has limited transactions that fall under the accounting rules of Financial Accounting Standards Board *Accounting Standards Codification* 815, *Derivatives and Hedging*. The plan does not use derivatives for trading purposes. The plan owns shares in a commingled international equity fund, and the managers of this fund may, from time to time, use currency futures and forward contracts to manage the fund's currency position. The plan also invests in commingled domestic equity funds. The managers of these funds have the authority to invest in futures contracts in the Standard & Poor's 500 Index to create exposure to equity securities as part of the fund's cash management strategy. Daily margin settlement for future contracts results in maintaining a zero market value for the contracts. The plan also invests in a commingled bond fund, and the manager of the fund may, from time to time, use derivatives for asset allocation and hedging purposes.

4.39

Note X: Derivative Financial Instruments

The stable value fund may hold wrapper contracts in order to manage market risks and to alter the return characteristics of underlying securities to match certain fixed income fund objectives. Wrapper contracts generally change the investment characteristics of underlying securities (such as corporate debt or U.S. government securities) to those of guaranteed investment contracts. The wrapper contracts provide that benefit-responsive distributions for specific underlying securities may be withdrawn at contract or face value. *Benefit responsive distributions* generally are defined as a withdrawal on account of a participant's retirement, disability, or death or participant-directed transfers in accordance with the terms of the plan. As of December 31, 20X2, the stable value fund held wrapper contracts with a negative fair value of $618,494 (negative fair value of $1,323,329 as of December 31, 20X1). At December 31, 20X2, the crediting interest rates on the wrapper contracts ranged from 2.96 percent to 5.04 percent (3.46 percent to 6.35 percent at December 31, 20X1). The average yield earned on the wrapper contracts was 3.72 percent in 20X2 (5.20 percent in 20X1).

4.40

Note X (In Part): Summary of Significant Accounting Policies

The derivatives most commonly used by the investment managers are highly liquid exchange traded equity and fixed income futures and over-the-counter foreign exchange forward contracts. The use of derivative instruments is not believed to materially increase the credit or market risk of the plan's investments.

4.41

Note X: Derivatives

The plan uses derivative financial instruments in the normal course of business to hedge against adverse changes in interest rates and foreign exchange rates. These financial instruments include options written, forward foreign exchange contracts, and futures contracts. The time period related to these hedges is dependent upon the types of securities being hedged and typically varies from three months to one year.

The plan manages market risk by limiting the use of derivatives to hedging activities or by limiting potential exposures to amounts that are not considered to be material to the statement of changes in net assets available for plan benefits. The plan does not enter into individually structured deals, limiting derivative investments to standardized exchange traded securities. The plan posts collateral for the equity and fixed income futures contracts in the form of U.S. Treasury bills with face values of $10,500,000 and $8,000,000 and market values of $10,374,000 and $7,918,000 at June 30, 20X2, and 20X1, respectively. The plan had sold $164,146,000 and $71,440,000 Standard & Poor's 500 Index futures as hedges against its equity holdings as of June 30, 20X2, and 20X1, respectively. The plan had sold $34,060,000 and $0 U.S. Treasury long bond futures as hedges against its fixed income holdings as of June 30, 20X2, and 20X1, respectively.

Forward foreign exchange contracts are contracts for delayed delivery of securities or money market instruments in which the seller agrees to make delivery at a specified future date of a specified instrument at a specified price or yield. The holder is exposed to credit risk for nonperformance and to market risk for changes in interest and currency rates. Those instruments involve, to varying degrees, elements of credit risk in excess of the amount recognized in the statement of net assets available for plan benefits. The plan attempts to mitigate this credit risk by utilizing the same policies in making commitments and conditional obligations as it does for on-balance sheet instruments and through structured trading with reputable parties and continual monitoring procedures. Accordingly, the plan does not anticipate losses for nonperformance. The plan does not require collateral or other security to support forward foreign exchange contracts.

At June 30, 20X2, and 20X1, the plan had $102,558,000 and $127,882,000 of foreign currency exchange contracts receivable and $105,012,000 and $133,758,000 of foreign currency exchange contracts payable, respectively.

The plan participates in a program of selling covered call and put options. The equities under option had a market value of $1,062,676,000 at June 30, 20X2, and $1,242,882,000 at June 30, 20X1.

4.42

Note X (In Part): Summary of Significant Accounting Policies

Derivative financial instruments are used by the plan's equity and balanced portfolio investment managers primarily to rebalance the fixed income and equity allocation of the plan's portfolio and to hedge the currency risk component of the plan's foreign investments. Certain of the fixed income investment managers are permitted to use certain specified types of derivative instruments as part of their respective strategies. These strategies include the use of futures and options as substitutes for certain types of fixed income securities. Leveraging of the plan's assets and speculation are prohibited. Currency hedge positions are not permitted to exceed the level of exposure in the related plan's assets.

4.43

Note X (In Part): Summary of Significant Accounting Policies

c. *Derivative financial instruments*—Derivative financial instruments are utilized by the group trust fund to reduce interest rate and foreign exchange risks. The group trust fund has established a control environment that includes policies and procedures for risk assessment and the approval, reporting, and monitoring of derivative financial instrument activities. The group trust fund does not hold or issue derivative financial instruments for trading purposes. At December 31, 20X2, and 20X1, the group trust fund held variable rate deposits ($1.8 million and $35.2 million, respectively) and forward exchange contracts ($5 million and $1.6 million, respectively). These derivative financial instruments are presented at estimated fair value on the statements of net assets. During 20X2 and 20X1, the net gains or losses generated from the purchases and sales of these derivative financial instruments were not material. The future value of these derivative financial instruments and the related currency positions are subject to offsetting market risk resulting from foreign currency exchange rate volatility. Current market pricing models were used to estimate the fair values of the forward exchange contracts and the variable rate deposits.

4.44

Note X: Derivative Financial Instruments

Foreign currency exchange contracts. The plan enters into forward contracts to purchase and sell foreign currencies in the normal course of its investing activities to manage the currency exposure associated with the plan's foreign equity and fixed income investments. The terms of these contracts generally do not exceed one year. The credit risk associated with these contracts is minimal because they are entered into with a limited number of highly rated counterparties.

The plan reflects the fair value of all forward contracts as an asset or liability in the plan's financial statements. The fair values associated with the foreign currency contracts have been estimated by valuing the net position of the contracts using the applicable spot rates and forward rates as of the reporting date. In the statements of net assets available for benefits, forward contracts to purchase foreign currency are shown as currency contract payables, and forward contracts to sell foreign currency are shown as currency contract receivables. Changes in fair value are accounted for as net appreciation (depreciation) in fair value of investments.

Futures contracts. The plan enters into futures contracts in the normal course of its investing activities to manage market risk associated with the plan's equity and fixed income investments and to achieve overall investment portfolio objectives. These contracts involve elements of market risk in excess of amounts recognized in the statement of net assets available for benefits. The credit risk associated with these contracts is minimal because they are traded on organized exchanges and settled daily.

During 20X2 and 20X1, the plan was a party to futures contracts held for trading purposes for the S&P 500 Index, Russell 2000 Index, S&P Barra Value Index, and U.S. Treasury bonds. Upon entering into a futures contract, the plan is required to deposit either in cash or securities an amount (initial margin) equal to a certain percentage of the nominal value of the contract. Subsequent payments are then made or received by the plan, depending on the daily fluctuation in the value of the underlying contracts. U.S. Treasury bills owned and included in the investments of the plan, with a value of $X million and $Y million at December 31, 20X2, and 20X1, respectively, were held by the plan's brokers as performance security on futures contracts.

The plan had futures contracts with notional amounts of $XX million and $XX million at December 31, 20X2, and 20X1, respectively. At December 31, 20X2, the plan had futures contracts to purchase (sell) S&P 500 Index, Russell 2000 Index, S&P Barra Value Index, and U.S. Treasury bonds contracts with notional amounts of $XX million, $XX million, $XX million, and ($XX million), respectively. At December 31, 20X1, the plan had futures contracts to purchase (sell) S&P 500 Index, Russell 2000 Index, S&P Barra Value Index, and U.S. Treasury bonds contracts with notional amounts of ($XX million), ($XX million), $XX million, and $XX million, respectively. Notional amounts do not quantify risk or represent assets or liabilities of the plan but are used in the calculation of cash settlements under the contracts.

The fair value of futures contracts in the statements of net assets available for benefits is zero at December 31, 20X2, and 20X1 because settlements are made by cash daily. Changes in fair value are accounted for as net appreciation (depreciation) in fair value of investments.

4.45

Note X: Interest Rate Swaps, Derivative Financial Instruments, and Other

The master trust may enter into fixed income interest rate swaps in order to manage certain interest rate risks and as part of the master trust's respective investment strategy. Swap agreements involve the exchange by the master trust with a counterparty of their respective commitments to pay or receive interest (for example, an exchange of fixed rate payments for floating rate payments) with respect to a notional amount of principal. The master trust carries the fair value of the swap as an asset or liability in the master trust's net assets. Market risk of loss is limited to the changes in fair value from December 31 of each year presented through the applicable expiration date. Due to the nature of the master trust's investments, the company does not believe credit risk is significant. As of December 31, 20X3, the total nominal amount of open interest rate swaps was $245,000,000, which had unrealized losses of $2,200,000 and unrealized gains of $3,500,000 as of that date. As of December 31, 20X2, the total nominal amount of open interest rate swaps was $301,000,000, which had unrealized losses of $0 and unrealized gains of $9,000,425 as of that date.

In addition, as a result of the master trust's participation in certain common and collective trusts, limited partnerships, or publicly traded mutual funds, those trusts may be invested from time to time in derivative financial instruments, as defined and allowed by the bylaws of each of the respective funds. Such activities may include the use of collateralized securities lending that may impair the liquidity of redemption requests, depending on credit markets; liquidity of collateral; and overall market activity. Financial exposure to the master trust is limited to its proportional interest in these funds. At December 31, 20X3, and 20X2, the financial exposure or potential liquidity constraints to the master trust were not material.

The master trust has investments in insurance company pooled separate accounts and insurance company general accounts, pursuant to certain guaranteed annuity contracts with various insurance companies. These contracts contain certain minimum balance requirements and certain restrictions on termination of the contracts. The minimum balance requirements were met as of December 31, 20X3, and 20X2. The company does not intend to terminate these contracts at this time.

5. RELATED PARTY DISCLOSURES

4.46

Note X: Related Party Transactions

Certain plan investments are shares of ABC Company common stock and shares of common collective trusts managed by DEF Finance, Inc. ABC Company is the plan sponsor, and DEF Finance, Inc., is the custodian and recordkeeper, as defined by the plan, and therefore, these transactions qualify as party-in-interest transactions. Fees paid by the plan for the custodial and recordkeeping services amounted to $25,000 for the year ended December 31, 20X3.

4.47

Note X: Related Party Transactions

One of the plan's investments represents a money market fund managed by Big Street. Big Street is the trustee, as defined by the plan, and therefore, these transactions qualify as party-in-interest transactions. Fees paid by the plan for investment management services were included as a reduction of the return earned on each fund.

At December 31, 20X3, and 20X2, the plan held 24,897,344 and 22,530,622 shares, respectively, of common stock of ABC Companies, Inc., the sponsoring employer, with a cost basis of $246,553,714 and $235,694,512, respectively. During the years ended December 31, 20X3, and 20X2, the plan recorded dividend income of $3,658,268 and $3,687,367, respectively.

4.48

Note X: Related Party Transactions

The plan sold approximately $8,100,000 and $9,200,000 of the plan sponsor stock fund in 20X2 and 20X1, respectively. In addition, contributions used to purchase the plan sponsor stock fund by the plan were approximately $16,300,000 and $17,400,000 in 20X2 and 20X1, respectively. The plan sponsor stock fund comprises common shares of the plan sponsor and cash. Shares of the plan sponsor were bought and sold in the open market at quoted fair market values at the date of purchase and sale.

4.49

Note X: Related Party Transactions

The plan allows for transactions with certain parties who may perform services or have fiduciary responsibilities to the plan, including the company. Certain plan investments are shares of various mutual funds that are owned and managed by ABC Funds, who has been designated as the investment manager. The plan invests in common stock of the company and issues loans to participants, which are secured by the balances in the participants' accounts.

The cash management trust primarily consists of a cash account that is used to facilitate the trustee in purchasing shares of the company's common stock. These transactions qualify as party-in-interest transactions.

4.50

Note X: Related Party Transactions

Certain plan investments are shares of separate pooled accounts managed by XYZ Financial Group. XYZ Financial Group is the trustee, as defined by the plan, and qualifies as a party-in-interest. The plan also invests in the common stock of the company.

4.51

Note X: Related Party Transactions

General Trust Company, the trustee of the plan, manages certain plan investments. Therefore, these transactions qualify as party-in-interest transactions and are denoted as such on the supplemental schedule of assets (held at end of year). Plan investments include publicly traded common stock of ABC Company, the plan sponsor.

4.52

Note X: Related Party Transactions

Certain plan investments are shares of mutual funds managed by Prosperity Investments. Prosperity Investments is the trustee, as defined by the plan, and therefore, these transactions qualify as party-in-interest transactions. Fees paid by the plan for the investment management services amounted to $105,000 for the year ended December 31, 20X2.

4.53

Note X: Related Party Transactions

ABC Bank and the trustee manage certain plan investment options. These transactions qualify as exempt party-in-interest transactions.

The master trust holds common shares of Black Corporation, the plan sponsor, and these qualify as exempt party-in-interest transactions.

The plan invested in the ABC stock fund (fund), which comprises a short term investment fund component and shares of common stock of Black Corporation. The unit values of the fund are recorded and maintained by ABC Bank. During the 3-months ended March 31, 20X2, the plan purchased units of the fund in the approximate amount of $87,000, including dividends, and interest of approximately $8,500; sold units of the fund in the approximate amount of $46,000; had net depreciation on the fund in the approximate amount of $235,000 and made transfers to the employee savings plan in the approximate amount of $1,034,000. The total value of the plan's interest in the fund was $0 and approximately $1,228,000 at March 31, 20X2, and December 31, 20X1, respectively.

4.54

Note X: Transactions With Parties in Interest

ABC provides to the plan certain accounting and administrative services for which no fees are charged.

4.55

Note X: Transactions With Parties in Interest

Fees paid during the year for administrative services rendered by parties in interest were based on customary and reasonable rates for such services and are paid by the employer. Certain plan investments are shares of common stock of the employer. Dividends of $0.29 per share were declared and paid on the employer's common stock during the year ended March 31, 20X2, representing $178,579 of dividend income. These transactions qualify as party-in-interest transactions.

4.56

Note X: Related Party Transactions

On December 29, 20X2, the plan issued seller notes to fund the purchase of 329,446 shares of the company's common stock for $11,316,470 from various members of the Jones family (see note 4).

In 20X2, the plan purchased, at fair value, as determined by an independent appraiser, approximately 379,000 shares of the company's common stock for approximately $12,887,000. These shares purchased include the remaining 332,681 outstanding shares the plan purchased on December 29, 20X2, at $34.35 per share (see note 4) from the selling shareholders. As of December 31, 20X2, the plan owns 100 percent of the company.

In 20X1, the plan purchased, at fair value, as determined by an independent appraiser, approximately 103,500 shares of the company's common stock for approximately $1,995,000. As of December 31, 20X1, the plan owns approximately 60 percent of the company.

4.57

[*The following disclosure is for a share purchase plan.*]

Note X: Related Party Transactions

At June 30, 20X2, and 20X1, 1,070,923 and 971,086 shares of company common stock were held by the plan, respectively. The cost of this stock at June 30, 20X2, and 20X1 was $3,195,410 and $2,666,069, respectively. During the years ended June 30, 20X2, and 20X1, the plan recorded dividend income from company common stock of $849,992 and $522,807, respectively. Contributions from participating companies of $483,476 and $377,341 were recorded for the years ended June 30, 20X2, and 20X1, respectively. Also, the plan received reimbursements for administrative expenses from the company titled Income From the Pink and Green Company in the statements of changes in net assets available for plan benefits for the years ended June 30, 20X2, and 20X1 of $17,045 and $11,562, respectively.

4.58

Note X: Related Party Transactions

The plan invests in shares of registered investment companies managed by the trustee. A substantial portion of the income or loss of the plan is derived from these investments. Fees paid by the plan to the trustee for certain investment management fees were deducted from the net asset values of the registered investment companies held by the plan. The various funds' operating expense ratios ranged from 0.9 percent to 1.44 percent, as of December 31, 20X3.

6. PROHIBITED TRANSACTIONS

4.59

Note X: Prohibited Transactions

During 20X2, the company failed to remit to the plan's trustee certain employee contributions totaling approximately $52,000 within the period prescribed by Department of Labor regulations. Delays in remitting contributions to the trustee were due to administrative errors, and the company has or will make contributions to the affected participants' accounts to compensate those participants an aggregate of approximately $800 for potential lost income due to the delays.

4.60

Note X: Prohibited Transactions

As required by ERISA Section 2510.3-102, the plan sponsor is required to segregate employee contributions to the plan from its general assets as soon as practicable but in no event more than 15 business days following the end of the month in which amounts are withheld from wages. Due to the change in plan administrator from ABC to DEF during the fourth quarter of 20X2 (see note 8), contributions from the November 30, 20X2, payroll were not able to be transferred to, and accepted by, the new third party plan administrator (DEF) until December 30, 20X2, which exceeded the 15 business day limitation by 7 business days. Total contributions and loan repayments for the November 30, 20X2, pay period were $60,160, of which $28,780 represented employee contributions; $27,681 represented the company's matching contributions; and $3,699 represented loan repayments. Contributions for this pay period are considered a prohibited transaction. The company made an interest payment of $2,587 to compensate the plan for lost investment earnings relating to this prohibited transaction. There were no prohibited transactions during 20X1.

4.61

Note X: Party in Interest Transaction

During 20X2, the plan sponsor did not remit certain participant contributions to the plan in a timely manner, as defined by ERISA. These instances were corrected during 20X2. These contributions are considered nonexempt party-in-interest transactions, which may result in an imposition of a 15 percent excise tax on the amount of the transactions. The plan sponsor intends to compensate participants for any lost interest resulting from the delay in contributions. Management estimates that lost income associated with the delay in contributions amounts to $147, computed at a 10.5 percent interest rate. These nonexempt transactions do not affect the tax status determination of the plan, and the company intends to pay all fines imposed.

4.62

Note X: Prohibited Transaction

During 20X2, the plan was advanced funds by one of the custodians, ABC Bank, for the purchase of certain investments. The amount payable to ABC Bank at March 31, 20X2, amounted to approximately $173,800. This amount is included in accounts payable in the March 31, 20X2, financial statements. The plan intends to repay ABC Bank for the amount borrowed, which was prohibited according to the provisions of ERISA and the Internal Revenue Code. The plan also paid $10,076 in interest during fiscal year 20X2 related to the funds advanced to the plan.

7. GOING CONCERN

4.63

Note X: Subsequent Events

On April 15, 20X2, Bluefish Incorporated filed for reorganization under the protection of Chapter 11 of the Bankruptcy Code. Management of the company is in the process of developing its plan of reorganization, which will include the plan's unfunded liability (approximately $900,000 at December 31, 20X1), for submission to the bankruptcy court for approval. In connection with this process, the possibility exists that the court may terminate the plan (a distress termination), or alternatively, the Pension Benefit Guaranty Corporation (PBGC) may terminate the plan (an involuntary termination). In either case, vested benefits of the plan are insured by the PBGC, subject to certain limitations, including a ceiling on the maximum benefits payable, which may be lower than certain plan participants would otherwise have received under the plan. In the event of a plan termination, the net assets of the plan would be distributed in accordance with the provisions of the plan document. No provision for the preceding uncertainty has been made in the plan's financial statements.

4.64

Note X (In Part): Summary of Significant Accounting Policies

a. *Basis of presentation*—The accompanying financial statements of the ABC hospital employees' pension plan (plan) have been prepared on an accrual basis of accounting. The financial statements and supplemental schedule have been prepared assuming that ABC Hospital (hospital), the plan's sponsor, will continue as a going concern. The hospital's recurring losses from operations and a partners' deficit raise substantial doubt about the hospital's ability to continue as a going concern. On December 23, 20X0, the hospital filed a petition for relief under Chapter 11 of the bankruptcy laws in the United States Bankruptcy Court, Eastern District of New York. The uncertainty regarding the hospital's ability to continue as a going concern raises substantial doubt about the plan's continuation. Should the plan be terminated, the terms discussed in note X(e) would be applicable. The financial statements and the supplemental schedule do not include any adjustments that might result from the outcome of this uncertainty.

8. TAX STATUS

4.65

Note X: Tax Status

The IRS has determined and informed the company by a letter dated June 20, 20XX, that the plan and related trust are designed in accordance with applicable sections of the Internal Revenue Code (IRC). The plan has been amended since receiving the determination letter. However, the plan administrator and the plan's tax counsel believe that the plan is designed and is currently being operated in compliance with the applicable provisions of the IRC.

4.66

Note X: Tax Status

On November 19, 20X1, the IRS stated that the prototype adopted by the plan, as then designed, qualifies under Internal Revenue Code (IRC) Section 401(a). The plan has not received a determination letter specific to the plan itself; however, the plan administrator and the plan's tax counsel believe that the plan was designed and was being operated in compliance with the applicable requirements of the IRC. Therefore, no provision for income taxes has been included in the plan's financial statements.

4.67

Note X: Tax Status

The plan has received a determination letter from the IRS dated June 8, 20X3, stating that the plan is qualified under Internal Revenue Code (IRC) Section 401(a), and therefore, the related trust is exempt from taxation. Once qualified, the plan is required to operate in conformity with the IRC to maintain its qualification. The plan administrator believes the plan is being operated in compliance with the applicable requirements of the IRC and, therefore, believes that the plan is qualified and the related trust is tax exempt.

4.68

Note X: Income Tax Status

The prototype plan sponsor has obtained an opinion letter dated August 7, 20X1, in which the IRS stated that the restated prototype plan document was in compliance with applicable requirements of the Internal Revenue Code (IRC). The plan administrator timely adopted the restated prototype plan. The plan administrator believes that the plan is currently being operated in accordance with the IRC.

4.69

Note X: Income Tax Status

The IRS issued, on October 15, 20X1, a favorable determination that the plan meets the requirements of Internal Revenue Code (IRC) Section 401(a) and is exempt from federal income taxes under IRC Section 501(a). Such determination letter did not involve a review of the effect on the plan of certain recent tax laws that have become effective after 20X1. The plan administrator and the plan's tax counsel believe that the plan is designed and has been operated in compliance with the applicable requirements of such recent tax laws.

4.70

Note X: Tax Status

The plan obtained its latest determination letter in 20X0, in which the IRS stated that the plan, as then designed, was in compliance with the applicable requirements of the Internal Revenue Code. The plan has been amended since receiving the determination letter. The plan was not timely amended to bring it into compliance with the requirements of the Tax Reform Act of 1986 and the Technical and Miscellaneous Revenue Act of 1988 (TAMRA). The company voluntarily requested to correct the defect under the Closing Agreement Program with the IRS. Under this program, the company amended the plan on September 30, 20X2, to bring the plan into compliance. On June 15, 20X3, the company and the IRS entered into a signed closing agreement in which the IRS concluded that it will treat the plan as having been timely amended for the purposes of the Tax Reform Act of 1986 and TAMRA, with respect to plan years beginning after December 31, 1986. As part of the agreement, the company paid $135,000 in penalties.

Effective October 1, 20X2, the plan was amended and restated. The company has not yet received a determination letter for the amended and restated plan. The company believes that the plan currently is designed and is being operated in compliance with the applicable requirements of the Internal Revenue

Code (IRC) and that, therefore, the plan continues to qualify under IRC Section 401(a), and the related trust continues to be tax exempt as of December 31, 20X1. Therefore, no provision for income taxes is included in the plan's financial statements.

4.71

Note X: Tax Status

The plan, then known as the Lando Corporation plan for eligible employees of the salary and weekly payrolls of Group Operations, obtained its latest determination letter in 20X0, in which the IRS stated that the plan, as then designed, was in compliance with the applicable requirements of the Internal Revenue Code (IRC). The plan has been amended and merged since receiving the determination letter. Lando Corporation (company) is currently restating the plan document to reflect all changes, and upon completion of the restatement, will request a new determination letter. The company believes that the plan currently is designed and being operated in compliance with the applicable requirements of the IRC and that, therefore, the plan continues to qualify under IRC Section 401(a), and the related trust continues to be tax exempt as of December 31, 20X2. Therefore, no provision for income taxes has been included in the plan's financial statements.

4.72

Note X: Federal Income Taxes

The company adopted a prototype standardized profit sharing plan with a cash or deferral arrangement that received a favorable opinion letter from the IRS on November 15, 20X0, which stated that the plan and related trust are designed in accordance with applicable sections of the Internal Revenue Code. The company identified certain operational omissions with respect to the plan and has submitted an application under the Standardized Voluntary Compliance Resolution (SVCR) program to the IRS. The plan administrator and counsel for the company expect that the final outcome of the SVCR process will not have any material effect on the plan's financial statements.

4.73

[*The following disclosure is for a health and welfare pension plan.*]

Note X: Income Tax Status

The trust established under the plan to hold the plan's assets is intended to qualify, pursuant to Internal Revenue Code (IRC) Section 501(c)(9), and accordingly, the trust's net investment income is exempt from income taxes. The trust has obtained a favorable determination letter from the IRS, and the plan sponsor believes that the trust, as amended, continues to qualify and operate in accordance with the applicable provisions of the IRC.

4.74

[*The following disclosure is for a health and welfare pension plan.*]

Note X: Income Tax Status

The trust established under the plan to hold the plan's net assets is qualified, pursuant to Internal Revenue Code Section 501(c)(9), and accordingly, the trust's net investment income is exempt from income taxes. The sponsor has obtained a favorable tax determination letter from the IRS, and the sponsor believes that the trust, as amended, continues to qualify and operate as designed.

4.75

[*The following disclosure is for a Voluntary Employees' Beneficiary Associations plan.*]

Note X: Income Tax Status

The trust funding the plan has received an exemption letter from the IRS dated September 15, 20X0, stating that the trust is tax exempt under the provisions of Internal Revenue Code (IRC) Section 501(c)(9) as a Voluntary Employee Beneficiary Association. The plan and trust are required to operate in conformity with the IRC to maintain the tax exempt status of the trust. The plan administrator believes the plan is being operated in compliance with the applicable requirements of the IRC and, therefore, believes the related trust is tax exempt.

4.76

[*The following disclosure is for an employee stock ownership plan defined contribution pension plan.*]

Note X: Income Tax Status

The IRS has determined and informed the company by a letter dated June 30, 20X0, that the plan is qualified and that the trust established under the plan is tax exempt under the appropriate sections of the Internal Revenue Code (IRC). The plan has been amended since receiving the determination letter. However, the plan administrator and the plan's tax counsel believe that the plan is currently designed and is being operated in compliance with the applicable requirements of the IRC. Therefore, they believe that the plan was qualified and the related trust was tax exempt, as of the financial statement date.

4.77

[*The following disclosure is for an employee stock purchase plan.*]

Note X: Income Tax Status

The plan is intended to constitute an employee stock purchase plan within the meaning of Internal Revenue Code (IRC) Section 423. Issuance of shares under this plan is not intended to result in taxable income to participants in the plan, based on provisions of the IRC. Accordingly, the plan is designed to be exempt from income taxes. The company believes that the plan has been operated in accordance with the IRC, and therefore, no provision for income taxes has been reflected in the accompanying financial statements.

4.78

[*This disclosure is for a supplemental unemployment benefit plan in accordance with Financial Accounting Standards Board* Accounting Standards Codification *965, Plan Accounting—Health and Welfare Benefit Plans.*]

Note X: Tax Status

The plan obtained its latest determination letter in 1990, in which the IRS stated that the plan, as then designed, was in compliance with the applicable requirements of the Internal Revenue Code (IRC). The plan has been amended since receiving the determination letter. Plan management and the plan's tax counsel believe that the plan is currently designed and is being operated in compliance with the applicable requirements of the IRC. Therefore, no provision for income taxes has been included in the plan's financial statements.

4.79

Note X: Income Tax Status

The plan has applied for, but has not received, a determination letter from the IRS stating that the plan is qualified under Internal Revenue Code Section 401(a). However, the plan administrator believes that the plan is qualified, and therefore, the related trust is exempt from taxation.

4.80

Note X: Income Tax Status

The plan has received a determination letter from the IRS dated July 14, 20X2, stating that the plan is qualified under Internal Revenue Code (IRC) Section 401(a), and therefore, the related trust is exempt from taxation. Once qualified, the plan is required to operate in conformity with the IRC to maintain its qualification.

Currently, the 20X2 plan year is under audit by the IRS, and the plan administrator expects that no issues will be identified as a result of the audit. Additionally, the plan administrator believes the plan is being operated in compliance with the applicable requirements of the IRC and, therefore, believes that the plan is qualified and the related trust is tax exempt.

4.81

[*The following disclosure is for a plan that either has entered into an IRS correction program or has identified issues that may require corrective action.*]

Note X: Income Tax Status

The plan has received a determination letter from the IRS dated July 1, 20XX, stating that the plan is qualified under Internal Revenue Code (IRC) Section 401(a), and therefore, the related trust is exempt from taxation. Once qualified, the plan is required to operate in conformity with the IRC to maintain its qualification. The plan sponsor has indicated that it will take the necessary steps, if any, to maintain the plan's qualified status.

9. RECONCILIATION OF FINANCIAL STATEMENTS TO FORM 5500

4.82

Note X: Reconciliation of Financial Statements to Form 5500

The following is a reconciliation of net assets available for plan benefits, per the financial statements, to Form 5500:

	For the Year Ended December 31	
	20X2	*20X1*
Net assets available for plan benefits, per the financial statements	$7,953,182	$6,608,408
Amounts allocated to withdrawing participants	(117,944)	(103,212)
Net assets available for plan benefits, per Form 5500	$7,835,238	$6,505,196

The following is a reconciliation of benefits paid to participants, per the financial statements, to Form 5500:

	For the Year Ended December 31, 20X2
Benefits paid to participants, per the financial statements	$1,195,582
Add: Amounts allocated to withdrawing participants at December 31, 20X2	117,944
Less: Amounts allocated to withdrawing participants at December 31, 20X1	(103,212)
Benefits paid to participants, per Form 5500	$1,210,314

10. EXCESS PARTICIPANT CONTRIBUTIONS PAYABLE

4.83

Note X: Excess Participant Contributions Payable

The plan failed to pass the Average Deferral Percentage (ADP) test and the Actual Contribution Percentage (ACP) test for the 20X2 and 20X1 plan years. For 20X2, no participants exceeded the limits of Internal Revenue Code Section 415; however, for 20X1, certain participants did exceed such limits. The accompanying statements of net assets available for benefits include approximately $140,000 and $191,000 as of December 31, 20X2, and 20X1, respectively, in excess participant contributions payable to participants related to these issues.

In order to correct the failure of the ADP and ACP tests for the 20X1 plan year, federal law generally required that corrective distributions be made no later than December 31, 20X2. The company did not fully settle the 20X1 corrective distribution obligation during 20X2. However, as permitted under applicable IRS guidance, the company opted to correct a portion of the nondiscrimination testing failures in 20X3 using the one-to-one correction method, which generally requires an excess contribution amount be refunded to highly compensated employees and a qualified nonelective contribution be made by the company to the plan in the same amount and allocated to certain nonhighly compensated employees. The accompanying statements of net assets available for benefits include approximately $19,000 in other receivables and an equal amount in excess participant contributions payable to participants related to this issue as of December 31, 20X2.

4.84

Note X: Excess Participant Contributions Payable

The plan failed the discrimination test for the year ended December 31, 20X2. Excess contributions amounting to $10,700 are recorded as a liability in the accompanying statement of net assets available for benefits and as a reduction of participant-directed contributions for the year. The plan expects to reimburse these excess contributions to its participants during 20X3.

The plan also has recognized a payable in the amount of $38,435 related to excess contributions made by the plan sponsor during 20X2. These excess contributions were reimbursed after year-end.

4.85

Note X: Excess Contributions Refundable

At December 31, 20X2 and 20X1, liabilities of $247,537 and $128,929, respectively, are recorded for amounts refundable by the plan to participants for contributions made in excess of amounts allowed by the IRS.

4.86

Note X: Excess Contributions Refundable

In 20X3, the plan will refund to highly compensated employees (HCEs) their excess 20X2 contributions. The HCEs will be refunded their excess contributions of $843,223, plus approximate investment earnings of $51,776, which is recorded as a liability on the statement of net assets available for benefits at December 31, 20X2.

4.87

Note X (In Part): Summary of Significant Accounting Policies

c. *Payment of benefits*—Benefits are recorded when paid. Corrective distributions payable generally represent the distribution of certain assets to employees in order for the plan to comply with ERISA nondiscrimination rules.

d. *Contributions*—Employee contributions and the related employer matching contributions are recorded in the period payroll deductions are made.

4.88

Note X: Benefits Payable

As of the report date, the company had not completed discrimination testing for the year ended December 31, 20X2. For the year ended December 31, 20X1, $42,832 (less than 0.2 percent of net assets available for plan benefits as of December 31, 20X1) was refunded during 20X2 as a result of the 20X1 tests. Management believes the amount of refunds, if any, resulting from the 20X2 testing would not be material to the financial statements, and therefore, no liability has been recorded for such refunds.

4.89

Note X: Benefit Obligations

Included in net assets available for benefits are amounts allocated to individuals who have elected to withdraw from the plan but who have not been paid. Plan assets allocated to these participants were $87,597 and $32,520 at December 31, 20X2, and 20X1, respectively.

11. FORFEITURES

4.90

Note X: Forfeitures

Forfeited nonvested amounts are first used to pay administrative expenses of the plan or to restore unvested amounts to reemployed participants. Any remaining forfeitures are used to reduce company contributions into the plan. Forfeited nonvested accounts totaled $2,336 and $2,007 at December 31, 20X2, and 20X1, respectively. During 20X2, forfeited nonvested accounts of $45 were used to pay administrative expenses of the plan and $2,040 was used to reduce employer matching contributions.

4.91

Note X: Forfeitures

Forfeited balances of terminated participants' nonvested accounts are reallocated among the remaining participants in the proportion that each participant's compensation for the year bears to the total compensation of all participants for the year.

Approximately $79,000 and $166,000 of forfeitures were allocated to remaining participants during fiscal years 20X2 and 20X1, respectively. At February 28, 20X2, net assets available for benefits include approximately $166,000 of unallocated forfeitures that will be allocated among remaining participants in fiscal 20X3.

4.92

Note X: Forfeitures

Upon termination of employment, participants forfeit their nonvested balances. Forfeited balances of terminated participants' nonvested accounts are used to reduce future company contributions. Unallocated forfeiture balances as of December 31, 20X2, and 20X1 are approximately $61,000 and $51,000, respectively, and forfeitures used to reduce employer matching contributions for 20X2 and 20X1 were approximately $49,000 and $143,000, respectively.

4.93

Note X: Forfeitures

The distribution and allocation of company profit sharing and matching contributions forfeited are first made available to reinstate previously forfeited company profit sharing or matching contributions account balances of rehired former participants, provided that certain provisions in the plan agreement are met. The remaining forfeitures are used to reduce company matching contributions or reduce plan expenses for the plan year in which such forfeitures occur. Forfeitures in the amount of $99,462 and $86,701 were used to reduce company matching contributions during 20X2 and 20X1, respectively. Forfeiture balances as of December 31, 20X2, and 20X1 amounted to $XX,XXX and $XX,XXX, respectively.

4.94

Note X (In Part): Summary of Significant Accounting Policies

f. *Forfeitures*—For profit sharing contributions made by the company prior to January 1, 20X0, if a participant terminates his or her employment before he or she is 100 percent vested, he or she forfeits any nonvested amounts. The nonvested portion of a participant's account is forfeited as of the date of distribution of his or her vested interest. Employees resuming participation in the plan prior to incurring the greater of five consecutive one year breaks in service or their prior service, if greater than five years, may have the nonvested portion of their account balance restored upon repayment to the plan of the full amount of such previously distributed vested interest. Restoration of the nonvested portion of a participant's account is to be made first from available forfeitures and then from company contributions.

12. OTHER

4.95

Note X: Due From Other Plans

On December 31, 20X2, the USA, Inc., profit sharing 401(k) plan (USA) was merged into the plan; however, the funds had not been remitted to the plan as of such date; accordingly, the amounts due are reflected as a receivable due from other plans on the statement of net assets available for benefits at December 31, 20X2, and included in the net transfers on the statement of changes in net assets available for benefits.

4.96

Note X (In Part): Summary of Significant Accounting Policies

g. *Net transfers from other plans*—In conjunction with ABC's business acquisition and divestiture activities, plan assets have been transferred into and out of the plan, respectively. When an acquired company's plan is terminated, those participants are given the option to roll over their accounts into the plan. Such rollovers are included in the "Rollover" line item of the accompanying statement of changes in net assets available for benefits. Mergers of acquired company plans, plan assets transferred out of the plan due to divestitures, and plan assets transferred into and out of the plan from and to other company sponsored qualified plans as a result of employee status changes are included in the "Transfers from/to other plans" line item of the accompanying statement of changes in net assets available for benefits. The following table summarizes such plan transfers for the year ended December 31, 20X2:

Transfers from other plans:	
Western, Inc., retirement savings plan	$ 987,248
Transfers to other plans:	
Fisher, Inc.	(275,004)
Other	(8,331)
Net transfer from or to other plans	$ 703,913

4.97

Note X: Voting Rights and Dividends

Each participant who has an interest in the company stock fund is entitled to exercise voting rights attributable to the shares allocated to his or her company stock fund account and is notified by the trustee prior to the time that such rights are to be exercised. If the trustee does not receive timely instructions, the trustee itself or by proxy shall vote all such shares in the same ratio as the shares with respect to which instructions were received from participants.

Each participant who has a vested interest in the company stock fund may elect to receive cash dividends that are paid on shares of company stock. Cash dividends that are distributed under this election shall be paid not later than 90 days after the close of the plan year in which the cash dividends are paid. If a participant does not elect to receive cash dividends, cash dividends that are paid on shares of company stock are reinvested in the company stock fund.

4.98

Note X: Plan Amendments

Assets of the plan were transferred from FDC to ABC on January 2, 20X3. Concurrent with the change of trustees, the plan was amended and restated to consolidate the ABC, Inc., matched retirement savings plan, which was the former retirement plan for the employees of ZZZ, Inc. Upon restatement, the plan name was changed to total incorporated retirement savings plan.

Effective January 1, 20X2, the plan was amended and restated to comply with several recent legislative actions. Additionally, effective January 1, 20X2, the plan was amended to allow participation by eligible employees of Small, Inc., a wholly owned subsidiary of the company, who previously participated in the Small, Inc. 401(k) plan. In February 20X2, the plan was amended to convert the company stock fund component of the plan to a nonleveraged employee stock ownership plan, satisfying the requirements of Internal Revenue Code Sections 401(a), 409, and 4975(e)(7).

4.99

Note X: Plan Description

The Giant Stores, Inc., 401(k) retirement savings plan is a defined contribution plan established by the company on January 1, 1994, which was amended, effective July 1, 20X2, to merge certain assets of the Giant Stores, Inc., profit sharing plan into the Giant Stores, Inc., 401(k) retirement savings plan. The surviving plan is named the Giant Stores, Inc., profit sharing and 401(k) plan. As a result of the merger, approximately $1.2 billion of assets were transferred into the plan on July 1, 20X2.

4.100

Note X: Final Form 11-K

Pursuant to the Securities Act of 1933, the filing of the annual report on Form 11-K with the Securities and Exchange Commission (SEC) is not required for defined contribution plans not involving the purchase of employer securities with employee contributions. As discussed in note 1, in the third quarter of 20X2, the ABC stock fund was frozen to new investments; therefore, no employee contributions will be used to purchase units of this fund beginning September 3, 20X2, and thereafter. As a result, the filing of this report with the SEC will not be required in the future.

4.101

Note X: Plan Termination

The plan is being terminated due to the closure of the southern facilities whose employees participate in this plan. In April 20X1, the company set the effective date of termination of the plan at April 30, 20X1. All assets were not distributed or transferred by year-end. Final distributions or transfers will commence when the IRS issues a favorable determination letter regarding the plan's termination. The IRS determination letter is anticipated to be received in 20X3.

4.102

Note X: Partial Termination of the Plan

As a result of the consolidation and closure of the company's Massachusetts facilities, as discussed in note Y, the company has determined that a partial termination of the plan occurred in 20X3. All affected plan participants were fully vested in their accounts upon the closure of these facilities.

4.103

Note X: Voluntary Correction Program

Two participants were each found to have taken out 3 separate loans concurrently. This is prohibited by the terms of the plan document (see note 1), and the loans were issued due to an administrative error. The third loan for each of these participants was classified as a deemed distribution. These deemed distributions totaled $18,500, which is included in "Benefits paid to participants" in the accompanying statement of changes in net assets available for benefits. This issue will be included in the company's Voluntary Correction Program submission (see note X).

4.104

Note X: Voluntary Correction Program

When the plan was amended in 20X0, the definition of *compensation* was amended such that the company was to have excluded certain withholdings from participants' compensation in determining participant contributions and the company matching contribution. However, the company continued to withhold participants' contributions and compute the company match contribution based on participants' gross wages, in accordance with the plan's prior definition of *compensation*.

Additionally, the company has identified certain loan administration errors involving 26 participants' balances that occurred during the transition of plan recordkeeping services from Guardian Retirement Services to the benefits group.

The company is in the process of filing a Voluntary Correction Program (VCP) submission with the IRS, which further details these matters and the company's plan for correcting them. The company also is researching certain other items that may be included in a supplement to the VCP submission.

None of these items had a material effect on the plan's net assets available for benefits, and the company does not expect the VCP submission to affect the plan's tax status.

4.105

Note X: Voluntary Compliance Program

Subsequent to December 31, 20X2, the company determined that participants were allowed to contribute certain compensation that did not meet the plan's definition of *eligible compensation*. The company is taking remedial actions under the Department of Labor Voluntary Compliance Program to correct the matter through a retroactive amendment to the plan's definition of *eligible compensation*, whereby the definition was expanded to include all such compensation contributed by participants. The company submitted its request to the IRS in June 20X3, and as of the date of this report, the company has not received a response.

4.106

Note X: Voluntary Compliance

The company intends to correct a limited number of isolated operational errors related to employee referrals under the IRS's Employee Plans Compliance Resolution System.

4.107

Note X: Voluntary Compliance

Certain computational and coding errors were identified relating to participant deferrals, contributions calculations, and delayed commencement of the plan's loan payroll deductions due to a conversion to a new payroll system in 20X2. Corrective contributions to participant accounts, including lost earnings, have been identified and quantified by the company. The company made a voluntary submission to the IRS under the Employee Plans Compliance Resolution System (EPCRS) on January 5, 20X3, outlining the foregoing operational issues and proposed resolution and corrective action. The estimate for the corrective contributions was based upon the plan provisions and was limited by various Internal Revenue Code regulations. An estimate of approximately $XX is recorded as corrective contributions receivable as of December 31, 20X2, in the accompanying statement of net assets available for benefits. The estimate reflects investment earnings and losses based upon the affected participants' investment elections during the correction year. These amounts will be remitted by the company and credited to participants' accounts as soon as administratively possible, upon approval by the IRS. These amounts have been estimated based on the proposed corrective action in the EPCRS. Any differences in the estimated and final correction methods, as agreed upon with the IRS, will be reflected in future years. Although the submission is still pending with the IRS, all corrective action, as required by the IRS, will be taken by the company. No provision for income taxes has been included in the plan's financial statement related to the foregoing matters because the company believes that the plan continues to be qualified, and the tax status of the related trust continues to be tax exempt.

4.108

Note X: Prohibited Transactions

During 20X2, the company failed to remit participant contributions in a timely manner. The company identified 4 instances for a total of $232,103 in which participant contributions were remitted to the plan in violation of Department of Labor (DOL) regulations. The company intends to enter into the DOL Voluntary Correction Program (VCP). The company estimated the amount of corrective payments due to the plan and determined that the amount is immaterial.

During 20X1, the company failed to remit certain participant contributions in a timely manner. The company identified 14 instances for a total of $915,297 in which participant contributions were remitted to the plan in violation of DOL regulations. As previously noted, the company intends to enter into the DOL VCP. During 20X1, it also was determined that the estimated amount of corrective payments due to the plan was immaterial.

4.109

Note X: Nonexempt Transactions

It was noted that in 20X2 there were unintentional delays by the company in submitting employee contributions and loan repayments in the aggregate amount of $75,000 to the trustee. The company intends to reimburse the plan for lost interest in the amount of $3,000 in 20X3.

4.110

Note X: Fidelity Bond

The plan was covered by a $2,000,000 fidelity bond during 20X2 and 20X1.

4.111

[*The following disclosure is for an employee stock ownership plan.*]

Note X: Loans Payable and Share Release

On October 13, 1998, the employee stock ownership plan purchased 479,900 shares of common stock of the company with the proceeds of a $7,682,281 loan from the company. These shares were recorded by the trustee in the suspense account. Such stock ceases to be collateral and is released from the suspense account as the loans are repaid. In each year prior to full payment of the loans, the number of shares of stock released will equal the number of shares of stock held as collateral immediately before the release for such plan year, multiplied by the release fraction. The loan balance was $3,219,461 and $3,819,461 at March 31, 20X2, and 20X1, respectively, and is payable in quarterly installments of $150,000 through April 20X7 and $69,461 in July 20X7, plus interest at the prime rate (3.25 percent at March 31, 20X2). The carrying value of the loan approximates fair value as determined using interest rates currently available for issuance of debt with similar terms and maturity dates.

The loan is collateralized by an equivalent number of shares of common stock recorded by the trustees in a suspense account.

Future maturities of loans payable for the years ended March 31 are as follows:

20X3	$ 600,000
20X4	600,000
20X5	600,000
20X6	600,000
20X7	600,000
Thereafter	219,461
	$3,219,461

The numerator of the release fraction is the amount of principal and interest payments made toward the loan during the plan year, and the denominator is the sum of the numerator, plus the principal and interest payments to be made on the loan in the future, using the interest rate applicable at the end of the plan year. Shares of stock released from the suspense account for a plan year shall be held in the trust on an unallocated basis until allocated by the benefits committee as of the last day of that plan year. That allocation shall be consistent with the method for allocating contributions to participants' accounts, which is based on a fraction of each participant's annual earnings during the preceding calendar year to the total earnings of those participants during such calendar year. The allocation of shares released resulting from dividends on participants' allocated shares, however, was based upon the fraction of each participant's allocated shares to the total number of allocated shares.

As of March 31, 20X2, and 20X1, 144,458 shares and 176,646 shares, respectively, were held as collateral for the loan; during the years ended March 31, 20X2, and 20X1, 32,188 shares and 37,021 shares, respectively, were released from the suspense account and allocated to participant accounts.

4.112

Note X: Line of Credit

In fiscal year 1998, the plan obtained a $35 million line of credit with ABC Bank to refinance a portion of the principal payable under the employee stock ownership plan loans and to more efficiently manage the number of shares released to fund the employee benefits. The line of credit bore interest at the London Interbank Offered Rate (LIBOR), multiplied by the applicable LIBOR adjustment. The line of credit matured on June 1, 20X2. On March 31, 20X1, the interest rate was 2.45 percent on the outstanding balance of $700,000. As of March 31, 20X1, the line of credit was collateralized by 16,023 unallocated shares of Brown Corporation common stock. The line of credit was prepaid in full on April 9, 20X1. On April 9, 20X1, the remaining 16,023 shares were released from collateral and were allocated to participants during fiscal year 20X2.

4.113

Note X: Other Matters

In June 20X2, it was determined that unusual trading activity initiated by certain participants within the plan's ABC stock fund occurred between September 20X1 and June 20X2. The trading activity had the effect of generating inflated unit balances within the ABC stock fund for the participants involved. The plan administrator has determined that the trading activity and results were not consistent with the intent of the

ABC stock fund offering. Subsequent to June 20X2, the plan has enacted trading restrictions to limit the frequency of ABC stock fund purchases to prevent this type of activity in the future. The plan administrator has obtained restitution agreements from some of the participants involved and is in the process of reallocating their inflated unit balances to affected participants. The plan administrator plans to utilize available means to bring any available action against the remaining participants involved. The outcome of such actions cannot be determined at this time. The trading activity did not affect reported net assets available for benefits or total investment gains or losses for the plan as a whole.

4.114

Note X: Other

During 20X3, the plan administrator discovered that certain employer matching contributions for the years ended December 31, 20X2, and 20X1 were calculated incorrectly. The company corrected this error, in accordance with the provision of the IRS's Employee Plans Compliance Resolution System. The additional amount required for the correction ($365,000), plus earnings, was recorded as an other employer contribution in 20X2, and an other employer contribution receivable was accrued at December 31, 20X1, and 20X2. On March 14, 20X3, the actual correction amount, including earnings, which together totaled $381,983, was paid to the plan.

4.115

Note X: Demutualization of City Life Insurance Company

During April 20X2, the plan received a onetime payment of City Life Insurance Company (CityLife) common stock under the contract issued by New England Financial. The payment was made to the plan as a result of the conversion of CityLife, the parent company of New England Financial, from a mutual insurance company to a stock insurance company. The amount received by the plan represents the compensation to which the plan was entitled under CityLife's demutualization plan that was approved by the state of New York on April 7, 20X2. The shares of common stock were sold in November 20X2, and the proceeds were allocated as a onetime pro rata earnings adjustment to the accounts of all current participants in proportion to each participant's account balance.

SECTION 5: LIMITED SCOPE AUDIT DISCLOSURES AND AUDITOR'S REPORTS

5.01

Employee Retirement Income Security Act of 1974 (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 that 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 Department of Labor's regulation and, therefore, are not adequate to allow plan administrators to limit the scope of the audit. This limited scope audit exemption does not apply to information about investments held by a broker or dealer or an investment company. This section provides guidance on limited scope audit disclosures and limited scope auditor's reports on financial statements of an employee benefit plan.

DISCLOSURES

1. Information Certified by Trustee

5.02

Note X: Trustee Information

The following is a summary of the investment information regarding the plan as of December 31, 20X2, and 20X1, and for the years then ended, included in the plan's financial statements and supplemental schedules, that was prepared by, or derived from, information prepared by ABC Bank, the trustee of the plan, and furnished to the plan administrator. The plan administrator has obtained certifications from the trustee that such information is complete and accurate.

	20X2	*20X1*
Investments:		
ABC Bank reserve fund	$1,482,712	$1,573,696
ABC Bank growth and income fund	2,538,366	2,100,286
ABC Bank stable fund	2,273,506	2,286,188
Investment income:		
Dividends	235,036	176,480
Interest	168,680	172,124
Net appreciation (depreciation) in fair value of investments	$ 467,154	$ (125,212)

5.03

Note X: Investment Information

The following is a summary of the investment information regarding the plan, included in the plan's financial statements and supplemental schedules, that was prepared by, or derived from, information prepared by

ABC Bank and furnished to the plan administrator. The plan administrator has obtained certifications from the custodian that the information is complete and accurate as of June 30, 20X2, and 20X1.

	20X2	*20X1*
Statement of net assets available for benefits:		
Investments—Value of interest in pooled separate accounts	$9,465,570	$8,537,038
Statements of changes in net assets available for benefits:		
Net investment gain from pooled separate accounts	$1,186,434	$ 596,712

5.04

Note X: Investments

The plan administrator has elected the method of compliance permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Accordingly, as permitted under such election, the following investment information was certified by the insurance company and was not subjected to any auditing procedures performed by the independent public accountants:

a. Total investments as shown in the accompanying statements of net assets available for benefits of $9,568,326 as of December 31, 20X2, and $4,431,808 as of December 31, 20X1
b. Net investment earnings as shown in the accompanying statement of changes in net assets available for benefits of $105,622 for the year ended December 31, 20X2
c. All investment-related information in the accompanying supplemental Schedule H, Line 4i—Schedule of Assets (Held at End of Year) as of December 31, 20X2, and Schedule H, line 4j—Schedule of Reportable Transactions for the year ended December 31, 20X2

The fair values of individual investments that represent 5 percent or more of the plan's net assets as of December 31 are as follows:

	20X2	*20X1*
Guaranteed investment account	$2,184,846	$ 990,396
U.S. equity account	2,830,554	1,440,492
Bond and mortgage account	1,420,766	755,016
International equity account	1,408,862	554,532
Stock index account	$1,007,920	$ 468,976

5.05

Note X: Investments

Other than the fair value of the investment in the ABC limited partnership and the related net depreciation, all investment information for the plan and master trust disclosed in the accompanying financial statements and supplemental schedules, including investments held at December 31, 20X2, and 20X1 and net appreciation (depreciation) in fair value of investments, interest, and dividends for the years ended December 31, 20X2, and 20X1, was obtained or derived from information provided to the plan administrator and certified as complete and accurate by ABC Bank, N.A., the trustee of the plan and the master trust. The following investment information was not certified by the trustee:

	For the Year Ended December 31	
	20X2	*20X1*
ABC limited partnership	$1,234,555	$ 997,564

	For the Year Ended December 31	
	20X2	*20X1*
Net depreciation in fair value of ABC limited partnership	$(50,000)	—

The fair value of individual investments that represent 5 percent or more of the plan's net assets available for benefits are as follows:

	For the Year Ended December 31	
	20X2	*20X1*
ABC Company, 6% bond, due 20X4	$1,950,000	$2,000,000
Candy, Inc., common stock	1,775,000	1,498,000
XYZ Company common stock	2,875,000	2,550,725
ABC fund	2,450,000	1,925,000
DEF fund	2,675,000	2,475,000
ABC fixed income fund	$2,500,000	$2,450,000

During 20X2 and 20X1, the plan's investments (including investments bought, sold, as well as held during the year) appreciated (depreciated) in fair value as follows:

	For the Year Ended December 31	
	20X2	*20X1*
U.S. government securities	$ 97,000	$ 28,000
Corporate bonds and notes	(54,587)	220,586
Common stocks	648,674	(1,995,100)
Common and collective trust fund	225,000	(35,000)
Mutual funds	236,150	(41,949)
ABC limited partnership	(50,000)	—
	$1,102,237	$(1,823,463)

Master Trust

Certain of the plan's investments are held in a master trust that was established for the investment of assets of the plan and several other company sponsored retirement plans. Each participating plan has an undivided interest in the master trust. The master trust assets are allocated among the participating plans by assigning to each plan those transactions (primarily contributions, benefit payments, and plan-specific expenses) that can be specifically identified by allocating among all plans, in proportion to each plan's beneficial interest in the master trust, income and expenses resulting from the collective investment of the assets of the master trust. At December 31, 20X2, and 20X1, the plan's interest in the net assets of the master trust was approximately 1.28 percent and 0.94 percent, respectively.

The following table presents the fair value of the net assets in the master trust:

	For the Year Ended December 31	
	20X2	*20X1*
U.S. government securities	$ 43,072,734	$127,304,752
Corporate bonds and notes	58,127,081	51,828,298
Money market fund	4,380,647	3,219,140
Common stocks	188,408,383	110,017,775
Mutual funds	69,386,368	113,576,366
Receivable for securities sold	46,043,110	—
Payable for securities purchased	—	(55,805,539)
	$409,418,323	$350,140,792

Net investment income for the master trust is as follows:

	For the Year Ended December 31	
	20X2	*20X1*
Net appreciation (depreciation) in fair value of investments:		
U.S. government securities	$ (3,210,990)	$ 7,943,950
Corporate bonds and notes	(1,260,398)	4,651,298
Money market fund	(3,672)	(2,328)
Common stocks	33,847,307	15,241,340
Mutual funds	(140,794)	2,306,922
Interest and dividend income	21,001,369	19,027,459
Administrative expenses	(312,245)	(369,470)
	$49,920,577	$48,799,171

5.06

[*The following disclosure is appropriate when all investments and related investment income of the plan are certified.*]

Note X: Information Certified by the Plan's Trustee

The plan administrator has elected the method of compliance permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Accordingly, ABC Bank, the trustee of the plan, has certified to the completeness and accuracy of all investments reflected on the accompanying statements of net assets available for pension benefits as of June 30, 20X2, and 20X1, note Y, and the supplemental Schedule H, line 4i—Schedule of Assets (Held at End of Year) as of June 30, 20X2; the related investment activity reflected in the statements of changes in net assets available for pension benefits for the years ended June 30, 20X2, and 20Xl; and the information reflected on the supplemental Schedule H, line 4j—Schedule of Reportable Transactions for the year ended June 30, 20X2.

5.07

Note X: Information Certified by the Plan's Custodian

The plan administrator has elected the method of compliance permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Accordingly, as permitted under such election, the plan administrator instructed the plan's independent auditors not to perform any auditing procedures with respect to the following information certified by ABC Bank, except for comparing such information certified by the custodian with information included in the plan's financial statements and supplemental Schedule H, line 4i—Schedule of Assets (Held at End of Year):

	For the Year Ended December 31	
Investments	*20X1*	*20X0*
Investment contract with insurance company	$1,000,000	$ 890,000
Corporate bonds and debentures	3,500,000	3,670,000
U.S. government securities	350,000	270,000
Mortgages	480,000	460,000
	$5,330,000	$5,290,000

The custodian also certified to the completeness and accuracy of $110,000 and $290,000 of net appreciation in fair value of investments and $195,000 and $75,000 of interest income related to the aforementioned investments for the years ended December 31, 20X1, and 20X0, respectively.

5.08

[*The following disclosure is appropriate when all or a portion of the investments and related investment income are certified.*]

Note X: Information Certified by the Trustee

The plan administrator has elected the method of compliance permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Accordingly, as permitted under such election, the plan administrator instructed the plan's independent auditors not to perform any auditing procedures with respect to the following information certified by ABC Bank, the trustee of the plan, as complete and accurate, except for comparing such information certified by the trustee with information included in the plan's financial statements and supplemental schedules:

a. Investments held and certified by ABC Bank:

	For the Year Ended December 31	
	20X2	*20X1*
Guaranteed investment fund	$ 230,522	$ 217,238
Diversified bond fund	8,956,988	7,032,488
Money market fund	173,470	1,014,596
Growth stock fund	12,510	9,426
Indexed stock fund	$9,386,200	$8,283,100

b. Investment income (loss) certified by ABC Bank:

	For the Year Ended December 31			
	20X2		*20X1*	
	Interest Income	*Net (Depreciation) Appreciation in Fair Value*	*Interest Income*	*Net (Depreciation) Appreciation in Fair Value*
Guaranteed investment fund	$12,108	$ —	$12,120	$ (18,888)
Diversified bond fund	—	1,242,404	—	(211,232)
Money market fund	—	56,958	—	36,014
Growth stock fund	—	3,084	—	8,778
Indexed stock fund	—	3,358	—	9,352
	$12,108	$1,305,804	$12,120	$(175,976)

AUDITOR'S REPORTS

1. Limited Scope Audit Reports

Standard Report

5.09

<u>Independent Auditor's Report</u>

[*Addressee*]

We were engaged to audit the financial statements and supplemental schedules of XYZ pension plan as of December 31, 20X2, and 20X1 and for the year ended December 31, 20X2, as listed in the accompanying index.[1] These financial statements and supplemental schedules are the responsibility of the plan's management.

As permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974, the plan administrator instructed us not to perform, and we did not perform, any auditing procedures with respect to the information summarized in note X, which was certified by ABC Bank, the trustee (or custodian) of the plan, except for comparing such information with the related information included in the financial statements and supplemental schedules. We have been informed by the plan administrator that the trustee (or custodian) holds the plan's investment assets and executes investment transactions. The plan administrator has obtained a certification from the trustee (or custodian) as of December 31, 20X2, and 20X1, and for the year ended December 31, 20X2, that the information provided to the plan administrator by the trustee (or custodian) is complete and accurate.

Because of the significance of the information that we did not audit, we are unable to, and do not, express an opinion on the accompanying financial statements and supplemental schedules taken as a whole. The form and content of the information included in the financial statements and supplemental schedules, other than that derived from the information certified by the trustee or custodian, have been audited by us in accordance with auditing standards generally accepted in the United States of America and, in our opinion, are presented in compliance with the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

[*Signature of Firm*]
[*City and State*]
[*Date*]

[1] If an index is not used, the first paragraph of the auditor's report would be as follows: We were engaged to audit the accompanying statements of net assets available for benefits of XYZ pension plan as of December 31, 20X2, and 20X1 and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2, and the statement of accumulated plan benefits as of December 31, 20X2, and 20X1 and the related statement of changes in accumulated plan benefits for the year ended December 31, 20X2, and the supplemental schedules of (1) Schedule H, line 4i—Schedule of Assets (Held at End of Year) and (2) Schedule H, line 4j—Schedule of Reportable Transactions. These financial statements and supplemental schedules are the responsibility of the plan's management.

Limited Scope Audit in Prior Year

5.10

The following illustrates a report on comparative financial statements of a 401(k) plan when the plan administrator elects not to limit the scope of the audit in the current year even though the scope of the audit in the prior year was limited in accordance with Department of Labor regulations.

5.11

Independent Auditor's Report

[*Addressee*]

We have audited the accompanying statements of net assets available for benefits of XYZ Company 401(k) plan as of December 31, 20X2, and 20X1 and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2. These financial statements are the responsibility of the plan's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

Except as explained in the following paragraph, we conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used, and significant estimates made, by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974, investment assets held by ABC Bank, the trustee of the plan, and transactions in those assets were excluded from the scope of our audit of the plan's 20X1 financial statements, except for comparing the information provided by the trustee, which is summarized in note X, with the related information included in the financial statements.

Because of the significance of the information that we did not audit, we are unable to, and do not, express an opinion on the plan's financial statements as of December 31, 20X1. The form and content of the information included in the 20X1 financial statements, other than that derived from the information certified by the trustee, have been audited by us and, in our opinion, are presented in compliance with the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

In our opinion, the financial statements referred to above of XYZ Company 401(k) plan as of December 31, 20X2, and for the year then ended present fairly, in all material respects, the net assets available for benefits of the plan as of December 31, 20X2, and the changes in net assets available for benefits for the year then ended in conformity with accounting principles generally accepted in the United States of America.

Our audit of the plan's financial statements as of and for the year ended December 31, 20X2, was made for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental schedules of [*identify*] are presented for the purpose of additional analysis and are not a required part of the basic financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. These supplemental schedules are the responsibility of the plan's management. The supplemental schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements for the year ended December 31, 20X2, and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

[*Signature of Firm*]
[*City and State*]
[*Date*]

Limited Scope Audit in Current Year

5.12

The following illustrates a report on comparative financial statements of a 401(k) plan when the plan administrator elects to exclude from the auditor's examination plan assets held by banks or insurance companies in the current year, whereas the scope of the audit in the prior year was unrestricted.

5.13

Independent Auditor's Report

[*Addressee*]

We were engaged to audit the accompanying statement of net assets available for benefits of XYZ Company 401(k) plan as of December 31, 20X2, and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2, and the supplemental schedules of (1) Schedule H, line 4i—Schedule of Assets (Held at End of Year), (2) Schedule H, line 4j—Schedule of Reportable Transactions, and (3) Schedule G, Part I—Schedule of Loans or Fixed Income Obligations in Default or Classified as Uncollectible as of or for the year ended December 31, 20X2. These financial statements and supplemental schedules are the responsibility of the plan's management.

As permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974, the plan administrator instructed us not to perform, and we did not perform, any auditing procedures with respect to the information summarized in note X, which was certified by ABC Bank, the trustee of the plan, except for comparing the information with the related information included in the 20X2 financial statements and the supplemental schedules. 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 trustee as of and for the year ended December 31, 20X2, that the information provided to the plan administrator by the trustee is complete and accurate.

Because of the significance of the information in the plan's 20X2 financial statements that we did not audit, we are unable to, and do not, express an opinion on the accompanying financial statements and supplemental schedules as of or for the year ended December 31, 20X2. The form and content of the information included in the financial statements and supplemental schedules, other than that derived from the information certified by the trustee, have been audited by us in accordance with auditing standards generally accepted in the United States of America and, in our opinion, are presented in compliance with the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

We have audited the statement of net assets available for benefits of XYZ Company 401(k) plan as of December 31, 20X1, and in our report dated May 20, 20X2, we expressed our opinion that such financial statement presents fairly, in all material respects, the net assets available for benefits of XYZ Company 401(k) plan as of December 31, 20X1, in conformity with accounting principles generally accepted in the United States of America.

[*Signature of Firm*]
[*City and State*]
[*Date*]

Modified Report—Omitted Information or Omitted Schedule Required Under Department of Labor Regulations in a Limited Scope Engagement

5.14

In the following illustration, the supplemental Schedule H, line 4i—Schedule of Assets (Held at End of Year) that accompanies the defined contributions plan's financial statements does not disclose that the plan has loans to participants. Because the omitted participant loan information is information that is not certified by the trustee or custodian, an omission of participant loan information would require that a qualified or adverse opinion be issued on the applicable supplemental schedules.

5.15

Independent Auditor's Report

[*Addressee*]

[*Same first and second paragraphs as the limited scope report.*]

The supplemental schedule, Schedule H, line 4i—Schedule of Assets (Held at End of Year) as of December 31, 20X2, that accompanies the plan's financial statements does not disclose that the plan has loans to participants which are considered assets held for investment purposes. Disclosure of this information is required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

Because of the significance of the information that we did not audit, we are unable to, and do not, express an opinion on the accompanying financial statements and schedules taken as a whole. The form and content of the information included in the financial statements and schedules, other than that derived from the information certified by the trustee, have been audited by us in accordance with auditing standards generally accepted in the United States of America and, in our opinion, except for the omission of the information discussed in the preceding paragraph, are presented in compliance with the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

[*Signature of Firm*]
[*City and State*]
[*Date*]

OR

5.16

In the following illustration, the plan has not presented the supplemental Schedule H, line 4j—Schedule of Reportable Transactions. Because the schedule of reportable transactions is information that is certified by the trustee or custodian, an omission of the schedule would require that an explanatory paragraph be added to the auditor's report.

5.17

Independent Auditor's Report

[*Addressee*]

[*Same first, second, and third paragraphs as the limited scope report.*]

The plan has not presented the supplemental Schedule H, line 4j—Schedule of Reportable Transactions for the year ended December 31, 20X2. Disclosure of this information is required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

[*Signature of Firm*]
[*City and State*]
[*Date*]

5.18

The following illustrates a limited scope audit in the current year with a comparative statement of net assets compiled. Cost information is missing from the supplemental schedules.

5.19

Independent Auditor's Report

The Trustees

Pictures, Inc., savings and investment plan:

We were engaged to audit the financial statements and supplemental schedules of Pictures, Inc., savings and investment plan (plan) as of and for the year ended December 31, 20X2, as listed in the accompanying index. These financial statements and supplemental schedules are the responsibility of the plan's management.

As permitted by Section 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974, the plan administrator instructed us not to perform, and we did not perform, any auditing procedures with respect to the information summarized in note X, which was certified by National Insurance Company, the custodian of the plan, except for comparing such information with the related information included in the financial statements and supplemental schedules. We have been informed by the plan administrator that the custodian holds the plan's investment assets and executes investment transactions. The plan administrator has obtained a certification from the custodian as of and for the year ended December 31, 20X2, that the information provided to the plan administrator by the custodian is complete and accurate.

Because of the significance of the information that we did not audit, we are unable to, and do not, express an opinion on the accompanying financial statements and schedules taken as a whole. The form and content of the information included in the financial statements and schedules, other than that derived from the information certified by the custodian, have been audited by us in accordance with auditing standards generally accepted in the United States of America and, in our opinion, is presented in compliance with the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

The supplemental Schedule H, line 4i—Schedule of Assets (Held at End of Year) that accompanies the plan's financial statements does not disclose the historical costs of certain nonparticipant directed plan assets held for investment purposes. Disclosure of this information is required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

We have compiled the accompanying statement of net assets available for benefits of the plan, as of December 31, 20X1, in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. A compilation is limited to presenting, in the form of financial statements, information that is the representation of management. We have not audited or reviewed the accompanying statement of net assets available for benefits and, accordingly, do not express an opinion or any other form of assurance on it.

[*Name of Firm*]
[*City and State*]
[*Date*]

Modified Cash Basis of Accounting

5.20

The financial statements and supplemental schedules were prepared on a modified cash basis of accounting.

5.21

Report of Independent Public Accountants

To the Administrative Committee of the pension plan of XYZ Corporation:

We were engaged to audit the accompanying financial statements (modified cash basis) and supplemental schedules (modified cash basis) of the pension plan of XYZ Corporation (the plan) as of and for the years ended December 31, 20X2, and 20X1, as listed in the accompanying index. These financial statements and schedules are the responsibility of the plan's management.

As permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974, the plan administrator instructed us not to perform, and we did not perform, any auditing procedures with respect to the information summarized in note X, which was certified by ABC Bank, the trustee of the plan, except for comparing such information with the related information included in the 20X2 and 20X1 financial statements and supplemental schedules. 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 trustee as of December 31, 20X2, and 20X1, and for the years then ended, that the information provided to the plan administrator by the trustee is complete and accurate.

As described in note Y, these financial statements and supplemental schedules were prepared on a modified cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles.

Because of the significance of the information that we did not audit, we are unable to, and do not, express an opinion on the accompanying financial statements and schedules taken as a whole. The form and content of the information included in the financial statements and schedules, other than that derived from the information certified by the trustee, have been audited by us in accordance with auditing standards generally accepted in the United States of America and, in our opinion, are presented in compliance with the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

[*Signature of Firm*]
[*City and State*]
[*Date*]

Plan Merger (With a Short Period)

5.22

Report of Independent Public Accountants

To the Compensation Committee of Lucky Company:

We were engaged to audit the accompanying financial statements and supplemental schedules of the Lucky Company employee savings plan as of January 31, 20X2, and December 31, 20X1, and 20X0 and from January 1, 20X2, to January 31, 20X2, and for the period ended January 31, 20X2, and for the year ended December 31, 20X1, as listed in the accompanying index. These financial statements and schedules are the responsibility of the plan's management.

As permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974, the plan administrator instructed us not to perform, and we did not perform, any auditing procedures with respect to the information summarized in note X, which was certified by ABC Bank, the trustee of the plan, except for comparing such information with the related information included in the 20X2, 20X1, and 20X0 financial statements and supplemental schedules. 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 certifications from the trustee for the period from January 1, 20X2, to January 31, 20X2, and for the year ended December 31, 20X1, that the information provided to the plan administrator by the trustee is complete and accurate.

As further discussed in note Y, the plan was merged into the Lucky Company deferred compensation plan effective January 31, 20X2.

Because of the significance of the information that we did not audit, we are unable to, and do not, express an opinion on the accompanying financial statements and schedules taken as a whole. The form and content of the information included in the financial statements and schedules, other than that derived from the information certified by the trustee, have been audited by us in accordance with auditing standards generally accepted in the United States of America and, in our opinion, are presented in compliance with the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

[*Signature of Firm*]
[*City and State*]
[*Date*]

Plan Termination

5.23

The following illustrates a limited scope audit report of a terminated plan.

5.24

<u>Report of Independent Public Accountants</u>

To the Advisory Committee of Sample Company pension plan:

We were engaged to audit the accompanying financial statements and supplemental schedules of Sample Company pension plan as of March 31, 20X1, and 20X0 and for the year ended March 31, 20X1, as listed in the accompanying index. These financial statements and schedules are the responsibility of the plan's management.

As permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974, the plan administrator instructed us not to perform, and we did not perform, any auditing procedures with respect to the information summarized in note X, which was certified by ABC Bank, the trustee of the plan, except for comparing such information with the related information included in the financial statements and supplemental schedules. 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 certifications from the trustee as of March 31, 20X1, and 20X0 and for the year ended March 31, 20X1, that the information provided to the plan administrator by the trustee is complete and accurate.

As further discussed in note Y, the company's board of directors elected to terminate the plan effective December 31, 20X0. In accordance with accounting principles generally accepted in the United States of America, the plan has changed its basis of accounting from the ongoing plan basis used in presenting the 20X0 financial statements to the liquidation basis used in presenting the 20X1 financial statements.

Because of the significance of the information that we did not audit, we are unable to, and do not, express an opinion on the accompanying financial statements and schedules taken as a whole. The form and content of the information included in the financial statements and schedules, other than that derived from the information certified by the trustee, have been audited by us in accordance with auditing standards generally accepted in the United States of America and, in our opinion, are presented in compliance with the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

[*Signature of Firm*]
[*City and State*]
[*Date*]

2. Prior Year Audited by Another Firm

Initial Limited Scope Audit in the Current Year With the Prior Year Limited Scope Audit Performed by Other Auditors

5.25

An example of an initial limited scope audit in the current year with the prior year limited scope audit performed by other auditors for a profit sharing plan follows.

5.26

Report of Independent Certified Public Accountants

To the ABC Company profit sharing plan and participants:

We were engaged to audit the accompanying statement of net assets available for benefits of ABC Company profit sharing plan (the plan) as of December 31, 20X2, and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2, and the supplemental Schedule H, line 4i—Schedule of Assets (Held at End of Year) as of December 31, 20X2. These financial statements and supplemental schedule are the responsibility of the plan's management. The financial statements of the plan as of December 31, 20X1, were audited by other auditors. As permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 (ERISA), the plan administrator instructed the other auditors not to perform, and they did not perform, any auditing procedures with respect to the information certified by the trustee. Their report, dated May 20, 20X2, indicated that (*a*) because of the significance of the information that they did not audit, they were unable to, and did not, express an opinion on the financial statements taken as a whole, and (*b*) the form and content of the information included in the financial statements, other than that derived from the information certified by the trustee, were presented in compliance with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

As permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974, the plan administrator instructed us not to perform, and we did not perform, any auditing procedures with respect to the information summarized in note E, which was certified by Bank & Trust Company, the trustee of the plan, except for comparing such information with the related information included in the 20X2 financial statements and supplemental schedule. 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 trustee as of and for the year ended December 31, 20X2, that the information provided to the plan administrator by the trustee is complete and accurate.

Because of the significance of the information in the plan's 20X2 financial statements and supplemental schedule that we did not audit, we are unable to, and do not, express an opinion on the accompanying 20X2 financial statements and supplemental schedule taken as a whole. The form and content of the information included in the 20X2 financial statements and supplemental schedule, other than that derived from the information certified by the trustee, have been audited by us in accordance with auditing standards generally accepted in the United States of America and, in our opinion, are presented in compliance with the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

[*Signature of Firm*]
[*City and State*]
[*Date*]

5.27

The following illustrates a full scope audit in the current year and limited scope in the prior year with reference made to the report of the prior auditor.

5.28

Independent Auditor's Report

To the Cookie Company savings and investment plan and participants:

We have audited the accompanying statement of net assets available for benefits of the Cookie Company savings and investment plan as of December 31, 20X2, and the statement of changes in net assets available for benefits for the year then ended. These financial statements are the responsibility of the plan's management. Our responsibility is to express an opinion on these financial statements based on our audit. Other auditors were engaged to audit the financial statements for the year ended December 31, 20X1. Their report dated May 21, 20X2, disclaimed an opinion on the 20X1 financial statements, as permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits as of December 31, 20X2, and the changes in net assets available for benefits for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedules of (1) Schedule H, line 4i—Schedule of Assets (Held at End of Year) and (2) Schedule H, line 4j—Schedule of Reportable Transactions are presented for the purpose of additional analysis and are not a required part of the basic financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. The supplemental schedules are the responsibility of the plan's management. Such supplemental schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

[*Signature of Firm*]
[*City and State*]
[*Date*]

3. Change in Trustee

5.29

An example of an auditor's report reflecting a change in trustee for a pension plan follows.

5.30

Report of Independent Certified Public Accountants

To the XYZ pension plan and participants:

We were engaged to audit the accompanying statements of net assets available for benefits and of accumulated plan benefits of XYZ pension plan as of December 31, 20X2 and 20X1, and the related statements of changes in net assets available for benefits and of changes in accumulated plan benefits for the year ended December 31, 20X2, and the supplemental schedules of (1) Schedule H, line 4i—Schedule of Assets (Held at End of Year) as of December 31, 20X2, and (2) Schedule H, line 4j—Schedule of Reportable Transactions for the year ended December 31, 20X2. These financial statements and schedules are the responsibility of the plan's management.

As permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974, the plan administrator instructed us not to perform, and we did not perform, any auditing procedures with respect to the investment information summarized in note X, which was certified by the ABC Bank and XYZ Trust Company, the trustees of the plan, except for comparing such information with the related information included in the financial statements and supplemental schedules. We have been informed by the plan administrator that XYZ Trust Company held the plan's investment assets and executed investment transactions from July 1, 20X2, to December 31, 20X2, and that ABC Bank held the plan's investment assets and executed investment transactions as of December 31, 20X1, and for the period from January 1, 20X1, to June 30, 20X2. The plan administrator has obtained certifications from the trustees as of and for the years ended December 31, 20X2, and 20X1 that the information provided to the plan administrator by the trustees is complete and accurate.

Because of the significance of the information that we did not audit, we are unable to, and do not, express an opinion on the accompanying financial statements and supplemental schedules taken as a whole. The form and content of the information included in the financial statements and supplemental schedules, other than that derived from the investment information certified by the trustees, have been audited by us in accordance with auditing standards generally accepted in the United States and, in our opinion, are presented in compliance with the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

[*Signature of Firm*]
[*City and State*]
[*Date*]

SECTION 6: INDEPENDENT AUDITOR'S REPORTS

6.01

This section provides examples of auditor's reports on employee benefit plan financial statements that have been performed in accordance with generally accepted auditing standards (GAAS). Issuers, such as Form 11-K filers, should instead refer to "the standards of the Public Company Accounting Oversight Board (United States)," in accordance with Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 1, *References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board* (AICPA, *PCAOB Standards and Related Rules*, Auditing Standards). See "Audits of Issuers, Such as Form 11-K Filers" of this section for an illustration of an audit opinion under Auditing Standard No. 1.

AUDIT REPORTS FOLLOWING TWO SETS OF STANDARDS

Securities and Exchange Commission Requirements

6.02

The Securities and Exchange Commission (SEC) requires employee stock purchase, savings, and similar plans with interests that constitute securities registered under the Securities Act of 1933 to file Form 11-K, pursuant to Section 15(d) of the Securities Exchange Act of 1934. Reports on Form 11-K must be filed with the SEC within 90 days after the end of the fiscal year of the plan, provided that plans subject to the Employee Retirement Income Security Act of 1974 (ERISA), as amended, file the plan financial statements within 180 days after the plan's fiscal year-end.

Applicable Audit Standards

6.03

Plans that are required to file Form 11-K are deemed to be issuers under the Sarbanes-Oxley Act of 2002 (SOX) and must submit to the SEC an audit, in accordance with the auditing and related professional practice standards promulgated by the PCAOB. These plans also may be subject to ERISA and must submit to the U.S. Department of Labor (DOL) an audit, in accordance with GAAS promulgated by the AICPA's Auditing Standards Board. It is our understanding that the SEC will not accept an audit report that references GAAS, and the DOL will not accept an audit report that does not reference GAAS.

Performance and Reporting Requirements

6.04

Based on AICPA staff discussions with the SEC and PCAOB staff to seek clarification of the performance and reporting requirements for audits of Form 11-K filers, firms will need to conduct their audits of these Form 11-K plans in accordance with two sets of standards and prepare two separate audit reports: an audit report referencing PCAOB standards for Form 11-K filings with the SEC and a separate audit report referencing GAAS for DOL filings. The PCAOB and SEC staff believe that an opinion issued in accordance with Auditing Standard No. 1 does not allow a reference to GAAS; hence, a dual standard report is not appropriate and will not be accepted by the SEC.

6.05

Any questions regarding performance and reporting requirements of audits of financial statements of Form 11-K filers should be directed to the SEC Division of Corporation Finance, Office of the Chief Accountant at (202) 942-2960.

INTERPRETATION NO. 17 (AUDIT OF NONISSUERS)

6.06

Interpretation No. 17, "Clarification in the Audit Report of the Extent of Testing of Internal Control Over Financial Reporting in Accordance With Generally Accepted Auditing Standards," of AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 9508 par. .85-.88), allows the following language to be added to the auditor's standard report (full scope audits of nonissuers) to clarify that an audit performed in accordance with GAAS does not require the same level of testing and reporting on internal control over financial reporting as an audit of an issuer when Section 404(b) of SOX is applicable:

6.07

Independent Auditor's Report

[*Same first paragraph as the standard report*]

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. *An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion.* An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

[*Same opinion paragraph as the standard report*]

6.08

The illustrative opinions in this section include this optional language.

1. UNQUALIFIED OPINIONS

Unqualified Opinion on the Financial Statements of a Profit Sharing Plan (Chapter 13 paragraphs .06 and .11 of the Audit and Accounting Guide Employee Benefit Plans*)*

6.09

Independent Auditor's Report

[*Addressee*]

We have audited the accompanying statements of net assets available for benefits of ABC Company Profit-Sharing Plan as of December 31, 20X2 and 20X1, and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. [*Optional: An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we express no such opinion.*] An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the Plan as of December 31, 20X2 and 20X1, and the changes in net assets available for benefits for the year ended December 31, 20X2 in conformity with accounting principles generally accepted in the United States of America.

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedules of *[identify title of schedules and period covered]* are presented for the purpose of additional analysis and are not a required part of the basic financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. These supplemental schedules are the responsibility of the Plan's management. The supplemental schedules have been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.[1]

[*Signature of Firm*]
[*City and State*]
[*Date*]

Unqualified Opinion on the Financial Statements of Defined Benefit Pension Plan, Assuming End-of-Year Benefit Information Date (Chapter 13 paragraph .04 of the Audit and Accounting Guide Employee Benefit Plans*)*

6.10

Independent Auditor's Report

[*Addressee*]

We have audited the accompanying statements of net assets available for benefits and of accumulated plan benefits of XYZ Pension Plan as of December 31, 20X2 and 20X1, and the related statements of changes in net assets available for benefits and of changes in accumulated plan benefits for the year ended December 31, 20X2. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. [*Optional: An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we express no*

[1] This paragraph on the supplemental schedules is required by the Employee Retirement Income Security Act of 1974, and Department of Labor regulations also may be shown separately in the auditor submitted document.

such opinion.] An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial status of the Plan as of December 31, 20X2 and 20X1, and the changes in its financial status for the year ended December 31, 20X2, in conformity with accounting principles generally accepted in the United States of America.

[*Signature of Firm*]
[*City and State*]
[*Date*]

Unqualified Opinion on the Financial Statements of Defined Benefit Pension Plan, Assuming Beginning-of-Year Benefit Information Date (Chapter 13 paragraph .05 of the Audit and Accounting Guide Employee Benefit Plans*)*

6.11

Independent Auditor's Report

[*Addressee*]

We have audited the accompanying statements of net assets available for benefits of XYZ Pension Plan as of December 31, 20X2 and 20X1, and the related statements of changes in net assets available for benefits for the years then ended and the statement of accumulated plan benefits as of December 31, 20X1, and the related statement of changes in accumulated plan benefits for the year then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. [*Optional: An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we express no such opinion.*] An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, information regarding the Plan's net assets available for benefits as of December 31, 20X2, and changes therein for the year then ended and its financial status as of December 31, 20X1, and changes therein for the year then ended in conformity with accounting principles generally accepted in the United States of America.

[*Signature of Firm*]
[*City and State*]
[*Date*]

Unqualified Opinion on the Financial Statements of an Employee Health and Welfare Benefit Plan (Chapter 13 paragraph .07 of the Audit and Accounting Guide **Employee Benefit Plans***)*

6.12

Independent Auditor's Report

[*Addressee*]

We have audited the accompanying statements of net assets available for benefits and of plan benefit obligations of Allied Industries Benefit Plan as of December 31, 20X2 and 20X1, and the related statements of changes in net assets available for benefits and of changes in benefits obligations for the year ended December 31, 20X2, These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. [*Optional: An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Plan's internal control over financial reporting. Accordingly, we express no such opinion.*] An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial status of the Plan as of December 31, 20X2 and 20X1, and the changes in its financial status for the year ended December 31, 20X2 in conformity with accounting principles generally accepted in the United States of America.

[*Signature of Firm*]
[*City and State*]
[*Date*]

Terminated Plan

6.13

Independent Auditor's Report

[*Addressee*]

We have audited the accompanying statements of net assets available for plan benefits of the GHI Company pension plan as of February 5, 20X2, and March 31, 20X1, and the related statement of changes in net assets available for plan benefits for the period ended February 5, 20X2. These financial statements are the responsibility of the plan's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for plan benefits of the GHI Company pension plan as of February 5, 20X2, and March 31, 20X1, and the changes in net assets available for plan benefits for the period ended February 5, 20X2, in conformity with accounting principles generally accepted in the United States of America.

As discussed in note Y to the accompanying financial statements, the plan has been terminated, and all assets of the plan have been distributed. In accordance with accounting principles generally accepted in the United States of America, the financial statements are presented on the liquidation basis of accounting.

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedule of Schedule H, line 4j—Schedule of Reportable Transactions is presented for purposes of additional analysis and is not a required part of the basic financial statements but is supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. The supplemental schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

[*Signature of Firm*]
[*City and State*]
[*Date*]

Terminating Plan—Defined Benefit Plan

6.14

The following is an illustration of the explanatory paragraph when the auditor wishes to emphasize that a plan sponsor voted to terminate the plan.

6.15

Independent Auditor's Report

[*Addressee*]

[*Same first, second, and third paragraphs as the standard report.*]

As further discussed in notes A and B to the financial statements, the board of directors of XYZ Company, the plan's sponsor, voted on November 9, 20X2, to terminate the plan. In accordance with accounting principles generally accepted in the United States of America, the plan has changed its basis of accounting used to determine the amounts at which investments in insurance contracts and the accumulated benefit information are stated, from the ongoing plan basis used in presenting the 20X1 financial statements to the liquidation basis used in presenting the 20X2 financial statements.

Terminating Plan—Defined Contribution Plan

6.16

The following is an illustration of the explanatory paragraph when the auditor wishes to emphasize that a plan sponsor voted to terminate the plan.

6.17

Independent Auditor's Report

[*Addressee*]

[*Same first, second, and third paragraphs as the standard report.*]

As further discussed in notes A and B to the financial statements, the board of directors of XYZ Company, the plan's sponsor, voted on November 9, 20X2, to terminate the plan. In accordance with accounting principles generally accepted in the United States of America, the plan has changed its basis of accounting from the ongoing plan basis used in presenting the 20X1 financial statements to the liquidation basis used in presenting the 20X2 financial statements.

Modified Cash Basis

6.18

The financial statements and supplemental schedules were prepared on a modified cash basis of accounting. A full scope audit was performed.

6.19

Report of Independent Public Accountants

To the Administrative Committee of the pension plan of XYZ Corporation:

We have audited the accompanying statements of net assets available for benefits (modified cash basis) of XYZ pension plan as of December 31, 20X2, and 20X1 and the related statement of changes in net assets available for benefits (modified cash basis) for the year ended December 31, 20X2. These financial statements are the responsibility of the plan's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in note X, these financial statements and supplemental schedules were prepared on a modified cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits and the accumulated plan benefits of XYZ pension plan as of December 31, 20X2, and 20X1 and the changes in net assets available for benefits and changes in accumulated plan benefits for the year ended December 31, 20X2, on the basis of accounting described in note X.

Our audits were performed for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental schedules (modified cash basis) of [*identify title of schedules and period covered*] are presented for the purpose of additional analysis and are not a required part of the basic financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. These supplemental schedules are the responsibility of the plan's management. The supplemental schedules have been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

[*Signature of Firm*]
[*City and State*]
[*Date*]

Reporting on the Financial Statements of a Trust Established Under a Plan

6.20

Under both Financial Accounting Standards Board *Accounting Standards Codification* 960, *Plan Accounting—Defined Benefit Pension Plans,* and the Employee Retirement Income Security Act of 1974, as amended, the reporting entity is the employee benefit plan. However, the plan administrator may engage an independent auditor to report on the financial statements of a trust established under a plan. The full scope auditing procedures would apply to such audits. Users of the financial statements of the trust may not be aware of the distinction between the trust and the plan. Therefore, when reporting on such a trust, the auditor's report explains that the financial statements of the trust do not purport to present the financial status or changes in financial status of the plan, in accordance with generally accepted accounting principles, and that the financial statements do not purport to satisfy the Department of Labor reporting and disclosure requirements. The following is an example of the auditor's report on the financial statements of a trust established under an employee benefit plan.

6.21

Report of Independent Public Accountants

To the Administrative Committee of ABC pension trust:

We have audited the accompanying statement of net assets of ABC pension trust as of December 31, 20X2, and the related statement of changes in net assets and trust balance for the year then ended. These financial statements are the responsibility of the trust's management. Our responsibility is to express an opinion on these financial statements, based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets of ABC pension trust as of December 31, 20X2, and the changes in its net assets and trust balance for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

The accompanying statements are those of ABC pension trust, which is established under XYZ pension plan; the statements do not purport to present the financial status of XYZ pension plan. The statements do not contain certain information on accumulated plan benefits and other disclosures necessary for a fair presentation of the financial status of XYZ pension plan, in conformity with accounting principles generally accepted in the United States of America. Furthermore, these statements do not purport to satisfy the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 relating to the financial statements of employee benefit plans.

[*Signature of Firm*]
[*City and State*]
[*Date*]

2. SUPPLEMENTAL SCHEDULES

Modified Report—Omitted Information or Omitted Schedule Required Under Department of Labor Regulations

6.22

The following are illustrations of paragraphs added to the auditor's report when the auditor modifies his or her report on the supplemental schedules because of omitted information or an omitted schedule that is required under Department of Labor regulations. (Chapter 13 paragraph .16 of the Audit and Accounting Guide *Employee Benefit Plans*)

6.23

Independent Auditor's Report

[*Addressee*]

[*Same first, second, and third paragraphs as the standard report.*]

Our audits were performed for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental schedules of [*identify title of schedules and period covered*] are presented for the purpose of additional analysis and are not a required part of the basic financial statements, but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. These supplemental schedules are the responsibility of the Plan's management. The supplemental schedules have been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The supplemental Schedule H, line 4i—Schedule of Assets (Held at End of Year) as of December 31, 20X2 that accompanies the Plan's financial statements does not disclose the historical cost of certain nonparticipant directed plan assets held by the Plan trustee [or custodian]. Disclosure of this information is required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

OR

6.24

The Plan has not presented the supplemental Schedule H, line 4j—Schedule of Reportable Transactions for the year ended December 31, 20X2. Disclosure of this information is required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

[*Signature of Firm*]
[*City and State*]
[*Date*]

Qualified Opinion—Omitted or Incomplete Schedule or Material Inconsistency

6.25

The following are examples of paragraphs added to the auditor's report when the auditor qualifies his or her opinion on the supplemental schedules because a schedule, or information thereon, was omitted (when the schedules are not covered by a trustee's certification about completeness and accuracy) or because information in a required schedule is materially inconsistent with the financial statements.

6.26

Independent Auditor's Report

[*Addressee*]

[*Same first, second, and third paragraphs as the standard report.*]

The supplemental Schedule H, line 4i—Schedule of Assets (Held at End of Year) that accompanies the plan's financial statements does not disclose that the plan had loans to participants which are considered assets held for investment purposes. Disclosure of this information is required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

Our audits were performed for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental schedules of [*identify title of schedules and period covered*] are presented for the purpose of additional analysis and are not a required part of the basic financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. These supplemental schedules are the responsibility of the plan's management. The supplemental schedules have been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, except for the omission of the information discussed in the preceding paragraph, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

[*Signature of Firm*]
[*City and State*]
[*Date*]

3. PROHIBITED TRANSACTIONS

Qualified Opinion—Disclosure of Material Prohibited Transaction With Party in Interest Omitted

6.27

The following illustrates an auditor's report on the plan's financial statements when the auditor concludes that the plan has entered into a prohibited transaction with a party in interest that also is considered a related party transaction and (1) is material to the financial statements, (2) the transaction has not been properly disclosed in the notes to the financial statements and the supplemental schedule, and (3) the auditor expresses a qualified opinion on the financial statements and supplemental schedule.

6.28

Independent Auditor's Report

[*Addressee*]

We have audited the accompanying statements of net assets available for benefits of XYZ Company profit sharing plan as of December 31, 20X2, and 20X1 and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2. These financial statements are the responsibility of the plan's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The plan's financial statements do not disclose that the plan [*describe related party transaction*]. Disclosure of this information is required by accounting principles generally accepted in the United States of America.

In our opinion, except for the omission of the information discussed in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the plan as of December 31, 20X2, and 20X1 and the changes in net assets available for benefits for the year ended December 31, 20X2, in conformity with accounting principles generally accepted in the United States of America.

The supplemental Schedule G, Part III—Schedule of Nonexempt Transactions that accompanies the plan's financial statements does not disclose that the plan [*describe prohibited transaction*]. Disclosure of this information is required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

Our audits were performed for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental schedules of [*identify title of schedules and period covered*] are presented for the purpose of additional analysis and are not a required part of the basic financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. These supplemental schedules are the responsibility of the plan's management. The supplemental schedules have been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, except for the omission of the information discussed in the preceding paragraph, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

[*Signature of Firm*]
[*City and State*]
[*Date*]

Adverse Opinion—Disclosure of Material Prohibited Transaction With Party in Interest Omitted

6.29

The following illustrates an auditor's report when the auditor decides that an adverse opinion is to be expressed on the supplemental schedules because disclosure of a material prohibited transaction with a party in interest is omitted. (Chapter 13 paragraph .17 of the Audit and Accounting Guide *Employee Benefit Plans*)

6.30

Independent Auditor's Report

[*Addressee*]

[*Same first, second, and third paragraphs as the standard report.*]

The supplemental Schedule G, Part III—Schedule of Nonexempt Transactions that accompanies the plan's financial statements does not disclose that the Plan [*describe prohibited transaction*]. Disclosure of this information is required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

Our audits were performed for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental schedules of [*identify title of schedules and period covered*] are presented for the purpose of additional analysis and are not a required part of the basic financial statements, but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. These supplemental schedules are the responsibility of the Plan's management. The supplemental schedules have been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, because of the omission of the information discussed in the preceding paragraph are not fairly stated in all material respects in relation to the basic financial statements taken as a whole.

[*Signature of Firm*]
[*City and State*]
[*Date*]

Modified Report—Disclosure of Immaterial Prohibited Transaction With Party in Interest Omitted

6.31

The following are examples of paragraphs added to the auditor's report on the plan's financial statements when the auditor decides to modify his or her report on the supplemental schedules because disclosure of a prohibited transaction with a party in interest that is not material to the financial statements has been omitted. (Chapter 13 paragraph .17 of the Audit and Accounting Guide *Employee Benefit Plans*)

6.32

Independent Auditor's Report

[*Addressee*]

[*Same first, second, and third paragraphs as the standard report.*]

Our audits were performed for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental schedules of [*identify title of schedules and period covered*] are presented for the purpose of additional analysis and are not a required part of the basic financial statements, but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. These supplemental schedules are the responsibility of the Plan's management. The supplemental schedules have been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The supplemental Schedule G, Part III—Schedule of Nonexempt Transactions that accompanies the plan's financial statements does not disclose that the Plan [*describe prohibited transaction*]. Disclosure of this information, which is not considered material to the financial statements taken as a whole, is required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

[*Signature of Firm*]
[*City and State*]
[*Date*]

4. GOING CONCERN

6.33

Independent Auditor's Report

The Administrative Committee, Dagobar Incorporated Past Services defined benefit plan:

We have audited the accompanying financial statements of the Dagobar Incorporated Past Services defined benefit plan as of December 31, 20X2, and 20X1 and for the years then ended listed in the foregoing table of contents. These financial statements and the supplemental schedules discussed below are the responsibility of the plan's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such financial statements referred to above present fairly, in all material respects, the financial status of the plan as of December 31, 20X2, and 20X1 and the changes in its financial status for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

As discussed in note X to the financial statements, Dagobar Incorporated (the plan sponsor) has filed for reorganization under the protection of Chapter 11 of the United States Bankruptcy Code, and at December 31, 20X2, the plan's net assets available for benefits were less than the actuarial present value of accumulated plan benefits. As a result of the plan sponsor's bankruptcy filing, the continuation of the plan is uncertain. The financial statements do not include any adjustments that might result from this uncertainty.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedules for 20X2, listed in the foregoing table of contents, are presented for purposes of additional analysis and are not a required part of the basic financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. The supplemental schedules have been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, are fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

[*Signature of Firm*]
[*City and State*]
[*Date*]

6.34

The following illustrates an auditor's report when the auditor concludes that there is substantial doubt about the plan's ability to continue as a going concern.

6.35

Independent Auditor's Report

To the trustees of DEF Hospital employees' pension plan:

We have audited the accompanying statements of assets available for plan benefits of DEF Hospital employees' pension plan (the plan) as of December 31, 20X2, and 20X1 and the related statements of changes in assets available for plan benefits for the years then ended. These financial statements are the responsibility of the plan's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the assets available for plan benefits of DEF Hospital employees' pension plan as of December 31, 20X2, and 20X1 and the changes in assets available for plan benefits for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental Schedule H, line 4i—Schedule of Assets (Held at End of Year) as of December 31, 20X2, is presented for purposes of additional analysis and is not a required part of the basic financial statements but is supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. This supplementary schedule is the responsibility of the plan's management. The supplemental schedule has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

The accompanying financial statements and supplemental schedule have been prepared assuming that DEF Hospital (hospital), the plan's sponsor, will continue as a going concern. Our report on the December 31, 20X2, financial statements of the hospital was issued under the date of April 5, 20X3, and stated that the hospital's recurring losses from operations and a partners' deficit raise substantial doubt about the hospital's ability to continue as a going concern. On December 23, 20X0, the hospital filed a petition for relief under Chapter 11 of the federal bankruptcy laws in the United States Bankruptcy Court, Eastern District of New York. The uncertainty regarding the hospital's ability to continue as a going concern raises substantial doubt about the plan's continuation. Should the plan be terminated, the terms discussed in note X(e) would be applicable. The financial statements and supplemental schedule do not include any adjustments that might result from the outcome of this uncertainty.

The schedule of assets held for investment purposes at end of year that accompanies the plan's financial statements does not disclose the historical cost of certain nonparticipant directed plan assets held by the plan custodian. Disclosure of this information is required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

The plan has not presented the schedule of reportable transactions (transaction or series of transactions in excess of 5 percent of the current value of plan assets at the beginning of the year). Disclosure of this information is required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

[*Signature of Firm*]
[*City, State*]
[*Date*]

5. PRIOR YEAR AUDITED BY ANOTHER FIRM

Reference Made to Report of Prior Auditor—Prior Year and Current Year Are Full Scope

6.36

Independent Auditor's Report

To the trustee of Alpha Inc. profit sharing plan:

We have audited the accompanying statement of net assets available for plan benefits of Alpha Inc. profit sharing plan and trust (plan) as of December 31, 20X2, and the related statement of changes in net assets available for plan benefits for the year then ended. These financial statements are the responsibility of the trustee and plan administrator of the plan. Our responsibility is to express an opinion on these financial statements, based upon our audit. The financial statements of the plan as of December 31, 20X1, were audited by other auditors whose report dated May 15, 20X2, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. These standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for plan benefits of the plan as of December 31, 20X2, and the changes in net assets available for plan benefits for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedules of [*identify title of schedules and period covered*] are presented for the purpose of additional analysis and are not a required part of the basic financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. These supplemental schedules are the responsibility of the plan's management. The supplemental schedules have been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, are fairly stated in all material respects in relation to the basic financial statements taken as a whole.

[*Signature of Firm*]
[*City, State*]
[*Date*]

6. INITIAL AUDITS

6.37

Independent Auditor's Report

To the Twinkle Company savings plan for certain eligible employees:

We have audited the accompanying statement of net assets available for benefits of the Twinkle Company savings plan for certain eligible employees (plan) as of December 31, 20X2, and related statement of changes in net assets available for benefits for the year then ended. These financial statements are the responsibility of the plan's management. Our responsibility is to express an opinion on these financial statements, based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, such financial statements present fairly, in all material respects, the net assets available for benefits of the plan as of December 31, 20X2, and the changes in net assets available for benefits for the year then ended, in conformity with accounting principles generally accepted in the United States of America.

Our audit was performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental Schedule H, line 4i—Schedule of Assets (Held at End of Year) as of December 31, 20X2, and supplemental Schedule H, line 4j—Schedule of Reportable Transactions for the year ended December 31, 20X2, are presented for the purpose of additional analysis and are not a required part of the basic financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. These supplemental schedules are the responsibility of the plan's management. The supplemental schedules have been subjected to the auditing procedures applied in our audit of the basic financial statements and, in our opinion, are fairly stated in all material respects when considered in relation to the basic financial statements taken as a whole.

[*Signature of Firm*]
[*City and State*]
[*Date*]

6.38

<u>Independent Auditor's Report</u>

To the Star Corporation Investment Committee:

We have audited the accompanying statement of net assets available for plan benefits of the Star Corporation employees' savings and profit sharing plan (plan) as of December 31, 20X2, and the related statement of changes in net assets available for plan benefits for the period from June 15, 20X2 (inception) to December 31, 20X2. These financial statements are the responsibility of the plan's management. Our responsibility is to express an opinion on these financial statements, based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for plan benefits of the plan at December 31, 20X2, and the changes in net assets available for plan benefits for the period from June 15, 20X2 (inception) to December 31, 20X2, in conformity with accounting principles generally accepted in the United States of America.

Our audit was made for the purpose of forming an opinion on the financial statements taken as a whole. The supplemental Schedule H, line 4i—Schedule of Assets (Held at End of Year) as of December 31, 20X2, and supplemental Schedule H, line 4j—Schedule of Reportable Transactions for the period from June 15, 20X2 (inception) to December 31, 20X2, are presented for purposes of additional analysis and are not a required part of the basic financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. These supplemental schedules are the responsibility of the plan's management. The supplemental schedules have been subjected to the auditing procedures applied in our audit of the financial statements and, in our opinion, are fairly stated in all material respects in relation to the financial statements taken as a whole.

[*Signature of Firm*]
[*City and State*]
[*Date*]

7. AUDITS OF ISSUERS, SUCH AS FORM 11-K FILERS

6.39

Generally, plans that are required to file Form 11-K would be considered issuers. Accordingly, public accounting firms registered with the Public Company Accounting Oversight Board (PCAOB) should adhere to all PCAOB standards in the audits of issuers. Auditing Standard No. 1, *References in Auditors' Reports to the Standards of the Public Company Accounting Oversight Board* (AICPA, *PCAOB Standards and Related Rules*, Auditing Standards), provides guidance on the auditors' report for an audit of an issuer. The following is an example of an opinion for a Form 11-K audit. (When also reporting on the supplemental schedules, see chapter 13 paragraph .11 of the Audit and Accounting Guide *Employee Benefit Plans* for guidance.)

6.40

Report of Independent Registered Public Accounting Firm

To participants and administrator of the ABC 401(k) plan:

We have audited the accompanying statements of net assets available for benefits of the ABC 401(k) plan (plan) as of December 31, 20X2, and 20X1 and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2. These financial statements are the responsibility of the plan's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the plan as of December 31, 20X2, and 20X1 and the changes in net assets available for benefits for the year ended December 31, 20X2, in conformity with U.S. generally accepted accounting principles.

8. 403(B) PLANS

6.41

In November 2007, the Department of Labor (DOL) issued amended regulations eliminating an exemption granted to 403(b) plans from annual Form 5500 reporting, disclosure, and audit requirements under Title I of the Employee Retirement Income Security Act (ERISA) of 1974, as amended. The removal of this exemption subjects ERISA-covered 403(b) plans to the same Form 5500 reporting and audit requirements as 401(k) plans, effective with their 2009 Form 5500 filings. A 403(b) plan generally will be covered under ERISA if there are employer contributions or employer involvement in the plan exceeds the limitations permitted under the DOL's safe harbor regulations (see also DOL Field Assistance Bulletin [FAB] No. 2010-01, *Annual Reporting and ERISA Coverage for 403(b) Plans*, for specific questions and answers [Q&As] addressing the DOL's safe harbor regulations).

6.42

On July 20, 2009, the DOL issued FAB No. 2009-02, *Annual Reporting Requirements for 403(b) Plans*, to provide certain transition relief for administrators of 403(b) plans that make good faith efforts to transition for the 2009 plan year to ERISA's generally applicable annual reporting requirements. DOL FAB No. 2009-02 was intended to address concerns over the DOL's enforcement of incomplete filings, which would be subject to rejection due to the inability to identify all participant accounts to be included in plan assets. DOL FAB No. 2009-02 states that the DOL will not reject a 403(b) plan Form 5500 filing on the basis of a qualified, adverse, or disclaimer of opinion if the accountant expressly states that the sole reason for such an opinion was because such pre-2009 contracts were not covered by the audit or included in the plan's financial statements. In February 2010, the DOL issued FAB No. 2010-01, which supplements DOL FAB No. 2009-02 and addresses questions the DOL received concerning the scope of FAB No. 2009-02 and the safe harbor regulations at 29 CFR 2510.3-2(f). DOL FAB No. 2010-01 addresses, among other things, the plan administrator's responsibility to determine whether the conditions of DOL FAB No. 2009-02 have been satisfied with respect to excluded contracts from the plan's annual report. The full text of DOL FAB Nos. 2009-02 and 2010-01 are available at www.dol.gov/ebsa/regs/fab2009-2.html and www.dol.gov/ebsa/regs/fab2010-1.html, respectively.

6.43

DOL FAB No. 2009-02 allows a plan administrator of a 403(b) plan to exclude certain contracts and accounts from plan assets for purposes of ERISA's annual reporting requirements under certain specified conditions. The following Q&A is intended to help the auditor make his or her determination of the form of report to be issued when the plan administrator has chosen to exclude certain contracts or accounts from plan assets.

Practice Tip:

For further guidance related to 403(b) plans, readers are encouraged to visit the AICPA Employee Benefit Plan Audit Quality Center 403(b) Plan Resource Center at http://ebpaqc.aicpa.org/Resources/Accounting+and+Auditing+Resource+Centers/403%28b%29+Plans.htm.

6.44

Inquiry—DOL FAB No. 2009-02 allows a plan administrator of a 403(b) plan to exclude certain contracts and accounts from plan assets for purposes of ERISA's annual reporting requirements under certain specified conditions. U.S. generally accepted accounting principles (GAAP) require inclusion of these contracts and accounts as plan assets in the plan's financial statements. If a plan excludes from the financial statements certain contracts and accounts as defined under DOL FAB No. 2009-02, what are the implications for the auditor's report?

6.45

Reply—The implications to the type of report will depend on the auditor's professional judgment of whether the auditor believes sufficient appropriate audit evidence has been obtained to form an opinion on the financial statements. If circumstances allow the auditor to perform a generally accepted auditing standards (GAAS) audit and, thereby, obtain sufficient appropriate audit evidence to form an opinion, then the auditor would likely express a qualified or adverse opinion. However, if the auditor is unable to obtain sufficient appropriate audit evidence to form an opinion, the auditor's scope would be restricted, and the auditor may need to qualify or disclaim an opinion.

6.46

In either case, the U.S. GAAP departure would be disclosed in the auditor's report.

Illustrative Reports

6.47

The following example auditor's reports illustrate three different fact patterns that might occur related to 403(b) plans. These illustrative auditor's reports are specific to the stated circumstances. In deciding the type of report to issue, auditors must apply their professional judgment to their specific facts and circumstances and refer to authoritative pronouncements.

Illustration 1: Disclaimer of Opinion

6.48

Fact Pattern: The following is an example of an auditor's report for a first year audit of a 403(b) plan. The plan administrator has elected to exclude certain contracts and accounts from plan assets, as permitted by DOL FAB No. 2009-02, and the plan administrator is not able to determine the amounts of the excluded contracts or whether the amounts of the excluded contracts are material because no records relating to the excluded contracts exist. In this situation, the auditor has concluded to issue a disclaimer of opinion due to the limitation on the scope of the audit because the auditor is unable to obtain sufficient appropriate audit evidence to form an opinion on the financial statements. (See paragraphs .61–.63 of AU section 508, Reports on Audited Financial Statements *[AICPA,* Professional Standards*, vol. 1], for guidance on disclaimers of opinion.)*

Note: *Paragraph .10 of AU section 551 A,* Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents *(AICPA,* Professional Standards*, vol.1), states that when the auditor expresses an adverse opinion or disclaims an opinion, on the basic financial statements, he should not express the opinion described in paragraph .06 of AU section 551A on any accompanying information.*[2]

Independent Auditor's Report

[*Addressee*]

We were engaged to audit the accompanying statements of net assets available for benefits of XYZ Company 403(b) plan as of December 31, 2009, and 2008 and the related statement of changes in net assets available for benefits for the year ended December 31, 2009. These financial statements are the responsibility of the plan's management.

The plan has not maintained sufficient accounting records and supporting documents relating to certain annuity and custodial accounts issued to current and former employees prior to January 1, 2009. Accordingly, we were unable to apply auditing procedures sufficiently to determine the extent to which the financial statements may have been affected by these conditions.

As described in note X, the plan has excluded from investments in the accompanying statement of net assets available for benefits certain annuity and custodial accounts issued to current and former employees prior to January 1, 2009, as permitted by the Department of Labor's Field Assistance Bulletin No. 2009-02, *Annual Reporting Requirements for 403(b) Plans*. The investment income and distributions related to such accounts have also been excluded in the accompanying statement of changes in net assets available for benefits. The amount of these excluded annuity and custodial accounts and the related income and distributions are not determinable. Accounting principles generally accepted in the United States of America require that these accounts and the related income and distributions be included in the accompanying financial statements.

Since we were not able to apply auditing procedures to satisfy ourselves as to the appropriateness and completeness of the plan's net assets available for benefits and changes in net assets available for benefits as of December 31, 2009, and 2008 and for the year ended December 31, 2009, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these accompanying financial statements.

We were engaged to audit the basic financial statements. The supplemental schedules of [*identify title of schedules and period covered*] are presented for the purpose of additional analysis and are not a required part of the basic financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. These supplemental schedules are the responsibility of the plan's management. Because of the significance of the matters described in the second and third paragraphs of this report, we express no opinion on the supplemental schedules.

[*Signature of Firm*]
[*City and State*]
[*Date*]

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[2] In February 2010, the Accounting Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 119, *Supplementary Information in Relation to the Financial Statements as a Whole* (AICPA, Professional Standards, vol. 1, AU sec. 551). This Standard, along with SAS No. 118, *Other Information in Documents Containing Audited Financial Statements* (AICPA, Professional Standards, vol. 1, AU sec. 551), supersede the requirements and guidance in AU section 551. This SAS is effective for audits of financial statements for periods beginning on or after December 15, 2010. Early application is permitted.

SAS No. 119 addresses the auditor's responsibility when engaged to report on whether supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole. The information covered by this SAS is presented outside the basic financial statements and is not considered necessary for the financial statements to be fairly presented in accordance with the applicable financial reporting framework. This SAS also may be applied, with the report wording adapted as necessary, when an auditor has been engaged to report on whether required supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole.

Illustration 2: Limited Scope Audit as Permitted by 29 CFR 2520.103-8 and FAB No. 2009-02 Contracts Have Been Excluded

6.49

Fact Pattern: The following is an example of an auditor's report for a first year audit of a 403(b) plan. The plan administrator has elected the limited scope audit exemption, as permitted by 29 CFR 2520.103-8, and also has elected to exclude certain contracts and accounts from plan assets, as permitted by DOL FAB No. 2009-02. The amounts of the excluded contracts or accounts are determinable and material. For example, the plan administrator is able to provide the auditor with a report from its custodian that lists each individual annuity and custodial account and the total amount of the excluded contracts and related activity for the current year. In this situation, the auditor has concluded to issue a disclaimer of opinion due to the limitation on the scope of the audit because the plan administrator has elected the limited scope audit exemption. Further, the auditor has concluded that an opinion on the form and content of the supplemental schedules is not appropriate because of the departure from U.S. GAAP. (See paragraphs .61–.63 of AU section 508 for guidance on disclaimers of opinion.)

***Note:** In accordance with paragraphs .61–.62 of AU section 508, all the substantive reasons for the disclaimer should be included in the report. In addition, the auditor also should disclose any other reservations he or she has regarding fair presentation in conformity with U.S. GAAP.*

Independent Auditor's Report

[*Addressee*]

We were engaged to audit the accompanying statements of net assets available for benefits of GHI Company 403(b) plan as of December 31, 2009, and 2008 and the related statement of changes in net assets available for benefits for the year ended December 31, 2009, and the supplemental schedules of (1) Schedule H, line 4i—Schedule of Assets Held (At End of Year) and (2) Schedule H, line 4j—Schedule of Reportable Transactions as of or for the year ended December 31, 2009. These financial statements and supplemental schedules are the responsibility of the plan's management.

As permitted by 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974, the plan administrator instructed us not to perform, and we did not perform, any auditing procedures with respect to the information summarized in note X, which was certified by ABC Bank, the trustee (or custodian) of the plan, except for comparing such information with the related information included in the financial statements and supplemental schedules. We have been informed by the plan administrator that the trustee (or custodian) holds the plan's investment assets and executes investment transactions. The plan administrator has obtained a certification from the trustee (or custodian) as of December 31, 2009, and 2008 and for the year ended December 31, 2009, that the information provided to the plan administrator by the trustee (or custodian) is complete and accurate.

As described in note X, the plan has excluded from investments in the accompanying statement of net assets available for benefits certain annuity and custodial accounts issued to current and former employees prior to January 1, 2009, as permitted by the Department of Labor's Field Assistance Bulletin No. 2009-02, *Annual Reporting Requirements for 403(b) Plans*. If the identified contracts, as reported by the custodian, were included, net assets available for benefits would increase by approximately $XX and $XX as of December 31, 2009, and 2008, respectively. Further, investment income of approximately $XX and distributions of approximately $XX related to such accounts, as identified by the custodian, have also been excluded in the accompanying statement of changes in net assets available for benefits for the year ended December 31, 2009. Accounting principles generally accepted in the United States of America require that these accounts and the related income and distributions be included in the accompanying financial statements.

Because of the significance of the information that we did not audit, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying financial statements and supplemental schedules taken as a whole.

[*Signature of Firm*]
[*City and State*]
[*Date*]

Illustration 3: Adverse Opinion

6.50

Fact Pattern: The following is an example of an auditor's report for a first year audit of a 403(b) plan. The plan administrator has elected to exclude certain contracts and accounts from plan assets, as permitted by DOL FAB No. 2009-02, and the amounts of the excluded contracts or accounts are determinable and material. For example, the plan administrator is able to provide the auditor with a report from its custodian that lists each individual annuity and custodial account and the total amount of the excluded contracts and the related activity for the current year. In addition, the auditor is able to perform a GAAS audit and is able to obtain sufficient appropriate audit evidence to conclude that the financial statements taken as a whole are not presented fairly in conformity with U.S. GAAP. In this situation, the auditor has concluded to issue an adverse opinion due to the departure from U.S. GAAP. (See paragraphs .58–.60 of AU section 508 for guidance on adverse opinions.)

Note: *Paragraph .10 of AU section 551A, states that when the auditor expresses an adverse opinion or disclaims an opinion, on the basic financial statements, he should not express the opinion described in paragraph .06 of AU section 551A on any accompanying information.*[3]

<u>Independent Auditor's Report</u>

[*Addressee*]

We have audited the accompanying statements of net assets available for benefits of ABC Company 403(b) plan as of December 31, 2009, and 2008 and the related statement of changes in net assets available for benefits for the year ended December 31, 2009. These financial statements are the responsibility of the plan's management. Our responsibility is to express an opinion on these financial statements, based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances but not for the purpose of expressing an opinion on the effectiveness of the plan's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As described in note X, the plan has excluded from investments in the accompanying statement of net assets available for benefits certain annuity and custodial accounts issued to current and former employees prior to January 1, 2009, as permitted by the Department of Labor's Field Assistance Bulletin No. 2009-02, *Annual Reporting Requirements for 403(b) Plans*. If the identified contracts, as reported by the custodian, were included, net assets available for benefits would increase by approximately $XX and $XX as of December 31, 2009, and 2008, respectively. Further, investment income of approximately $XX and distributions of approximately $XX related to such accounts, as

[3] See footnote 2.

identified by the custodian, have also been excluded in the accompanying statement of changes in net assets available for benefits for the year ended December 31, 2009. Accounting principles generally accepted in the United States of America require that these accounts and the related income and distributions be included in the accompanying financial statements.

In our opinion, because of the effects of the matters discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with accounting principles generally accepted in the United States of America, the net assets available for benefits of the plan as of December 31, 2009, and 2008 and the changes in its net assets available for benefits for the year ended December 31, 2009.

Our audits were performed for the purpose of forming an opinion on the basic financial statements taken as a whole. The supplemental schedules of [*identify title of schedules and period covered*] are presented for the purpose of additional analysis and are not a required part of the basic financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974. These supplemental schedules are the responsibility of the plan's management. These supplemental schedules have been subjected to the auditing procedures applied in the audits of the basic financial statements. Because of the effects of the matter discussed in the third paragraph of this report, we express no opinion on the supplemental schedules.

[*Signature of Firm*]
[*City and State*]
[*Date*]

SECTION 7: ILLUSTRATIVE FORM 5500 SCHEDULES

7.01

Form 5500 requires that certain supplemental schedules be attached to the annual Form 5500 filing. Such schedules include the following:

- Schedule H, line 4a—Schedule of Delinquent Participant Contributions
- Schedule H, line 4i—Schedule of Assets (Held at End of Year)
- Schedule H, line 4i—Schedule of Assets (Acquired and Disposed of Within Year)
- Schedule H, line 4j—Schedule of Reportable Transactions[1]

7.02

The following schedules are required to be reported on Schedule G (Financial Transaction Schedules):

- Schedule G, Part I—Schedule of Loans or Fixed Income Obligations in Default or Classified as Uncollectible
- Schedule G, Part II—Schedule of Leases in Default or Classified as Uncollectible
- Schedule G, Part III—Nonexempt Transactions

Practice Tip:

Schedule H, line 4i—Schedule of Assets (Held at End of Year) and Schedule H, line 4j—Schedule of Reportable Transactions. Large plan filers and certain direct filing entities that have assets held for investment purposes at the end of the year and reportable transactions are required to complete these forms. Auditors should note the following:

- Historical cost information is not required on Schedule H, line 4i—Schedule of Assets (Held at End of Year) for participant- or beneficiary-directed investments under an individual account plan. (The illustrative schedules in this chapter may show cost information for some participant-directed investments because such disclosure is not prohibited, and some plans may continue to disclose it.)
- Participant- or beneficiary-directed transactions are not required to be taken into account for purposes of preparing Schedule H, line 4j—Schedule of Reportable Transactions.
- Participant loans may be aggregated and presented with a general description of terms and interest rates.
- In a plan's initial year, the 5 percent threshold for Schedule H, line 4j—Schedule of Reportable Transactions is based on the end-of-year balance of the plan's assets.
- With the exception of investments in tangible personal property, participant-directed brokerage accounts should be reported in the aggregate on line 1c(15) of Schedule H and treated as one asset on Schedule H, line 4i—Schedule of Assets (Held at End of Year).
- Any asset held for investment purposes in the 401(h) account should be shown on Schedule H, line 4i—Schedule of Assets (Held at End of Year) and Schedule H, line 4j—Schedule of Reportable Transactions for the pension plan.

REPORTING OF DELINQUENT PARTICIPANT CONTRIBUTIONS

7.03

Failure to remit or untimely remittance of participant contributions constitutes a prohibited transaction under Section 406 of the Employee Retirement Income Security Act of 1974, as amended, regardless of materiality.

[1] Participant- or beneficiary-directed transactions are not required to be taken into account for purposes of preparing the schedule of reportable transactions. In a plan's initial year, the 5 percent threshold for Schedule H, line 4j—Schedule of Reportable Transactions is based on the end-of-year balance of the plan's assets.

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.

7.04

Information on all delinquent participant contributions should be reported only on line 4a of either Schedule H or Schedule I of 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 Form 5330 and paying any applicable excise taxes.

7.05

Information on all delinquent participant contributions should be reported on line 4a of either Schedule H or Schedule I of Form 5500 and should not be reported on line 4d of Schedule H or Schedule I or on Schedule G. Beginning for 2009 plan years, large plans with delinquent participant contributions should attach a schedule clearly labeled "Schedule H Line 4a—Schedule of Delinquent Participant Contributions" using the following format.

7.06

Participant loan repayments paid to or withheld by an employer for purposes of transmittal to the plan that were not transmitted to the plan in a timely fashion must be reported either on line 4a, in accordance with the reporting requirements that apply to delinquent participant contributions, or line 4d. See Advisory Opinion 2002-2A at www.dol.gov/ebsa.

7.07

Delinquent forwarding of participant loan repayments is eligible for correction under the Voluntary Fiduciary Correction Program (VFCP) and Prohibited Transaction Exemption 2002-51 on terms similar to those that apply to delinquent participant contributions.

7.08

For further guidance, see the instructions to Form 5500 and the frequently asked questions (FAQs) on the Employee Benefits Security Administration (EBSA) Web site at www.dol.gov/ebsa/faqs/faq_compliance_5500.html.

Reporting of Delinquent Loan Repayments

7.09

Generally speaking, participant loan repayments are not subject to the U.S. Department of Labor's (DOL's) participant contribution regulation (29 C.F.R. 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.

7.10

In Advisory Opinion 2002-2A, the DOL concluded that, although 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, Advisory Opinion 2002-2A 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.

7.11

Accordingly, the DOL will not reject a Form 5500 report based solely on the fact that delinquent forwarding of participant loan repayments is included on line 4a of Schedule H or Schedule I. Filers who choose to include such participant loan repayments on line 4a must apply the same supplemental schedule and independent qualified public accountant disclosure requirements to the loan repayments as apply to delinquent transmittals of participant contributions.

7.12

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.

7.13

See the FAQs about reporting delinquent participant contributions on Form 5500 at the EBSA Web site at www.dol.gov/ebsa/faqs/faq_compliance_5500.html.

1. Schedule of Assets (Held at End of Year)

7.14

SCHEDULE I
DEF Holdings, Inc. 401(k) Plan
Plan Sponsor: DEF Holdings, Inc.
Plan Sponsor EIN: 55-5555555
Plan Number: 002
Schedule of Assets (Held at End of Year) as of December 31, 20X2

(a)	(b) Identity of Issue, Borrower, Lessor, or Similar Party	(c) Description of Investments (Number of Shares)	(d) Cost[1]	(e) Current Value
	MUTUAL FUNDS			
	Cash or Cash Equivalents			
*	DEF Dollar Fund	1,207,358	$1,207,358	$1,207,358
	Fixed Income Investments			
*	DEF Strategic Income Fund	60,246	638,496	730,788
*	DEF Government Income Fund	18,678	91,594	164,926
*	DEF High Income Fund	110,232	1,317,904	1,694,282
	Total Fixed Income		2,047,994	2,589,996
	Growth and Income Investments			
*	DEF Growth & Income Fund	107,338	642,970	795,368
	Equity Investments			
*	DEF New Pacific Growth Fund	127,506	1,601,002	1,677,968
*	DEF Europe Growth Fund	87,142	944,424	1,125,866
*	DEF Japan Growth Fund	34,822	403,966	341,604
*	DEF International Growth Fund	59,024	535,758	531,216
*	DEF America Growth Fund	110,304	2,010,514	2,289,904
*	DEF Worldwide Growth Fund	138,780	2,132,738	2,334,268
*	DEF Health Care Fund	35,646	689,836	875,132
*	DEF Latin America Growth Fund	41,796	724,574	774,056
*	DEF Telecommunications Fund	82,152	1,287,640	1,289,802
*	DEF Emerging Markets Fund	164,872	2,573,790	2,397,228
*	DEF Financial Services Fund	5,592	1,378	77,716
*	DEF Infrastructure Fund	39,658	475,094	583,370
*	DEF Natural Resources Fund	63,648	980,202	1,122,744
*	DEF Consumer Products Fund	61,704	960,046	1,232,238
*	DEF America Value Fund	20,140	274,502	296,448
*	DEF Small Cap Growth Fund	30,758	382,286	386,936
	Bank in Lisbon Bearer Participating Certificates	1,102	566,022	564,676
	Total Equity		16,543,772	17,901,172
*	Participant loans: Interest rate = 9.75%–10%		574,816	574,816
	TOTAL INVESTMENTS		$21,016,910	$23,068,710

* Represents a party in interest to the plan.

[1] Historical cost information is no longer required on the Schedule of Assets (Held at End of Year) for participant-directed investments. This example shows the cost information for some participant-directed investments because such disclosure is not prohibited, and some plans continue to disclose it.

7.15

SCHEDULE I
AB&C Enterprises
401(k) Retirement Plan
EIN: 55-5555555 Plan Number: 001
Schedule of Assets (Held at End of Year) as of December 31, 20X2

(a)	*(b) Identity*	*(c) Description of Investment*	*(d) Cost*	*(e) Current Value*
*	The National Group	133,404 shares of National Fund	**	$ 3,488,532
*	The National Group	1,792,072 shares of National Money Market Reserves—Federal Portfolio	**	1,792,072
*	The National Group	123,494 shares of National Fixed Income Securities Fund—Short Term Portfolio	**	1,327,554
*	The National Group	51,204 shares of National Index Trust—500 Portfolio	**	3,541,276
*	The National Group	50,770 shares of National International Portfolio	**	1,398,188
*	The National Group	78,402 shares of National Equity Income Fund	**	1,436,336
*	The National Group	81,312 shares of National U.S. Growth Portfolio	**	1,930,340
*	The National Group	17,520 shares of National Index Market Portfolio	**	458,852
*	Participant loans	Interest ranging from 6.5% to 7%	**	55,482
	Total		**	$15,428,632

* A party in interest, as defined by the Employee Retirement Income Security Act of 1974, as amended.
** Cost omitted for participant-directed investments.

7.16

Sample Company Retirement Plan

Schedule for Assets (Held at End of Year) as of December 31, 20X2

(a)	*(b) Identity of Issue, Borrower, Lessor, or Similar Party*	*(c) Description of Investment, Including Maturity Date, Rate of Interest, Collateral, Par, or Maturity Value*	*(d) Cost*	*(e) Current Value*
	XYZ Trust Fixed Income Fund	Retirement mutual fund; 64,500 shares	$ 200,000	$ 300,000
	XYZ Trust Equity Fund	Retirement mutual fund; 68,900 shares	400,000	450,000
	XYZ Trust Growth Fund	Retirement mutual fund; 48,800 shares	1,100,000	1,000,000
	XYZ Cash Fund	Money market fund	30,000	30,000
*	Participant loans	Loans ranging from 0–5 years maturity with interest rates from 7.25% to 9.25%	90,000	90,000
	Federal government	U.S. Treasury note; maturity date December 31, 2001; 7.25% interest	400,000	400,000
	Total		$2,220,000	$2,270,000

* A party in interest, as defined by the Employee Retirement Income Security Act of 1974, as amended.

7.17

XYZ Savings Program
EIN: 55-5555555
Plan Number: 002
Schedule of Assets (Held at End of Year) as of December 31, 20X2

(a) Identity of Party Involved	*(b) Description of Asset*	*(c) Number of Shares or Units*	*(d) Current Value*
*ABC Bank	Money market fund	8,284,990	$ 8,603,200
Prosperity Investments	Mutual fund	3,001,084	201,224,580
DEF Inc.	Money market mutual fund	32,830,692	32,762,690
GHI Investors	Balanced Fund	1,637,252	85,138,916
ABC Global Investors	Equity Index Fund	7,656,770	125,894,220
Participant Loans	Interest ranging from 7% to 10%	13,247,714	12,933,714
National Synthetic:			
GNMA ARM	#H3-9246 6.50%	2,600,000	1,931,158
GNMA ARM	#H3-9013 6.50%	1,145,708	723,358
GNMA ARM	#H3-957882, 6.50%	1,572,778	1,127,842
GNMA ARM	#H3-9611, 7.15%	2,321,586	819,084
GNMA ARM	#H3-9645, 7.15%	5,000,132	1,828,616
GNMA ARM	#H3-9933, 7.15%	1,950,002	1,208,864
GNMA ARM	#H3-9080, 7.75%	1,950,000	999,994
FHLMC FRM	7.50%	16,000,000	15,975,040
GNMA FRM	7.50%	10,044,994	10,044,994
Interest Rate Floor Agreement	5.50%	16,000,000	317,600
U.S. Treasury Note	#U-091642, 6.00%	710,000	712,108
*ABC Bank	Money market fund	32,308,798	32,316,798
National Wrapper	Synthetic Wrapper Agreement	—	(393,352)
ABC Life Contract	#HBD-41463, 6.15%, 3-1-×6	20,661,604	20,661,604
DEF Contract	#HBD-8568322, 5.65%, 9-1-×3	26,272,740	26,272,740
GHI Mutual Contract	#HBD-50870, 5.00%, 2-28-×4	17,796,028	17,814,028
GHI Mutual Contract	#HBD-50870-3, 6.50%, 3-1-×5	11,574,102	11,560,102
JKL Life Contract	#HBD-25193, 7.25%, 3-1-×5	14,290,224	14,290,224
JKL Life Contract	#HBD-25276, 6.15%, 3-1-×6	17,299,096	17,299,096
MNO Contract	#HBD-23991, 5.50%, 3-2-×4	13,880,466	13,880,466
PQR International Group	#HBD-29318, 7.00%, 9-1-×5	14,379,788	14,379,788
STU Contract	#HBD-0019, 5.75%, 3-1-×4	4,331,894	4,331,894
STU Contract	#HBD-0882, 4.75%, 8-31-×3	8,724,514	8,724,514
VWX Int'l Group Contract	#HBD-987, 5.75%, 3-1-×5	11,781,558	11,781,558
YZA Int'l Life	#HBD-29205, 7.00%, 9-1-×5	7,256,842	7,256,842
BCD Life Insurance Company	#HBD-HB0004, 7.25%, 9-1-×4	8,219,378	8,219,378
ABC Life Contract	#HBD-41587, 6.25%, 3-1-×7	20,000,000	20,887,880
EFG Mutual Life Insurance	#HBD-9737, 6.75%, 3-1-×7	14,657,064	14,656,664
HIJ Contract	#CJD 114062, 6.50%, 9-1-×3	10,893,652	10,884,652
			$757,070,854

* A party in interest, as defined by the Employee Retirement Income Security Act of 1974, as amended.

7.18

Plan Name: ABC Company Pension Plan II
Sponsor: ABC Holdings (Operations) Inc.
Employer Identification Number: 55-5555555
Plan Number: 001
Plan Year Ending: December 31, 20X2
Schedule of Assets (Held at End of Year)—See Form 5500

(a)	(b) Identity of Issue, Borrower, Lessor, or Similar Party	(c) Description of Investment, Including Maturity Date, Rate of Interest Collateral, Par, or Maturity Value	(d) Face Value or Number of Shares	(e) Current Value
*	ABC Bank Liquid Reserve Fund	Money market fund	485,698	$ 485,698
*	GHI Bank Temporary Investment	Money market fund	1,542	1,542
*	GHI Bank Bond Index Fund	Bond fund	110,612	19,225,196
*	GHI Bank Stock Index Fund	Equity fund	85,578	59,901,044
*	Sample Company, Ltd.	Common stock	115,956	3,275,756
	XYZ Company	Common stock	28	230
*	DEF Realty Fund	Real estate fund	42	1,741,808
	Total			$84,631,274

* A party in interest, as defined by the Employee Retirement Income Security Act of 1974, as amended.

7.19

SCHEDULE I
Sample Company, Inc. Pension Plan
Schedule of Assets (Held at End of Year) as of December 31, 20X2

Description	Cost	Current Value
ABC Bank money market variable rate—4.87% as of 12/31/20X2	$2,438,340	$2,438,340
Prosperity Life Insurance Company, Inc. group annuity contract No. 207503 variable rate—5% as of 12/31/20X2	53,142	53,142
Prosperity Life Insurance Company, Inc. group annuity contract No. 207636 variable rate—5% as of 12/31/20X2	89,616	89,616
National Life Insurance Company group annuity variable rate—5.5% as of 12/31/20X2	242,718	242,718
National Life Insurance Company group annuity contract No. 6455744 variable rate—5.5% as of 12/31/20X2	933,536	933,536
	$3,757,352	$3,757,352

7.20

Sample Employee Stock Ownership Plan
EIN:55-5555555
Plan Number: 001
Schedule of Assets (Held at End of Year) as of December 31, 20X2

(a)	(b) Identity of Issue, Borrower, Lessor, or Similar Party	(c) Description of Investment, Including Maturity Date, Rate of Interest, Collateral, Par, or Maturity Value	(d) Cost	(e) Current Value
*	Sample Corporation	Common stock—36,428.57 shares allocated	$4,371,428	$3,169,286
*	Sample Corporation	Common stock—23,571.43 shares unallocated	2,828,572	2,050,714
	Total		$7,200,000	$5,220,000

* A part in interest, as defined by the Employee Retirement Income Security Act of 1974, as amended.

2. Schedule of Reportable Transactions

7.21

Sample Company Retirement Plan

Schedule of Reportable Transactions for the Year Ending December 31, 20X2

(a) Identity of Party Involved	(b) Description of Asset	(c) Purchase Price	(d) Selling Price	(e) Lease Rental	(f) Expense Incurred With Transaction	(g) Cost of Asset	(h) Current Value of Asset on Transaction Date	(i) Net Gain (Loss)
XYZ Trust Fixed Income Fund	Retirement mutual fund, 12 purchases, 20,500 shares	$100,000	N/A	N/A	N/A	$100,000	$100,000	N/A
XYZ Trust Equity Fund	Retirement mutual fund, 20 sales, 40,000 shares	N/A	$400,000	N/A	N/A	$300,000	$400,000	$100,000
ABC Company	$450,000 note dated 2/15/20X0, 7.25% interest, matures 2/15/20X6	N/A	$432,278	N/A	N/A	$429,272	$432,280	$ 3,008
DEF Growth Fund	Retirement mutual fund, purchase of 100,000 shares	$500,000	N/A	N/A	N/A	$500,000	$500,000	N/A

[a] Represents a transaction or a series of transactions in securities of the same issue in excess of 5 percent of the plan market value as of December 31, 20X1.

7.22

DEF Holdings Inc. Pension Plan
Plan Sponsor: DEF Holdings, Inc.
Plan Sponsor EIN: 55-5555555
Plan Number: 002
Schedule of Reportable Transactions for the Year Ended December 31, 20X2

(a) Identity of Party Involved*	(b) Description of Securities	Number of Transactions	(c) Transactions' Aggregate Purchase Price	(d) Transactions' Aggregate Sale Price	(e) Lease Rental	(f) Expenses Incurred With Transaction	(g) Cost of Asset	(h) Current Value of Asset on Transaction Date	(i) Net Gain (Loss)
DEF Dollar Fund	Mutual fund shares	82	$ 836,064	—	—	—	$ 836,064	$ 836,064	—
DEF Dollar Fund	Mutual fund shares	84	—	773,288	—	—	**	773,288	**
DEF America Growth Fund	Mutual fund shares	60	696,986	—	—	—	696,986	696,986	—
DEF America Growth Fund	Mutual fund shares	94	—	1,297,394	—	—	**	1,297,394	**
DEF Emerging Markets Fund	Mutual fund shares	60	1,082,634	—	—	—	1,082,634	1,082,634	—
DEF Emerging Markets Fund	Mutual fund shares	82	—	931,458	—	—	**	931,458	**
DEF High Income Fund	Mutual fund shares	82	1,113,632	—	—	—	1,113,632	1,113,632	—
DEF High Income Fund	Mutual fund shares	62	—	804,396	—	—	**	804,396	**
DEF Natural Resources Fund	Mutual fund shares	60	1,015,116	—	—	—	1,015,116	1,015,116	—
DEF Natural Resources Fund	Mutual fund shares	22	—	62,554	—	—	**	62,554	**
DEF Consumer Products Fund	Mutual fund shares	60	919,756	—	—	—	919,756	919,756	—
DEF Consumer Products Fund	Mutual fund shares	64	$ —	325,118	—	—	$ **	$ 325,118	**

* All parties represent parties in interest to the plan.
** Information not available.

EBP-ATT

7.23

XYZ Profit Sharing Program
EIN: 55-5555555
Plan Number: 002
Schedule of Reportable Transactions for the Year Ended December 31, 20X2

(a) Identity Party of Involved*	(b) Description of Asset	Number of Purchase Transactions	(c) Purchase Price	Number of Sales Transactions	(d) Selling Price	(e) Lease Rental	(f) Expense Incurred With Transaction	(g) Cost of Assets	(h) Current Value of Asset on Transaction Date	(i) Net Gain (Loss)
*ABC Bank	Money market fund	718	$374,309,306	—	—	—	—	$374,309,306	$374,309,306	—
*ABC Bank	Money market fund	—	—	700	365,660,824	—	—	365,660,824	365,660,824	—
Prosperity Investments	Mutual fund	148	60,082,384	—	—	—	—	60,082,384	60,082,384	—
Prosperity Investments	Mutual fund	—	—	298	56,731,132	—	—	52,321,134	56,731,132	4,409,998
DEF Inc.	Money market mutual fund	166	18,729,248	—	—	—	—	18,729,248	18,729,248	—
DEF Inc.	Money market mutual fund	—	—	312	11,197,446	—	—	11,197,446	11,197,446	—
GHI Investors	Balanced fund	272	33,188,156	—	—	—	—	33,188,156	33,188,156	—
GHI Investors	Balanced fund	—	—	184	11,748,138	—	—	10,356,300	11,748,138	1,391,838
ABC Global Investors	Equity index fund	324	51,644,964	—	—	—	—	51,644,964	51,644,964	—
ABC Global Investors	Equity index fund	—	—	116	17,692,672	—	—	16,211,918	17,692,672	1,480,754

* A party in interest, as defined by the Employee Retirement Income Security Act of 1974, as amended.

7.24

Sample Company, Inc., Pension Plan
Schedule of Reportable Transactions for the Year Ended December 31, 20X2

Identity of Party	Description of Asset	Number of Transactions	Purchase Price	Number of Transactions	Selling Price	Cost	Net Gain (Loss)
ABC Bank	United States Treasury bills	1	$1,804,000	1	$1,804,000	$1,804,000	$0
Prosperity Life Insurance	Life insurance policies	0	0	516	990,894	990,894	0

7.25

This schedule is prepared using the alternative way of reporting (Hi) series transactions under 29 U.S CFR 2520.103-b(d)(2).

7.26

Plan Name: ABC Company Pension Plan II
Sponsor: ABC Holdings (Operations) Inc.
Employer Identification Number: 55-5555555
Plan Number: 001
Plan Year Ending: December 31, 20X2
Schedule of Reportable Transactions—See Form 5500

Identity of Party Involved	*Description of Asset (Include Interest Rate and Maturity in Case of a Loan)*	*(a) Number of Purchases*	*(b) Number of Sales*	*(c) Total Value of Purchases*	*(d) Total Value of Sales*	*(e) Net Gain (Loss)*
*ABC Bank Liquid Reserve Fund	Commingled Employee Benefit Trust	52	—	7,073,036	—	—
*ABC Bank Liquid Reserve Fund	Commingled Employee Benefit Trust	—	40	—	6,587,338	—
*CHI Bank	GHI Bank Stock Index Fund	22	—	758,650	N/A	—
*CHI Bank	GHI Bank Stock Index Fund	—	8	—	4,051,452	1,180,478
*CHI Bank	GHI Bank Bond Index Fund	16	—	1,101,452	—	—
*CHI Bank	GHI Bank Bond Index Fund	—	10	—	3,461,454	(73,002)

* A party in interest, as defined by the Employee Retirement Income Security Act of 1974, as amended.

7.27

Sample Association Retirement Plan
EIN: 55-5555555
Plan Number: 001
Schedule of Reportable Transactions for the Year Ended December 31, 20X2

(a) Identity of Party Involved	(b) Description of Assets	(c) Purchase Price	(d) Selling Price	(e) Lease Rental	(f) Expense Incurred With Transaction	(g) Cost of Asset	(h) Current Value of Assets on the Transaction Date	(i) Net Gain (Loss)
Category I and III individual transactions in excess of 5 percent of plan assets and all remaining transactions of the same issue:								
*Example Insurance Company	Corporate Bond Fund							
	Sale	$ —	$9,000,000	$—	$—	$ 7,962,276	$ 9,000,000	$1,037,724
	Aggregate transactions							
	Purchase	$ 234,603	$ —	$—	$—	$ 234,603	$ 234,603	$ —
	Sales	$ —	$9,134,264	$—	$—	$ 8,081,059	$ 9,134,264	$1,053,205
	Income Fund							
	Purchase	$ 9,000,000	$ —	$—	$—	$ 9,000,000	$ 9,000,000	$ —
	Purchase	$ 9,000,000	$ —	$—	$—	$ 9,000,000	$ 9,000,000	$ —
	Aggregate transactions							
	Purchase	$24,416,215	$ —	$—	$—	$24,416,215	$24,416,215	$ —
	Sales	$ —	$4,000,000	$—	$—	$ 4,183,747	$ 4,000,000	$(183,747)

* A party in interest, as defined by the Employee Retirement Income Security Act of 1974, as amended.

3. Schedule of Delinquent Participant Contributions

7.28

Sample 401(k) Plan
EIN: 55-5555555
Plan Number: 001
Schedule of Delinquent Participant Contributions for the Year Ended December 31, 20X2

Participant Contributions Transferred Late to the Plan			Check Here if Late Participant Loan Repayments Are Included	Total That Constitutes Nonexempt Prohibited Transactions			
				Contributions Not Corrected	Contributions Corrected Outside Voluntary Fiduciary Correction Program	Contributions Pending Correction in Voluntary Fiduciary Correction Program	Total Fully Corrected Under Voluntary Fiduciary Correction Program and PTE 2002-51
Amount Withheld	Date Withheld	Date Remitted					
$68,372	6/6/20X2	8/8/20X2		$—	$68,372	$—	$—
$72,633	9/26/20X2	11/10/20X2		$—	$72,633	$—	$—

4. Schedule of Nonexempt Transactions

7.29

Sample Company Profit Sharing Plan
EIN: 55-5555555
Plan Number: 001
Schedule of Nonexempt Transactions for the Year Ended December 31, 20X2

(a) Identity of Party Involved	(b) Relationship to Plan, Employer, to Other Party in Interest	(c) Description of Transactions	(d) Purchase Price	(e) Selling Price	(f) Lease Rental	(g) Expenses Incurred in Connection With the Transaction	(h) Cost of Asset	(i) Current Value of Asset	(j) Net Gain (Loss)
John Smith	Employee of plan sponsor	Use of plan assets by party in interest	$—	$35,000	$—	$—	$35,000	$35,000	$—

SECTION 8: MANAGEMENT LETTER COMMENTS (AUDITS OF NONISSUERS)

8.01

This section pertains to audits of nonissuers only. For audits of issuers, such as Form 11-K audits, the guidance in AU-P section 325, *Communications About Control Deficiencies in an Audit of Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, Interim Standards), should be followed.

COMMUNICATING INTERNAL CONTROL RELATED MATTERS IDENTIFIED IN AN AUDIT

8.02

AU section 325, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards,* vol. 1), provides guidance to enhance your ability to evaluate deficiencies in internal control that are identified during an audit and then communicate to management and those charged with governance those deficiencies that you believe are significant deficiencies or material weaknesses. Auditors should be aware that the nature of the employee benefit plan environment is likely to give rise to the written communications required by AU section 325.

8.03

The standard is applicable whenever an auditor expresses or disclaims an opinion on financial statements. In particular, this standard

- defines the terms *deficiency in internal control*, *significant deficiency*, and *material weakness*.
- provides guidance on evaluating the severity of deficiencies in internal control identified in an audit of financial statements.
- requires the auditor to communicate in writing to management and those charged with governance significant deficiencies and material weaknesses identified in an audit.

8.04

This standard is not applicable if the auditor is engaged to report on the effectiveness of an entity's internal control over financial reporting under AT section 501, *An Examination of an Entity's Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements* (AICPA, *Professional Standards*, vol. 1). When conducting an audit of financial statements, you are not required to perform procedures to identify deficiencies in internal control. However, during the course of the audit, you may become aware of deficiencies in the design or operation of the entity's internal control. You may identify deficiencies in internal control at any point in the audit. For example, while

- obtaining an understanding of the entity and its environment, including its internal control;
- assessing the risks of material misstatement of the financial statements due to error or fraud;
- performing further audit procedures to respond to assessed risks; or
- communicating with management or others (for example, internal auditors or governmental authorities).

8.05

The awareness of deficiencies in internal control will vary with each audit and will be influenced by the nature, timing, and extent of audit procedures performed, as well as other factors. The results of substantive procedures may result in the need to reevaluate the earlier assessment of internal control.

Evaluating Internal Control Deficiencies

8.06

A deficiency in internal control may be considered just a deficiency. More severe deficiencies are significant deficiencies, and the most severe deficiencies are material weaknesses.

Definitions of Material Weakness *and* Significant Deficiency

8.07

A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected, on a timely basis. For the purpose of this definition, a reasonable possibility exists when the likelihood of the event is either *reasonably possible* or *probable*, as those terms are used in Financial Accounting Standards Board (FASB) Statement No. 5, *Accounting for Contingencies*.[1]

8.08

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness yet important enough to merit attention by those charged with governance.

The Evaluation Process

8.09

You should evaluate the severity of each deficiency in internal control identified during the audit and determine whether the deficiency, individually or in combination with other deficiencies in internal control, rises to the level of significant deficiency or material weakness. The severity of a deficiency in internal control depends on

- the magnitude of the potential misstatement resulting from the deficiency or deficiencies and
- whether there is a reasonable possibility that the entity's controls will fail to prevent, or detect and correct, a misstatement of an account balance or disclosure.

8.10

The severity of a deficiency does not depend on whether a misstatement actually occurred. If you identify a deficiency in internal control but have not identified an actual misstatement related to that deficiency, you cannot automatically conclude that the deficiency is not a significant deficiency or material weakness. If a misstatement has been identified, you should consider the potential for further misstatement in the financial statements being audited.

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[1] The term *reasonable possibility*, as used in the definition of the term *material weakness*, has the same meaning as defined in the Financial Accounting Standards Board *Accounting Standards Codification* glossary, which provides the following definitions:

Probable. The future event or events are likely to occur.

Reasonably possible. The chance of the future event or events occurring is more than remote but less than likely.

Remote. The chance of the future event or events occurring is slight.

Therefore, the likelihood of an event is a reasonable possibility when it is reasonably possible or probable.

The Prudent Official Test

8.11

If you determine that a deficiency, or a combination of deficiencies, is not a material weakness, you should consider whether prudent officials, having knowledge of the same facts and circumstances, would likely reach the same conclusion.

WHAT ARE MANAGEMENT LETTER COMMENTS?

8.12

Paragraph .21 of AU section 325 states that nothing precludes the auditor from communicating to management and those charged with governance other matters that the auditor believes to be of potential benefit to the entity, such as recommendations for operational or administrative efficiency or for improving internal control, or if the auditor has been requested to communicate, for example, control deficiencies that are not significant deficiencies or material weaknesses. Such matters may be communicated orally or in writing. If the information is communicated orally, the auditor should document the communication. These matters often are referred to as management letter comments (MLCs).

8.13

This section shows three illustrative management letters and illustrative MLCs that have been communicated to management on actual employee benefit plan audits to illustrate control deficiencies noted and suggestions for improving operations of the plan. These examples are deficiencies in internal control that are not significant deficiencies or material weaknesses. AU section 325 provides guidance on how to assess whether deficiencies are significant deficiencies or material weaknesses. When a letter is issued in accordance with AU section 325, these other matters may be communicated in the letter, as well (see AU section 325 for guidance).

8.14

Alternatively, a separate management letter may be issued as illustrated subsequently (only for those matters not considered to be significant deficiencies or material weaknesses).

SAMPLE MANAGEMENT LETTERS

8.15

The following three reports illustrate typical management letters when there are control deficiencies but those deficiencies were determined not to be significant deficiencies or material weaknesses. A client may ask the auditor to issue a communication indicating that no material weaknesses were identified during the audit. Paragraphs .24–.25 and .28 of AU section 325 provide guidance and an illustrative communication that may be used in such situations.

Plan Administrator
XYZ Company 401(k) plan

In planning and performing our audit of the financial statements of the XYZ Company 401(k) plan for the year ended December 31, 20X2, we considered its internal control in order to determine our auditing procedures for the purpose of expressing our opinion on the financial statements and supplemental schedules and not to provide assurance on the internal control. During our engagement to audit, the following matters came to our attention that we believe merit your consideration.

[*Insert comments here.*]

This letter is intended solely for the information and use of the plan administrator and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

We would be pleased to discuss the above matters or to respond to any questions at your convenience.

[*Signature*]
[*Date*]

Limited Scope Audit

8.16

Plan Administrator
XYZ Company 401(k) Plan

We were engaged to audit the financial statements of XYZ Company 401(k) plan (plan) for the year ended December 31, 20X2. In connection with planning and performing our engagement, we developed the following recommendations concerning certain matters related to the plan's internal control and certain observations and recommendations on other [*accounting, administrative, and operating*] matters. In our report dated June 15, 20X3, we disclaimed an opinion on the plan's 20X2 financial statements because of the election by the plan administrator to limit the scope of our audit with respect to information which was certified by the trustee of the plan (as permitted by Section 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974, as amended). Had the scope of our audit not been limited as described above, other matters might have come to our attention that would have been reported to you. Our comments, arranged by function [*operating unit or employee benefit plan*], are presented in exhibit I and are listed in the table of contents thereto. Our principal recommendations are summarized below.

[*Insert comments here.*]

This letter is intended solely for the information and use of the plan administrator and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

We would be pleased to discuss the above matters or to respond to any questions at your convenience.

[*Signature*]
[*Date*]

Governmental Employee Pension Trust

8.17

The Pension Committee and plan administrator of the ABC government employees pension trust.

We have completed our audit of the financial statements of the ABC government employees pension trust for the year ended December 31, 20X2. While an audit is not intended to provide assurance on the internal control structure, as a result of our observations and documentation of the plan's systems, we noted several areas for improvement that we would like to convey to you for further action.

[*Insert comments here.*]

We appreciate the opportunity to be of service to the ABC government employees pension trust. We have enjoyed working with the staff and look forward to continuing our relationship. We hope that our comments and suggestions will be received in the caring and constructive fashion they are intended. We would be pleased to offer additional insight into, or assist in implementing, any of our suggestions. It is our hope that you should contact us should you have any questions any time.

[*Signature*]
[*Date*]

ILLUSTRATIVE MANAGEMENT LETTER COMMENTS

8.18

The following illustrative management letter comments relate to control deficiencies that were determined not to be significant deficiencies or material weaknesses. These comments are for illustrative purposes only and should be modified for the individual circumstances of each engagement. The auditor should evaluate the control deficiencies that have been identified to determine whether they rise to the level of a significant deficiency or material weakness, depending upon the magnitude and reasonable possibility. See AU section 325 for guidance.

8.19

This section contains the following illustrative management letter comments:

1. Benefits

Accumulated Plan Benefit Obligations

8.20

Issue:

During our audit, we noted errors in the participant data (for example, hire date and birth date) used by the actuary.

Although an occasional error does not materially distort the actuarial information, a lack of reliable, accurate data can invalidate the actuary's results.

Recommendation:
We recommend that the plan sponsor perform a detailed review of the current participant data records to ensure accuracy. For large data files, software, such as ACL, can assist in identifying errors. In addition, we recommend that the plan sponsor design and implement controls to ensure that all eligible employees are included and that the information about each participant is correct.

8.21

Issue:
The plan's actuary determines the actuarial methods and assumptions with little input from plan management.

The plan engages an actuary because of the complexity of the actuarial calculations. It is appropriate to rely on a specialist for these services; however, plan management possess knowledge that may influence the actuary's selection of methods and assumptions.

Recommendation:
We recommend plan management review the actuarial methods and assumptions with the actuary prior to completion of the valuation and challenge whether the factors used in the valuation are reasonable in lieu of prior year factors and changes in the plan, demographics of the employee group, and major changes in the plan sponsor (such as mergers and spin-offs).

Benefit Obligations (Health and Welfare Benefit Plan)

8.22

Issue:
During our testing, we noted several instances of missing or incomplete information, including missing participant enrollment forms and missing or incomplete documentation for claims processed by [*insurance company*]. Maintaining proper documentation regarding participant data and claims can safeguard the plan and the plan sponsor. Transactions construed as a breach of fiduciary duty could result in penalties against the plan sponsor or be considered prohibited transactions, or both.

Recommendation:
Procedures should be implemented to ensure all enrollment forms and supporting documentation for claims processed are maintained and properly filed.

Benefit Payments

8.23

Issue:
During our testing of benefit payments made during 20X2, we noted two instances in which the participant requested a distribution of his or her account in the defined contribution plan of ABC Company. However, the plan sponsor's personnel completed the wrong paperwork, and the participant received a distribution of his or her account from the tax sheltered annuity plan of ABC Company.

Recommendation:
We recommend that the plan sponsor correct the error and develop and execute policies and procedures to have distributions reviewed by someone other than the individual preparing the requests prior to submission to the recordkeeper. Transactions construed as a breach of fiduciary duty could result in penalties against the plan sponsor or be considered prohibited transactions, or both.

8.24

Issue:
We noted several instances in which incorrect benefit payment distributions were processed. These instances included overpayments to beneficiaries of deceased individuals, overpayments due to calculations based on hours worked instead of elapsed time, and manual calculation errors.

We understand that the overpayments to beneficiaries of deceased individuals were identified in an audit performed by XXXX last year and are being corrected. We also understand that XXX changed from hours counting to elapsed time, retroactive to the beginning of the year. This change resulted in de minimus errors, which have since been corrected. XXX also intends to begin utilizing calculator software, which should eliminate manual errors in the future.

Recommendation:
We recommend considering any additional procedures that may need to be implemented to assess the propriety of benefit payments and the computation of the payments. We also recommend that the plan sponsor consult with an Employee Retirement Income Security Act of 1974 (ERISA) specialist as soon as possible to determine options for correction. Failure to timely correct the error could potentially result in the loss of the plan's tax qualified status. Please let us know if we can be of assistance in correcting these matters through one of the IRS programs.

2. Contributions

Participant or Employee Contributions

a. Timely Deposit of Participant Contributions

8.25

Issue:
During our audit, it was noted that sufficient controls are not in place to ensure participant contributions are remitted to the plan in a timely manner. Participant contributions for certain payrolls in December 20X2 were not remitted timely. The Department of Labor (DOL) requires that participant contributions be remitted to the plan on the earliest date on which they can be reasonably segregated from the company's general assets but in no event later than the 15th business day following the end of the month in which amounts are contributed by employees or withheld from their wages. Failure to remit participant contributions to the plan in a timely manner results in a prohibited transaction that must be separately reported to the DOL and may result in penalties to the plan sponsor.

Recommendation:
We recommend that the plan sponsor review the procedures involved in remittance of participant contributions to the plan and institute the necessary controls to ensure participant contributions are remitted timely. A Form 5330 should be filed with the IRS to remit excise taxes due on the contributions that were not remitted timely, and lost earnings must be remitted to the plan and allocated to participants.

8.26

Issue:
During our audit, we found that one employee who should have been allowed to make deferrals and receive matching contributions was not allowed to do so. This occurred due to the employee setting a maximum limit on her contributions that had to be manually stopped once the employee reached the maximum in the previous year. For 20X2, her deferral contribution rate was not reset, resulting in no deferral contributions in 20X2.

Recommendation:
We recommend that the plan sponsor develop and execute policies and procedures to review employee contributions at the beginning of each year to ensure that the proper deferrals are being made. We also recommend that the plan sponsor consult with an ERISA specialist as soon as possible to determine options

for correction. Failure to timely correct the error could potentially result in the loss of the plan's tax qualified status. Please let us know if we can be of assistance in correcting these matters through one of the IRS programs.

b. Inaccurate Contribution Percentages

8.27

Issue:
We noted that the plan document provides for contributions from 2 percent to 10 percent of qualified compensation. In operation, the plan is allowing contributions from 1 percent to 15 percent.

Recommendation:
We recommend that the plan's management amend the plan document to allow for prospective contributions from 1 percent to 15 percent. We also recommend that the plan sponsor consult with an ERISA specialist as soon as possible to determine options for correction. Failure to timely correct the errors could potentially result in the loss of the plan's tax qualified status.

Available Options for Correction:
[***Note:*** In situations in which an issue has been identified and a recommendation made, consider consulting with ERISA counsel regarding available options for correction.]

c. Inaccurate Deduction or Calculations

8.28

Issue:
We noted that contribution deductions were not properly calculated for certain participants receiving manual checks.

Recommendation:
We recommend that the plan's management correct these errors and implement controls or programming check changes to ensure these types of errors do not occur. If not corrected, these errors, including restoring lost investment earnings, would be considered a plan operational violation.

8.29

Issue:
The plan document permits a separate election for a deferral on each bonus that is paid.

Recommendation:
The plan sponsor should require bonus recipients to clearly document whether the recipient wants 401(k) deferrals to apply to each bonus.

d. Timing of Contribution Election Changes

8.30

Issue:
We noted a few instances in which a participant changed contribution election percentages or investment allocation elections twice within a six month period; however, the plan document allows two changes per year and only one such change within one six month period.

Recommendation:
We recommend that the plan's management establish policies to monitor participant contribution election changes to ensure compliance with the provisions of the plan document. In addition, the plan's management should review the plan document and determine if an amendment to the plan document or a change in policy is necessary.

Available Options for Correction:
[***Note:*** In situations in which an issue has been identified and a recommendation made, consider consulting with ERISA counsel regarding available options for correction.]

e. Accuracy of Administering Contribution Election Changes

8.31

Issue:
We noted several instances in which an employee's change in elective contributions was made earlier or later than the calculated effective date allowed by the plan document.

Recommendation:
We recommend that the plan's management document the procedures for making elective contributions allowed under the plan document and review with the personnel responsible for setting up the elections on the payroll system.

Available Options for Correction:
[***Note:*** In situations in which an issue has been identified and a recommendation made, consider consulting with ERISA counsel regarding available options for correction.]

f. Participant Deferrals

8.32

Issue:
During our audit, we noted that one participant made deferrals that exceeded the plan's 15 percent limit, per the plan document.

Recommendation:
We recommend that the plan sponsor develop and execute policies and procedures to review participant deferral percentages. We also recommend that the plan sponsor consult with an ERISA specialist as soon as possible to determine options for correction. Failure to timely correct the error could potentially result in the loss of the plan's tax qualified status. Please let us know if we can be of assistance in correcting these matters through one of the IRS programs.

8.33

Issue:
During our audit, we noted that one participant made deferrals that exceeded the Internal Revenue Code (IRC) Section 402(g) limits due to a problem in the programming of the payroll system. Refunds were appropriately made prior to April 15, 20X2.

Recommendation:
We recommend that the plan sponsor develop and execute policies and procedures to ensure that the IRC Section 402(g) limits are not exceeded in the future.

Employer Contributions

a. Accuracy of Utilization of Forfeitures of Employer Contributions

8.34

Issue:
We noted that forfeitures totaling approximately $20,000 and $18,000 for 20X2 and 20X1, respectively, were not used to reduce employer contributions as allowed under the plan document.

Recommendation:
We recommend that the plan's management establish procedures for tracking forfeitures to ensure the company is not funding amounts needlessly and that appropriate amounts are offset for the applicable year.

b. Adoption Agreement

8.35

Issue:
Through the year ended December 31, 20X2, no employer contributions have ever been made to the plan. Because the adoption agreement was completed in a contradictory manner with regard to the discretionary matching provisions, it is questionable whether any employer match is allowed under the plan.

Recommendation:
We recommend that the adoption agreement be amended before any employer contributions are made to the plan to clarify the contradictory language related to the discretionary match.

c. Other

8.36

Issue:
Our testing of employer contributions noted two issues to be considered by the administrator for corrective action. The first is that the management company excluded bonuses from compensation for both employee and employer contributions. The plan definition of *compensation* is all W-2 wages, excluding fringe benefits. The second is that the plan states that participants are eligible for the optional company contribution during years in which they have completed 1,000 hours of credited service. The management and construction companies make contributions monthly with the assistance of Automatic Data Processing, Inc. (ADP). Although this facilitates administration, it may allow certain participants to receive contributions for which they are not entitled if they terminate prior to accomplishing 1,000 hours of service.

Recommendation:
In order to not apply employee deferral elections to bonuses, there should be documentation for each employee authorizing such a deviation from a previously signed election. Bonuses should always be included in the calculation of the optional company contribution. Regarding the 1,000 hour requirement for the company optional contribution, the plan should either be amended to properly reflect the intent of the company and maintain administrative ease or procedures should be implemented to ensure compliance with the plan document. This could be achieved by tracking the cumulative hours of each participant and applying the contributions monthly, then for those employees who terminate during the year, consideration of their eligibility for optional contributions must be given and their account balances adjusted accordingly for those ineligible contributions, which should be returned to the employer or used to offset total employer contributions for the year.

8.37

Issue:
The ABC Company holds and controls employer contributions well after the date the funds can be identified and segregated. Additionally, ABC Company pays administrative fees for the plan from the temporary holding account that accrues interest on the contributions. This interest is supposed to benefit the employees. However, the interest earned that goes to the employees is reduced by the administrative fees that are the employer's responsibility.

Recommendation:
We recommend that the plan's management consider opening a separate account for the sole purpose of funding administrative expenses. Before any decision is made to initiate this change, we recommend consulting with legal counsel to determine the effect of this change.

d. Employer Matching Contributions

8.38

Issue:
During our audit for the year ended December 31, 20X2, we noted that a 401(k) contribution was not withheld from one employee's paycheck for one pay period. The plan sponsor found and corrected this error; however, another error was made in calculating the employer matching contribution.

Recommendation:
We recommend that the plan sponsor develop and execute policies and procedures to ensure any corrections of employee deferral contributions and employer matching contributions be reviewed by someone other than the individual processing the correction. We also recommend that the plan sponsor consult with an ERISA specialist as soon as possible to determine options for correction. Failure to timely correct the error could potentially result in the loss of the plan's tax qualified status. Please let us know if we can be of assistance in correcting these matters through one of the IRS programs.

8.39

Issue:
During our audit for the year ended December 31, 20X2, we noted that there was a problem in the company's payroll system that caused the matching contributions for several participants to be less than that provided in the plan document. The company found and corrected this error; however, another error was made in the manual correction that was noted during our participant data testing.

Recommendation:
We recommend that the plan sponsor develop and execute policies and procedures to review employer contributions and that any corrections be reviewed by someone other than the individual calculating the correction. We also recommend that the plan sponsor consult with an ERISA specialist as soon as possible to determine options for correction. Failure to timely correct the error could potentially result in the loss of the plan's tax qualified status. Please let us know if we can be of assistance in correcting these matters through one of the IRS programs.

8.40

Issue:
During our testing of contributions, we were unable to test the employer matching contribution for two participants selected because certain locations did not properly utilize the matching function when sending their payroll information to ADP.

Recommendation:
We recommend that the plan sponsor have all locations utilize the matching function on the ADP payroll register. This will allow the plan sponsor to verify that employer matching contributions are correct and will facilitate the reconciliation of the employer matching contributions.

8.41

Issue:
During our audit, we found that two nonunion employees who worked in a primarily union-related department were not receiving the appropriate employer matching contribution.

Recommendation:
We recommend that the plan sponsor develop and execute policies and procedures to review employer matching contributions. We also recommend that the plan sponsor consult with an ERISA specialist as soon as possible to determine options for correction. Failure to timely correct the error could potentially result in the loss of the plan's tax qualified status. Please let us know if we can be of assistance in correcting these matters through one of the IRS programs.

8.42

Issue:
We understand that plan business is carried out during executive meetings of ABC's board of directors.

Recommendation:
Because the plan's trustees have the fiduciary responsibility to act in a prudent manner, we recommend that plan business be separately identified and recorded in minutes of meetings of the board of trustees. In addition to documenting the adoption of plan amendments, these minutes should evidence that the trustees are reviewing and monitoring investment performance, approving retiree benefits, approving the annual audit of the plan, and other such plan activity on a periodic basis.

e. Accuracy of Recording Plan Contributions

8.43

Issue:
We noted that funds transferred to the trust are not reconciled to the company's wires and payroll registers each pay period to ensure proper receipt and recording.

Recommendation:
We recommend that the plan's management implement controls and procedures to ensure all assets are accurately transferred and recorded.

f. Plan Contribution Limits

8.44

Issue:
During our audit, we noted that two participants made deferrals that exceeded the plan's established limit, per the provisions of the plan document, and one participant received an employer matching contribution that was in excess of the plan's established limit, per the provisions of the plan document.

Recommendation:
We recommend that the plan sponsor develop and execute policies and procedures to ensure that the plan operates as designed. We also recommend that the plan sponsor consult with an ERISA specialist as soon as possible to determine options for correction. Failure to timely correct the error could potentially result in the loss of the plan's tax qualified status. Please let us know if we can be of assistance in correcting these matters through one of the IRS programs.

8.45

Issue:
During our audit, we noted that a number of participants received matching contributions that exceeded the plan's established limit, per the provisions of the plan document.

Recommendation:
We recommend that the plan sponsor develop and execute policies and procedures to ensure that the plan operates as designed. We also recommend that the plan sponsor consult with an ERISA specialist as soon as possible to determine options for correction. Failure to timely correct the error could potentially result in the loss of the plan's tax qualified status. Please let us know if we can be of assistance in correcting these matters through one of the IRS programs.

8.46

Issue:
During our audit, we noted that one participant received an employer matching contribution that was in excess of the plan's specified limits.

Recommendation:
We recommend that the plan sponsor develop and execute policies and procedures to review employer matching contributions. It is our understanding that the plan sponsor has determined that it was ineligible to self-correct under the IRS's Self-Correction Program offered by Revenue Procedure 2001-17 and that the plan sponsor has self-corrected the excess contribution in accordance with that revenue procedure; however, if that is not the case, please let us know if we can assist the plan sponsor. Failure to timely correct the error could potentially result in the loss of the plan's tax qualified status.

Excess Contribution Deferrals

a. Prevention of Excess Deferral Refunds

8.47

Issue:
We noted that excess contributions refunded subsequent to year-end totaled approximately $120,000. As such, numerous highly compensated employees (HCEs) were limited in sheltering from tax the entire amount they elected to defer under the existing plan.

Recommendation:
We recommend that the plan's management establish procedures to determine maximum percentages allowed for contributions by HCEs in order to eliminate the need to refund these excess amounts.

In addition, we recommend that the plan's management consider implementing a "wrapper" nonqualified deferred compensation plan to which the excess annual deferrals can be contributed. Implementation of this 401(k) "wrapper" plan will enable select HCEs to shelter the maximum amount permitted by law.

b. Timing of Excess Deferral Refunds

8.48

Issue:
A plan must pass certain discrimination tests under IRC Sections 401(k) 401(m). If a plan fails the discrimination tests, any excess deferrals must be returned to the participant within 2½ months after the plan year-end in order to avoid the 10 percent excise tax on the amount not timely refunded under IRC Section 4979.

We noted that the plan had aggregate excess annual deferral refunds in excess of $100,000 for the 20X2 plan year and was unable to obtain the payroll data necessary to calculate the refund within a 2½ month period. As a result, the company owed an excise tax of more than $10,000 for the 20X2 plan year.

Recommendation:
We recommend that the plan's management establish procedures to ensure that the excess annual deferrals be refunded within the 2½ month period to avoid excise tax liabilities.

c. Distribution of Excess Deferrals to Terminated Employees

8.49

Issue:
We noted that an employee who had taken a distribution from the plan during the 20X2 plan year was found to have required an ADP excess contribution refund for that year, resulting in incorrect recording of the distribution.

Recommendation:
We recommend that the plan's management establish procedures to ensure that a Form 1099-R (original or amended) is issued showing the correct portion as a plan distribution and the correct portion as a return of excess ADP deferrals. Because the distribution was made in January 20X2, Form 1099-R is required by January 31, 20X2. Failure to issue a proper Form 1099-R for the ADP excess would be considered a failure to correct the ADP excess for the entire plan.

d. Coverage Testing Effects on ADP Testing

8.50

Issue:
We noted that based on the information provided, the plan did not pass the 410(b) coverage test for the 20X2 and 20X1 plan years, and accordingly, the ADP testing was not passed for these plan years.

Recommendation:
We recommend that the plan's management review the provisions of the 410(b) coverage testing and implement procedures to ensure that the plan will pass this test for upcoming years.

Available Options for Correction:
[***Note:*** In situations in which an issue has been identified and a recommendation made, consider consulting with ERISA counsel regarding available options for correction.]

Rollovers

8.51

Issue:
During our testing of rollover contributions, we noted six exceptions for participants tested. For each of these participants, the rollover was inadvertently deposited into the nonexempt 401(k) plan of ABC Company instead of the defined contribution plan of ABC Company. Transactions construed as a breach of fiduciary duty could result in penalties against the plan sponsor or be considered prohibited transactions, or both.

Recommendation:
We recommend that the rollover funds be moved into the correct plan as soon as reasonably possible. We also recommend that a procedure be instituted that ensures that all rollovers are reviewed to verify that the rollover funds have been deposited into the correct plan.

3. Distributions

Hardship Withdrawals

8.52

Issue:
During our testing of withdrawals by participants, we noted that although the plan document requires elective deferrals to be suspended for a period of six months following a hardship withdrawal, deferrals were not suspended in all cases when participants took hardship withdrawals. In addition, employer matching contributions relating to the unallowable participant deferrals were inappropriately made.

Recommendation:
We recommend that the plan sponsor develop and execute policies and procedures governing the hardship withdrawal process. We also recommend that the plan sponsor consult with an ERISA specialist as soon as possible to determine options for correction. Failure to timely correct these errors could potentially result in the loss of the plan's tax qualified status. Please let us know if we can be of assistance in correcting these matters through one of the IRS programs.

Improper Calculation of Benefits

a. Improper Calculation of Vesting

8.53

Issue:
We noted several instances in which the vesting calculated in accordance with the plan document differed from the vesting paid upon termination.

Recommendation:
We recommend that the plan's management establish procedures for review of the vesting calculations prior to authorizing the distribution to participants.

Available Options for Correction:
[***Note:*** In situations in which an issue has been identified and a recommendation made, consider consulting with ERISA counsel regarding available options for correction.]

b. Improper Support for Calculation

8.54

Issue:
We noted several instances in which a terminated participant's monthly accrued benefit could not be recomputed based on the provisions of the plan document because of the lack of supporting documentation regarding the hours of service worked during employment.

Recommendation:
We recommend that the plan's management establish procedures to recalculate monthly accrued benefits on a select basis for retirees, and benefit files should be reviewed in order to determine that all information necessary to recompute a participant's benefit has been maintained.

Available Options for Correction:
[***Note:*** In situations in which an issue has been identified and a recommendation made, consider consulting with ERISA counsel regarding available options for correction.]

c. Improper Valuation Period

8.55

Issue:
We noted several instances in which a terminated participant was paid a distribution based on the account valuation prior to termination rather than based on the account valuation subsequent to termination, as specified by the plan document. As a result, participants were either overpaid or underpaid.

Recommendation:
We recommend that the plan's management review the provisions of the plan document and the operating procedures in effect to decide if an amendment or a change in operating procedure is necessary.

Available Options for Correction:
[***Note:*** In situations in which an issue has been identified and a recommendation made, consider consulting with ERISA counsel regarding available options for correction.]

d. Improper Credited Service

8.56

Issue:
We noted inconsistent treatment of periods for which an employee was on sick or annual leave. Further, this extended to inconsistent crediting of unused leave time upon termination. Also, under the plan, an individual was required to be on medical leave for six months before he or she qualified for worker's compensation payments, and this six month period was not treated consistently.

Recommendation:
We recommend that the plan's management develop written standards for calculating and crediting these periods of service and train the appropriate personnel in the application of these new written guidelines. We recommend that these calculations be retained in participant files. Should an employee challenge the calculation of breaks in service, the plan should have adequate support for the calculation.

Improper or Missing Benefit Approval

a. Lack of Authorization

8.57

Issue:
We noted several instances in which the benefit request form supporting a distribution greater than $5,000 per participant was not signed by the employer or the employee.

Recommendation:
We recommend that the plan's management establish procedures for review of the benefit request forms before releasing distribution checks to ensure that all required signatures have been obtained.

Available Options for Correction:
[***Note:*** In situations in which an issue has been identified and a recommendation made, consider consulting with ERISA counsel regarding available options for correction.]

b. Lack of Spousal Consent

<u>Termination Benefits</u>

8.58

Issue:
We noted a number of instances in which the spouse did not consent to the form of benefit or such consent was not timely witnessed. Of the three consent issues, lack of witness was by far the most prevalent. We also noticed instances in which the witnessing occurred after the fact.

As a related issue, the plan offers, as the standard form of benefit, a joint and 50 percent survivor annuity. Yet, some locations provide a joint and 100 percent survivor annuity. In almost every case of a 100 percent annuity, the spouse did not consent to the distribution.

Recommendation:
We recommend that the plan's management establish written procedures to ensure that correct spousal consent is obtained on all distributions, except lump sum distributions, which, by definition, may be exempted from consent if they are under $5,000.

<u>Hardship Benefits</u>

8.59

Issue:
We noted that spousal consent is not required on distributions for hardship withdrawals. Spousal consent is required, per the plan document, for termination distributions and loan withdrawals.

Recommendation:
We recommend that the plan's management and counsel consider whether the plan document implies that spousal consent is required on hardship withdrawals.

Improper Payment of Benefits

a. Improper Timing of Payment

8.60

Issue:
We noted a number of occasions in which a participant requested his or her benefit, and the lump sum was correctly computed as of a specified future date. However, the lump sum was not actually paid until several months later, and with the time value of money, if the participant was under age 65, this resulted in underpayment of the lump sum.

We noted that the timing of the cash-out was inconsistent. The cash-out varied from 2 months to 26 months after termination.

Recommendation:
We recommend that the plan's management establish defined cash-out periods each year (for example, June 1 and December 1) and a mandatory deadline by which the application must be submitted. For example, to receive a December 1 lump sum, the plan administrator must have received all information and paperwork not later than the preceding October 15. Any applications received after October 15 will be processed for the next June 1.

b. Duplication of Payments

8.61

Issue:
We noted that on several occasions, an individual was approved for a second lump sum payout, having already received a first payment. According to the trustee, both participants received the second payment.

Recommendation:
We recommend that the plan's management contact the participants to request a refund or correct the error and establish procedures in conjunction with the trustee to cross-check all lump sum distributions, using Social Security number, name, and location codes.

c. Untimely Cessation of Benefits at Death

8.62

Issue:
We noted that the trustee's reconciliation report contains a section titled "Pensioners Removed," whereby the trustee either stops future payments or removes the deceased pensioner and sets up the beneficiary. Under normal circumstances, two or three months elapse between date of death and removal from the records.

We noted, however, a number of occasions in which the removal did not occur until more than six months later and a few longer than a year.

Recommendation:
We recommend that the plan's management develop procedures to test, on a monthly basis, a list of pension checks that did not clear the account within 45–60 days of issuance and contact those participants or their beneficiaries to determine if the participant has died.

Lack of Reconciliation or Review of Benefits

a. Lack of Reconciliation

8.63

Issue:
We noted several instances in which the distribution recorded, per the trust statement, did not agree with the distribution amount recorded in the individual participant account statement.

Recommendation:
We recommend that the plan's management establish procedures for reconciling the distributions, per the trust, to the distributions recorded, per the participants' accounts, routinely (monthly) in order to detect and resolve errors on a timely basis.

b. Lack of Review (Check Endorsements)

8.64

Issue:
We noted that benefit check endorsements are not compared with signatures in applicable participant records.

Recommendation:
We recommend that the plan's management establish procedures to periodically test a sample of benefit check endorsements to signatures in applicable participant records.

c. Calculations by Third Parties

8.65

Issue:
We noted that retirement payments are calculated by an external third party and not by the plan administrator. During our testing we noted that one monthly retirement payment to a participant used the incorrect number of months of service in a benefit calculation.

Recommendation:
We recommend that the plan's management correct the error and implement control procedures to periodically review all data used for benefit calculations and recalculate the actual benefit amount on a selected basis.

d. Payment From Improper Trust

8.66

Issue:
We noted during fiscal 20XX, certain benefits were inadvertently paid from the salaried voluntary employee beneficiary association (VEBA) and should have been deducted from the hourly VEBA.

Recommendation:
We recommend that the plan's management establish controls to ensure that funds are distributed correctly among the VEBA trusts. In addition, to avoid a financial reporting issue, the error should be corrected prior to the fiscal year 20XX plan year-end.

Taxability of Distributions

a. Failure to Withhold on Amounts Greater Than $200

8.67

Issue:
We noted several instances in which distributions greater than $200 did not withhold the mandatory 20 percent taxes.

Recommendations:
We recommend that the plan's management periodically review current tax legislation and the operating procedures in effect to ensure that the plans are operating in compliance with the applicable laws in effect. In addition, we recommend that the plan's management establish procedures to ensure that all participants complete the mandatory withholding acknowledgement form.

Available Options for Correction:
[***Note:*** In situations in which an issue has been identified and a recommendation made, consider consulting with ERISA counsel regarding available options for correction.]

b. Improper Tax Withholding on Foreign Citizens

8.68

Issue:
We noted that U.S. income taxes were incorrectly withheld on distributions under the plan; however, under general guidelines that we understand are met, non-U.S. citizens are not subject to U.S. withholding requirements. Because income taxes were incorrectly withheld, Form 1099R is improper.

Recommendation:
We recommend that the plan's management periodically review current tax legislation and the operating procedures in effect to ensure that the plan is operating in compliance with the applicable laws in effect.

Available Options for Correction:
[***Note:*** In situations in which an issue has been identified and a recommendation made, consider consulting with ERISA counsel regarding available options for correction.]

c. Improper Tax Withholding on Minimum Required Distributions

8.69

Issue:
We noted that withholding on minimum required distributions is done at 20 percent rather than the specified rate for annuities under the plan (which allows an election out of withholding).

Recommendation:
We recommend that the plan's management periodically review current tax legislation and the operating procedures in effect to ensure that the plan is operating in compliance with the applicable laws in effect.

Available Options for Correction:
[***Note:*** In situations in which an issue has been identified and a recommendation made, consider consulting with ERISA counsel regarding available options for correction.]

Miscellaneous Distributions

a. Nonverification of Disability Status for Benefits

8.70

Issue:
Per review of the plan document, we noted that employees becoming permanently and totally disabled for a period of a minimum of 6 months, after 20XX, and having completed a minimum of 10 years of vesting service are eligible for monthly pension benefits equal to the employee's accrued benefit. The company has the option of requiring additional proof of the continued disability once every 6 months.

Additional disability proof is not requested on a periodic basis. Therefore, because approximately XX former employees are claimed to be permanently and totally disabled, the potential exists that the company is unnecessarily distributing pension benefits to these individuals.

Recommendation:
We recommend that the plan's management establish procedures to periodically obtain proof from these individuals to verify the continuance of their disability.

Qualified Domestic Relations Order

a. Improper Qualified Domestic Relations Order Execution

8.71

Issue:
We noted that a distribution made under a divorce decree was not executed in accordance with all the specifications of the qualified domestic relations order (QDRO).

Recommendation:
We recommend that the plan's management establish procedures to review the calculation of the distribution in accordance with the terms of the QDRO before authorization and release of the distribution.

4. Investments

8.72

Issue:
The plan has not adopted a formal investment policy.

ERISA imposes a fiduciary responsibility requiring a plan, among other things, to manage plan assets solely in the interest of participants and beneficiaries and diversify investments to minimize the risk of large losses. If the plan's fiduciary is determined not to have fulfilled his or her responsibility, the participants would have to be "made whole." This would likely represent costly cash deposits from the plan sponsor and possibly even jeopardize the plan's tax qualification status or lead to penalties, or both.

Recommendation:
In order to ensure that plan assets are prudently and effectively managed, we recommend that the plan adopt an investment policy that outlines the roles and responsibilities of those individuals and committees involved in the plan's administration and management. Such a policy also should address permitted investments, asset mix, and concentration, as well as provide for a method of reviewing, monitoring, and taking appropriate action with regard to the plan's overall investment return.

8.73

Issue:
During our review of the plan's investment activity, we noted that the administrator does not receive monthly transaction statements from ABC Associates and is instead using DEF Company monthly statements of account to record investment activity. These statements are not as complete and thorough as the manager's statements and do not provide the administrator with the details necessary to correctly record investment earnings.

Recommendation:
We recommend that the plan administrator begin receiving monthly investment statements from ABC Associates and record investment activity on a monthly basis. Once investment activity has been recorded, the general ledger should be reconciled to the DEF Company monthly statements of account. This will allow the plan administrator to accurately and timely report on the investment valuation and earnings of the plan.

Lack of Investment Policy

8.74

Issue:
We noted that the plan committee has not adopted a formal investment policy.

Recommendation:
We recommend that the plan's management adopt a formal investment policy for there to be a guideline against which to measure investment performance and fiduciary responsibilities.

Lack of Investment Appraisals

8.75

Issue:
The IRC and Title I of ERISA require that plan assets be stated at fair market value. We noted that the company did not have a current appraisal performed on the company stock in the plan and that the last valuation was dated 20XX.

Recommendation:
The plan's management should establish procedures to ensure that an independent appraisal of the company stock in the plan is performed annually.

Available Options for Correction:
[***Note:*** In situations in which an issue has been identified and a recommendation made, consider consulting with ERISA counsel regarding available options for correction.]

Uninvested Assets

8.76

Issue:
We noted that the VEBA plan document currently states that VEBA cash funds should be invested. The cash currently is held in a noninterest bearing account. During the past year, the cash balance has ranged from approximately $200,000 to over $1 million.

Recommendation:
We recommend that the plan's management should consider investing the cash in an interest bearing account to comply with the plan document and earn interest income.

Lack of Historical Cost Data for Nonparticipant-Directed Investments

8.77

Issue:
We were unable to obtain from the trustee a detailed report of investment sales with historical cost information. This was not a problem for reporting the gain or loss on reportable transactions because there were no transactions over the reportable threshold in the current plan year. However, this information is a required disclosure by the DOL and will present a problem in future years.

Recommendation:
We recommend that the plan's management request from the trustee a report showing the historical cost, selling price, quantity, identification, and acquisition date to eliminate a potential issue as sales transactions increase and surpass the reportable transaction threshold.

Nonverification of Investment Income

8.78

Issue:
We noted that investment returns, including dividends and capital gains, are not compared with public sources for interest and dividend values.

Recommendation:
We recommend that the plan's management establish a procedure whereby investment returns are monitored and compared with public sources to ensure the completeness and accuracy of the returns posted by the trustee or asset custodian.

5. Loans

Participant Loans

8.79

Issue:
The plan document does not limit loans to the lesser of $50,000 or the greater of one-half of the nonforfeitable account balance or $10,000.

The IRS requires these limits in order for loans not to be considered deemed distributions. In addition, failure to comply could result in penalties against the plan sponsor; possible reporting of prohibited transactions; and, ultimately, loss of qualifying tax status.

Recommendation:
We recommend plan management amend the plan document to bring the participant loan provisions in accordance with the IRC. Past transactions should be reviewed and any not in compliance with the statutory limits should be brought into compliance through an IRS corrections program.

8.80

Issue:
No written procedures exist for the processing and administration of loans. As a result, plan requirements and control procedures may not be clearly understood. Improper loans could be deemed distributions and, therefore, taxable to the participant. In addition, failure to comply could result in penalties against the plan sponsor; possible reporting of prohibited transactions; and, ultimately, loss of qualifying tax status.

Recommendation:
We recommend plan management develop and document policies and procedures governing the participant loan process. This document should then be attached and used in conjunction with the plan document.

8.81

Issue:
Term of participant loans is greater than five years.

The IRS requires loan terms be subject to limits. Except for the purchase of a principal residence, loan terms are limited to five years. Improper loans could be deemed distributions and, therefore, taxable to the participant. In addition, failure to comply could result in penalties against the plan sponsor; possible reporting of prohibited transactions; and, ultimately, loss of qualifying tax status.

Recommendation:
We recommend that the plan's management amend the plan document to bring the participant loan provisions in accordance with the IRC. Past transactions should be reviewed and any not in compliance with the statutory limits should be brought into compliance through an IRS corrections program.

8.82

Issue:
Loans in default are not administered in accordance with the plan document.

Recommendation:
ERISA and the IRS require loans deemed to be in default, as defined by the plan document, to be treated as a distribution and a Form 1099 issued to the participant.

Existing loans should be reviewed and amended, if necessary, and past transactions brought into compliance through an IRS or DOL corrections program.

8.83

Issue:
During our testing of loans, we identified one participant who had two accounts with two different Social Security numbers. One of the accounts appeared to be inactive.

Recommendation:
We recommend that the inactive account for this person be deleted so that no activity can be posted. We also recommend that plan management, on a test basis, run diagnostic tests to identify duplicate Social Security numbers and participant names. Plan management should take corrective actions to investigate, resolve, and remove participant records that have duplicate names and Social Security numbers.

Improper Execution of Loans

a. Improper Approval for Loans

8.84

Issue:
We noted that several loan agreements lacked the signature of the employer, the lender, or the employee.

Recommendation:
We recommend that the plan's management establish procedures to review the loan agreements before releasing the loan checks to ensure that all appropriate signatures and required supporting documents have been obtained.

b. Improper Interest Rates Utilized

8.85

Issue:
We noted one instance in which the interest rate on a loan under the plan was not adjusted to reflect an increase in the prime rate, as specified in the loan procedures.

Recommendation:
We recommend that the plan's management establish procedures to ensure that the rates on all new loans are proper and in accordance with written loan procedures.

c. Untimely Repayment of Loans

8.86

Issue:
We noted several instances in which the payroll deductions for plan participant loans were not started on a timely basis, resulting in outstanding loan balances that differed significantly from that scheduled per the loan amortization schedule.

Recommendation:
We recommend that the plan's management establish procedures to ensure that loan repayment information is set up on the payroll system promptly so that delays in payment do not occur.

Available Options for Correction:
[***Note:*** In situations in which an issue has been identified and a recommendation made, consider consulting with ERISA counsel regarding available options for correction.]

d. Improper Support for Loans

8.87

Issue:
We noted that approved principal residence loan agreements did not have a sales contract or other supporting documentation attached, as required by established procedures.

Recommendation:
We recommend that the plan's management establish a checklist for required supporting documentation to be obtained for principal residence loans to be completed prior to the approval of the loan; review the loan application form and determine whether to require a copy of a sales contract for principal residence loans; and make revisions to the loan application form, as necessary.

6. Participant Data Testing

Participant Accounts

8.88

Issue:
Incidences of missing or incomplete participant account information (such as enrollment forms, investment change forms, and loan authorization forms) were experienced during the audit.

Maintaining proper documentation regarding participant data can safeguard the plan and the plan sponsor. Transactions construed as a breach of fiduciary duty could result in penalties against the plan sponsor or be classified as prohibited transactions, or both.

Recommendation:
A procedure should be instituted that ensures all documentation is forwarded and filed into participant files. Also, a record retention policy should be drafted covering all paper and electronic files.

a. Documentation Contained in Personnel Files

8.89

Issue:
During our testing of participant data, we noted that there were instances in which employee personnel files did not contain adequate support for the employees' dates of hire or did not contain the employees' dates of birth, or both.

Recommendation:
We recommend that documentation be obtained and maintained in employee files to support plan operations.

b. Inconsistencies in Demographic Data

8.90

Issue:
During our audit, we noted discrepancies between information recorded on the payroll report and personnel files relating to employee data, such as date of birth and hire date. Because information recorded on the payroll report is used as a source for updating employee data to be used by the third party administrator (TPA) and to determine the eligibility of an employee, failure to keep accurate employee data might result in eligibility status of employees being incorrectly determined. Also, it was noted that incorrect employee data was provided to the actuary, which uses the census data to perform the FASB *Accounting Standards Codification* 965, *Plan Accounting—Health and Welfare Benefit Plans*, liability calculation.

Recommendation:
We recommend that in the future, any new or updated employee data being entered into the system be reviewed to make sure it agrees with supporting documents in the personnel files. The accuracy of employee data should be reviewed before it is sent to the actuary.

8.91

Issue:
During our testing of participant data, we noted two exceptions for participants tested. The most recent enrollment form for each of these individuals was missing evidence of authorization by the plan administrator. Documentation supporting appropriate authorization of all enrollments should be maintained. Maintaining proper documentation regarding participant data can safeguard the plan and the plan sponsor. Transactions construed as a breach of fiduciary duty could result in penalties against the plan sponsor or be considered prohibited transactions, or both.

Recommendation:
We recommend that enrollments not be processed until proper written authorization has been received. We also recommend that a procedure be instituted that ensures all documentation is forwarded and filed into participant files.

8.92

Issue:
During our testing of participant data, we could not obtain written documentation of the authorization of the change in the deferral percentage by one participant selected for testing. Documentation supporting all changes should be maintained as evidence of the appropriate authorization. Maintaining proper documentation regarding participant data can safeguard the plan and the plan sponsor. Transactions construed as a breach of fiduciary duty could result in penalties against the plan sponsor or be considered prohibited transactions, or both.

Recommendation:
We recommend that deferral changes not be processed until proper written authorization has been received. We also recommend that a procedure be instituted that ensures all documentation is forwarded and filed into participant files.

8.93

Issue:
During our testing of participant data, we noted one exception related to the maintenance of an employee's status. For the exception noted, the employee had changed her status from full time to temporary; however, the status change was not documented correctly and was recorded as reduced hour part time. This affected her eligibility to participate in the plan.

Recommendation:
We recommend that a procedure be instituted that ensures that all employment status changes be reviewed by someone other than the individual preparing them. Documentation supporting all employment status changes should be maintained as evidence of the appropriate change. Maintaining proper documentation regarding participant data can safeguard the plan and the plan sponsor. Transactions construed as a breach of fiduciary duty could result in penalties against the plan sponsor or be considered prohibited transactions, or both.

8.94

Issue:
During our testing of participant data, we could not obtain written documentation of the authorization of a hardship withdrawal by one participant selected for testing from the tax sheltered annuity plan of ABC Company. Documentation supporting appropriate authorization of all hardship withdrawals should be maintained. Maintaining proper documentation regarding participant data can safeguard the plan and the plan sponsor. Transactions construed as a breach of fiduciary duty could result in penalties against the plan sponsor or be considered prohibited transactions, or both.

Recommendation:
We recommend that hardship withdrawals not be processed until proper written authorization has been received. We also recommend that a procedure be instituted that ensures all documentation is forwarded and filed into participant files.

8.95

Issue:
During our testing of benefit payments, we noted that certain demographic information, per the recordkeeping system, such as date of birth, date of hire, or date of termination, for five participants selected for testing did not agree with the information in the participants' personnel files.

Recommendation:
We recommend that the plan sponsor develop and execute policies and procedures to review and approve the participant data after it is entered into the recordkeeping system by someone other than the individual submitting the information to ensure that all required information is accurate and submitted for processing.

8.96

Issue:
During our testing of participant data, we could not obtain written documentation of the authorization of the change in the deferral percentage by one participant selected for testing. Documentation supporting all changes should be maintained as evidence of the appropriate authorization. Maintaining proper documentation regarding participant data can safeguard the plan and the plan sponsor. Transactions construed as a breach of fiduciary duty could result in penalties against the plan sponsor or be considered prohibited transactions, or both.

Recommendation:
We recommend that deferral changes not be processed until proper written authorization has been received. We also recommend that a procedure be instituted that ensures all documentation is forwarded and filed into participant files.

8.97

Issue:
During our testing of participant data, we noted two exceptions for participants tested. For one participant selected, the date of hire, per the participant recordkeeping system, was incorrect. For another participant selected, evidence of authorization of the participant's contribution deferral percentage could not be located. Documentation supporting all enrollments and election changes should be maintained as evidence of the appropriate authorization. Maintaining proper documentation regarding participant data can safeguard the plan and the plan sponsor. Transactions construed as a breach of fiduciary duty could result in penalties against the plan sponsor or be considered prohibited transactions, or both.

Recommendation:
We recommend that a procedure be instituted that ensures documentation evidencing authorization of enrollment and deferral rate changes or investment election changes is maintained. Enrollments and election changes should not be processed until proper authorization has been received.

8.98

Issue:
During our testing of participant data, we noted that there were components of participant data that did not match those of the actuary. The date of hire for Joe Smith was incorrectly reported as April 4, 20X0, and the Social Security number for Tom Jones was incorrect. In addition, it appears that the compensation given to the actuary by the administrator was taken from box 3 of the W-2, which excludes nontaxable health insurance premiums and includes any taxable portion of the participant's group term life insurance premiums paid by the organization. This is not consistent with the plan definition of *compensation*.

Recommendation:
We recommend that the administrator and actuary make the correction to the date of hire and the Social Security number for the participants previously named. We also recommend that the administrator use the

total earnings, as reported on the December 31 payroll register, for compiling participant compensation for reporting to the actuary. Although the effect of the year 20X2 incorrect data is not significant to the plan as a whole, continued reliance on incorrect data may become significant and should not go uncorrected.

Participant Enrollment Forms

8.99

Issue:
During our testing of participant data, we noted 22 exceptions for participants tested. Evidence of authorization of the most recent contribution deferral percentages could not be located. Documentation supporting all enrollments and election changes should be maintained as evidence of the appropriate authorization. Maintaining proper documentation regarding participant data can safeguard the plan and the plan sponsor. Transactions construed as a breach of fiduciary duty could result in penalties against the plan sponsor or be considered prohibited transactions, or both.

Recommendation:
We recommend that a procedure be instituted that ensures documentation evidencing authorization of enrollment and deferral rate changes or investment election changes is maintained. Enrollments and election changes should not be processed until proper authorization has been received.

8.100

Issue:
During our testing of participant data, we noted four exceptions for participants tested. The most recent enrollment form indicating the contribution deduction percentages could not be located for four participants. Two of the exceptions related to employees of a company that was merged with the plan sponsor. Documentation supporting all enrollments and election changes should be maintained as evidence of the appropriate authorization. Maintaining proper documentation regarding participant data can safeguard the plan and the plan sponsor. Transactions construed as a breach of fiduciary duty could result in penalties against the plan sponsor or be considered prohibited transactions, or both.

Recommendation:
We recommend that a procedure be instituted that ensures documentation evidencing authorization of enrollment and deferral rate changes or investment election changes is maintained. Enrollments and election changes should not be processed until proper authorization has been received.

a. Monitoring of Accounts of Participants 70½ Years of Age and Older

8.101

Issue:
We noted that there is no monitoring of accounts for participants who are 70½ years of age or older by plan management or ABC TPA, the trustee of the plan.

Recommendation:
We recommend that the plan's management, on a periodic basis, review the accounts of those participants who are 70½ years of age or older to ascertain whether mandatory distributions are required to be paid from the accounts.

b. Removal of Deceased Participants

8.102

Issue:
During our procedures to verify if participants and beneficiaries of ABC pension plan 90 years of age or older were still living, we noted that 2 beneficiaries who were deceased prior to January 1, 2006, had been improperly included in the census data.

Recommendation:
We suggest that the company expand its procedures to check that deceased beneficiaries are properly excluded from the census data, particularly with regard to joint and survivor forms of payment. Additionally, the company should review participants who are at a higher risk for being deceased by using an age threshold (for example, 90 years of age or older) to ensure they have not passed away. The company can utilize the Web site http://ssdi.rootsweb.com to assist in this task.

7. Internal Control

Internal Controls

8.103

Issue:
Currently, a formal bank reconciliation is not being prepared for the [*name of bank account*]. Bank reconciliations are an important internal control procedure to ensure that all assets are accounted for and that any errors are detected and corrected on a timely basis.

Recommendation:
We recommend that formal bank reconciliations be prepared for this account as long as funds remain in this account and there are receipt and disbursement activities within it.

8.104

Issue:
The plan administrator initiates cash receipt and disbursement activity for loan payments and benefit distributions in an account drawn on the brokerage account. No bank reconciliations are prepared for this account. In addition, plan administrator personnel summarize the cash receipt and disbursement activity only as it is reflected as cleared in the brokerage money market account's monthly statements. Benefit distributions were properly recorded from those checks that were written; however, cash was not reduced by the amount of the checks that had not cleared by year-end. Consequently, the cash balance reported to the administrator was overstated, and the balance of unrealized gains and losses was "forced" improperly.

Recommendation:
We recommend that bank account reconciliations be prepared monthly in order to maintain the integrity of cash controls and ensure that cash is properly accounted for. We also recommend that all cash receipts and disbursements be recorded on a double entry accounting method as receipts are deposited and checks are written. All activity should then be summarized monthly and entered into the general ledger, as recommended previously.

8. Administrative Matters

Regulatory Compliance

8.105

Issue:
During our audit of the plan's records, it came to our attention that the level of documentation normally expected with respect to a retirement plan is not present. Although nothing came to our attention causing us to believe that errors may have occurred, sufficient procedural controls do not seem to be in place. For example, we did not find any documentation by the plan administrator regarding the definition of *HCEs*; the top heavy test, which is a test showing compliance with the participation and coverage rules; satisfaction of the maximum contribution or allocation limits; compliance with the nondiscrimination rules for salary deferral arrangements; proper verification of previous employment; or verification of signatures on cashed benefit checks. In addition, the trustees do not maintain adequate records of the basis for investment decisions.

Further, the trustees do not maintain an up-to-date list of parties in interest and disqualified persons because those terms are defined by the law. This makes it difficult to ensure that no prohibited transactions occur. Maintaining such a list is required. Finally, the ERISA bond is not up to date, is not large enough, or does not name the plan as the insured. Violation of the bonding law means that the handling of plan assets by nonbonded persons is an illegal act.

Recommendation:
We recommend that the plan sponsor adopt a written set of policies and procedures designed to mitigate the plan's risk with regard to regulatory compliance. These procedures should outline the various responsibilities applicable to plan administration and those parties that are responsible for executing the procedures.

Administrative Costs

8.106

Issue:
The disclosure rules for benefit plan audits require that we look at the administrative costs of the plan that are paid by the employer. In this investigation, it came to light that the annual costs of this plan exceed the average. (According to the National Chamber of Commerce study of X1 plan activity, the average per participant cost of running a defined contribution qualified plan is $XX. This is for plan recordkeeping and government filings only, not investment fees.) Your plan's recordkeeping for last year was $XXX per participant. We suggest that you investigate where these fees are being generated. Sometimes, this is simply due to a duplication of services. When separate administrators are used for both plans, each administrator may be doing all the nondiscrimination testing for both plans. It may be that both the fund manager and the contract administrator are tracking the 401(k) plan limits. It may be that communication between your personnel and the administrator is not going as well as it could. We found nothing wrong but are simply suggesting that the matter should be reviewed to see if efficiencies and cost savings can be realized.

Recommendation:
We recommend that the plan sponsor review the assignment of responsibilities, with respect to meeting regulatory compliance requirements, and eliminate duplication of effort, if any exists. Additionally, it may be advisable to seek competitive bids for some aspects of plan administration to ensure only reasonable costs are borne by the plan sponsor or plan participants, as applicable.

Investment Policy Guidelines

8.107

Issue:
We noted during our audit that the plan did not have written investment policy guidelines or seem to maintain adequate records of the basis for investment decisions. In addition, the plan does not have procedures to periodically monitor investment performance against expected performance.

Recommendation:
We recommend that the plan develop written investment policy guidelines to establish investment mix, risk, safety, liquidity, and targeted investment returns. In addition, the plan trustees or their designees should periodically monitor investment performance compared with the established guidelines.

Personnel Files

8.108

Issue:
The company could not locate numerous personnel files, and files we reviewed did not contain important documents. It is the company's policy to retain a copy of the participants' investment elections and investment allocation changes. This is an important procedure because the only trail for changes made by the participants is the company's copy and the copy sent to the investment manager.

Recommendation:
We recommend that the personnel files be reviewed for completeness and all missing election forms and change requests be replaced. Copies of the original enrollment forms and change requests should be requested from the investment manager.

Segregation of Duties

8.109

Issue:
The payroll function of the plan sponsor has an inadequate segregation of duties. The same person inputs new employees and weekly payroll information into the payroll system, transmits the data to the payroll service, receives the checks and the payroll register, and distributes the checks to the supervisors. The same individual who is responsible for entering new employee and pay rate changes into the payroll system should not be authorized to input weekly payroll information into the system or transmit payroll data. In addition, the individuals authorized to input new employees, rate, or time worked should not have access to the paychecks upon their receipt from the payroll service.

Recommendation:
We recommend that paychecks be delivered to a person other than the payroll clerks, who could then distribute the checks to the supervisors, thus, completely segregating the accounting for payroll from the distribution of paychecks. Although the employee currently in charge of payroll gives the payroll register to another employee to review, we recommend that the reviewer initial the report to evidence the verification. In addition, we recommend that someone other than the supervisors distribute the checks to the employees on a periodic basis.

Dual Signatures

8.110

Issue:
Currently, checks written on the plan's checking account require only one signature. The same individual who signs the checks maintains the records of the plan.

Recommendation:
We recommend that two signatures be required on all disbursements or that another member of the committee review all bank statements and canceled checks on a monthly basis and evidence this review by initializing the bank statements.

a. Bank Reconciliations

8.111

Issue:
While performing procedures related to the ABC supplemental unemployment benefit plan, it was noted that accounting personnel could not locate the December 20X2 bank statement and reconciliation for the plan checking account.

Recommendation:
Although no issues were noted in previous years or in other months related to these bank reconciliations, we recommend that the company implement procedures to retain such records.

Accuracy of Data Sent From TPA

8.112

Issue:
While performing our tests on a selected sample of participants, we noted several participants with incorrect vesting percentages. Our sample was expanded and finally resulted in a review by the plan administrator of each employee's vesting percentage. Upon further inquiry of plan administrator personnel, we noted that many of the reports sent from the outside TPA were not being reviewed by plan administrator personnel.

Recommendation:
We suggest that procedures be adopted to ensure that plan administrator personnel review all data sent from the TPA on a timely basis. Checklists could be developed to ensure all pertinent data gets reviewed. If certain data is not received or is missing, the plan administrator could request copies of the TPA's reports to verify the proper vesting percentages; compensation amounts; birth, hire, and termination dates; and number of hours worked.

Accuracy of Employee Data

8.113

Issue:
During our audit, we noted discrepancies between information recorded on the payroll report and personnel files relating to employee data, such as date of birth and hire date. Because information recorded on the payroll report is used as a source for updating employee data to be used by the TPA and to determine the eligibility of an employee, failure to keep accurate employee data might result in eligibility status of employees being incorrectly determined. Also, it was noted that incorrect employee data was provided to the third party plan administrator, resulting in a terminated participant of the plan still listed as active on the allocation report. Classification errors may result in forfeitures being incorrectly allocated to ineligible participants.

Recommendation:
We recommend that in the future, any new or updated employee data being entered into the system be reviewed to make sure it agrees with supporting documents in the personnel files. The accuracy of employee data also should be reviewed before it is sent to the TPA.

Use of TPAs

8.114

Issue:
We noted that one of the plan trustees performs all administration for the plan. Compliance with the ERISA regulations is both complex and difficult. Significant and increased complexities in the laws include tests for coverage, discrimination, and top heavy rules; HCEs tests; and forfeitures tracking for rehired employees.

Recommendation:
We recommend the plan utilize a TPA to perform the various required coverage tests and to perform allocations of contributions, earnings, and forfeitures; maintain participant account balances; and prepare participant account statements.

Minutes of Trustees' Meetings

8.115

Issue:
No formal minutes are maintained for actions taken by the trustees. With the significant number of investment failures within benefit plans, the complexity of investment alternatives, and the complexity of the tax laws covering the qualifications of the plan and fiduciary responsibilities of the trustees, it is important that the trustees adequately document the due diligence they exercise over operations of the plan, including selection of an investment policy and investment alternatives to offer participants who defer their earnings into the plan's investments, and monitor investment performance against the plan's objectives.

The [*trustees*] [*administrative committee*] should meet at least annually to review the investment returns, review the soundness of the investments, select investment managers, determine investment strategies, approve benefit payments, monitor tax and qualification compliance, and approve plan amendments.

In addition, the plan changed trustees during the year from the bank trust department to the group of individuals appointed by the company's board of directors. It is prudent to maintain formal minutes for certain decisions made and actions directed or carried out by the trustees of the plan because they have fiduciary responsibility over the plan. In addition, the trustees and the company may wish to reduce some of their liability as fiduciaries. Now that the plan has become participant directed, if the plan fiduciaries wish to shift to plan participants the responsibility for investment performance and how funds are invested, as permitted under ERISA Section 404(c), certain procedures must be followed. Even if such action is taken, the fiduciary remains responsible for the following:

- Properly selecting and monitoring investment funds
- Timely and accurately carrying out participant directions
- Distributing timely information on investment choices
- Avoiding prohibited transactions and other transactions in violation of plan terms or which could result in the disqualification of the plan

For responsibility for asset management to shift to the participants, the plan must give the participants the opportunity to exercise control on an informed basis over those assets by selecting investments from a broad range of investment alternatives. For the plan administrator to escape this responsibility, the participant must be informed that he or she is responsible for these decisions.

Recommendation:
We recommend the trustees and plan administrator establish procedures for carrying out the preceding and document the establishment of those procedures in formal minutes. Procedures should include performance and documentation in the minutes of (*a*) an annual review of investment performance of each investment offered in light of the objectives established for that investment option, compared with market benchmarks for each related market sector; (*b*) a periodic review of the operations of the plan as carried out by the plan administrator, TPA, and investment manager; and (*c*) review and approval of all benefit distributions. If the plan is amended to modify or change certain elections on operating the plan, the company is already

documenting its approval of the board resolution; documentation of any actions taken or recommendations made by the trustees leading to the modification of such operations should be included.

Plan Fees and Expenses

8.116

Issue:

A participant-directed retirement savings plan, such as a 401(k) plan, is an important tool to help your employees achieve a secure retirement. As part of offering this type of program, you or someone you choose must select the investment options from which your employees will choose, select the service providers for the plan, and monitor the performance of the investments and the provision of services. All of these duties require you to consider the costs to the plan. You or the person you select to carry out these responsibilities must comply with the standards provided under ERISA. This federal law protects private sector pension plans. The law's standards include ensuring that you act prudently and solely in the interest of the plan's participants and beneficiaries. Understanding fees and expenses is important in providing for the services necessary for your plan's operation. This responsibility is ongoing. After careful evaluation during the initial selection, the plan's fees and expenses should be monitored to determine whether they continue to be reasonable. Although ERISA does not set a specific level of fees, it does require that fees charged to a plan be reasonable. Of course, the process of selecting a service provider and investment options should address many factors, including those related to fees and expenses. You must consider the plan's performance over time for each investment option. This selection process and continual monitoring will make it possible for your employees to make sound investment decisions. As part of your evaluation process, here are 10 questions to help focus your consideration of fees and expenses:

1. Have you given each of your prospective service providers complete and identical information with regard to your plan?
2. Do you know what features you want to provide (for example, loans, number of investment options, types of investments, and Internet trading)?
3. Have you decided which fees and expenses you, as plan sponsor, will pay; which your employees will pay; and which you will share?
4. Do you know which fees and expenses are charged directly to the plan and which are deducted from investment returns?
5. Do you know what services are covered under the base fee and what services incur an extra charge? Do you know what the fees are for extra or customized services?
6. Do you understand that some investment options have higher fees than others because of the nature of the investment?
7. Does the prospective service arrangement have any restrictions, such as charges for early termination of your relationship with the provider?
8. Does the prospective arrangement assist your employees in making informed investment decisions for their individual accounts (for example, providing investment education, information on fees, and the like) and, if so, how are you charged for this service?
9. Have you considered asking potential providers to present uniform fee information that includes all fees charged?
10. What information will you receive on a regular basis from the prospective provider so that you can monitor the provision of services and the investments that you select and make changes, if necessary?

Recommendation:

Fees are just one of several factors you need to consider in your decision making. All services have costs. Compare all services to be provided with the total cost for each prospective provider. Consider obtaining estimates from more than one service provider before making your decision. Cheaper is not necessarily better. Ask each prospective provider to be specific about which services are covered for the estimated fees and which are not. To help in gathering this information and in making equivalent comparisons, you may want to use the same format for each prospective provider. See www.dol.gov/ebsa for an example of a uniform fee disclosure format to assist in your selection and monitoring process. If you need assistance to evaluate the fees you are paying for your service provider, we would be happy to assist you.

a. Monitoring Compliance With the Service Agreements

8.117

Issue:
We noted that the latest fee schedules are not obtained from service providers, although the agreements are reviewed and updated on a periodic basis. We also noted that there may be an over-reliance on the integrity of the service provider to act within the terms of the agreement, with little, if any, review by management.

Recommendation:
We recommend that a person who is independent of the negotiations of the service agreements perform periodic checks on the service providers' compliance with the service agreements; that fees charged are within the guidelines of the agreements; that fees are properly attributable to the plan's operation; and that fees, if assessed to the plan, are properly charged and allocated.

9. Other Matters

Float Pool Employees

8.118

Issue:
The plan does not cover float pool employees (who are leased employees) or any other leased employees of ABC Company and its participating employers (collectively, the company). Per discussion with company personnel, it was noted that some of the leased employees may have been employed by the company for longer than 12 consecutive months and could have worked more than 1,500 hours. Float pool employees who meet the preceding criteria should be, but may not have been, included in testing to demonstrate compliance with the IRC requirements for nondiscrimination in coverage [IRC Section 410(b)]. This requirement must be satisfied in order for the plan to retain its qualified status.

Recommendation:
We recommend that any leased employees meeting the preceding criteria be included in the IRC coverage testing and that the plan sponsor take whatever action will be required, based on the results of those tests, prior to December 31, 20X3.

Nondiscrimination Rules

8.119

Issue:
During our audit, we noted that the plan was originally not in compliance with the IRC requirements for nondiscrimination in benefits [such as IRC Sections 401(k) and 401(m)] for 20X2. Refunds were made after March 15, 20X3.

Recommendation:
We recommend that the plan sponsor file Form 5330 for late correction of this failure.

Participation

8.120

Issue:

The plan adoption agreement has handwritten reference to eligibility that excludes part time [*name of club*] club employees. The other companies use 1,000 hours as a requirement for eligibility, which is appropriate under IRS regulations. Until 20X2, employees of the club with part time status who worked at least 1,000 hours were excluded from the plan. It does not appear that the part-time exclusion, as the plan is drafted, is proper under IRS regulations. Those part time employees of the club who worked more than 1,000 hours have subsequently terminated from the plan and did not achieve any vesting.

Recommendation:

We recommend that the plan be administered in accordance with the IRS-approved prototype plan, not in accordance with handwritten modifications.

Plan Administration

8.121

Issue:

As of the date of our report, we could not determine whether the plan sponsor had performed testing for all adopting employers to demonstrate compliance with certain IRC requirements (for example, nondiscrimination in coverage [IRC Section 410(b)], top heavy [IRC Section 416], annual additions [IRC Section 415(c)], limits on elective deferrals [IRC Section 402(g)], and nondiscrimination in benefits [IRC Sections 401(k) and 401(m)]). These requirements must be satisfied in order for a plan to retain its qualified status. Additionally, according to the testing we did receive, a number of adopting employers failed certain tests. We were unable to determine whether the appropriate steps were taken to correct those failures.

Recommendation:

We recommend that the IRC testing be performed for all adopting employers and that the plan sponsor take whatever action will be required, based on the results of those tests, prior to December 31, 20X2.

8.122

Issue:

As of the date of our report, the plan sponsor had not performed testing to ensure that fund income was not subject to the tax on unrelated business income, in accordance with IRC requirements (such as IRC Sections 419A and 511).

Recommendation:

We recommend that the IRC testing be performed and that the plan sponsor take whatever action will be required, based on the results of those tests, prior to December 31, 20X3.

8.123

Issue:

As of the date of our report, ABC Company (plan sponsor) had not performed testing to demonstrate compliance with IRC requirements for nondiscrimination in benefits [such as IRC Section 401(m)] for the tax sheltered annuity plan of ABC Company. These requirements must be satisfied in order for the plan to retain its 403(b) status.

Recommendation:

We recommend that the IRC testing be performed and that the plan sponsor take whatever action will be required, based on the results of those tests, prior to December 31, 20X3.

8.124

Issue:
As of the date of our report, the plan sponsor had not performed testing to demonstrate compliance with certain IRC requirements (for example, nondiscrimination in coverage [IRC Section 410(b)], annual additions [IRC Section 415(c)], and limits on elective deferrals [IRC Section 402(g)]. These requirements must be satisfied in order for a plan to retain its qualified status.

Recommendation:
We recommend that the IRC testing be performed and that the plan sponsor take whatever action will be required, based on the results of those tests, prior to December 31, 20X2.

Reconciliations

8.125

Issue:
During our audit, it was noted that the plan sponsor does not reconcile the participant deferral contributions, per the payroll records, and the employer contributions, per the company records, to the contributions, per the trust statements, or the monthly benefit payments, per the company records, to benefit payments, per the trust statements.

Recommendation:
We recommend that the plan sponsor perform the preceding reconciliations on a periodic basis. By performing these reconciliations on a periodic basis, the plan sponsor will be able to identify reconciling items on a timely basis and ensure that all contributions and benefit payments are properly recorded on a timely basis.

Plan Compensation

a. Interpretation of Definition of Eligible Compensation

8.126

Issue:
We noted that there is some inconsistency in the application of the terms in the plan document relating to the definition of *eligible wages* for the purposes of calculating the employees' contributions and the employer's contribution. One participant in our sample received contributions based on his compensation including severance pay, although the severance pay should not have been included, based on our reading of the plan document. We also noted that there was some confusion between the payroll department and the human resources department regarding what constituted eligible wages.

Recommendation:
We recommend that the plan's management establish procedures to ensure that the payroll and human resources departments are well-versed in the provisions of the plan document because these provisions relate to their functions. We also recommend that the plan document be modified to clarify the definition of what is included in eligible wages. This will ensure that the contribution calculations are made accurately and are understood by the employees who review their accounts. We recommend that the plan's management review their calculation of eligible pay and periodically spot check the calculation to ensure the proper amount of earnings is being used.

b. Accuracy of Application of 415(c) Plan Compensation

8.127

Issue:
We noted that the 415(c) compensation used in the ADP test was not in accordance with the plan document.

Recommendation:
The plan's management should review the definition of *415(c) plan compensation* in the plan document, in conjunction with the calculations of the ADP testing, to ensure proper amounts are used in the testing.

Available Options for Correction:
[***Note:*** In situations in which an issue has been identified and a recommendation made, consider consulting with ERISA counsel regarding available options for correction.]

c. Nondeferral of Form 1099 Compensation

8.128

Issue:
We noted that one contributing participant of the plan had Form 1099 compensation that was eligible for deferral and no deferral was made.

Recommendation:
We recommend that the plan's management review Forms 1099 for instances when compensation was eligible for deferral and no deferral was made. The plan's management should implement policies to ensure that these amounts have deferrals prospectively.

Available Options for Correction:
[***Note:*** In situations in which an issue has been identified and a recommendation made, consider consulting with ERISA counsel regarding available options for correction.]

d. After-Tax Contributions

8.129

Issue:
We noted that several participants in the plan had contributions to after-tax accounts; however, the plan document does not allow for contributions on an after-tax basis.

Recommendation:
We recommend that the plan's management review the provisions of the plan document related to contributions and determine whether to amend the plan document to allow for such contributions or establish procedures to prevent any further contributions to after-tax accounts.

Available Options for Correction:
[***Note:*** In situations in which an issue has been identified and a recommendation made, consider consulting with ERISA counsel regarding available options for correction.]

Authorization of Plan Expenses

8.130

Issue:
We noted that administrative expenses are deducted from plan earnings without notification or approval from the plan administrator. We also noted that because fees are deducted from earnings, the plan administrator is unaware of the amount of fees actually deducted.

Recommendation:
We recommend that the plan administrator establish a process for reviewing and authorizing administrative expenses prior to payment from plan assets.

Eligibility

a. No Enrollment Period

8.131

Issue:
We noted that there are currently no annual notification procedures for eligible employees under the plan. Per our review, there were only X participants with account balances out of X eligible participants.

Recommendation:
We recommend that the plan's management establish procedures to give annual notification to all eligible participants and implement employee education programs to increase enrollment.

b. Documentation of Nonparticipation

8.132

Issue:
We were unable to determine if employees who were eligible to participate in the plan who were not contributing to the plan had elected not to participate or were being improperly excluded from participation.

Recommendation:
We recommend that the plan's management establish procedures such that upon initial eligibility for participation, those employees who elect not to enroll in the plan should complete a negative enrollment form.

c. Eligibility of Part Time Employees

8.133

Issue:
During our review of the plan document, we noted that the plan documents excluded part time employees from the definition of *eligible employees*. The IRS has recently taken a new position that states that it is impermissible to exclude a class of employees from participation; however, it is permissible to make a plan available to only a selected class of employees.

Recommendation:
We recommend that the plan's management amend the plan document such that eligible employees are defined under the plan as those in a full time position.

d. Eligibility of Rehires

8.134

Issue:
We noted several participants who had become eligible for the plan (achieved the minimum 1,000 hours of service) were terminated, were rehired without incurring a break in service, and were improperly excluded from participation upon reemployment. Accordingly, these participants were improperly excluded for purposes of the plan discrimination testing.

Recommendation:
We recommend that the plan's management establish procedures to review the eligibility for all rehires to ensure that all eligible employees are properly treated for plan purposes.

Available Options for Correction:
[***Note:*** In situations in which an issue has been identified and a recommendation made, consider consulting with ERISA counsel regarding available options for correction.]

Adopting Employers

8.135

Issue:
In accordance with Section 2.01(11) of the plan, in order for a company's employees to be covered by the plan, that company must be either the adopting employer or a related employer, as named in Section 1.02(a)–(b) of the adoption agreement. In the adoption agreement, the adopting employer is listed as ABC Company, and the only named related employer is DEF Company. During the course of our audit, it came to our attention that employees of GHI Company began participating in the plan during 20X2.

Recommendation:
We recommend that the plan sponsor amend Section 1.02(b) to reflect all the related employers who participate in the plan and determine if all employers who have participated in the plan have executed the proper documentation to adopt the plan.

8.136

Issue:
During the course of the audit, we were unable to determine exactly who was covered by the plan because the adoption agreements, tax testing, and Form 5500 reporting did not match.

Recommendation:
We recommend that the plan sponsor determine if all employers who have participated in the plan have executed the proper documentation to adopt the plan and if those who are no longer participating have executed the proper documentation to withdraw from the plan. If an employer has not properly adopted or withdrawn from the plan, we recommend that the plan sponsor utilize the Employee Plans Compliance Resolution System promulgated in Revenue Procedure 2001-18 to have the applicable employers retroactively adopt the plan. In lieu of that, the plan sponsor should have the applicable employers immediately adopt the plan so they will be protected in the future.

Demographic Data

8.137

Issue:
During our testing of benefit payments, we were unable to verify certain demographic information, per the recordkeeping system, such as date of birth, date of hire, or date of termination, for two participants selected for testing because the information could not be located in the participants' personnel files. Both participants became employees of the plan sponsor as a result of a merger.

Recommendation:
We recommend that the plan sponsor develop and execute policies and procedures to obtain the necessary demographic information for all employees who become participants of the plan as a result of a merger.

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