University of Mississippi

eGrove

Accounting Trends and Techniques

American Institute of Certified Public Accountants (AICPA) Historical Collection

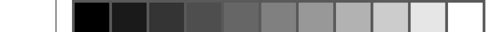
2014

Employee benefit plans : best practices in presentation and disclosure; Accounting Trends & Techniques

American Institute of Certified Public Accountants (AICPA)

Follow this and additional works at: https://egrove.olemiss.edu/aicpa_att

Part of the Accounting Commons



Employee Benefit Plans

Best Practices in Presentation and Disclosure

ISBN 978-1-94023-578-3

ATTEBP14P

Employee Benefit Plans Best Practices in Presentation and Disclosure – Fifth Edition

AICPA American Institute of CPAs®

aicpa.org | cpa2biz.com

ACCOUNTING TRENDS & TECHNIQUES

Employee Benefit Plans

Best Practices in Presentation and Disclosure

AICPA®

15122-360 EBP Acct Trends and Tech final2.indd 1

4/22/14 11:59 AM

ACCOUNTING TRENDS & TECHNIQUES

Employee Benefit Plans

Best Practices in Presentation and Disclosure

15122A-360

AICPA®

Copyright © 2014 by
American Institute of Certified Public Accountants, Inc.
New York, NY 10036-8775

All rights reserved. For information about the procedure for requesting permission to make copies of any part of this work, please visit www.copyright.com or call (978) 750-8400.

1 2 3 4 5 6 7 8 9 0 AAP 1 9 8 7 6 5 4

ISBN 978-1-94023-578-3

Notice to readers: This book does not represent an official position of the American Institute of Certified Public Accountants, and it is distributed with the understanding that the authors and publisher are not rendering legal, accounting, or other professional services via this publication.

Director, Content and Product Development: Linda Cohen
Senior Technical Manager: Jennifer Hackim
Technical Manager: Diana Krupica
Content Development Specialist: David Cohen
Production Administrator: Charlotte Ingles

Recognition

Employee Benefit Plans—Best Practices in Presentation and Disclosure (formerly known as *Accounting Trends & Techniques—Employee Benefit Plans*) was developed by

DIANA G. KRUPICA, CPA
TECHNICAL MANAGER
AICPA A&A CONTENT DEVELOPMENT

LINDA C. DELAHANTY, CPA
SENIOR TECHNICAL MANAGER
AICPA AUDIT & ATTEST STANDARDS

The AICPA staff wishes to thank the members of the 1997–1998 AICPA Employee Benefit Plans Committee, who helped to develop the original publication; the 2013–2014 Employee Benefit Plans Expert Panel members who reviewed this publication: Theresa Banka, Doug Bertossi, Alice Evans, Dan Fox, Josie Hammond, Diane Wasser, and Michele Weldon; and the Office of the Chief Accountant of the U.S. Department of Labor Employee Benefits Security Administration.

EMPLOYEE BENEFIT PLANS COMMITTEE
(1997–1998)

Randi L. Starr, *Chair*
Theresa P. Ahlstrom
David Cattalini
Kenneth E. Dakdduk
David Evangelista
Michael J. Fitzpatrick
William M. LeRoy
Alexander Miller
Rebecca J. Miller
Andrew E. Nolan
Kenneth L. Rubin
Diana J. Scott

Preface

About *Employee Benefit Plans—Best Practices in Presentation and Disclosure*

This publication provides illustrative disclosures for financial statements of employee benefit plans. It has been issued by the A&A Content Development 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 were originally shaped by the members of the 1997–1998 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, *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 the second, third, and fourth editions reissued in 2005, 2010, and 2012 respectively.

This publication has been updated by the AICPA staff and renamed *Employee Benefit Plans—Best Practices in Presentation and Disclosure*. It includes certain changes necessary because of the issuance of authoritative guidance since the last edition, such as Financial Accounting Standards Board (FASB) Accounting Standards Updates (ASUs), clarified auditing standards, and other changes necessary to keep this publication current on accounting, auditing, industry, and regulatory matters.

Authoritative guidance issued through March 1, 2014, has been considered in the development of this publication. This includes relevant guidance issued up to and including the following:

- ASU No. 2014-05, *Service Concession Arrangements (Topic 853) (a consensus of the FASB Emerging Issues Task Force)*
- Statement on Auditing Standards (SAS) No. 127, *Omnibus Statement on Auditing Standards—2013* (AICPA, *Professional Standards*)

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

NEW IN THIS PUBLICATION

Among other things, this publication has been updated to reflect illustrative disclosures in accordance with FASB *Accounting Standards Codification* (ASC) 820, *Fair Value Measurement*. This includes the changes from FASB ASU No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*.

This publication also includes changes from ASU No. 2011-11, *Balance Sheet (Topic 210): Disclosures about Offsetting Assets and Liabilities*, and ASU No. 2012-04 *Technical Corrections and Improvements*, as applicable.

In addition, the illustrative auditor's reports have been updated for the following clarified reporting standards:

- AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*
- AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report*
- AU-C section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*
- AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*

FINANCIAL STATEMENT EXAMPLES

The examples contained herein have been taken from (*a*) actual financial statements of audited pension and benefit 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*, as of January 1, 2014 (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 disclosures 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 retirement 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 fair value measurements, derivatives, 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 guidance. Users of this publication are urged to refer directly to applicable authoritative guidance, when appropriate.

These disclosures are intended to be illustrative in nature 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 AICPA *Checklists and Illustrative Financial Statements for Defined Contribution Retirement Plans*.

MANAGEMENT LETTER COMMENTS (FOR NONISSUERS)

Section 8 pertains to audits of nonissuers only.[1] AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*), addresses the auditor's responsibility to appropriately communicate to those charged with governance and management deficiencies in internal control that the auditor has identified in an audit of financial statements.

Paragraph .11 of AU-C section 265 states that the auditor should communicate in writing to those charged with governance on a timely basis significant deficiencies and material weaknesses identified during the audit, including those that were remediated during the audit.

Paragraphs .12–.13 of AU-C section 265 state that the auditor also should communicate to management at an appropriate level of responsibility, on a timely basis, (*a*) in writing, significant deficiencies and material weaknesses that the auditor has communicated or intends to communicate to those charged with governance, unless it would be inappropriate to communicate directly to management in the circumstances, and (*b*) in writing or orally, other deficiencies in internal control during the audit that have not been communicated to management by other parties and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention. If other deficiencies in internal control are communicated orally, the auditor should document the communication. The communication should also be no later than 60 days following the report release date.

Section 8 of this publication shows illustrative other 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-C section 265 provides guidance on how to assess whether

[1] Subject to SEC oversight, Section 103 of the Sarbanes-Oxley Act of 2002 (act) authorizes the 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 section 325, *Communications About Control Deficiencies in an Audit of Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, Interim Standards), for guidance.

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 section 325, *Communications About Control Deficiencies in an Audit of Financial Statements* (AICPA, *PCAOB Standards and Related Rules*, 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 (GAAP), 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 plan sponsors avoid basic filing errors and can be found on the Employee Benefits Security Administration (EBSA) website at www.dol.gov/ebsa.

ERISA FILING ACCEPTANCE SYSTEM II

ERISA Filing Acceptance System II (EFAST2) is the all-electronic system designed by the DOL, IRS, and Pension Benefit Guaranty Corporation for submission, receipt, processing, and accessing of the Form 5500 and Form 5500-SF. These forms must be electronically filed each year by employee benefit plan sponsors to satisfy annual reporting requirements under ERISA and the Internal Revenue Code (IRC).

The EFAST2 website, www.efast.dol.gov, provides filers with a variety of tools and guidance, including the Form 5500 and Form 5500-SF schedules and instructions, frequently asked questions (FAQs), user guide, and a tutorial. Filers and preparers can register for an account, complete the required forms and schedules online in multiple sessions, print and copy for their records, and submit it at no cost.

SMALL PENSION PLAN AUDIT WAIVER

The DOL has released 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 website 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]

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

[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.

SECTION 403(b) RETIREMENT PLANS

Beginning with 2009 Form 5500 filings, employee benefit plans under Section 403(b) of the IRC that are sponsored by charitable organizations and covered under ERISA became subject to the same reporting and audit requirements that currently exist for Section 401(k) plans. These requirements eliminated a previous exemption granted to 403(b) plans for the annual Form 5500 reporting, disclosure, and audit requirements of ERISA. For large 403(b) plans, as defined by ERISA, the 2009 reporting requirements include not only the completion of the entire Form 5500 but also the engagement of an independent qualified public accountant to conduct an independent audit of the plan.

403(b) plans are considered a type of defined contribution plan. Therefore, the financial statements and disclosures would be similar to those described in chapter 5 (and appendix C) of the EBP guide. However, consideration should be given concerning which disclosures may need to be modified or added. It will be important to obtain an understanding of the operations of the plan in order to determine whether the presentation and disclosures are adequate and in accordance with U.S. GAAP. In addition, section 6 of this publication includes illustrative auditor's reports for employee benefit plans, including 403(b) plans.

Recent Accounting Updates

FASB ASC

FASB ASC is the source of authoritative GAAP for nongovernmental entities. The effective dates of recently released guidance affect the timing of its inclusion in the financial statements of the plans, thereby affecting the availability of illustrative excerpts for potential inclusion in each publication. Unless otherwise indicated, the narrative accounting and reporting guidance throughout this publication refers to the requirements of FASB ASC effective for annual reporting periods ending on December 31, 2013. When necessary, author's notes provide information about newly issued ASUs effective for annual periods ending after that date. Similarly, unless otherwise indicated, the illustrative disclosures included throughout this publication reflect the requirements of FASB ASC sections effective for annual reporting periods ending on December 31, 2013.

The following is a list of FASB ASC sections where plan-specific accounting may be found. Other FASB ASC topics may also apply:

- 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 MEASUREMENT

FASB ASC 820 defines fair value, sets out a framework for measuring fair value, and requires certain disclosures about fair value measurements. FASB ASC 820-10-50 discusses the disclosures required for assets and liabilities measured at fair value. It requires the reporting entity to disclose certain information that enables users of its financial statements to assess the valuation techniques and inputs used to develop those measurements. The reporting entity should provide sufficient information to permit reconciliation of the fair value measurement disclosures from the various classes of assets and liabilities to the line items in the net assets available for benefits.

In May 2011, FASB issued ASU No. 2011-04, which applies to all reporting entities that are required or permitted to measure or disclose the fair value of an asset, a liability, or an instrument classified in a reporting entity's shareholders' equity in the financial statements. The amendments in this ASU result in common fair value measurement and disclosure requirements in GAAP and International Financial Reporting Standards. Consequently, the amendments change the wording used to describe many of the requirements in GAAP for measuring fair value and for disclosing information about fair value measurements. Some of the amendments clarify FASB's intent about the application of existing fair value measurement requirements, and others change a particular principle or requirement for measuring fair value or for disclosing information about fair value measurements.

This ASU is effective for public entities during interim and annual periods beginning after December 15, 2011 (that is, January 1, 2012, for calendar year plans). It is effective for nonpublic entities for annual periods beginning after December 15, 2011 (that is, January 1, 2012, for calendar year plans). Early application is not permitted for public entities. Nonpublic entities may implement the guidance early during interim periods beginning after December 15, 2011 (that is, January 1, 2012, for calendar year plans). The guidance should be applied prospectively. This publication has been updated, as applicable, for the reporting and disclosure requirements of ASU No. 2011-04.

In July 2013, FASB issued ASU No. 2013-09, *Fair Value Measurement (Topic 820): Deferral of Effective Date of Certain Disclosures for Nonpublic Employee Benefit Plans in Update No. 2011-04*. The amendments in this ASU apply to certain quantitative disclosure requirements for an

employee benefit plan, other than those plans that are subject to the SEC's filing requirements (hereafter, *nonpublic employee benefit plan*), that holds investments in its plan sponsor's own nonpublic entity equity securities, including equity securities of its plan sponsor's nonpublic affiliated entities and that are within the scope of the disclosure requirements contained in ASU No. 2011-04. The deferral in this amendment is effective upon issuance for financial statements that have not been issued as of July 2013.

See the "Fair Value Measurement" section of chapter 8 of the EBP guide for further discussion. In addition, readers are encouraged to consult the entire section of FASB ASC 820.

OFFSETTING OF DERIVATIVES, FINANCIAL ASSETS, AND FINANCIAL LIABILITIES

ASU No. 2011-11, issued in December 2011, amends FASB ASC 210, *Balance Sheet*, to require an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position. The amendments in this ASU affect all entities that have financial instruments and derivative instruments that are either (*a*) offset in accordance with either FASB ASC 210-20-45 or FASB ASC 815-10-45 or (*b*) subject to an enforceable master netting arrangement or similar agreement. In addition, ASU No. 2013-01, *Balance Sheet (Topic 210): Clarifying the Scope of Disclosures about Offsetting Assets and Liabilities*, was issued to limit the scope of the disclosure requirements in ASU No. 2011-11 to derivatives, repurchase and reverse repurchase agreements, and securities borrowing and securities lending transactions.

There may be disclosure requirements for plans that participate in securities lending or derivatives and hedging activities. A plan is required to disclose both gross and net information about instruments and transactions eligible for offset, in accordance with the guidance in FASB ASC 210-20-45 and FASB ASC 815-10-45, in the statement of net assets available for benefits as well as instruments and transactions subject to an agreement similar to a master netting arrangement. In addition, disclosure of collateral received and posted in connection with master netting agreements or similar arrangements is required.

These ASUs are effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosures required by the amendments in this ASU retrospectively for all comparative periods present.

Author's Note:
This publication does not illustrate the changes from ASU No. 2011-11 and ASU No. 2013-01 due to their effective dates. For information regarding these ASUs, refer to the EBP guide and the AICPA Audit Risk Alert *Employee Benefit Plans Industry Developments—2014*.

TECHNICAL CORRECTIONS AND IMPROVEMENTS

In October 2012, FASB issued ASU No. 2012-04. ASU No. 2012-04 contains amendments that affect a wide variety of topics in FASB ASC. The amendments are presented in two sections—*Technical Corrections and Improvements* and *Conforming Amendments Related to Fair Value*. The majority of the amendments are not expected to change practice and, therefore, do not have transition guidance. Those amendments were effective upon issuance for both public and nonpublic entities. For public entities, the amendments that are subject to transition guidance will be effective for fiscal periods beginning after December 15, 2012. For nonpublic entities, the amendments that are subject to transition guidance will be effective for fiscal periods beginning after December 15, 2013. Readers are encouraged to consult the complete text of ASU No. 2012-04 for complete guidance. This publication has been updated, as applicable, for the reporting and disclosure requirements of ASU No. 2012-04.

LIQUIDATION BASIS OF ACCOUNTING

In April 2013, FASB issued ASU No. 2013-07, *Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting*. The amendments require an entity to prepare its financial statements using the liquidation basis of accounting when liquidation is imminent. Liquidation is imminent when the likelihood is remote that the entity will return from liquidation and either (*a*) a plan for liquidation is approved by the person or persons with the authority to make such a plan effective, and the likelihood is remote that the execution of the plan will be blocked by other parties, or (*b*) a plan for liquidation is being imposed by other forces (for example, involuntary bankruptcy).

The amendments require financial statements prepared using the liquidation basis of accounting to present relevant information about an entity's expected resources in liquidation by measuring and presenting assets at the amount of the expected cash proceeds from liquidation. An entity should recognize and measure its liabilities in accordance with U.S. GAAP that otherwise applies to those liabilities. The entity should not anticipate that it will be legally released from being the primary obligor under those liabilities, either judicially or by creditor(s).

The entity also is required to accrue and separately present the costs that it expects to incur and the income that it expects to earn during the expected duration of the liquidation, including any costs associated with sale or settlement of those assets or liabilities.

Additionally, the amendments require disclosure about an entity's plan for liquidation, the methods and significant assumptions used to measure assets and liabilities, the type and amount of costs and income accrued, and the expected duration of the liquidation process.

The amendments are effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein. Entities should apply the requirements prospectively from the day that liquidation becomes imminent. Early adoption is permitted. Entities that already use the liquidation basis of accounting as of the effective date in accordance with other FASB ASC topics (for example, terminating employee benefit plans) are not required to apply the amendments. Instead, those entities should continue to apply the guidance in those other FASB ASC topics until they have completed liquidation.

Author's Note:
This publication does not illustrate the changes from ASU No. 2013-07 due to the effective date. For information regarding this ASU, refer to www.fasb.org or the AICPA Audit Risk Alert *Employee Benefit Plans Industry Developments—2014*.

Recent Auditing Updates

ASB CLARITY PROJECT

To address concerns over the clarity, length, and complexity of its standards, the Auditing Standards Board (ASB) has made a significant effort to clarify the SASs. In addition, as the ASB redrafted standards for clarity, it also converged the standards with the International Standards on Auditing, issued by the International Auditing and Assurance Standards Board. As part of redrafting the standards, they now specify more clearly the objectives of the auditor and the requirements that the auditor has to comply with when conducting an audit in accordance with generally accepted auditing standards (GAAS). The clarified auditing standards are now fully effective.

As part of the clarity project, the "AU-C" identifier was established to avoid confusion with reference to existing "AU" sections. The "AU-C" identifier will be retained indefinitely. The superseded AU sections have been archived within *Professional Standards*.

CLARIFIED REPORTING STANDARDS

Among the changes brought about by the ASB Clarity Project were changes to the reporting standards. This publication presents illustrative auditor's reports on employee benefit plans financial statements prepared in accordance with the AU-C sections 700, 705, 706, and 800 of AICPA *Professional Standards*. The effects of the clarified reporting standards resulted in changes to all audit reports that are to be filed with the DOL, in accordance with GAAS, for audits of financial statements for periods ending on or after December 15, 2012.

AU-C SECTION 700

AU-C section 700 addresses the auditor's responsibilities to form an opinion on the financial statements and the form and content of the auditor's report issued as a result of an audit of financial statements. It requires the use of headings throughout the auditor's report to clearly distinguish each section of the report. It also requires a description of management's responsibility for the preparation and fair presentation of the financial statements in more detail than what was required in the previous standards. The description includes an explanation that management is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework and that this responsibility includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

AU-C SECTION 705

AU-C section 705 addresses how the form and content of the auditor's report are affected when the auditor expresses a modified opinion (a qualified opinion, an adverse opinion, or a disclaimer of opinion). The decision regarding which type of modified opinion is appropriate depends upon the following:

- The nature of the matter giving rise to the modification (that is, whether the financial statements are materially misstated or, in the case of an inability to obtain sufficient appropriate audit evidence, may be materially misstated)
- The auditor's professional judgment about the pervasiveness of the effects or possible effects of the matter on the financial statements

AU-C SECTION 706

AU-C section 706 addresses additional communications in the auditor's report when the auditor considers it necessary to

- draw users' attention to a matter or matters presented or disclosed in the financial statements that are of such importance that they are fundamental to users' understanding of the financial statements (emphasis-of-matter paragraph) or
- draw users' attention to any matter or matters other than those presented or disclosed in the financial statements that are relevant to users' understanding of the audit, the auditor's responsibilities, or the auditor's report (other-matter paragraph).

AU-C SECTION 800

AU-C section 800 addresses special considerations in the application of AU-C sections 200–700 to an audit of financial statements prepared in accordance with a special purpose framework, which is a cash, tax, regulatory, contractual, or an other basis of accounting. It is written in the context of a complete set of financial statements prepared in accordance with a special purpose framework.

Author's Note:
See sections 5 and 6 of this publication for updated illustrative auditor's reports and additional information.

Feedback

We hope that you find *Employee Benefit Plans—Best Practices in Presentation and Disclosures* 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.

Diana Krupica—A&A Content Development

American Institute of Certified Public Accountants

220 Leigh Farm Road

Durham, NC 27707-8110

Telephone: 919-402-4006

E-mail: dkrupica@aicpa.org

You also can contact the A&A Content Development group of the AICPA directly via e-mail at A&Apublications@aicpa.org.

TABLE OF CONTENTS

Section		Paragraph
1	Disclosures Specific to Defined Benefit Pension Plans	.01-.94
	1. Description of the Plan	.01-.14
	Disclosure	.01
	Disclosure Excerpts	.02-.04
	Disclosure Excerpt—Supplemental Defined Benefit	.05
	Disclosure—401(h) Account	.06
	Disclosure Excerpts—401(h) Account	.07-.09
	Overview—Cash Balance Plan	.10
	Disclosure Excerpt—Cash Balance Plan	.11
	Overview—Multiemployer Plan	.12
	Disclosure Excerpt—Multiemployer Plan	.13-.14
	2. Summary of Significant Accounting Policies	.15-.24
	Disclosure—Summary of Significant Accounting Policies	.15-.17
	Disclosure Excerpts—Summary of Significant Accounting Policies	.18-.21
	Disclosure Excerpt—Cash Balance Plans	.22
	Disclosure Excerpts—Multiemployer Plans	.23-.24
	3. Investments	.25-.32
	Disclosure—Investments	.25-.28
	Disclosure Excerpts—Investments	.29-.30
	Overview—Multiple Employer Plan	.31
	Disclosure Excerpt—Multiple Employer Plan	.32
	4. Contracts With Insurance Entities	.33-.36
	Disclosure—Contracts With Insurance Entities	.33-.34
	Disclosure Excerpts—Contracts With Insurance Entities	.35-.36
	5. Interest in Master Trusts	.37-.40
	Disclosure—Interest in Master Trusts	.37-.39
	Disclosure Excerpt—Interest in Master Trusts	.40
	6. Plan Amendments	.41-.48
	Disclosure—Plan Amendments	.41
	Disclosure Excerpts—Plan Amendments	.42-.46
	Disclosure Excerpts—Multiemployer Plan	.47
	Disclosure Excerpts—Voluntary Early Retirement Window	.48
	7. Plan Mergers, Acquisitions, and Spin-Offs	.49-.58
	Disclosure—Plan Mergers, Acquisitions, and Spin-Offs	.49-.51
	Disclosure Excerpts—Plan Mergers, Acquisitions, and Spin-Offs	.52-.58
	8. Plan Terminations	.59-.72
	Disclosure—Plan Terminations	.59-.61
	Disclosure Excerpts—Plan Terminations	.62-.66
	Disclosure Excerpt—Plan Sponsor Files for Bankruptcy After Year-End	.67
	Disclosure Excerpt—Partial Termination Due to Terminating Employees of a Division	.68
	Disclosure Excerpts—Multiemployer Plan, Benefits, and Participation Frozen	.69-.72
	9. Other	.73-.94
	Disclosure—Funding Policy	.73
	Disclosure Excerpts—Funding Policy	.74-.75

Section		Paragraph
1	Disclosures Specific to Defined Benefit Pension Plans—continued	
	Disclosure Excerpt—Funding Policy, Multiple Employer Plan	.76
	Disclosure—Accumulated Plan Benefits	.77-.78
	Disclosure Excerpts—Accumulated Plan Benefits, Multi, and Multiple Employer Plans	.79-.81
	Disclosure—Critical or Endangered Status	.82-.84
	Disclosure Excerpts—Critical or Endangered Status, Multiemployer Plan	.85-.86
	Disclosure—Changes in Net Assets Available for Benefits	.87
	Disclosure Excerpt—Changes in Net Assets Available for Benefits—Multiemployer Plan	.88
	Disclosure—Reconciliation to Form 5500	.89-.90
	Disclosure Excerpts—Reconciliation to Form 5500, 401(h) Account	.91-.92
	Disclosure—Plan Sponsor	.93
	Disclosure Excerpt—Plan Sponsor	.94
2	Disclosures Specific to Defined Contribution Retirement Plans	.01-.79
	1. Description of the Plan	.01-.06
	Disclosure—Description of the Plan	.01
	Disclosure Excerpts—Description of the Plan	.02-.06
	2. Summary of Significant Accounting Policies	.07-.12
	Disclosure—Summary of Significant Accounting Policies	.07-.08
	Disclosure Excerpts—Summary of Significant Accounting Policies	.09-.11
	Disclosure Excerpt—Modified Cash Basis	.12
	3. Investments	.13-.21
	Disclosure—Investments	.13-.17
	Disclosure Excerpts—Investments	.18-.21
	4. Contracts With Insurance Entities and Investment Contracts	.22-.26
	Disclosure—Contracts With Insurance Entities and Investment Contracts	.22-.24
	Disclosure Excerpts—Contracts With Insurance Entities and Investment Contracts	.25-.26
	5. Employer Contributions	.27-.32
	Disclosure—Employer Contributions	.27-.29
	Disclosure Excerpts—Employer Contributions	.30
	Disclosure Excerpts—Contribution Disclosures in the Description of the Plan Disclosure	.31-.32
	6. Interest in Master Trusts	.33-.37
	Disclosure—Interest in Master Trusts	.33-.34
	Disclosure Excerpt—Interest in Master Trust	.35
	Disclosure Excerpts—Master Trust Midyear, Prior Investment in Own Related Trust	.36-.37
	7. Plan Amendments	.38-.41
	Disclosure—Plan Amendments	.38
	Disclosure Excerpt—Plan Amendment Disclosure Included in General Description of the Plan Disclosure	.39
	Disclosure Excerpt—Changes in the Plan	.40
	Disclosure Excerpt—Plan Amendment	.41
	8. Plan Mergers, Acquisitions, and Spin-Offs	.42-.51
	Disclosure—Plan Mergers, Acquisitions, and Spin-Offs	.42
	Disclosure Excerpts—Plan Mergers, Acquisitions, and Spin-Offs Included in the Description of the Plan Disclosure	.43
	Disclosure Excerpt—Plan Merger Disclosure Included in Subsequent Events Disclosure	.44-.46
	Disclosure Excerpt—Plan Sponsor Bankruptcy Included as Subsequent Event Disclosure	.47
	Disclosure Excerpt—Plan Split Into Two Plans (From Perspective of Original Plan)	.48

Section		Paragraph
2	Disclosures Specific to Defined Contribution Retirement Plans—continued	
	Disclosure Excerpt—Decision Made After Plan's Year-End to Merge Plan	.49
	Disclosure Excerpt—Change in Plan Sponsor	.50
	Disclosure Excerpt—Change in Plan Year-End (Assuming Preceding Year End March 31)	.51
	9. Plan Terminations	.52-.59
	Disclosure—Plan Terminations	.52-.54
	Disclosure Excerpts—Plan Terminations	.55-.57
	Disclosure Excerpts—Plan Termination Disclosure Included in the Description of the Plan Disclosure	.58-.59
	10. Employee Stock Ownership Plans	.60-.65
	Overview—Employee Stock Ownership Plans	.60-.61
	Disclosure Excerpts—Employee Stock Ownership Plans	.62-.65
	11. 403(b) Plans	.66-.73
	Overview—403(b) Plans	.66-.68
	Disclosure Excerpts—403(b) Plans	.69-.73
	12. Other	.74-.79
	Overview—Other	.74-.76
	Disclosure Excerpts—Failure to Remit Contributions Timely (Material to Financial Statements)	.77-.79
3	Disclosures Specific to Health and Welfare Benefit Plans	.01-.52
	1. Description of the Plan	.01-.07
	Disclosure—Description of the Plan	.01
	Disclosure Excerpts—Description of the Plan	.02-.05
	Disclosure Excerpts—401(h) Account	.06-.07
	2. Summary of Significant Accounting Policies	.08-.13
	Disclosure—Summary of Significant Accounting Policies	.08-.09
	Disclosure Excerpts—Summary of Significant Accounting Policies	.10-.13
	3. Benefit Obligations	.14-.22
	Disclosure—Benefit Obligations	.14-.17
	Disclosure Excerpts—Benefit Obligations	.18-.22
	4. Investments	.23-.27
	Disclosure—Investments	.23-.26
	Disclosure Excerpt—Investments	.27
	5. Plan Amendments	.28-.30
	Disclosure—Plan Amendments	.28
	Disclosure Excerpts—Plan Amendments	.29-.30
	6. Plan Termination	.31-.37
	Disclosure—Plan Termination	.31-.33
	Disclosure Excerpts—Plan Termination	.34-.37
	7. Other	.38-.52
	Disclosure—Delinquent Transmittals	.38
	Disclosure—Funding Policy	.39-.40
	Disclosure Excerpts—Funding Policy	.41-.43
	Disclosure Excerpt—Contributions Receivable	.44
	Disclosure Excerpt—Plan Merger	.45
	Disclosure Excerpt—Health Care Reform	.46
	Disclosure Excerpts—Mergers and Spin-Offs	.47-.48
	Disclosure—401(h) Account	.49-.51
	Disclosure Excerpts—401(h) Account	.52

Section		Paragraph
4	Other Financial Statement Disclosures	.01-.169
	1. Fair Value Measurement	.01-.07
	Disclosure—Fair Value Measurement	.01-.03
	Disclosure Excerpt—Fair Value Measurement—Defined Benefit Pension Plan	.04
	Disclosure Excerpt—Fair Value Measurement—Defined Contribution Plan	.05
	Disclosure Excerpt—Fair Value Measurement—Employee Stock Ownership Plan	.06
	Disclosure Excerpt—Health & Welfare Benefit Plan	.07
	2. Subsequent Events	.08-.27
	Disclosure—Subsequent Events	.08
	Disclosure Excerpts—Subsequent Events	.09-.27
	3. Risks and Uncertainties	.28-.49
	Disclosure—Risks and Uncertainties	.28-.30
	Disclosure Excerpts—Risks and Uncertainties—Defined Contribution Plans	.31-.35
	Disclosure Excerpts—Risks and Uncertainties—Health and Welfare Benefit Plan	.36-.37
	Disclosure Excerpts—Risks and Uncertainties—Defined Benefit Pension Plan	.38-.39
	Disclosure Excerpts—Concentrations	.40-.49
	4. Commitments and Contingencies	.50-.53
	Disclosure—Commitments and Contingencies	.50-.51
	Disclosure Excerpts—Commitment and Contingencies	.52-.53
	5. Securities Lending	.54-.58
	Disclosure—Securities Lending	.54-.56
	Disclosure Excerpts—Securities Lending	.57-.58
	6. Derivatives	.59-.77
	Disclosure—Derivatives	.59-.61
	Disclosure Excerpts—Derivatives	.62-.77
	7. Related Party	.78-.93
	Disclosure—Related Party	.78-.79
	Disclosure Excerpts—Related Party	.80-.92
	Disclosure Excerpts—Related Party—Share Purchase Plan	.93
	8. Prohibited Transactions	.94-.102
	Disclosure—Prohibited Transactions	.94-.95
	Disclosure Excerpts—Prohibited Transactions	.96-.102
	9. Going Concern	.103-.106
	Disclosure—Going Concern	.103-.104
	Disclosure Excerpts—Going Concern	.105-.106
	10. Tax Status	.107-.126
	Disclosure—Tax Status	.107-.109
	Disclosure Excerpts—Tax Status	.110-.117
	Disclosure—Tax Status—Health and Welfare Pension Plan	.118
	Disclosure Excerpts—Tax Status—Health and Welfare Pension Plan	.119-.121
	Disclosure Excerpts—Tax Status—Employee Stock Ownership Plan	.122-.126
	11. Reconciliation of Financial Statements to Form 5500	.127-.130
	Disclosure—Reconciliation of Financial Statements to Form 5500	.127-.128
	Disclosure Excerpts—Reconciliation of Financial Statements to Form 5500	.129-.130
	12. Excess Participant Contributions Payable	.131-.139
	Disclosure—Excess Participant Contributions Payable	.131-.132
	Disclosure Excerpts—Excess Participant Contributions Payable	.133-.139

Section **Paragraph**

4 Other Financial Statement Disclosures—continued

13. Forfeitures .140-.147

Disclosure—Forfeitures .140-.141

Disclosure Excerpts—Forfeitures .142-.147

14. Partial Plan Termination .148-.150

Disclosure—Partial Plan Termination .148

Disclosure Excerpts—Partial Plan Termination .149-.150

15. Voluntary Correction Programs .151-.156

Disclosure—Voluntary Correction Programs .151

Disclosure Excerpts—Voluntary Correction Programs .152-.156

16. Other .157-.169

Disclosure—Other .157

Disclosure Excerpts—Other .158-.168

Disclosure Excerpt—Other—Employee Stock Ownership Plan .169

5 Limited Scope Audit Disclosures and Auditor's Reports .01-.52

Disclosures .04-.11

1. Information Certified by Trustee .04-.11

Disclosure—Information Certified by Trustee .04

Disclosure Excerpts—Information Certified by Trustee .05-.11

Auditor's Reports .12-.43

1. Limited-Scope Audit Reports .12-.43

Disclosure—Limited-Scope Audit Reports .12

Supplemental Schedules Relating to ERISA and DOL Regulations .13-.15

Reporting Excerpt—Standard Limited-Scope Audit Report—401(k) Plan .16

Reporting Excerpt—Standard Limited-Scope Audit Reports Defined Benefit Pension Plan [End of Year Valuation] .17

Reporting—Limited-Scope Audit in Prior Year .18-.20

Reporting Excerpts—Limited-Scope Audit in Prior Year .21

Reporting—Limited-Scope Audit in Current Year .22-.23

Reporting Excerpt—Limited-Scope Audit in Current Year .24

Reporting—Standard Limited-Scope Audit Report With Modifications to the Report on Supplemental Schedules .25-.26

Reporting Excerpt—Omitted Schedule Required Under DOL Regulations in a Limited-Scope Engagement .27

Reporting Excerpt—Modified Opinion on Supplemental Schedules—Omitted Information Required Under DOL Regulations in a Limited-Scope Engagement .28

Reporting—Initial Audits of Plans .29-.31

Reporting Excerpt—Initial Audit of Plan (Prior Year Compiled) .32

Reporting—Modified Cash Basis of Accounting .33-.37

Reporting Excerpt—Modified Cash Basis of Accounting .38

Reporting—Plan Merger .39

Reporting Excerpt—Plan Merger (With a Short Period) .40

Reporting—Terminating and Terminated Plans .41-.42

Terminating Plan (Defined Benefit Pension Plan) .43

2. Prior Year Audited by Another Firm .44-.47

Section		Paragraph
5	Limited Scope Audit Disclosures and Auditor's Reports—continued	
	Reporting—Prior Year Audited by Another Firm (Limited-Scope Audit for Both Years)	.44-.45
	Reporting Excerpt—Limited Scope Audit in Current Year, Prior Year Limited-Scope Audit Performed by Other Auditors	.46
	Reporting Excerpt—Prior Year Audited by Another Firm (Full Scope Audit in the Current Year, Limited Scope Audit in the Prior Year)	.47
	3. Change in Trustee	.48-.49
	Reporting—Change in Trustee	.48
	Reporting Excerpt—Change in Trustee	.49
	4. 403(b) Plans	.50-.52
	Reporting—403(b) Plans	.50-.51
	Reporting Excerpt—403(b) Plans—Modified Limited-Scope Audit Report for a 403(b) Defined Contribution Plan When There Is Also a Scope Limitation Related to Annuity Contracts Issued Before January 1, 2009.	.52
6	Independent Auditor's Reports	.01-.66
	Background	.03
	Audit Reports Following Two Sets of Standards	.04-.08
	Reporting on Form 11-K Audit When Filing With the SEC	.04-.08
	Independent Auditor's Reports and Supplemental Schedules	.09-.66
	1. Unmodified Opinions	.09-.12
	Reporting—Unmodified Opinions	.09-.11
	Reporting—Supplemental Schedules Relating to ERISA and DOL Regulations (Full-Scope Audits When Filing With the DOL)	.12
	Full-Scope Audit Considerations	.13-.32
	Reporting Excerpt—Unmodified Reports, Full-Scope Audits Under GAAS: Defined Contribution 401(k) Profit Sharing Plan	.18
	Reporting Excerpt—Unmodified Reports, Full-Scope Audits Under GAAS: Defined Benefit Plan—End of Year Information Date	.19
	Reporting Excerpt—Unmodified Reports, Full-Scope Audits Under GAAS: Defined Benefit Plan—Beginning-of-Year Benefit Information Date	.20
	Reporting Excerpt—Unmodified Reports, Full-Scope Audits Under GAAS: Defined Benefit Plan—Health and Welfare Plan	.21
	Reporting—Special Purpose Frameworks	.22-.26
	Reporting Excerpt—Special Purpose Framework (Modified Cash Basis)	.27
	Reporting—Financial Statements of a Trust Established Under a Plan	.28
	Reporting Excerpt—Financial Statements of a Trust Established Under a Plan	.29
	Reporting—Terminating and Terminated Plans	.30-.31
	Reporting Excerpt—Terminating Plan (Defined Benefit Pension Plan)	.32
	2. Unmodified Opinions on the Financial Statements With Modifications to the Report on the Supplementary Information	.33-.39
	Reporting—Departures From, or Omission of, Supplementary Information Required by the DOL	.33-.36
	Reporting Excerpt—Omitted Information in a Schedule Required Under DOL Regulations	.37
	Reporting Excerpt—Omitted Schedule Required Under DOL Regulations	.38
	Reporting Excerpt—Qualified Report on Supplementary Information—Omitted Information	.39
	3. Prohibited Transactions	.40-.43
	Reporting	.40
	Reporting Excerpt—Qualified Report—Disclosure of Material Prohibited Transaction With Party in Interest Omitted	.41

Section		Paragraph
6	Independent Auditor's Reports—continued	
	Reporting Excerpt—Disclosure of Immaterial Prohibited Transaction With Party in Interest Omitted	.42
	Reporting Excerpt—Qualified Report—Prohibited Transaction With Party in Interest That Is Also Considered a Related-Party Transaction	.43
	4. Going Concern	.44-.46
	Reporting	.44-.45
	Reporting Excerpts—Going Concern	.46
	5. Prior Year Audited by Another Firm	.47-.48
	Reporting	.47
	Reporting Excerpt—Reference Made to Report of Prior Auditor—Prior Year and Current Year Are Full Scope	.48
	6. Initial Audits	.49-.53
	Reporting	.49-.50
	Reporting Excerpt—Initial Year of Existence	.51
	Reporting Excerpt—Initial Audit From Date of Inception	.52
	Reporting Excerpt—Initial Audit When Prior Period Statement of Net Assets Was Previously Compiled	.53
	7. Audits of Issuers, Such as Form 11-K Filers	.54-.58
	Reporting—Unmodified Opinion Form 11-K Filing With the SEC	.54-.57
	Reporting Excerpt—Audit Report When the Plan Files a Form 11-K With the SEC	.58
	8. 403(b) Plans	.59-.66
	Reporting—403(b) Plans	.59-.64
	Reporting Excerpt—403(b) Plan Disclaimer of Opinion Due to Excluded Contracts	.65
	Reporting Excerpt—403(b) Plan—Adverse Opinion Due to Excluded Contracts	.66
7	Illustrative Form 5500 Schedules	.01-.26
	Reporting of Delinquent Participant Contributions (Including Delinquent Loan Repayments)	.03-.26
	1. Schedule of Delinquent Participant Contributions	.10
	2. Schedule of Assets (Held at End of Year)	.11-.15
	3. Schedule of Assets (Acquired and Disposed of Within Year)	.16-.17
	4. Schedule of Reportable Transactions	.18-.23
	5. Schedule of Loans or Fixed Income Obligations in Default or Classified as Uncollectible—Schedule G, Part I	.24
	6. Schedule of Leases in Default or Classified as Uncollectible—Schedule G, Part II	.25
	7. Schedule of Nonexempt Transactions—Schedule G, Part III	.26
8	Management Letter Comments (GAAS Audits)	.01-.135
	Communicating Internal Control Related Matters Identified in an Audit	.02-.14
	Evaluating Internal Control Deficiencies	.08
	Definitions of *Deficiency, Significant Deficiency,* and *Material Weakness*	.09-.11
	Evaluating Identified Deficiencies in Internal Control	.12-.13
	The Prudent Official Test	.14
	Reporting	.15-.16
	Management Letter Comments	.15-.16
	Reporting Excerpts	.17-.19
	Reports for Control Deficiencies That Are Not Significant Deficiencies or Material Weaknesses	.17
	Limited Scope Audit	.18
	Governmental Employee Pension Trust	.19
	Illustrative Management Letter Comments	.20-.135
	1. Benefits	.22-.26
	Accumulated Plan Benefit Obligations	.22-.23

Section **Paragraph**

8 Management Letter Comments (GAAS Audits)—continued
Benefit Obligations (Health and Welfare Benefit Plan) .24
Benefit Payments .25-.26
2. Contributions .27-.54
Participant or Employee Contributions .27-.36
Employer Contributions .37-.49
Excess Contribution Deferrals .50-.53
Rollovers .54
3. Distributions .55-.74
Hardship Withdrawals .55-.56
Improper Calculation of Benefits .57-.60
Improper or Missing Benefit Approval .61-.62
Improper Payment of Benefits .63-.66
Lack of Reconciliation or Review of Benefits .67-.70
Taxability of Distributions .71-.72
Miscellaneous Distributions: Nonverification of Disability Status for Benefits .73
Qualified Domestic Relations Order: Improper Qualified Domestic Relations Order Execution .74
4. Investments .75-.83
Lack of Review of Investment Valuation .75-.76
Lack of Investment Policy .77-.80
Uninvested Assets .81
Lack of Historical Cost Data for Nonparticipant-Directed Investments .82
Nonverification of Investment Income .83
5. Notes Receivable .84-.92
Notes Receivable From Participants .84-.88
Improper Execution of Loans .89-.92
6. Participant Data Testing .93-.102
Participant Accounts .93-.102
7. Internal Control .103-.104
Internal Controls .103-.104
8. Administrative Matters .105-.116
Regulatory Compliance .105-.106
Investment Policy Guidelines .107
Segregation of Duties—General Comments Not Included in Topics Noted Previously .108
Dual Signatures .109-.110
Accuracy of Data Sent From the Third-Party Administrator .111
Accuracy of Employee Data .112
Use of Third Party Administrators .113
Minutes of Trustees' Meetings .114
Plan Fees and Expenses .115
Monitoring Compliance With Service Agreements .116
9. Other Matters .117-.135
Fiduciary Liability Insurance .117
Leased Employees .118
Nondiscrimination Rules .119
Plan Administration .120-.123
Reconciliations .124

Section **Paragraph**

8 Management Letter Comments (GAAS Audits)—continued

Plan Compensation .125-.128

Authorization of Plan Expenses .129

Eligibility .130-.132

Adopting Employers .133-.134

Demographic Data .135

Section 1: Disclosures Specific to Defined Benefit Pension Plans

1. Description of the Plan

DISCLOSURE

1.01 Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 960-205-50-1(a) requires disclosure of a brief general description of the plan agreement, including, but not limited to, vesting and benefit provisions. If a plan agreement, or a description thereof, providing this information is otherwise published and made available, this description may be omitted provided that reference to such other source is made.

DISCLOSURE EXCERPTS

1.02

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 controls and manages 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 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 approved options as defined in the plan.

1.03

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.
4. *Pension Protection Act.* On August 17, 2006, the Pension Protection Act (Act) was signed into law. Included in its many provisions are numerous revisions surrounding new funding rules for defined benefit plans that may significantly increase required contributions for underfunded plans. The Act establishes minimum funding standards and limits benefit increases and accruals for underfunded plans. Plans with a funding percentage below 80 percent will be required to implement certain benefit limitations such as restricting lump sum payments and restricting the plan from amending the plan to enhance benefits. Further limitations such as freezing the accrual of all future benefits will be required for plans that are underfunded by more than 60 percent until such time as the percentage increases above 60 percent. Additionally, pursuant to the Act, each year actuaries are required to certify to a plan's funded percentage. The plan received such certification for the 20XX plan year for the Adjusted Funding Target Attainment Percentage (AFTAP), which is one way of measuring the funded status of a plan using actuarial assumptions mandated by the IRS, and the actuary determined that the 20XX AFTAP for the plan is ___%.

1.04

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.

DISCLOSURE EXCERPT—SUPPLEMENTAL DEFINED BENEFIT

1.05

NOTE X: DESCRIPTION OF THE PLAN

The following brief description of the supplemental retirement plan for non-represented employees of Jaba Corporation (the 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 (the company's) basic retirement plan [the retirement plan for employees of Jaba Corporation (the 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, 20X2, 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 (loss) 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.

DISCLOSURE—401(h) ACCOUNT

1.06 FASB ASC 960-205-50-4 states that defined benefit pension plans (DB plans) should disclose in the notes to financial statements the nature of the assets related to the 401(h) account and the fact that the assets are available only to pay retiree health benefits. In addition, FASB ASC 960-205-50-5 states that because ERISA requires 401(h) accounts to be reported as assets of the pension plan, a reconciliation of the net assets reported in the financial statements to those reported in Form 5500 is required. The reconciliation should be accompanied by a discussion of the 401(h) account, explaining clearly that the assets in the 401(h) account are not available to pay pension benefits.

DISCLOSURE EXCERPTS—401(h) ACCOUNT

1.07

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.

1.08

NOTE X: 401(H) ACCOUNT

Effective January 1, 20X2, 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).

1.09

NOTE X: 401(H) ACCOUNTS

The Program provides a postretirement medical benefit component in addition to the normal retirement benefits of the plan, pursuant to Section 401(h) of the Internal Revenue Code (IRC). These benefits are employer funded, subject to certain restrictions and limitations, and can be disbursed only to reimburse participating Employers for payment of certain non-pension retiree health benefits, as outlined in the Program's provisions. If an Employer were to withdraw from the Program, or if the Program were to be terminated, all 401(h) amounts on deposit in the trust would revert to the Employer that established and funded the account. Distributions to the Program's participants are not permitted.

OVERVIEW—CASH BALANCE PLAN

1.10 As defined in paragraph 6.04 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*, a *cash balance plan* is a special form of career average compensation plan. Typically, a cash balance DB plan maintains hypothetical "accounts" for participants. The employer credits participants' "accounts" with a certain number of dollars each plan year and promises earnings at a specified rate. Interest on the "account" balance is credited at a stated rate, which may be, and is often, different from the plan's actual rate of investment return.

DISCLOSURE EXCERPT—CASH BALANCE PLAN

1.11

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 pay credits are credited to the participant's account 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.

OVERVIEW—MULTIEMPLOYER PLAN

1.12 As defined by the FASB ASC glossary, a *multiemployer plan* is a plan in which two or more unrelated employers contribute, usually pursuant to one or more collective bargaining agreements. A characteristic of multiemployer plans is that assets contributed by one participating employer may be used to provide benefits to employees of other participating employers because assets contributed by an employer are not segregated in a separate account or restricted to provide benefits only to employees of that employer.

DISCLOSURE EXCERPT—MULTIEMPLOYER PLAN

1.13

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 advisers. 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 achieved 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 (including lawfully married same-sex spouses), 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 5 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.

1.14

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.

2. Summary of Significant Accounting Policies

DISCLOSURE—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1.15 FASB ASC 960-325-50-1 states that disclosure of the plan's accounting policies should include a description of valuation techniques and inputs used to measure the fair value of investments (as required by FASB ASC 820-10-50) and a description of the methods and significant assumptions used to measure the reported value of contracts with insurance entities.

1.16 In accordance with FASB ASC 960-205-50-1(e), plans should also disclose the policy regarding the purchase of contracts with insurance entities that are excluded from plan assets and the plan's dividend income for the period, if any, related to the excluded contracts.

1.17 In addition, paragraphs 8–9 of FASB ASC 960-20-50 state that disclosures of the plan's accounting policies should include a description of the methods and significant assumptions used to determine the actuarial present value of accumulated plan benefits (for example, assumed rates of return, inflation rates, or retirement ages). Any significant changes of method or assumptions between benefit information dates should be described.

Author's Note:
See FASB ASC 235, *Notes to Financial Statements*, for additional information on required accounting policy disclosures.

DISCLOSURE EXCERPTS—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

1.18

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.

1.19

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 accordance 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 ex-dividend 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.

1.20

NOTE X (IN PART): SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

d. Use of estimates. The preparation of financial statements in accordance 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.

1.21

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.

DISCLOSURE EXCERPT—CASH BALANCE PLANS

1.22

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.

DISCLOSURE EXCERPTS—MULTIEMPLOYER PLANS

1.23

NOTE X (IN PART): SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES
ALLOCATION OF ADMINISTRATION EXPENSES

Certain expenses incurred for the benefit of both the fund and the other Union and Industry benefits funds (benefits funds) 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.

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.

1.24

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 should 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

DISCLOSURE—INVESTMENTS

1.25 According to FASB ASC 960-325-35-1, plan investments should be presented at their fair value at the reporting date. The FASB ASC glossary defines *fair value of plan investments* as 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.

1.26 FASB ASC 960-325-45-1 states that information regarding a plan's investments should be presented in enough detail to identify the types of investments. Plan investments should indicate whether reporting fair values have been measured by quoted prices in an active market or are fair values otherwise determined.

1.27 In accordance with paragraphs 2–3 of FASB ASC 960-325-50, investments that represent 5 percent or more of total net assets available for benefits should be disclosed. In addition, the historical cost of plan investments presented at fair value is neither required nor proscribed.

1.28 According to paragraphs 1–2 of FASB ASC 960-30-45, information regarding changes in net assets available for benefits should be presented in enough detail to identify the significant changes during the year and should present the net appreciation (depreciation) in fair value for each significant class of investments, segregated between investments whose fair values have been measured by quoted prices in an active market and those whose fair values have been otherwise determined.

Author's Note:
See section 4, "Other Financial Statement Disclosures," for information and disclosure examples related to FASB ASC 820, *Fair Value Measurement*.

DISCLOSURE EXCERPTS—INVESTMENTS

1.29

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	—	$(434,382)
Equity securities	3,880,090	152,126
Mutual funds	326,618	(167,588)
	$4,206,708	$(449,844)

1.30

NOTE X: INVESTMENTS

Investments 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

OVERVIEW—MULTIPLE EMPLOYER PLAN

1.31 As defined by the FASB ASC glossary, *a multiple employer plan* is a plan maintained by more than one employer but not treated as a multiemployer plan. Multiple employer plans are not as prevalent as single employer plans, but some of the ones that do exist are large and involve many employers. Multiple employer plans are generally not collectively bargained and are intended to allow participating employers, commonly in the same industry, to pool their assets for investment purposes and reduce the costs of plan administration. A multiple employer plan maintains separate accounts for each employer so that contributions provide benefits only for employees of that contributing employer.

DISCLOSURE EXCERPT—MULTIPLE EMPLOYER PLAN

1.32

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, 20X1.

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

4. Contracts With Insurance Entities

DISCLOSURE—CONTRACTS WITH INSURANCE ENTITIES

1.33 A plan may invest assets with an insurance entity pursuant to any of a number of different types of contracts. The nature of the contract will determine the related accounting and regulatory reporting requirements.

1.34 FASB ASC 960-325-35-3 states that insurance contracts should be presented in the same manner as specified in the annual report filed by the plan with certain governmental agencies pursuant to ERISA, that is, either at fair value or at amounts determined by the insurance entity (contract value). A plan not subject to ERISA should present its insurance contracts as if the plan were subject to the reporting requirements of that act.

DISCLOSURE EXCERPTS—CONTRACTS WITH INSURANCE ENTITIES

1.35

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, 19W2. Such contract is permitted to be carried at contract value.

1.36

NOTE X: CONTRACT WITH INSURANCE ENTITY

In 20W8, the plan entered into an insurance 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 X 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.

5. Interest in Master Trusts

DISCLOSURE—INTEREST IN MASTER TRUSTS

1.37 In accordance with paragraph 6.47 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*, a *master trust* is a trust account made up of assets of some or all the employee benefit plans of a company that sponsors more than one plan or a group of corporations under common control. Typically, each plan has an undivided interest in the assets of the trust, and ownership is represented by a record of proportionate dollars interest or by units of participation.

1.38 As stated in FASB ASC 960-30-45-11, investments in master trusts are presented in a single line item in the statement of net assets available for benefits. In addition, paragraphs 1–2 of FASB ASC 960-30-50 state that in the notes to the financial statements the investments of the master trust should be detailed by general type, such as government securities, short-term securities, corporate bonds, common stocks, mortgages, and real estate, as of the date of each statement of net assets available for benefits presented. The net change in the fair value of each significant type of investment of the master trust and total investment income of the master trust by type (for example, interest and dividends) should also be disclosed in the notes for each period for which a statement of changes in net assets available for benefits is presented.

1.39 FASB ASC 960-30-50-3 states that the notes to the financial statements should also include a description of the basis used to allocate net assets, net investment income, gains and losses to participating plans, and the plan's percentage interest in the master trust as of the date of each statement of net assets available for benefits presented.

DISCLOSURE EXCERPT—INTEREST IN MASTER TRUSTS

1.40

NOTE X: INTEREST IN C&H MASTER TRUST

A portion of the plan's investments are in the master trust, which 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 the amount of the time the plan's assets were invested in the master trust.

The following table presents the net assets of the master trust as of December 31, 20X2 and 20X1. Investments that represent 5 percent or more of the master trust net assets are separately identified.

	For the Year Ended December 31,	
	20X2	*20X1*
Common stocks		
C&H common stock	$ 1,255,000	$ 1,115,000
Other (stocks on loan were 50,000 and 50,000, respectively)	9,745,000	6,885,000
Corporate bonds	11,800,000	6,700,000
U.S. government securities	867,000	750,000
Securities lending collateral	900,000	800,000
Total investments	24,567,000	16,250,000
Unrealized gain on foreign currency forward exchange contract	1,233,000	1,344,091
Obligation to return securities lending collateral	(900,000)	(800,000)
Accrued income	150,000	135,000
Accrued liabilities	(50,000)	(20,000)
Total net assets	$25,000,000	$16,909,091
Plan interest in C&H master trust	$ 2,250,000	$ 1,860,000

During 20X2 and [20X1],[1] the master trust investments (including investments bought and sold, as well as held during the year) appreciated (depreciated) as follows:

	For the Year Ended December 31,	
	20X2	*20X1*
Net appreciation in fair value of investments:		
Common stocks	$300,000	$200,000
Corporate bonds	200,000	200,000
Derivative instruments	90,000	50,000
U.S. government securities	800,000	600,000
	$800,000	$600,000

The following are the changes in net assets for the master trust for the year ended December 31, 20X2. [The use of the beginning-of-year benefit information would require this note to include December 31, 20X1 information.]

Changes in Net Assets:	
Net appreciation in fair value of investments	$ 800,000
Interest	400,000
Dividends	230,000
Net investment income	1,430,000
Net transfers	7,060,909
Administrative expenses	(400,000)
Increase in net assets	$ 8,090,909
Net Assets:	
Beginning of year	$16,909,091
End of year	$25,000,000

Refer to note F for the description of the valuation methodologies used.

[1] Necessary modification to the notes when beginning-of-year benefit information is presented in brackets.

6. Plan Amendments

DISCLOSURE—PLAN AMENDMENTS

1.41 FASB ASC 960-205-50-1(b) requires a description of significant plan amendments adopted during the year ending on the latest benefit information date. If significant amendments were adopted between the latest benefit information date and the plan's year-end, it should be indicated that the actuarial present value of accumulated plan benefits does not reflect those amendments.

DISCLOSURE EXCERPTS—PLAN AMENDMENTS

1.42

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.

1.43

NOTE X: CHANGES IN THE PLAN

There were no amendments made to the plan for the year ended 20X2.

Effective January 15, 20X1, the plan was amended to provide full credited service for all lay-off 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.

1.44

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).

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.

The plan's actuary estimates that amendments becoming effective subsequent to December 31, 20X1, will decrease accumulated plan benefits by approximately $250,000.

1.45

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, 20X1, 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, 20X1, was an increase of approximately $1,750,000, of which approximately $1,300,000 represents an increase in vested benefits.)

1.46

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 [including lawfully married same-sex spouses]) 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 (including lawfully married same-sex spouses), 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.
5. The plan's actuary estimates that amendments becoming effective subsequent to December 31, 20X1, will increase accumulated plan benefits by approximately $75,000.

DISCLOSURE EXCERPTS—MULTIEMPLOYER PLAN

1.47

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.

DISCLOSURE EXCERPTS—VOLUNTARY EARLY RETIREMENT WINDOW

1.48

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.

7. Plan Mergers, Acquisitions, and Spin-Offs

DISCLOSURE—PLAN MERGERS, ACQUISITIONS, AND SPIN-OFFS

1.49 Company mergers and acquisitions or other events may result in employee benefit plan mergers or spin-offs. Merger and spin-off documentation and plan documents should be reviewed to determine the effective merger date and the appropriate timing of the transfer of the benefit obligations, in addition to any applicable assets, to the successor plan. The Financial Reporting Executive Committee recommends that the net assets transferred be recorded as a transfer in or out, as applicable, on the statement of changes in net assets, below the net increase or decrease from the period prior to plan transfer.

1.50 Additionally, the plan sponsor of the predecessor plan should consider the need for determining obligations as of the merger date, with the statement of changes in benefit obligations reflecting the transfer of such amounts to the successor plan. Further spin-off considerations include determination of the amount of assets that would also be transferred to the successor plan in addition to the identified benefit obligations. How such amounts are to be calculated may be included in the spin-off agreement.

1.51 In accordance with FASB ASC 960-20-50-3, the effects of certain factors affecting the change in the actuarial present value of accumulated plan benefits from the preceding to the current benefit information date should be identified. The disclosure should include the significant effects of factors such as changes in the nature of the plan (for example, a plan spin-off or a merger with another plan).

DISCLOSURE EXCERPTS—PLAN MERGERS, ACQUISITIONS, AND SPIN-OFFS

1.52

NOTE X: PLAN MERGER (MIDYEAR)

On June 15, 20X2, 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

1.53

NOTE X: PLAN MERGER (YEAR-END)

On December 31, 20X2, 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, 20X2.*]

1.54

NOTE X (IN PART): DESCRIPTION OF THE PLAN

b. Plan merger. Effective August 31, 20X2, the plan merged with the following 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, 20X2, and an aggregate present value of accumulated plan benefits at December 31, 20X1, of $6.6 billion (computed in accordance with FASB ASC 960, *Plan Accounting—Defined Benefit Pension Plans*—see note 2). This merger does not affect participant pension benefits because the benefit provisions of the merged plans are incorporated into the plan.

1.55

NOTE X (IN PART): DESCRIPTION OF THE PLAN

c. *Plan merger*. Effective August 31, 20X2, 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. The merged plan had aggregate plan net assets of $23.4 billion at August 31, 20X2, and an aggregate present value of accumulated plan benefits at August 31, 20X2 of $19 billion (computed in accordance with FASB ASC 960, *Plan Accounting—Defined Benefit Pension Plans*.) 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.

1.56

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.

1.57

NOTE X: PLAN MERGER AND 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 ABC Plan (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.

1.58

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.

8. Plan Terminations

Author's Note:

FASB Accounting Standards Update (ASU) No. 2013-07, *Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting*, was issued in April 2013 and provides guidance on when and how an entity should prepare its financial statements using the liquidation basis of accounting and describes the related disclosures that should be made. ASU No. 2013-07 has been codified in FASB ASC 205-30.

The amendments in this ASU are effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein. Entities should apply the requirements prospectively from the day that liquidation becomes imminent. Early adoption is permitted.

Terminating employee benefit plans that already use the liquidation basis of accounting in accordance with FASB ASC 960-40, 962-40, or 965-40 as of the effective date are not required to apply FASB ASC 205-30; rather, those plans should continue to apply the guidance in FASB ASC 960-40, 962-40, or 965-40 until they have completed liquidation.

This ASU contains amendments that require an entity to prepare its financial statements using the liquidation basis of accounting when liquidation is imminent. Liquidation is imminent when the likelihood is remote that the entity will return from liquidation and either (*a*) a plan for liquidation is approved by the person or persons with the authority to make such a plan effective and the likelihood is remote that the execution of the plan will be blocked by other parties, or (*b*) a plan for liquidation is being imposed by other forces (for example, involuntary bankruptcy).

The amendments in this ASU require financial statements prepared using the liquidation basis of accounting to present relevant information about an entity's expected resources in liquidation by measuring and presenting assets at the amount of the expected cash proceeds from liquidation. In addition, the amendments require disclosures about an entity's plan for liquidation, the methods and significant assumptions used to measure assets and liabilities, the type and amount of costs and income accrued, and the expected duration of the liquidation process.

"Pending Content" in FASB ASC 205-30-50-2 states that at a minimum, an entity should disclose all of the following when it prepares financial statements using the liquidation basis of accounting:

a. That the financial statements are prepared using the liquidation basis of accounting, including the facts and circumstances surrounding the adoption of the liquidation basis of accounting and the entity's determination that liquidation is imminent.

b. A description of the entity's plan for liquidation, including a description of each of the following:

1. The manner by which it expects to dispose of its assets and other items it expects to sell that it had not previously recognized as assets (for example, trademarks)
2. The manner by which it expects to settle its liabilities
3. The expected date by which the entity expects to complete its liquidation.

(*continued*)

c. The methods and significant assumptions used to measure assets and liabilities, including any subsequent changes to those methods and assumptions.

d. The type and amount of costs and income accrued in the statement of net assets in liquidation and the period over which those costs are expected to be paid or income earned.

DISCLOSURE—PLAN TERMINATIONS

1.59 FASB ASC 960-40 provides guidance for terminating plans that are DB plans. According to the FASB ASC glossary, *terminating plans* include any plan about which a decision to terminate has been made, regardless of whether the terminated plan will be replaced.

1.60 According to FASB ASC 960-40-50-1, when the decision to terminate a plan has been made, or when a *wasting trust* (that is, a plan under which participants no longer accrue benefits but that will remain in existence as long as necessary to pay already accrued benefits) exists, the relevant circumstances should be disclosed in all subsequent financial statements issued by the plan.

1.61 In accordance with FASB ASC 960-205-50-1(c), defined benefit pension plans should disclose a brief general description of the priority order of participants' claims to the assets of the plan upon plan termination and benefits guaranteed by the PBGC, including a discussion of the application of its guaranty to any recent plan amendment.

DISCLOSURE EXCERPTS—PLAN TERMINATIONS

1.62

NOTE X: PLAN TERMINATION

The plan sponsor froze the accrued benefits as of February 28, 20X2, and terminated the plan as of March 31, 20X2. Therefore, the accrued benefits of each participant became fully vested 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 20X3 and 20X2, 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.

1.63

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.

1.64

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.

1.65

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.

1.66

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.

DISCLOSURE EXCERPT—PLAN SPONSOR FILES FOR BANKRUPTCY AFTER YEAR-END

1.67

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.

DISCLOSURE EXCERPT—PARTIAL TERMINATION DUE TO TERMINATING EMPLOYEES OF A DIVISION

1.68

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.

DISCLOSURE EXCERPTS—MULTIEMPLOYER PLAN, BENEFITS, AND PARTICIPATION FROZEN

1.69

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 employers continued to have an obligation to contribute to the plan under their collective bargaining agreements.

The trustees terminated the accrual of future pension credits for all covered participants, effective January 1, 19W8. Also, due to the Pension Benefit Guaranty Corporation (PBGC) funding requirements, effective October 1, 20X2, 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.

1.70

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, 20X6, for DEF Company and June 1, 20X7, 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, 20X2, and 20X1 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, 20X2, and 20X1.

1.71

NOTE Z: PLAN AMENDMENT

During the year ended September 30, 20X2, 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.

1.72

NOTE AA: INSOLVENCY AND THE PENSION BENEFIT GUARANTY CORPORATION FUNDING

During the year ended September 30, 20X1, 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, 20X1, the PBGC began providing financial assistance to the plan, and during the year ended September 30, 20X2, 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.

9. Other

DISCLOSURE—FUNDING POLICY

1.73 FASB ASC 960-205-50-1(d) requires disclosures of the funding policy and any changes in the policy during the plan year. If significant costs of plan administration are being absorbed by the employer(s), that fact should be disclosed. For a contributory plan, the disclosure should state the method of determining participants' contributions. Plans subject to ERISA should disclose whether the minimum funding

requirements of ERISA have been met. If a minimum funding waiver has been granted by the IRS, or if a request for a waiver is pending before the IRS, that fact should be disclosed.

DISCLOSURE EXCERPTS—FUNDING POLICY

1.74

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.

1.75

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.

DISCLOSURE EXCERPT—FUNDING POLICY, MULTIPLE EMPLOYER PLAN

1.76

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.

DISCLOSURE—ACCUMULATED PLAN BENEFITS

1.77 Accumulated plan benefits are to be presented as the present value of future benefits attributable under the plan's provisions to service rendered to the date of the actuarial valuation. The actuarial present value of accumulated plan benefits may be presented as of the beginning or the end of the plan year; under FASB ASC 960-205-45-4, however, an end-of-year benefit information date is considered preferable.

1.78 Information regarding the change in actuarial present value of accumulated plan benefits from the preceding benefit information date to the current benefit information date should be presented to identify significant factors affecting the comparability of the year-to-year accumulated benefits. In accordance with FASB ASC 960-20-50-3, minimum disclosures should include the significant effects of factors, such as (*a*) plan amendments, (*b*) changes in the nature of the plan, and (*c*) changes in actuarial assumptions. Changes in actuarial assumptions are to be viewed as changes in accounting estimates and, therefore, previously reported amounts should not be restated. FASB ASC 960-20-45-9 states that if only the minimum required disclosure is presented, presentation in a statement format will necessitate an additional unidentified *other* category to reconcile the beginning and ending amounts.

DISCLOSURE EXCERPTS—ACCUMULATED PLAN BENEFITS, MULTI, AND MULTIPLE EMPLOYER PLANS

1.79

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

1.80

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—2000 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, 20X2, and 20X1 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 20X2 and 20X1, respectively.

1.81

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.

DISCLOSURE—CRITICAL OR ENDANGERED STATUS

1.82 Section 202 and Section 212 of the Pension Protection Act of 2006 (PPA) amended ERISA by adding Section 305. In general, Section 305(b)(3)(A) of ERISA provides that not later than the 90th day of each plan year, the actuary of a multiemployer defined benefit pension plan should certify to the Secretary of the Treasury and to the plan sponsor (i) whether or not the plan is in endangered status for the plan year and whether or not the plan is, or will be, in critical status for the plan year, and (ii) in the case of a plan that is in a funding improvement or rehabilitation period, whether or not the plan is making the scheduled progress in meeting the requirements of its funding improvement or rehabilitation plan.

1.83 Section 305(b)(3)(D)(i) of ERISA provides that, in any case in which it is certified under Section 305(b)(3)(A) that a multiemployer plan is, or will be, in endangered or critical status for a plan year, the plan sponsor should, not later than 30 days after the date of the certification, provide notification of the endangered or critical status to participants and beneficiaries, bargaining parties, the PBGC, and the Secretary of Labor.

1.84 Section 305(c)(1)(A) and Section 305(e)(1)(A) provide that in the first year that a plan is certified to be in endangered or critical status, the plan sponsor generally has a 240-day period from the required date of the certification to adopt a funding improvement plan (in the case of a plan that is in endangered status) or a rehabilitation plan (in the case of a plan that is in critical status).

DISCLOSURE EXCERPTS—CRITICAL OR ENDANGERED STATUS, MULTIEMPLOYER PLAN

1.85

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.

1.86

NOTE X: PENSION PROTECTION ACT FILING OF CRITICAL STATUS

Under ERISA, as amended by the Pension Protection Act of 2006 (PPA), on March 29, 20X2, the actuary of the plan certified that the plan is in critical status for the plan year beginning January 1, 20X2. Based on this critical status certification, the plan's board of trustees adopted a rehabilitation plan, effective November 25, 20X2, based on plan information as of January 1, 20X2, 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.

DISCLOSURE—CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS

1.87 According to paragraphs 1–3 of FASB ASC 960-30-45, information regarding changes in net assets available for benefits should be presented in enough detail to identify the significant changes during the year and should present, at a minimum, all of the following:

a. The net appreciation (depreciation) in fair value for each significant class of investments, segregated between investments whose fair values have been measured by quoted prices in an active market and those whose fair values have been otherwise determined. Realized gains and losses on investments that were both bought and sold during the year should be included. Such information may be useful in assessing the relative degree of objectivity or subjectivity in measuring the plan's investments and the relationship thereof to investment performance during the year. (Separate disclosure of realized gains and losses on investments sold during the year is neither required nor proscribed.)

b. Investment income, exclusive of changes in fair value described in (*a*) preceding.

c. Contributions from employers, segregated between cash and noncash contributions. A noncash contribution should be recorded at fair value. The nature of noncash contributions should be described either parenthetically or in a note.

d. Contributions from participants, including those transmitted by the plan sponsor.

e. Contributions from other identified sources (for example, state subsidies or federal grants).

f. Benefits paid to participants.

g. Payments to insurance entities to purchase contracts that are excluded from plan assets.

h. Administrative expenses.

i. Other changes (for example, transfers of assets to and from other plans) should also be presented if they are significant.

DISCLOSURE EXCERPT—CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS—MULTIEMPLOYER PLAN

1.88

NOTE X: OCCUPANCY EXPENSE AND LEASE COMMITMENT

The plan and the benefit 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.

DISCLOSURE—RECONCILIATION TO FORM 5500

1.89 The reconciliation of amounts reported in the plan's financial statements to amounts reported in Form 5500 is required by ERISA.

1.90 FASB ASC 960-205-50-5 states that because ERISA requires 401(h) accounts to be reported as assets of the pension plan, a reconciliation of the net assets reported in the financial statements to those reported in Form 5500 is required. The reconciliation should be accompanied by a discussion of the 401(h) account, explaining clearly that the assets in the 401(h) account are not available to pay pension benefits.

DISCLOSURE EXCERPTS—RECONCILIATION TO FORM 5500, 401(h) ACCOUNT

1.91

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

1.92

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

DISCLOSURE—PLAN SPONSOR

1.93 FASB ASC 960-205-10-1 states that the primary objective of a pension plan's financial statements is to provide financial information that is useful in assessing the plan's present and future ability to pay benefits when due.

DISCLOSURE EXCERPT—PLAN SPONSOR

1.94

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 Retirement Plans**

1. Description of the Plan

DISCLOSURE—DESCRIPTION OF THE PLAN

2.01 Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 962-205-50-1(a) requires disclosure of a brief, general description of the plan agreement including, but not limited to, vesting and allocation provisions and the disposition of forfeitures. If a plan agreement or a description providing this information is otherwise published and made available, this description may be omitted from the financial statements, provided that reference to the other source is made.

DISCLOSURE EXCERPTS—DESCRIPTION OF THE PLAN

2.02

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 document 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.

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

   The plan is administered by Blue and advised by a committee whose members are appointed by the board of directors of Blue (administrative 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 individually designed 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 administrative committee believes that the plan is currently designed and is being operated in compliance with the applicable requirements of the IRC. The administrative committee will make any changes deemed necessary to ensure that the plan is granted tax-exempt status.

   Accounting principles generally accepted in the United States of America require plan management to evaluate tax positions taken by the plan and recognize a tax liability (or asset) if the plan has taken an uncertain position that more likely than not would not be sustained upon examination by a government authority. The plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes the plan is no longer subject to income tax examinations for years prior to 20W9.

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 should 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 administrative committee. No portion of the assets of the plan, directly or indirectly, should revert to or accrue to the benefit of Blue. In addition, in the event of the termination or partial termination of the plan, all affected participants should 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 100 percent of his or her annual salary. The annual contributions are 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. No nonelective contributions by Blue were made in 20X2 or 20X1.

f. *Vesting*. If a 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. Forfeitures are used to reduce matching contributions.

g. *Participants' accounts and benefits*. Individual accounts are maintained for each plan participant to reflect the participant's contributions and related matching and nonelective contributions. Allocations are based on participant earnings or account balances, as defined. 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. *Notes receivable from participants*. The plan agreement specifies that in the event the administrative 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.

2.03

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 month immediately following date of 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*. Participants may elect to contribute a percentage of their compensation, excluding bonuses and commissions, to the plan each year, subject to limitations, as defined in the plan document. 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. The company makes 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. 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.

c. *Investment elections*. The participant contributions and the company matching contributions are allocated to the various investment options offered by the plan as directed by participants.

d. *Notes receivable from participants.* Notes receivable from participants are measured at their unpaid principal balance plus any accrued but unpaid interest. Participants may borrow a minimum of $1,000 and the maximum of the lesser of one-half of the vested account balance or $50,000 reduced by the highest outstanding loan balance in the account during the prior 12-month period. Loan terms

range from one to five years; however, terms may exceed five years for the purchase of a primary residence. The loans are secured by the balance in the participant's account and bear interest at a rate commensurate with local prevailing rates as determined by the plan administrator, ranging from 4.25% to 8.25%. Principal and interest are paid ratably through payroll deductions.

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 $59^1/_2$. Withdrawals prior to attaining age $59^1/_2$ 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 $59^1/_2$.

f. *Forfeitures*. Generally, when a participant terminates participation in the plan, 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.

2.04

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 completed 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 XX 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 a pooled separate account 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. *Notes receivable from participants*. Participants may borrow from their 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 4 percent to 8 percent. Principal and interest is paid ratably through 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. 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. During 20X2, company contributions were reduced by $5,000 from forfeited nonvested accounts.

2.05

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 completed 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 generally 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 a percentage 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. 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, 20X2, forfeited nonvested accounts totaled $10,000. Pursuant to the provisions of the plan, these accounts will be reallocated to participants in the same manner as employer contributions.

2.06

NOTE X: DESCRIPTION OF THE PLAN

The following description of the Individual Account Retirement Plan for Bargaining Unit Employees in Alpha 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 funding, vesting, and benefit provisions.

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 who are members of the International Association of Rocks and Scissors 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 participants' accounts 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. Participants become 100 percent vested in the company contributions upon completion of 3 years of service.

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 $8,000 and $6,000, respectively, were used to reduce company contributions. Upon termination of the plan, all remaining forfeitures are to be allocated to the participant accounts. The balance in the forfeiture account as of December 31, 20X2 and 20X1 totaled $1,500 and $900, respectively.

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 one 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

DISCLOSURE—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.07 FASB ASC 962-325-50-1 states that disclosure of a defined contribution plan's (DC plan) accounting policies should include a description of the valuation techniques and inputs used to measure the fair value less costs to sell, if significant, of investments (as required by FASB ASC 820-10-50) and a description of the methods and significant assumptions used to measure the reported value of insurance contracts (if any).

2.08 In accordance with FASB ASC 962-205-50-1(f), plans should also disclose the policy regarding the purchase of contracts with insurance entities that are excluded from plan assets.

Author's Note:
See FASB ASC 235, *Notes to Financial Statements*, for additional information on required accounting policy disclosures.

DISCLOSURE EXCERPTS—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

2.09

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 for fully benefit-responsive investment contracts.

Use of estimates. The preparation of financial statements in accordance 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 ex-dividend date. Net appreciation (depreciation) 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 administrative 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.

Notes receivable from participants. Notes receivable from participants are measured at their unpaid principal balance plus any accrued but unpaid interest. Delinquent participant loans are reclassified as distributions based upon the terms of the plan document.

2.10

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 ex-dividend date.

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

2.11

NOTE X: INVESTMENT VALUATION

Plan investments held in Star Brokerage Link Accounts, which consist primarily of registered investment companies, are stated at fair value. Fair value of shares of registered investment companies represents 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 is based on the last quoted market price as of the close of business at period-end.

DISCLOSURE EXCERPT—MODIFIED CASH BASIS

2.12

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, and disbursements are recognized when made. 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 accordance with accounting principles generally accepted in the United States of America.

3. Investments

Author's Note:

The following disclosures may sometimes be combined with the disclosures required by FASB ASC 820, *Fair Value Measurement*. See section 4, "Other Financial Statement Disclosures," for FASB ASC 820 guidance and illustrative disclosures.

DISCLOSURE—INVESTMENTS

2.13 According to FASB ASC 962-325-35-1, plan investments should generally be presented at their fair value at the reporting date. The FASB ASC glossary defines *fair value* of plan investments as 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.

2.14 FASB ASC 962-325-45-3 states that participant-directed plan investments may be shown in the aggregate, as a one-line item, in the statement of net assets available for benefits.

2.15 According to FASB ASC 962-325-45-5, the presentation of nonparticipant-directed investments in the statement of net assets available for benefits or in the notes should be detailed by general type, such as registered investment companies (for example, mutual funds), government securities, common-collective trusts, pooled separate accounts, short-term securities, corporate bonds, common stocks, mortgages, and real estate.

2.16 In accordance with FASB ASC 962-325-45-7, in addition to the requirement to identify those investments that represent 5 percent or more of net assets available for benefits, DC plans should specifically identify those investments that represent 5 percent or more of net assets available for benefits that are nonparticipant-directed.

2.17 Paragraphs 4 and 6 of FASB ASC 962-325-45 state that the presentation should indicate whether the fair values of the investments have been measured by quoted market prices in an active market or were determined otherwise.

DISCLOSURE EXCERPTS—INVESTMENTS

2.18

NOTE X: INVESTMENTS

The following table presents investments 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	*Fair Value*
Prosperity Trust Company mutual funds:		
Balanced fund	1,706,096	$29,020,694
Stock fund	1,309,820	40,303,192
Equity fund	798,756	17,117,360
XYZ Company common stock*	500,000	10,110,000
ABC Company common stock*	200,000	5,000,000

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

2.19

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*
Prosperity Investments Common Stock Fund	$2,262,500*	$2,000,000*
XYZ Company common stock	470,000*	420,000*
ABC Corporation common stock	490,000*	450,000*
Prosperity Investments S&P 500 Collective Trust Fund	1,422,000	2,100,000
Guaranteed investment contract with National Insurance Company at contract value #2012A, matures 12/31/X5 (fair value $1,515,000 and $660,000, respectively) (see note F)	$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 (depreciated) in value by $279,000 as follows:

Mutual funds	$187,000
Common stock	30,000
Collective trust fund	42,000
Corporate bonds	30,000
U.S. government securities	(10,000)
	$279,000

2.20

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

2.21

NOTE X: 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

4. Contracts With Insurance Entities and Investment Contracts

DISCLOSURE—CONTRACTS WITH INSURANCE ENTITIES AND INVESTMENT CONTRACTS

2.22 A plan may invest assets with an insurance entity pursuant to any of a number of different types of contracts. The nature of the contract will determine the related accounting and regulatory reporting requirements.

2.23 In accordance with FASB ASC 962-325-35-5, DC plans should report all investments (including derivative contracts) at fair value. However, contract value is the relevant measurement attribute for that portion of the net assets available for benefits of a DC plan attributable to fully benefit-responsive investment contracts. As defined by the FASB ASC glossary, the contract value of a fully benefit-responsive investment contract held by a DC plan is the amount a participant would receive if he or she were to initiate transactions under the terms of the ongoing plan. In accordance with paragraphs 2–3 and 6 of FASB ASC 962-205-45, the statement of net assets available for benefits of the plan should present amounts for (*a*) total assets, (*b*) total liabilities, (*c*) net assets reflecting all investments at fair value, and (*d*) net assets available for benefits. The amount representing the difference between (*c*) and (*d*) should be presented on the face of the statement of net assets available for benefits as a single amount, calculated as the sum of the amounts necessary to adjust the portion of net assets attributable to each fully benefit-responsive investment contract from fair value to contract value. The statement of changes in net assets available for benefits should be prepared on a basis that reflects income credited to participants in the plan and net appreciation or depreciation in the fair value of only those investment contracts that are not deemed to be fully benefit responsive.

2.24 According to FASB ASC 962-325-35-6, DC plans should report insurance contracts in the same manner required by ERISA annual reporting requirements of U.S. Department of Labor (DOL) Form 5500 (that is, either at fair value or at amounts determined by the insurance enterprise [contract value]). A plan not subject to ERISA should present insurance contracts as if the plan were subject to the reporting requirements of that act.

DISCLOSURE EXCERPTS—CONTRACTS WITH INSURANCE ENTITIES AND INVESTMENT CONTRACTS

2.25

NOTE X: GUARANTEED INVESTMENT CONTRACT WITH NATIONAL INSURANCE COMPANY

In 20X1, the plan entered into a fully benefit-responsive guaranteed investment contract with National Insurance Company (National). National maintains the contributions in its 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 (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 believes that any events that would limit the plan's ability to transact at contract value with participants are not probable of occurring.

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

The average yields earned by the guaranteed investment contract are as follows:

	20X2	*20X1*
Average yields:		
Based on actual earnings	4.68%	4.90%
Based on interest credited to participants	3.97%	4.16%

2.26

NOTE X: INVESTMENT CONTRACTS

The plan's Stable Value Fund is a separately managed account within the plan's trust managed by XYZ Trust Company, whereby the Plan owns the Fund's underlying investments. The plan's investment policy allows the stable value fund to invest in global wraps. Global wrap contracts operate similarly to guaranteed investment contracts, except that the plan purchases government-backed, asset-backed, mortgage-backed, or corporate bonds, which are held in the plan's trust. To enable the plan to realize a specific known value for the assets, if it needs to liquidate them to make benefit payments, global wrap contracts utilize a benefit-responsive "wrapper" contract with a third-party insurance carrier that provides market and cash flow risk protection to the plan. The "wrapper" contract enables the plan to execute participant transactions without regard to the appreciation or depreciation in the day-to-day value of the underlying assets.

The effective yields on these contracts represent the crediting rate, less the "wrapper" fee paid to the insurance carrier. Global wraps do not expire as assets are sold or mature; instead, the wrap remains intact and the maturity of the contract is open-ended. The underlying investments are valued at quoted redemption values on the last business day of the plan's year-end. The fair value of the stable value fund equals the total of the fair value of the underlying assets plus the total wrap rebid value. Net assets are adjusted to contract value, which represents the contributions made under the contract, plus earnings, less participant withdrawals and administrative expenses.

The following summarizes the stable value fund's global wrap contracts at December 31:

	20X2			
Contract Issuer	*Major Credit Ratings*	*Fair Value of Underlying Assets*	*Adjustment From Fair Value to Contract Value*	*Contract Value*
LMNOP	A+	$ 82,877,500	$ (2,480,085)	$ 80,397,415
QRS	AA —	112,607,304	(3,832,837)	108,774,467
XYZ Bank	AAA	53,860,642	(1,896,470)	51,964,172
ABC Bank	AA —	82,882,598	(2,480,238)	80,402,360
Short-Term Wrapper Investment		17,223,688	—	17,223,688
Total		$349,451,732	$(10,689,630)	$338,762,102

	20X1			
Contract Issuer	*Major Credit Ratings*	*Fair Value of Underlying Assets*	*Adjustment From Fair Value to Contract Value*	*Contract Value*
LMNOP	A+	$ 83,718,660	$(2,012,972)	$ 81,705,688
QRS	AA —	113,349,033	(2,727,780)	110,621,253
XYZ Bank	AAA	54,208,274	(1,422,469)	52,785,805
ABC Bank	AA —	83,917,457	(2,207,811)	81,709,646
Short-Term Wrapper Investment		7,056,601	—	7,056,601
Total		$342,250,025	$(8,371,032)	$333,878,993

Wrap contracts accrue interest using a formula called the "crediting rate." Wrap contracts use the crediting rate formula to convert market value changes in the covered assets into income distributions in order to minimize the difference between the market and contract value of the covered assets over time. Using the crediting rate formula, an estimated future market value is calculated by compounding the fund's current market value at the fund's current yield to maturity for a period equal to the fund's duration. The crediting rate is the discount rate that equates the estimated future market value with the fund's current contract value. Crediting rates are reset quarterly. The wrap contracts provide a guarantee that the crediting rate will not fall below 0%.

The crediting rate, and hence the fund's return, may be affected by many factors, including purchases and redemptions by participants. The precise impact on the fund depends on whether the market value of the covered assets is higher or lower than the contract value of those assets. If the market value of the covered assets is higher than their contract value, the crediting rate will ordinarily be higher than the yield of the covered assets. Under these circumstances, cash from new investors will tend to lower the crediting rate and the fund's return, and redemptions by participants will tend to increase the crediting rate and the fund's return.

If the fund experiences significant redemptions when the market value is below the contract value, the fund's yield may be reduced significantly, to a level that is not competitive with other investment options. This may result in additional redemptions, which would tend to lower the crediting rate further. If redemptions continued, the fund's yield could be reduced to zero. If redemptions continued thereafter, the fund might have insufficient assets to meet redemption requests, at which point the fund would require payments from the wrap issuer to pay further shareholder redemptions.

The average yield and crediting rate on the plan's global wrap contracts was 2.43% and 2.12%, respectively, for all contract issuers in 20X2. The average yield and crediting rate on the plan's global wrap contracts was 3.09% and 2.66%, respectively, for all contract issuers in 20X1.

The stable value fund and the wrap contracts purchased by the fund are designed to pay all participant-initiated transactions at contract value. Participant-initiated transactions are those transactions allowed by the plan (typically, this would include withdrawals for benefits, loans, or transfers to non-competing funds within the plan). However, the wrap contracts limit the ability of the fund to transact at contract value upon the occurrence of certain events. These events include

- the plan's failure to qualify under Section 401(a) or Section 401(k) of the Internal Revenue Code.
- the establishment of a defined contribution plan that competes with the plan for employee contributions.
- any substantive modification of the plan or the administration of the plan that is not consented to by the wrap issuer.
- complete or partial termination of the plan.
- any change in law, regulation, or administrative ruling applicable to the plan that could have a material adverse effect on the fund's cash flow.
- merger or consolidation of the plan with another plan, the transfer of plan assets to another plan, or the sale, spin-off, or merger of a subsidiary or division of the plan sponsor.
- any communication given to participants by the plan sponsor or any other plan fiduciary that is designed to induce or influence participants not to invest in the fund or to transfer assets out of the fund.
- exclusion of a group of previously eligible employees from eligibility in the plan.
- any early retirement program, group termination, group layoff, facility closing, or similar program.
- any transfer of assets from the fund directly to a competing option.

At this time, management does not consider the occurrence of these events probable.

5. Employer Contributions

DISCLOSURE—EMPLOYER CONTRIBUTIONS

2.27 The most common sources of contributions made to a DC plan include employer, employee, and rollover contributions. These contributions may be discretionary or mandatory and may be cash or noncash (such as employer securities), as well as pretax or after

tax. For all types of employee benefit plans, the basis for determining employer contributions is specified in the plan instrument or related documents.

2.28 In accordance with FASB ASC 962-205-50-1(d), the financial statements should disclose the basis for determining contributions by employers and, for a contributory plan, the method of determining participants' contributions. Plans subject to the minimum funding requirements of ERISA, such as money purchase pension plans, should disclose whether those requirements have been met. If a minimum funding waiver has been granted by the IRS, or if a request for waiver is pending before the IRS, that fact should be disclosed.

2.29 FASB ASC 962-205-50-1(j) states that the financial statements should disclose the amount and disposition of forfeited nonvested accounts, specifically, identification of those amounts that are used to reduce future employer contributions, expenses, or are reallocated to participant's accounts, in accordance with plan documents.

DISCLOSURE EXCERPTS—EMPLOYER CONTRIBUTIONS

2.30

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 by contributing to a tandem leveraged employee stock ownership plan. See the following note F. In 20X2 and 20X1, these incentive goals were met, and an additional performance matching contribution was made on behalf of each participant.

DISCLOSURE EXCERPTS—CONTRIBUTION DISCLOSURES IN THE DESCRIPTION OF THE PLAN DISCLOSURE

2.31

NOTE X (IN PART): DESCRIPTION OF THE PLAN

Contributions. Participants may elect to contribute between 1 percent and 25 percent of their total compensation, as defined in the plan document, each year, subject to annual limitations. 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.

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. 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.

2.32

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 various mutual funds and a money market account at the discretion of the participants. Participants may transfer or redirect contributions daily.

   The corporation 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.

6. Interest in Master Trusts

DISCLOSURE—INTEREST IN MASTER TRUSTS

2.33 As stated in paragraphs 6–7 of FASB ASC 962-325-50, in the notes to the financial statements, the investments of a master trust should be detailed by general type, such as government securities, short-term securities, corporate bonds, common stocks, mortgages, and real estate, as of the date of each statement of net assets available for benefits presented. The net change in the fair value of each significant type of investment of the master trust and total investment income of the master trust by type (for example, interest and dividends) should also be disclosed in the notes for each period for which a statement of changes in net assets available for benefits is presented.

2.34 FASB ASC 962-325-50-8 states that the notes to financial statements should also include both a description of the basis used to allocate net assets, net investment income, and gains and losses to participating plans, and the plan's percentage interest in the master trust as of the date of each statement of net assets available for benefit presented.

DISCLOSURE EXCERPT—INTEREST IN MASTER TRUST

2.35

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 Bank 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
Insurance Company Pooled separate 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
Insurance Company Pooled separate 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)
Insurance Company Pooled separate 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.

DISCLOSURE EXCERPTS—MASTER TRUST MIDYEAR, PRIOR INVESTMENT IN OWN RELATED TRUST

2.36

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, valued at $1,250,000 based on the issuer's assumptions about the contract's value, 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.

NOTES RECEIVABLE FROM PARTICIPANTS

Notes receivable from participants are measured at their unpaid principal balance plus any accrued but unpaid interest. Delinquent participant loans are reclassified as distributions based upon the terms of the plan document.

2.37

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

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

7. Plan Amendments

DISCLOSURE—PLAN AMENDMENTS

2.38 FASB ASC 962-205-50-1(b) requires a description of significant plan amendments adopted during the period and the effects of such amendments on net assets if significant, either individually or in the aggregate.

DISCLOSURE EXCERPT—PLAN AMENDMENT DISCLOSURE INCLUDED IN GENERAL DESCRIPTION OF THE PLAN DISCLOSURE

2.39

NOTE X (IN PART): DESCRIPTION OF THE PLAN

Plan amendment. Effective October 1, 20X2, the plan was amended and restated, and a new custodian, administrator, and record keeper were appointed. Plan assets transferred to the new custodian were transferred into funds comparable to those offered by the previous custodian. The conversion initiated a blackout period beginning October 1, 20X2, and continuing through November 1, 20X2. During this period, funds could not be applied to the employee-selected funds with the custodian or withdrawn from the plan until the custodian could 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 income fund until the completion of the blackout period. At the end of the blackout period, such funds were transferred to the investment options requested by each participant.

DISCLOSURE EXCERPT—CHANGES IN THE PLAN

2.40

NOTE X: CHANGES IN THE PLAN

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 four additional 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.

Other than the above, the plan had no significant amendments during the periods ended December 31, 20X2; December 31, 20X1; or November 30, 20X1, except for changing the plan year-end from November 30 to December 31, effective December 1, 20X1.

DISCLOSURE EXCERPT—PLAN AMENDMENT

2.41

NOTE X: PLAN AMENDMENT

Effective March 15, 20X2, the plan was amended to reflect a change in the trustee from ABC Bank to XYZ Trust Company. As a result of this change, participants can no longer contribute to investment options offered by ABC Bank. The plan sponsor and investment adviser completed a mapping of the previous investment options to the new investment options provided by XYZ Trust Company.

8. Plan Mergers, Acquisitions, and Spin-Offs

DISCLOSURE—PLAN MERGERS, ACQUISITIONS, AND SPIN-OFFS

2.42 Company mergers and acquisitions, or other events, may result in employee benefit plan mergers. According to the relevant plan merger documents, the effective date of a merger often is prior to the actual transfer date of the related plan assets. Plan amendments and merger documentation should be reviewed to determine the effective date of the transaction and the appropriate period to record the transfer of the applicable plans' net assets to the successor plan. The Financial Reporting Executive Committee recommends that the net assets transferred into or out of the plan be recorded on the statement of changes in net assets available for benefits, after the net increase or decrease for the period.

DISCLOSURE EXCERPTS—PLAN MERGERS, ACQUISITIONS, AND SPIN-OFFS INCLUDED IN THE DESCRIPTION OF THE PLAN DISCLOSURE

2.43

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 notes receivable from participants, 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.

DISCLOSURE EXCERPT—PLAN MERGER DISCLOSURE INCLUDED IN SUBSEQUENT EVENTS DISCLOSURE

2.44

NOTE X: SUBSEQUENT EVENTS

On January 1, 20X3, 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 record keeper from DEF to GHI, effective January 1, 20X3. In April 20X3, GHI was acquired, and recordkeeping responsibilities were assumed by Alpha Bank and Trust Company.

2.45

NOTE X: SUBSEQUENT EVENT

Effective May 1, 20X3, the Company's matching contribution for participants hired prior to May 1, 20X3 was suspended indefinitely.

2.46

NOTE X: SUBSEQUENT EVENT

On August 18, 20X3, the Company completed its Voluntary Correction Program filing under the IRS Revenue Procedure 2008-50, which disclosed all employee loans that had been in default and have since been corrected.

DISCLOSURE EXCERPT—PLAN SPONSOR BANKRUPTCY INCLUDED AS SUBSEQUENT EVENT DISCLOSURE

2.47

NOTE X: SUBSEQUENT EVENT

On March 1, 20X3, the Plan Sponsor filed a voluntary petition for relief under Chapter 11 of Title 11 of the United States Code, in the United States Bankruptcy Court for the District of Sunny State. The Company continued to operate their business as "debtor-in-possession" until the Company's Pre-packaged Plan of Reorganization was approved at a confirmation hearing on May 16, 20X3. The Reorganization Plan became effective on June 2, 20X3.

DISCLOSURE EXCERPT—PLAN SPLIT INTO TWO PLANS (FROM PERSPECTIVE OF ORIGINAL PLAN)

2.48

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. The accounts of the respective participants were transferred 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. As a result, on January 1, 20X2, the plan transferred $26,578,985 to the supplemental plan.

DISCLOSURE EXCERPT—DECISION MADE AFTER PLAN'S YEAR-END TO MERGE PLAN

2.49

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.

DISCLOSURE EXCERPT—CHANGE IN PLAN SPONSOR

2.50

NOTE X: SUBSEQUENT EVENT

Effective April 1, 20X3, ABC Company became the sponsor of the plan as part of a stock purchase agreement whereby ABC Company acquired the stock of XYZ Company.

DISCLOSURE EXCERPT—CHANGE IN PLAN YEAR-END (ASSUMING PRECEDING YEAR END MARCH 31)

2.51

NOTE X: SUBSEQUENT EVENT

Effective July 1, 20X3, the plan was amended to change the plan year to January 1 of each year through December 31.

9. Plan Terminations

Author's Note:
FASB Accounting Standards Update (ASU) No. 2013-07, *Presentation of Financial Statements (Topic 205) Liquidation Basis of Accounting*, was issued in April 2013 and provides guidance on when and how an entity should prepare its financial statements using the liquidation basis of accounting and describes the related disclosures that should be made. ASU No. 2013-07 has been codified in FASB ASC 205-30.

The amendments in this ASU are effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein. Entities should apply the requirements prospectively from the day that liquidation becomes imminent. Early adoption is permitted.

Terminating employee benefit plans that already use the liquidation basis of accounting in accordance with FASB ASC 960-40, 962-40, or 965-40 as of the effective date are not required to apply FASB ASC 205-30; rather, those plans should continue to apply the guidance in FASB ASC 960-40, 962-40, or 965-40 until they have completed liquidation.

This ASU contains amendments that require an entity to prepare its financial statements using the liquidation basis of accounting when liquidation is imminent. Liquidation is imminent when the likelihood is remote that the entity will return from liquidation and either (*a*) a plan for liquidation is approved by the person or persons with the authority to make such a plan effective and the likelihood is remote that the execution of the plan will be blocked by other parties, or (*b*) a plan for liquidation is being imposed by other forces (for example, involuntary bankruptcy).

The amendments in this ASU require financial statements prepared using the liquidation basis of accounting to present relevant information about an entity's expected resources in liquidation by measuring and presenting assets at the amount of the expected cash proceeds from liquidation. In addition, the amendments require disclosures about an entity's plan for liquidation, the methods and significant as-sumptions used to measure assets and liabilities, the type and amount of costs and income accrued, and the expected duration of the liquidation process.

"Pending Content" in FASB ASC 205-30-50-2 states that at a minimum, an entity should disclose all of the following when it prepares financial statements using the liquidation basis of accounting:

a. That the financial statements are prepared using the liquidation basis of accounting, including the facts and circumstances surrounding the adoption of the liquidation basis of accounting and the entity's determination that liquidation is imminent.
b. A description of the entity's plan for liquidation, including a description of each of the following:
    1. The manner by which it expects to dispose of its assets and other items it expects to sell that it had not previously recognized as assets (for example, trademarks)
    2. The manner by which it expects to settle its liabilities
    3. The expected date by which the entity expects to complete its liquidation.
c. The methods and significant assumptions used to measure assets and liabilities, including any subsequent changes to those methods and assumptions.
d. The type and amount of costs and income accrued in the statement of net assets in liquidation and the period over which those costs are expected to be paid or income earned.

DISCLOSURE—PLAN TERMINATIONS

2.52 FASB ASC 962-40 provides guidance for terminating plans that are DC plans. A *terminating plan* includes any plan about which a termination decision has been made regardless of whether the terminating plan will be replaced.

2.53 According to FASB ASC 962-40-50-1, when the decision has been made to terminate a plan, or a *wasting trust* (that is, a plan under which participants no longer accrue benefits but that will remain in existence as long as necessary to pay already accrued benefits) exists, the relevant circumstances should be disclosed in all subsequent financial statements issued by the plan.

2.54 Upon full or partial termination of a plan, affected participants become fully vested in their account at the termination date. Based on IRS rules, a partial termination can occur if approximately 20 percent or more of plan participants are terminated by the plan sponsor as a result of an action, such as a plant closure, a decision to downsize, or the termination of a product line. The reduction can accumulate over one or more plan years and still be classified as a partial termination.

DISCLOSURE EXCERPTS—PLAN TERMINATIONS

2.55

NOTE X: PLAN TERMINATION

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.

2.56

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 Oceanic Systems Division became eligible to participate in the Dolphin Corporation Employee Savings Plan effective May 1, 20X3. The hourly employees at the Ames, Cedar Rapids, Dubuque, Des Moines, and Waterloo, IA, facilities of the Beach Division became eligible to participate in the new Dolphin Corporation Retirement Savings Plan, effective June 1, 20X3.

2.57

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 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 was also 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.

DISCLOSURE EXCERPTS—PLAN TERMINATION DISCLOSURE INCLUDED IN THE DESCRIPTION OF THE PLAN DISCLOSURE

2.58

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. Upon termination, all participant accounts became 100% vested.

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

2.59

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 should be nonforfeitable on the date of such termination or discontinuance. Any unallocated assets of the plan fund then held by the trustee should 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.

10. Employee Stock Ownership Plans

OVERVIEW—EMPLOYEE STOCK OWNERSHIP PLANS

2.60 An employee stock ownership plan (ESOP) is a unique form of DC plan. Under the prohibited transaction statutory exemptions, an ESOP has the ability to borrow money and concentrate plan investments in qualifying employer securities. Frequently, these securities are not publicly traded.

2.61 Typically, the plan obtains an annual appraisal of the securities. Leveraged ESOPs will have obligations to a financial institution or a related party lender (such as the plan sponsor). FASB ASC 820 would be applicable if the ESOP debt is reported at fair value. Participant allocations are subject to unique attributes arising from plan design considerations, nonexempt transaction compliance, or specific Internal Revenue Code provisions.

DISCLOSURE EXCERPTS—EMPLOYEE STOCK OWNERSHIP PLANS

2.62

NOTE X: PLAN DESCRIPTION AND BASIS OF PRESENTATION

The following brief description of the Sponsor Company Employee Stock Ownership Plan (the plan) is provided for general information purposes only. Participants should refer to the plan agreement for complete information.

The Sponsor Company (company) established the plan, effective as of January 1, 20XX. As of January 1, 20XY, the plan was amended and operates, in relevant part, as a leveraged employee stock ownership plan (ESOP) and is designed to comply with Section 4975(e)(7) and the regulations thereunder of the Internal Revenue Code of 1986, as amended, (IRC) 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 stock using the proceeds of a bank borrowing (see note X) and holds the common stock in a trust established under the plan. As the plan makes debt payments, an appropriate percentage of stock will be allocated to eligible employees' accounts in accordance with applicable regulations under the IRC.

The borrowing is collateralized by the unallocated shares of common stock and is guaranteed by the company. The lender has no rights against shares of common stock once they are allocated to participants in accordance with the terms of the ESOP. Accordingly, the financial statements of the plan as of December 31, 20X2 and 20X1, and for the years ended December 31, 20X2, present separately the assets and liabilities and changes therein pertaining to the following:

a. The accounts of employees with vested rights in allocated common stock (allocated)

b. Common stock not yet allocated to employees (unallocated)

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

Employer contributions. The company is obligated to make contributions in cash to the plan which, when aggregated with the plan's dividends and interest earnings, equal the amount necessary to enable the plan to make its regularly scheduled payments of principal and interest due on its term loan.

Payment of benefits. Distributions on account of death, disability, or retirement are made in a lump sum in the plan year following the event. Distributions for other separations from service commence in the fifth plan year following the separation from service and are made in five annual installments. The amount to be distributed is based upon the account valuation date immediately preceding the distribution. Distributions are made in cash or, if a participant elects, in the form of company common stock, plus cash for any fractional share of common stock.

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 XXXX shares at prices determined from the independent appraisal.

Administrative expenses. As provided in the plan agreement, administrative expenses may be paid either by the plan or by the company. The company has historically paid the operating expenses for the plan.

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 permitted to vote any allocated share for which instructions have not been given by a participant. The trustee is required to vote any unallocated shares on behalf of the collective best interest of plan participants and beneficiaries.

Plan 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 should direct the trustee to pay all liabilities and expenses of the trust fund and to sell shares of financed common stock held in the loan suspense account to the extent it determines such sale to be necessary in order to repay the loan.

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. Plan earnings are allocated to each participant's account based on the ratio of the participant's account balance.

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 33 1/3 percent per year of service and are 100 percent vested after 3 years of service.

Put option. Under federal income tax regulations, the employer 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 current 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 employer 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.

Forfeitures. 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 $X,XXX and $X,XXX, respectively.

2.63

NOTE X: LOAN PAYABLE

In 20X2, 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. Shares are released from collateral and allocated to participants as payments of principal and interest are made. The number of shares released in any year is the number of shares held as collateral, times the ratio of the current year payments divided by the total of this year's payments, plus all future years' principal and interest payments. This resulted in 142,000 shares being released and allocated for the plan year ended December 31, 20X2.

The agreement provides for the loan to be repaid over 10 years. The fair value of the note payable as of December 20X2 and 20X1, was approximately $77,000,000 and $82,000,000, respectively, determined by using interest rates currently available for issuance of debt with similar terms, maturity dates, and nonperformance risk. 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—$36,470,000. The loan bears interest at the prime rate of the lender. For 20X2 and 20X1, the loan interest rate averaged 5.75 percent and 5.25 percent, respectively.

2.64

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.

2.65

NOTE X: EMPLOYEE STOCK OWNERSHIP PLAN AND NOTE PAYABLE TO THE ENTITY

In May 20X1, Guppie, Inc. (Guppie) established an employee stock ownership 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 June 1, commenced in 20X1. The terms of the plan's promissory note reflect a 35-year amortization period. The minimum loan amortization requirements for the next 5 years are as follows: 20X2—$324,026; 20X3—$350,758; 20X4— $379,696;

20X5—$411,022; 20X6—$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 June 30, 20X0, as the promissory note was repaid. The Preference stock has an annual dividend rate of $2.50 per share, and at December 31, 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.

11. 403(b) Plans

OVERVIEW—403(b) PLANS

2.66 *403(b) plans* are retirement savings arrangements sponsored by certain nonprofit organizations (such as hospitals and private colleges) and public schools. They are DC plans with individual salary deferral limits that are similar, but not identical to, 401(k) programs. Contributions typically include employee salary deferrals.

2.67 Investments held in these arrangements are typically restricted by law to annuity contracts or custodial accounts holding units of participation of regulated investment companies (for example, mutual funds).

2.68 403(b) plans are considered a type of DC plan. Therefore, the financial statements and disclosures would be similar to those types of plans. However, consideration should be given concerning which disclosures may need to be modified or added. For example, the general description of the plan, eligibility requirements, funding, and tax status should reflect the requirements of the 403(b) plan document. Additional or modified disclosures of the accounting policies surrounding the accounting treatment of certain contracts may be necessary.

DISCLOSURE EXCERPTS—403(b) PLANS

2.69

NOTE X: DESCRIPTION OF THE PLAN

The following description of the 403(b) Retirement Savings Plan ABC Organization (plan) provides only general information. Participants should refer to the plan document for a more complete description of the plan's provisions.

General—The organization established the plan to provide employees with a systematic means of saving and investing for the future. All permissible employees of the organization, as defined in accordance with the universal availability standards, are eligible to enroll on their date of hire. Deferrals begin on the first day of the month subsequent to enrollment. The Plan is a defined contribution plan subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA).

2.70

NOTE X: DESCRIPTION OF THE PLAN

The College of Happy Students Defined Contribution Plan is a defined contribution plan, also known as a tax-sheltered annuity plan, covering all full-time employees as defined by the College of Happy Students (the College). Generally, new employees are eligible to join immediately to make deferral contributions, yet to receive the College's contributions, they must be employed for one year unless previously employed by a not-for-profit organization.

Contributions

Participants may contribute up to 100% of pretax annual compensation, as defined by the Plan. Those participants deferring at least 5% receive the employer matching contribution. Participants who have attained the age of 50 may also make catch-up contributions to the Plan. Special Internal Revenue Code Section 403(b) catch-up contributions are permitted as well, if a participant has 15 years of service. In no event may a participant's contributions exceed any statutory limitations. Participants may also contribute amounts representing distributions from other qualified defined benefit or contribution plans.

The College matches an amount equal to 8% of a participant's compensation. To be eligible to receive the employer contributions, a participant must be at least 18 years of age.

Loans to participants and notes receivable from participants

Participants may borrow from the insurance entity and use their plan account balance (invested in the XXX Annuity) as collateral for the loan. The collateral must be equal to or exceed 110% of the loan, and payments on the loan are made outside of the plan. As of December 31, 20X2 and 20X1, approximately $30,000 and $28,000 of plan assets were pledged as collateral for such loans made by the plan's participants, respectively.

Participants may also borrow from their fund accounts a minimum of $1,000, up to a maximum equal to the lesser of $50,000 or 50% of their account balance. Loan terms range from one to five years; however, terms may exceed five years for the purchase of a primary residence. The loans are secured by the balance in the participant's account and bear interest at a rate commensurate with local prevailing rates, as determined by the plan administrator. Principal and interest is paid ratably through payroll deductions.

2.71 ***Disclosure Excerpt—Contributions*** Participants may contribute up to 100% of pretax annual compensation, as defined by the plan. Participants who have attained age 50 before the end of the plan year are eligible to make catch-up contributions. Special IRC Section 403(b) catch-up contributions are permitted if a participant has 15 years of service with the same employer (15 years of service catch-up). The 15 years of service catch-up enables the limit on elective deferrals to a participant's account to be increased by up to $3,000 in any year up to a maximum of $15,000. In addition, participants may contribute up to 15% of after-tax compensation, as defined by the plan. In no event may participant pretax and after-tax contributions exceed any statutory limitations. Participants may also contribute amounts representing distributions from other qualified defined benefit or contribution plans.

2.72

NOTE X: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Excluded contracts and accounts—The plan administrator has elected to exclude certain contracts and accounts from plan assets in accordance with DOL FAB 2009-02 due to the fact that

- the contract or account was issued to a current or former employee before January 1, 2009;
- the employer ceased to have any obligation to make contributions (including employee salary reduction contributions), and in fact, stopped making contributions to the contract or account before January 1, 2009;
- all the rights under the contract or account are legally enforceable against the insurer by the individual owner of the contract or account without any involvement by the employer; and
- the individual owner of the contract should be fully vested in the contract or account.

Because the plan administrator has elected to exclude certain contracts in accordance with DOL FAB 2009-02, the excluded contracts are not in accordance with GAAP and, accordingly, it is not intended that these financial statements be presented in accordance with GAAP.

2.73

NOTE X: TAX STATUS

The plan terms have been drafted in reliance on the sample language provided by the Internal Revenue Service in Revenue Procedure 2007-71. The plan is required to operate in accordance with the Internal Revenue Code (IRC) to maintain its tax exemption. Plan management believes the plan is currently designed and operated in compliance with the applicable requirements of the IRC. Therefore, no provision for income tax has been included in the Plan's financial statements.

Accounting principles generally accepted in the United States of America require plan management to evaluate tax positions taken by the plan and recognize a tax liability if the plan has taken an uncertain position that more likely than not would not be sustained upon examination by a government authority. The plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes it is no longer subject to income tax examinations for years prior to 20W9.

12. Other

OVERVIEW—OTHER

2.74 In accordance with FASB ASC 962-10-10-1, the primary objective of a DC plan's financial statements is to provide information that is useful in assessing the plan's present and future ability to pay benefits when they are due. In a DC plan, the plan's net assets available to pay benefits equal the sum of participants' individual account balances. Accordingly, benefits that can be paid by the plan when they are due relate to the value of the net assets that may currently be made available to the individual participants.

2.75 According to FASB ASC 962-205-45-7, information regarding changes in net assets available for benefits is intended to present the effects of significant changes in net assets during the year and should present, at a minimum, all of the following:

a. The change in fair value of each significant type of investment, including participant-directed and self-directed investments held in brokerage accounts. Gains and losses from investments sold need not be segregated from unrealized gains and losses relating to investments held at year-end. Realized gains and losses on investments that were both bought and sold during the period should be included. This information may be presented in the accompanying notes.

b. Investment income, exclusive of changes in fair value described in (*a*).

c. Contributions from employers, segregated between cash and noncash contributions (a noncash contribution should be recorded at fair value; the nature of noncash contributions should be described either parenthetically or in a note).

d. Contributions from participants, including those transmitted by the sponsor.

e. Contributions from other identified sources (for example, state subsidies or federal grants).

f. Benefits paid to participants.

g. Payments to insurance entities to purchase contracts that are excluded from plan assets.

h. Administrative expenses.

2.76 Per DOL Regulation 2520.3-120, participant contributions, including salary reduction amounts, are considered to be employee contributions under ERISA and generally do constitute plan assets. An employer is required to segregate employee contributions from its general assets as soon as practicable but in no event more than the 15th business day following the month in which amounts are contributed by employees or withheld from their wages for a pension benefit plan.

DISCLOSURE EXCERPTS—FAILURE TO REMIT CONTRIBUTIONS TIMELY (MATERIAL TO FINANCIAL STATEMENTS)

2.77

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 4, 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 on December 20, 20X2.

2.78

NOTE X: DELINQUENT EMPLOYEE DEFERRAL TRANSMITTALS

During 20X2, the Company erroneously failed to remit certain employee deferrals and loan repayments to the plan aggregating $X,XXX. These deferrals and loan repayments are included in the plan's receivables at December 31, 20X2.The company computed the lost earnings on these 20X2 deposits and subsequently remitted the deposits and made a contribution for lost earnings to the plan.

2.79

NOTE X: OPERATIONAL DEFECT

During the year ended December 31, 20X2, it was discovered that certain of the plan's provisions were not properly applied in the daily operation of the plan. The definition of *compensation for participant and employer contributions* as per the plan document was not properly applied when calculating contribution amounts. The plan administrator determined the affected participants and deposited approximately $40,000 into the plan on October 14, 21X3 to make the plan whole, including interest, which is included in the financial statements in contributions receivable as of December 31, 20X2.

Section 3: Disclosures Specific to Health and Welfare Benefit Plans

1. Description of the Plan

DISCLOSURE—DESCRIPTION OF THE PLAN

3.01 Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 965-205-50-1(a) requires disclosure of a brief, general description of the plan agreement, including, but not limited to, participants covered, vesting, and benefit provisions. If a plan agreement, or a description thereof, providing this information is otherwise published or made available, the description in the financial statement disclosures may be omitted, provided that a reference to the other source is made.

DISCLOSURE EXCERPTS—DESCRIPTION OF THE PLAN

3.02

NOTE X: DESCRIPTION OF THE PLAN

The following description of the Allied Industries (company) 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 ABC Employers' Trade Association and the ABC 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, prescription, and dental); life insurance coverage; long-term disability benefits; and death benefits to full-time participants and 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 Mr. Claim Company, the claims administrator, 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	*20X2 Retiree Contribution*	*20X1 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 20X2 due to adverse claims experience in 20X1.

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.

3.03

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, 20X0, was 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, 20X0, 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.

3.04

NOTE X: DESCRIPTION OF THE PLAN

The following description of the XXX Medical 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.

3.05

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.

DISCLOSURE EXCERPTS—401(h) ACCOUNT

3.06

NOTE X: DESCRIPTION OF THE PLAN

The Modern 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.

3.07

NOTE X: 401(H) ACCOUNT

Effective January 1, 20X2, 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.

2. Summary of Significant Accounting Policies

DISCLOSURE—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.08 FASB ASC 965-325-50-1(a) states that disclosure of a health and welfare benefit plan's (H&W plan's) accounting policies should include a description of the methods and significant assumptions used to determine the fair value of investments and the reported value of insurance contracts.

3.09 In accordance with FASB ASC 965-205-50-1(e), plans should disclose the policy regarding the purchase of contracts with insurance entities that are excluded from plan assets. Consideration should be given to disclosing the type and extent of insurance coverage, as well as the extent to which risk is transferred (for example, coverage period and claims reported or claims incurred).

Author's Note:
See FASB ASC 235, *Notes to Financial Statements*, for additional information on required accounting policy disclosures.

DISCLOSURE EXCERPTS—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

3.10

NOTE X: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

a. Use of estimates. The preparation of financial statements in accordance 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.

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 ex-dividend date. Net appreciation (depreciation) includes the plan's gains and losses on investments bought and sold, as well as held during the year. The plan's trustees determine the plan's valuation policies utilizing information provided by the investment custodians. See note E for a discussion of fair value measurement.

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, 20X3, the date the financial statements were available to be issued.

3.11

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).

3.12

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. The plan's trustees determine the plan's valuation policies utilizing information provided by the investment custodians. 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 ex-dividend date. Net appreciation (depreciation) 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 accordance 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, benefit obligations, and changes therein; claims incurred but not reported; eligibility credits; claims payable; 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 $7^1/_2$ 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.

3.13

NOTE X: SUMMARY OF ACCOUNTING POLICIES

Basis of accounting. The accompanying financial statements have been prepared on the accrual method of accounting in accordance with generally accepted accounting principles in the United States of America.

Use of estimates. The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of certain assets and liabilities, including estimated health claims incurred but not reported and claims payable and the disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

Plan benefits. The postretirement benefit obligation represents the actuarial present value of those estimated future benefits that are attributed to employee service rendered through December 31, 20X2. Postretirement benefits include future benefits expected to be paid to or for (1) currently retired employees and their beneficiaries and dependents and (2) active employees and their beneficiaries and dependents after retirement from service. 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.

The significant actuarial assumptions used in the valuations as of December 31, 20X2 and 20X1 include:

Valuation Method	Projected Unit Credit
Long-term earnings rate	9.00%
Retirement age	65 years old
Mortality	RP-2000 Mortality

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.

Plan obligations at December 31, 20X2, for health claims incurred by active participants but not reported at that date and for accumulated eligibility of participants at December 31, 20X2, are estimated by the plan's actuary in accordance with accepted actuarial principles. Such estimated amounts are reported in the accompanying statements of the plan's benefit obligations at present value, based on a 6.1% and 6.4% discount rate at December 31, 20X2 and 20X1, respectively. Health claims incurred by retired participants, but not reported at year end, are included in the postretirement benefit obligation.

Subsequent events. The plan has evaluated subsequent events through August 30, 20X3, the date the financial statements were available to be issued.

3. Benefit Obligations

DISCLOSURE—BENEFIT OBLIGATIONS

3.14 FASB ASC 965-30-35-1 states that benefit obligations for single-employer, multiple-employer, and multiemployer defined benefit H&W plans should include the actuarial present value, as applicable, for all of the following:

- Claims payable, claims incurred but not reported, and premiums due to insurance entities
- Accumulated eligibility credits and postemployment benefits, net of amounts currently payable
- Postretirement benefits for the following groups of participants:
  - — Retired plan participants, including their beneficiaries and covered dependents, net of amounts currently payable and claims incurred but not reported
  - — Other plan participants fully eligible for benefits
  - — Plan participants not yet fully eligible for benefits

3.15 In accordance with FASB ASC 965-30-45-1, to the extent they exist, the amounts of benefit obligations in each of the major classifications identified previously should be shown as separate line items in the financial statements or notes to financial statements.

Regardless of the format selected, the plan financial statements should present the benefit obligations information in its entirety in the same location.

3.16 FASB ASC 965-30-50-5 states that disclosure of an H&W plan's accounting policies should include a description of the methods and significant actuarial assumptions used to determine the plan's benefit obligations, any significant changes in assumptions made between financial statement dates and their effects, and the weighted-average assumed discount rate used to measure the plan's obligation for postemployment benefits.

3.17 FASB ASC 965-30-50-7 states that if administrative expenses expected to be paid by the plan (but not those paid directly by the plan's participating employer[s]) that are associated with providing the plan's benefits are reflected by reducing the discount rate(s) used in measuring the benefit obligation, the resulting reduction in the discount rate(s) should be disclosed.

DISCLOSURE EXCERPTS—BENEFIT OBLIGATIONS

3.18

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 attributable 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 ABC 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.

3.19

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.

3.20

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) 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.

3.21

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.

3.22

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,	
	20X2	*20X1*
Accumulated eligibility credits and total benefit obligations	$1,107,777	$1,095,620

Changes in Benefit Obligations

	For the Year Ended December 31, 20X2
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

Author's Note:
The following disclosures may sometimes be combined with the disclosures required by FASB ASC 820, *Fair Value Measurement*. See section 4, "Other Financial Statement Disclosures," for FASB ASC 820 guidance and illustrative disclosures.

DISCLOSURE—INVESTMENTS

3.23 According to FASB ASC 965-325-35-1, plan investments, whether they are in the form of equity or debt securities, real estate, or other investments (excluding insurance contracts), should be reported at their fair value at the financial statement date. The FASB ASC glossary defines *fair value* of plan assets as 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.

3.24 FASB ASC 965-325-45-2 states that the presentation of nonparticipant-directed investments in the statement of net assets available for benefits or in the notes should be detailed by general type, such as registered investment entities (also known as mutual funds), government securities, short-term securities, corporate bonds, common stocks, mortgages, and real estate.

3.25 According to FASB ASC 965-325-50-1(b), disclosure of an H&W plan's accounting policies should include identification of investments that represent 5 percent or more of the net assets available for benefits as of the end of the year. Consideration should be given to disclosing provisions of insurance contracts included as plan assets that could cause an impairment of the asset value upon liquidation or other occurrence (for example, surrender charges and market value adjustments).

3.26 FASB ASC 965-325-45-1 states that information regarding a plan's investments should be presented in enough detail to identify the types of investments and should indicate whether reported fair values have been measured by quoted prices in an active market or have been determined otherwise.

DISCLOSURE EXCERPT—INVESTMENTS

3.27

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:

	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 is as follows:

	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. Plan Amendments

DISCLOSURE—PLAN AMENDMENTS

3.28 FASB ASC 965-205-50-1(b) requires a description of significant plan amendments adopted during the period, as well as significant changes in the nature of the plan (for example, a plan spinoff or merger with another plan) and changes in actuarial assumptions.

DISCLOSURE EXCERPTS—PLAN AMENDMENTS

3.29

NOTE X: PLAN AMENDMENT

Effective January 5, 20X0, the Plan merged and combined with ABC Company 401(k) Plan and XYZ Company Profit Sharing 401(k) Savings Plan. The merged plans authorized the transfer of their assets to the Plan effective January 5, 20X0. Accordingly, the two merged plans' assets have been transferred to the Plan. Subsequent to the merger, the Plan was restated and renamed PDQ Company Profit Sharing 401(k) Plan.

3.30

NOTE X: PLAN AMENDMENT

Effective August 31, 20X0 (Freeze Date), the Plan was amended to terminate the Plan and freeze participants' Plan benefits. Upon freezing the Plan, all participants were 100% vested in their accrued retirement benefits. New employees since the Freeze Date should not be eligible to participate in the Plan.

6. Plan Termination

Author's Note:
FASB Accounting Standards Update (ASU) No. 2013-07, *Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting*, was issued in April 2013 and provides guidance on when and how an entity should prepare its financial statements using the liquidation basis of accounting and describes the related disclosures that should be made. ASU No. 2013-07 has been codified in FASB ASC 205-30.

The amendments in this ASU are effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein. Entities should apply the requirements prospectively from the day that liquidation becomes imminent. Early adoption is permitted.

Terminating employee benefit plans that already use the liquidation basis of accounting in accordance with FASB ASC 960-40, 962-40, or 965-40, as of the effective date are not required to apply FASB ASC 205-30; rather, those plans should continue to apply the guidance in FASB ASC 960-40, 962-40, or 965-40 until they have completed liquidation.

This ASU contains amendments that require an entity to prepare its financial statements using the liquidation basis of accounting when liquidation is imminent. Liquidation is imminent when the likelihood is remote that the entity will return from liquidation and either (*a*) a plan for liquidation is approved by the person or persons with the authority to make such a plan effective and the likelihood is remote that the execution of the plan will be blocked by other parties or (*b*) a plan for liquidation is being imposed by other forces (for example, involuntary bankruptcy).

The amendments in this ASU require financial statements prepared using the liquidation basis of accounting to present relevant information about an entity's expected resources in liquidation by measuring and presenting assets at the amount of the expected cash proceeds from liquidation. In addition, the amendments require disclosures about an entity's plan for liquidation, the methods and significant assumptions used to measure assets and liabilities, the type and amount of costs and income accrued, and the expected duration of the liquidation process.

"Pending Content" in FASB ASC 205-30-50-2 states that at a minimum, an entity should disclose all of the following when it prepares financial statements using the liquidation basis of accounting:

a. That the financial statements are prepared using the liquidation basis of accounting, including the facts and circumstances surrounding the adoption of the liquidation basis of accounting and the entity's determination that liquidation is imminent.

b. A description of the entity's plan for liquidation, including a description of each of the following:

1. The manner by which it expects to dispose of its assets and other items it expects to sell that it had not previously recognized as assets (for example, trademarks)
2. The manner by which it expects to settle its liabilities
3. The expected date by which the entity expects to complete its liquidation.

c. The methods and significant assumptions used to measure assets and liabilities, including any subsequent changes to those methods and assumptions.

d. The type and amount of costs and income accrued in the statement of net assets in liquidation and the period over which those costs are expected to be paid or income earned.

DISCLOSURE—PLAN TERMINATION

3.31 FASB ASC 965-40 provides guidance for terminating plans that are H&W plans. Terminating plans include all plans about which a termination decision has been made regardless of whether the terminating plan will be replaced.

3.32 According to FASB 965-40-50-1, when the decision has been made to terminate a plan or when a *wasting trust* (that is, a plan under which participants no longer accrue benefits but that will remain in existence as long as necessary to pay already accrued benefits) exists, the relevant circumstances should be disclosed in all subsequent financial statements issued by the plan.

3.33 FASB ASC 965-205-50-1(m) states H&W plans should disclose the termination provisions of the plan and priorities for distribution of assets, if applicable.

DISCLOSURE EXCERPTS—PLAN TERMINATION

3.34

NOTE X: TERMINATION OF THE PLAN

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

3.35

NOTE X: PLAN TERMINATION

Although it has not expressed any intent to do so, the Company has the right under the Plan to modify the benefits provided to employees, to discontinue its contributions at any time, and to terminate the plan subject to the provisions to ERISA.

Benefits should be paid to the extent that assets held in the Plan are sufficient to pay outstanding claims. Any excess funds must be used to provide benefits for the Plan participants on such equitable basis as should be determined by the Plan's Advisory Committee.

3.36

NOTE X: PLAN TERMINATION
TERMINATION PROVISIONS

Although it has not expressed any intention to do so, the Sponsor has the right under the Plan to modify the benefits provided to participants, to discontinue its contributions at any time, or to terminate the Plan, subject to the provisions set forth in ERISA. In the event of such termination, the net assets of the Plan should be allocated to pay the benefit obligations of the Plan in accordance with ERISA.

3.37

NOTE X: PLAN TERMINATION

Although it has not expressed any intent to do so, the Trusts may be terminated by the Welfare Benefit Plan Committee if, in its sole discretion, it determines the Trusts are no longer effective in serving its purposes or that the interest of the participants could be better served through an alternative arrangement.

Upon termination, the assets of the Trusts will be paid out at the direction of the Welfare Benefit Plan Committee in the following order: payment of administrative expenses, payment of benefits to participants and beneficiaries entitled to claim payments for benefits prior to such termination, and lastly, at the discretion of the Welfare Benefit Plan Committee in accordance with IRC Section 501(c)(9) and ERISA.

7. Other

DISCLOSURE—DELINQUENT TRANSMITTALS

3.38 According to Department of Labor Regulation 2520.3-120, participant contributions, including salary reduction amounts, are considered to be employee contributions under ERISA and generally do constitute plan assets. An employer is required to segregate employee contributions from its general assets as soon as practicable, but in no event more than 90 days after the contributions are paid by employees or withheld from their wages for a welfare benefit plan.

DISCLOSURE—FUNDING POLICY

3.39 FASB ASC 965-205-50-1(c) requires disclosures of the funding policy and any changes in the policy made during the plan year. If the benefit obligations exceed the net assets of the plan, the method of funding this deficit, as provided for in the plan agreement or collective bargaining agreement, also should be disclosed. If significant plan administration or related costs are being borne by the employer, that fact should be disclosed.

3.40 For a contributory plan, the disclosure should state the method of determining participants' contributions. For each year for which a year-end statement of net assets available for benefits is presented, the plan should disclose a description of the portion of the plan's estimated cost of providing postretirement benefits funded by retiree contributions.

DISCLOSURE EXCERPTS—FUNDING POLICY

3.41

NOTE X: 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.

3.42

NOTE X: CONTRIBUTIONS

The plan agreement provides that the Company make contributions to provide for the payment of benefits. The Company contributes all amounts in excess of amounts contributed by the participants that are necessary to provide current benefit payments under the Plan. Participant contributions to the Plan are required for coverage. The Company determines the amounts to be contributed to the Plan by the Plan participants. The Plan also contains a flexible spending feature that enables participants to receive reimbursements for eligible medical expenses not otherwise reimbursable under any other health care coverage. Prior to the beginning of each plan year, participants may elect to designate a portion of their compensation to provide for health, dental, or dependent care benefits. Amounts designated to pay for basic health and medical coverage are excluded from the employee's taxable income. The balance in the flexible spending accounts totaled approximately $83,000 and $131,000, as of December 31, 20X2 and 20X1, respectively.

3.43

NOTE X: FUNDING

The Company may make payments to the Trust from time to time to provide funding for the Plan. During the year ended December 31, 20X2, $54,596 was contributed to the Trust. The Trust may accept contributions from participants if so permitted by the Plan documents. There were no participant contributions during the year ended December 31, 20X2.

DISCLOSURE EXCERPT—CONTRIBUTIONS RECEIVABLE

3.44

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 20X2 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.

DISCLOSURE EXCERPT—PLAN MERGER

3.45

NOTE X: PLAN MERGER

On February 21, 20X2, the GHI Disability Plan (the LTD Plan) was legally merged with the GHI Medical Plan and the resulting plan was renamed the GHI LTD and Medical VEBA Plan. As of the legal merger date of February 21, 20X2, the GHI LTD Plan's net assets available for benefits totaling to $8,698,522 and benefit obligations totaling $3,699,722 were transferred to the GHI LTD and Medical VEBA Plan.

DISCLOSURE EXCERPT—HEALTH CARE REFORM

3.46

NOTE X: HEALTH CARE REFORM

In March 2010, two pieces of legislation were passed, the Patient Protection and Affordable Care Act, followed by the Health Care and Education Reconciliation Act of 2010, collectively referred to as the Affordable Care Act. Although the legislation generally deals with the health care system, it does contain many revisions to the IRC, which may affect plan design or operation. Under both prior law and the Affordable Care Act, employers who provide retiree prescription drug coverage that is at least as valuable as Medicare Part D are entitled to a subsidy from the federal government to help offset the cost of the coverage. This subsidy is not treated as income to the employer, and the employer is currently able to deduct the full cost of the retiree prescription drug coverage for income tax purposes (including the portion that is offset by the subsidy). Under the Affordable Care Act, for tax years beginning after December 31, 2012, companies will no longer be able to deduct the portion of the retiree prescription drug coverage cost that is subsidized by the federal government. These law changes are expected to result in an increase in the total cost of retiree medical coverage.

DISCLOSURE EXCERPTS—MERGERS AND SPIN-OFFS

3.47

NOTE X: PLAN MERGER

In June 20X2, the Welfare Committee adopted resolutions effective as of January 1, 20X3 that removed the active employee medical and long-term disability benefits provided under the Plan, and merged these benefits into another plan offered by the plan sponsor.

3.48

NOTE X: PLAN SPIN-OFF

Effective March 1, 20X3, The LMNOP Company created a new plan for retirees. Accordingly, accumulated benefit obligations at December 31, 20X2, were reduced by $18,641,000, representing the obligation at that date for the retirees.

DISCLOSURE—401(h) ACCOUNT

3.49 FASB ASC 965-205-50-2 states that the notes to the financial statements should disclose the significant components of net assets and changes in net assets of the 401(h) account. In accordance with FASB ASC 965-205-50-3, if retiree health benefit obligations are funded partially through a 401(h) account of the defined benefit pension plan, the plan should also disclose the fact that the assets are available only to pay retiree health benefits. The notes to financial statements should disclose the significant components of net assets and changes in net assets of the 401(h) account. Additionally, the notes should include a reconciliation of amounts reported in the financial statements to the amounts reported in the Form 5500 of the IRS.

3.50 FASB ASC 965-205-45-6 states that certain retiree health benefits may be funded through a 401(h) account in a defined benefit pension plan, pursuant to Section 401(h) of the IRC. The 401(h) account assets and liabilities used to fund the retiree health benefits and the changes in those assets and liabilities should be reported in the financial statements of the H&W plan.

3.51 In accordance with FASB ASC 965-205-45-7, the 401(h) account assets and liabilities and changes in them can be shown in the H&W plan financial statements either as a single line item on the face of the statements or included in individual line items with separate disclosure in the footnotes about the 401(h) amounts included in those individual line items.

DISCLOSURE EXCERPTS—401(h) ACCOUNT

3.52

NOTE X: 401(H) ACCOUNT

A portion of the plan's obligations are funded through contributions to the Allied Industries Defined Benefit Plan in accordance with IRC 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

	December 31,	
	20X1	*20X0*
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[1]	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 for benefits	$1,072,000	$966,000

Changes in Net Assets in 401(h) Account

	For the Year Ended December 31, 20X1
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 for benefits	$106,000

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, 20X1 and 20X0.

> *U.S. government securities*: Valued by a third-party pricing source that incorporates market observable data, such as reported sales of similar securities, broker quotes, and reference data.
>
> *Money market fund*: Valued at the daily closing price as reported by the fund. The money market fund held in the 401(h) account is an open-end mutual fund that is registered with the SEC. This fund is required to publish its daily net asset value and to transact at that price. The money market fund held by the 401(h) account is deemed to be actively traded.

Note: For purposes of this hypothetical illustration, the assets of 401(h) account are classified within level 1 and level 2 of the fair value hierarchy. Note that this is not representative of all 401(h) accounts. Accordingly, other 401(h) accounts may hold assets that are also classified within levels 2 and 3 of the fair value hierarchy. Presentation in the notes to the financial statements should be made accordingly.

[1] A receivable from the employer must meet the requirements of Financial Accounting Standards Board *Accounting Standards Codification* 960-310-25-2.

The following table sets forth by level, within the fair value hierarchy, the assets held in the 401(h) account at fair value as of December 31, 20X1 and 20X0:

	Assets at Fair Value as of December 31, 20X1			
	Level 1	*Level 2*	*Level 3*	*Total*
U.S. government securities	$ —	$140,000	$—	$ 140,000
Money market fund	900,000	—	—	$900,000
Total assets at fair value	$900,000	140,000	—	$1,040,000

	Assets at Fair Value as of December 31, 20X0			
	Level 1	*Level 2*	*Level 3*	*Total*
U.S. government securities	$ —	$150,000	$—	$150,000
Money market fund	800,000	—	—	$800,000
Total assets at fair value	$800,000	$150,000	—	$950,000

Section 4: **Other Financial Statement Disclosures**

1. Fair Value Measurement

DISCLOSURE—FAIR VALUE MEASUREMENT

4.01 Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 820, *Fair Value Measurement*, defines fair value, sets out a framework for measuring fair value, and requires certain disclosures about fair value measurements. FASB ASC 820-10-20 defines *fair value* as 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.

4.02 FASB ASC 820-10-50 discusses the disclosures required for assets and liabilities measured at fair value. FASB ASC 820-10-50-1 requires the reporting entity to disclose information that helps users of its financial statements to assess both (*a*) the valuation techniques and inputs used to develop those measurements for assets and liabilities that are measured at fair value on a recurring or nonrecurring basis after initial recognition and (*b*) for recurring fair value measurements using significant unobservable inputs (level 3), the effect of the measurements on earnings (or changes in net assets) for the period.

4.03 In May 2011, FASB issued Accounting Standards Update (ASU) No. 2011-04, *Fair Value Measurement (Topic 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs*. According to FASB, the objective of this ASU is to improve the comparability of fair value measurements presented and disclosed in financial statements prepared in accordance with generally accepted accounting principles (GAAP) and International Financial Reporting Standards by changing the wording used to describe many of the requirements in GAAP for measuring fair value and disclosing information about fair value measurements. The amendments include those that clarify FASB's intent about the application of existing fair value measurement and disclosure requirements and those that change a particular principle or requirement for measuring fair value or disclosing information about fair value measurements.

This ASU, which was to be applied prospectively, was effective for public entities during interim and annual periods beginning after December 15, 2011 (early application is not permitted). For nonpublic entities, the amendments were effective for annual periods beginning after December 15, 2011. Some of the disclosures required by the amendments in this ASU are not required for nonpublic entities.

DISCLOSURE EXCERPT—FAIR VALUE MEASUREMENT—DEFINED BENEFIT PENSION PLAN

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

This illustrative disclosure has been fully updated for ASU No. 2011-04. Also, see section 1 for additional disclosures specifically related to defined benefit pension plans.

4.04

NOTE X: FAIR VALUE MEASUREMENTS

The framework for measuring fair value 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) and the lowest priority to unobservable inputs (level 3).

The three levels of the fair value hierarchy 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 maximize the use of relevant 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.

- *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 the insurance company 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 H).
- *Corporate bonds.* Valued using pricing models maximizing the use of observable inputs for similar securities. This includes basing value 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 or a broker quote, if available.
- *U.S. government securities.* Valued using pricing models maximizing the use of observable inputs for similar securities.
- *Hedge fund and real estate fund.* Valued based on the net asset value (NAV) per share, without further adjustment. NAV is based upon the fair value of the underlying investments.
- *Derivative instruments.* Value using pricing models based on the prevailing forward exchange rate of the underlying currencies, taking into account the counterparties' creditworthiness.

The following table sets forth by level, within the fair value hierarchy, the plan's assets at fair value measurements at 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 G):

	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:				
Investment grade bonds	—	$3,000,000	—	3,000,000
Non-investment grade bonds	—	100,000	400,000	500,000
Total corporate—bonds	—	3,100,000	400,000	3,500,000
U.S. government securities	—	350,000	—	350,000
Hedge fund	—	480,000	—	480,000
Real estate fund	—	—	270,000	270,000
Total assets, excluding plan interest in C&H master trust, at fair value	$690,000	$3,930,000	$1,670,000	$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
Guaranteed investment contract with National Insurance Company	—	—	$ 890,000	890,000
Corporate bonds:				
Investment grade bonds	—	$3,250,000	—	3,250,000
Non-investment grade bonds	—	200,000	220,000	420,000
Total corporate—bonds	—	3,450,000	220,000	3,670,000
U.S. government securities	—	270,000	—	270,000
Hedge fund	—	460,000	—	460,000
Real estate fund	—	240,000	—	240,000
Total assets, excluding plan interest in C&H master trust, at fair value	$880,000	$4,420,000	$1,110,000	$6,410,000

TRANSFERS BETWEEN LEVELS

The availability of observable market data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

Management has evaluated the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total net assets available for benefits.

On March 25, 20X2, a contractual limitation was instituted for the real estate fund, which delays certain withdrawal requests; therefore, this fund has been transferred from level 2 to level 3 in the fair value hierarchy.

CHANGES IN FAIR VALUE OF LEVEL 3 ASSETS AND RELATED 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.

[The use of the beginning-of-year benefit information would require this note to include December 31, 20X1 information.]

	Guaranteed Investment Contract	*Corporate Bonds*	*Real Estate Fund*	*Total*
Balance, beginning of year	$ 890,000	$ 220,000	—	$1,110,000
Transfer into Level 3	—	—	$240,000	240,000
Realized gains/(losses)	—	100,000	—	100,000
Unrealized gains/(losses) relating to assets still held at the reporting date	40,000	(30,000)	(50,000)	(40,000)
Purchases	337,000	210,000	80,000	627,000
Sales	(267,000)	(100,000)	—	(367,000)
Issuances	—	—	—	—
Settlements	—	—	—	—
Balance, end of year	$1,000,000	$ 400,000	$270,000	$1,670,000
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)	$ (50,000)	$ (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.

QUANTITATIVE INFORMATION ABOUT SIGNIFICANT UNOBSERVABLE INPUTS USED IN LEVEL 3 FAIR VALUE MEASUREMENTS

The following table represents the plan's level 3 financial instruments, the valuations techniques used to measure the fair value of those financial instruments as of December 31, 20X2,[1] and the significant unobservable inputs and the ranges of values for those inputs:

Instrument	*Fair Value*	*Principal Valuation Technique*	*Significant Unobservable Inputs*	*Range of Significant Input Values*	*Weighted Average*
Guaranteed investment contract	$1,000,000	Discounted cash flow	Discount rate	X%	Y%
			Duration (years)	5	
Corporate bonds	$ 400,000	Discounted cash flow	Credit risk (basis points)	xx–xxx	Y%
			Liquidity risk (basis points)	xx–xxx	Y%

[1] This is the initial year for these disclosure requirements, and these disclosures are effective prospectively. Therefore, only one year of these disclosures are illustrated in these financial statements. In future years, these disclosures should be comparative.

In estimating fair value of the investments in level 3, the Investment Committee may use third-party pricing sources or appraisers. In substantiating the reasonableness of the pricing data provided by third parties, the Investment Committee evaluates a variety of factors, including review of methods and assumptions used by external sources, recently executed transactions, existing contracts, economic conditions, industry and market developments, and overall credit ratings.

FAIR VALUE OF INVESTMENTS THAT CALCULATE NAV

The following table summarizes investments measured at fair value based on NAV per share as of December 31, 20X2 and 20X1, respectively.

December 31, 20X2	*Fair Value*	*Unfunded Commitments*	*Redemption Frequency (if currently eligible)*	*Redemption Notice Period*
Hedge fund (a)	$480,000	$ 100,000	Monthly	30–60 days
Real estate fund (b)	$270,000	$1,000,000	See (b)	See (b)

December 31, 20X1	*Fair Value*	*Unfunded Commitments*	*Redemption Frequency (if currently eligible)*	*Redemption Notice Period*
Hedge fund (a)	$460,000	$ 100,000	Monthly	30–60 days
Real estate fund (b)	$240,000	$1,000,000	See (b)	See (b)

(a) *Hedge fund*. The hedge fund's objective is to use leveraged, long, short, and derivative positions in both domestic and international markets with the goal of generating high returns. The plan can redeem monthly from the fund (30 days prior to month end).

(b) *Real estate fund*. The real estate fund invests primarily in commercial real estate and includes mortgage loans that are backed by the associated properties. It focuses on properties that return both lease income and appreciation of the buildings' marketable value. As of December 31, 20X2, a limitation was in effect that delayed the payment of withdrawal requests and provided for payment of such requests on a pro rata basis as cash becomes available. Aside from the withdrawal limitation in place at December 31, 20X2, investments in this category could previously be redeemed 2 times in a 30-day period at the current NAV per share based on the fair value of the underlying assets. Participants are not allowed to transfer back into this category until the 30-day period has expired. New contributions are allowed during this time period.

DISCLOSURE EXCERPT—FAIR VALUE MEASUREMENT—DEFINED CONTRIBUTION PLAN

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

This illustrative disclosure does not contain any transfers between fair value levels and, therefore, no disclosure has been made.

This illustrative disclosure has been fully updated for ASU No. 2011-04. Also, see section 2 for additional disclosures specifically related to defined contribution plans.

4.05

NOTE X: FAIR VALUE MEASUREMENTS

The framework for measuring fair value 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) and the lowest priority to unobservable inputs (level 3). The three levels of the fair value hierarchy under FASB ASC 820 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 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*. Valued at the closing price reported on the active market on which the individual securities are traded.
- *Corporate bonds*. Valued using pricing models maximizing the use of observable inputs for similar securities. This includes basing value on yields currently available on comparable securities of issuers with similar credit ratings.
- *Mutual funds*. Valued at the daily closing price as reported by the fund. Mutual funds held by the plan are open-end mutual funds that are registered with the SEC. These funds are required to publish their daily NAV and to transact at that price. The mutual funds held by the plan are deemed to be actively traded.
- *Collective trust fund*. Valued at the NAV of units of a bank collective trust. The NAV, as provided by the trustee, is used as a practical expedient to estimate fair value. The NAV is based on the fair value of the underlying investments held by the fund less its liabilities. This practical expedient is not used when it is determined to be probable that the fund will sell the investment for an amount different than the reported NAV. Participant transactions (purchased and sales) may occur daily. Were the plan to initiate a full redemption of the collective trust, the investment adviser reserves the right to temporarily delay withdrawal from the trust in order to ensure that securities liquidation will be carried out in an orderly business manner.
- *U.S. government securities*. Valued using pricing models maximizing the use of observable inputs for similar securities.
- *Guaranteed investment contract*. Guaranteed investment contracts are valued at fair value by the insurance company by discounting the related cash flows based on current yields of similar instruments with comparable durations considering the creditworthiness of the issuer (see note F). Because the participants transact at contract value, fair value is determined annually for financial statements reporting purposes only. In determining the reasonableness of the methodology, the Investment Committee evaluates a variety of factors, including review of existing contracts, economic conditions, industry and market developments, and overall credit ratings. Certain unobservable inputs are assessed through review of contract terms (for example, duration or payout date), whereas others are substantiated utilizing available market data (for example, swap curve rate).

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

	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	1,375,000	—	—	1,375,000
Fixed income funds	800,000	—	—	800,000
Other funds	25,000	—	—	25,000
Total mutual funds	4,462,500	—	—	4,462,500
Common stocks		—	—	
Industrials	490,000	—	—	490,000
Telecommunications	470,000	—	—	470,000
Total common stocks	960,000	—	—	960,000
Collective trust fund—S&P 500	—	1,422,000	—	1,422,000
Corporate bonds (Aaa credit rating)	—	307,500	—	307,500
U.S. government securities	—	225,000	—	225,000
Guaranteed investment contract	—	—	$1,515,000	1,515,000
Total assets at fair value	$5,422,500	$1,954,500	$1,515,000	$8,892,000

	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 fund	1,150,000	—	—	1,150,000
Fixed income	400,000	—	—	400,000
Other funds	100,000	—	—	100,000
Total mutual funds	3,650,000	—	—	3,650,000
Common stocks				
Industrials	450,000	—	—	450,000
Telecommunications	420,000	—	—	420,000
Total common stocks	870,000	—	—	870,000
Collective trust fund—S&P 500	—	2,100,000	—	2,100,000
Corporate bonds	—	255,000	—	255,000
U.S. government securities	—	120,000	—	120,000
Guaranteed investment contract	—	—	$660,000	660,000
Total assets at fair value	$4,520,000	—	$660,000	$7,655,000

CHANGES IN FAIR VALUE OF LEVEL 3 ASSETS AND RELATED 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 Year Ended December 31, 20X2
	Guaranteed Investment Contract
Balance, beginning of year	$660,000
Realized gains/(losses)	5,000
Unrealized gains/(losses) relating to instruments still held at the reporting date	40,000
Purchases	835,000
Sales	(25,000)
Transfers in and/or out of level 3	—
Balance, end of year	$1,515,000
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

Unrealized gains/(losses) from the guaranteed investment contract are not included in the statement of changes in net assets available for benefits as the contract is recorded at contract value for purposes of the net assets available for benefits.

QUANTITATIVE INFORMATION ABOUT SIGNIFICANT UNOBSERVABLE INPUTS USED IN LEVEL 3 FAIR VALUE MEASUREMENTS

The following table represents the plan's level 3 financial instruments, the valuation techniques used to measure the fair value of those financial instruments, and the significant unobservable inputs and the ranges of values for those inputs.

Instrument	*Fair Value*	*Principal Valuation Technique*	*Unobservable Inputs*	*Range of Significant Input Values*	*Weighted Average*
Guaranteed investment contract	$1,515,000	Discounted cash flow	Swap yield rates	1.749–2.707	Y%
			Duration	2.3–2.7	
			Payout date	6/28/13–12/31/13	
			Payout percentage	33% to 100%	

FAIR VALUE OF INVESTMENTS IN ENTITIES THAT USE NAV

The following table summarizes investments measured at fair value based on NAV per share as of December 31, 20X2 and 20X1, respectively.

December 31, 20X2	*Fair Value*	*Unfunded Commitments*	*Redemption Frequency (if currently eligible)*	*Redemption Notice Period*
Collective trust fund—S&P 500[2]	$1,422,000	n/a	Daily	30 days

[2] Financial Accounting Standards Board *Accounting Standards Codification* 820-10-50-6A requires disclosure of a description of the significant investment strategies. This illustration assumes that the title of the investment (that is S&P 500), clearly shows the investment strategy for this investment. If the investment strategy is not clearly recognizable through the title of the investment, then further disclosure would be required.

December 31, 20X1	Fair Value	Unfunded Commitments	Redemption Frequency (if currently eligible)	Redemption Notice Period
Collective trust fund—S&P 500[3]	$2,100,000	n/a	Daily	30 days

DISCLOSURE EXCERPT—FAIR VALUE MEASUREMENT—EMPLOYEE STOCK OWNERSHIP PLAN

Author's Note:

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

This illustrative disclosure does not contain any transfers between fair value levels and, therefore, no disclosure has been made.

In July 2013, FASB issued ASU No. 2013-09, *Fair Value Measurement (Topic 820): Deferral of Effective Date of Certain Disclosures for Nonpublic Employee Benefit Plans in Update No. 2011-04*. The amendments in this update apply only to certain quantitative disclosure requirements for an employee benefit plan, other than those plans that are subject to the SEC's filing requirements (hereafter, *nonpublic employee benefit plan*), that holds investments in its plan sponsor's own nonpublic entity equity securities, including equity securities of its plan sponsor's nonpublic affiliated entities and that are within the scope of the disclosure requirements contained in ASU No. 2011-04. Other non-quantitative disclosures required by ASU No. 2011-04 were not affected by the deferral and are reflected in this example. The deferral in this amendment is effective upon issuance for financial statements that have not been issued as of July 2013.

Although this ASU is effective for financial statements that have not been issued as of July 2013, this edition has been updated, as applicable, to illustrate the changes from ASU No. 2013-09. For information regarding this ASU, refer to www.fasb.org.

This illustrative disclosure has been fully updated for ASU No. 2011-04. Also, see section 2 for additional disclosures specifically related to employee stock ownership plans.

4.06

NOTE X: FAIR VALUE MEASUREMENTS

The framework for measuring fair value 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) and the lowest priority to unobservable inputs (level 3). The 3 levels of the fair value hierarchy under FASB ASC 820, *Fair Value Measurement*, 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 maximize the use of observable inputs and minimize the use of unobservable inputs.

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

[3] See footnote 2.

	Assets at Fair Value as of December 31			
	20X2		20X1	
	Level 3	Total	Level 3	Total
Investment in Sponsor Company common stock	$92,320,000	$92,320,000	$71,583,000	$71,583,000
Total assets at fair value	$92,320,000	$92,320,000	$71,583,000	$71,583,000

CHANGES IN FAIR VALUE OF LEVEL 3 ASSETS AND RELATED 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 Year Ended December 31, 20X2
	Investment in Sponsor Company Common Stock
Balance, beginning of year	$71,583,000
Realized gains/(losses)	0
Unrealized gains/(losses) relating to assets still held at the reporting date	24,264,000
Shares distributed to participants	(3,527,000)
Balance, end of year	$92,320,000
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	$24,264,000

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.

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 fair value of the Sponsor company common stock held by the plan is valued at fair value based upon an independent appraisal. This appraisal was based upon a combination of the market and income valuation techniques consistent with prior years. The appraiser took into account historical and projected cash flow and net income, return on assets, return on equity, market comparables, and fair value of company assets and liabilities. Plan management has concluded that a market participant would also recognize a discount for lack of marketability.

The valuation process involves plan management's selection of an independent appraiser under contract for a term of three years, with the right to cancel such contract at any time. Plan management accumulates the data for the appraiser from the audited financial statements of the company. The appraiser prepares a preliminary report that plan management, along with the ESOP trustee, reviews in detail, discusses, and approves. The results of this process are documented in minutes of the plan fiduciary.

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.

DISCLOSURE EXCERPT—HEALTH & WELFARE BENEFIT PLAN

Author's Note:

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

This illustrative disclosure does not contain any transfers between fair value levels and, therefore, no disclosure has been made.

This illustrative disclosure has been fully updated for ASU No. 2011-04. Also, see section 3 for additional disclosures specifically related to health and welfare benefit plans.

4.07

NOTE X: FAIR VALUE MEASUREMENTS

The framework for measuring fair value 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) and the lowest priority to unobservable inputs (level 3).

The three levels of the fair value hierarchy 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 maximize the use of relevant 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 short-term investment fund is a common trust fund and is valued at the net asset value (NAV) of units of the common trust fund. The NAV, as provided by the trustee, is used as a practical expedient to estimating fair value. The NAV is based on the fair value of the underlying investments held by the fund less its liabilities. This practical expedient is not used when it is determined to be probable that the fund will sell the investment for an amount different than the reported NAV. Plan transactions (issuances and redemptions) may occur daily. Were the plan to initiate a full redemption of the common trust fund, the investment adviser reserves the right to temporarily delay withdrawal from the trust in order to ensure that securities liquidations will be carried out in an orderly business manner. The common trust fund is designed to protect capital with low-risk investments and includes cash, bank notes, corporate notes, government bills, and various short-term debt instruments.[4]

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

	Assets at Fair Value Measurements as of December 31, 20X2			
	Level 1	*Level 2*	*Level 3*	*Total*
Short-term investment fund	—	$5,000,000	—	$5,000,000
Total assets at fair value	—	$5,000,000	—	$5,000,000

	Assets at Fair Value December 31, 20X1			
	Level 1	*Level 2*	*Level 3*	*Total*
Short-term investment fund	—	$4,000,000	—	$4,000,000
Total assets at fair value	—	$4,000,000	—	$4,000,000

[4] The Financial Reporting Executive Committee believes that this disclosure may be shown in narrative or tabular format, as appropriate to the circumstances.

2. Subsequent Events

DISCLOSURE—SUBSEQUENT EVENTS

4.08 Guidance on the accounting and reporting for subsequent events is provided in FASB ASC 855, *Subsequent Events*. As stated in FASB ASC 855-10-50-1, if an entity is not a filer with the SEC, then the entity should disclose both the date through which subsequent events have been evaluated and whether that date is either the date the financial statements were issued or the date the financial statements were available to be issued.

DISCLOSURE EXCERPTS—SUBSEQUENT EVENTS

4.09 *[The following note may be included in the summary of significant accounting policies or as a separate footnote.]*

NOTE X: SUBSEQUENT EVENTS

The plan administrator has evaluated subsequent events through June 20, 20X3, the date the financial statements were available to be issued.

4.10

NOTE X: SUBSEQUENT EVENTS

The plan has evaluated subsequent events through June 30, 20X3, the date the financial statements were available to be issued.

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.

4.11

NOTE X: SUBSEQUENT EVENTS

The plan has evaluated subsequent events through June 30, 20X3, the date the financial statements were available to be issued.

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.

4.12

NOTE X: SUBSEQUENT EVENTS

The plan has evaluated subsequent events through July 5, 20X3, the date the financial statements were available to be issued.

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.

4.13

NOTE X: SUBSEQUENT EVENTS

The plan has evaluated subsequent events through May 31, 20X3, the date the financial statements were available to be issued.

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 *eligible 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.

4.14

NOTE X: SUBSEQUENT EVENTS

The plan has evaluated subsequent events through June 15, 20X3, the date the financial statements were available to be issued.

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 should not extend beyond the date on which a participant attains age 70.

4.15

NOTE X: SUBSEQUENT EVENTS

The plan has evaluated subsequent events through June 30, 20X3, the date the financial statements were available to be issued.

Effective May 1, 20X3, the company changed its plan administrator and record keeper 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

4.16

NOTE X: SUBSEQUENT EVENTS

The plan has evaluated subsequent events through March 31, 20X3, the date the financial statements were available to be issued.

Effective January 1, 20X3, the company adopted an amendment to the plan to 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.

4.17

NOTE X: SUBSEQUENT EVENTS

The plan has evaluated subsequent events through June 30, 20X3, the date the financial statements were available to be issued.

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 SEC filings. A notice to participants was distributed on June 25, 20X3.

4.18

NOTE X: SUBSEQUENT EVENT

The plan has evaluated subsequent events through May 15, 20X3, the date the financial statements were available to be issued.

Effective January 1, 20X3, assets of participants who are employees of Red Corporation and Green Filmworks, Inc., were spun off to a separate qualified plan.

Effective January 1, 20X3, 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.

4.19

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.

4.20

NOTE X: SUBSEQUENT EVENT

The plan has evaluated subsequent events through June 30, 20X3, the date the financial statements were available to be issued.

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.

4.21

NOTE X: SUBSEQUENT EVENT

The plan has evaluated subsequent events through April 30 20X3, the date the financial statements were available to be issued.

During 20X3, the sponsoring employer amended and restated the plan and trust document, effective January 1, 19W7, 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.

4.22

NOTE X: SUBSEQUENT EVENT

The plan has evaluated subsequent events through May 15, 20X3, the date the financial statements were available to be issued.

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.

4.23

NOTE X: SUBSEQUENT EVENTS

The plan has evaluated subsequent events through June 30, 20X3, the date the financial statements were available to be issued.

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

- For XYZ 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 should 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.

4.24

NOTE X: SUBSEQUENT EVENTS

The plan has evaluated subsequent events through July 15, 20X3, the date the financial statements were available to be issued.

On July 6, 20X3 the Swordfish Company's board of directors approved the merger, effective August 31, 20X3, 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.

4.25

NOTE X: SUBSEQUENT EVENT

The plan has evaluated subsequent events through July 15, 20X3, the date the financial statements were available to be issued.

During March 20X3, the Company was acquired by ABC Company. Additionally, during March 20X3, the board of directors of the ABC Company approved the company's inclusion as a participating employer in the ABC Company 401(k) Plan effective July 1, 20X3. Effective July 1, 20X3, the net assets of the plan were transferred to the ABC Plan.

4.26

NOTE X: SUBSEQUENT EVENT

The plan has evaluated subsequent events through June 30, 20X3, the date the financial statements were available to be issued.

The administrative committee of the plan amended and restated the plan effective January 1, 20X3. The amendment increased the maximum participant contribution to 60%, changed the eligibility requirement to one year of credited service, and changed the trustee to State Bank. This change in trustees resulted in new investment options for participant contributions.

4.27

NOTE X: SUBSEQUENT EVENT

The plan has evaluated subsequent events through October 15, 20X3, the date the financial statements were available to be issued.

On August 27, 20X2, the Company filed voluntary petitions for relief under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court for the District of Delaware. The Bankruptcy Court approved the sale of substantially all of the Company's business operations and related assets to XYZ Company on October 8, 20X2, and in conjunction with this sale, assigned to XYZ Company the trust agreement between the Company and National Bank, Trustee, with respect to the plan; therefore, XYZ Company became sponsor of the plan, effective as of October 8, 20X3.

3. Risks and Uncertainties

DISCLOSURE—RISKS AND UNCERTAINTIES

4.28 FASB ASC 275-10-50-1 requires plans to include in their financial statements disclosures about the (*a*) nature of their operations and (*b*) use of estimates in the preparation of financial statements. In addition, if specified criteria are met, FASB ASC 275, *Risks and Uncertainties*, requires plans to include in their financial statements disclosures about (*a*) certain significant estimates and (*b*) current vulnerability due to concentrations.

4.29 In accordance with FASB ASC 275-10-50-8, certain significant estimates should be made when known information available before the financial statements are issued or available to be issued (as discussed in FASB ASC 855-10-25) indicates that both (*a*) it is at least reasonably possible that the estimate of the effect on the financial statements of a condition, situation, or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events, and (*b*) the effect of the change would be material to the financial statements.

4.30 FASB ASC 275-10-50-16 states that vulnerability from concentrations arises when a plan is exposed to risk of loss greater than it would have had it mitigated its risk through diversification.

DISCLOSURE EXCERPTS—RISKS AND UNCERTAINTIES—DEFINED CONTRIBUTION PLANS

4.31

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 change could materially affect participants' account balances and the amounts reported in the statement of net assets available for benefits.

4.32

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.

4.33

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.

4.34

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, 20X0, 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.

4.35

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). Pending the outcome 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.

DISCLOSURE EXCERPTS—RISKS AND UNCERTAINTIES—HEALTH AND WELFARE BENEFIT PLAN

4.36

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 postretirement 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.

4.37

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.

DISCLOSURE EXCERPTS—RISKS AND UNCERTAINTIES—DEFINED BENEFIT PENSION PLAN

4.38

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 those 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.

4.39

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.

DISCLOSURE EXCERPTS—CONCENTRATIONS

4.40

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.

4.41

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.

4.42

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.

4.43

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.

4.44

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.

4.45

NOTE X: CERTAIN SIGNIFICANT ESTIMATES

The plan sponsor is engaged in negotiations over a new collective bargaining agreement 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.

4.46

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.

4.47

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.

4.48

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.

4.49

NOTE X: GEOGRAPHIC CONCENTRATION OF INVESTMENTS

Approximately 95% of the plan's investments are stock and other investments in companies that are based in California or are heavily dependent on the economy of California.

4. Commitments and Contingencies

DISCLOSURE—COMMITMENTS AND CONTINGENCIES

4.50 Commitments and contingencies related to an employee benefit plan typically involve plan compliance issues or future plan amendments that affect the plan and its participants. Contingencies may take the form of a gain or loss contingency. Loss contingencies may involve collectability of receivables, tax issues, or litigation claims. Commitments and loss contingencies may result from nontraditional investments, such as limited partnership interest, real estate, or hedge funds. Commitments and contingencies are required to be disclosed by entities, including plans, as described in FASB ASC 450, *Contingencies.* In accordance with FASB ASC 450-10-20, a *contingency* is defined as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to a plan that will ultimately be resolved when one or more future events occur or fail to occur.

4.51 FASB ASC 450-20-50-1 states that disclosure of the nature of an accrual made pursuant to the provisions of FASB ASC 450-20-25-2, and, in some circumstances, the amount accrued, may be necessary for the financial statements not to be misleading. In accordance with FASB ASC 450-30-50-1, adequate disclosure should be made of a contingency that might result in a gain, but care should be exercised to avoid misleading implications about the likelihood of realization.

DISCLOSURE EXCERPTS—COMMITMENT AND CONTINGENCIES

4.52

NOTE X: COMMITMENTS AND CONTINGENCIES

From 19W7 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.

4.53

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.

5. Securities Lending

DISCLOSURE—SECURITIES LENDING

4.54 FASB ASC 860, *Transfers and Servicing*, provides accounting and reporting guidance for transfers of financial assets, including accounting for securities lending activities. If the securities lending transaction includes an agreement that entitles and obligates the plan (the transferor) to repurchase the transferred securities under which the plan maintains effective control over those securities, then the plan must account for those transactions as secured borrowings (not sales) and continue to report the securities on the statement of net assets.

4.55 Typically, in a securities lending arrangement, the transferee has the right by custom or contract to sell or repledge the security loaned. In these instances, the securities loaned should be reclassified and reported by the plan (the transferor) separately from other assets not so encumbered (for example, as security pledged to creditors) pursuant to FASB ASC 860-30-25-5. Alternatively, if the transferee does not have the right by custom or contract to sell or repledge the security loaned, the plan should disclose in the notes to the financial statements the carrying amount and classification of any assets pledged as collateral, associated liabilities, and qualitative information about the relationship between those assets and associated liabilities as of the date of the latest statement of net assets presented pursuant to FASB ASC 860-30-50-1A.

4.56 Pursuant to FASB ASC 860-30-50-1A, the plan must disclose the fair value as of the date of each statement of net assets presented of that collateral and of the portion of that collateral that it has sold or re-pledged and information about the sources and uses of that collateral. The plan must disclose its policy for requiring collateral or other security in accordance with FASB ASC 860-30-50-1A. According to FASB ASC 960-30-25-2, the interest income earned and rebate interest paid as a result of securities lending activity should be recorded on the statement of changes in net assets available for benefits.

Author's Note:

In December 2011, FASB issued ASU No. 2011-11, *Balance Sheet (Topic 210): Disclosure about Offsetting Assets and Liabilities,* which requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position.

This ASU is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosure required by the amendment in this ASU retrospectively for all comparative periods presented.

This edition does not illustrate the changes from ASU No. 2011-11 due to the effective date.

DISCLOSURE EXCERPTS—SECURITIES LENDING

4.57

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.

4.58

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 should 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 should 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.

6. Derivatives

DISCLOSURE—DERIVATIVES

4.59 FASB ASC 815, *Derivatives and Hedging*, provides accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as *derivatives*), and hedging activities. Certain employee benefit plans invest in derivative instruments and participate in hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position (net assets available for benefit) and measure those instruments at fair value.

4.60 FASB ASC 815-10-50-1 states that an entity with derivative instruments should disclose information to enable users of the financial statements to understand all of the following: (1) how and why an entity uses derivative instruments (or such nonderivative instruments); (2) how derivative instruments (or such nonderivative instruments) and related hedged items are accounted for under FASB ASC 815; and (3) how derivative instruments (or such nonderivative instruments) and related hedged items affect an entities financial position (net assets available for benefit), financial performance (statement of changes in net assets available for benefits), and cash flows.

4.61 In accordance with paragraphs 1A–B of FASB ASC 815-10-50, an entity that holds or issues derivative instruments (or nonderivative instruments that are designated and qualify as hedging instruments pursuant to FASB ASC 815-20-25-58 and 815-20-25-66) should disclose all of the following for every annual and interim reporting period for which a statement of financial position and statement of financial performance are presented: (1) its objectives for holding or issuing those instruments; (2) the context needed to understand those objectives; (3) its strategies for achieving those objectives; and (4) information that would enable users of its financial statements to understand the volume of its activity in those instruments. For item (4), an entity should select the format and the specifics of disclosures relating to its volume of such activity that are most relevant and practicable for its individual facts and circumstances. Information about the instruments in items (1)–(3) should be disclosed in the context of each instrument's primary underlying risk exposure. Further, those instruments should be distinguished between those used for risk management purposes and those used for other purposes. Derivative instruments (and nonderivative instruments that are designated and qualify as hedging instruments pursuant to paragraphs 58 and 66 of FASB ASC 815-20-25) used for risk management purposes include those designated as hedging instruments under FASB ASC 815-20, as well as those used as economic hedges, and for other purposes related to the entity's risk exposures.

Author's Note:
In December 2011, FASB issued ASU No. 2011-11, which requires an entity to disclose information about offsetting and related arrangements to enable users of its financial statements to understand the effect of those arrangements on its financial position.

This ASU is effective for annual reporting periods beginning on or after January 1, 2013, and interim periods within those annual periods. An entity should provide the disclosure required by the amendment in this ASU retrospectively for all comparative periods presented.

This edition does not illustrate the changes from ASU No. 2011-11 due to the effective date.

DISCLOSURE EXCERPTS—DERIVATIVES

4.62

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.

4.63

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.

The following is a summary of open forward currency contracts at December 31, 20X2:

Currency Purchased	*Settlement Date*	*Aggregate Face Value*	*Market Value*	*Unrealized Appreciation (Depreciation)*
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	$111,500,000	$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 indexes, 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 indexes, 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)

4.64

NOTE X: FINANCIAL INVESTMENTS

As of and during the years ended December 31, 20X2, and 20X1, the plan held no direct investments in derivatives.

4.65

NOTE X (IN PART): SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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.

4.66

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.

4.67

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).

4.68

NOTE X (IN PART): SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Derivatives. 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.

4.69

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.

4.70

NOTE X (IN PART): SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Derivative financial instruments. 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.

4.71

NOTE X (IN PART): SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

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.

4.72

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.

4.73

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, 20X2, 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, 20X1, 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, 20X2, and 20X1, 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, 20X2, and 20X1. The company does not intend to terminate these contracts at this time.

4.74

NOTE X: DERIVATIVES

The plan's derivative contracts consist of various futures contracts, foreign currency contracts, options contracts, and interest rate and credit default swaps. Since all derivative instruments are held within the Pension Master Trust, all are included at fair value in the Allocated Share in Master Trust as presented in the Statement of Net Assets Available for Benefits. Changes in the fair value (i.e., gains or losses) of the derivatives are recorded in the Allocated Share of Master Trust Net Investment Income in the accompanying Statement of Changes in Net Assets Available for Benefits.

FINANCIAL FUTURES CONTRACTS

The plan invests in financial futures contracts principally for the purpose of hedging its existing portfolio against adverse fluctuations in the market. Upon entering into a financial futures contract, the plan is required to pledge to the broker an amount of cash, U.S. government securities, or other assets, equal to a certain percentage of the contract amount (initial margin deposit). Subsequent payments, known as "variation margin," are made or received by the plan each day, depending on the daily fluctuations in the fair value of the underlying security. The plan recognizes an unrealized gain or loss equal to the daily variation margin. Should market conditions move unexpectedly, the plan may not achieve the anticipated benefits of the financial futures contracts and may realize a loss. The use of futures transactions involves the risk of imperfect correlation in movements in the price of futures contracts, interest rates, and the underlying hedged assets.

FORWARD FOREIGN EXCHANGE CONTRACTS

During years ended December 31, 20X2 and 20X1, foreign exchange transactions were processed by the Master Trust as part of the overall portfolio strategy. Forward foreign exchange contracts are valued at the spot market foreign exchange rate of the underlying currencies as of the year-end date.

WRITTEN OPTIONS AND PURCHASED OPTIONS

The plan may purchase or write option contracts to manage exposure to fluctuations in interest rates or hedge the fair value of other plan investments. Option contracts entered into by the plan, as it relates to hedging interest rate fluctuations, typically represent an option that

gives the purchaser the right, but not the obligation, to enter into a swap contract on a future date. If a call option is exercised, the purchaser will enter a swap to receive the fixed rate and pay a floating rate in exchange. Exercising a put would entitle the purchaser to pay a fixed rate and receive a floating rate.

Option contracts are marked-to-market as the net amount due to or from the plan in accordance with the terms of the contract based on the closing level of the relevant market rate of interest. Changes in the value of the option are reported as unrealized gains or losses. Gain or loss is recognized when the option contract expires or is closed. When the plan writes an option, the premium received is recorded as a liability and is subsequently adjusted to the current fair value of the option written. Premiums received from writing options that expire unexercised are treated by the plan on the expiration date as realized gains from investments. The difference between the premium and the amount paid on effecting a closing purchase transaction, including brokerage commissions, is also treated as a realized gain, or if the premium is less than the amount paid for the closing purchase, as a realized loss.

Entering into an option contract involves, to varying degrees, the elements of credit, market, and interest rate risk in excess of the amounts reported in the statement of net assets available for benefits. To reduce credit risk from potential counterparty default, the plan enters into option contracts with counterparties whose creditworthiness has been approved by the investment manager. The plan bears the market risk arising from any change in index values or interest rates.

SWAPS

The plan may invest in interest rate swap contracts. The plan uses interest rate swap contracts to manage its exposure to interest rates. Interest rate swap contracts entered into by the plan typically represent the exchange by the plan with a counterparty of a commitment to make variable rate and fixed rate payments with respect to a notional amount of principal. Such contracts may have a term of one to ten years, but typically require periodic interim settlement in cash, at which time both the value of the index or security and the specified interest rate are reset for the next settlement period. During the period that the swap contract is open, the contract is marked-to-market as the net amount due to or from the plan in accordance with the terms of the contract based on the closing level of the relevant index or security and interest accrual through the valuation date. Changes in the value of the swap contract are recorded as unrealized gains or losses, while periodic cash settlements are recorded as realized gains or losses.

The plan also invests in credit default swaps. Credit default swap contracts entered into by the plan typically represent the exchange by the plan with a counterparty of a commitment to provide a level of credit protection for a commitment to receive interest at a fixed rate based on the potential risk of default of the relevant underlying issuer. Providing credit protection to a counterparty tends to increase a plan's exposure to the underlying instrument. Receiving credit protection from a counterparty tends to decrease a plan's exposure to the underlying instrument held by a plan, or hedge the fair value of other plan investments. Such contracts may have a term of one to ten years, but typically require periodic interim settlement in cash. During the period that the credit default swap contract is open, the contract is marked-to-market in accordance with the terms of the contract based on the current interest rate spreads and credit risk of the referenced obligation of the underlying issuer and interest accrual through valuation date. Changes in the value of the credit default swap are recorded as unrealized gains or losses, while periodic cash settlements are recorded as realized gains or losses.

Entering into a swap contract involves, to varying degrees, elements of credit, market, and interest rate risk in excess of the amounts reported in the statement of net assets available. Notional principal amounts are used to express the extent of involvement in the transactions, but are not delivered under the contracts. Accordingly, credit risk is limited to any amounts receivable from the counterparty. To reduce credit risk from potential counterparty default, the plan enters into swap contracts with counterparties whose creditworthiness has been approved by the investment manager. The plan bears the market risk arising from any change in index or security values or interest rates.

Derivative securities of the Pension Master Trust as of December 31, 20X2 and activity for the year then ended are summarized as follows:

	Notional Amount	*Assets*	*Liabilities*	*Gain (Loss)*	*Classification of Gain (Loss)*
Futures Contracts Cash and Cash Equivalent Futures	$279,923,888	$ 409,350	$ 231,713	$ 899,663	Allocated Share of Master Trust Net Investment Income (MT Income)
Fixed Income Security Futures	34,091,875	225,851	1,456,218	3,809,231	MT Income
Swap Contracts Interest Rate Swaps	19,000,000	1,280,140	0	(13,039)	MT Income
Credit Default Swap	0	0	0	33,170	MT Income
Total Return Swaps	20,459,600	0	1,127,249	(1,515,764)	MT Income
Forward Foreign Exchange Contracts	106,651,775	107,631,252	107,291,378	628,008	MT Income
Options Contracts	(2,900,162)	25,934	157,487	769,639	MT Income
Short Sales	0	0	0	(17,498)	MT Income
Total	$457,226,976	$109,572,527	$110,264,045	$ 4,593,410	

Derivative securities of the Pension Master Trust as of December 31, 20X1 and activity for the year then ended are summarized as follows:

	Notional Amount	*Assets*	*Liabilities*	*Gain (Loss)*	*Classification of Gain (Loss)*
Futures Contract Cash and Cash Equivalent Futures	$ 49,928,350	$ 71,050	$ 87,750	$ (16,700)	MT Income
Fixed Income Security Futures	53,560,078	159,250	1,893,045	(8,232,276)	MT Income
Swap Contracts Interest Rate Swaps	57,100,000	1,292,236	768,157	276,756	MT Income
Credit Default Swaps	6,100,000	210,490	3,417,660	3,831,391	MT Income
Forward Foreign Exchange Contracts	112,784,805	111,878,155	111,948,996	(4,008,895)	MT Income
Options Contracts	32,800,230	0	385,182	(180,219)	MT Income
Short Sales	3,311,225	0	3,311,225	17,498	MT Income
Total	$315,584,688	$113,611,181	$121,812,015	$(8,312,445)	

4.75

NOTE X: SECURITIES LENDING

The Fund has a securities lending program with ABC Company. The Fund requires collateral with a market value of at least 102% of the market value of the loaned securities at the time a loan is transacted. Collateral is provided by the borrower and may be held, invested, or reinvested in certain types of securities.

The fair market value of the securities pledged to borrowers was $336,749,690 and $373,844,353 at December 31, 20X2 and 20X1, respectively. The cash collateral accepted by the Fund was $347,297,188 and $383,612,660 at December 31, 20X2 and 20X1, respectively. The fair market value of the Fund's investment in the cash collateral pools is $344,591,885 and $380,787,624 at December 31, 20X2 or 20X1, respectively. No collateral had been sold or repledged at December 31, 20X2 or 20X1.

The Fund receives a portion of the income earned on the collateral and also continues to earn income on the loaned securities. Any gain or loss in the market price of the securities loaned that may occur during the term of the loan will be for the account of the Fund. The lending agent provides the Fund with indemnification against losses due to the borrower default. The Fund bears the risk of loss only with respect to the investment of any cash collateral.

The Board of Trustees regularly reviews the performance of the cash collateral pools and the variation between their per unit fair values and $1.00. The cash collateral pools follow industry standards with respect to pricing and receiving valuations from an independent pricing service. Securities or other assets for which market valuations are not readily available or are deemed to be inaccurate are valued at fair value as determined in good faith using methods approved by XYZ. In determining fair value, XYZ takes into account all information available and any factors it deems appropriate, including quotes from third-party broker/dealers. At December 31, 20X2 and 20X1, the per unit fair value was $1.00 and $.98 for the Open Pool, $.98 and $.95 for the Term Pool, and $.23 and $.20 for Pool C (Lehman), respectively.

For purposes of determining transaction price for issuance and redemptions, the Fund evaluates additional inputs to the fair value of the investments in the cash collateral pools, including market conditions, credit quality, liquidity, and the assessed probability of incurring a realized loss on the cash collateral pools. Additionally, the Fund evaluates the qualitative aspects of ABC's securities lending program, including the historical performance of XYX as lending agent, the cash collateral pools' investment strategy and past performance, and the expected continuing transaction price of the cash collateral Open and Term pools at $1.00 per unit.

Accordingly, for purposes of calculating the transaction price, the Fund has valued its investments in the cash collateral Open and Term pools at their per unit transaction price of $1.00. The Board of Trustees will continue to review the Fund's participation in ABC's securities lending program and whether it continues to be appropriate to value the cash collateral Open and Term pools at their expected transaction price of $1.00 per unit for transaction purposes or, alternatively, at a lower per unit fair value.

Type of Contract	Number of Contracts Buy (Sell)	Expiration	Notional	Fair Value
Derivative assets:				
Interest rate contracts				
90-Day Eurodollar Future			$ 125,000	$ 150,000
Euro—Bond Future			138,000	145,000
US Treasury Bond Future			95,000	105,000
10-Year US Treasury Notes Future			87,000	98,000
5-Year US Treasury Note Future			74,000	82,000
2-Year US Treasury Note Future			65,000	71,000
Equity contract				
S&P 500 Index Future			98,000	102,000
Total			$ 682,000	$ 753,000
Derivative liabilities:				
Interest rate contracts				
90-Day Eurodollar Future			$ 210,000	$ 220,000
Euro—Bond Future			190,000	200,000
US Treasury Bond Future			175,000	182,000
10-Year US Treasury Notes Future			150,000	168,000
5-Year US Treasury Note Future			136,000	148,000
2-Year US Treasury Note Future			125,000	130,000
Equity contract				
S&P 500 Index Future			115,000	118,000
Total			$1,101,000	$1,166,000

Board of Trustees has recognized that it is unlikely the Fund's investment in Pool C will recover to a $1.00 per unit transaction price and has, therefore, valued the Pool C security at a present value of $.23 and $.20 per unit, for the years ended December 31, 20X2 and 20X1, respectively, resulting in an unrealized gain of $119,733 and $393,144 for the years ended December 31, 20X2 and 20X1, respectively.

4.76

NOTE X: DERIVATIVES

FUTURES CONTRACTS

The primary risk managed by the plan using future contracts is the price risk associated with investments. On behalf of the plan, investment managers enter into various futures contracts to economically hedge investments in domestic securities. These contracts, which are considered derivatives under FASB ASC 815, *Derivatives and Hedging*, are agreements between two parties to buy or sell a security or financial interest at a set price on a future date and are standardized and exchange-traded. Upon entering into such a contract on behalf of the plan, the investment manager is required to pledge to the broker an amount of cash or securities equal to the minimum "initial margin" requirements of the exchange on which the contract is traded. Pursuant to the contract, the investment manager agrees to receive from or pay to the broker an amount of cash equal to the daily fluctuation in the value of the contract. Such receipts or payments are known as *variation margin* and are recorded on a daily basis by the trustee as a realized gain or loss equal to the difference in the value of the contract between daily closing prices.

The table below presents open futures contracts at December 31, 20X2. The fair value presented in this table includes cumulative appreciation (depreciation) of futures contracts, but only the current day's variation margin receivable/payable is reported in the statements of net assets available for benefits.

OPTION CONTRACTS

The primary risk managed by the plan using option contracts is the price risk associated with investments. On behalf of the plan, investment managers have purchased and written various option contracts, which are agreements between two parties giving the buyer the right, but not the obligation, to buy or sell a specified item at a fixed price (exercise or strike) during a specified period, and giving the seller the obligation to sell or buy a specified item at a fixed price. These option contracts are intended by the plan to economically hedge and manage its price exposures with respect to investments in foreign and domestic securities. When the investment manager buys or writes an option contract, a nonrefundable fee (the premium) is paid or received by the plan and is recorded as an asset or liability and is subsequently adjusted to the current market value of the option purchased or written. The premiums paid or received from buying or writing options are recorded as realized gains or losses when the options expire. The difference between the premium and the amount paid or received on

affecting a closing purchase or sale transaction is also treated as a realized gain or loss. If an option is exercised, the premium paid or received is recorded as a realized gain or loss if sold or an adjustment to cost of the underlying if acquired upon exercise.

The following tables present the total number of purchased options and written options held by the plan at December 31, 20X2. The fair value presented in these tables is located in the statements of net assets available for benefits as options receivable/payable.

Type of Contract	*Cost (Premium Received)*	*Number of Contracts*	*Notional*	*Fair Value*
Derivative Assets:				
Interest rate contracts				
90-Day Eurodollar Future	$ 95,000	6	$ 96,000	$100,000
10-Year US Treasury Notes Future	90,000	5	92,000	98,000
US Treasury Bond Future	84,000	5	88,000	95,000
Total	$269,000	16	$276,000	$293,000

4.77

NOTE X: FOREIGN CURRENCY CONTRACTS

The primary risks managed by the plan using foreign currency forward contracts is the foreign currency exchange rate risk associated with the plan's investments denominated in foreign currencies. On behalf of the plan, investment managers entered into forward foreign currency contracts, which are agreements to exchange foreign currencies at a specified future date at a specified rate, the terms of which are not standardized on an exchange. These contracts are intended to minimize the effect of currency fluctuations on the performance of investments denominated in foreign currencies. All the plan's contracts address the currency risk of the U.S. Dollar versus the Euro. Risk arises both from the possible inability of the counterparties to meet the terms of the contracts (credit risk) and from the movements in foreign currency exchange rates (market risk). The contracts are recorded at fair value on the date the contract is entered into, which is typically zero.

The following table presents the contracts held by the plan. The fair value presented in this table is located in the statements of net assets available for benefits as other assets/liabilities.

	Notional		*Fair Value*	
	20X2	*20X1*	*20X2*	*20X1*
Derivative assets:				
Euro/USD forward	$150,000	$125,000	$175,000	$165,000
Derivative liabilities:				
Euro/USD forward	$130,000	$110,000	$180,000	$150,000

7. Related Party

DISCLOSURE—RELATED PARTY

4.78 Section 3(14) of ERISA defines a *party in interest* to include, among others, fiduciaries or employees of the plan, any person who provides service to the plan, an employer whose employees are covered by the plan, an employee organization whose members are covered by the plan, a person who owns 50 percent or more of such an employer or employee organization, or relatives of such person just mentioned. Although not identical, ERISA defines parties in interest in much the same way as FASB ASC 850, *Related Party Disclosures*, defines the term *related parties*, except that ERISA's definition is broader and includes all entities and individuals that provide service to the plan; however, these entities may not necessarily be related parties.

4.79 In accordance with FASB ASC 850-10-50-1, financial statements should include disclosures of material related party transactions, other than compensation arrangements, expense allowances, and other similar items in the ordinary course of business. The disclosures should include the following:

1. The nature of the relationship(s) involved
2. A description of the transactions, including transactions to which no amounts or nominal amounts were ascribed, for each of the periods for which income statements are presented, and such other information deemed necessary to an understanding of the effects of the transactions on the financial statements

3. The dollar amounts of transactions for each of the periods for which income statements are presented and the effects of any change in the method of establishing the terms from that used in the preceding period
4. Amounts due from or to related parties as of the date of each balance sheet presented and, if not otherwise apparent, the terms and manner of settlement
5. The information required by FASB ASC 740-10-50-17

DISCLOSURE EXCERPTS—RELATED PARTY

4.80

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 record keeper, as defined by the plan and, therefore, these transactions qualify as party-in-interest transactions. Fees paid by the plan for the custodial and record-keeping services amounted to $25,000 for the year ended December 31, 20X2.

4.81

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, 20X2, and 20X1, 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, 20X2, and 20X1, the plan recorded dividend income of $3,658,268 and $3,687,367, respectively.

4.82

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.

4.83

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 vested 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.

4.84

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.

4.85

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.

4.86

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.

4.87

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.

4.88

NOTE X: TRANSACTIONS WITH PARTIES IN INTEREST

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

4.89

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.

4.90

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.

4.91

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, 20X2.

4.92

NOTE X: TRANSACTIONS WITH PARTIES IN INTEREST

Certain plan investments are shares of mutual funds managed by the Trustee and the Custodian 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. Certain administrative fees related to the administration of the plan were paid by the plan or by the Company. These transactions qualify as party-in-interest transactions.

DISCLOSURE EXCERPTS—RELATED PARTY—SHARE PURCHASE PLAN

4.93

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.

8. Prohibited Transactions

DISCLOSURE—PROHIBITED TRANSACTIONS

4.94 Certain plan transactions with parties in interest are prohibited under Section 406 and 407 of ERISA and are required, without regard to their materiality, to be disclosed to the Department of Labor (DOL) in the plan's annual report Form 5500. Prohibited transactions are also of interest from the perspective of the plan's financial statements. They can give rise to significant receivables because a plan fiduciary is liable to make good on losses to the plan resulting from a breach of fiduciary duty and to restore to the plan any profits the fiduciary made through the use of the plan's assets. The potential effects of any contingencies on the plan as a result of engaging in prohibited transactions may need to be disclosed in the plans financial statements in accordance with the requirements of FASB ASC 450.

4.95 Transactions between a plan and a party in interest that are generally prohibited under Section 406(a) of ERISA include the following:

- A sale, exchange, or lease of property
- A loan or other extension of credit (including late deposits of employee deferrals to the trust)
- The furnishings of goods, services, or facilities
- A transfer of plan assets to a party in interest for the use or benefit of a party in interest
- An acquisition of employer securities or real property in violation of the 10-percent limitation

DISCLOSURE EXCERPTS—PROHIBITED TRANSACTIONS

4.96

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.

4.97

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.

4.98

NOTE X: PARTY IN INTEREST TRANSACTIONS

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.

4.99

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.

4.100

NOTE X: DELINQUENT TRANSMITTALS

During 20X2, the Company erroneously failed to remit certain employee deferrals and loan repayments to the plan aggregating $X,XXX. These deferrals and loan repayments are included in the plan's receivables at December 31, 20X2. The Company computed the lost earnings on these 20X2 deposits and subsequently remitted the deposits and made a contribution for lost earnings to the plan.

4.101

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.

4.102

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.

9. Going Concern

DISCLOSURE—GOING CONCERN

4.103 AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*), addresses the auditor's responsibility in an audit of financial statements with respect to evaluating whether there is substantial doubt about the entity's ability to continue as a going concern. For financial reporting purposes, continuation of a plan as a going concern is assumed in the absence of significant information to the contrary. Ordinarily, information that significantly contradicts the going concern assumption relates to the plan's ability to continue to meet its obligations as they become due without an extraordinary contribution by the sponsor or substantial disposition of assets outside the ordinary course of business, externally forced revision of its operations, or similar actions.

4.104 Although employee benefit plans are not automatically and necessarily affected by the plan sponsor's financial adversities, this situation may result in the auditor determining it to be a condition or an event sufficient to evaluate whether there is substantial doubt about the plan's ability to continue as a going concern.

DISCLOSURE EXCERPTS—GOING CONCERN

4.105

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.

4.106

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, 20X2, 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.

10. Tax Status

DISCLOSURE—TAX STATUS

4.107 A trust established under an employee benefit pension plan or welfare plan ordinarily is qualified under the IRC as exempt from federal income taxes. Plans must be designed and operated in accordance with IRC requirements in order to maintain their tax-exempt status. The existence of a favorable determination letter does not, in and of itself, serve as evidence that the plan is qualified. Determination letters provide evidence that the plan, at the time of issuance of the determination letter, was designed in accordance with applicable IRC requirements. Nevertheless, the auditor of an employee benefit plan should be aware of the possibility that violations of tax laws and regulations may have occurred and the potential consequences of such violations.

4.108 Currently, there is no tax determination letter program for a 403(b) plan. The tax exempt status of a 403(b) plan is different from a 401(k) plan because the tax exempt status of a 403(b) plan relates to an exclusion from income for the participant, rather than an exemption of tax for the plan.

4.109 FASB ASC 740-10 clarifies the accounting and provides implementation guidance for uncertainty in income taxes recognized in an entity's financial statements. It prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken, or expected to be taken, in a tax return. FASB ASC 740-10 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. A plan's tax exempt status is a tax position that may be subject to uncertainty. According to FASB ASC 740-10-50-15, all entities should disclose all of the following at the end of each annual reporting period presented:

- The total amounts of interest and penalties recognized in the statement of operations and the total amounts of interest and penalties recognized in the statement of financial position
- For positions for which it is reasonably possible that the total amounts of unrecognized tax benefits will significantly increase or decrease within 12 months of the reporting date:
  - The nature of the uncertainty
  - The nature of the event that could occur in the next 12 months that would cause the change
  - An estimate of the range of the reasonably possible change or a statement that an estimate of the range cannot be made
- A description of tax years that remain subject to examination by major tax jurisdiction

DISCLOSURE EXCERPTS—TAX STATUS

4.110

NOTE X: TAX STATUS

The IRS has determined and informed the company by a letter dated June 20, 20X2, 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.

GAAP requires plan management to evaluate tax positions taken by the plan and recognizes a tax liability (or asset) if the plan has taken an uncertain position that more likely than not would not be sustained upon examination by the applicable authorities. The plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes it is no longer subject to income examination for years prior to 20W7.

4.111

NOTE X: TAX STATUS

On November 19, 20X2, 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.

GAAP requires plan management to evaluate tax positions taken by the plan and recognizes a tax liability (or asset) if the plan has taken an uncertain position that more likely than not would not be sustained upon examination by the applicable authorities. The plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes it is no longer subject to income examination for years prior to 20W7.

4.112

NOTE X: TAX STATUS

The plan has received a determination letter from the IRS dated June 8, 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 accordance 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.

GAAP requires plan management to evaluate tax positions taken by the plan and recognizes a tax liability (or asset) if the plan has taken an uncertain position that more likely than not would not be sustained upon examination by the applicable authorities. The plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes it is no longer subject to income examination for years prior to 20W7.

4.113

NOTE X: INCOME TAX STATUS

The prototype plan sponsor has obtained an opinion letter dated August 7, 20X2, 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.

GAAP requires plan management to evaluate tax positions taken by the plan and recognizes a tax liability (or asset) if the plan has taken an uncertain position that more likely than not would not be sustained upon examination by the applicable authorities. The plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes it is no longer subject to income examination for years prior to 20W7.

4.114

NOTE X: INCOME TAX STATUS

The IRS issued, on October 15, 20X2, 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 20X2. 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.

GAAP requires plan management to evaluate tax positions taken by the plan and recognizes a tax liability (or asset) if the plan has taken an uncertain position that more likely than not would not be sustained upon examination by the applicable authorities. The plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes it is no longer subject to income examination for years prior to 20W7.

4.115

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 (IRC). 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, 20X1, to bring the plan into compliance. On June 15, 20X2, 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 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 is included in the plan's financial statements.

GAAP requires plan management to evaluate tax positions taken by the plan and recognizes a tax liability (or asset) if the plan has taken an uncertain position that more likely than not would not be sustained upon examination by the applicable authorities. The plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes it is no longer subject to income examination for years prior to 20W7.

4.116

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, 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.

GAAP requires plan management to evaluate tax positions taken by the plan and recognizes a tax liability (or asset) if the plan has taken an uncertain position that more likely than not would not be sustained upon examination by the applicable authorities. The plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes it is no longer subject to income examination for years prior to 20W7.

4.117

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.

GAAP requires plan management to evaluate tax positions taken by the plan and recognizes a tax liability (or asset) if the plan has taken an uncertain position that more likely than not would not be sustained upon examination by the applicable authorities. The plan is subject to

routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes it is no longer subject to income examination for years prior to 20W7.

DISCLOSURE—TAX STATUS—HEALTH AND WELFARE PENSION PLAN

4.118 In accordance with FASB ASC 965-205-50-1, separate disclosures may be made to the extent that the plan provides both health and other welfare benefits. The disclosures should include the federal income tax status of the plan. No determination letter program for health and welfare plans exists; however, a 501(c)(9) voluntary employees' beneficiary association trust must obtain a determination letter to be exempt from taxation.

DISCLOSURE EXCERPTS—TAX STATUS—HEALTH AND WELFARE PENSION PLAN

4.119

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.

GAAP requires plan management to evaluate tax positions taken by the plan and recognizes a tax liability (or asset) if the plan has taken an uncertain position that more likely than not would not be sustained upon examination by the applicable authorities. The plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes it is no longer subject to income examination for years prior to 20W7.

4.120

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.

GAAP requires plan management to evaluate tax positions taken by the plan and recognizes a tax liability (or asset) if the plan has taken an uncertain position that more likely than not would not be sustained upon examination by the applicable authorities. The plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes it is no longer subject to income examination for years prior to 20W7.

4.121

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 accordance 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.

GAAP requires plan management to evaluate tax positions taken by the plan and recognizes a tax liability (or asset) if the plan has taken an uncertain position that more likely than not would not be sustained upon examination by the applicable authorities. The plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes it is no longer subject to income examination for years prior to 20W7.

DISCLOSURE EXCERPTS—TAX STATUS—EMPLOYEE STOCK OWNERSHIP PLAN

4.122

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.

GAAP requires plan management to evaluate tax positions taken by the plan and recognizes a tax liability (or asset) if the plan has taken an uncertain position that more likely than not would not be sustained upon examination by the applicable authorities. The plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes it is no longer subject to income examination for years prior to 20W7.

4.123

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.

GAAP requires plan management to evaluate tax positions taken by the plan and recognizes a tax liability (or asset) if the plan has taken an uncertain position that more likely than not would not be sustained upon examination by the applicable authorities. The plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes it is no longer subject to income examination for years prior to 20W7.

4.124

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.

GAAP requires plan management to evaluate tax positions taken by the plan and recognizes a tax liability (or asset) if the plan has taken an uncertain position that more likely than not would not be sustained upon examination by the applicable authorities. The plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes it is no longer subject to income examination for years prior to 20W7.

4.125

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 accordance 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.

GAAP requires plan management to evaluate tax positions taken by the plan and recognizes a tax liability (or asset) if the plan has taken an uncertain position that more likely than not would not be sustained upon examination by the applicable authorities. The plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes it is no longer subject to income examination for years prior to 20W7.

4.126

NOTE X: INCOME TAX STATUS

The plan has received a determination letter from the IRS dated July 1, 20X0, 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 accordance 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.

GAAP requires plan management to evaluate tax positions taken by the plan and recognizes a tax liability (or asset) if the plan has taken an uncertain position that more likely than not would not be sustained upon examination by the applicable authorities. The plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The plan administrator believes it is no longer subject to income examination for years prior to 20W7.

11. Reconciliation of Financial Statements to Form 5500

DISCLOSURE—RECONCILIATION OF FINANCIAL STATEMENTS TO FORM 5500

4.127 The report of most significance to the auditor is the annual report. The annual report required to be filed for employee benefit plans generally is the Form 5500. The Form 5500 is a joint-agency form developed by the IRS, DOL, and PBGC that may be used to satisfy the annual reporting requirements of the IRC and Titles I and IV of ERISA. For purposes of Title I of ERISA only, a plan administrator may, in lieu of filing the Form 5500, elect to file the information required by ERISA Section 103. However, almost all plan administrators use the Form 5500. Use of the Form 5500 is required for filings under the IRC and Title IV of ERISA.

4.128 ERISA requires a plan's financial statements to include financial statement disclosures of reconciling difference, if any, between amounts reported in the financial statements and the amounts reported in the Form 5500. The regulations also require (1) current value, comparing the beginning and end of the plan year, and (2) a description of accounting principles and practices reflected in the financial statements.

DISCLOSURE EXCERPTS—RECONCILIATION OF FINANCIAL STATEMENTS TO FORM 5500

4.129

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

4.130

NOTE X: RECONCILIATION OF FINANCIAL STATEMENTS TO FORM 5500

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

	20X2	*20X1*
Net assets available for benefits per the financial statements	$7,180,268	$6,875,995
Refunds of excess contributions to participants	—	14,989
Rounding	—	2
Net assets available for benefits per the Form 5500	$7,180,268	$6,890,986

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

	20X2	*20X1*
Changes in net assets available for benefits per the financial statements	$304,273	$1,347,251
Current year refund of excess contributions to participants	—	14,989
Prior year refunds of excess contributions to participants	(14,989)	(18,208)
Rounding	(2)	2
Changes in net assets available for benefits per the Form 5500	$289,282	$1,344,034

12. Excess Participant Contributions Payable

DISCLOSURE—EXCESS PARTICIPANT CONTRIBUTIONS PAYABLE

4.131 The financial statements of an employee benefit plan generally have no accrued income tax liability or provision for income tax expense. Plans must be designed and operated in accordance with IRC requirements in order to maintain their qualified status. The existence of a determination letter does not, in and of itself, serve as evidence that the plan is qualified. Determination letters provide evidence that the plan is designed in accordance with applicable IRC requirements. However, qualified plans must comply with certain operating tests in order to be tax qualified (for example, coverage, discrimination, and maximum benefit limitation tests). The auditor may become aware of possible violations of tax laws and regulations that could adversely affect the plan's tax status. In those situations, the auditor should consider the effect on the financial statements.

4.132 Examples of IRC requirements with which a plan must comply in order to maintain its tax exempt status include the following:

i. Minimum coverage test (retirement plans only).

ii. Minimum participation tests (retirement plans only).

iii. Nondiscrimination test (both retirement and welfare plans).

iv. Average deferral and contribution percentage limits (both apply to 401(k) plans only; 403(b) plans with employer contributions are subject to the contribution percentage test).

v. Annual additions limitation (generally retirement plans only, but funded health plans can reduce the allowable benefit for key employees).

vi. Top heavy test (qualified retirement plans only; not 403(b) plans).

vii. Exclusive benefit rule (both retirement and welfare plans).

viii. Diversification of certain employer security holdings.

DISCLOSURE EXCERPTS—EXCESS PARTICIPANT CONTRIBUTIONS PAYABLE

4.133

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.

4.134

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.

4.135

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.

4.136

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.

4.137

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 nondiscrimination rules.

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

4.138

NOTE X: BENEFITS PAYABLE

As of the date the financial statements were available to be issued, the company had not completed the discrimination testing for the plan 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.

4.139

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.

13. Forfeitures

DISCLOSURE—FORFEITURES

4.140 Upon termination of employment, a participant may not be fully vested in the employer's contributions that have been allocated to his or her account. The forfeited nonvested portion of the participant's account remains as a plan asset (either in the participant's account or in a suspense account). The forfeitures account may only be used or allocated in accordance with the plan document. The Financial Reporting Executive Committee recommends that forfeitures not be shown separately on the face of the financial statements but, rather, be combined in the appropriate investment classification.

4.141 The financial statements should disclose the amount and disposition of forfeited, nonvested accounts. Specifically, the financial statements should identify those amounts that are used to reduce future employer contributions, expenses, or are reallocated to participant's accounts, in accordance with the plan document.

DISCLOSURE EXCERPTS—FORFEITURES

4.142

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.

4.143

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.

4.144

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.

4.145

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.

4.146

NOTE X: FORFEITURES

Forfeitures—Benefit payments to terminated employees partially vested in the plan include their vested portion of employer contributions. Forfeitures may be used to reduce employer contributions or to pay administrative expense of the plan, as determined by the Company at its sole discretion. For the years ended December 31, 20X2 and 20X1, forfeitures of $32,985 and $34,746, were used to reduce future employer contributions and/or pay administrative expenses, respectively. At December 31, 20X2 and 20X1, there were $14,269 and $32,985, respectively, of forfeitures that had not yet been applied to employer contributions or used to pay administrative expenses.

4.147

NOTE X (IN PART): FORFEITURE

f. Forfeitures. For profit sharing contributions made by the company prior to January 1, 20X2, 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.

14. Partial Plan Termination

DISCLOSURE—PARTIAL PLAN TERMINATION

4.148 Upon full or partial termination of a plan, affected participants become fully vested in accrued benefits at the termination date. A partial termination can occur if approximately 20 percent or more of plan participants are terminated by the plan sponsor as a result of an action, such as a plant closure, a decision to downsize, or the termination of a product line. The reduction can accumulate over one or more plan years and still be classified as a partial termination. Judgment is needed to determine whether a partial termination has occurred. The plan sponsor may need to consult with the IRS or qualified legal counsel if questions arise regarding the occurrence of a partial plan termination. Consideration also may be given to determine that terminated participants receive their fully vested benefits and that there were no forfeited amounts. When the decision to terminate a plan has been made, or a wasting trust exists, the relevant circumstances should be disclosed in all subsequent financial statements issued by the plan.

DISCLOSURE EXCERPTS—PARTIAL PLAN TERMINATION

4.149

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 20X2, the company set the effective date of termination of the plan at April 30, 20X2. 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.

4.150

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.

15. Voluntary Correction Programs

DISCLOSURE—VOLUNTARY CORRECTION PROGRAMS

4.151 Plan officials faced with prohibited transactions (including late remittance of employee deferrals) ordinarily should consult with legal counsel to determine if the plan sponsor should apply to the DOL's Voluntary Fiduciary Correction Program (VFCP) with respect to a prohibited transaction. Full compliance with the VFCP will result in the DOL's issuance of a "no action letter" and no imposition of penalties. Therefore, in addition to disclosing the prohibited transaction, the plan should disclose the application and status of the VFCP.

DISCLOSURE EXCERPTS—VOLUNTARY CORRECTION PROGRAMS

4.152

NOTE X: VOLUNTARY CORRECTION PROGRAM

Two participants were each found to have taken out three 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).

4.153

NOTE X: VOLUNTARY CORRECTION PROGRAM

When the plan was amended in 20X2, 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.

4.154

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.

4.155

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.

4.156

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.

16. Other

DISCLOSURE—OTHER

4.157 The following section contains other scenarios that require disclosure in the notes to the financial statements in order for the financial statements to be in compliance with applicable rules and regulations.

DISCLOSURE EXCERPTS—OTHER

4.158

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.

4.159

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

4.160

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 should 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 should 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.

4.161

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).

4.162

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.

4.163

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 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.

4.164

NOTE X: FIDELITY BOND

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

4.165

NOTE X: LINE OF CREDIT

In fiscal year 19W8, 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.

4.166

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.

4.167

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 another employer

contribution in 20X2, and another 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.

4.168

NOTE X: DEMUTUALIZATION OF CITY LIFE INSURANCE ENTITY

During April 20X2, the plan received a one-time 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 City Life, 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 City Life'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 one-time pro rata earnings adjustment to the accounts of all current participants in proportion to each participant's account balance.

DISCLOSURE EXCERPT—OTHER—EMPLOYEE STOCK OWNERSHIP PLAN

4.169

NOTE X: LOANS PAYABLE AND SHARE RELEASE

On October 13, 19W8, 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 should 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 should 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.

P1: KpB
ACPA300-05 aicpa-att-epb.cls June 9, 2014 14:16

Section 5: Limited Scope Audit Disclosures and Auditor's Reports

5.01 Under certain circumstances, plan management may elect to adopt an exemption under the Employee Retirement Income Security Act of 1974 (ERISA) Section 103(a)(3)(c) that allows the plan management to instruct the auditor not to perform any auditing procedures with respect to the 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. This election is available only if the qualified certifying institution certifies both the accuracy and completeness of the investment information submitted. Certifications that address only accuracy or completeness, but not both, do not comply with the Department of Labor's (DOL) regulation and, therefore, are not adequate to allow plan management to limit the scope of the audit.

5.02 This limited-scope audit exemption does not apply to information about investments held by a broker or dealer or an investment company. In addition, if a limited-scope audit is to be performed on a plan funded under a master trust arrangement or other similar vehicle, then separate individual plan certifications from the certifying institution need to be obtained by plan management to support the allocation of the assets and the related net investment income to the specific plan.

5.03 The exemption applies only to investment information certified by the qualified certifying institution and does not extend to participant data, contributions, benefit payments, required financial statement disclosures, or other information regardless of whether it is included in the certified information. Thus, except for the investment-related functions performed by the qualified certifying institution, an auditor conducting a limited-scope audit would need to include in the scope of the audit functions performed by the plan sponsor or other third-party service organizations, such as third-party welfare plan claims administrators or third-party savings plan administrators, as applicable. 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

DISCLOSURE—INFORMATION CERTIFIED BY TRUSTEE

5.04 In accordance with DOL regulations, the audit may be restricted with respect to assets held and transactions executed by certain institutions. In an ERISA limited-scope audit, the plan management can instruct the auditor to limit the scope of testing of investment information, which has been prepared and certified by a qualifying institution as complete and accurate.

DISCLOSURE EXCERPTS—INFORMATION CERTIFIED BY TRUSTEE

5.05

NOTE X: TRUSTEE INFORMATION

The following is a summary of the plan's investment information 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 management. The plan management 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)

5.06

NOTE X: INVESTMENT INFORMATION

The following is a summary of the plan's investment information, included in the plan's financial statements and supplemental schedules that was prepared by, or derived from, information prepared by ABC Bank, the custodian of the plan, and furnished to the plan management. The plan management has obtained certifications from the custodian that the information is complete and accurate as of and for the years ended 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

5.07

NOTE X: INVESTMENTS

The plan management 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. As permitted under such election, the following investment information was certified by XYZ 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

5.08

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 management 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. The investments in the master trust have been certified by XYZ Financial Institution. 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)
	$52,448,717	$48,803,827

5.09

NOTE X: INFORMATION CERTIFIED BY THE PLAN'S TRUSTEE

The plan management 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, 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.

5.10

NOTE X: INFORMATION CERTIFIED BY THE PLAN'S CUSTODIAN

The plan management 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 management 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	*20X2*	*20X1*
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, 20X2, and 20X1, respectively.

5.11

NOTE X: INFORMATION CERTIFIED BY THE TRUSTEE

The plan management 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 management 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

DISCLOSURE—LIMITED-SCOPE AUDIT REPORTS

5.12 Under DOL regulations, the plan auditor need not examine and report on certain information prepared by banks, similar institutions, or insurance carriers that are regulated, supervised, and subject to period examination by a state or federal agency if that information is certified as complete and accurate by the bank or similar institution, or an insurance carrier and the plan administrator elects the limited-scope audit exemption. Thus, the plan administrator may restrict the auditor's examination of the assets held and transactions executed by such institutions.

SUPPLEMENTAL SCHEDULES RELATING TO ERISA AND DOL REGULATIONS

5.13 When the auditor is engaged to perform a limited-scope audit, as permitted under 29 CFR 2520.103-8 of the DOL's Rules and Regulations for Reporting and Disclosure under ERISA, and consequently disclaims an opinion on the financial statements as a whole, the auditor is precluded from issuing an opinion on the supplemental schedules in relation to the financial statements under AU-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole* (AICPA, *Professional Standards*). Therefore, unless the auditor is specifically engaged to perform the procedures required in AU-C section 725, the auditor is not required to follow such AU-C section. However, because the DOL requires supplemental schedules to be presented with the financial statements, the auditor is required to follow the guidance in AU-C section 720, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*). AU-C section 720 requires the auditor to read the other information in order to identify material inconsistencies, if any, with the audited financial statements. AU-C section 720 also addresses if, on reading the other information, the auditor becomes aware of an apparent material misstatement of fact. (See AU-C section 720 for specific guidance.)

5.14 Paragraph .A2 of AU-C section 720 states that the auditor is not required to make reference to the other information in the auditor's report on the financial statements. However, the auditor may include an other-matter paragraph disclaiming an opinion on the other information. For example, an auditor may choose to include a disclaimer on the other information when the auditor believes that the auditor could be associated with the information, and the user may infer a level of assurance that is not intended.

5.15 In addition, under a limited-scope audit, although the auditor is precluded from expressing an opinion on the supplemental schedules in relation to the financial statements, the DOL requires the auditor to offer an opinion on the supplemental schedules. This is accomplished by expressing an opinion on the form and content of the information included in the supplemental schedules, other than that derived from the information certified by a qualifying institution. Accordingly, in addition to the requirements in AU-C section 720, the auditor may also need to perform certain audit procedures the auditor deems necessary to provide an opinion that the form and content of the information included in the supplemental schedules, other than that derived from the information certified by a qualifying institution, have been audited and are presented in compliance with the DOL's Rules and Regulations for Reporting and Disclosure under ERISA.

REPORTING EXCERPT—STANDARD LIMITED-SCOPE AUDIT REPORT—401(k) PLAN

5.16

Circumstances include the following:

- *A standard limited-scope auditor's report for a 401(k) plan financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP).*[1]
- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*
- *The plan administrator limits the scope of the audit, as permitted by 29 CFR 2520.103-8 of the DOL's rules and regulations for reporting and disclosure under ERISA.*
- *The auditor follows AU-C section 720 relating to the supplemental schedules and chooses to disclaim an opinion on the supplemental schedules.*

[Source: Paragraph 11.64 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*]

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of XYZ 401(k) Plan, which comprise the statements of net assets available for benefits 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 related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audits in accordance with auditing standards generally accepted in the United States of America. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of 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, 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)[2] of the plan, except for comparing such information with the related information included in the financial statements. We have been informed by the plan administrator that the trustee (or custodian)[3] holds the plan's investment assets and executes investment transactions. The plan administrator has obtained a certification from the trustee (or custodian)[4] as of December 31,

[1] All references made in this publication to U.S. generally accepted accounting principles relate to accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board.
[2] The words in this sentence may be modified when the assets are certified by an insurance entity.
[3] See footnote 2.
[4] See footnote 2.

20X2 and 20X1, and for the year ended December 31, 20X2, that the information provided to the plan administrator by the trustee (or custodian)[5] is complete and accurate.

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

Other Matter

The supplemental schedules [*identify schedules*] as of or for the year ended December 31, 20X2, are required by the Department of Labor's (DOL) Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 and are presented for the purpose of additional analysis and are not a required part of the financial statements. Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we do not express an opinion on these supplemental schedules.

Report on Form and Content in Compliance With DOL Rules and Regulations

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),[6] 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.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

REPORTING EXCERPT—STANDARD LIMITED-SCOPE AUDIT REPORTS DEFINED BENEFIT PENSION PLAN [END OF YEAR VALUATION]

5.17

Circumstances include the following:

- *A standard limited-scope auditor's report for a defined benefit pension plan financial statements prepared in accordance with U.S. GAAP.*
- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*
- *The plan uses an end-of-year benefit information date.*
- *The information regarding the actuarial present value of accumulated plan benefits and changes therein is presented in separate statements within the financial statements.*
- *The plan administrator limits the scope of the audit, as permitted by 29 CFR 2520.103-8 of the DOL's rules and regulations for reporting and disclosure under ERISA.*
- *The auditor follows AU-C section 720 relating to the supplemental schedules and chooses to disclaim an opinion on the supplemental schedules.*

[5] See footnote 2.
[6] See footnote 2.

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of XYZ Pension Plan, which comprise the statements of net assets available for benefits and statements of accumulated plan benefits as of December 31, 20X2 and 20X1, and the related statements of changes in net assets available for benefits and statement of changes in accumulated plan benefits for the year ended December 31, 20X2, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audits in accordance with auditing standards generally accepted in the United States of America. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of 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, 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)[7] of the plan, except for comparing such information with the related information included in the financial statements. We have been informed by the plan administrator that the trustee (or custodian)[8] holds the plan's investment assets and executes investment transactions. The plan administrator has obtained a certification from the trustee (or custodian)[9] 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)[10] is complete and accurate.

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

Other Matter

The supplemental schedules [*identify schedules*] as of or for the year ended December 31, 20X2, are required by the Department of Labor's (DOL) Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 and are presented for the purpose of additional analysis and are not a required part of the financial statements. Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we do not express an opinion on these supplemental schedules.

[7] See footnote 2.
[8] See footnote 2.
[9] See footnote 2.
[10] See footnote 2.

Report on Form and Content in Compliance With DOL Rules and Regulations

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),[11] 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.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

REPORTING—LIMITED-SCOPE AUDIT IN PRIOR YEAR

5.18 An employee benefit plan administrator may elect 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 DOL regulations. DOL regulations prescribe that the annual report include a statement of net assets available for benefits on a comparative basis; the statement of changes in net assets available for benefits is required for the current year only.

5.19 Because the auditor was unable to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the 20X1 financial statements due to the limitation on the scope of the audit, the auditor should perform auditing procedures to gain sufficient appropriate audit evidence in regard to the opening balances in the current year financial statements (see paragraphs .08–.09 of AU-C section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements* [AICPA, *Professional Standards*]) in order to opine on the 20X2 statement of changes in net assets available for benefits. Accordingly, the illustrative report refers to having audited both years of the statement of net assets available for benefits in the introductory paragraph because of the necessity to perform opening balance audit procedures on the statement of net assets available for benefits. The auditor will need to determine whether the auditor is going to perform audit procedures sufficient to provide an opinion on the prior year statement of net assets available for benefits or to bring forward the disclaimer of opinion on the prior year financial statements. In the subsequent illustration, the auditor has determined to bring forward the disclaimer of opinion from the prior year and only opine on the 20X2 financial statements.

5.20 The following is an illustration of an auditor's report when a limited-scope audit was performed in the prior year, and a full-scope audit is performed in the current year.

REPORTING EXCERPTS—LIMITED-SCOPE AUDIT IN PRIOR YEAR

5.21

Circumstances include the following:

- *The auditor performs a full-scope audit for the current year. The scope of the audit for the prior year was limited, as permitted by 29 CFR 2520.103-8 of the DOL's rules and regulations for reporting and disclosure under ERISA.*
- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*
- *The introductory paragraph refers to having audited the net assets available for benefits for both 20X2 and 20X1 because the auditor performed audit procedures to gain sufficient appropriate audit evidence on the 20X2 opening balances so that the auditor can opine on the 20X2 statement of changes in net assets available for benefits.*
- *The auditor has been engaged to report on the ERISA supplemental schedules, in accordance with AU-C section 725, for the current year, and the auditor concludes that the supplemental schedules are fairly stated, in all material respects, in relation to the financial statements.*
- *The auditor reports on the supplemental schedules in an other-matter paragraph included in the auditor's report, in accordance with paragraph .09 of AU-C section 725 and AU-C section 706.*

[Source: Paragraph 11.67 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*]

[11] See footnote 2.

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements

We have audited the accompanying financial statements of ABC 401(k) Plan, which comprise the statements of net assets available for benefits 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 related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility for the 20X2 Financial Statements

Our responsibility is to express an opinion on the 20X2 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on the 20X2 financial statements.

Auditor's Responsibility for the 20X1 Financial Statements

Our responsibility is to express an opinion on the 20X1 financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States of America. Because of the matters described in the Basis for Disclaimer of Opinion on the 20X1 Financial Statements paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of 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, the investment assets held by ABC Bank, the trustee (or custodian)[12] 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 (or custodian),[13] which is summarized in Note X, with the related information included in the financial statements.

Disclaimer of Opinion on the 20X1 Financial Statements

Because of the significance of the matter described in the Basis for Disclaimer of Opinion on the 20X1 Financial Statements paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the 20X1 financial statements.

[12] See footnote 2.
[13] See footnote 2.

Opinion on the 20X2 Financial Statements

In our opinion, the financial statements referred to above, of ABC 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 ended December 31, 20X2, in accordance with accounting principles generally accepted in the United States of America.

Report on Supplementary Information[14]

Our audit of the plan's financial statements as of and for the year ended December 31, 20X2, was conducted for the purpose of forming an opinion on the financial statements 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 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. Such information is the responsibility of the plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the 20X2 financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Report on Form and Content of the 20X1 Financial Statements in Compliance With DOL Rules and Regulations

The form and content of the information included in the 20X1 financial statements, other than that derived from the information certified by the trustee (or custodian),[15] 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.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[Date of the auditor's report]

REPORTING—LIMITED-SCOPE AUDIT IN CURRENT YEAR

5.22 A plan may exclude from the auditor's examination its assets held by banks or insurance companies in the current year, whereas the scope of the audit in the prior year was unrestricted. When comparative financial statements will be issued in those circumstances, the auditor will report on the prior year's financial statements of the plan. Although the auditor's report should be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements for the most recent audit, the procedures performed in an audit that has been restricted, as permitted by 29 CFR 2520.103-8 of the DOL's rules and regulations for reporting and disclosure under ERISA, generally are not sufficient to enable the auditor to update the report on the prior year's financial statements. Accordingly, the auditor may refer to the date of the previously issued report on the prior year's financial statements in expressing an opinion on that information.

5.23 The following is an illustration of an auditor's report on the financial statements of an employee benefit plan when a limited-scope audit was performed in the current year, and a full-scope audit was performed in the prior year.

[14] The auditor is reporting on the supplemental schedules in an other-matter paragraph, as required by AU-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole* (AICPA, *Professional Standards*). In accordance with paragraph .08 of AU-C section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report* (AICPA, *Professional Standards*), the heading "Other Matter" or other appropriate heading should be used when including an other-matter paragraph in the auditor's report. In this illustration the heading "Report on Supplementary Information" is used rather than "Other Matter."

[15] See footnote 1.

REPORTING EXCERPT—LIMITED-SCOPE AUDIT IN CURRENT YEAR

5.24

Circumstances include the following:

- *The scope of the audit for the current year was limited, as permitted by 29 CFR 2520.103-8 of the DOL's rules and regulations for reporting and disclosure under ERISA. The auditor performed a full-scope audit for the prior year.*
- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits for a defined contribution retirement plan (DC plan) whose financial statements are prepared in accordance with U.S. GAAP.*
- *Because the current year is a limited-scope audit, the audit procedures are not sufficient to update the report on the prior year; therefore, the auditor refers to the previously issued report. (This illustration is adapted from the requirements in paragraph .54 of AU-C section 700 for reporting when the prior period financial statements are audited by a predecessor auditor.)*

[Source: Paragraph 11.69 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*]

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of XYZ 401(k) Plan, which comprise the statements of net assets available for benefits 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 related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these 20X2 financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States of America. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the 20X2 financial statements.

Basis for Disclaimer of Opinion on the 20X2 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, 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)[16] of the plan, except for comparing such information with the related information included in the 20X2 financial statements. We have been informed by the plan administrator that the trustee (or custodian)[17] holds the plan's investment assets and executes investment transactions. The plan administrator has obtained a certification from the trustee (or custodian)[18] as of and for the year ended December 31, 20X2, that the information provided to the plan administrator by the trustee (or custodian)[19] is complete and accurate.

[16] See footnote 2.
[17] See footnote 2.
[18] See footnote 2.
[19] See footnote 2.

Disclaimer of Opinion on the 20X2 Financial Statements

Because of the significance of the matter described in the Basis for Disclaimer of Opinion on the 20X2 Financial Statements paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the 20X2 financial statements. Accordingly, we do not express an opinion on the 20X2 financial statements.

Other Matters—Report on Supplementary Information and Report on 20X1 Financial Statements

The supplemental schedules [*identify schedules*] as of or for the year ended December 31, 20X2, are required by the Department of Labor's (DOL) Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 and are presented for the purpose of additional analysis and are not a required part of the financial statements. Because of the significance of the matter described in the Basis for Disclaimer of Opinion on the 20X2 Financial Statements paragraph, we do not express an opinion on these supplemental schedules.

We have audited the accompanying financial statement of XYZ 401(k) Plan, which comprise the statement of the net assets available for benefits 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, net assets available for benefits of the plan as of December 31, 20X1, and the changes in net assets available for benefits for the year ended December 31, 20X1, in accordance with accounting principles generally accepted in the United States of America.

Report on Form and Content in Compliance With DOL Rules and Regulations for 20X2 Financial Statements

The form and content of the information included in the 20X2 financial statements and supplemental schedules, other than that derived from the information certified by the trustee (or custodian),[20] 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.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

REPORTING—STANDARD LIMITED-SCOPE AUDIT REPORT WITH MODIFICATIONS TO THE REPORT ON SUPPLEMENTAL SCHEDULES

5.25 AU-C section 720 addresses how the auditor should report when there is a material inconsistency or material misstatement of fact between the financial statements and the other information. Paragraphs 11.73–.76 of the AICPA Audit and Accounting Guide *Employee Benefit Plans* provides a detailed discussion on this topic.

5.26 The following illustrations of other-matter paragraphs are added to the auditor's report or modifications are made to the report on form and content in compliance with DOL rules and regulations because a schedule or information thereon was omitted.

REPORTING EXCERPT—OMITTED SCHEDULE REQUIRED UNDER DOL REGULATIONS IN A LIMITED-SCOPE ENGAGEMENT

5.27 The following is an illustration of an auditor's report on a limited-scope audit when the auditor has chosen to include an other-matter paragraph in the auditor's report to describe the omission of a DOL-required supplemental schedule.

Circumstances include the following:

- *Limited-scope audit on financial statements prepared in accordance with U.S. GAAP.*
- *The plan has not presented the supplemental Schedule H, line 4j—Schedule of Reportable Transactions.*

[20] See footnote 2.

- *The auditor chose to include an other-matter paragraph in the auditor's report to describe the omission of the schedule because Schedule H, line 4j—Schedule of Reportable Transactions, is information that is certified by the trustee or custodian.*

[Source: Paragraph 11.78 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*]

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

[*Same auditor report sections for "Report on the Financial Statements," "Management's Responsibility for the Financial Statements," "Auditor's Responsibility," "Basis for Disclaimer of Opinion," and "Disclaimer of Opinion," as those illustrated in the standard limited-scope audit report in paragraph 5.17.*]

Other Matters

The supplemental schedules [*identify schedules*] as of or for the year ended December 31, 20X2, are required by the Department of Labor's (DOL) Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 and are presented for the purpose of additional analysis and are not a required part of the financial statements. Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we do not express an opinion on these supplemental schedules.

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.

Report on Form and Content in Compliance With DOL Rules and Regulations

(Same paragraph as illustrated in the standard limited-scope audit report in paragraph 5.17.)

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

REPORTING EXCERPT—MODIFIED OPINION ON SUPPLEMENTAL SCHEDULES—OMITTED INFORMATION REQUIRED UNDER DOL REGULATIONS IN A LIMITED-SCOPE ENGAGEMENT

5.28 The following is an illustration of an auditor's report on a limited-scope audit when information has been omitted from a DOL-required supplemental schedule.

Circumstances in the following:

- *Limited-scope audit on financial statements prepared in accordance with U.S. GAAP.*
- *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.*
- *The loans to participants have not been certified by a qualifying institution.*
- *The auditor has qualified the report on form and content of the supplemental schedules because the omitted participant loan information is information that has not been certified by a qualifying institution, and the limited-scope audit report provides an opinion on whether the form and content of the information included in the financial statements and supplemental schedules are presented in compliance with the DOL rules and regulations for reporting and disclosure under ERISA.*

[Source: Paragraph 11.79 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*]

INDEPENDENT AUDITOR'S REPORT

[Appropriate Addressee]

[Same auditor report sections for "Report on the Financial Statements," "Management's Responsibility for the Financial Statements," "Auditor's Responsibility," "Basis for Disclaimer of Opinion," "Disclaimer of Opinion," and "Other Matter," as those illustrated in the standard limited-scope audit report in paragraph 5.17]

Report on Form and Content in Compliance With DOL Rules and Regulations

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),[21] 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 loans to participants, that has not been disclosed in the supplemental Schedule H, line 4i—Schedule of Assets (Held at End of Year) as of December 31, 20X2 and are considered assets held for investment purposes, 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.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

REPORTING—INITIAL AUDITS OF PLANS

5.29 For initial audits of plans when the plan had assets in the prior year, ERISA requires comparative statements of net assets available for benefits. Comparative statements are not required under U.S. GAAP. AU-C section 510 addresses the auditor's responsibilities relating to opening balances in an initial audit engagement, including reaudit engagement. Paragraphs 2.126–.134 in the AICPA Audit and Accounting Guide *Employee Benefit Plans* provide a detailed discussion on initial audits.

5.30 Guidance on reporting on audited and unaudited financial statements in comparative form is contained in AU-C section 700. When current period financial statements are audited and presented in comparative form with compiled or reviewed financial statements for the prior period, and the report on the prior period is not reissued, paragraph .56 of AU-C section 700 states that the auditor should include an other-matter paragraph in the current period auditor's report that includes (*a*) the service performed in the prior period, (*b*) the date of the report on that service, (*c*) a description of any material modifications noted in that report, and (*d*) a statement that the service was less in scope than an audit and does not provide the basis for the expression of an opinion on the financial statements.

5.31 If the prior period financial statements were not audited, reviewed, or compiled, the financial statements should be clearly marked to indicate their status, and the auditor's report should include an other-matter paragraph to indicate that the auditor has not audited, reviewed, or compiled the prior period financial statements and that the auditor assumes no responsibility for them. (See paragraph .57 of AU-C section 700.)

REPORTING EXCERPT—INITIAL AUDIT OF PLAN (PRIOR YEAR COMPILED)

5.32 The following is an illustration of an auditor's report on a limited-scope audit when the plan has never been audited before. The current year financial statements are audited, and the prior year's financial statements are compiled.

Circumstances in the following:

- *First-year audit of a 401(k) plan. The financial statements are prepared in accordance with U.S. GAAP.*
- *The plan administrator limits the scope of the audit, as permitted by 29 CFR 2520.103-8 of the DOL's rules and regulations for reporting and disclosure under ERISA.*
- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*

[21] See footnote 2.

- *The auditor audits the current year financial statements and compiles the prior year statement of net assets available for benefits.*
- *The auditor follows AU-C section 720 relating to the supplemental schedules and chooses to disclaim an opinion on the supplemental schedules.*

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS

[*Appropriate Addressee*]

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of XYZ 401(k) Plan, which comprise the statement of net assets available for benefits 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 related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility on the 20X2 Financial Statements

Our responsibility is to express an opinion on the 20X2 financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States of America. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion on the 20X2 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, 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)[22] of the plan, except for comparing such information with the related information included in the 20X2 financial statements. We have been informed by the plan administrator that the trustee (or custodian)[23] holds the plan's investment assets and executes investment transactions. The plan administrator has obtained a certification from the trustee (or custodian)[24] as of and for year ended December 31, 20X2, and for the year ended December 31, 20X2, that the information provided to the plan administrator by the trustee (or custodian)[25] is complete and accurate.

Disclaimer of Opinion on the 20X2 Financial Statements

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on the 20X2 financial statements.

Other Matter—Supplementary Information

The supplemental schedules [*identify schedules*] as of or for the year ended December 31, 20X2 are required by the Department of Labor's (DOL) Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 and are presented for the purpose of additional analysis and are not a required part of the financial statements. Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we do not express an opinion on these supplemental schedules.

[22] See footnote 2.
[23] See footnote 2.
[24] See footnote 2.
[25] See footnote 2.

Report on Form and Content in Compliance With DOL Rules and Regulations

The form and content of the information included in the 20X2 financial statements and supplemental schedules, other than that derived from the information certified by the trustee (or custodian),[26] 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.

Accountant's Compilation Report on 20X1 Financial Statements

We have compiled the accompanying statement of net assets available for benefits of XYZ 401(k) plan as of December 31, 20X1. We have not audited or reviewed the 20X1 XYZ 401(k) plan statement of net assets available for benefits and, accordingly, do not express an opinion or provide any assurance about whether the 20X1 financial statements are in accordance with accounting principles generally accepted in the United States of America.

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America and for designing, implementing, and maintaining internal control relevant to the preparation and fair presentation of the financial statements.

Our responsibility is to conduct the compilation in accordance with Statements on Standards for Accounting and Review Services issued by the American Institute of Certified Public Accountants. The objective of a compilation is to assist management in presenting financial information in the form of financial statements without undertaking to obtain or provide any assurance that there are no material modifications that should be made to the financial statements.

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

REPORTING—MODIFIED CASH BASIS OF ACCOUNTING

5.33 Present DOL regulations permit, but do not require, financial statements included in the annual report (Form 5500) to be prepared on a basis of accounting other than U.S. GAAP (for example, a special purpose framework such as a modified cash basis of accounting). In such cases, they do not prohibit variances from U.S. GAAP if the variances are described in a note to the financial statements.[27]

5.34 A common example of the use of a basis other than U.S. GAAP is financial statements prepared on the modified cash basis of accounting for filing with the DOL. AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks* (AICPA, *Professional Standards*), addresses special considerations in the application of AU-C sections 200–700 to an audit of financial statements prepared in accordance with a special purpose framework, which is a cash, tax, regulatory, contractual, or an other basis of accounting. A *cash basis of accounting* is defined as a basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support. For an employee benefit plan, cash basis financial statements that adjust investments to fair value are typically considered to be prepared on a modified cash basis of accounting.

5.35 Paragraph .15 of AU-C section 800 states that in an audit of special purpose financial statements, the auditor should evaluate whether the financial statements are suitably titled, include a summary of significant accounting policies, and adequately describe how the special purpose framework differs from GAAP. In accordance with paragraph .18 of AU-C section 800, in the case of an auditor's report on special purpose financial statements, the explanation of management's responsibility for the financial statements should also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances when management has a choice of financial reporting frameworks in the preparation of such financial statements.

[26] See footnote 2.

[27] Paragraph .15 of AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks* (AICPA, *Professional Standards*), requires the auditor to adequately describe how the special purpose framework differs from generally accepted accounting principles. Also see paragraph A.52 in appendix A, "ERISA and Related Regulations" of the AICPA Audit and Accounting Guide *Employee Benefit Plans*.

5.36 The auditor's report on special purpose financial statements should include an emphasis-of-matter paragraph, under an appropriate heading, that (*a*) indicates that the financial statements are prepared in accordance with the applicable special purpose framework, (*b*) refers to the note to the financial statements that describes that framework, and (*c*) states that the special purpose framework is a basis of accounting other than GAAP. See paragraph .19 of AU-C section 800.

5.37 The following is an illustration of a limited-scope auditor's report on a 401(k) plan prepared on the modified cash basis of accounting.

REPORTING EXCERPT—MODIFIED CASH BASIS OF ACCOUNTING

5.38

Circumstances include the following:

- *A standard limited-scope auditor's report for a 401(k) plan financial statements prepared on the modified cash basis of accounting.*
- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*
- *The plan administrator limits the scope of the audit, as permitted by 29 CFR 2520.103-8 of the DOL's rules and regulations for reporting and disclosure under ERISA.*
- *The auditor follows AU-C section 720 relating to the supplemental schedules and chooses to disclaim an opinion on the supplemental schedules.*

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of XYZ 401(k) Plan, which comprise the statements of net assets available for benefits (modified cash basis) 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, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the modified cash basis of accounting described in Note X; this includes determining that the modified cash basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audits in accordance with auditing standards generally accepted in the United States of America. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of 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, 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)[28] of the plan, except for comparing such information with the related information included in the financial statements. We have been informed by the plan administrator that the trustee (or custodian)[29] holds the plan's investment assets

[28] See footnote 2.
[29] See footnote 2.

and executes investment transactions. The plan administrator has obtained a certification from the trustee (or custodian)[30] 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)[31] is complete and accurate.

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

Basis of Accounting

We draw attention to Note X of the financial statements, which describes the basis of accounting. The financial statements are prepared on the modified cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our disclaimer of opinion is not modified with respect to this matter.

Other Matter

The supplemental schedules (modified cash basis) [*identify schedules*] as of or for the year ended December 31, 20X2 are required by the Department of Labor's (DOL) Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 and are presented for the purpose of additional analysis and are not a required part of the financial statements. Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we do not express an opinion on these supplemental schedules.

Report on Form and Content in Compliance With DOL Rules and Regulations

The form and content of the information included in the financial statements and supplemental schedules (modified cash basis), other than that derived from the information certified by the trustee (or custodian),[32] 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.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

REPORTING—PLAN MERGER

5.39 Company mergers and acquisitions, or other events, may result in employee benefit plan mergers. The effective date of a merger, according to the relevant plan merger documents, often is prior to the actual transfer date of the related plan assets. Determining the appropriate accounting and reporting for a plan merger can be difficult. The effective date of the merger is a legal determination that may be documented in a plan amendment or board resolution and may differ from the date assets are physically transferred to the successor plan's trust. A plan can hold assets in more than one trust; accordingly, the successor plan may have legal control of the assets or trust of the predecessor plan prior to the date the assets physically transfer. This may result in difficulties in determining the date of the final audit for the plan merging out of existence. The Form 5500 instructions state, "A final return/report should be filed by the plan year (12 months or less) that ends when all plan assets were legally transferred to the control of another plan." The plan administrator may seek guidance from the plan's ERISA legal counsel to determine the date when all plan assets were legally transferred to the control of the successor plan when the effective date of the merger differs from the date the assets were physically transferred.

[30] See footnote 2.
[31] See footnote 2.
[32] See footnote 2.

REPORTING EXCERPT—PLAN MERGER (WITH A SHORT PERIOD)

5.40 The following is an illustration of a limited scope audit report when the plan was merged with another plan.

Circumstances include the following:

- *A standard limited-scope auditor's report for an employee savings plan financial statements prepared in accordance with U.S. GAAP.*
- *The plan was merged into a deferred compensation plan effective January 31, 20X3.*
- *In accordance with 29 CFR 2520.104-50* Short plan years, deferral of accountant's examination and report, *the plan administrator deferred the audit of the financial statements. Accordingly, the plan presents the statements of net assets available for benefits for a short period (January 31, 20X3) along with December 31, 20X2 and 20X1. The plan presents the statement of changes in net assets available for benefits for the period January 1, 20X3 to January 31, 20X3 and for the year ended December 31, 20X2.*
- *The plan administrator limits the scope of the audit, as permitted by 29 CFR 2520.103-8 of the DOL's rules and regulations for reporting and disclosure under ERISA.*
- *The auditor follows AU-C section 720 relating to the supplemental schedules and chooses to disclaim an opinion on the supplemental schedules.*

INDEPENDENT AUDITOR'S REPORT

[*Addressee*]

Report on Financial Statements

We were engaged to audit the accompanying financial statements of the Lucky Company Employee Savings Plan, which comprise the statements of net assets available for benefits as of January 31, 20X3, and December 31, 20X2 and 20X1, and the related statements of changes in net assets available for benefits for the one month period ended January 31, 20X3, and for the year ended December 31, 20X2, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audits in accordance with auditing standards generally accepted in the United States of America. Because of the matter described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of 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, 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)[33] of the plan, except for comparing such information with the related information included in the financial statements. We have been informed by the plan administrator that the trustee (or custodian)[34] holds the plan's investment assets and executes investment transactions. The plan administrator has obtained certifications from the trustee (or custodian)[35] as of January 31, 20X3 and December 31, 20X2 and 20X1 and for the one month period ended January 31, 20X3, and for the year

[33] See footnote 2.
[34] See footnote 2.
[35] See footnote 1.

ended December 31, 20X2, that the information provided to the plan administrator by the trustee (or custodian)[36] is complete and accurate.

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

Emphasis of Matter—Plan Merger

As further discussed in Note Y, the plan was merged into the Lucky Company Deferred Compensation plan effective January 31, 20X2. Our disclaimer of opinion is not modified with respect to this matter.

Other Matter

The supplemental schedules [*identify title of schedules and periods covered*] are required by the Department of Labor's (DOL) Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 and are presented for the purpose of additional analysis and are not a required part of the financial statements. Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we do not express an opinion on these supplemental schedules.

Report on Form and Content in Compliance With DOL Rules and Regulations

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),[37] 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.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

REPORTING—TERMINATING AND TERMINATED PLANS

5.41 FASB ASC 960-40, 962-40, and 965-40 provides guidance for terminating plans. A terminating plan includes any plan about which a termination decision has been made regardless of whether the terminating plan will be replaced. If liquidation of a plan is deemed to be imminent (as defined in FASB ASC 205-30-25-2) before the end of the plan year, the plan's year-end financial statements should be prepared using the *liquidation* basis of accounting in accordance with FASB ASC 205-30. Plan financial statements for periods ending after the determination that liquidation is imminent are prepared using the liquidation basis of accounting. For terminating plan assets, accumulated plan benefits should be determined using the liquidation basis of accounting, and their value may differ from the actuarial present value of accumulated plan benefits reported for an ongoing plan. In general, upon termination all benefits should be reported as vested.

Author's Note:

FASB Accounting Standards Update (ASU) No. 2013-07, *Presentation of Financial Statements (Topic 205) Liquidation Basis of Accounting*, was issued in April 2013 and provides guidance on when and how an entity should prepare its financial statements using the liquidation basis of accounting and describes the related disclosures that should be made. ASU No. 2013-07 has been codified in FASB ASC 205-30. The amendments in this ASU are effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein. Entities should apply the requirements prospectively from the day that liquidation becomes imminent. Early adoption is permitted.

(*continued*)

[36] See footnote 1.
[37] See footnote 1.

Terminating employee benefit plans that already use the liquidation basis of accounting in accordance with FASB ASC 960-40, 962-40, or 965-40, as of the effective date are not required to apply FASB ASC 205-30; rather, those plans should continue to apply the guidance in FASB ASC 960-40, 962-40, or 965-40 until they have completed liquidation.

5.42 The auditor's report may include an emphasis-of-matter paragraph that explains that the plan is being terminated and that the financial statements (including the accumulated plan benefit information disclosures, if applicable) have been presented using the liquidation basis of accounting.

TERMINATING PLAN (DEFINED BENEFIT PENSION PLAN)

5.43 The following illustrates a limited-scope audit report of a terminating plan.

Circumstances include the following:

- *A standard limited-scope auditor's report for defined benefit pension plan financial statements prepared in accordance with U.S. GAAP.*
- *The plan presents statement of net assets available for benefits and of accumulated plan benefits in liquidation as of December 31, 20X2, and statement of net assets available for benefits and of accumulated plan benefits as of December 31, 20X1 (on-going), and a single-year statement of changes in net assets available for benefits and of changes in accumulated plan benefits (in liquidation).*
- *The plan uses an end-of-year benefit information date.*
- *The information regarding the actuarial present value of accumulated plan benefits and changes therein is presented in separate statements within the financial statements.*
- *The plan was terminated in 20X2 and as of April 1, 20X2, 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, in accordance with FASB ASC 205-30. As of December 31, 20X2, all assets of the plan have not yet been fully liquidated.*
- *The plan administrator limits the scope of the audit, as permitted by 29 CFR 2520.103-8 of the DOL's rules and regulations for reporting and disclosure under ERISA.*
- *The auditor follows AU-C section 720 relating to the supplemental schedules and chooses to disclaim an opinion on the supplemental schedules.*
- *The auditor includes an emphasis-of-matter paragraph in the auditor's report to bring the reader's attention to the termination of the plan.*

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of XYZ Pension Plan, which comprise the statements of net assets available for benefits and of accumulated plan benefits as of December 31, 20X2 (in liquidation) and 20X1, and the related statement of changes in net assets available for benefits and of changes in accumulated plan benefits for the year ended December 31, 20X2 (in liquidation), and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audits in accordance with auditing standards generally accepted in the United States of America. Because of the matter described in the Basis for Disclaimer

of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of 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, 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)[38] of the plan, except for comparing such information with the related information included in the financial statements. We have been informed by the plan administrator that the trustee (or custodian)[39] holds the plan's investment assets and executes investment transactions. The plan administrator has obtained a certification from the trustee (or custodian)[40] 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)[41] is complete and accurate.

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

Emphasis of Matter—Plan Termination

As further discussed in Note Y to the financial statements, the Board of Directors of XYZ Company made a decision to terminate the XYZ Pension Plan. As a result, XYZ Pension Plan has changed its basis of accounting from the ongoing basis of accounting used in presenting the 20X1 financial statements to the liquidation basis of accounting used in presenting the 20X2 financial statements. Our disclaimer of opinion is not modified with respect to this matter.

Other Matter—Supplementary Information

The supplemental schedules [*identify schedules*] as of or for the year ended December 31, 20X2 are required by the Department of Labor's (DOL) Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 and are presented for the purpose of additional analysis and are not a required part of the financial statements. Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we do not express an opinion on these supplemental schedules.

Report on Form and Content in Compliance With DOL Rules and Regulations

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),[42] 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.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

[38] See footnote 2.
[39] See footnote 2.
[40] See footnote 2.
[41] See footnote 2.
[42] See footnote 2.

2. PRIOR YEAR AUDITED BY ANOTHER FIRM

REPORTING—PRIOR YEAR AUDITED BY ANOTHER FIRM (LIMITED-SCOPE AUDIT FOR BOTH YEARS)

5.44 If the financial statements of the prior period were audited by a predecessor auditor, and the predecessor auditor's report on the prior period's financial statements is not reissued, in addition to expressing an opinion on the current period's financial statements, paragraph .54 of AU-C section 700 states that the auditor should state the following in an other-matter paragraph:

a. That the financial statements of the prior period were audited by a predecessor auditor

b. The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore

c. The nature of an emphasis-of-matter paragraph or other-matter paragraph included in the predecessor auditor's report, if any

d. The date of the report

5.45 The following is an illustration of an auditor's report on a limited-scope audit in the current year when the prior year was audited by other auditors.

REPORTING EXCERPT—LIMITED SCOPE AUDIT IN CURRENT YEAR, PRIOR YEAR LIMITED-SCOPE AUDIT PERFORMED BY OTHER AUDITORS

5.46

Circumstances include the following:

- *Limited-scope audit in the current year on comparative statement of net assets available for benefits and single-year statement of changes in net assets available for benefits for a 401(k) plan whose financial statements are prepared in accordance with U.S. GAAP.*
- *The prior year financial statements were audited by other auditors. (See paragraph .54 of AU-C section 700 for reporting requirements.)*

[Source: Paragraph 11.71 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*]

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of XYZ 401(k) Plan, which comprise the statement of net assets available for benefits as of December 31, 20X2, and the related statement of changes in net assets available for benefits for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audit in accordance with auditing standards generally accepted in the United States of America. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of 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, 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)[43] of the plan, except for comparing such information with the related information included in the 20X2 financial statements. We have been informed by the plan administrator that the trustee (or custodian)[44] holds the plan's investment assets and executes investment transactions. The plan administrator has obtained a certification from the trustee (or custodian)[45] as of and for the year ended December 31, 20X2, that the information provided to the plan administrator by the trustee (or custodian)[46] is complete and accurate.

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion on the 20X2 financial statements. Accordingly, we do not express an opinion on the 20X2 financial statements.

Other Matter—Supplemental Schedules

The supplemental schedules [*identify schedules*] as of or for the year ended December 31, 20X2, are required by the Department of Labor's (DOL) Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 and are presented for the purpose of additional analysis and are not a required part of the financial statements. Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we do not express an opinion on these supplemental schedules.

Other Matter—20X1 Financial Statements

The financial statements of the plan as of December 31, 20X1, were audited by predecessor 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 predecessor auditors not to perform, and they did not perform, any auditing procedures with respect to the information certified by the trustee (or custodian).[47] Their report, dated May 20, 20X2, indicated that (*a*) because of the significance of the information that they did not audit, they were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion and, accordingly, they did not express an opinion on the financial statements, and (*b*) the form and content of the information included in the financial statements other than that derived from the certified investment information were presented in compliance with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

Report on Form and Content in Compliance With DOL Rules and Regulations 20X2

The form and content of the information included in the 20X2 financial statements and supplemental schedules, other than that derived from the information certified by the trustee (or custodian),[48] 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.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

[43] See footnote 2.
[44] See footnote 2.
[45] See footnote 2.
[46] See footnote 2.
[47] See footnote 2.
[48] See footnote 2.

REPORTING EXCERPT—PRIOR YEAR AUDITED BY ANOTHER FIRM (FULL SCOPE AUDIT IN THE CURRENT YEAR, LIMITED SCOPE AUDIT IN THE PRIOR YEAR)

5.47 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.

Circumstances include the following:

- *The auditor performs a full-scope audit for the current year on comparative statement of net assets available for benefits and a single-year statement of changes in net assets available for benefits for a 401(k) plan whose financial statements are prepared in accordance with GAAP.*
- *The scope of the audit for the prior year was limited, as permitted by 29 CFR 2520.103-8 of the DOL's rules and regulations for reporting and disclosure under ERISA and has been audited by other auditors.*
- *The auditor has been engaged to report on the ERISA supplemental schedules, in accordance with AU-C section 725, for the current year, and the auditor concludes that the supplemental schedules are fairly stated, in all material respects, in relation to the financial statements.*
- *The auditor reports on the supplemental schedules in an other-matter paragraph included in the auditor's report, in accordance with paragraph .09 of AU-C section 725 and AU-C section 706.*

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements

We have audited the accompanying financial statements of ABC 401(k) Plan, which comprise the statement of net assets available for benefits as of December 31, 20X2, and the related statement of changes in net assets available for benefits for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility for the 20X2 Financial Statements

Our responsibility is to express an opinion on the 20X2 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on the 20X2 financial statements.

Opinion on the 20X2 Financial Statements

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of ABC 401(k) Plan at December 31, 20X2, and the changes in its net assets available for benefits for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matter—Report on Supplementary Information[49]

Our audit of the plan's financial statements as of and for the year ended December 31, 20X2, was conducted for the purpose of forming an opinion on the financial statements 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 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. Such information is the responsibility of the plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the 20X2 financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Other Matter—20X1 Financial Statements

The financial statements of the Plan as of December 31, 20X1, were audited by predecessor 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 predecessor auditors not to perform, and they did not perform, any auditing procedures with respect to the information certified by the trustee (or custodian).[50] Their report, dated May 21, 20X2, indicated that (*a*) because of the significance of the information that they did not audit, they were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion and, accordingly, they did not express an opinion on the 20X1 financial statements and (*b*) the form and content of the information included in the 20X1 financial statements other than that derived from the certified investment information were presented in compliance with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

3. CHANGE IN TRUSTEE

REPORTING—CHANGE IN TRUSTEE

5.48 The following is an illustration of an auditor's report on a limited-scope audit reflecting a change in trustee for a defined benefit pension plan.

REPORTING EXCERPT—CHANGE IN TRUSTEE

5.49

Circumstances include the following:

- *Auditor's report for a limited-scope audit for a defined benefit plan whose financial statements are prepared in accordance with U.S. GAAP.*
- *There has been a change in trustee that has been reflected in the auditor's report.*

[49] The auditor is reporting on the supplemental schedules in an other-matter paragraph, as required by AU-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole* (AICPA, *Professional Standards*). In accordance with paragraph .08 of AU-C section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report* (AICPA, *Professional Standards*), the heading "Other Matter" or other appropriate heading should be used when including an other-matter paragraph in the auditor's report. In this illustration the heading "Report on Supplementary Information" is used rather than "Other Matter."

[50] See footnote 2.

- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*
- *The plan uses an end-of-year benefit information date.*
- *The information regarding the actuarial present value of accumulated plan benefits and changes therein is presented in separate statements within the financial statements. (See paragraph 6.14.)*

[Source: Paragraph 11.72 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*]

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of XYZ Pension Plan, which comprise the statements of net assets available for benefits and statements of accumulated plan benefits 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 related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audits in accordance with auditing standards generally accepted in the United States of America. Because of the matters described in the Basis for Disclaimer of Opinion paragraph, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of 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, 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 and XYZ Trust Company, the trustees of the plan, except for comparing such information with the related information included in the financial statements. 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 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.

Disclaimer of Opinion

Because of the significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

Other Matter

The supplemental schedules [*identify schedules*] as of or for the year ended December 31, 20X2, are required by the Department of Labor's (DOL) Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 and are presented for the purpose of additional analysis and are not a required part of the financial statements. Because of the

significance of the matter described in the Basis for Disclaimer of Opinion paragraph, we do not express an opinion on these supplemental schedules.

Report on Form and Content in Compliance With DOL Rules and Regulations

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.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

4. 403(b) PLANS

REPORTING—403(b) PLANS

5.50 403(b) plans (also known as *tax-sheltered annuities*) are considered tax advantaged defined contribution plans and are provided for under Section 403(b) of the Internal Revenue Code. A *403(b) plan* is a retirement plan for certain employees of public schools, employees of certain tax-exempt organizations, and certain ministers. Generally, these plans may invest in annuity contracts or mutual funds, and contributions may include employee elective deferrals, employer nonelective contributions, or after-tax contributions (that are not Roth contributions).

5.51 Investments held in these arrangements are typically restricted by law to annuity contracts or custodial accounts holding units of participation of regulated investment companies (for example, mutual funds). Beginning with the 2009 Form 5500 filings, 403(b) plans became subject to the same Form 5500 reporting and audit requirements that currently exist for 401(k) plans. These requirements eliminate a previous exemption granted to 403(b) plans from the annual Form 5500 reporting, disclosure, and audit requirements of ERISA. For large 403(b) plans, as defined by ERISA, the 2009 reporting requirements include not only the completion of the entire Form 5500 but also the engagement of an independent qualified public accountant to conduct an independent audit of the plan.

REPORTING EXCERPT—403(b) PLANS—MODIFIED LIMITED-SCOPE AUDIT REPORT FOR A 403(b) DEFINED CONTRIBUTION PLAN WHEN THERE IS ALSO A SCOPE LIMITATION RELATED TO ANNUITY CONTRACTS ISSUED BEFORE JANUARY 1, 2009.

5.52 The following is an illustration of an auditor's report on a limited-scope audit of a 403(b) plan with a modified opinion due to a scope limitation related to annuity contracts issued before January 1, 2009. The following is an illustration of a limited-scope audit report for a 403(b) plan when there is also a scope limitation related to annuity contracts.

Circumstances:

- *Limited scope auditor's report for a 403(b) defined contribution plan financial statements prepared in accordance with U.S. GAAP.*
- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*
- *The plan administrator limits the scope of the audit, as permitted by 29 CFR 2520.103-8 of the DOL's rules and regulations for reporting and disclosure under ERISA.*
- *Additionally, there is a scope limitation relating to contracts that meet the criteria specified in the DOL Field Assistance Bulletin 2009-02* Annual Reporting Requirements for 403(b) Plans (FAB 2009-02)*, and the auditor was unable to determine whether all of these contracts are appropriately included in the plan's net assets. Additionally, the auditor was unable to audit, and did not audit, the balances of the annuity contracts and custodial accounts that were issued prior to January 1, 2009, that did not meet the criteria of FAB 2009-02 and the related activity in these contracts prior to January 1, 2009.*

- *Certain annuity contracts and custodial accounts that meet the criteria of FAB 2009-02 have been excluded from the statements of net assets available for benefits and related statement of changes in net assets available for benefits, and such amounts are not determinable.*
- *The auditor follows AU-C section 720 relating to the supplemental schedules.*
- *The auditor's report disclaims an opinion on the financial statements and supplemental schedule(s).*

Note: The DOL requires that an opinion be offered on the form and content of the information included in the financial statements and supplemental schedule(s), other than that derived from the information certified by a qualifying institution. However, due to the additional scope limitation described above, the auditor does not have sufficient appropriate audit evidence to express an opinion on the form and content of the information and, therefore, does not express such an opinion.

REPORT OF INDEPENDENT AUDITORS

[*Appropriate addressee*]

Report on the Financial Statements

We were engaged to audit the accompanying financial statements of XYZ 403(b) Plan, which comprise the statements of net assets available for benefits 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 related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audits in accordance with auditing standards generally accepted in the United States of America. Because of the matters described in the Basis for Disclaimer of Opinion paragraphs, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of 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, 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),[51] except for comparing such information with the related information included in the financial statements. We have been informed by the plan administrator that the trustee (or custodian)[52] holds the plan's investment assets and executes investment transactions. The plan administrator has obtained certifications 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)[53] is complete and accurate.

Additionally the XYZ 403(b) Plan has not maintained sufficient accounting records and supporting documents relating to certain annuity contracts and custodial accounts issued to current and former employees prior to January 1, 2009. Accordingly, we were unable to apply auditing procedures sufficient to determine the extent to which the accompanying financial statements may have been affected by these conditions.

Further, as described in Note Y, the XYZ 403(b) Plan has excluded from investments in the accompanying statements of net assets available for benefits certain annuity contracts and custodial accounts issued to current and former employees prior to January 1,

[51] See footnote 2.
[52] See footnote 2.
[53] See footnote 2.

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 contracts 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.

Disclaimer of Opinion on Financial Statements

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraphs, we have not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

Other Matter—Disclaimer of Opinion on Supplemental Schedules

The accompanying supplemental schedule(s) of [*identify schedules*], as of and for the year ended December 31, 20X2 are required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974 and are presented for the purposes of additional analysis and are not a required part of the financial statements. Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraphs, we do not express an opinion on the supplemental schedules.

____

[*Auditor's Signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

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). Department of Labor (DOL) regulations require the auditor to form an opinion on the financial statements and offer an opinion on the supplemental schedules accompanying the financial statements. The supplemental schedules are required by the Employee Retirement Income Security Act of 1974 (ERISA) and DOL regulations.

6.02 The auditor should form an opinion on whether the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. For purposes of this section, the applicable financial reporting framework is accounting principles generally accepted in the United States of America as promulgated by the Financial Accounting Standards Board (U.S. GAAP), unless otherwise noted (for example, modified cash basis of accounting, which is considered a special purpose framework).

Author's Note:
This section primarily pertains to reports prepared in accordance with GAAS. When reporting on an audit of an issuer (for example, a Form 11-K audit engagement), the standards of the PCAOB would apply for filings with the SEC. See paragraphs 6.04–.08 and 6.55–.59 for further discussion about audit reports following two sets of standards and the form of the auditor's report for a Form 11-K audit engagement in accordance with PCAOB standards, when filing with the SEC.

Background

6.03 When the auditor is forming an opinion and issuing an auditor's report in connection with an audit of financial statements, AU-C section 700, *Forming an Opinion and Reporting on Financial Statements* (AICPA, *Professional Standards*), is applicable. AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report* (AICPA, *Professional Standards*), addresses how the form and content of the auditor's report are affected when the auditor expresses a modified opinion (qualified, adverse, or disclaimer of opinion), and AU-C section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report* (AICPA, *Professional Standards*), addresses situations when the auditor considers it necessary, or is required, to include additional communications in the auditor's report that are not modifications to the auditor's opinion (emphasis-of-matter paragraphs and other-matter paragraphs).

Audit Reports Following Two Sets of Standards

REPORTING ON FORM 11-K AUDIT WHEN FILING WITH THE SEC

6.04 Plans that are required to file Form 11-K are deemed to be issuers and must submit to the SEC an audit performed in accordance with the auditing and related professional practice standards promulgated by the PCAOB. To perform an audit for a plan that files Form 11-K, public accounting firms have to be registered with the PCAOB. The PCAOB provides guidance on the auditor's report for an audit of an issuer when filing with the SEC.

6.05 Accordingly, plans that are required to file a Form 11-K should refer to "the standards of the Public Company Accounting Oversight Board (United States)" in the auditor's report, in accordance with 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), as amended, when filing with the SEC.

6.06 Auditors will need to conduct their audits of these Form 11-K plans in accordance with two sets of auditing standards (PCAOB and GAAS) and prepare two separate audit reports: an audit report following PCAOB standards, including Auditing Standard No. 1, for Form 11-K filings with the SEC and a separate audit report prepared in accordance with GAAS, including AU-C sections 700, 705, and 706 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 when

filing with the SEC; hence, a "dual" standard report is not appropriate and will not be accepted by the SEC. Generally, the DOL will reject Form 5500, Annual Return/Report of Employee Benefit Plan, filings that contain an auditor's opinion that has not been performed in accordance with GAAS.

6.07 The instructions to the Form 11-K and Article 6A of Regulation S-X address reporting requirements for employee stock purchase, savings, and similar plans that are required to file reports with the SEC. The SEC rules for Form 11-K permit plans subject to ERISA to file financial statements and supplemental schedules prepared in accordance with ERISA rather than in accordance with Regulation S-X.

6.08 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 202.551.5300.

Independent Auditor's Reports and Supplemental Schedules

1. UNMODIFIED OPINIONS

REPORTING—UNMODIFIED OPINIONS

6.09 The following illustrative auditor's reports present unmodified auditor's reports on financial statements of employee benefit plans in accordance with AU-C section 700. The auditor should express an unmodified opinion, in accordance with AU-C section 700, when the auditor concludes that the financial statements are presented fairly, in all material respects, in accordance with the applicable financial reporting framework. The auditor's report should be addressed as required by the circumstances of the engagement. For employee benefit plans, the report may be addressed to the plan or trust whose financial statements are being audited, the plan administrator or board of trustees, or participants and beneficiaries.

6.10 The auditor's report should be dated no earlier than the date on which the auditor has obtained sufficient appropriate audit evidence on which to base the auditor's opinion on the financial statements. Paragraph .41 of AU-C section 700 states that this includes evidence that (*a*) the audit documentation has been reviewed; (*b*) all the statements that the financial statements comprise, including the related notes, have been prepared; and (*c*) management has asserted that they have taken responsibility for those financial statements.

6.11 Generally, the DOL will reject Form 5500, Annual Return/Report of Employee Benefit Plan, filings that contain modified opinions, other than the disclaimer of opinion issued in connection with a limited-scope audit pursuant to Title 29 U.S. *Code of Federal Regulations* (CFR) Part 2520.103-8 or -12. If the employee benefit plan financial statements are materially misstated, or the auditor is unable to obtain sufficient appropriate audit evidence on which to form an opinion, then the guidance in AU-C section 705 applies.

REPORTING—SUPPLEMENTAL SCHEDULES RELATING TO ERISA AND DOL REGULATIONS (FULL-SCOPE AUDITS WHEN FILING WITH THE DOL)

6.12 Besides the financial statements and related disclosures, which may conform to the requirements of Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 960, *Plan Accounting—Defined Benefit Pension Plans*; 962, *Plan Accounting—Defined Contribution Pension Plans*; and 965, *Plan Accounting—Health and Welfare Benefit Plans*, ERISA and DOL regulations require additional information to be disclosed in the financial statements or presented in the supplemental schedules. Some of this information is required to be covered by the auditor's report. The supplemental information required by ERISA and the regulations is described in appendix A, "ERISA and Related Regulations," of the AICPA Audit and Accounting Guide *Employee Benefit Plans*. Because the supplemental schedules are required by ERISA and DOL regulations, not a designated accounting standard setter, the supplemental schedules are not considered *required supplementary information*, as defined in AU-C section 730, *Required Supplementary Information* (AICPA, *Professional Standards*); therefore, AU-C section 730 does not apply.

FULL-SCOPE AUDIT CONSIDERATIONS

Author's Note:
For guidance when performing a limited-scope audit (as permitted under 29 CFR 2520.103-8 of the DOL's rules and regulations for reporting and disclosure under ERISA), see section 5, "Limited Scope Audit Disclosures and Auditor's Reports."

For an illustration of a Form 11-K audit when filing with the SEC, see paragraphs 6.55–.59.

6.13 When performing a full-scope audit of an employee benefit plan, the auditor is typically engaged to report on whether the supplemental schedules that are required to be covered by the auditor's report are fairly presented in relation to the financial statements as a whole; therefore, AU-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole* (AICPA, *Professional Standards*), applies. Paragraphs .05–.08 of AU-C section 725 require certain audit procedures to be performed in addition to the procedures performed during the audit of the financial statements in order for the auditor to provide such an opinion on the supplemental schedules. AU-C section 725 also provides guidance on the form and content of the report. When the plan presents the supplemental schedules with the financial statements, the auditor should report on the supplementary information in either an other-matter paragraph, in accordance with AU-C section 706, or a separate report on the supplemental schedules.

6.14 Paragraph .09 of AU-C section 725 states that the other-matter paragraph or separate report, in those circumstances, should include the following elements:

a. A statement that the audit was conducted for the purpose of forming an opinion on the financial statements as a whole

b. A statement that the supplementary information is presented for purposes of additional analysis and is not a required part of the financial statements

c. A statement that the supplementary information is the responsibility of management and was derived from, and relates directly to, the underlying accounting and other records used to prepare the financial statements

d. A statement that the supplementary information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves and other additional procedures, in accordance with auditing standards generally accepted in the United States of America

e. If the auditor issues an unmodified opinion on the financial statements and the auditor has concluded that the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole, a statement that, in the auditor's opinion, the supplementary information is fairly stated, in all material respects, in relation to the financial statements as a whole

f. If the auditor issues a qualified opinion on the financial statements and the qualification has an effect on the supplementary information, a statement that, in the auditor's opinion, except for the effects on the supplementary information (refer to the paragraph in the auditor's report explaining the qualification), such information is fairly stated, in all material respects, in relation to the financial statements as a whole

6.15 When the auditor's report on the audited financial statements contains an adverse opinion or a disclaimer of opinion and the auditor has been engaged to report on whether the supplementary information is fairly stated, in all material respects, in relation to such financial statements as a whole, the auditor is precluded from expressing an opinion on the supplementary information. See paragraph .11 of AU-C section 725 for further guidance.

6.16 The following is an illustration of an other-matter paragraph that has been added to the auditor's report on the financial statements of an employee benefit plan (full-scope audit in accordance with GAAS).

Circumstances include the following:

- *The auditor has been engaged to report on the supplementary information under AU-C section 725.*
- *The auditor has expressed an unmodified opinion on the financial statements of the plan.*
- *The auditor has concluded that the supplementary information required by ERISA and DOL regulations is fairly stated, in all material respects, in relation to the financial statements as a whole.*
- *The auditor is reporting on the supplementary information by adding an other-matter paragraph to the auditor's report on the financial statements.*

[Source: Paragraph 11.22 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*]

REPORT ON SUPPLEMENTARY INFORMATION[1]

Our audits were conducted for the purpose of forming an opinion on the financial statements 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 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. Such information is the responsibility of the Plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

6.17 In accordance with paragraph .13 of AU-C section 725, if the auditor concludes, on the basis of the procedures performed, that the supplementary information is materially misstated in relation to the financial statements as a whole, the auditor should discuss the matter with management and propose appropriate revision of the supplementary information. If management does not revise the supplementary information, the auditor should either

a. modify the auditor's opinion on the supplemental schedules and describe the misstatement in the auditor's report or

b. if a separate report is being issued on the supplemental schedules, withhold the auditor's report on the supplemental schedules.

Author's Note:
Generally, the DOL will reject a Form 5500 filing that contains a qualified, an adverse, or a disclaimer of opinion, other than those issued in connection with a limited-scope audit pursuant to Title 29 CFR 2520.103-8 or -12.

REPORTING EXCERPT—UNMODIFIED REPORTS, FULL-SCOPE AUDITS UNDER GAAS: DEFINED CONTRIBUTION 401(k) PROFIT SHARING PLAN

6.18 The following illustrates an unmodified opinion on the financial statements of a 401(k) plan.

Circumstances include the following:

- *The report contains an unmodified opinion on the financial statements of a 401(k) plan prepared in accordance with U.S. GAAP (full-scope audit).*
- *The auditor has been engaged to report on the ERISA supplemental schedules, in accordance with AU-C section 725, and the auditor concludes that the supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole.*
- *The auditor reports on the supplemental schedules in an other-matter paragraph included in the auditor's report, in accordance with paragraph .09 of AU-C section 725 and AU-C section 706.*

[Source: Paragraph 11.25 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*]

[1] The auditor is reporting on the supplemental schedules in an other-matter paragraph, as required by AU-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole* (AICPA, *Professional Standards*). In accordance with paragraph .08 of AU-C section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report* (AICPA, *Professional Standards*), the heading "Other Matter" or other appropriate heading should be used when including an other-matter paragraph in the auditor's report. In this illustration the heading "Report on Supplementary Information" is used rather than "Other Matter."

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[2]

We have audited the accompanying financial statements of ABC 401(k) Plan, which comprise the statements of net assets available for benefits 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 related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 accordance with accounting principles generally accepted in the United States of America.

Report on Supplementary Information[3]

Our audits were conducted for the purpose of forming an opinion on the financial statements 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 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. Such information is the responsibility of the Plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and

[2] The subtitle "Report on the Financial Statements" is unnecessary when the second subtitle, "Report on Other Legal and Regulatory Requirements," is not applicable. In this illustration, the heading "Report on the Financial Statements" has been included even though there is no report on other legal and regulatory requirements included in this report.

[3] See footnote 1.

other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

REPORTING EXCERPT—UNMODIFIED REPORTS, FULL-SCOPE AUDITS UNDER GAAS: DEFINED BENEFIT PLAN—END OF YEAR INFORMATION DATE

6.19 The following is an illustration of an auditor's report on the financial statements of a defined benefit pension plan (DB plan) assuming an end-of-year benefit information date.

Circumstances include the following:

- *The report contains an unmodified opinion on the financial statements of a DB plan prepared in accordance with U.S. GAAP (full-scope audit).*
- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*
- *The plan uses an end-of-year benefit information date.*
- *The auditor has been engaged to report on the ERISA supplemental schedules, in accordance with AU-C section 725, and the auditor concludes that the supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole.*
- *The auditor reports on the supplemental schedules in an other-matter paragraph included in the auditor's report, in accordance with paragraph .09 of AU-C section 725 and AU-C section 706.*
- *The information regarding the actuarial present value of accumulated plan benefits and changes therein is presented in separate statements within the financial statements.*

[Source: Paragraph 11.35 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*]

Author's Note:

FASB ASC 960 permits variation in the presentation of information regarding the actuarial present value of accumulated plan benefits and changes therein. If such information is not presented in separate financial statements but is presented on the face of one or more financial statements or the notes thereto, the opening paragraph of the auditor's report should refer only to the financial statements that are presented. For example, if information regarding accumulated plan benefits and changes therein is presented in the notes to the financial statements regarding net assets available for benefits and changes therein, the first sentence of the auditor's report might read as follows: "We have audited the accompanying financial statements of XYZ Pension Plan, which comprise the statements of net assets available for benefits 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." The wording of the opinion paragraph would be the same as in the illustration and would refer to the financial status of the plan.

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[4]

We have audited the accompanying financial statements of XYZ Pension Plan, which comprise the statements of net assets available for benefits and of accumulated plan benefits as of December 31, 20X2 and 20X1, and the related statements of changes

[4] See footnote 2.

in net assets available for benefits and of changes in accumulated plan benefits for the year ended December 31, 20X2, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 accordance with accounting principles generally accepted in the United States of America.[5]

Report on Supplementary Information[6]

Our audits were conducted for the purpose of forming an opinion on the financial statements 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 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. Such information is the responsibility of the Plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

[5] Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 960, *Plan Accounting—Defined Benefit Pension Plans*, left unresolved the question of whether accumulated plan benefit information represents a liability of a defined benefit pension plan (DB plan). Accordingly, because the financial statements of a DB plan do not present information on accumulated plan benefits as a liability of the plan and because they do not present an account comparable to the owners' equity of other types of entities, the auditor's opinion in the illustrative reports does not refer to the presentation of the financial position of the plan. The terms *financial status* and *changes in financial status*, as used here, refer to the presentation of information regarding net assets available for plan benefits and changes therein and information regarding accumulated plan benefits and changes therein as specified in FASB ASC 960.

[6] See footnote 1.

REPORTING EXCERPT—UNMODIFIED REPORTS, FULL-SCOPE AUDITS UNDER GAAS: DEFINED BENEFIT PLAN—BEGINNING-OF-YEAR BENEFIT INFORMATION DATE

6.20 The following is an illustration of an auditor's report on the financial statements of a DB plan assuming a beginning-of-year benefit information date.

Circumstances include the following:

- *The report contains an unmodified opinion on the financial statements of a DB pension plan prepared in accordance with U.S. GAAP (full-scope audit).*
- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*
- *The plan uses a beginning-of-year benefit information date.*
- *The auditor has been engaged to report on the ERISA supplemental schedules, in accordance with AU-C section 725, and the auditor concludes that the supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole.*
- *The auditor reports on the supplemental schedules in an other-matter paragraph included in the auditor's report, in accordance with paragraph .09 of AU-C section 725 and AU-C section 706.*
- *The information regarding the actuarial present value of accumulated plan benefits and changes therein is presented in separate statements within the complete financial statements.*

[Source: Paragraph 11.36 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*]

Author's Note:
FASB ASC 960 permits variation in the presentation of information regarding the actuarial present value of accumulated plan benefits and changes therein. If such information is not presented in separate financial statements but is presented on the face of one or more financial statements or the notes thereto, the opening paragraph of the auditor's report should refer only to the financial statements that are presented. For example, if information regarding accumulated plan benefits and changes therein is presented in the notes to the financial statements regarding net assets available for benefits and changes therein, the first sentence of the auditor's report might read as follows: "We have audited the accompanying financial statements of XYZ Pension Plan, which comprise the statements of net assets available for benefits 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." The wording of the opinion paragraph would be the same as in the illustration and would refer to the financial status of the plan.

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[7]

We have audited the accompanying financial statements of XYZ Pension Plan, which comprise the statements of net assets available for benefits 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, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

[7] See footnote 2.

P1: KpB
ACPA300-06 aicpa-att-epb.cls June 9, 2014 14:30

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 accordance with accounting principles generally accepted in the United States of America.[8]

Report on Supplementary Information[9]

Our audits were conducted for the purpose of forming an opinion on the financial statements 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 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. Such information is the responsibility of the Plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

REPORTING EXCERPT—UNMODIFIED REPORTS, FULL-SCOPE AUDITS UNDER GAAS: DEFINED BENEFIT PLAN—HEALTH AND WELFARE PLAN

6.21 The following is an illustration of an auditor's report on the financial statements of a defined benefit health and welfare benefit plan (H&W plan).

Circumstances include the following:

- *The report contains an unmodified opinion on the financial statements of a defined benefit H&W plan prepared in accordance with U.S. GAAP (full-scope audit).*

---

[8] See footnote 5.

[9] See footnote 1.

- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*
- *The auditor has been engaged to report on the ERISA supplemental schedules, in accordance with AU-C section 725, and the auditor concludes that the supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole.*
- *The auditor reports on the supplemental schedules in an other-matter paragraph included in the auditor's report, in accordance with paragraph .09 of AU-C section 725 and AU-C section 706.*

[Source: Paragraph 11.37 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*]

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[10]

We have audited the accompanying financial statements of Allied Industries Benefit Plan, which comprise the net assets available for benefits and of plan benefit obligations as of December 31, 20X2 and 20X1, and the related statements of changes in net assets available for benefits and of changes in benefit obligations for the year ended December 31, 20X2, and the related notes to the financial statements.[11]

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 accordance with accounting principles generally accepted in the United States of America.

[10] See footnote 2.

[11] For a defined contribution health and welfare benefit plan, this paragraph would be worded as follows: "We have audited the accompanying financial statements of Allied Industries Health Plan, that comprise the net assets available for benefits of Allied Industries Health 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 related notes to the financial statements."

Report on Supplementary Information[12]

Our audits were conducted for the purpose of forming an opinion on the financial statements 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 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. Such information is the responsibility of the Plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

REPORTING—SPECIAL PURPOSE FRAMEWORKS

6.22 DOL regulations permit, but do not require, financial statements included in the annual report (Form 5500) to be prepared on a basis of accounting other than U.S. GAAP (for example, a special purpose framework such as a modified cash basis of accounting.). In such cases, they do not prohibit variances from U.S. GAAP if the variances are described in a note to the financial statements.[13]

6.23 A common example of the use of a basis other than U.S. GAAP is financial statements prepared on the modified cash basis of accounting for filing with the DOL. AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks* (AICPA, *Professional Standards*), addresses special considerations in the application of AU-C sections 200–700 to an audit of financial statements prepared in accordance with a special purpose framework, which is a cash, tax, regulatory, contractual, or an other basis of accounting. A *cash basis of accounting* is defined as a basis of accounting that the entity uses to record cash receipts and disbursements and modifications of the cash basis having substantial support. For an employee benefit plan, cash basis financial statements that adjust investments to fair value are typically considered to be prepared on a modified cash basis of accounting.

6.24 In accordance with paragraph .18 of AU-C section 800, in the case of an auditor's report on special purpose financial statements, the explanation of management's responsibility for the financial statements should also make reference to its responsibility for determining that the applicable financial reporting framework is acceptable in the circumstances when management has a choice of financial reporting frameworks in the preparation of such financial statements.

6.25 The auditor's report on special purpose financial statements should include an emphasis-of-matter paragraph, under an appropriate heading, that (*a*) indicates that the financial statements are prepared in accordance with the applicable special purpose framework, (*b*) refers to the note to the financial statements that describes that framework, and (*c*) states that the special purpose framework is a basis of accounting other than GAAP. See paragraph .19 of AU-C section 800.

6.26 Paragraphs 11.26–.34 in the AICPA Audit and Accounting Guide *Employee Benefit Plans* provides further guidance when reporting on a special purpose framework.

[12] See footnote 1.

[13] Paragraph .15 of AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks* (AICPA, *Professional Standards*), requires the auditor to adequately describe how the special purpose framework differs from generally accepted accounting principles.

REPORTING EXCERPT—SPECIAL PURPOSE FRAMEWORK (MODIFIED CASH BASIS)

6.27 The following is an illustration of an auditor's report on a 401(k) plan prepared on the modified cash basis of accounting.

Circumstances include the following:

- *The report contains an unmodified opinion on the financial statements of a 401(k) plan prepared on the modified cash basis of accounting (full-scope audit).*
- *The auditor has been engaged to report on the ERISA supplemental schedules, in accordance with AU-C section 725, and the auditor concludes that the supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole.*
- *The auditor reports on the supplemental schedules in an other-matter paragraph included in the auditor's report, in accordance with paragraph .09 of AU-C section 725 and AU-C section 706.*

[Source: Paragraph 11.34 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*]

INDEPENDENT AUDITOR'S REPORT

[*Addressee*]

Report on the Financial Statements[14]

We have audited the accompanying financial statements of XYZ 401(k) Plan, which comprise the statements of net assets available for benefits (modified cash basis) 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, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with the modified cash basis of accounting described in Note X; this includes determining that the modified cash basis of accounting is an acceptable basis for the preparation of the financial statements in the circumstances. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 (modified cash basis) as of December 31, 20X2 and 20X1, and the changes in net assets available for benefits

[14] See footnote 2.

(modified cash basis) for the year ended December 31, 20X2, in accordance with the modified cash basis of accounting described in Note X.

Basis of Accounting

We draw attention to Note X to the financial statements, which describes the basis of accounting. The financial statements are prepared on the modified cash basis of accounting, which is a basis of accounting other than accounting principles generally accepted in the United States of America. Our opinion is not modified with respect to this matter.

Report on Supplementary Information[15]

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplemental schedules (modified cash basis) of [*identify titles of schedules and period covered*] are presented for the purpose of additional analysis and are not a required part of the 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. Such information is the responsibility of the Plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

REPORTING—FINANCIAL STATEMENTS OF A TRUST ESTABLISHED UNDER A PLAN

6.28 Under both FASB ASC 960 and ERISA, 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 the plan. The limited scope exemption, as described in paragraph 5.12, applies to employee benefit plans. If the auditor is engaged to report on the financial statements of a trust, the full-scope auditing procedures would apply. In such audits, following the applicable auditing guidance contained in this guide would be appropriate. Users of the financial statements of the trust may not be aware of the distinction between the trust and plan. Therefore, when reporting on such a trust, the auditor's report may explain 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 GAAP and that the financial statements do not purport to satisfy the DOL reporting and disclosure requirements.

REPORTING EXCERPT—FINANCIAL STATEMENTS OF A TRUST ESTABLISHED UNDER A PLAN

6.29 The following is an illustration of an auditor's report on the financial statements of a trust established under an employee benefit plan.

Circumstances include the following:

- *The report contains an unmodified opinion on the financial statements of a trust established under an employee benefit plan prepared in accordance with U.S. GAAP (single year).*
- *The auditor includes an other-matter paragraph, following the opinion paragraph, to explain that the financial statements of the trust do not purport to present the financial status or changes in financial status of the plan and do not satisfy DOL reporting and disclosure requirements.*

[Source: Paragraph 11.39 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*]

[15] See footnote 2.

INDEPENDENT AUDITOR'S REPORT

[*Addressee*]

Report on the Financial Statements[16]

We have audited the accompanying financial statements of ABC Pension Trust, which comprise the statement of net assets as of December 31, 20X2, and the related statement of changes in net assets and trust balance for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 accordance with accounting principles generally accepted in the United States of America.

Other Matter

The accompanying financial statements are those of ABC Pension Trust, which is established under XYZ Pension Plan; these financial statements do not purport to present the financial status of XYZ Pension Plan and 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 accordance with accounting principles generally accepted in the United States of America. Further, these financial 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.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

[16] See footnote 2.

REPORTING—TERMINATING AND TERMINATED PLANS

6.30 FASB ASC 960-40, 962-40, and 965-40 provides guidance for terminating plans. A terminating plan includes any plan about which a termination decision has been made regardless of whether the terminating plan will be replaced. If liquidation of a plan is deemed to be imminent (as defined in FASB ASC 205-30-25-2) before the end of the plan year, the plan's year-end financial statements should be prepared using the liquidation basis of accounting in accordance with FASB ASC 205-30. Plan financial statements for periods ending after the determination that liquidation is imminent are prepared using the liquidation basis of accounting. For terminating plan assets, accumulated plan benefits should be determined using the liquidation basis of accounting, and their value may differ from the actuarial present value of accumulated plan benefits reported for an ongoing plan. In general, upon termination all benefits should be reported as vested.

Author's Note:

FASB Accounting Standards Update (ASU) No. 2013-07, *Presentation of Financial Statements (Topic 205): Liquidation Basis of Accounting*, was issued in April 2013 and provides guidance on when and how an entity should prepare its financial statements using the liquidation basis of accounting and describes the related disclosures that should be made. ASU No. 2013-07 has been codified in FASB ASC 205-30. The amendments in this ASU are effective for entities that determine liquidation is imminent during annual reporting periods beginning after December 15, 2013, and interim reporting periods therein. Entities should apply the requirements prospectively from the day that liquidation becomes imminent. Early adoption is permitted.

Terminating employee benefit plans that already use the liquidation basis of accounting in accordance with FASB ASC 960-40, 962-40, or 965-40, as of the effective date are not required to apply FASB ASC 205-30; rather, those plans should continue to apply the guidance in FASB ASC 960-40, 962-40, or 965-40 until they have completed liquidation.

6.31 The auditor's report may include an emphasis-of-matter paragraph that explains that the plan is being terminated and that the financial statements (including the accumulated plan benefit information disclosures, if applicable) have been presented using the liquidation basis of accounting.

REPORTING EXCERPT—TERMINATING PLAN (DEFINED BENEFIT PENSION PLAN)

6.32 The following is an illustration of an auditor's report for a terminating defined benefit pension plan.

Circumstances include the following:

- *The report contains an unmodified opinion on the financial statements of a terminating plan. The plan's financial statements have been prepared in accordance with GAAP.*
- *The plan presents a statement of net assets available for benefits in liquidation and of accumulated plan benefits in liquidation as of December 31, 20X2, a statement of net assets available for benefits and of accumulated plan benefits as of December 31, 20X1 (on-going), and a single-year statement of changes in net assets available for benefits in liquidation and of changes in accumulated plan benefits in liquidation.*
- *The plan uses an end-of-year benefit information date.*
- *The information regarding the actuarial present value of accumulated plan benefits and changes therein is presented in separate statements within the financial statements.*
- *The plan was terminated in 20X2 and as of April 1, 20X2, 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, in accordance with FASB ASC 205-30. As of December 31, 20X2, all assets of the plan have not yet been fully liquidated.*
- *The auditor has been engaged to report on the ERISA supplemental schedules, in accordance with AU-C section 725, and the auditor concludes that the supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole.*
- *The auditor reports on the supplemental schedules in an other-matter paragraph included in the auditor's report, in accordance with paragraph .09 of AU-C section 725 and AU-C section 706.*
- *The auditor includes an emphasis-of-matter paragraph in the auditor's report to bring to the reader's attention the termination of the plan.*

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[17]

We have audited the accompanying financial statements of XYZ Pension Plan, which comprise the statements of net assets available for benefits and of accumulated plan benefits as of December 31, 20X2 (in liquidation) and 20X1, and the related statement of changes in net assets available for benefits and of changes in accumulated plan benefits for the year ended December 31, 20X2 (in liquidation), and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

Opinion

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial status of the plan in liquidation as of December 31, 20X2, and the financial status of the plan as of December 31, 20X1, and the changes in its net assets available for benefits in liquidation and of accumulated plan benefits in liquidation for the year ended December 31, 20X2, in accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter—Plan Termination

As further discussed in Note Y to the financial statements, the Board of Directors of XYZ Company, made a decision to terminate the XYZ Pension Plan. As a result, in accordance with accounting principles generally accepted in the United States of America, XYZ Pension Plan has changed its basis of accounting from the ongoing basis of accounting used in presenting the 20X1 financial statements to the liquidation basis of accounting used in presenting the 20X2 financial statements. Our opinion is not modified with respect to this matter.

Other Matter—Report on Supplemental Schedules[18]

Our audits were conducted for the purpose of forming an opinion on the financial statements 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

[17] See footnote 2.
[18] See footnote 1.

required part of the 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. Such information is the responsibility of the Plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

2. UNMODIFIED OPINIONS ON THE FINANCIAL STATEMENTS WITH MODIFICATIONS TO THE REPORT ON THE SUPPLEMENTARY INFORMATION

Author's Note:
Limited scope examples are presented in section 5.

REPORTING—DEPARTURES FROM, OR OMISSION OF, SUPPLEMENTARY INFORMATION REQUIRED BY THE DOL

6.33 When the auditor is engaged to provide an opinion on the supplemental schedules under AU-C section 725 (full-scope audit), and the auditor concludes, on the basis of the procedures performed, that the supplementary information is materially misstated in relation to the financial statements as a whole, the auditor should discuss the matter(s) with management and propose appropriate revision of the supplementary information. If management does not revise the supplementary information, the auditor should modify the auditor's opinion on the supplemental schedules (qualified or adverse opinion, as appropriate) and describe the misstatement in the auditor's report, in accordance with paragraph .13 of AU-C section 725.

6.34 In an audit performed in accordance with GAAS, the report need not state that the financial statements and schedules comply with DOL filing requirements. During the audit, however, the auditor may become aware of a departure from such requirements that is not also a departure from GAAP. If the departure is not related to a prohibited transaction with a party in interest, the auditor may consider including an additional communication in the auditor's report (emphasis-of-matter or other-matter paragraph), in accordance with AU-C section 706.

6.35 When the auditor concludes that the supplemental schedules do not contain all required information or contain information that is inaccurate or inconsistent with the financial statements, and the omission or inconsistency is not considered a material misstatement, the auditor may decide to include an additional paragraph in the report on supplemental schedules to disclose the omission or inconsistency of the information.

6.36 The following table illustrates various scenarios that may be considered by the auditor for reporting on the supplementary information when the DOL-required information contains errors, omissions, or inconsistencies:

Error, Omission, or Inconsistency	*Effect on Report Full-Scope Audit*
DOL-required information is omitted from the supplemental schedule (for example, historical cost information for nonparticipant-directed transactions), and the omission or inconsistency is not considered a material misstatement.	Other-matter paragraph (See paragraph 6.37 for an illustration.)
The required schedule is omitted (for example, Form 5500, Schedule H, line 4j—Schedule of Reportable Transactions), and the omission or inconsistency is not considered a material misstatement.	Other-matter paragraph (See paragraph 6.38 for an illustration.)
The required schedule is materially misstated in relation to the financial statements as a whole (full-scope audit).	Qualified or adverse regarding schedules (See paragraph 6.39.)

REPORTING EXCERPT—OMITTED INFORMATION IN A SCHEDULE REQUIRED UNDER DOL REGULATIONS

6.37 The following illustrates an auditor's report on an employee benefit plan when the historical cost information of certain nonparticipant-directed plan assets held by the plan trustee has been omitted from the DOL-required Schedule H, line 4i—Schedule of Assets (Held at End of Year).

Circumstances include the following:

- *The report contains an unmodified opinion on the financial statements of a 401(k) plan prepared in accordance with U.S. GAAP (full-scope audit).*
- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*
- *The auditor has been engaged to report on the ERISA supplemental schedules, in accordance with AU-C section 725, and the auditor concludes that the supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole.*
- *The auditor reports on the supplemental schedules in an other-matter paragraph included in the auditor's report, in accordance with paragraph .09 of AU-C section 725 and AU-C section 706.*
- *An additional communication is added to the report on the supplemental schedules because the historical cost information of certain nonparticipant-directed plan assets held by the plan trustee has been omitted from the DOL-required Schedule H, line 4i—Schedule of Assets (Held at End of Year).*

[Source: Paragraph 11.46 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*]

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[19]

We have audited the accompanying financial statements of ABC 401(k) Plan, which comprise the statements of net assets available for benefits 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 related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

[19] See footnote 2.

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 accordance with accounting principles generally accepted in the United States of America.

Report on Supplementary Information[20]

Our audits were conducted for the purpose of forming an opinion on the financial statements 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 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. Such information is the responsibility of the Plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements 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.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

REPORTING EXCERPT—OMITTED SCHEDULE REQUIRED UNDER DOL REGULATIONS

6.38 The following is an illustration of an auditor's report on an employee benefit plan when a DOL-required schedule has been omitted.

Circumstances include the following:

- *The report contains an unmodified opinion on the financial statements prepared in accordance with U.S. GAAP (full-scope audit).*
- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*
- *The auditor has been engaged to report on the ERISA supplemental schedules, in accordance with AU-C section 725, and the auditor concludes that the supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole.*
- *The auditor reports on the supplemental schedules in an other-matter paragraph included in the auditor's report, in accordance with paragraph .09 of AU-C section 725 and AU-C section 706.*
- *An additional communication is added to the report on the supplemental schedules because Schedule H, line 4j—Schedule of Reportable Transactions, has been omitted.*

[20] See footnote 1.

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[21]

We have audited the accompanying financial statements of ABC 401(k) Plan, which comprise the statements of net assets available for benefits 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 related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 accordance with accounting principles generally accepted in the United States of America.

Report on Supplementary Information[22]

Our audits were conducted for the purpose of forming an opinion on the financial statements 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 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. Such information is the responsibility of the Plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

[21] See footnote 2.
[22] See footnote 1.

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.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

REPORTING EXCERPT—QUALIFIED REPORT ON SUPPLEMENTARY INFORMATION—OMITTED INFORMATION

6.39 The following is an illustration of an auditor's report on the supplemental schedules that has been qualified due to information being omitted from the supplemental schedules.

Circumstances include the following:

- *The report contains an unmodified opinion on the financial statements prepared in accordance with U.S. GAAP (full-scope audit).*
- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*
- *The auditor has been engaged to report on the ERISA supplemental schedules, in accordance with AU-C section 725, and the auditor concludes that the report on the supplemental schedules should be qualified because the supplemental schedule does not disclose that the plan had loans to participants that are considered assets held for investment purposes that should be disclosed in supplemental Schedule H, Line 4i—Schedule of Assets (Held at End of Year).*
- *The auditor reports on the supplemental schedules in an other-matter paragraph included in the auditor's report, in accordance with paragraph .09 of AU-C section 725 and AU-C section 706.*

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[23]

We have audited the accompanying financial statements of ABC 401(k) Plan, which comprise the statements of net assets available for benefits 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 related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the

[23] See footnote 2.

financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 accordance with accounting principles generally accepted in the United States of America.

Report on Supplementary Information[24]

Our audits were conducted for the purpose of forming an opinion on the financial statements 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 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. Such information is the responsibility of the Plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. 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 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. In our opinion, except for the omission of the disclosure of participant loans from the supplemental Schedule H, line 4i—Schedule of Assets (Held at End of Year) as of December 31, 20X2, the information is fairly stated in all material respects in relation to the financial statements as a whole.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

3. PROHIBITED TRANSACTIONS

REPORTING

6.40 When the auditor concludes that the plan has entered into a prohibited transaction with a party in interest, and the transaction has not been properly disclosed in the DOL required supplemental schedule, the auditor should modify the report on the supplemental schedule if the effect of the transaction is material based on the financial statement materiality. If a material party in interest transaction that is not disclosed in the supplemental schedule is also considered a related party transaction and if that transaction is not properly disclosed in the notes to the financial statements, the auditor should express a qualified or an adverse opinion on the financial statements, in accordance with AU-C section 705. If the effect of the transaction is not material to the financial statements, then the auditor may add a paragraph to the report on the supplemental schedule to disclose the omitted transaction. Illustrations of reports modified in these circumstances follow. All the illustrations are presented assuming that the report on the supplementary information is added to the auditor's report on the financial statements.

[24] See footnote 1.

REPORTING EXCERPT—QUALIFIED REPORT—DISCLOSURE OF MATERIAL PROHIBITED TRANSACTION WITH PARTY IN INTEREST OMITTED

6.41 The following is an illustration of an auditor's report for an employee benefit plan when the disclosure of a material prohibited transaction with a party in interest has been omitted from the supplementary information.

Circumstances include the following:

- *The report contains an unmodified opinion on the financial statements prepared in accordance with U.S. GAAP.*
- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*
- *The auditor has been engaged to report on the ERISA supplemental schedules, in accordance with AU-C section 725, and the auditor concludes that the report on the supplementary information should be qualified because disclosure of a material prohibited transaction with a party in interest is omitted.*
- *The auditor reports on the supplementary information in an other-matter paragraph in the auditor's report, in accordance with paragraph .09 of AU-C section and AU-C section 706.*

[Source: Paragraph 11.54 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*]

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

[*Same auditor report sections for "Report on the Financial Statements," "Management's Responsibility for the Financial Statements," "Auditor's Responsibility," and "Opinion," as illustrated in paragraph 6.18*]

Report on Supplementary Information[25]

Our audits were conducted for the purpose of forming an opinion on the financial statements as a whole. The supplemental schedules [*identify title of schedules and period covered*] are presented for the purpose of additional analysis and are not a required part of the 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. Such information is the responsibility of the Plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. The supplemental Schedule G, Part III—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. In our opinion, except for the omission of the information discussed in the preceding sentences, the information is fairly stated in all material respects in relation to the financial statements as a whole.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

REPORTING EXCERPT—DISCLOSURE OF IMMATERIAL PROHIBITED TRANSACTION WITH PARTY IN INTEREST OMITTED

6.42 The following is an illustration of an auditor's report for an employee benefit plan when disclosure of an immaterial prohibited transaction with a party in interest has been omitted from the supplementary information.

[25] See footnote 1.

Circumstances include the following:

- *The report contains an unmodified opinion on the financial statements prepared in accordance with U.S. GAAP.*
- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*
- *The auditor has been engaged to report on the ERISA supplemental schedules, in accordance with AU-C section 725, and the auditor concludes that the supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole.*
- *The auditor reports on the supplementary information in an other-matter paragraph included in the auditor's report, in accordance with paragraph .09 of AU-C section 725 and AU-C section 706.*
- *An additional communication is added to the 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.*

[Source: Paragraph 11.55 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*]

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

[*Same auditor report sections for "Report on the Financial Statements," "Management's Responsibility for the Financial Statements," "Auditor's Responsibility," and "Opinion," as illustrated in paragraph 6.18*]

Report on Supplementary Information[26]

Our audits were conducted for the purpose of forming an opinion on the financial statements 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 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. Such information is the responsibility of the Plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Schedule G, Part III—Nonexempt Transactions does not disclose that the Plan [*describe prohibited transaction*]. Disclosure of this information, although not considered to be material, is required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

REPORTING EXCERPT—QUALIFIED REPORT—PROHIBITED TRANSACTION WITH PARTY IN INTEREST THAT IS ALSO CONSIDERED A RELATED-PARTY TRANSACTION

6.43 The following is an illustration of an auditor's report for an employee benefit plan when the auditor qualifies the opinion on the financial statements and qualifies the report on the supplementary information because a material prohibited transaction with a party in interest that is also a related party transaction has not been properly disclosed in the notes to the financial statements or supplemental schedules.

[26] See footnote 1.

Circumstances include the following:

- *The report contains a qualified opinion on the financial statements of a profit sharing plan due to a material prohibited transaction with a party in interest that is also a related party transaction that has not been properly disclosed in the notes to the financial statements.*
- *The financial statements have been prepared in accordance with U.S. GAAP.*
- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*
- *The auditor has been engaged to report on the ERISA supplemental schedules, in accordance with AU-C section 725, and the auditor concludes that the report on the supplemental schedules should be qualified because a material prohibited transaction with a party in interest that is also a related-party transaction that has not been properly disclosed in the notes to the financial statements has not been disclosed in the required supplemental schedules.*
- *The auditor reports on the supplemental schedules in an other-matter paragraph included in the auditor's report, in accordance with paragraph .09 of AU-C section 725 and AU-C section 706.*

[Source: Paragraph 11.56 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*]

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[27]

We have audited the accompanying financial statements of XYZ Company Profit-Sharing Plan, which comprise the statements of net assets available for benefits 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 related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our qualified audit opinion.

Basis for Qualified 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.

[27] See footnote 2.

Qualified Opinion

In our opinion, except for the omission of the information discussed in the Basis for Qualified Opinion 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 accordance with accounting principles generally accepted in the United States of America.

Report on Supplementary Information[28]

Our audits were conducted for the purpose of forming an opinion on the financial statements 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 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. Such information is the responsibility of the Plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America.

Schedule G, Part III—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. In our opinion, except for the omission of [*describe prohibited transaction*] from Schedule G, Part III—Nonexempt Transactions, the information is fairly stated in all material respects in relation to the financial statements as a whole.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

4. GOING CONCERN

REPORTING

6.44 During the audit of a nonterminated employee benefit plan, the auditor may become aware that the plan sponsor may not be able to continue as a going concern. Although employee benefit plans are not automatically and necessarily affected by the plan sponsor's financial adversities, this situation may result in the auditor determining it to be a condition or an event sufficient to evaluate whether there is substantial doubt about the plan's ability to continue as a going concern. AU-C section 570, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AICPA, *Professional Standards*), addresses the auditor's responsibilities in an audit of financial statements with respect to evaluating whether there is substantial doubt about the entity's ability to continue as a going concern. This AU-C section applies to all audits of financial statements, regardless of whether the financial statements are prepared in accordance with a general purpose or special purpose framework. This AU-C section does not apply to an audit of financial statements based on the assumption of liquidation (for example, when [*a*] an entity is in the process of liquidation; [*b*] the owners have decided to commence dissolution or liquidation; or [*c*] legal proceedings, including bankruptcy, have reached a point at which dissolution or liquidation is probable). See AU-C section 570 for considerations of the effects on the auditor's report when the auditor concludes that substantial doubt about the entity's ability to continue as a going concern exists.

6.45 In accordance with paragraphs .15–.16 of AU-C section 570, if, after considering identified conditions or events and management's plan, the auditor concludes that substantial doubt about the entity's ability to continue as a going concern for a reasonable period of time remains, the auditor should include an emphasis-of-matter paragraph in the auditor's report to reflect that conclusion. The auditor's conclusion about the entity's ability to continue as a going concern should be expressed through the use of the phrase "substantial doubt about its (the entity's) ability to continue as a going concern" or similar wording that includes the terms *substantial doubt* and *going concern*.

[28] See footnote 1.

In a going-concern emphasis-of-matter paragraph, the auditor should not use conditional language in expressing a conclusion concerning the existence of substantial doubt about the entity's ability to continue as a going concern.

REPORTING EXCERPTS—GOING CONCERN

6.46 The following is an illustration of an auditor's report for a defined benefit pension plan when the auditor includes an emphasis-of-matter paragraph in the auditor's report because the auditor concluded that there is substantial doubt about the plan's ability to continue as a going concern.

Circumstances include the following:

- *The report contains an unmodified opinion on the financial statements of a DB plan prepared in accordance with U.S. GAAP (full-scope audit).*
- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*
- *The plan uses an end-of-year benefit information date.*
- *The auditor has been engaged to report on the ERISA supplemental schedules, in accordance with AU-C section 725, and the auditor concludes that the supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole.*
- *The auditor reports on the supplemental schedules in an other-matter paragraph included in the auditor's report, in accordance with paragraph .09 of AU-C section 725 and AU-C section 706.*
- *The information regarding the actuarial present value of accumulated plan benefits and changes therein is presented in separate statements within the financial statements.*
- *The auditor includes an emphasis-of-matter paragraph in the auditor's report because the auditor has concluded that there is substantial doubt about the plan's ability to continue as a going concern.*

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[29]

We have audited the accompanying financial statements of XYZ Pension Plan, which comprise the statements of net assets available for benefits and statements of accumulated plan benefits as of December 31, 20X2 and 20X1, and the related statement of changes in net assets available for benefits and statement of changes in accumulated plan benefits for the year ended December 31, 20X2, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal

[29] See footnote 2.

control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 accordance with accounting principles generally accepted in the United States of America.

Emphasis of Matter Regarding Going Concern

The accompanying financial statements have been prepared assuming that the Plan will continue as a going concern. As discussed in note X to the financial statements, XYZ 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, there is substantial doubt about the Plan's ability to continue as a going concern. The financial statements do not include any adjustments that might result from this uncertainty. Our opinion is not modified with respect to this matter.

Other Matter—Report on Supplementary Information[30]

Our audits were conducted for the purpose of forming an opinion on the financial statements 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 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. Such information is the responsibility of the Plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

5. PRIOR YEAR AUDITED BY ANOTHER FIRM

REPORTING

6.47 If the financial statements of the prior period were audited by a predecessor auditor, and the predecessor auditor's report on the prior period's financial statements is not reissued, in addition to expressing an opinion on the current period's financial statements, paragraph .54 of AU-C section 700 states that the auditor should state the following in an other-matter paragraph:

a. That the financial statements of the prior period were audited by a predecessor auditor

b. The type of opinion expressed by the predecessor auditor and, if the opinion was modified, the reasons therefore

c. The nature of an emphasis-of-matter paragraph or other-matter paragraph included in the predecessor auditor's report, if any

d. The date of the report

[30] See footnote 1.

REPORTING EXCERPT—REFERENCE MADE TO REPORT OF PRIOR AUDITOR—PRIOR YEAR AND CURRENT YEAR ARE FULL SCOPE

6.48 The following is an illustration of an auditor's report when the prior year was audited by other auditors.

Circumstances include the following:

- *Full-scope audit in the current year on comparative statement of net assets available for benefits, and single-year statement of changes in net assets available for benefits for a 401(k) plan whose financial statements are prepared in accordance with U.S. GAAP.*
- *The prior year financial statements were audited by other auditors who performed a full scope audit. (See paragraph .54 of AU-C section 700 for reporting requirements.)*

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[31]

We have audited the accompanying financial statements of ABC 401(k) Plan, which comprise the statement of net assets available for benefits as of December 31, 20X2, and the related statement of changes in net assets available for benefits for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the 20X2 Financial Statements

Management is responsible for the preparation and fair presentation of the 20X2 financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility on the 20X2 Financial Statements

Our responsibility is to express an opinion on the 20X2 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on the 20X2 financial statements.

Opinion on the 20X2 Financial Statements

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 the changes in net assets available for benefits for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

[31] See footnote 2.

Other Matter Report on Supplementary Information[32]

Our audit of the plan's financial statements as of and for the year ended December 31, 20X2, was conducted for the purpose of forming an opinion on the financial statements 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 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. Such information is the responsibility of the Plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

Other Matter—20X1 Financial Statements

The financial statements of the Plan as of and for the year ended December 31, 20X1, were audited by predecessor auditors whose report dated May 15, 20X2, expressed an unmodified opinion on those statements.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

6. INITIAL AUDITS

REPORTING

6.49 For initial audits of plans when the plan had assets in the prior year, ERISA requires comparative statements of net assets available for benefits. Comparative statements are not required under U.S. GAAP. AU-C section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements* (AICPA, *Professional Standards*), addresses the auditor's responsibilities relating to opening balances in an initial audit engagement, including a reaudit engagement.

6.50 Guidance on reporting on audited and unaudited financial statements in comparative form is contained in AU-C section 700. When current period financial statements are audited and presented in comparative form with compiled or reviewed financial statements for the prior period, and the report on the prior period is not reissued, paragraph .56 of AU-C section 700 states that the auditor should include an other-matter paragraph in the current period auditor's report that includes (*a*) the service performed in the prior period, (*b*) the date of the report on that service, (*c*) a description of any material modifications noted in that report, and (*d*) a statement that the service was less in scope than an audit and does not provide the basis for the expression of an opinion on the financial statements. If the prior period financial statements were not audited, reviewed, or compiled, the financial statements should be clearly marked to indicate their status, and the auditor's report should include an other-matter paragraph to indicate that the auditor has not audited, reviewed, or compiled the prior period financial statements and that the auditor assumes no responsibility for them. (See paragraph .57 of AU-C section 700.)

REPORTING EXCERPT—INITIAL YEAR OF EXISTENCE

6.51 The following is an illustration of an auditor's report when the plan is newly formed and this is the first year the plan is in existence.

Circumstances include the following:

- *Full-scope audit in the current year on single-year statement of net assets available for benefits, and single-year statement of changes in net assets available for benefits for a 401(k) plan whose financial statements are prepared in accordance with U.S. GAAP.*
- *This is the initial year the plan is in existence.*

[32] See footnote 1.

- *The auditor has been engaged to report on the ERISA supplemental schedules, in accordance with AU-C section 725, and the auditor concludes that the supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole.*
- *The auditor reports on the supplemental schedules in an other-matter paragraph included in the auditor's report, in accordance with paragraph .09 of AU-C section 725 and AU-C section 706.*

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[33]

We have audited the accompanying financial statements of Twinkle Company Savings Plan for Certain Eligible Employees (Plan), which comprise the statement of net assets available for benefits as of December 31, 20X2, and the related statement of changes in net assets available for benefits for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 the changes in net assets available for benefits for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Report on Supplementary Information[34]

Our audit was conducted for the purpose of forming an opinion on the financial statements 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 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. Such information is the responsibility of the Plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of

[33] See footnote 2.
[34] See footnote 1.

the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

REPORTING EXCERPT—INITIAL AUDIT FROM DATE OF INCEPTION

6.52 The following is an illustration of an auditor's report for an initial audit of a plan from its inception.

Circumstances include the following:

- *The report contains an unmodified opinion on the financial statements of a profit sharing plan prepared in accordance with U. S. GAAP (full-scope audit).*
- *The auditor's report covers the plan from inception.*
- *The auditor has been engaged to report on the ERISA supplemental schedules, in accordance with AU-C section 725, and the auditor concludes that the supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole.*
- *The auditor reports on the supplemental schedules in an other-matter paragraph included in the auditor's report, in accordance with paragraph .09 of AU-C section 725 and AU-C section 706.*

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[35]

We have audited the accompanying financial statements of Star Corporation Employees' Savings and Profit Sharing Plan (Plan), which comprise the statement of net assets available for benefits as of December 31, 20X2, and the related statement of changes in net assets available for benefits for the period from June 15, 20X2 (inception) to December 31, 20X2, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are

[35] See footnote 2.

appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

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 the changes in net assets available for benefits for the period from June 15, 20X2 (inception) to December 31, 20X2, in accordance with accounting principles generally accepted in the United States of America.

Report on Supplementary Information[36]

Our audit was conducted for the purpose of forming an opinion on the financial statements 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 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. Such information is the responsibility of the Plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the financial statements as a whole.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

REPORTING EXCERPT—INITIAL AUDIT WHEN PRIOR PERIOD STATEMENT OF NET ASSETS WAS PREVIOUSLY COMPILED

6.53 The following is an illustration of an auditor's report for an initial audit of a plan when the prior period statement of net assets available for benefits has been compiled.

Circumstances include the following:

- *The report contains an unmodified opinion on the financial statements of a 401(k) plan prepared in accordance with U.S. GAAP (full-scope audit).*
- *This is an initial audit of the plan, and the prior period financial statements were compiled.*
- *The auditor has been engaged to report on the ERISA supplemental schedules, in accordance with AU-C section 725, and the auditor concludes that the supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole.*
- *The auditor reports on the supplemental schedules in an other-matter paragraph included in the auditor's report, in accordance with paragraph .09 of AU-C section 725 and AU-C section 706.*

[36] See footnote 1.

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[37]

We have audited the accompanying financial statements of Star Corporation 401(k) plan, which comprise the statement of net assets available for benefits as of December 31, 20X2, and the related statement of changes in net assets available for benefits for the year then ended, and the related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility on the 20X2 Financial Statements

Our responsibility is to express an opinion on the 20X2 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 from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion on the 20X2 financial statements.

Opinion on the 20X2 Financial Statements

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 the changes in net assets available for benefits for the year then ended, in accordance with accounting principles generally accepted in the United States of America.

Other Matter—Report on Supplementary Information[38]

Our audit was conducted for the purpose of forming an opinion on the 20X2 financial statements 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 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. Such information is the responsibility of the Plan's management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information has been subjected to the auditing procedures applied in the audit of the 20X2 financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with auditing standards generally accepted in the United States of America. In our opinion, the information is fairly stated in all material respects in relation to the 20X2 financial statements as a whole.

[37] See footnote 2.
[38] See footnote 1.

Other Matter—Report on 20X1 Financial Statements

The statement of net assets available for benefits for the year ended December 31, 20X1, was compiled by us and our report thereon, dated March 1, 20X2, stated we have not audited or reviewed the 20X1 financial statement and, accordingly, we do not express an opinion on the 20X1 financial statement.

____

[*Auditor's signature*]

[*Auditor's city and state*]

[*Date of the auditor's report*]

7. AUDITS OF ISSUERS, SUCH AS FORM 11-K FILERS

Author's Note:

Form 11-K Considerations. Plans that are required to file a Form 11-K are deemed to be issuers and, accordingly, auditors of such plans have to be registered with the PCAOB and adhere to the PCAOB standards.

Auditors are reminded that the audits of Form 11-K plans will need to be conducted under two sets of standards and prepare two separate audit reports: an audit report referencing PCAOB standards for filing with the SEC (including the explanatory paragraph wording from AU section 551, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* [AICPA, *PCAOB Standards and Related Rules*, Interim Standards]) and a separate report referencing GAAS for DOL filings (including the explanatory paragraph wording from AU-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole* [AICPA, *Professional Standards*]).

REPORTING—UNMODIFIED OPINION FORM 11-K FILING WITH THE SEC

6.54 Plans that are required to file Form 11-K are deemed to be issuers and must submit to the SEC an audit performed in accordance with the auditing and related professional practice standards promulgated by the PCAOB. To perform an audit for a plan that files Form 11-K, public accounting firms have to be registered with the PCAOB. The PCAOB provides guidance on the auditor's report for an audit of an issuer when filing with the SEC.

6.55 Accordingly, plans that are required to file a Form 11-K should refer to "the standards of the Public Company Accounting Oversight Board (United States)" in accordance with PCAOB Auditing Standard No. 1, as amended, when filing with the SEC.

6.56 Auditors will need to conduct their audits of these Form 11-K plans in accordance with two sets of auditing standards (PCAOB and GAAS) and prepare two separate audit reports: an audit report following PCAOB standards, including Auditing Standard No. 1, for Form 11-K filings with the SEC and a separate audit report prepared in accordance with GAAS, including AU-C sections 700, 705, and 706 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 when filing with the SEC; hence, a "dual" standard report is not appropriate and will not be accepted by the SEC.

6.57 The instructions to the Form 11-K and Article 6A of Regulation S-X address reporting requirements for employee stock purchase, savings, and similar plans that are required to file reports with the SEC. The SEC rules for Form 11-K permit plans subject to ERISA to file financial statements and supplemental schedules prepared in accordance with ERISA rather than in accordance with Regulation S-X.

REPORTING EXCERPT—AUDIT REPORT WHEN THE PLAN FILES A FORM 11-K WITH THE SEC

6.58 The following is an illustrative audit report for an employee benefit plan that is filing Form 11-K with the SEC.

Circumstances include the following:

- *The report contains an unmodified opinion for a plan that files Form 11-K with the SEC.*
- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*

- *The report is prepared in accordance with AU section 508,* Reports on Audited Financial Statements *(AICPA,* PCAOB Standards and Related Rules, *Interim Standards), as amended by subsequent PCAOB auditing standards.*
- *The report includes an opinion that the supplemental schedules are fairly stated in all material respects in relation to the basic financial statements taken as a whole, in conformity with AU section 551.*

[Source: Paragraph 11.44 of the AICPA Audit and Accounting Guide *Employee Benefit Plans*]

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

[*Addressee*]

We have audited the accompanying statements of net assets available for benefits of the ABC 401(k) plan (the 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.[39] 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.

[*Signature of Firm*]

[*City and State*]

[*Date*]

8. 403(b) PLANS

REPORTING—403(b) PLANS

6.59 *403(b) plans* are retirement savings arrangements sponsored by certain nonprofit organizations (such as hospitals and private colleges) and public schools. They are defined contribution plans with individual salary deferral limits that are similar, but not identical to, 401(k) plans. Contributions typically include employee salary deferrals. Nonprofit organizations often establish a 401(a) plan that funds employer-matching contributions to a 403(b) plan. Investments held in these arrangements are typically restricted by law to annuity

[39] The following optional language may be added to the auditor's report to replace the rest of this paragraph to clarify that the audit performed did 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) is applicable. This wording has been adapted from an AICPA Center for Public Company Audit Firms Alert issued on March 22, 2005.

The plan is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included 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 control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, 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.

contracts or custodial accounts holding units of participation of regulated investment companies (for example, mutual funds). The auditor's report for a 403(b) plan with an unmodified opinion would look similar to a 401(k) report (see the illustration in paragraph 6.18).

6.60 Beginning with the 2009 Form 5500 filings, 403(b) plans became subject to the same Form 5500 reporting and audit requirements that currently exist for 401(k) plans. These requirements eliminate a previous exemption granted to 403(b) plans from the annual Form 5500 reporting, disclosure, and audit requirements of ERISA. For large 403(b) plans, as defined by ERISA, the 2009 reporting requirements include not only the completion of the entire Form 5500 but also the engagement of an independent qualified public accountant to conduct an independent audit of the plan.

6.61 On July 20, 2009, the DOL issued Field Assistance Bulletin (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. Provided that certain conditions are met, DOL FAB No. 2009-02 indicates that certain inactive contracts will not be required to be part of the employer's Title 1 plan or as plan assets for purposes of the annual report (Form 5500). If the plan administrator elects to exclude some or all of those contracts or accounts meeting the conditions of DOL FAB No. 2009-02 from the plan's financial statements or instructs the auditor not to perform procedures on certain or all pre-2009 contracts, or both, the auditor will need to consider the effect of the exclusions on the completeness of the financial statement presentation, restrictions on the scope of the audit, and the effect on the auditor's report.

6.62 Whereas 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, GAAP requires inclusion of these contracts and accounts as plan assets in the plan's financial statements.

6.63 If a plan excludes from the financial statements certain contracts and accounts as defined under DOL FAB No. 2009-02, the effect on the auditor's 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 GAAS audit and, thereby, obtain sufficient appropriate audit evidence to form an opinion on the financial statements, then the auditor may express a qualified or adverse opinion due to the excluded contracts under DOL FAB No. 2009-02. 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.

6.64 In either case, the GAAP departure would be disclosed in the auditor's report.

REPORTING EXCERPT—40(b) PLAN DISCLAIMER OF OPINION DUE TO EXCLUDED CONTRACTS

6.65 The following is an example of an auditor's report for an audit of a 403(b) plan when 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 addition, the plan did not maintain sufficient accounting records and supporting documents relating to certain annuity and custodial accounts issued to current and former employees prior to January 1, 20X2.

Circumstances include the following:

- *Full-scope audit for a 403(b) defined contribution plan financial statements prepared in accordance with U.S. GAAP.*
- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*
- *Certain annuity contracts and custodial accounts that meet the criteria of DOL FAB No. 2009-02 have been excluded from the statements of net assets available for benefits, and such amounts are not determinable because no records relating to the excluded contracts exist.*
- *The plan also has not maintained sufficient accounting records and supporting documentation relating to certain annuity and custodial accounts issued to current and former employees prior to January 1, 2009.*
- *The auditor has concluded to issue a disclaimer of opinion on the financial statements 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.*
- *The auditor was engaged to report on the supplemental schedules in accordance with AU-C section 725.*

Note: Paragraph .11 of AU-C section 725 states that when the auditor's report on the audited financial statements contains an adverse opinion or a disclaimer of opinion and the auditor has been engaged to report on whether supplementary information is fairly stated, in all material respects, in relation to such financial statements as a whole, the auditor is precluded from expressing an opinion on the supplementary information. The auditor's report on the supplementary information should state that because of the significance of the matter disclosed in the auditor's report, it is inappropriate to, and the auditor does not, express an opinion on the supplementary information.

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[40]

We were engaged to audit the accompanying financial statements of XYZ Company 403(b) Plan, which comprise the statements of net assets available for benefits 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 related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

Our responsibility is to express an opinion on these financial statements based on conducting the audits in accordance with auditing standards generally accepted in the United States of America. Because of the matters described in the Basis for Disclaimer of Opinion paragraphs, however, we were not able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion.

Basis for Disclaimer of Opinion

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.

Disclaimer of Opinion

Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraphs, we have not been able to obtain sufficient appropriate evidence to provide a basis for an audit opinion. Accordingly, we do not express an opinion on these financial statements.

Other Matter—Report on Supplemental Schedules

We were engaged for the purpose of forming an opinion on the financial statements as a whole. The supplemental schedules [*identify title of schedules and period covered*] are presented for the purpose of additional analysis and are not a required part of the 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. Because of the significance of the matters described in the Basis for Disclaimer of Opinion paragraphs, it is inappropriate to and we do not express an opinion on the supplementary information referred to above.

[*Signature of Firm*]

[*City and State*]

[*Date*]

[40] See footnote 2.

REPORTING EXCERPT—403(b) PLAN—ADVERSE OPINION DUE TO EXCLUDED CONTRACTS

6.66 The following is an example of an auditor's report for an audit of a 403(b) plan when 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 as a whole are not presented fairly in accordance with GAAP. In this situation, the auditor has concluded to issue an adverse opinion due to the departure from GAAP.

Circumstances include the following:

- *Full-scope audit for a 403(b) defined contribution plan financial statements prepared in accordance with U.S. GAAP.*
- *The plan presents comparative statements of net assets available for benefits and a single-year statement of changes in net assets available for benefits.*
- *Certain annuity contracts and custodial accounts that meet the criteria of DOL FAB No. 2009-02 have been excluded from the statements of net assets available for benefits, and such amounts are determinable and material.*
- *The auditor has concluded to issue an adverse opinion on the financial statements due to the exclusion of certain annuity contracts and custodial accounts that meet the criteria of DOL FAB No. 2009-02. Such contracts are material to the financial statements, and although they are permitted to be excluded from the Form 5500, they are considered plan assets for GAAP purposes.*
- *The auditor was engaged to report on the supplemental schedules in accordance with AU-C section 725.*

Note: Paragraph .11 of AU-C section 725 states that when the auditor's report on the audited financial statements contains an adverse opinion or a disclaimer of opinion and the auditor has been engaged to report on whether supplementary information is fairly stated, in all material respects, in relation to such financial statements as a whole, the auditor is precluded from expressing an opinion on the supplementary information. The auditor's report on the supplementary information should state that because of the significance of the matter disclosed in the auditor's report, it is inappropriate to, and the auditor does not, express an opinion on the supplementary information.

INDEPENDENT AUDITOR'S REPORT

[*Appropriate Addressee*]

Report on the Financial Statements[41]

We have audited the accompanying financial statements of ABC Company 403(b) plan, which comprise the statements of net assets available for benefits 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 related notes to the financial statements.

Management's Responsibility for the Financial Statements

Management is responsible for the preparation and fair presentation of these financial statements in accordance with accounting principles generally accepted in the United States of America; this includes the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error.

Auditor's Responsibility

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 audits to obtain reasonable assurance about whether the financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control

[41] See footnote 2.

relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our adverse audit opinion.

Basis for Adverse 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, 20X2, and 20X1, 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, 20X2. 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.

Adverse Opinion

In our opinion, because of the significance of the matter discussed in the Basis for Adverse Opinion paragraph, the financial statements referred to above do not present fairly the net assets available for benefits of the Plan as of December 31, 20X2, and 20X1 and the changes in its net assets available for benefits for the year ended December 31, 20X2, in accordance with accounting principles generally accepted in the United States of America.

Other Matter—Report on Supplemental Schedules

Our audits were conducted for the purpose of forming an opinion on the financial statements 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 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. Because of the significance of the matter described in the Basis for Adverse Opinion paragraph, it is inappropriate to, and we do not express an opinion on, the supplementary information referred to above.

[*Signature of Firm*]

[*City and State*]

[*Date*]

Section 7: **Illustrative Form 5500 Schedules**

7.01 The 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

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

Author's Note:
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 section 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. Participant loans are required to be reported on the schedule because they are considered investments for purposes of reporting and disclosure in the Form 5500, despite the fact that they are not considered investments for purposes of the financial statements prepared in accordance with accounting principles generally accepted in the United States of America.
- In a plan's initial year, the 5-percent threshold for Schedule H, line 4j—Schedule of Reportable Transactions may be 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). In addition, investments in Internal Revenue Code (IRC) Section 403(b) annuity contracts and IRC Section 403(b)(7) custodial accounts should also be treated as one asset held for investment for purposes on the line 4i schedules.
- 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 (Including Delinquent Loan Repayments)

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 (ERISA), as amended, regardless of materiality. Such transactions constitute either a use

of plan assets for the benefit of the employer or a prohibited extension of credit. In certain circumstances, such transactions may even be considered an embezzlement of plan assets.

7.04 Delinquent remittance of participant loan repayments is a prohibited transaction. 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 on the transaction. Information on delinquent participant contributions should not be reported on line 4d of Schedule H or Schedule I or on Schedule G.

7.05 In Advisory Opinion 2002-2A, the Department of Labor concluded that although not subject to the participant contribution regulation (Title 29 U.S. *Code of Federal Regulations* [CFR] Part 2510.3-102), 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.

7.06 Accordingly, the Department of Labor 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.

7.07 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.

7.08 Delinquent forwarding of participant loan repayments is eligible for correction under the Voluntary Fiduciary Correction Program and Prohibited Transaction Exemption 2002-51 on terms similar to those that apply to delinquent participant contributions.

7.09 For further guidance, see the instructions to Form 5500 and the frequently asked questions on the Employee Benefits Security Administration website at www.dol.gov/ebsa/faqs/faq_compliance_5500.html.

1. SCHEDULE OF DELINQUENT PARTICIPANT CONTRIBUTIONS

7.10

Sample 401(k) Plan
EIN: 55-5555555
Plan Number: 001

Schedule H, line 4a—Schedule of Delinquent Participant Contributions for the Year Ended December 31, 20X2

		Total That Constitutes Nonexempt Prohibited Transactions			
Participant Contributions Transferred Late to the Plan	*Check Here if Late Participant Loan Repayments Are Included*	*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 Prohibited Transaction Exemption 2002-51*
Check here if Late Participant Loan Repayments Are Included:					
		$—	$68,372	$—	$—
		$—	$72,633	$—	$—

2. SCHEDULE OF ASSETS (HELD AT END OF YEAR)

7.11

SCHEDULE H, Line 4i
DEF Holdings, Inc. 401(k) Plan
Plan Sponsor: DEF Holdings, Inc.
Plan Sponsor EIN: 55-5555555
Plan Number: 002

Schedule H, line 4i—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			
	Interest-bearing cash accounts			
*	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=4.5% to 6%			574,816
	TOTAL INVESTMENTS		$20,442,094	$23,068,710

* Represents a party in interest to the plan.

[1] Historical cost information is not 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.

7.12

SCHEDULE H, Line 4i
AB&C Enterprises
401(k) Retirement Plan
EIN: 55-5555555
Plan Number: 001

Schedule H, line 4i—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.

7.13

Sample Company Retirement Plan
EIN: 55-5555555
Plan Number: 001

Schedule H, line 4i—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 3.25% 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.

7.14

SCHEDULE H, Line 4i
Sample Company, Inc. Pension Plan
EIN: 55-5555555
Plan Number: 002

(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
*	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

* A party in interest, as defined by the Employee Retirement Income Security Act of 1974, as amended.

7.15

Sample Employee Stock Ownership Plan
EIN: 55-5555555
Plan Number: 001

Schedule H, line 4i—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 party in interest, as defined by the Employee Retirement Income Security Act of 1974, as amended.

3. SCHEDULE OF ASSETS (ACQUIRED AND DISPOSED OF WITHIN YEAR)

7.16 The Schedule of Assets (Acquired and Disposed of Within Year) may be excluded due to the variety of investments that are exempt from being reported on this schedule. The exemptions include the following:

- Debt obligations of the United States
- Interests issued by a company registered under the Investment Company Act of 1940
- Bank certificates of deposit with a maturity of not more than one year
- Certain commercial paper with a maturity of not more than nine months
- Participation in a bank common or collective trust
- Participation in an insurance company pooled separate account
- Certain securities purchased from a person registered as a broker/dealer under the Securities Exchange Act of 1934
- Certain investment assets reported in other supplemental schedules

7.17

Sample Company Profit Sharing Plan
EIN: 55-5555555
Plan Number: 001

Schedule H, line 4i—Schedule of Assets (Acquired and Disposed of Within the Year) for the Year Ended December 31, 20X2

(a) Identity of Issue, Borrower, Lessor, or Similar Party	(b) Description of Investment, Including Maturity Date, Rate of Interest, Collateral, Par, or Maturity Value	(c) Cost of Acquisitions	(d) Proceeds of Dispositions
ABC Bank	Balanced fund	$150,000	$10,450
DEF Bank	Index fund	$275,000	$25,475
XYZ Trust Company	Growth fund	$310,000	$28,550
		$735,000	$64,475

4. SCHEDULE OF REPORTABLE TRANSACTIONS

7.18

Sample Company Retirement Plan
EIN: 55-5555555
Plan Number: 001

Schedule H, line 4j—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	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	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	$432,278	$ 3,006
DEF Growth Fund	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 fair value as of December 31, 20X1.

7.19

XYZ Profit Sharing Program
EIN: 55-5555555
Plan Number: 002

Schedule H, line 4j—Schedule of Reportable Transactions for the Year Ended December 31, 20X2

(a) Identity of Party 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.

7.20

Sample Company, Inc., Pension Plan
EIN: 55-5555555
Plan Number: 002

Schedule H, line 4j—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

7.21 This schedule is prepared using the alternative method of reporting (H) series transactions under 29 CFR 2520.103-b(d)(2).

7.22

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 H, line 4j—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	—
* GHI Bank	GHI Bank stock index fund	22	—	758,650	N/A	—
* GHI Bank	GHI Bank stock index fund	—	8	—	4,051,452	1,180,478
* GHI Bank	GHI Bank bond index fund	16	—	1,101,452	—	—
* GHI 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.

7.23

Sample Association Retirement Plan
EIN: 55-5555555
Plan Number: 001

Schedule H, line 4j—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.

5. SCHEDULE OF LOANS OR FIXED INCOME OBLIGATIONS IN DEFAULT OR CLASSIFIED AS UNCOLLECTIBLE—SCHEDULE G, PART I

7.24 This schedule lists loans or fixed-income obligations for which required payments have not been made by the due date; that have matured but have not been paid and determined that payment will not be made; and loans that were in default even if renegotiated during the year. The due date, payment amount, and conditions for determining default of a note or loan are contained in the note agreement or loan policy. Do not include on this schedule participant loans under an individual account plan, made in accordance with 29 CFR 2550.408b-1, and that are secured by the remaining account balance. Include the following:

- Identify each obligor known to be a party in interest
- Identity and address of the obligor
- A detailed description of the loan, including the dates of making and maturity, interest rate, the type and value of collateral, any renegotiation of the loan and the terms of the renegotiation, along with other material items
- Original amount of loan
- Principal received during the plan year
- Interest received during the plan year
- Unpaid balance at the end of the year
- Principal amount overdue
- Interest amount overdue

6. SCHEDULE OF LEASES IN DEFAULT OR CLASSIFIED AS UNCOLLECTIBLE—SCHEDULE G, PART II

7.25 This schedule lists any leases in default (when requirement payment[s] has not been made) or classified as uncollectible (when there is little probability that the missed payments will be made). Include the following items on the Schedule of Leases in Default or Classified as Uncollectible—Schedule G, Part II, in the appropriate columns as indicated in the instructions to the Form 5500 supplemental schedules:

- Identify each obligor known to be a party in interest
- Identity of lessor or lessee
- Relationship to plan, employer, employee organization, or other party-in-interest
- Terms and description (type of property, location, and date it was purchased, terms regarding rent, taxes, insurance, repairs, expenses, renewal options, date property was leased)
- Original cost
- Current value at time of the lease
- Gross rental receipts during the plan year
- Expenses paid during the plan year
- Net receipts
- Amount of lease payments that are in arrears as of the end of the plan year

7. SCHEDULE OF NONEXEMPT TRANSACTIONS—SCHEDULE G, PART III

7.26

Sample Company Profit Sharing Plan
EIN: 55-5555555
Plan Number: 001

Schedule G, Part III—Schedule of Nonexempt Transactions for the Year Ended December 31, 20X2

(a) Identity of Party Involved	*(b) Relationship to Plan, Employer, 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 (GAAS Audits)**

8.01 This section pertains to generally accepted auditing standards audits only. For audits of issuers, such as Form 11-K audits, the guidance in AU 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-C section 265, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*), addresses the auditor's responsibility to appropriately communicate deficiencies in internal control that the auditor has identified in an audit of financial statements to those charged with governance and management. Those charged with governance is defined in AU-C section 260, *The Auditor's Communication With Those Charged With Governance* (AICPA, *Professional Standards*). AU-C section 265 specifies which identified deficiencies the auditor is required to communicate to those charged with governance and management. Paragraph .11 of AU-C section 265 states that the auditor should communicate in writing to those charged with governance on a timely basis significant deficiencies and material weaknesses identified during the audit, including those that were remediated during the audit.

8.03 When reading a type 1 or type 2 SOC 1[SM] report for a service organization, the user auditor may become aware of situations at the service organization or with the use of a service organization that constitute significant deficiencies or material weaknesses for the user organization. In accordance with paragraph .A40 of AU-C section 402, *Audit Considerations Relating to an Entity Using a Service Organization* (AICPA, *Professional Standards*), matters related to the use of a service organization that the user auditor may identify during the audit and may communicate to management and those charged with governance of the user entity include the following:

- Any needed monitoring controls that could be implemented by the user entity, including those identified as a result of obtaining a type 1 or type 2 SOC 1 report
- Instances when relevant complementary user entity controls identified in the type 1 or type 2 SOC 1 report are not implemented at the user entity
- Controls that may be needed at the service organization that do not appear to have been implemented or that were implemented, but are not operating effectively

8.04 The auditor also may communicate other control-related matters, including deficiencies that are not significant deficiencies or material weaknesses.

8.05 Paragraphs .12–.13 of AU-C section 265 state that the auditor also should communicate to management at an appropriate level of responsibility, on a timely basis

- in writing, significant deficiencies and material weaknesses that the auditor has communicated or intends to communicate to those charged with governance, unless it would be inappropriate to communicate directly to management in the circumstances, and
- in writing or orally, other deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention. If other deficiencies in internal control are communicated orally, the auditor should document the communication.

The communication should be made no later than 60 days following the report release date.

8.06 This standard is not applicable if the auditor is engaged to examine the design and operating effectiveness of an entity's internal control over financial reporting that is integrated with an audit of the entity's financial statements 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*). 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 those charged with governance or others (for example, internal auditors or governmental authorities).

8.07 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-C section 265. 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

8.08 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 DEFICIENCY, SIGNIFICANT DEFICIENCY, AND MATERIAL WEAKNESS

8.09 In accordance with paragraph .07 of AU-C section 265, a *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis.

A *deficiency in design* exists when

- a control necessary to meet the control objective is missing, or
- an existing control is not properly designed so that even if the control operates as designed, the control objective would not be met.

A *deficiency in operation* exists when

- a properly designed control does not operate as designed, or
- the person performing the control does not possess the necessary authority or competence to perform the control effectively.

8.10 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.

8.11 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 the Financial Accounting Standards Board *Accounting Standards Codification* glossary.[1]

EVALUATING IDENTIFIED DEFICIENCIES IN INTERNAL CONTROL

8.12 Paragraph .09 of AU-C section 265 states that if the auditor has identified one or more deficiencies in internal control, the auditor should evaluate each deficiency to determine, on the basis of the audit work performed, whether, individually or in combination, they constitute significant deficiencies or material weaknesses. Paragraph .A5 of AU-C section 265 states that the severity of a deficiency, or a combination of deficiencies, in internal control depends not only on whether a misstatement has actually occurred but also 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.

[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.

Significant deficiencies and material weaknesses may exist even though the auditor has not identified misstatements during the audit.

8.13 According to paragraph .A6 of AU-C section 265, factors that affect the magnitude of a misstatement that might result from a deficiency, or deficiencies, in internal control include, but are not limited to, the following:

- The financial statement amounts or total of transactions exposed to the deficiency
- The volume of activity (in the current period or expected future periods) in the account or class of transactions exposed to the deficiency

THE PRUDENT OFFICIAL TEST

8.14 Paragraph .10 of AU-C section 265 states that if the auditor determines that a deficiency, or a combination of deficiencies, in internal control is not a material weakness, the auditor should consider whether prudent officials, having knowledge of the same facts and circumstances, would likely reach the same conclusion.

Reporting

MANAGEMENT LETTER COMMENTS

8.15 Paragraph .03 of AU-C section 265 states that nothing precludes the auditor from communicating to those charged with governance or management other internal control matters that the auditor has identified during the audit. As stated in paragraphs .A24–.A25 of AU-C section 265, during the audit, the auditor may identify other deficiencies in internal control that are not significant deficiencies or material weaknesses but that may be of sufficient importance to merit management's attention. The communication of other deficiencies in internal control that merit management's attention need not be in writing. These matters often are referred to as *management letter comments* (MLCs).

8.16 This section shows illustrative management letters and illustrative MLCs that have been communicated to management on actual employee benefit plan audits to illustrate 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-C section 265 provides guidance on how to evaluate identified deficiencies in internal control and how to determine whether deficiencies are significant deficiencies or material weaknesses. When a letter is issued in accordance with AU-C section 265, these other matters may be communicated in the letter, as well (see AU-C section 265 for guidance). Alternatively, a separate management letter may be issued as illustrated subsequently (only for those matters not considered to be significant deficiencies or material weaknesses).

Reporting Excerpts

REPORTS FOR CONTROL DEFICIENCIES THAT ARE NOT SIGNIFICANT DEFICIENCIES OR MATERIAL WEAKNESSES

8.17 The following reports illustrate typical management letters when there are 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 .A34–.A36 and .A39 of AU-C section 265 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, in accordance with auditing standards generally accepted in the United States of America, we considered the plan's internal control over financial reporting (internal control) as a basis for designing audit procedures that are appropriate in the circumstance for the purpose of expressing our opinion on the financial statements and supplemental schedules, but not for the

purpose of expressing an opinion on the effectiveness of the plan's internal control. Accordingly, we do not express an opinion on the effectiveness of the plan's internal control.

A deficiency in internal control exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct, misstatements on a timely basis. A material weakness is a deficiency, or a combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the plan's financial statements will not be prevented, or detected and corrected, on a timely basis.

Our consideration of internal control was for the limited purpose described in the first paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses. Given these limitations, during our audit we did not identify any deficiencies in internal control that we consider to be material weaknesses. However, material weaknesses may exist that have not been identified.

This communication is intended solely for the information and use of plan management 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

8.18

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 that 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). 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 listed in the table of contents thereto. Our principal recommendations are summarized below.

[*Insert comments here.*]

This communication is intended solely for the information and use of plan management 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

8.19

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

8.20 The following illustrative MLCs 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-C section 265 for guidance.

8.21 This section contains the following illustrative MLCs:

1. Benefits	Accumulated Plan Benefit Obligations
	Benefit Obligations (Health and Welfare Benefit Plan)
	Benefit Payments
2. Contributions	Participant or Employee Contributions
	Employer Contributions
	Excess Contribution Deferrals
	Rollovers
3. Distributions	Hardship Withdrawals
	Improper Calculation of Benefits
	Improper or Missing Benefit Approval
	Improper Payment of Benefits
	Lack of Reconciliation or Review of Benefits
	Taxability of Distributions
	Miscellaneous Distributions
	Qualified Domestic Relations Order
4. Investments	Lack of Review of Investment Valuation
	Lack of Investment Policy
	Lack of Investment Appraisals
	Uninvested Assets
	Lack of Historical Cost Data for Nonparticipant-Directed Investments
	Nonverification of Investment Income
5. Notes Receivable	Notes Receivable from Participant
	Improper Execution of Loans
6. Participant Data Testing	Participant Accounts
7. Internal Control	Internal Controls

(continued)

8. Administrative Matters	Regulatory Compliance Investment Policy Guidelines Segregation of Duties Dual Signatures Accuracy of Data Sent From Third Party Administrator Accuracy of Employee Data Use of Third Party Administrators Minutes of Trustees' Meetings Plan Fees and Expenses
9. Other Matters	Monitoring Compliance With Service Agreements Fiduciary Liability Insurance Leased Employees Nondiscrimination Rules Plan Administration Reconciliations Plan Compensation Authorization of Plan Expenses Eligibility Adopting Employers Demographic Data

1. BENEFITS

ACCUMULATED PLAN BENEFIT OBLIGATIONS

8.22

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, data extraction software, such as ACL or IDEA, 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.

8.23

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 possesses 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)

8.24

Issue:

During our testing, we noted several instances of missing or incomplete information, including missing supporting documentation for participant enrollments and missing or incomplete documentation for claims processed by [*third party claims administrator*]. Maintaining proper documentation regarding participant data and claims safeguards the plan and the plan sponsor.

Recommendation:

Procedures should be implemented to ensure all enrollment forms and supporting documentation for claims processed are maintained. A plan sponsor's fiduciary responsibility includes acting solely in the interest of plan participants and their beneficiaries with the exclusive purpose of providing benefits to them, carrying out their duties prudently, and following the plan documents. Therefore, properly processing plan transactions on behalf of participants, including those outsourced to third parties, is critical.

BENEFIT PAYMENTS

8.25

Issue:

During our testing of benefit payments during 20X2, we noted two instances in which a participant requested a distribution of his or her account in the defined contribution plan of ABC Company. However, the participant received a distribution of his or her account from the tax sheltered annuity plan of ABC Company in error because plan sponsor personnel incorrectly processed the participants' requests.

Recommendation:

We recommend that the plan sponsor correct these errors, review other distribution requests to assure other participant requests were properly processed, and develop and execute policies and procedures requiring review of distributions by an employee other than the individual preparing the requests prior to submission to the third party record keeper for processing and payment. A plan sponsor's fiduciary responsibility includes acting solely in the interest of plan participants and their beneficiaries with the exclusive purpose of providing benefits to them, carrying out their duties prudently, and following the plan documents. Therefore, properly processing plan transactions on behalf of participants, including those outsourced to third parties, is critical. In addition, prohibited transactions may arise from improper distributions, subjecting the plan sponsor to penalties.

8.26

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 XXX 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 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.

2. CONTRIBUTIONS

PARTICIPANT OR EMPLOYEE CONTRIBUTIONS

a. Timely Deposit of Participant Contributions

8.27

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.

8.28

Issue:

During our audit, we found that one employee who elected to make deferrals and, therefore, also to receive matching contributions was not given the opportunity to do so. This occurred due to the employee setting a maximum limit on his or her contributions that had to be manually stopped once the employee reached the maximum in the previous year. For 20X2, his or her deferral contribution rate was not reset, resulting in no deferral contributions in 20X2.

Recommendation:

We recommend the plan sponsor develop and execute policies and procedures to frequently review employee contributions to ensure the proper deferrals are withheld. 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.

8.29

Issue:

During the audit of the plan for the year ended December 31, 20X2, we noted several instances in which amounts withheld from participants were not remitted to the plan in a consistent manner. The 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. Furthermore, the participant contributions must be remitted timely and in a consistent manner.

Recommendation:

We recommend the plan sponsor review the procedures for remitting amounts withheld from participants to the plan and determine a timeline upon which deferred amounts can be reasonably segregated from the company's general assets and implement procedures to ensure that the remittances are made timely and consistently in accordance with such timeline.

b. Inaccurate Contribution Percentages

8.30

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 plan management consult with an ERISA specialist as soon as possible to determine options for correction and to address possible amendment to the plan's terms going forward. Failure to timely correct the errors could potentially result in the loss of the plan's tax qualified status.

c. Inaccurate Deduction or Calculations

8.31

Issue:

We noted that contribution deductions were not properly calculated for certain participants receiving manual checks.

Recommendation:

We recommend plan management correct these errors and make the participants whole by contributing the missed deferrals and earnings thereon, as well as implement controls or programming check changes to ensure these types of errors do not continue.

8.32

Issue:

It was noted during our audit procedures that there was inconsistency in the application of the terms in the plan document relating to the definition of eligible compensation for the purposes of calculating employee and employer contributions. Certain participants at several locations did not receive deferrals on total compensation, including bonuses and overtime, as provided for per the definition of compensation in the plan document.

Recommendation:

We recommend the plan sponsor uniformly train all personnel who work with the plan and review the setup of deductions in the payroll system to ensure all locations are operating in the same manner and are calculating deferral amounts consistent with the terms of the plan document. In addition, we recommend plan management correct and make the participants whole by contributing the missed deferrals and earnings thereon.

8.33

Issue:

We noted during our audit that the plan document permits a separate election for a deferral on each bonus that is paid.

Recommendation:

We recommend that the plan sponsor require bonus recipients to clearly document whether the recipient elects 401(k) deferrals withheld from each bonus.

d. Accuracy of Administering Contribution Election Changes

8.34

Issue:

We noted several instances in which a participant's change in elective contributions was not properly or not timely processed by the payroll department upon notification by the third party record keeper.

Recommendation:

We recommend plan management review policies and procedures for implementing deferral changes in the payroll system and implement additional procedures requiring review of the processing of the changes received from the third party record keeper. A plan sponsor's fiduciary responsibility includes acting solely in the interest of plan participants and their beneficiaries with the exclusive purpose of providing benefits to them, carrying out their duties prudently, and following the plan documents. Therefore, properly processing plan transactions on behalf of participants, including those outsourced to third parties, is critical.

e. Participant Deferrals

8.35

Issue:

During our audit, we noted that 1 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.

8.36

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

8.37

Issue:

We noted that forfeitures totaling approximately $200,000 and $18,000 for 20X2 and 20X1, respectively, were not used to reduce employer contributions and any remainder allocated to participants as provided for per the terms of the plan document.

Recommendation:

We recommend investigating any unallocated forfeitures to ascertain timely disposition and consulting with ERISA counsel regarding the disposition of forfeitures. Going forward, at least annually, forfeitures should be addressed to assure compliance with plan documents.

The IRC does not allow plan administrators to place forfeited amounts into a plan suspense account allowing them to accumulate over several years. Forfeitures must be used or allocated in the plan year incurred. The IRC does not authorize forfeiture suspense accounts to hold unallocated monies beyond the plan year in which they arise. Revenue Ruling 80-155 states that a defined contribution plan will not be qualified unless all funds are allocated to participant's accounts in accordance with a definite formula defined in the plan.

b. Adoption Agreement

8.38

Issue:

We understand the company is considering making a matching contribution to the plan in 20X3. Since the inception of the plan and through the year ended December 31, 20X2, employer contributions were not made to the plan. The plan provisions outlined in the adoption agreement are contradictory with regard to the discretionary matching provisions, and we believe it is questionable whether any employer match is allowed under the current plan provisions.

Recommendation:

We recommend consulting with an ERISA specialist and considering an amendment to the adoption agreement prior to making an employer contribution to the plan in order to determine the need to clarify the contradictory language related to the discretionary match.

c. Incorrect Definition of Compensation and Incorrect Calculation of Employer Contribution

8.39

Issue:

Our testing of employer contributions noted 2 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 the payroll provider. 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 exclude bonuses from the calculation of employee deferrals, plan management should implement a policy requiring documentation from each employee authorizing such a deviation from a previously signed election. Regarding the 1,000 hour requirement for the company optional contribution, plan management should correct prior errors and consider amending the plan to properly reflect the intent of the company and maintain administrative ease or implement procedures 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.

We also recommend 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.

d. Other

8.40

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 the plan's investment performance, monitoring service providers, approving retiree benefits, approving discretionary employer contributions, approving the annual audit of the plan, and other such plan activity on a periodic basis.

8.41

Issue:

The plan does not retain ERISA counsel.

Recommendation:

Due to the unique regulations of ERISA, the IRS, and the DOL as they relate to employee benefit plans, we recommend retaining outside counsel with a specialization in the employee benefits area and ERISA. We understand the custodian has in-house counsel but feels consideration should be given to retaining counsel to independently review the plan document and plan operations.

e. Employer Matching Contributions

8.42

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.

8.43

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.

8.44

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 the payroll provider.

Recommendation:

We recommend that the plan sponsor have all locations utilize the matching function on the payroll provider 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.

8.45

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.

f. Accuracy of Recording Plan Contributions

8.46

Issue:

We noted that funds transferred to the plan's trust are not reconciled to the company's wires and payroll registers each pay period to ensure proper receipt and recording by the custodian.

Recommendation:

We recommend plan management implement controls and procedures to ensure all contributions are accurately transmitted and recorded properly and timely as plan assets. Ongoing reconciliation with each pay period would serve to prevent prohibited transactions resulting from amounts withheld and not timely remitted to the plan.

g. Plan Contribution Limits

8.47

Issue:

During our audit, we noted 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 in excess of the plan's established limit, per the provisions of the plan document.

Recommendation:

We recommend the plan sponsor develop and execute policies and procedures to ensure 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 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.

8.48

Issue:

During our audit, we noted a number of participants who received matching contributions exceeding the plan's established limit, per the provisions of the plan document.

Recommendation:

We recommend 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.

8.49

Issue:

During our audit, we noted one participant received an employer matching contribution in excess of the plan's specified limits.

Recommendation:

We recommend the plan sponsor develop and execute policies and procedures to review employer matching contributions and assure contributions are calculated according to the plan's provisions. It is our understanding that the plan sponsor has determined that self-correction under the IRS's Self-Correction Program offered by Revenue Procedure 2008-50 was not available; however, it has self-corrected the excess contribution in accordance with the guidelines contained in Revenue Procedure 2008-50. 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

8.50

Issue:

We noted, due to failure of required nondiscrimination testing, excess contributions refunded subsequent to year-end of approximately $120,000. As such, numerous highly compensated employees (HCEs) were not able to defer the entire amount they elected to defer under the terms of the plan.

Recommendation:

We recommend plan management establish procedures to determine maximum percentages allowed for contributions by HCEs in order to eliminate the need for refund of these excess amounts.

In addition, we recommend plan management consider implementing a nonqualified deferred compensation plan to which the excess annual deferrals can be contributed. Implementation of a nonqualified deferred compensation plan will enable select HCEs to shelter the maximum amount permitted by law.

b. Timing of Excess Deferral Refunds

8.51

Issue:

A plan must pass certain nondiscrimination tests under IRC Sections 401(k) and 401(m). If a plan fails the annual testing, corrective action must be taken to protect the qualified status of the plan. The law and related regulations provide various methods for correcting mistakes during certain correction periods. For this purpose, the statutory correction period is the 12-month period following the close of the plan year in which the mistake occurs. If corrective distributions are made to HCEs after the first $2^1/_2$ months after the plan year-end, the employer (not the HCE) is liable for an excise tax. If correction is not made within the 12-month correction period, the plan is considered to have lost its tax qualified status. Therefore, any excess deferrals should be returned to plan participants within $2^1/_2$ months after the plan year-end in order to avoid a 10-percent excise tax on the amount not timely refunded under IRC Section 4979.

We noted the plan had aggregate excess annual deferral refunds in excess of $100,000 for the 20X2 plan year and were unable to obtain the payroll data necessary to calculate the refund within a $2^1/_2$ month period. As a result, the company owed an excise tax of more than $10,000 for the 20X2 plan year.

Recommendation:

We recommend plan management consider implementing limits for HCE contributions in order to avoid testing failures and, in the event testing failures occur, establish procedures to ensure that any excess annual deferrals be refunded within the $2^1/_2$ month period to avoid excise taxes.

c. Distribution of Excess Deferrals to Terminated Employees

8.52

Issue:

We noted an employee who received a distribution from the plan during the 20X2 plan year required an actual deferral percentage (ADP) excess contribution refund for that year. This resulted in incorrect recording of the distribution.

Recommendation:

We recommend 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

8.53

Issue:

We noted, based on the information provided, that 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. In general, 410(b) sets out rules on who the plan must cover.

Recommendation:

We recommend plan management review the provisions of the 410(b) coverage requirements and implement procedures to ensure the plan will pass this test for upcoming years.

ROLLOVERS

Author's Note:
In situations in which an issue has been identified and a recommendation made, consider consulting with ERISA counsel regarding available options for correction.

8.54

Issue:

During our testing of rollover contributions, we noted six exceptions for participants tested. For each of these participants, the rollover was improperly deposited into the 401(k) plan of ABC Company instead of the profit sharing plan of ABC Company. If such transactions are construed as a breach of fiduciary duty, penalties against the plan sponsor may apply or such could be considered prohibited transactions, or both.

Recommendation:

We recommend the rollover funds be deposited into the correct plan as soon as possible and recommend implementing a procedure to ensure all rollovers are reviewed on an ongoing basis to verify that the rollover funds are deposited into the correct plan.

3. DISTRIBUTIONS

HARDSHIP WITHDRAWALS

8.55

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 were inappropriately made on the improper participant deferrals.

Recommendation:

We recommend 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.

8.56

Issue:

During our testing, we noted there is no formal review process for hardship distributions. If a 401(k) plan provides for hardship distributions, it must provide the specific criteria used to make the determination of hardship. In determining the existence of a need and of the amount necessary to meet the need, the plan must specify and apply nondiscriminatory and objective standards. Generally, employers rely on the employee's representation that he or she is experiencing an immediate and heavy financial need that cannot be relieved from other resources. However, an employer cannot rely on an employee's representation if the employer has actual knowledge that the employee's need can be relieved through other means. Employers use one of two methods to issue financial hardship withdrawals, proof of need whereby the employer requires financial proof of the need for the distribution or self-certification, which does not require participants to disclose their finances.

Recommendation:

Given the regulations surrounding hardship distributions, we recommend consulting with an ERISA specialist and implementing formal review and documentation processes for hardship distributions.

IMPROPER CALCULATION OF BENEFITS

a. Improper Calculation of Vesting

8.57

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 plan management establish procedures for review of the vesting calculations prior to authorizing the distribution to participants. 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.

b. Improper Support for Calculation

8.58

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 due to a lack of supporting documentation regarding the hours of service worked during employment.

Recommendation:

ERISA requires that plan administrators retain records supporting information included in the annual reports and disclosures for six years from the date the annual reports were filed (ERISA Section 107) and are sufficient to determine the benefits due or which may become due (ERISA Section 209). We recommend plan management establish procedures to recalculate monthly accrued benefits on a select basis for retirees and review benefit files in order to determine that all information necessary to recompute a participant's benefit is maintained.

c. Improper Valuation Period

8.59

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 plan management review the provisions of the plan document and the operating procedures in effect to determine if an amendment or a change in operating procedure is necessary. We also recommend that the plan sponsor consult with an ERISA specialist as soon as possible regarding available options for correction.

d. Improper Credited Service

8.60

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, pursuant to the terms of the plan, an individual was required to be on medical leave for six months prior to he or she qualifying for worker's compensation payments, and this six-month period was not treated consistently.

Recommendation:

We recommend plan 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 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 Spousal Consent: Termination Benefits

8.61

Issue:

We noted a number of instances in which a 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 plan 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 under $5,000.

b. Lack of Spousal Consent: Hardship Benefits

8.62

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 plan 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

8.63

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 without being recomputed. If the participant was under age 65, this resulted in underpayment of the lump sum.

In addition, we noted the timing of the cash-out was inconsistent. The cash-out varied from 2 months to 26 months after termination.

Recommendation:

We recommend plan 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

8.64

Issue:

We noted on several occasions that an individual was approved for a second lump sum payout, having already received a first payment. According to the trustee, these participants received the second payment and, thus, were paid more than that to which they were entitled.

Recommendation:

We recommend that the plan's management contact the participants to request a refund or otherwise 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

8.65

Issue:

We noted that the trustee's reconciliation report contains a section, "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.

d. Benefits Paid From Incorrect Plan

8.66

Issue:

During our audit, we noted that a beneficiary of a death benefit was erroneously paid out of the wrong plan.

Recommendation:

We recommend implementing a process whereby distribution forms are reviewed for accuracy prior to processing. Additionally, we recommend implementing specific processes for review of distribution forms surrounding death benefits.

LACK OF RECONCILIATION OR REVIEW OF BENEFITS

a. Lack of Reconciliation

8.67

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 plan 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)

8.68

Issue:

We noted for distributions paid by check that benefit check endorsements are not compared with signatures in applicable participant records.

Recommendation:

We recommend plan management establish procedures to periodically test a sample of benefit check endorsements to signatures in applicable participant records.

c. Calculations by Third Parties

8.69

Issue:

We understand that retirement payments are calculated by an external third party and not by the plan administrator. During our testing, we noted one monthly retirement payment to a participant was calculated using the incorrect number of months of service.

Recommendation:

We recommend plan 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 select basis.

d. Payment From Improper VEBA Trust

8.70

Issue:

We noted during fiscal 20X2 that 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 plan 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 20X3 plan year-end.

TAXABILITY OF DISTRIBUTIONS

a. Failure to Withhold on Amounts Greater Than $200

8.71

Issue:

We noted several instances in which distributions greater than $200 did not withhold the mandatory 20-percent taxes.

Recommendation:

We recommend plan 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 plan management establish procedures to ensure that all participants complete the mandatory withholding acknowledgement form.

b. Improper Tax Withholding on Minimum Required Distributions

8.72

Issue:

We noted 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 plan 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.

MISCELLANEOUS DISTRIBUTIONS: NONVERIFICATION OF DISABILITY STATUS FOR BENEFITS

8.73

Issue:

Per review of the plan document, we noted 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 plan management establish procedures to periodically obtain proof from these individuals to verify the continuance of their disability.

QUALIFIED DOMESTIC RELATIONS ORDER: IMPROPER QUALIFIED DOMESTIC RELATIONS ORDER EXECUTION

8.74

Issue:

We noted 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 plan management establish procedures to review the calculation of distributions in accordance with the terms of the QDRO before authorization and release of the distribution.

4. INVESTMENTS

LACK OF REVIEW OF INVESTMENT VALUATION

8.75

Issue:

We noted there is no formal policy to review investment valuation.

Recommendation:

Investments are the most significant assets in a benefit plan, and plan management is responsible for ensuring proper valuation and reporting of those assets. Each different investment has unique valuation and disclosure considerations. Even if outside investment custodians, asset or fund managers, or other service providers are used to assist in determining the value of investments reported in the plan's financial statements and on Form 5500, the DOL holds plan management responsible for the proper reporting of plan investments. This responsibility cannot be outsourced or assigned to a party other than plan management. Plan sponsors should have sufficient information to evaluate and independently challenge the valuation of plan investments. Therefore, it is important that plan management be familiar with the plan's investments and the methods and significant assumptions used to value them, especially for investments for which readily determinable market values do not exist.

We recommend plan management implement policies and procedures requiring formal review of investment valuation methods, including guidelines for challenging valuation, as applicable.

8.76

Issue:

We noted plan investments comprise a significant amount of alternative investments, or investments without a readily determinable fair value, and plan management does not follow a formal process to review investment valuation when third party pricing sources are used to value investments especially for fair value measurements that rely on broker quotes or outside pricing or valuation service providers.

Recommendation:

Investments are the most significant asset in a benefit plan, and plan management is responsible for ensuring proper valuation and reporting of those assets. Each different investment has unique valuation and disclosure considerations. Even if outside investment custodians, asset or fund managers, or other service providers are used to assist in determining the value of investments reported in the plan's financial statements and on Form 5500, the DOL holds plan management responsible for the proper reporting of plan investments. This responsibility cannot be outsourced or assigned to a party other than plan management. Plan sponsors should have sufficient information to evaluate and independently challenge the valuation of plan investments. Therefore, it is important that plan management be familiar with the plan's investments and the methods and significant assumptions used to value them, especially for investments for which readily determinable market values do not exist.

We recommend plan management implement policies and procedures requiring formal review of investment valuation methods including guidelines for challenging valuation, as applicable.

LACK OF INVESTMENT POLICY

8.77

Issue:

We noted during our audit that the plan has not adopted a formal investment policy.

Recommendation:

ERISA requires plan sponsors and employers to establish a prudent process for selecting investment alternatives and service providers; ensuring fees paid to service providers and other plan expenses are reasonable; determining that investment alternatives are prudent and

adequately diversified; and monitoring service providers and investment alternatives to assure they continue to be appropriate over time. As a means to assist the company in complying with this fiduciary responsibility, we recommend creating and frequently monitoring an investment policy statement. This investment policy statement would outline investment objectives, define the roles of those responsible for the plan's investments, describe the criteria and procedures for selecting investment options and investment managers and, among several other items, describe ways to address investment options and investment managers that fail to satisfy established objectives.

The investment policy statement would provide guidelines and support for crucial investment-related decisions made on behalf of the plan and should be reviewed at least annually and, if appropriate, can be amended to reflect changes in the markets, plan participant objectives, or other factors relevant to the plan. This process should be documented and recorded in the minutes to support the plan sponsor or employers' responsibility and fiduciary obligation under ERISA.

8.78

Issue:

We noted during our audit that 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 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, investment 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.

8.79

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 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.

8.80

Issue:

We noted the plan committee has not adopted a formal investment policy.

Recommendation:

We recommend plan management adopt a formal investment policy to document guidelines against which to measure investment performance and document fiduciary due diligence.

UNINVESTED ASSETS

8.81

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 more than $1 million.

Recommendation:

We recommend plan management 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

8.82

Issue:

We were unable to obtain from the trustee a detailed report of investment sales with historical cost information, and disclosure of this information is required by the DOL.

Recommendation:

We recommend plan management request from the trustee a report detailing the historical cost, selling price, quantity, identification, and acquisition date to assure proper disclosure and eliminate a potential issue as sales transactions increase and surpass the reportable transaction threshold.

NONVERIFICATION OF INVESTMENT INCOME

8.83

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 plan 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. NOTES RECEIVABLE

NOTES RECEIVABLE FROM PARTICIPANTS

8.84

Issue:

We noted that 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.

A 401(k) plan that permits participants to take loans sets forth the loan limits of IRC Section 72(p)(2) so that a loan to a plan participant will not be treated as a distribution to the participant. Thus, the plan provides for the appropriate dollar limit on loans, for level amortizations

over no longer than five years (longer if the loan is used to purchase a principle residence), and for payments to be made at least quarterly. If a loan does not satisfy the IRC's requirements, then the loan is deemed to be a taxable distribution to the participant. This can happen if the participant does not make the payments required under the terms of the loan. Failure to comply could result in penalties against the plan sponsor; possible reporting of prohibited transactions; and, ultimately, loss of the plan's tax qualified status.

Recommendation:

We recommend plan management amend the plan document to bring the participant loan provisions in accordance with the IRC. We recommend past transactions be reviewed and any not in compliance with the statutory limits be corrected and brought into compliance through an IRS corrections program.

8.85

Issue:

During our audit we noted that no written procedures exist for the processing and administration of loans. As a result, plan requirements and control procedures may not be clearly understood. A 401(k) plan that permits participants to take loans sets forth the loan limits of IRC Section 72(p)(2) so that a loan to a plan participant will not be treated as a distribution to the participant. Thus, the plan provides for the appropriate dollar limit on loans, for level amortizations over no longer than five years (longer if the loan is used to purchase a principle residence), and for payments to be made at least quarterly. If a loan does not satisfy the IRC's requirements, then the loan is deemed to be a taxable distribution to the participant. This can happen if the participant does not make the payments required under the terms of the loan. Failure to comply could result in penalties against the plan sponsor; possible reporting of prohibited transactions; and, ultimately, loss of the plan's tax qualified 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.

8.86

Issue:

We noted that the 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. A 401(k) plan that permits participants to take loans sets forth the loan limits of IRC Section 72(p)(2) so that a loan to a plan participant will not be treated as a distribution to the participant. Thus, the plan provides for the appropriate dollar limit on loans, for level amortizations over no longer than five years (longer if the loan is used to purchase a principle residence), and for payments to be made at least quarterly. If a loan does not satisfy the IRC's requirements, then the loan is deemed to be a taxable distribution to the participant. This can happen if the participant does not make the payments required under the terms of the loan. Failure to comply could result in penalties against the plan sponsor; possible reporting of prohibited transactions; and, ultimately, loss of the plan's tax qualified status.

Recommendation:

We recommend plan management amend the plan document to bring the participant loan provisions in accordance with the IRC. We recommend past transactions be reviewed and any not in compliance with the statutory limits be corrected and brought into compliance through an IRS corrections program.

8.87

Issue:

Loans in default are not administered in accordance with the plan document. A 401(k) plan that permits participants to take loans sets forth the loan limits of IRC Section 72(p)(2) so that a loan to a plan participant will not be treated as a distribution to the participant. Thus, the plan provides for the appropriate dollar limit on loans, for level amortizations over no longer than five years (longer if the loan is used to purchase a principle residence), and for payments to be made at least quarterly. If a loan does not satisfy the IRC's requirements, then the

loan is deemed to be a taxable distribution to the participant. This can happen if the participant does not make the payments required under the terms of the loan. Failure to comply could result in penalties against the plan sponsor; possible reporting of prohibited transactions; and, ultimately, loss of the plan's tax qualified status.

Recommendation:

ERISA and the IRS require loans deemed to be in default, as defined by the plan document, be treated as a distribution and a Form 1099 issued to the participant.

We recommend existing loans be reviewed and amended, if necessary, and we recommend past transactions be reviewed and any not in compliance with the statutory limits be corrected and brought into compliance through an IRS corrections program.

8.88

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 deleting the inactive account for this person to prevent activity being 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

8.89

Issue:

We noted several hard copy loan agreements lacked the signature of the employer, the lender, or the employee. A 401(k) plan that permits participants to take loans sets forth the loan limits of IRC Section 72(p)(2) so that a loan to a plan participant will not be treated as a distribution to the participant. Thus, the plan provides for the appropriate dollar limit on loans, for level amortizations over no longer than five years (longer if the loan is used to purchase a principle residence), and for payments to be made at least quarterly. If a loan does not satisfy the IRC's requirements, then the loan is deemed to be a taxable distribution to the participant. This can happen if the participant does not make the payments required under the terms of the loan. Failure to comply could result in penalties against the plan sponsor; possible reporting of prohibited transactions; and, ultimately, loss of the plan's tax qualified status.

Recommendation:

We recommend plan 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

8.90

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 document. A 401(k) plan that permits participants to take loans sets forth the loan limits of IRC Section 72(p)(2) so that a loan to a plan participant will not be treated as a distribution to the participant. Thus, the plan provides for the appropriate dollar limit on loans, for level amortizations over no longer than five years (longer if the loan is used to purchase a principle residence), and for payments to

be made at least quarterly. If a loan does not satisfy the IRC's requirements, then the loan is deemed to be a taxable distribution to the participant. This can happen if the participant does not make the payments required under the terms of the loan. Failure to comply could result in penalties against the plan sponsor; possible reporting of prohibited transactions; and, ultimately, loss of the plan's tax qualified status.

Recommendation:

We recommend plan 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

8.91

Issue:

We noted several instances in which the payroll deductions for notes receivable from participants were not started on a timely basis, resulting in outstanding loan balances that differed significantly from that scheduled per the loan amortization schedule. A 401(k) plan that permits participants to take loans sets forth the loan limits of IRC Section 72(p)(2) so that a loan to a plan participant will not be treated as a distribution to the participant. Thus, the plan provides for the appropriate dollar limit on loans, for level amortizations over no longer than five years (longer if the loan is used to purchase a principle residence), and for payments to be made at least quarterly. If a loan does not satisfy the IRC's requirements, then the loan is deemed to be a taxable distribution to the participant. This can happen if the participant does not make the payments required under the terms of the loan. Failure to comply could result in penalties against the plan sponsor; possible reporting of prohibited transactions; and, ultimately, loss of the plan's tax qualified status.

Recommendation:

We recommend plan 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.

d. Improper Support for Loans

8.92

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. A 401(k) plan that permits participants to take loans sets forth the loan limits of IRC Section 72(p)(2) so that a loan to a plan participant will not be treated as a distribution to the participant. Thus, the plan provides for the appropriate dollar limit on loans, for level amortizations over no longer than five years (longer if the loan is used to purchase a principle residence), and for payments to be made at least quarterly. If a loan does not satisfy the IRC's requirements, then the loan is deemed to be a taxable distribution to the participant. This can happen if the participant does not make the payments required under the terms of the loan. Failure to comply could result in penalties against the plan sponsor; possible reporting of prohibited transactions; and, ultimately, loss of the plan's tax qualified status.

Recommendation:

We recommend plan 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

a. Documentation Contained in Personnel Files

8.93

Issue:

During our testing of participant data, we noted 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 proper documentation be obtained and maintained in employee files to support plan operations. In addition, we recommend performing reviews of such data to assure accuracy of the data, as well as the plan's record of that data, in order to assure information used to calculate plan benefits is accurate.

b. Inconsistencies in Demographic Data

8.94

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 date of hire. 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 could result in the eligibility status of employees being incorrectly determined. Also, this affects other plans maintained by the company because it was noted that incorrect employee data was provided to the actuary, who uses the census data to perform Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 965, *Plan Accounting—Health and Welfare Benefit Plans*, and FASB ASC 960, *Plan Accounting—Defined Benefit Pension Plans* calculations of benefit obligations.

Recommendation:

We recommend any new or updated employee data entered into the system be reviewed to assure the data agrees with supporting documentation in the personnel files. In addition, the accuracy of employee data should be reviewed prior to transmittal to the actuary.

8.95

Issue:

During our testing of participant data, we noted several exceptions whereby the data maintained by the plan did not agree with personnel data on file at the company.

Recommendation:

Much of the operations and documentation for employee benefit plans is electronic; however, that does not relieve plan sponsors of their responsibility for the accuracy of plan data. Incorrect plan census data can affect the accuracy of matching contributions, vesting calculations, and benefit payments. We recommend plan management implement a policy requiring periodic review of data maintained by the plan to assure proper calculation of plan benefits.

8.96

Issue:

During our testing of participant data, we noted that deferral changes are not paperless, and plan management could not provide written documentation of the authorization of the change in the deferral percentage by several participants selected for testing.

Recommendation:

Documentation supporting all changes should be maintained as evidence of the appropriate authorization. Maintaining proper documentation regarding participant data serves to safeguard the plan and the plan sponsor and prevents improper deferrals. We recommend formalizing the policy regarding changes to deferral percentages and considering automating the process with the record keeper to enable a direct feed to the payroll department of changes made by participants directly on the record keeper's website. If participant-directed transactions are not properly and timely implemented, the plan sponsor must take action to correct any errors.

8.97

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 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 serves to safeguard the plan and the plan sponsor.

8.98

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 serves to safeguard the plan and the plan sponsor.

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.

8.99

Issue:

During our testing of benefit payments, we noted certain demographic information, per the record-keeping 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 the plan sponsor develop and execute policies and procedures to review and approve the participant data after it is entered into the record-keeping system by someone other than the individual submitting the information to ensure all required information is accurate and submitted for processing.

8.100

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 one participant was incorrectly reported as April 4, 20X2, and the Social Security number for one participant 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 notifying the actuary and requesting updated valuations as well as determining the impact on distribution calculations and funding requirements.

c. Monitoring of Accounts of Participants $70^1/_2$ Years of Age and Older

8.101

Issue:

We noted that there is no monitoring of accounts for participants who are $70^1/_2$ 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 $70^1/_2$ years of age or older to ascertain whether mandatory distributions are required to be paid from the accounts.

d. 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, 20X2, had been improperly included in the census data.

Recommendation:

We suggest the company implement a policy to review the census to assure any deceased participants and beneficiaries are properly excluded from the census data and cease receiving benefit payments as applicable. Additionally, we recommend the company implement a policy requiring review of the census for 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 those remaining on the census are accurate and not deceased. The company can utilize the website http://ssdi.rootsweb.com to assist in this task.

7. INTERNAL CONTROL

INTERNAL CONTROLS

Establish Internal Control Over Financial Statement Preparation and Review

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 any errors are detected and corrected on a timely basis.

Recommendation:

We recommend that formal bank reconciliations be prepared and independently reviewed 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:

We noted during our audit that the amount of the ERISA-required fidelity bond was insufficient.

Recommendation:

ERISA requires fidelity bonding for employee benefit plans. The bond is intended to protect the plan against loss of funds due to fraud or dishonesty. Generally speaking, coverage should be at least 10 percent of plan assets measured at the beginning of a plan year and need not be for less than $1,000 or more than $500,000 per plan ($1,000,000 for plans that have employer stock as an investment option). We suggest that you frequently assess the fidelity bonding coverage to comply with requirements.

8.106

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. Finally, the ERISA bond is not up to date, is not large enough, or does not name the plan as the insured.

Recommendation:

We recommend the plan sponsor adopt a written set of policies and procedures designed to mitigate the plan's risk with regard to regulatory compliance and to protect the plan fiduciaries as they carry out their duties related to the plan. These procedures should outline the various responsibilities applicable to plan administration and those parties that are responsible for executing the procedures.

INVESTMENT POLICY GUIDELINES

8.107

Issue:

We noted during our audit that the plan does not have written investment policy guidelines or adequate records supporting the basis for investment decisions. In addition, the plan does not have procedures to periodically monitor investment performance against expected performance.

Recommendation:

We recommend creation of 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.

SEGREGATION OF DUTIES—GENERAL COMMENTS NOT INCLUDED IN TOPICS NOTED PREVIOUSLY

8.108

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 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

8.109

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 requiring two signatures 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.

8.110

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 the company implement procedures to retain such records.

ACCURACY OF DATA SENT FROM THE THIRD-PARTY ADMINISTRATOR

8.111

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 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 provided by 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. The plan administrator can outsource plan operations yet cannot relinquish responsibility for plan operations and internal controls. TPA performance should be monitored on an ongoing basis and reports provided subject to timely review and reconciliation.

ACCURACY OF EMPLOYEE DATA

8.112

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 THIRD PARTY ADMINISTRATORS

8.113

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. Furthermore, performance of the administration in this manner does not provide the trustee with an appropriate opportunity to critically review the work being performed.

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. This would allow the trustee to serve in a reviewer capacity that is more aligned with that position's fiduciary responsibility.

MINUTES OF TRUSTEES' MEETINGS

8.114

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 that 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

8.115

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, the following 10 questions will 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? Do you periodically benchmark your plan's expenses?
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? Are all fee arrangements in place for the plan in writing?

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 providers, we would be happy to assist you.

MONITORING COMPLIANCE WITH SERVICE AGREEMENTS

8.116

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

FIDUCIARY LIABILITY INSURANCE

8.117

Issue:

We noted during our audit that the company has not secured fiduciary liability insurance.

Recommendation:

Although not required by ERISA, we recommend consideration be given to securing fiduciary liability insurance for protection against fiduciary breaches. Fiduciary liability insurance is designed to provide defense costs and applicable damages for actual or alleged breaches of fiduciary duty. Unlike the fidelity bond, fiduciary liability insurance offers plan fiduciaries protection of personal assets.

LEASED 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. 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 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 subsequent to March 15, 20X3.

Recommendation:

We recommend the plan sponsor file Form 5330 for late correction of this failure and institute policies and procedures to complete the required testing timely to enable correction within the two and a half month time period provided in the regulations.

PLAN ADMINISTRATION

8.120

Issue:

Plan management was unable to provide support for the annual required plan testing for all adopting employers or 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 the IRC testing be performed for all adopting employers and that the plan sponsor take whatever action is required, based on the results of those tests, prior to December 31, 20X2. In addition, we recommend instituting policies and procedures to complete the required testing properly and timely to enable correction within the two and a half month time period provided in the regulations.

8.121

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.

8.122

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 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, 20X3. In addition, we recommend instituting policies and procedures to complete the required testing timely to enable correction within the two and a half month time period provided in the regulations.

8.123

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. In addition, we recommend instituting policies and procedures to complete the required testing timely to enable correction within the two and a half month time period provided in the regulations.

RECONCILIATIONS

8.124

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

8.125

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 plan 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

8.126

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.

c. Nondeferral of Form 1099 Compensation

8.127

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 plan 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.

d. After-Tax Contributions

8.128

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.

AUTHORIZATION OF PLAN EXPENSES

8.129

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

8.130

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

8.131

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 Rehires

8.132

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.

ADOPTING EMPLOYERS

8.133

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.

8.134

Issue:

During the course of the audit, we were unable to determine exactly what employers are covered by the plan.

Recommendation:

We recommend 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 to address this.

DEMOGRAPHIC DATA

8.135

Issue:

During our testing of benefit payments, we were unable to verify certain demographic information, per the record-keeping 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. Upon further investigation, it was determined that both participants became employees of the plan sponsor as a result of a merger.

Recommendation:

Given the frequency of business combinations by the plan sponsor, we recommend developing and executing policies and procedures to obtain the necessary demographic information for all employees who become participants of the plan, especially as a result of a merger.