1-1-2007

Employee benefit plans industry developments - 2007; Audit risk alerts

American Institute of Certified Public Accountants

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

Part of the Accounting Commons, and the Taxation Commons

Recommended Citation
https://egrove.olemiss.edu/aicpa_indev/1079
Employee Benefit Plans Industry Developments—2007

Strengthening Audit Integrity
Safeguarding Financial Reporting

American Institute of Certified Public Accountants
Notice to Readers

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

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

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

Linda C. Delahanty
Technical Manager
Audit and Attest Standards

Copyright © 2007 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 AAG 0 9 8 7
# Table of Contents

**ACKNOWLEDGMENTS** ...........................................................................vii  
**EMPLOYEE BENEFIT PLANS INDUSTRY DEVELOPMENTS—2007 ........1**  
How This Alert Helps You .................................................................1  
**Hot Topics ................................................................................2**  
  Pension Protection Act of 2006 .........................................................2  
  Financial Accounting Standards Board Staff  
    Position AAG INV-1 and SOP 94-4-1 ........................................4  
  Risk Assessment Standards ............................................................9  
  Limited-Scope Certifications .........................................................16  
  Alternative Investments ..................................................................17  
**AICPA Resources and Projects....................................................18**  
  The AICPA Employee Benefit Plan Audit  
    Quality Center ...........................................................................18  
  Guide Overhaul Project .................................................................20  
**Audit Issues .............................................................................22**  
  Recent Auditing Pronouncements ..................................................22  
  SAS No. 103, *Audit Documentation* ..............................................23  
  SAS No. 112, *Communicating Internal Control Related Matters Identified in an Audit* ........................................26  
  SAS No. 114, *The Auditor’s Communication With Those Charged With Governance* .............................................26  
  Auditing Plan Fees and Expenses ..................................................26  
  Separately Managed Accounts .....................................................27  
  Unitized Trusts ................................................................................28  
  Unaudited PSA Accounts ...............................................................29  
  Investments Reported as 103-12 Entities as Required by the DOL .................................................................30  
  Self-Directed Investments .............................................................31  
  Auditing Health and Welfare Plans ..............................................31
Eligible Compensation and Payroll Data ..................41
Actuarial Reports for Defined Benefit Plans ...............43
Allocation Testing for DC Plans ..........................48
Missing Participant Data ..................................48
Analytical Procedures as Substantive Tests ............49

On the Horizon—Auditing ........................................50
Auditing Pipeline—Nonpublic Companies ...............51
Auditing Pipeline—Public Companies ..................52

AICPA Peer Review Developments—Recurring Deficiencies
Found in Employee Benefit Plan Audits .................52

Form 11-K Audits ....................................................53
Form 8-K Requirements for Form 11-K Filers ..........53
Preapproval of Employee Benefit Plan Audits ..........54
Audit Reports—Following Two Sets of Standards ....55
PCAOB Standards and Conforming Amendments ....56
PCAOB Auditing Standard No. 4 ..........................57

Accounting Issues ..................................................57
Recent Accounting Pronouncements ..................57
FASB Interpretation No. 48, Accounting for
Uncertainty in Income Taxes ...............................58
FASB Statement No. 157, Fair Value Measurements ....59
FASB Statement No. 158, Employers’ Accounting
for Defined Benefit Pension and Other Postretirement Plans ..59
Securities Lending Transactions ...........................61

On the Horizon—Accounting ................................72

Accounting Pipeline .............................................62
Proposed FASB Statement, The Hierarchy of Generally
Accepted Accounting Principles .........................62
FASB Project on Derivative Disclosures ..................62
Proposed FASB EITFs and FSPs ..........................63
<table>
<thead>
<tr>
<th>Section</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory Developments</td>
<td>64</td>
</tr>
<tr>
<td>2006 Form 5500 Series</td>
<td>64</td>
</tr>
<tr>
<td>2006 Form M-1 for Multiple Employer Welfare Arrangements</td>
<td>65</td>
</tr>
<tr>
<td>Correspondence from EFAST or the DOL OCA</td>
<td>66</td>
</tr>
<tr>
<td>EBSA-Enhanced Programs to Assess Plan Audit Quality</td>
<td>69</td>
</tr>
<tr>
<td>DOL Fiduciary Education Initiatives</td>
<td>70</td>
</tr>
<tr>
<td>Delinquent Filer Voluntary Compliance Program</td>
<td>72</td>
</tr>
<tr>
<td>VFCP</td>
<td>74</td>
</tr>
<tr>
<td>EBSA Outreach and Customer Service Efforts</td>
<td>75</td>
</tr>
<tr>
<td>Timeliness of Remittance of Participant Contributions</td>
<td>75</td>
</tr>
<tr>
<td>Remains an Enforcement Initiative for the EBSA</td>
<td></td>
</tr>
<tr>
<td>Reporting of Delinquent Loan Repayments</td>
<td>77</td>
</tr>
<tr>
<td>DOL Final Rule on Electronic Filing of the Form 5500 and Proposed Changes to the 2008 Form 5500</td>
<td>78</td>
</tr>
<tr>
<td>DOL Proposes PPA Revisions to the Form 5500 Annual Report for 2008</td>
<td>79</td>
</tr>
<tr>
<td>DOL Abandoned Individual Account Plan Final Regulations and Class Exemption</td>
<td>80</td>
</tr>
<tr>
<td>Rollover Safe Harbor for Missing Participants</td>
<td>81</td>
</tr>
<tr>
<td>DOL Consultant Advisor Program</td>
<td>83</td>
</tr>
<tr>
<td>Independence Request for Information</td>
<td>83</td>
</tr>
<tr>
<td>EBSA's Proposed Rule on Default Investment Alternatives for Participant-Directed Plans</td>
<td>83</td>
</tr>
<tr>
<td>EBSA's Final Amendment on Securities Lending Exemption</td>
<td>84</td>
</tr>
<tr>
<td>Model Notice of Pending Election of Multiemployer Plan Status</td>
<td>85</td>
</tr>
<tr>
<td>EBP Resources</td>
<td>85</td>
</tr>
<tr>
<td>Related Publications</td>
<td>85</td>
</tr>
<tr>
<td>Web Casts</td>
<td>87</td>
</tr>
<tr>
<td>Conferences</td>
<td>87</td>
</tr>
<tr>
<td>Education Courses</td>
<td>88</td>
</tr>
</tbody>
</table>
Acknowledgments

The AICPA staff wishes to thank the members of the AICPA Employee Benefit Plans Expert Panel; the AICPA Employee Benefit Plans Audit Guide Revision Task Force; and the Office of the Chief Accountant (OCA), Employee Benefits Security Administration (EBSA) of the U.S. Department of Labor (DOL) for their contributions to this Alert.


Marilee P. Lau, Chair
Robert Cote
Cindy Finestone
Robert Lavenberg
Lynne McMennamin
Kevin Murphy

Alan Ross
Deborah Smith
Kristin Tveit
Michele Weldon
Alice Wunderlich
Employee Benefit Plans Industry Developments—2007

How This Alert Helps You

.01 This Alert helps you plan and perform your employee benefit plan audits. It provides information on current industry developments and emerging practice issues as well as current auditing, accounting, and regulatory developments affecting employee benefit plans. The knowledge delivered by this Alert assists you in achieving a more robust understanding of the business, economic, and regulatory environment in which your clients operate.

.02 References to Professional Standards. When referring to the professional standards, this Alert may cite the applicable sections as codified in the AICPA Professional Standards and not the numbered statements, as appropriate. For example, Statement on Auditing Standards (SAS) No. 54, Illegal Acts by Clients, is referred to as AU section 317 of the AICPA Professional Standards.

Help Desk—See the AICPA publication Audit Risk Alert—2006/07 (product no. 022337kk) for general guidance. For a thorough discussion of recent developments and key issues in the area of independence and ethics, see the AICPA Audit Risk Alert Independence and Ethics Alert—2006/07 (product no. 022477kk). For a thorough discussion of recent Securities and Exchange Commission (SEC) and Public Company Accounting Oversight Board (PCAOB) developments, see the AICPA Audit Risk Alert SEC and PCAOB Alert—2006/07 (product no. 022497kk). These Alerts can be obtained by calling the AICPA at (888) 777-7077 or by going online at www.cpa2biz.com. It is important to point out that for Employee Retirement Income Security Act of 1974 (ERISA) engagements, the DOL has separate independence standards that may be more restrictive than those of the AICPA. See paragraph A.88 in Appendix A of the AICPA Audit and Accounting Guide Employee Benefit Plans, with conforming changes as of March 1, 2007.
Hot Topics

Pension Protection Act of 2006

.03 On August 17, 2006, President Bush signed into law the Pension Protection Act of 2006 (PPA), which is the most comprehensive pension reform legislation since ERISA was enacted in 1974. The PPA, which comprises approximately 400 pages, will lead many companies to change the way their plans are designed and administered, amend plan documents, increase plan funding, and make additional plan disclosures in regulatory filings and to plan participants.

Audit Considerations as a Result of the PPA

.04 Plan sponsors and administrators will need to understand the effects of the new law on their plans and to seek professional advice and assistance in implementing the new requirements. Plan auditors will also need to understand the effects of the new law and consider modifications to the audit approach. Certain changes are effective now or in 2007, but most changes are effective for plan years that begin in 2008 or later.

.05 The PPA is extensive, and certain provisions will affect the plan audit. The AICPA Employee Benefit Plan Audit Quality Center has prepared a summary analysis of key provisions of the PPA, which is available online at www.ebpaqc.aicpa.org. Notable provisions of the PPA that will require auditor attention as the audit is planned and performed include the following:

- Effective in 2007, all employer contributions to a defined-contribution (DC) plan must vest no slower than the schedule that currently applies to matching contributions (the 3-year cliff or 6-year graded schedule). The new vesting rules apply only to contributions made in plan years beginning on or after January 1, 2007, but can also be applied to past contributions.
• It permanently extends a number of employee benefit provisions that were part of the 2001 Economic Growth and Tax Relief Reconciliation Act that had been set to expire in 2010, including increased contribution limits, faster vesting, catch-up contributions, and Roth contributions.

• It provides miscellaneous rules addressing administration of plans including new benefit statement requirements. Quarterly benefit statements must be provided to participants who have the right to direct investments in a plan, and annually to those who do not.

• It provides new annuity rules for defined benefit pension plans and money purchase pension plans effective beginning in 2008. Participants must be offered a new qualified optional survivor annuity.

• It revises rollover and plan distribution rules.

• There are new rules encouraging automatic enrollment in 401(k) plans.

• In 2008, safe harbor automatic enrollment is allowed.

• It revises the rules that govern employer funding of defined benefit pension plans that will require the auditor to gain an understanding of the impact of the changes when reviewing the actuarial valuation. The PPA revised many rules surrounding defined benefit plans.

• It provides for new rules related to funding, withdrawal liability, and disclosures for multiemployer plans.

• It created a new plan design, DB(k), to become effective beginning in 2010.

• Plans will be required to be amended to conform to the PPA by the end of 2009 plan year. Collectively bargained plans have until the end of the 2011 plan year.

• It includes new DOL Safe Harbor guidelines to be issued to provide Section 404(c) protection to plan sponsors for
participants who fail to make an affirmative election if the contributions are invested in a default investment option.

• It provides for a new prohibited transaction exemption (PTE) for investment advice from a fiduciary advisor to DC plan participants under an eligible investment advice arrangement. It also establishes a new independent audit requirement for DC plans with eligible investment advice arrangements with respect to compliance with applicable requirements for such arrangements. Be alert to the issuance of guidance from the DOL on how this requirement is to be fulfilled.

• Beginning in 2007, it provides for more diversification rights of investments in publicly traded employer securities to participants in a DC plan.

.06 The above highlights serve only as a brief summary of provisions of the PPA that will affect the plan auditor. The auditor will need to be familiar with the PPA to address certain changes in his or her audit approach. While many of the changes are effective for plan years beginning in 2008, auditors should learn more about the immediate impact on the plans they audit and gain an understanding of the intention of management to effectively and efficiently plan and prepare for future audits.

Financial Accounting Standards Board Staff Position AAG INV-1 and SOP 94-4-1

.07 In December 2005, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) AAG INV-1 and SOP 94-4-1, Reporting of Fully Benefit-Responsive Investment Contracts Held by Certain Investment Companies Subject to the AICPA Investment Company Guide and Defined-Contribuition Health and Welfare and Pension Plans.¹

¹ The financial statement presentation and disclosure guidance in paragraphs 8 through 11 of Financial Accounting Standards Board (FASB) Staff Position (FSP) AAG INV-1 and SOP 94-4-1, Reporting of Fully Benefit-Responsive Investment Contracts Held by Certain Investment Companies Subject to the AICPA Investment Company Guide and Defined-Contribuition Health and Welfare and Pension Plans, is effective for financial statements for plan years ending after December 15, 2006.
This FSP provides (1) a definition of fully benefit-responsive investment contracts and (2) guidance with respect to the financial statement presentation and disclosure of fully benefit-responsive investment contracts.

This FSP amends the guidance in AICPA Statement of Position (SOP) 94-4, Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans, with respect to the definition of fully benefit responsive and the presentation and disclosure of fully benefit-responsive investment contracts; SOP 92-6, Accounting and Reporting by Health and Welfare Benefit Plans; and paragraph 10(h) of FASB Statement No. 133, Accounting for Derivative Instruments and Hedging Activities, to effectively remove the scope exception provided for fully benefit-responsive investment contracts reported at contract value in accordance with SOP 94-4. Appendix B of the FSP shows the amendments to SOP 94-4, SOP 92-6, and FASB Statement No. 133.

Financial Statement Presentation and Disclosure Requirements

Defined-benefit health and welfare benefit plans should report investment contracts at fair value. Defined-contribution plans, including both health and welfare and pension 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 defined-contribution plan attributable to fully benefit-responsive investment contracts. An investment contract is considered fully benefit responsive for purposes of this SOP if certain criteria are met for that contract, analyzed on an individual basis. See paragraph 3.19 of the EBP Guide for such criteria.

The revised definition of fully benefit responsive in paragraph 7 of the FSP shall be effective for all investment contracts as of the last day of the annual period ending after December 15, 2006. Earlier application is permitted for fiscal years in which annual financial statements have not been issued. If comparative financial statements are presented, the guidance in that FSP shall be applied retroactively to all prior periods presented. If an investment contract is considered fully benefit responsive under the revised definition as of the last day of the annual period ending after December 15, 2006, that contract shall be considered fully benefit responsive for all periods presented, provided that contract would have been considered fully benefit responsive in accordance with the then-existing provisions of this Statement of Position (SOP).
The statement of net assets available for benefits of the plan shall present amounts for (1) total assets, (2) total liabilities, (3) net assets reflecting all investments at fair value, and (4) net assets available for benefits. The amount representing the difference between 3 and 4 shall 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 shall 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.

Defined-contribution plans, including both health and welfare, and pension plans shall disclose the following in connection with fully benefit-responsive investment contracts, in the aggregate:

1. A description of the nature of those investment contracts, how they operate, and the methodology for calculating the interest crediting rate, including the key factors that could influence future average interest crediting rates, the basis for and frequency of determining interest crediting rate resets, and any minimum interest crediting rate under the terms of the contracts. This disclosure should explain the relationship between future interest crediting rates and the amount reported on the statement of net assets available for benefits representing the adjustment for the portion of net assets attributable to fully benefit-responsive investment contracts from fair value to contract value.

2. The average yield earned by the plan for all fully benefit-responsive investment contracts (which may differ from the interest rate credited to participants in the plan) for each period for which a statement of net assets available for benefits is presented. This average yield shall be calculated by dividing the annualized earnings of all fully benefit-
responsive investment contracts in the plan (irrespective of the interest rate credited to participants in the plan) by the fair value of all fully benefit-responsive investment contracts in the plan.

**Help Desk**—The average yield should be based on the investment income from the investments in the fund (not the crediting rate) as of the last day of the period, annualized, divided by the fair value of the investments as of the last day of the period. In situations where there are material unsettled trades as of year end, consideration should be given to adjusting the investment earnings for the estimated amount relating to those unsettled trades.

3. The average yield earned by the plan for all fully benefit-responsive investment contracts with an adjustment to reflect the actual interest rate credited to participants in the plan for each period for which a statement of net assets available for benefits is presented. This average yield shall be calculated by dividing the annualized earnings credited to participants in the plan for all fully benefit-responsive investment contracts in the plan (irrespective of the actual earnings of those investments) by the fair value of all fully benefit-responsive investment contracts in the plan.

**Help Desk**—The average yield should be based on the amounts credited to participants in the fund as of the last day of the period, annualized, divided by the fair value of the investments in the fund as of the last day of the period. Note that even though the numerator is the earnings credited to participants in the fund (crediting rate) based on contract value, the denominator is based on the fair value, not the contract value, of the investments.

4. A description of the events that limit the ability of the plan to transact at contract value with the issuer (for example, premature termination of the contracts by the plan, plant closings, layoffs, plan termination, bankruptcy, mergers, and early retirement incentives), including a statement as to whether the occurrence of those events that would limit the plan's ability to transact at contract value with participants
in the plan is probable or not probable. The term probable is used in this Statement consistent with its use in FASB Statement No. 5, Accounting for Contingencies.

5. A description of the events and circumstances that would allow issuers to terminate fully benefit-responsive investment contracts with the plan and settle at an amount different from contract value.

Help Desk—See Appendix D of this Alert for Technical Practice Aids (TPAs) that provide guidance on implementing this FSP and for illustrative financial statements. The complete FSP can be viewed on the FASB Web site at www.fasb.org.

Related Auditing Issues

.13 The valuation of investment contracts in accordance with the FSP is the responsibility of the plan sponsor. The plan sponsor can look to an outside service provider to assist in the mechanics of the valuation. The plan sponsor must have sufficient information to evaluate and independently challenge the valuation. Plan sponsors may need to work with the various service providers (for example, trustee or custodian, investment advisor, or recordkeeper) surrounding the investment contracts to determine which service provider will assist in the mechanics of the valuation. Auditors should recommend to plan sponsors that discussions with service providers happen early in the audit planning process to ensure the investment contract valuation will be completed in time for filing deadlines.

.14 For full-scope audits of plans with investments in investment contracts, auditors should gain an understanding of the valuation methodology during planning through discussion with clients and service providers and review of valuation documentation. The auditor should review and test the significant assumptions and underlying data used in the valuation of the investment contracts. Additional guidance can also be found in the AICPA Practice Aid titled Alternative Investments—Audit Considerations: A Practice Aid for Auditors.
Related TPAs

.15 The AICPA has issued three TPAs to provide additional guidance when implementing FSP AAG INV-1 and SOP 94-4-1. See Appendix D of this Alert to view the TPAs.

Risk Assessment Standards

.16 In March 2006, the AICPA’s Auditing Standards Board (ASB) issued 8 SASs. SAS No. 104 through No. 111 were issued together and are known as the risk assessment standards, applying to audits conducted in accordance with Generally Accepted Auditing Standards (GAAS). While the new risk assessment standards include many of the underlying concepts and detailed performance requirements contained in existing standards, they do create significant new requirements for the auditor. The primary objective of the SASs is to provide extensive guidance on how to apply the audit risk model when planning and performing financial statement audits, focusing on identifying and assessing the risk of material misstatements; further designing and performing tailored audit procedures in response to the assessed risks at relevant assertion levels; and improving the linkage between the risks, controls, audit procedures, and conclusions. They are effective for audits of financial statements for periods beginning on or after December 15, 2006, with earlier application permitted. A table listing the 8 SASs and their effects on existing standards follows.

<table>
<thead>
<tr>
<th>Statement on Auditing Standard</th>
<th>Effect on Existing Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td>SAS No. 104, Amendment to Statement on Auditing Standards No. 1, Codification of Auditing Standards and Procedures (“Due Professional Care in the Performance of Work”)</td>
<td>This Statement amends SAS No. 1, Due Professional Care in the Performance of Work (AU section 230).</td>
</tr>
<tr>
<td>SAS No. 105, Amendment to Statement on Auditing Standards No. 95, Generally Accepted Auditing Standards</td>
<td>This Statement amends SAS No. 95, Generally Accepted Auditing Standards (AU section 150).</td>
</tr>
<tr>
<td>SAS No. 106, Audit Evidence</td>
<td>This Statement supersedes SAS No. 31, Evidential Matter (AU section 326A).</td>
</tr>
</tbody>
</table>

(continued)
<table>
<thead>
<tr>
<th>Statement on Auditing Standard</th>
<th>Effect on Existing Standards</th>
</tr>
</thead>
<tbody>
<tr>
<td>SAS No. 107, Audit Risk and Materiality in Conducting an Audit</td>
<td>This Statement supersedes SAS No. 47, Audit Risk and Materiality in Conducting an Audit (AU section 312A).</td>
</tr>
<tr>
<td>SAS No. 108, Planning and Supervision</td>
<td>This Statement supersedes SAS No. 1, Appointment of the Independent Auditor (AU section 310), and supersedes SAS No. 22, Planning and Supervision (AU section 311).</td>
</tr>
<tr>
<td>SAS No. 109, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement</td>
<td>This Statement supersedes SAS No. 55, Consideration of Internal Control in a Financial Statement Audit (AU section 319).</td>
</tr>
<tr>
<td>SAS No. 110, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained</td>
<td>This Statement supersedes SAS No. 45, Substantive Tests Prior to the Balance Sheet Date (AU section 313), and, together with SAS No. 109, supersedes SAS No. 55, Consideration of Internal Control in a Financial Statement Audit (AU section 319).</td>
</tr>
<tr>
<td>SAS No. 111, Amendment to Statement on Auditing Standards No. 39, Audit Sampling</td>
<td>This Statement amends SAS No. 39, Audit Sampling (AU section 350).</td>
</tr>
</tbody>
</table>

Some Important Highlights of the New Risk Assessment Standards

Whether due to errors or fraud, the new risk assessment standards require the auditor to understand and respond to risks of material misstatements. That understanding should identify risks to your client’s business and the mitigating controls in place. The risk assessment standards place an even greater emphasis on the understanding and testing of internal control. Auditors may no longer simply default to maximum control risk. While this does not mean auditors are required to test and rely on controls as part of their audit strategy, they should assess how all five components of internal control over financial reporting relate to the client that they are auditing. See the Committee on Sponsoring Organizations of the Treadway Commission’s (COSO) framework
at www.coso.org/key.htm. These standards may significantly affect the formality of your risk assessment and documentation and may vary greatly from what you have previously done. Implementation of the SASs will most likely result in significant changes to your firm's audit methodologies and the training of your personnel. Therefore, it is recommended that you allow ample time in advance of the required implementation date. Readers can obtain the SASs and the related AICPA Audit Risk Alert titled Understanding the New Auditing Standards Related to Risk Assessments (product number 022526kk) at www.cpa2biz.com.

New Companion Audit Guide

.18 In December 2006, the AICPA issued an Audit Guide titled Assessing and Responding to Audit Risk in a Financial Statement Audit (product no. 012456kk). This Guide helps practitioners understand and implement the risk assessment standards. It includes practical guidance, examples, and an in-depth case study. The Guide can be ordered by calling the AICPA at 888-777-7077 or going online at www.cpa2biz.com.

Employee Benefit Plan Considerations

.19 The following paragraphs offer a brief description of the fundamental audit concepts described in the AICPA Audit Guide Assessing and Responding to Audit Risk in a Financial Statement and examples of how these concepts may be applied in your audits of employee benefit plans.

.20 Reasonable assurance. GAAS requires the auditor to “obtain reasonable assurance about whether the financial statements are free from material misstatement.” SAS No. 104 clarifies that reasonable assurance is a high but not absolute level of assurance. For example, the auditor may obtain reasonable assurance in an employee benefit plan audit by gathering evidence that:

- Hard to value investments such as real estate, limited partnerships, and private placement equities are valued at fair market value.

- The completeness objective has been achieved with respect to employer contributions.
• Pensions and annuities paid and benefits paid have been accurately calculated and have been properly shown on the plan's financial statements.

• The benefit obligations determined by the plan's actuary appear reasonable and significant changes are understood by the auditor.

• Expenses paid by the plan are reasonable and necessary.

21 **Audit risk and the risk of material misstatement.** The auditor must consider audit risk and must determine a materiality level for the financial statements taken as a whole. Audit risk is the risk that the financial statements are materially misstated and the auditor fails to detect such a misstatement or appropriately modify the audit opinion. The auditor should perform the audit to reduce audit risk to a low level. The auditor should assess the risk of material misstatement (in other words, the combined assessment of inherent and control risks) as a basis for further audit procedures. In an employee benefit plan, the following should be considered:

• An overall materiality level for the plan should be determined. The determination of what is material to the users is a matter of professional judgment.

• The impact of current developments in the financial markets as they relate to the valuation of plan investments.

• Whether the risk of material misstatement would be high for areas such as: investments, contributions, and benefits paid.

22 **Materiality and tolerable misstatement.** Audit materiality represents the maximum amount that the auditor believes the financial statements could be misstated and still fairly present the plan's net assets available for benefits and the changes in net assets available for benefits. Tolerable misstatement is the maximum known error within the financial statements that you are willing to accept. The following areas are typically the most material areas in a benefit plan's financial statements:
• Investments (and cash in a health and welfare plan)
• Benefits paid (in a health and welfare plan)
• Pensions and annuities paid (in a pension plan)
• Contributions

.23 Care should be taken by the auditor in determining the maximum level of tolerable error in these areas. Other balances in an employee benefit plan (for example, cash in a pension plan) are not normally material to a plan’s financial statements; therefore, errors might be significant in relation to the account balance but still would be below the tolerable error established for that account. Whereas an error in cash that is below tolerable misstatement may not cause the auditor to modify the auditor’s opinion, the auditor should consider the inherent risk within the class of transactions as a qualitative factor that could affect materiality considerations.

.24 Financial statement assertions. Assertions are management’s implicit or explicit representations regarding the recognition, measurement, presentation, and disclosure of information in the financial statements. Assertions fall into three categories: (1) classes of transactions, (2) account balances, and (3) presentation and disclosure. Certain significant risks at the assertion level for an employee benefit plan include the following:

• Investments exist, are valued at fair value, and are shown properly by investment type in the statement of net assets available for benefits and are properly disclosed.

• Claims for pensions and other benefit payments have been properly approved or denied and, if approved, have been paid in accordance with the plan document.

• Employer contribution income is properly recognized and is complete with respect to any accruals, including amounts due at the end of the period, a valuation for amounts deemed uncollectible, and the present value of any employer withdrawal liability (for multiemployer plans).
• Participant data used to calculate plan benefit obligation are complete.

• Transactions with parties in interest have been properly shown in the plan’s financial statements.

• Plan expenses have been recorded in the proper amount, in the proper accounting period and in accordance with the plan document.

.25 Internal control. Internal control is a process designed to provide reasonable assurance about the achievement of the plan’s objectives. These objectives fall into three categories: financial reporting, operations, and compliance with laws and regulations. The five interrelated components of internal control are the control environment, risk assessment, information and communication systems, control activities, and monitoring. Specific controls that an employee benefit auditor may test include:

• Assessing whether plan’s management has controls in place to maintain compliance with applicable rules and regulations (for example, DOL, Pension Benefit Guaranty Corporation (PBGC), IRS, or PCAOB)

• Ensuring that the plan has a system for paying and denying pensions or health claims

• Ensuring that all investment income has been received and recorded appropriately

• Ensuring that the plan actuary has utilized the appropriate data in calculating the present value of plan obligations

• Assessing whether plan personnel have the capability to prepare the plan’s financial statements

• Ensuring that employer and employee contributions are complete and accurate

• Ensuring that securities lending activity has been appropriately accounted for
The auditor’s understanding of internal control involves determining whether and how specific controls may prevent or detect and correct material misstatements.

Information technology. A client’s use of information technology (IT) may affect any of the five components of internal control relevant to the achievement of the entity’s financial reporting, operations, compliance objectives, and operating units or business functions. In an employee benefit plan audit, the auditor may decide to test whether:

- The client’s IT system is being properly utilized to determine participant data (for example, payroll and employee information) and pension and health benefit payments
- A database system is being properly utilized to check for duplicate payments, improper utilization, and other payments made in the health care payment system
- Pension credits earned are being properly accounted for and utilized in calculating the payment of benefits
- Passwords are utilized by the plan and appropriate restrictions exist to prevent or detect fraud
- The IT system is accurately allocating shared expenses between plans that share facilities and other expenses

Audit evidence. Audit evidence is all the information the auditor uses to arrive at the conclusions that support the opinion on the audit. Audit evidence is cumulative in nature. Audit evidence must be sufficient and appropriate. Sufficient and appropriate audit evidence in an employee benefit plan audit as part of the overall risk assessment would include, but would not be limited to:

- Reading the minutes of meetings of plan trustees and designing audit steps based on the actions taken during those meetings
- Interviewing the plan’s administrator regarding internal controls
• Conducting SAS 99 interviews with non-accounting personnel
• Obtaining a Type II SAS No. 70 letter from the service provider who processes plan activity
• For full scope audits, obtaining confirmation of securities held by the plan’s investment custodian and testing investment valuations on the plan’s investments
• Testing the trustees and plan employees expense reimbursement forms

Help Desk—The AICPA has developed and published an Audit Guide titled Assessing and Responding to Audit Risk in a Financial Statement Audit (product no. 012456kk) to aid in implementing the new risk assessment standards. This Guide can be purchased by contacting the AICPA CPA2BIZ Service Center at 888-777-7077 or online at www.cpa2biz.com.

Limited-Scope Certifications

.29 Under DOL regulations, certain assets held by a bank, trust company, or similar institution or by a regulated insurance company and related investment information do not have to be audited provided the institution certifies the information. All noninvestment activity of the plan, such as participant allocations, contributions, benefit payments, and expenses, are subject to audit. Paragraphs 7.65, 7.66, and 13.26 in the EBP Guide provide guidance for limited-scope audit procedures and reporting.

.30 The Form 5500 instructions state that current value means fair market value where available. Otherwise, current value means the fair value as determined in good faith under the terms of the plan by a trustee or a named fiduciary assuming an orderly liquidation at the time of the determination. Refer to ERISA Section 3(26). Plan management should instruct the institutions certifying investment information for purposes of limited-scope audits to certify as to the current value of investments at the date of the plan’s year end and to exclude any investments that are not valued at fair value as of the plan’s year end.
.31 It is the plan administrator’s responsibility to prepare the financial statements and footnote disclosures in accordance with GAAP. The AICPA Audit Issues Task Force is currently discussing certain revisions to paragraphs 7.65 and 7.66 of the EBP Guide to help clarify guidance. Be alert for the issuance of additional guidance.

**Alternative Investments**

.32 Alternative investments are investments for which a readily determinable fair value does not exist (that is, investments that are not listed on national exchanges or over-the-counter markets, or for which quoted market prices are not available from sources such as financial publications, the exchanges, or the National Association of Securities Dealers Automated Quotations System [NASDAQ]). These investments include private investment funds meeting the definition of an investment company under the provisions of the AICPA Audit and Accounting Guide *Investment Companies* (product no. 012625kk), such as:

- Hedge funds
- Private equity funds
- Real estate funds
- Venture capital funds
- Commodity funds
- Offshore fund vehicles
- Funds of funds
- Bank common and collective trust funds

.33 Collectively, these types of investment funds are referred to herein as *alternative investments*. Alternative investments may be structured as limited partnerships, limited liability corporations, trusts, or corporations. Investors in alternative investments include pension plans. Many invest a small percentage of their total investments, while others invest a substantial percentage of their total investments in these vehicles. In addition, the underlying
investments of the alternative investments can range from marketable securities to complex or illiquid investments. Alternative investments can present challenges with respect to obtaining sufficient appropriate audit evidence in support of the existence and valuation assertions because of the lack of a readily determinable fair value for these investments and the limited investment information generally provided by fund managers.

.34 When auditing alternative investments, it is important to understand the client’s process related to valuation. This includes, but is not limited to, determining the nature of the underlying investments, understanding how often plan management interacts with fund manager(s) of such investments, the availability of audited financial statements for such investments, and Type II SAS 70 reports on the determination of unit values of such investments. Obtaining a confirmation from the trustee, custodian, or investment manager that contains fair values does not constitute valuation testing. For further guidance, refer to Interpretation No. 1 of AU section 328, “Auditing Interests in Trusts Held by a Third-Party Trustee and Reported at Fair Value.”

.35 Additional guidance can also be found in the AICPA Practice Aid titled Alternative Investments—Audit Considerations: A Practice Aid for Auditors. This Practice Aid addresses challenges associated with auditing investments for which a readily determinable fair value does not exist.

.36 Auditors need to determine that they have obtained sufficient and competent audit evidence to support the existence and valuation assertions related to alternative investments. In the event that such evidence is not obtained, consideration of modifications to the audit opinion may be required.

AICPA Resources and Projects

The AICPA Employee Benefit Plan Audit Quality Center

.37 The AICPA Employee Benefit Plan Audit Quality Center (the Center) is a firm-based, voluntary membership Center created in March 2003 with the goal of promoting quality employee
benefit plan audits. Center member firms demonstrate their commitment to ERISA audit quality by joining the Center and agreeing to adhere to its membership requirements. The Center now has over 1,300 members in all 50 states, the District of Columbia, the U.S. Virgin Islands, and Puerto Rico.

.38 Recent reviews performed by the DOL’s EBSA have shown a difference in the quality of ERISA audits performed by Center member firms compared with those performed by non-member firms. To help members meet the challenges of performing quality audits in the employee benefit plan area, the Center:

- Monitors activities of standard setters, the DOL, stakeholder groups, and others and communicates this information to its members via periodic E-Alerts
- Develops valuable tools and resources—such as audit preparedness and planning checklists and schedules, auditor guidelines for preparing proposals, “Topix” primers, and more—that are sent to members and developed and archived on the Center’s Web site
- Sponsors “Live Forum” and “Roundtable Discussion” member-only conference calls to share important information and answer participant questions on a wide range of technical and practice topics
- Provides an online member forum for sharing ideas, best practices, and questions with other members
- Develops information for auditors to share with plan stakeholders regarding issues of importance to plan auditors, such as the importance of plan sponsors and trustees monitoring their TPAs
- Serves as a single voice for Center members to the DOL

.39 Visit the Center Web site at www.aicpa.org/ebpaqc to see a complete list of Center members and to preview Center benefits. For more information, contact the Center at ebpaqc@aicpa.org.
Guide Overhaul Project

Description and Background

.40 The EBP Guide was last issued in 1991. The Guide has not been revised or amended, other than for conforming changes, since then. Since 1991, significant changes have occurred in the types of retirement plans offered by employers, the way plans are administered, and the types of plan investments. Many of these changes have resulted in accounting issues that are not contemplated in the existing Guide. In 2004, a task force began work on a project to revise the EBP Guide.

Tentative Conclusions

.41 Some of the tentative conclusions reached by AcSEC in discussing the accounting issues for the EBP Guide are listed in the following sections. The tentative conclusions are subject to change as AcSEC continues to deliberate the accounting issues and are not considered guidance. Visit the AICPA Web site for updates on this AcSEC project at www.aicpa.org.

.42 Accounting for contributions receivable for defined benefit pension plans. Minimum contributions required should be accrued, and any excess amounts would be considered a Type II subsequent event unless there were evidence of a formal commitment as of the balance sheet date. When the issue is drafted for the EBP Guide, it should be expanded to discuss all of the factors listed in paragraph 10 of FASB Statement No. 35, Accounting and Reporting by Defined Benefit Pension Plans, with emphasis placed on the formal commitment.

.43 Accounting for contributions receivable for DC pension plans. Additional guidance should be included in the Guide discussing factors that should be reviewed in determining whether contributions should be recorded due to an obligation resulting from a formal commitment under paragraph 10 of FASB Statement No. 35. Additional information about the relationship between employees and employer as compared to defined benefit plans should also be included.
44 Accounting for contributions receivable for defined benefit health and welfare benefit plans. A receivable from the employer should be accrued equal to the liability for employees’ claims recorded prior to plan’s year end. A receivable from the employer should be accrued equal to the liability for incurred but not reported (IBNR) employee claims if, as of the date of the financial statements, there is a legal or contractual requirement for the employer to fund this amount.

45 Employee deferral and related matching contributions for DC plans. It would be rare that this amount would be significant; therefore, this issue will not be included in the Guide.

46 Accounting for excess employee contributions. Excess employee contributions should be recorded as a liability in the year in which they were contributed to the plan (in accordance with Paragraph 3.31 of the EBP Guide) with the corresponding debit side of the entry being netted against contributions received. Additionally, disclosure thereof should be presented in the notes to the financial statements.

47 Presentation of investment income from commingled investment funds. The Guide should express two views. One is that dividends and distributions should be considered investment income and shown separately from changes in fair value. The second is that dividends should only be considered investment income and shown separately from changes in fair value.

48 Disclosures for limited partnerships and similar investments. Additional disclosures should be made relating to limited partnerships and similar investments. The Guide should clarify that these disclosures apply to certain types of investments that are hard to value or not liquid (alternative investments). If the information for the disclosures cannot be obtained or is prohibited from being disclosed, that should be disclosed as well. AcSEC also noted that the task force should look at the disclosures required by the FASB Fair Value project.

49 Current developments and plans. AcSEC will continue its discussions of issues at a future meeting.
Audit Issues

Recent Auditing Pronouncements

.50 Presented in the following section is a list of auditing and attestation pronouncements and related guidance issued since the publication of last year’s Alert. For information on auditing and attestation standards and related guidance issued subsequent to the writing of this Alert, please refer to the AICPA Web site at www.aicpa.org/members/div/auditstd/technic.htm. For audits of issuers, such as Form 11-K audits, see the section “Form 11-K Audits” of this Alert. As a reminder, AICPA auditing and attest standards are applicable only to audits and attestation engagements of nonissuers.

.51 You may also look for announcements of newly issued standards in the CPA Letter, Journal of Accountancy, and the quarterly electronic newsletter In Our Opinion, which is issued by the AICPA’s Auditing Standards team and is available at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Opinion/.

### Recent Auditing and Attestation Pronouncements and Related Guidance

<table>
<thead>
<tr>
<th>Pronouncement</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>SAS No. 112, Communicating Internal Control Related Matters Identified in an Audit (May 2006)</td>
<td>The new standard supersedes SAS No. 60, Communication of Internal Control Related Matters Noted in an Audit. It establishes requirements and provides extensive guidance about communicating matters related to an entity’s internal control over financial reporting identified while performing an audit of financial statements. SAS No. 112 also requires that certain communications be in writing. It is effective for periods ending on or after December 15, 2006. See Appendix B of this Alert for further guidance.</td>
</tr>
<tr>
<td>SAS No. 113, Omnibus Statement on Auditing Standards—2006 (November 2006)</td>
<td>This SAS amends SAS No. 95, Generally Accepted Auditing Standards; SAS No. 99, Consideration of Fraud in a Financial Statement Audit; SAS No. 101, Auditing Fair Value Measurements and Disclosures; SAS No. 59, The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern; SAS No. 57, Auditing Accounting Estimates;</td>
</tr>
</tbody>
</table>
Recent Auditing and Attestation Pronouncements and Related Guidance

“Subsequent Events” of SAS No. 1, Codification of Auditing Standards and Procedures; and SAS No. 85, Management Representations. The amendments in paragraphs 1 through 5 of this SAS are effective for audits of financial statements for periods beginning on or after December 15, 2006. Earlier application is permitted. The amendments in paragraphs 7 through 14 of this SAS are effective for audits of financial statements for periods ending on or after December 15, 2006. Earlier application is permitted.

SAS No. 114, The Auditor’s Communication With Those Charged With Governance (December 2006)

The new standard supersedes SAS No. 61, Communication With Audit Committees. It establishes and provides guidance on the auditor’s communication with those charged with governance in relation to an audit of financial statements. Although this Statement applies regardless of an entity’s governance structure or size, particular considerations apply where all of those charged with governance are involved in managing an entity. It is effective for periods beginning on or after December 15, 2006.

AICPA TPA sections 8100.01–8100.02 (Nonauthoritative)

“Determining the Effective Date of a New Statement on Auditing Standards for Audits of a Single Financial Statement” and “Determining the Effective Date of a New Statement of Auditing Standards for Audits of Interim Periods.”

.52 As necessary, auditors should obtain and understand the complete text of the applicable standards and other guidance. You should visit the applicable Web site for complete information.

SAS No. 103, Audit Documentation

.53 Paragraphs 5.17 through 5.24 of the EBP Guide provide the background of SAS No. 103, Audit Documentation. In documenting the nature, timing, and extent of audit procedures performed, SAS No. 103 requires that the auditor record:
• Who performed the work and the date such work was completed

• Who reviewed specific audit documentation and the date of such review

.54 This documentation can be performed manually or electronically depending on the nature of the workpapers.

.55 In addition, SAS No. 103 requires that identifying characteristics of the specific items tested be documented. This includes the following:

• For a detail test of participants, this includes their name and employer number. Care should be given when using the entire social security number of a participant due to privacy and confidentiality issues.

• For a procedure requiring selection or review of all items over a specific amount from a given population, the auditor should record the scope of the procedures and identify the population (for example, all distributions over $XX from the benefit payment register).

• For a procedure requiring inquiries of specific plan or entity personnel (for example, fraud and illegal act inquiries), the auditor should record the dates of the inquiries, the names and job designations of the plan or entity personnel, and the inquiry made.

• For a procedure requiring systematic sampling from a population of documents, the auditor should identify the documents selected by recording their source, the starting point and the sampling interval.

**Dating of the Auditor’s Report**

.56 SAS No. 103 also provides guidance regarding the dating of an audit report. Paragraph 23 of SAS No. 103 states that the auditor’s report should not be dated earlier than the date on which the auditor has obtained sufficient appropriate evidence to support the opinion. Sufficient appropriate evidence includes
that the audit documentation has been reviewed; that all testing procedures have been completed; and that the plan’s financial statements, including disclosures, have been prepared and management has asserted that it has taken responsibility for them. The timing of the review of the Form 5500 may affect the dating of the audit report. If the Form 5500 has not been prepared prior to release of the financial statements, the auditor should consider obtaining a draft of the Form 5500 to prevent differences from arising after the report has been issued. If differences arise additional procedures may have to be performed and the report possibly reissued for reconciling items.

.57 The auditor’s responsibility with regard to the Form 5500 is outlined in AU sec. 550, Other Information in Documents Containing Audited Financial Statements (AICPA, Professional Standards, vol. 1), as amended. In accordance with AU sec. 550, the auditor’s responsibility for the information does not extend beyond the financial information identified in his or her report, and the auditor has no obligations to perform any procedures to corroborate other information contained in the document. However, the auditor should read the information and consider whether such information, or the manner of its presentation, is materially inconsistent with information, or the manner of its presentation, appearing in the financial statements. If the auditor concludes that there is a material inconsistency, he or she should determine whether the financial statements, his or her report, or both require revision. If he or she concludes that they do not require revision, he or she should request the client to revise the other information contained in the Form 5500.

.58 The final assembly of the audit file should be completed within 60 days following the report release date. Statutes, regulations, or the audit firm’s quality control policies may specify a shorter period of time in which this process should be completed. SAS No. 103 also provides guidance in the event that changes to documentation after the assembly of the audit work papers is required.
SAS No. 112, Communicating Internal Control Related Matters Identified in an Audit

.59 SAS No. 112 provides guidance to enhance your ability to identify and evaluate control deficiencies during an audit and then communicate to management and those charged with governance those deficiencies that you believe are significant deficiencies or material weaknesses. See Appendix B of this Alert for further guidance specific to employee benefit plans.

SAS No. 114, The Auditor’s Communication With Those Charged With Governance

.60 SAS No. 114, The Auditor’s Communication With Those Charged With Governance (AICPA, Professional Standards, vol. 1, AU sec. 380), replaces SAS No. 61, Communication With Audit Committees (AICPA, Professional Standards, vol. 1, AU sec. 380A), as amended. The new SAS requires the auditor to conduct two-way communication with those charged with governance about certain significant matters related to the audit. It also establishes standards and provides guidance on (1) which matters should be communicated, (2) to whom they should be communicated, and (3) the form and timing of the communication. SAS No. 114 is applicable for audits of the financial statements of all nonissuers and is effective for audits of financial statements for periods beginning on or after December 15, 2006.

Help Desk—The requirement for the auditor to communicate with those charged with governance are included in other SASs. SAS No. 114 does not change the requirements in those standards, including the requirements in SAS No. 112 to communicate in writing to management and those charged with governance control deficiencies identified during an audit that upon evaluation are considered significant deficiencies or material weaknesses. See Appendix A of SAS No. 114 for a complete list of requirements included in other SASs.

Auditing Plan Fees and Expenses

.61 Most defined benefit plans and many DC plans pay administrative expenses out of plan assets. As plan sponsors look for
ways to decrease operating costs, it is becoming more common to amend benefit plans to allow for the payment of the expenses out of the plan. In certain instances, forfeitures are used to pay plan expenses. The auditor’s responsibilities with respect to testing administrative expenses are detailed in paragraphs 12.10 and 12.11 of the EBP Guide. Typically, plan expenses are below materiality levels in a benefit plan audit and, therefore, are not subject to significant detailed testing. Often, auditors gain assurance over expense balances using other audit procedures such as substantive analytics. Irrespective of the materiality level, auditors need to gain an understanding of the expenses that are allowed to be paid by the plan according to the plan document.

.62 Auditors should be especially aware of fees paid by one plan on behalf of another plan resulting from errors or inappropriate allocations. In addition, auditors should be aware of fees paid by the plan for certain services (actuarial fees) that may relate to services provided to the plan sponsor. Expenses paid by the plan that are not allowed by the plan document or excessive fees, no matter how immaterial, may be deemed a prohibited transaction requiring further testing and disclosure as described in paragraph 11.13 of the EBP Guide.

.63 In addition, any fees or expenses paid to related parties need to be considered for disclosure under FASB Statement No. 57, Related Party Disclosures. In certain instances, it may be difficult to understand the nature of the expenses being paid by the plan due to the netting of expenses against income or other “hidden” arrangements. In these situations, the auditor may determine that additional inquiries with management and the service providers or review of service provider agreements may assist in understanding the fee arrangements. Also, refer to the DOL-issued publication Understanding Retirement Plan Fees and Expenses to better understand and evaluate plan fees and expenses.

Separately Managed Accounts

.64 Some plans have accounts at a trust company, insurance company, or similar institution consisting of individual plan assets that are managed by an investment manager specifically for
the plan. Often, these separately managed accounts are mistaken for pooled investment vehicles (for example, insurance company pooled separate accounts [PSAs], mutual funds, or common collective trusts). A review of the underlying investment agreement with the investment manager or discussions with the service providers will typically reveal whether the investment is a pooled or separately managed vehicle. Individual assets of a separately managed account are held in the name of the plan and should be audited in a manner similar to other individual investments held directly by the plan. The auditing objectives and procedures described in paragraphs 7.15 and 7.16 of the EBP Guide apply to individual assets and activity for a separately managed account. Such individual investments are also subject to the reporting requirements in paragraphs 2.14, 3.22, or 4.39 of the EBP Guide. In addition, these investments would be considered individual investments for purposes of reporting on Form 5500, Schedule H, line 4i—Schedule of Assets (Held at End of Year) and line 4j—Schedule of Reportable Transactions.

Unitized Trusts

.65 In certain instances, the recordkeeper of a separately managed account will maintain a net asset value per unit or unitization for the account. Purchases and sales of the account on behalf of the plan sponsor will be transacted at that net asset value per unit. For plan auditors to test the value of the purchases and sale transactions, the auditor will need to be comfortable with the price (net asset value per unit) at which the transactions were executed. The auditor should gain an understanding of the process to calculate the net asset value per unit through review of pertinent investment agreements, discussion with the service provider, or review of service provider’s SAS No. 70 report. The auditor should then determine the level of testing required to gain comfort over the unit values. The accumulation of the net asset value per unit may be covered by the SAS No. 70 report, which may be used to reduce the scope of substantive testing.

.66 Unitization is also typically used when employer stock or guaranteed investment contracts are offered as an investment
option in DC plans. A cash or money market component is added to the investment for liquidity purposes, and the transaction activity is unitized.

Unaudited PSA Accounts

.67 Pooled separate accounts (PSAs) are very common benefit plan investments and are similar to mutual funds except that they are issued by insurance companies and are not publicly traded like mutual funds. Usually PSAs have audited financial statements; however, for certain insurance companies, audited PSA financial statements are not available, and, therefore, the valuation and investment activity is not tested.

.68 Where there are no audited PSA financial statements, paragraphs 7.52 and 7.16 in the EBP Guide states that the auditor should obtain a copy of the service auditor’s report (SAS No. 70 report) if available, but the Guide does not discuss how to perform the substantive testing.

.69 While the best and ultimate solution may be for plan sponsors to require insurance companies to provide audited financial statements on the funds in which their plans invest, there are currently situations where plans have most of their investments in unaudited PSAs.

.70 When a PSA does not have audited financial statements, the auditor may consider the following:

1. Confirm existence of the underlying investments of the PSA on a security-by-security basis
2. Test valuation of the underlying investments in the PSA
3. Gain an understanding of the process to calculate the net asset value per unit
4. Determine the level of testing required to gain comfort over the unit values

.71 For transaction information during the year, consider performing the following:
1. Obtain, review and assess the insurance company PSA SAS No. 70 report, if available. See Chapter 6 of the EBP Guide for further guidance on the use of SAS No. 70 reports.

2. Test investment activity (such as, purchases and sales).

3. Test investment income through analytics or detailed testing.

4. If no SAS No. 70 report is available, consider expanding testing procedures.

**Investments Reported as 103-12 Entities as Required by the DOL**

.72 Many limited partnerships, hedge funds and other pooled funds such as group trusts elect to file with the DOL as a 103-12 entity. DOL regulation 29 CFR 2520.103-12 provides an alternative method of reporting for plans that invest in an entity, other than a master trust investment account, common/collective trust (CCT), or PSA, whose underlying assets include *plan assets* (within the meaning of DOL regulation 29 CFR 2510.2-101) of two or more plans that are not members of a related group of employee benefit plans. Making this determination can be complicated and may necessitate legal or other specialized industry consultation. Generally, a 103-12 entity will operate based on its legal structure (according to its operating agreements) in the form of a financial services product such as a trust or a limited partnership. Typically, audited financial statements are required by the entity's operating agreement and are prepared in accordance with GAAP in a format following industry standards consistent with the entity's operations. For example, a 103-12 entity that operates as a limited partnership would prepare financial statements in accordance with GAAP for limited partnerships. See paragraph A.56 of the EBP Guide for guidance on the filing requirements for 103-12 entities.

.73 To determine the auditing procedures for a plan's investment in a 103-12 entity, the auditor needs to understand the legal structure (for example, limited partnership or trust) and follow the auditing procedures as described in paragraphs 7.60 (limited partnerships) or 7.20 to 7.22 (CCTs) in the EBP Guide.
Self-Directed Investments

Plan sponsors of participant-directed DC plans continue to allow participants to expand their control over investment decisions through self-directed investments, which are sometimes referred to as self-directed brokerage accounts. These features allow participants to select any investment they choose without oversight from the plan administrator or investment committee. Self-directed investments are different from participant-directed investment fund options. Participant-directed investment fund options allow the participant to select from among various available alternatives and to periodically change that selection. The alternatives are usually fund vehicles, such as registered investment companies (that is, mutual funds), commingled funds of banks, or insurance company PSAs providing varying kinds of investments (for example, equity funds and fixed income funds). Paragraphs 7.61 through 7.63 of the EBP Guide provide additional guidance on self-directed features. Also, see paragraphs 7.59 and 7.60 of the EBP Guide if the self-directed assets consist of alternative investments such as limited partnerships, hedge funds, or private equity funds.

Help Desk—Auditors should note that when a SAS No. 70 report is available, it often does not cover the self-directed investments. In addition, auditors should obtain a reconciliation of the self-directed investment balances according to the trustee or custodian to the amount recorded in the financial statements.

Help Desk—The Form 5500 Schedule H, line 4i—Schedule of Assets Held (At End of Year) allows one line item reporting for self-directed assets except for investments in hard-to-value assets such as limited partnerships, joint ventures, and real estate. See Form 5500 Schedule H instructions for further detail.

Auditing Health and Welfare Plans

Health and welfare plans present unique audit challenges. They continue to be more complex and more expensive to audit than other types of plans. The administration of health claims payments has always been complicated, and the requirements for more timely claims processing, appeal decisions, and the privacy
requirements under the Health Insurance Portability and Accountability Act of 1996 (HIPAA) have added to these complexities. Standard audit programs for employee benefit plans should be tailored to the unique nature of health and welfare plans.

Before performing a health and welfare plan audit, it is critical for the auditor to obtain a clear understanding of the plan. It is important to note that the audit requirement is of the plan and not of the trust. Therefore, the auditor needs to understand the benefits offered by the plan and should consider the following:

- Which benefits are fully insured versus self-insured
- Who the providers are and the elements of the contractual arrangement with the plan
- For self-insured claims, how the various claims are administered and adjudicated; how fees are charged; and if the benefit payment is recognized when the check is written, when check is presented for payment, or when check has cleared the bank
- For insured benefits, how the premiums are determined and billed, and if the contract requires or provides for premium stabilization reserves or experience-rated adjustments
- What the funding arrangement is for each benefit offered (for example, paid from trust like the VEBA, taxable trust, 401(h) account or general assets of plan sponsor), and frequency of payment (daily, monthly, quarterly, or annually)
- What information systems are used to support the plan operations and which of those are in-house systems or outsourced

When answering these questions, the auditor should consider the responses with regard to all covered participants (that is, active participants, dependents, terminated employees under the Consolidated Omnibus Budget Reconciliation Act (COBRA), and retirees). Understanding the various benefits offered, the
service providers, and the control environment are integral to de-
veloping the audit approach and the sampling methodology.

.78 This section is intended to describe certain areas unique
to health and welfare benefit plans, including suggested audit proce-
dures\(^2\) such as:

1. HIPAA privacy concerns
2. Health and welfare claims and potential problems
3. Contracts with benefit service providers
4. Rebates receivable
5. Accumulated eligibility credits
6. Actuarial data and census information
7. Stop-loss coverage
8. Premium stabilization reserves
9. COBRA
10. Health savings accounts and health reimbursement
    arrangements

1. HIPAA Privacy Concerns

.79 HIPAA established standards for the privacy and protec-
tion of individually identifiable electronic health information as
well as administrative simplification standards. HIPAA includes
protection for those who move from one job to another, who are
self-employed, or who have preexisting medical conditions. It
places requirements on employer-sponsored group health plans,
insurance companies, and health maintenance organizations.

.80 The rules include standards to protect the privacy of indi-
vividually identifiable health information. The rules (applicable to
health plans, health care clearinghouses, and certain health care
providers) present standards with respect to the rights of individ-
uals who are the subjects of this information, procedures for the

\(^2\) Some of the audit procedures noted may be more extensive than what is required by
generally accepted auditing standards (GAAS).
exercise of those rights, and the authorized and required uses and disclosures of this information. These are the first-ever national standards to protect medical records and other personal health information.

**Business Associates Agreements**

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

**Audit Documentation**

.82 As previously noted, HIPAA requires that plan sponsors enter into a business associates agreement with any of their service providers that have access to PHI. Accordingly, an auditor is considered a business associate and, after entering into a business associates agreement, should be permitted access to the necessary information required by professional standards to opine on a
plan’s financial statements. HIPAA regulations allow for the auditors’ working papers to contain PHI; however, PHI in working papers obligates the auditing firm to comply with the HIPAA privacy laws and business associates agreement provisions to maintain the privacy of the PHI, which includes:

- Restricting access to the working papers
- Providing an accounting of disclosures of PHI
- Reporting to the sponsor any misuse of PHI by the accounting firm

.83 AU section 339, Audit Documentation (AICPA, Professional Standards, vol. 1), (SAS No. 103) provides guidance to auditors on documentation requirements. See paragraphs 5.17 through 5.24 of the EBP Guide for guidance.

.84 De-identified health information is not subject to HIPAA. To be considered de-identified under HIPAA, information in work papers should not contain:

- Names
- Dates (such as birth date, admission date, discharge date, and date of death)
- Age if 90 or over
- Social security numbers (or block out all except last four digits)
- Telephone and fax numbers
- E-mail addresses
- Medical record numbers
- Health plan beneficiary numbers
- Account numbers

2. Health and Welfare Claims and Potential Problems

.85 The auditor should have a basic understanding of the terms of the plan and have the skill and knowledge to test that
claims are being properly adjudicated. It is not expected that the auditor would have the knowledge of a skilled billing claims specialist or a skilled medical specialist when claims are processed by a third-party administrator. The auditor should be aware, however, of the typical problems that a health and welfare plan might experience when processing claims. The auditor should be aware of any processing problems that the plan is experiencing with claims and should discuss what the plan is doing to correct these issues with the plan administrator. See Appendix G of this Alert for claims testing information. Potential problems may include:

- Unbundling (charging for performance of multiple procedures when only one procedure was performed) or upcoding (charging for a higher level of service than the procedure actually performed)
- Fictitious services or unnecessary services performed by providers
- Duplicate claims or duplicate coverage
- Kickbacks
- Nontransmittal of rebates and discounts to the plan

When testing health and welfare claims, some errors typically found include:

- **Eligibility.** Testing for eligibility is different from those procedures for a pension or 401(k) plan. In many cases the person receiving the benefit is different from the actual participant. Audit procedures may include verifying the coverage elected by the participant at the date of service. Many plans allow coverage for a spouse, dependents, or other family members. Most problems with eligibility relate to a participant who terminates and whose eligibility ceased before the date of service for which the claim was filed.

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

- **Other errors.** These may occur in the diagnosis code, the Current Procedural Terminology or Healthcare Common Procedure Coding System code, or in the information in the claims form.

### 3. Contracts With Benefit Service Providers

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

### 4. Rebates Receivable

If there are rebates receivable from a service provider, those rebates should be examined to determine if the correct amount for the appropriate periods of time has been reflected in the proper period. In addition, the auditor should gain an understanding of the service contracts and apply procedures to determine if all rebates have been received by the plan. These include rebates from prescription drug programs or excess premiums paid over claims incurred under certain contractual arrangements with insurance companies. Finally, the auditor should consider the propriety of the rebate. For example, if the payment vehicle for the claims receiving the rebate was the Voluntary Employees' Beneficiary Association (VEBA) trust account, receipt of the rebate by the plan sponsor and deposit of such rebate into a non-trust account may not be appropriate.

---

3. Physicians’ Current Procedural Terminology (CPT) is a listing of descriptive terms and identifying five-digit codes for reporting medical services and procedures. The Health Care Financing Administration (HCFA) developed level II and level III codes in its Healthcare Common Procedure Coding System (HCPCS codes) to bill for supplies and services not covered by a CPT code (level I).
5. Accumulated Eligibility Credits

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

6. Actuarial Data and Census Information

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

7. Stop-Loss Coverage

.91 One way for a plan to protect itself against excessive losses is to purchase stop-loss insurance. Stop-loss insurance can be either specific or aggregate. Specific stop-loss insurance protects the plan against claims that exceed a predetermined maximum per person or per family. All claims above the specific stop-loss amount (for example, $25,000) are normally reimbursed at 100 percent up to a limit contained in the plan. Aggregate stop-loss coverage reimburses the plan when total eligible claims exceed a predetermined aggregate, such as 125 percent of expected claims.

.92 The auditor should gain an understanding of the stop-loss coverage that a plan has and should test that claims have been
properly filed against the policy within the period specified by the policy.

8. Premium Stabilization Reserves

In some fully insured or minimum premium arrangements, an insurance company may require a contract holder to maintain a premium stabilization reserve. Such reserves are usually adjusted by the insurance company at the end of the policy year. The annual adjustment is often the computed difference, or some factor thereof, between actual claims experience of the insurer and premiums paid by the contract holder. Generally, premium stabilization reserves are held in the general assets of the insurance company and are used to pay future premiums of the contract holder. If the premium stabilization reserve is certain to provide future benefits to the plan, the reserve is reported as an asset of the plan. In some cases, the contract holder may liquidate the premium stabilization reserve via cash payment from the insurance company. In other cases, the premium stabilization reserve is forfeited by the contract holder in the event of termination of coverage. Criteria for realization of the reserve should be considered when evaluating the existence of the asset.

9. COBRA

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

.95 In many cases, the collection of COBRA contributions and payment of COBRA benefits are performed by third-party administrators. The administration of these benefits should be understood, so accounting for all COBRA activity is included in the financial statements of the plan. In the event that benefits provided by COBRA are self-insured, the obligation for claims IBNR should include COBRA participants.

**Notices for COBRA Continuation Health Care Coverage**

.96 The DOL has published final rules clarifying the requirements for notices under COBRA for employees, employers, and plan administrators. The rules provide guidance and model notices for workers and family members to continue their group health care coverage. Under COBRA, most group health plans must give employees and their families the opportunity to elect a temporary continuation of their group health coverage when coverage would otherwise be lost for reasons such as termination of employment, divorce, or death. COBRA requires that certain notices be given before individuals can elect COBRA coverage. The plan administrator must give employees and spouses a general notice explaining COBRA when the employees and spouses first become covered under the plan. When an event occurs that would trigger a right to elect COBRA coverage, either the employer or the employee and his or her family members must notify the plan of the event. Finally, when the plan receives this notice, the plan must notify individuals of their COBRA rights and allow them to elect continuation coverage. Model notices contained in the regulation are available for download from the EBSA's Web site at www.dol.gov/ebsa.

**10. Health Savings Accounts and Health Reimbursement Arrangements**

.97 Individuals enrolled in certain high-deductible health plans can establish HSAs to receive tax-favored contributions (from either the employee or employer). The contribution made to the HSA is distributed on a tax-free basis to pay or reimburse
qualifying health expenses, may be used for future expenses, or may be used (on a taxable basis) for nonhealth purposes. Funds held in the HSA can be used to pay premiums for long-term care insurance and health insurance premiums while receiving unemployment benefits or continuation benefits under COBRA. The HSA’s funds are required to be held by an insurance company or trustee (bank).

When HSAs or HRAs are standalone, they have no audit requirement. However, HSAs and HRAs that are components of a health and welfare plan are subject to audit, as are the other components of that health and welfare plan, provided that the plan in question is subject to ERISA’s audit requirement. In Field Assistance Bulletins (FABs) 2004-1 and 2006-2, the DOL addressed various questions concerning HSAs, including the issue of whether HSAs established in connection with employment-based group health plans constitute employee welfare benefit plans for purposes of Title I of ERISA. See these FABs and paragraph 4.06 in the EBP Guide for further information about HSAs and HRAs.

**Eligible Compensation and Payroll Data**

**Eligible Compensation**

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

---

4. This refers to qualified health expenses as defined under Internal Revenue Code section 213(d).
.100 The auditor should examine the definition of compensation used to determine whether the method used is allowable within the Internal Revenue Code (IRC). An employer may use any definition of compensation that satisfies IRC section 414(s), which does not allow a method of determining compensation if that method discriminates in favor of highly compensated employees. Salary deferrals do not have to be included in the definition of compensation if the plan specifically provides for this limitation.

Payroll Data

.101 If one audit firm performs both the plan audit and corporate audit, there may be some efficiencies to be achieved surrounding the testing of payroll. While testing of the payroll area may have been performed in conjunction with the corporate audit, all of the assertions surrounding payroll relevant to the plan audit may or may not have been tested. The plan auditor needs to understand which assertions surrounding payroll were tested during the corporate audit to determine the scope of payroll testing required for the plan audit.

.102 For example, payroll testing performed for a corporate audit may include only high-level analytics with limited documentation of the control environment or performance of substantive procedures and may be insufficient to satisfy the payroll testing requirements for a plan audit. Often, payroll processing is outsourced to an outside service provider that may have a SAS No. 70 type 1 report, which provides a description of procedures and controls but does not have a SAS No. 70 type 2 report, which also includes testing of the procedures and controls and can be used to reduce the scope of substantive testing. There are some payroll service providers that have a SAS No. 70 type 2 report. However, the SAS No. 70 type 2 reports often have extensive user controls that must be present at the plan sponsor and be tested by the plan auditor to rely on the SAS No. 70 type 2 report. Paragraph 10.05 of the EBP Guide describes procedures the auditor should consider to test payroll in conjunction with the plan audit. Also see Appendix H of this Alert for guidance on payroll auditing.
.103 In certain circumstances, the plan sponsor may issue an integrated Rule 404 report under PCAOB Auditing Standard No. 2, *An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements* (AICPA, PCAOB Standards and Related Rules, AU sec. 320), that includes tests of controls surrounding the payroll area. The report should be reviewed carefully by the plan auditor to determine its usefulness in reducing the scope of testing for the plan audit. Plan auditors should be aware that while they may be able to rely on key controls tested by the corporate auditor to reduce the scope of payroll testing for the plan audit, key controls tested by management may not be used to reduce the scope of the payroll testing for the plan audit.

.104 If the plan sponsor has an internal audit department that has performed work on payroll data that is relevant to the audit, and if it is efficient to incorporate their work into the audit, AU sec. 322, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements* (AICPA, Professional Standards, vol. 1), provides guidance on what the auditor needs to consider when making use of the internal auditors' work in the plan audit.

**Actuarial Reports for Defined Benefit Plans**

.105 Several economic and demographic assumptions are used in actuarial valuations for defined benefit plans to determine funding requirements and the actuarial present value of accumulated plan benefits in accordance with FASB Statement No. 35. One of the most significant economic assumptions is the discount rate. There are two approaches that can be used to select the discount rate. The most commonly used approach is to reflect the long-term expected rate of return on assets. This amount is generally stable from one year to the next. Based on recent economic trends, the range of discount rates used is 7 percent to 8.5 percent for 2006 calendar year-end plans. When this approach is used, the rate selected will generally be the same as that used for funding purposes. The plan auditors should not assume that the FASB Statement No. 35 discount rate under this approach will be
the same as the FASB Statement No. 87, *Employers’ Accounting for Pensions*, expected long-term rate of return on assets or the FASB Statement No. 87 discount rate. In most cases, the plan discount rate will be different than either of the FASB Statement No. 87 rates. Care should be taken to determine if the proper amount is disclosed in the benefit plan’s financial statements.

.106 The second approach that may be used to select the FASB Statement No. 35 discount rate is to select a rate that reflects an insurance company’s purchase rates as of the benefit information date. Because this is a settlement type of rate, it may be similar to (but not necessarily the same) as the FASB Statement No. 87 discount rate. A discount rate selected on this basis can be expected to change from year to year to reflect changes in the long-term interest rate markets.

.107 The most significant demographic assumptions used to determine the actuarial present value of accumulated plan benefits include mortality rates, turnover, retirement, marriage statistics, and form of payment or type of benefit elections. With the increase in life expectancies, the mortality assumption should be improving. Certain mortality tables used by actuaries include the 1983 GAM table, 1994 GAM, UP 1994, and RP-2000 tables. The 1983 GAM table is a required table for certain of the calculations to determine minimum funding requirements under ERISA through 2006. It has been common practice to use the same table for FASB Statement No. 35 purposes as is required for minimum funding purposes. It can therefore be expected that the 1983 GAM table will be used frequently for 2006 audits. Beginning in 2007, the new table that will be required for minimum funding purposes will be based on the RP-2000 table.

.108 Because older mortality tables such as 1983 GAM are becoming outdated and will no longer be used for ERISA purposes after 2006, auditors should consider challenging the use of such tables for purposes of determining the FASB Statement No. 35 liability beginning in 2007. It is possible that the use of the 1983 GAM table may continue to be acceptable depending on the plan’s experience; however, most plans will be changing to use
the 1994 GAM, UP 1994, or the recent RP-2000 tables for their mortality assumptions.

.109 Regardless of the assumption used, each assumption must be individually reasonable. Plan administrators should review actual plan experience with assumptions used periodically to determine if any changes should be made. The following should also be considered as plan auditors review actuarial valuations:

• Trends and nature of benefit distributions (for example, lump sum versus annuity) should be considered. A plan that predominantly pays lump sum benefits will have a higher cost than an equivalent plan that pays annuities. To properly value the plan’s liabilities, there must be assumptions used to reflect the cost of the lump sum benefits. If there are only assumptions that reflect annuities, the lump sum benefits will be undervalued.

• Whether there has been a shift in the plan population over time should be considered. This could warrant a different assumption for turnover or retirement if, for example, participants are retiring much earlier or later than assumed.

• Whether there have been recent plan mergers or acquisitions should be considered. In the case of a plan merger, all assumptions should be reviewed for their continued reasonableness because the assumptions used for one plan may not be appropriate for the plan being merged.

• Whether there have been any plan benefit formula changes or a freezing of the plan should be considered. Changes in plan benefits available may affect anticipated turnover and retirement patterns. These assumptions should be reviewed if the plan is amended to change benefits.

• Whether consistent gains and losses are generated each year should be considered. If yes, this may indicate that assumptions are not reasonable based on actual experience.

• When reviewing an actuarial report, consideration should be given to:
a. Consistency of benefits accumulated each year (auditors should expect changes if there has been a plan merger, acquisition, or significant plan provision change)

b. Benefit payments in the roll forward of accumulated plan benefits should match the amount per the statement of changes in net assets (to properly match these amounts, it is necessary to understand if the beginning of the year or end of the year information is used for the actuarial valuation)

c. The asset value on the financial statements should match the asset value shown in the actuarial report

d. Inclusion of impact of a change in plan provisions and impact of merger, spin-off, or acquisition

.110 It is also important to note that the assumption of salary increases is not relevant for FASB Statement No. 35 because FASB Statement No. 35 is based on the disclosure of the actuarial present value of accumulated plan benefits, which does not take into account future salary increases.

The Use of Beginning-of-Year Benefit Information Date

.111 The presentation of the financial statement information and the footnotes are affected by the benefit information date selected for disclosure. The preferred approach is to use an end-of-year benefit information date. If this is done, the present value of accumulated plan benefits will be as of the same date as the net assets. In this case, at a minimum, there will be two statements of net assets available for benefits and one statement of changes in net assets. There will be two corresponding statements (or disclosure in the footnotes) of the present value of accumulated plan benefits and one statement of changes. Examples of this are shown in Exhibits D-1, D-2, D-3, and D-4 of the EBP Guide.

.112 However, if beginning-of-year benefit information is used, the date of the benefit information in the actuarial report may not match the date at which net assets are presented. For example, for financial statements presented as of December 31, 2006, and December 31, 2005, the actuarial valuation will be as
of January 1, 2006. For the benefit information to match the statement of net assets, the present value of accumulated plan benefits should be presented as of December 31, 2005 (one day earlier). Typically, this will not cause a material misstatement unless there was a plan amendment that took place on January 1, 2006. In that case, the effect of the amendment must be removed. As shown in the EBP Guide, when beginning-of-year benefit information is used, two statements of net assets and two statements of changes would be included. Only a single year of present value of accumulated plan benefits is required with a reconciliation from the prior year. Examples of this are shown in Exhibits D-1, D-7, and D-8 of the EBP Guide.

**Medicare Prescription Drug, Improvement, and Modernization Act**

.113 The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 provides for subsidies payable from the government to an employer or a health care plan that provides drug benefits that are at least actuarially equivalent to the Medicare Part D benefits. Depending upon the type of plan, the benefit obligations should either reflect or not reflect the effect of these subsidies.

.114 For a single employer plan, the subsidies are generally payable to the employer and not to the plan. As a result, the employer’s obligation is reduced, but the plan’s obligation has not been reduced. In determining the employer’s obligations according to FASB Statement No. 106 for the employer’s financial statements, the benefit obligation is reduced to reflect the effect of the subsidy. Because the plan’s obligation is not reduced, it is not appropriate for the plan to show the same FASB Statement No. 106 obligation that was reported by the employer. In these circumstances, two valuations are required. One valuation is needed for the employer’s reporting under FASB Statement No. 106, and a second valuation (without removing the effect of the subsidy) is required to report the plan’s obligations. Auditors need to be sure that the second valuation is being used for the plan’s financial statements and that the plan is not reporting the same obligation as the employer.
For a multiemployer plan, the subsidies are due to the plan. Therefore, the obligations reported by the multiemployer plan should reflect the effect of the Medicare subsidy. Unlike the single employer plan, there is no FASB Statement No. 106 reporting required for employers participating in the multiemployer plan. Therefore, there is only one valuation required for multiemployer plans, and that valuation should reflect the reduced obligation that reflects the Medicare subsidy.

Allocation Testing for DC Plans

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

Missing Participant Data

With recent trends in plan mergers as a result of corporate actions, a number of plan sponsors have been experiencing difficulties in maintaining all pertinent participant data relating to census data and benefit payments. Often, plan sponsors do not maintain the proper detail supporting the deferred vested benefits for defined benefit plans. Lapses in maintaining data can also be caused by a change in service providers (for example, actuaries or other third-party administrators). ERISA requires plans to maintain records that are detailed enough to determine benefits due or that may become due. When auditors are unable to obtain the necessary information to test participant data or benefit payments,
this could be considered a restriction on the scope of the audit. According to AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol.1), restrictions on the scope of the audit, whether imposed by the client or by circumstances (such as the timing of his or her work, the inability to obtain sufficient competent evidential matter, or an inadequacy in the accounting records), may require the auditor to qualify his or her opinion or to disclaim an opinion. In these situations, the auditor will need to determine how significant the restriction on the scope of the audit is to the overall engagement to determine the effect on the auditor’s report.

.118 The missing participant data issue is exacerbated when there is a change in auditor, especially for defined benefit plans. Often, the predecessor auditor has been auditing the participant data for years and is comfortable with the cumulative audit knowledge. However, if the participant data have not been maintained, the successor auditor may have a scope limitation. Auditors should take special care in determining if there are any missing participant data prior to accepting a new benefit plan engagement.

.119 Auditors should recommend that a plan sponsor consult with legal counsel and consider contacting the DOL prior to attaching a qualifier or disclaimer of opinion relating to a Form 5500 filing for a benefit plan.

**Analytical Procedures as Substantive Tests**

.120 For all audits of financial statements in accordance with GAAS, analytical procedures should be applied to some extent for the purposes of assisting the auditor in planning the nature, timing, and extent of other auditing procedures and as an overall review of the financial information in the final review stage of the audit. In some cases, however, analytical procedures can be more effective or efficient than tests of details for achieving particular substantive testing objectives. Analytical procedures may be used as substantive tests to obtain evidential matter about particular assertions related to account balances or classes of transactions.
See Appendix F of this Alert for further guidance on the use of analytical procedures in employee benefit plan audits.

**On the Horizon—Auditing**

.121 Auditors should keep abreast of auditing developments and upcoming guidance that may affect their engagements. Presented in the following section is brief information about some ongoing projects that have particular significance to employee benefit plans or that may result in very significant changes. Read the AICPA general *Audit Risk Alert—2006/07* (product no. 022337kk) for a more complete list of ongoing auditing and accounting projects. Remember that exposure drafts are nonauthoritative and cannot be used as a basis for changing GAAP or GAAS.

.122 The following table lists the various standard-setting bodies’ Web sites where information may be obtained on outstanding exposure drafts, including downloading exposure drafts. These Web sites contain much more in-depth information about proposed standards and other projects in the pipeline. Many more auditing projects exist in addition to those discussed here. Readers should refer to information provided by the various standard-setting bodies for further information.

<table>
<thead>
<tr>
<th>Standard-Setting Body</th>
<th>Web Site</th>
</tr>
</thead>
<tbody>
<tr>
<td>AICPA Auditing Standards Board (ASB)</td>
<td><a href="http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Exposure+Drafts+of+Proposed+Statements">www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Exposure+Drafts+of+Proposed+Statements</a></td>
</tr>
<tr>
<td>AICPA Accounting Standards Executive Committee (AcSEC)</td>
<td><a href="http://www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+Standards/edo/index.htm">www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+Standards/edo/index.htm</a></td>
</tr>
<tr>
<td>Financial Accounting Standards Board (FASB)</td>
<td><a href="http://www.fasb.org/draft/index.shtml">www.fasb.org/draft/index.shtml</a></td>
</tr>
<tr>
<td>Public Company Accounting Oversight Board (PCAOB)</td>
<td><a href="http://www.pcaobus.org">www.pcaobus.org</a> or <a href="http://www.pcaob.com">www.pcaob.com</a></td>
</tr>
<tr>
<td>Professional Ethics Executive Committee (PEEC)</td>
<td><a href="http://www.aicpa.org/members/div/ethics/index.htm">www.aicpa.org/members/div/ethics/index.htm</a></td>
</tr>
</tbody>
</table>
Help Desk—The AICPA's standard-setting committees publish exposure drafts of proposed professional standards exclusively on the AICPA Web site. The AICPA will notify interested parties by e-mail about new exposure drafts. To be added to the notification list for all AICPA exposure drafts, send your e-mail address to service@aicpa.org. Indicate “exposure draft e-mail list” in the subject header field to help process your submission more efficiently. Include your full name, mailing address, and your membership and subscriber number in the message. The AICPA Web site also has links to the other standard-setting bodies listed in the previous table.

Auditing Pipeline—Nonpublic Companies

Proposed Amendment to SAS No. 69, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles

.123 The ASB has issued an exposure draft introducing a proposed SAS titled Amendment to Statement on Auditing Standards No. 69, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles, for Nongovernmental Entities. This proposed SAS, which applies only to nongovernmental entities, has been issued in response to the FASB’s proposed Statement titled The Hierarchy of Generally Accepted Accounting Principles. The FASB proposal moves responsibility for the GAAP hierarchy for nongovernmental entities from the auditing literature to the accounting literature. The proposed SAS deletes the GAAP hierarchy for nongovernmental entities from SAS No. 69, The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles (AICPA, Professional Standards, vol. 1, AU sec. 411). The ASB decided to coordinate the provisions and effective date of this exposure draft with the FASB proposed Statement, which can be obtained at www.fasb.org.

Proposed Statement on Standards for Attestation Engagements Regarding Reporting on an Entity’s Internal Control Over Financial Reporting

.124 In January 2006, the ASB issued a revised exposure draft of a proposed Statement on Standards for Attestation
Engagements (SSAE) that would supersede Chapter 5, “Reporting on an Entity’s Internal Control Over Financial Reporting,” of SSAE No. 10, *Attestation Standards: Revision and Recodification* (AICPA, *Professional Standards*, vol. 1, AT sec. 501), as amended. This proposed SSAE establishes standards and provides guidance to the practitioner who is engaged to issue or does issue an examination report on the effectiveness of an entity’s internal control over financial reporting as of a point in time (or on an assertion thereon). In May 2006, the PCAOB announced plans to amend certain aspects of PCAOB Auditing Standard No. 2 to improve its implementation. Because the forthcoming changes to the PCAOB standard will be relevant to the revision of AT section 501, the ASB has decided to defer the issuance of a final AT standard until the PCAOB issues their amendments and the ASB has time to consider them.

**Auditing Pipeline—Public Companies**

.125 For pending projects for both the PCAOB and the SEC, readers may refer to the *SEC and PCAOB Alert—2006/07* (product no. 022497kk), mentioned previously.

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

.126 The AICPA, working with the EBSA, has made a concerted effort to improve the guidance and training available to auditors of employee benefit plans. The AICPA self-regulatory teams continue to be concerned about deficiencies noted on audits of employee benefit plans, and practitioners need to understand that severe consequences can result from inadequate plan audits, including loss of membership in the AICPA and loss of license. Some recurring deficiencies found in employee benefit plan audits include:

- Inadequate testing of participant data
- Inadequate testing of investments, particularly when held by outside parties
Inadequate disclosures related to participant-directed investment programs

Failure to understand testing requirements on a limited-scope engagement

Inadequate consideration of prohibited transactions

Incomplete description of the plan and its provisions

Inadequate or missing disclosures related to investments

Failure to properly report on a DOL limited-scope audit

Improper use of limited-scope exemption because the financial institution did not qualify for such an exemption

Inadequate or missing disclosures related to participant data

Failure to properly report on or include the required supplemental schedules relating to ERISA and the DOL.

The EBP Guide provides guidance concerning areas of noted deficiencies.

Form 11-K Audits

Form 8-K Requirements for Form 11-K Filers

For an employee benefit plan required to file Form 11-K, the SEC staff has historically expected a change in a plan’s auditor to be reported on Form 8-K; however, plans that filed their financial statements as part of the plan sponsor’s annual report (as provided for in Exchange Act Rule 15d-21) have not been expected to report changes in its auditors on Form 8-K. This requirement was discussed at the April 4, 2006, AICPA SEC Regulations Committee meeting. While the SEC staff unofficially stated that all employee stock purchase, savings, or similar plans that change auditors are not required to file a Form 8-K (regardless of whether it files its annual financial statements on Form 11-K or as part of the plan sponsor’s annual report), the committee observed that, under Section 1000.08(m), “Notification of the
Commission or Resignations and Dismissals from Audit Engagements for Commission Registrants,” of the PCAOB Interim Quality Control Standards, an independent registered public accounting firm is required to report the termination of the auditor-client relationship for any SEC registrant, which is defined to include employee benefit plans that file Form 11-K. The SEC staff agreed to discuss its position on Form 8-K reporting by employee benefit plans with the PCAOB staff. Until authoritative guidance is provided by the SEC that provides a specific exemption, public accounting firms should continue to provide “five-day” letters to comply with PCAOB requirements for a change in auditor of a plan that files a Form 11-K. An employee benefit plan whose financial statements are filed as an amendment to the sponsor’s Form 10-K does not meet the definition of an SEC Engagement and would therefore fall outside the scope of Section 1000.08(m).

Preapproval of Employee Benefit Plan Audits

.129 In December 2005, the SEC issued “Current Accounting and Disclosures Issues in the Division of Corporation Finance” to provide guidance regarding the preapproval of audits of employee benefit plans. Section II.R.3 is summarized in the following paragraph.

.130 An employee benefit plan may be an affiliate of a registrant as its plan sponsor. The SEC’s independence rules related to pre-approval surround services provided to the issuer and the issuer’s subsidiaries but not services provided to other affiliates of the issuer that are not subsidiaries. Therefore, the independence rules do not require the audit committee of the plan sponsor to pre-approve audits of the employee benefit plans, although the audit committee is encouraged to do so. When employee benefit plans are required to file Form 11-K, those plans are separate issuers under the Exchange Act; as a result, those issuers are subject to the preapproval requirements. This pre-approval can be provided by either the audit committee of the plan sponsor or the appropriate entity overseeing the activities of the employee benefit plan, such as the trustee, plan administrator or responsible
party. The SEC’s rules require that all fees, including fees related to audits of employee benefit plans, paid to the principal auditor be included in the company’s fee disclosures, regardless of whether the audit committee of the company pre-approved those fees. As part of the exercise to gather the information for the required fee disclosures, the audit committee should be made aware of all fees paid to the principal auditor, including those related to audits of the employee benefit plans. The company may elect to separately indicate in their disclosures those fees paid to the principal auditor that were not subject to the pre-approval requirements. Registrants and their auditors are reminded that the financial statements included in a Form 11-K must be audited by an independent auditor that is registered with the PCAOB, and the audit report must refer to the standards of the PCAOB rather than GAAS.

Audit Reports—Following Two Sets of Standards

SEC Requirements

.131 The SEC requires employee stock purchase, savings, and similar plans with interests that constitute securities registered under the Securities Act of 1933 to file Form 11-K pursuant to Section 15(d) of the Securities Exchange Act of 1934. Reports on Form 11-K must be filed with the SEC within 90 days after the end of the fiscal year of the plan, provided that plans subject to ERISA file the plan financial statements within 180 days after the plan’s fiscal year end.

Applicable Audit Standards

.132 Plans that are required to file Form 11-Ks are deemed to be issuers under the Sarbanes-Oxley Act and must submit to the SEC an audit in accordance with the auditing and related professional practice standards promulgated by the PCAOB. These plans may also be subject to ERISA and must submit to the DOL an audit in accordance with GAAS promulgated by the AICPA’s ASB. It is our understanding that the SEC will not accept an audit report that references GAAS, and the DOL will not accept an audit report that does not reference GAAS.
Performance and Reporting Requirements

.133 Based on AICPA staff discussions with the SEC and PCAOB staff to seek clarification of the performance and reporting requirements for audits of 11-K filers, firms will need to conduct their audits of these 11-K plans in accordance with two sets of standards and prepare two separate audit reports: an audit report referencing PCAOB standards for Form 11-K filings with the SEC and a separate audit report referencing GAAS for DOL filings. The PCAOB and SEC staff believes that an opinion issued 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), does not allow a reference to GAAS, hence a “dual” standard report is not appropriate and will not be accepted by the SEC.

.134 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, OCA at (202) 942-2960. See the EBP Guide, paragraph 13.19, for an example of an opinion for an 11-K audit.

PCAOB Standards and Conforming Amendments

.135 As a result of the Sarbanes-Oxley Act of 2002, both U.S. and non-U.S. public accounting firms wishing to prepare or issue reports, or to play a substantial role in the preparation or issuance of such reports, on U.S. public companies must be registered with the PCAOB and comply with the standards and rules of the PCAOB. The PCAOB’s standards and rules apply to registered public accounting firms and their associated persons in connection with their audits of the financial statements of issuers, as defined in Section 2(a)(7) of the Sarbanes-Oxley Act, and those firms’ auditing and related attestation practices. Plans that are required to file Form 11-K are deemed to be issuers under the Sarbanes-Oxley Act and must submit to the SEC an audit in accordance with the auditing and related professional practice standards promulgated by the PCAOB. The PCAOB does not intend to suggest that registered public accounting firms and their associated persons must comply with the PCAOB’s standards and rules in auditing.
nonissuers. Auditors who fall within the PCAOB’s scope should understand and follow the standards, rules, and other requirements of the PCAOB. All PCAOB standards and rules must be approved by the SEC before taking effect.

**PCAOB Auditing Standard No. 4**

.136 Since the publication of last year’s Alert, the PCAOB has issued PCAOB Auditing Standard No. 4, *Reporting on Whether a Previously Reported Material Weakness Continues to Exist* (AICPA, *PCAOB Standards and Related Rules*). This standard applies if auditors report on the elimination of a material weakness in a company’s internal control over financial reporting. The standard establishes a voluntary engagement that would be performed at the election of the company.

**Help Desk**—For information on auditing standards and related guidance issued subsequent to the writing of this Alert, please refer to the PCAOB Web site at www.pcaobus.org (audits of issuers only).

**Accounting Issues**

**Recent Accounting Pronouncements**

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

**Recent Accounting Pronouncements and Related Guidance**

<table>
<thead>
<tr>
<th>FASB Statement No. 157 (September 2006)</th>
<th><em>Fair Value Measurements</em></th>
</tr>
</thead>
<tbody>
<tr>
<td>FASB Statement No. 158 (September 2006)</td>
<td><em>Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans—an amendment of FASB Statements No. 87, 88, 106, and 132(R)</em> (continued)</td>
</tr>
</tbody>
</table>
Recent Accounting Pronouncements and Related Guidance

An employer without publicly traded equity securities is required to recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after June 15, 2007. However, an employer without publicly traded equity securities is required to disclose certain information in the notes to financial statements for a fiscal year ending after December 15, 2006, but before June 16, 2007, unless it has applied the recognition provisions of this Statement in preparing those financial statements.

FASB Statement No. 159
(February 2007)
The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115
This Statement is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provisions of FASB Statement No. 157, Fair Value Measurements.

FASB Interpretation No. 48
(June 2006)
Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109
This Interpretation is effective for fiscal years beginning after December 15, 2006. Earlier application of the provisions of this Interpretation is encouraged if the enterprise has not yet issued financial statements, including interim financial statements, in the period this Interpretation is adopted.

FASB Emerging Issues Task Force (EITF) Issues
(Various dates)
Go to www.fasb.org/eitf/ for a complete list of EITF Issues.
FSPs
(Various dates)
Go to www.fasb.org/fasb_staff_positions/ for a complete list of FSPs.

FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes

FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109, clarifies the accounting for uncertainty in income taxes recognized
in an enterprise’s financial statements in accordance with FASB Statement No. 109, *Accounting for Income Taxes*. This Interpretation 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. This Interpretation also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition.

.139 This Interpretation is effective for fiscal years beginning after December 15, 2006. Earlier application of the provisions of this Interpretation is encouraged if the enterprise has not yet issued financial statements, including interim financial statements, in the period this Interpretation is adopted.

**FASB Statement No. 157, *Fair Value Measurements***

.140 FASB Statement No. 157, *Fair Value Measurements*, defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. This Statement applies under other accounting pronouncements that require or permit fair value measurements because the FASB previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, this Statement does not require any new fair value measurements. However, for some entities, the application of this Statement will change current practice.

.141 This Statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Earlier application is encouraged, provided that the reporting entity has not yet issued financial statements for that fiscal year, including financial statements for an interim period within that fiscal year.

**FASB Statement No. 158, *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans***

.142 FASB Statement No. 158, *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans—*an
amendment of FASB Statements No. 87, 88, 106, and 132(R), improves financial reporting by requiring an employer to recognize the overfunded or underfunded status of a defined benefit postretirement plan (other than a multiemployer plan) as an asset or liability in its statement of financial position and to recognize changes in that funded status in the year in which the changes occur through comprehensive income of a business entity or changes in unrestricted net assets of a not-for-profit organization. This Statement also improves financial reporting by requiring an employer to measure the funded status of a plan as of the date of its year-end statement of financial position, with limited exceptions.

.143 An employer with publicly traded equity securities is required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006.

.144 An employer without publicly traded equity securities is required to recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after June 15, 2007.

.145 However, an employer without publicly traded equity securities is required to disclose certain information in the notes to financial statements for a fiscal year ending after December 15, 2006, but before June 16, 2007, unless it has applied the recognition provisions of this Statement in preparing those financial statements.

Help Desk—FASB Statement No. 158 will result in testing of investment amounts at the plan sponsor. Such testing by the plan sponsor audit team would not preclude the plan auditor from performing a limited-scope audit of the plan.

.146 When the auditor audits both the plan sponsor and the plan, coordination of investment testing with the plan sponsor audit team may be useful. If the plan auditor does not audit the plan sponsor, consideration should be given to inquiring of the client if any issues arose during the audit of the plan sponsor when auditing investments.
Securities Lending Transactions

.147 Under FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*, plans that engage in securities lending should present the assets received in return for the securities, as well as the exchanged securities, on the statement of net assets available for benefits. The plan should also recognize its obligation to return the collateral in the statement of net assets available for benefits. The exchanged securities, as well as the assets received for them (if an investment), should be reported on the ERISA-required supplemental schedule of assets (held at end of year) with the appropriate disclosures.

.148 For securities lending arrangements within a master trust, footnote disclosure of the master trust investments should include the collateral pledged as well as an offsetting liability for the return of the collateral. Because plan investments in a master trust are recorded as a single line item on the plan’s statements of net assets, securities lending in the master trust would not be reflected on the face of the plan’s financial statements. Often, auditors are unaware that the plan has entered into these transactions because the trustee or custodian nets the collateral assets against the collateral liabilities and because the only indication is the existence of “other income” on the statements. Auditors should ask the plan sponsor and service providers about the existence of a securities lending arrangement and review plan documents to determine the proper auditing procedures. It is important to note that the terms of security lending agreements vary; therefore, it is recommended that auditors obtain a copy and review the security lending agreements to gain an understanding of the security lending arrangements entered into by the plan sponsor.

.149 Securities loaned under a securities lending program at the end of the year should be reported on the Form 5500 Schedule H, line 4i—*Schedule of Assets (Held at End of Year)*. If the transferee has the right by custom or contract to sell or repledge the security loaned, a notation should be made in column (c) of the plan’s Form 5500 Schedule H, line 4i—*Schedule of Assets (Held at End of Year)* showing there is a restriction on transferability of the loaned securities. If the transferee does not have the
right by custom or contract to sell or repledge the security loaned, no such notation is required on the plan’s Form 5500 Schedule H, line 4i—Schedule of Assets (Held at End of Year).

On the Horizon—Accounting

.150 Auditors should keep abreast of accounting developments and upcoming guidance that may affect their engagements. Presented in the following sections is brief information about some ongoing projects that have particular significance to employee benefit plans or that may result in very significant changes. Read the AICPA general Audit Risk Alert—2006/07 (product no. 022337kk) for a more complete list of ongoing auditing and accounting projects. Remember that exposure drafts are nonauthoritative and cannot be used as a basis for changing GAAP or GAAS.

.151 Refer to the table in the section “On the Horizon—Auditing” in this Alert for a listing of various standard-setting bodies’ Web sites where information may be obtained on outstanding exposure drafts, including downloading exposure drafts. Many more accounting and auditing projects exist in addition to those discussed there. Readers should refer to information provided by the various standard-setting bodies for further information.

Accounting Pipeline

.152 Presented in the following list are accounting pronouncements currently in the exposure process.

Proposed FASB Statement, The Hierarchy of Generally Accepted Accounting Principles

.153 This proposed Statement would identify the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of non-governmental companies that are presented in conformity with U.S. GAAP (or the GAAP hierarchy). The GAAP hierarchy is currently presented in AICPA SAS No. 69. However, the FASB
believes that the GAAP hierarchy should be directed specifically to companies because it is the company, not the auditor, that is responsible for selecting its accounting principles for financial statements. Accordingly, the FASB concluded that the GAAP hierarchy should reside in the accounting literature established by the FASB. The FASB decided to carry forward the GAAP hierarchy as set forth in SAS No. 69, subject to certain modifications. The FASB staff will coordinate with the AICPA (as previously discussed in the “Auditing Pipeline—Nonpublic Companies” section) to ensure that each of the documents has a uniform effective date. Readers should be alert for the issuance of a final Statement.

**FASB Project on Derivative Disclosures**

FASB Statement No. 133 has been criticized by certain analysts, auditors, investors, and others for lacking transparent disclosures, which would allow a user of the financial statements to assess the overall risk of derivatives on a reporting entity from both a quantitative and qualitative perspective. An exposure draft was issued on December 8, 2006, titled *Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133*. The comment deadline is March 2, 2007. The objective of this project is to provide guidance on enhanced disclosure requirements and balance sheet and income statement display of derivatives accounted for in accordance with FASB Statement No. 133. The proposed disclosures will be effective for both interim and annual reporting periods ending after December 15, 2007, with early application encouraged. At initial adoption, disclosures for earlier periods presented for comparative purposes will be encouraged but not required. Disclosures for earlier periods presented for comparative purposes will be required beginning in the first year after the year of initial adoption. Auditors can monitor the progress of this project on the FASB’s Web site.

**Proposed FASB EITFs and FSPs**

*Proposed FASB EITF Issues.* Numerous open issues are under deliberation by the EITF. Readers should visit the FASB

156 Proposed FSPs. A number of proposed FSPs are currently in progress. Readers should visit the FASB Web site at www.fasb.org/fasb_staff_positions for complete information.

Regulatory Developments

2006 Form 5500 Series

157 The DOL, IRS, and the PBGC have released the 2006 Form 5500 return/reports, schedules, and instructions to be used by employee benefit plans for plan year 2006 filings. The IRS has also released the Form 5500-EZ return and instructions to be used by certain one-participant retirement plans for plan year 2006 filings.

158 The modifications to the Form 5500 for plan year 2006 are described under “Changes to Note” in the 2006 instructions. Modifications to the Form 5500 Annual Report for 2006 include the following:

Form 5500. (1) The lines 6 and 7 instructions on counting participants and beneficiaries in welfare benefit plans have been expanded to include the definition of when an individual is no longer a participant or beneficiary. (2) The instructions covering small and large pension plans, under the Pension Benefit Plan Filing Requirements, have been clarified for attaching the pages of Schedule SSA to Form 5500. Filers should attach only one page 1. Filers can attach more than one page 2 as necessary.

Schedule B. (1) The instructions for lines 1d(2)(a), 1d(2)(c), and 6a have been modified because the PPA changed the interest rate to be used in calculating a plan’s current liability for the 2006 plan year. (2) The PPA provides funding relief for certain defined benefit plans (other than multiemployer plans) maintained by a commercial passenger airline or by an employer whose principal business is providing catering services
to a passenger airline. Special instructions have been added for this provision, allowing eligible plans to be funded using an alternative funding schedule based on a 17-year amortization of unfunded liabilities.

Schedules H and I. The TIPs in the instructions for lines 4a and 4d of Schedules H and I have been updated to refer to the revised Voluntary Fiduciary Correction Program (VFCP), which was published in the Federal Register on April 19, 2006. The TIPs also explain that applicants that satisfy both the VFCP requirements and the condition of PTE 2002-51 are relieved from the obligation to file the Form 5330 with the IRS.

Schedule P. The IRS no longer requires the filing of Schedule P, Annual Return of Fiduciary of Employee Benefit Trust.

.159 Modifications to the Form 5500-EZ Annual Report for 2006 include the following:

- The IRS has eliminated the filing requirement for the Schedule P, Annual Return of Fiduciary of Employee Benefit Trust.
- Instructions have been added for new line 10i for funding (see IRC section 412).

Help Desk—The official government-printed forms are available by calling (800) TAX-FORM (800-829-3676). In addition, EBSA publications may be ordered by calling (866) 444-EBSA (3272). Information, copies of the forms, schedules, and instructions are available on the EBSA’s Web site at www.efast.dol.gov. Filers should monitor the ERISA Filing Acceptance System (EFAST) Web site for information on approved software vendors when completing 2006 Forms 5500 by computer and for electronic filing options. Filers may contact the EFAST Help Line for general assistance by calling (866) 463-3278.

2006 Form M-1 for Multiple Employer Welfare Arrangements

.160 On December 7, 2006, the DOL published the 2006 Form M-1 annual report for multiple employer welfare arrangements (MEWAs). Plan administrators may use EBSA’s online filing system to expedite processing of the form.
MEWAs are arrangements that offer medical benefits to the employees of two or more employers or to their beneficiaries. The annual filing date for the 2006 Form M-1 is March 1, 2007. In addition, administrators can request an automatic 60-day extension to May 1, 2007. The 2006 form is virtually identical to the previous year’s form.

The online filing system is available on the DOL’s Web site. It allows filers to complete the form and submit it at no cost. The online form can be completed in multiple sessions and can be printed for the filer’s records. The Web site includes a user manual, frequently asked questions, and a link to submit questions electronically.

Help Desk—To use the online filing process, go to www.askesba.dol.gov/mewa/. Technical assistance for the online filing system is also available by calling (202) 693-8600. Information about the Form M-1 and how to fill it out is available on the Web site or by calling (202) 693-8360. Paper copies of the form may be obtained by calling EBSA’s toll free number at (866) 444-EBSA (3272) or visiting the Web site at www.dol.gov/ebsa and clicking on “Forms/Doc Requests.”

Correspondence from EFAST or the DOL OCA

Plan administrators often receive correspondence from the DOL regarding the Form 5500 filed for their pension and welfare benefit plans. These letters are generated by both the EFAST processing center in Lawrence, KS, and the DOL’s OCA in Washington, DC. Auditors are often asked by their clients to assist in the resolution of issues contained in these government letters.

EFAST-Generated Correspondence

Each year, plan administrators complete and submit to the DOL a Form 5500 for each of their qualified employee benefit plans. Large plans (and certain small pension plans) also require an annual audit, and the independent auditor’s report and audited financial statements become an integral part of the Form 5500 filing.
Once completed, the Form 5500 is filed with the DOL’s EFAST processing center in Lawrence, KS. EFAST uses sophisticated electronic technologies to review each filing before acceptance. The DOL, IRS, and the PBGC have created a variety of edit tests designed to check for things such as completeness, accuracy, timeliness, internal consistency, missing schedules or attachments, and failure to answer mandatory questions. If deficiencies or discrepancies are identified after subjecting Form 5500 filings to these multiagency edit tests, the EFAST system generates a letter addressed to the plan administrator that identifies the problem(s) and provides 30 days to make any necessary corrections. After 30 days, if the filing remains deficient, EFAST will generate a second letter in a final attempt to perfect the filing. At the end of a second 30-day period, the Form 5500 filings post to the ERISA database. Those filings still containing errors or omissions are flagged for further review by the DOL’s OCA, the IRS, and the PBGC.

**Correspondence from the OCA**

The DOL’s OCA has the responsibility for enforcing ERISA reporting and disclosure requirements. This includes ensuring that the Form 5500 filings are filed timely and correctly and determining whether plan audits are performed in accordance with professional auditing and regulatory standards. The OCA routinely queries the ERISA database and targets for review Form 5500 filings that satisfy certain criteria, including those filings in which processing errors went uncorrected and those with improperly prepared auditor’s reports. The OCA staff reviews the Form 5500 filings and requests copies of working papers that support audit engagements. If the OCA staff identifies problems, a formal enforcement process commences with the issuance of a Notice of Rejection (NOR) against the plan administrator.

Upon receipt of an NOR, the plan administrator has 45 days to make any necessary corrections to the Form 5500 filing. This may involve the auditors having to correct their audit reports or even perform additional fieldwork in audit areas where work was previously not performed or deemed by the DOL to be insufficient. At the end of the 45-day period, if the Form 5500
filing remains deficient, the DOL issues a Notice of Intent to Assess a Penalty (NOI), potentially subjecting the plan administrator to civil penalties of up to $1,100 per day (imposed from the day after the original due date of the filing). As a policy matter, however, most deficiencies are penalized at $150 per day with penalties capped at $50,000.

When plan administrators receive an NOI, they have 35 days to submit to the DOL a Statement of Reasonable Cause, submitted under penalty of perjury, in which they set forth any reasons why the penalty should be abated in part or in full. It is important to note that traditionally the DOL will not consider abatement of any penalties in cases where deficiencies still exist. If the plan administrator fails to comply with the requirements of the NOI, the penalty becomes a final agency action, and the plan administrator forfeits all appeal rights.

After the DOL reviews the Statement of Reasonable Cause, the agency issues a Notice of Determination that contains the final penalty amount assessed against the plan administrator. The plan administrators may choose to pay the penalty amount or, within 35 days as provided for in the letter, file an “Answer” with the administrative law judge that appeals the penalty.

**Important Reminders**

Plan administrators should make all efforts to respond timely and thoroughly to all correspondence they receive from the EFAST processing center. Failure to do so may result in future enforcement correspondence from the DOL’s OCA. The DOL’s penalty process contains rigid timeframes, and DOL officials do not have latitude to extend the deadlines contained in any correspondence. Plan administrators should also be aware that they may receive future enforcement correspondence from the IRS or PBGC regarding any unresolved filing issues.

Plan auditors often assist their clients in responding to the various DOL penalty notices. To respond on behalf of their clients, plan auditors must be authorized to do so pursuant to a duly executed, notarized power of attorney. Any questions regarding
the DOL penalty process should be directed to the OCA at (202) 693-8360.

**EBSA-Enhanced Programs to Assess Plan Audit Quality**

.172 The EBSA continues its enhanced programs aimed at assessing and improving the quality of employee benefit plan audits. According to the EBSA, 48 public accounting firms audit more than 100 plans that cover approximately 80 percent of plan assets subject to audit. The balance of the more than 70,000 ERISA audits is performed by nearly 10,000 different CPA firms, 8,200 of whom perform 5 audits or fewer. The EBSA utilizes both top-down and bottom-up strategies in selecting and evaluating ERISA audits.

.173 First, the EBSA conducts periodic inspections of firms with substantial ERISA audit practices. The EBSA staff meets with firm management, reviews firm policies and procedures that relate to employee benefit plan audits, and conducts onsite reviews of a sample of ERISA audit engagements. This top-down approach will provide the EBSA with more efficient means of evaluating the quality of audit work performed by these large firms and ensure that findings and recommendations are communicated to those in a position to effect any necessary changes. To date, the EBSA has completed five such reviews.

.174 Next, for firms with small- to medium-sized employee benefit plan audit practices, the EBSA focuses its in-house work on reviewing copies of selected audit working papers. When circumstances warrant, the scope of the EBSA’s reviews is expanded to additional audit areas. To date, the EBSA has conducted approximately 900 of these desk reviews.

.175 In instances in which deficient audit work is identified, the related Form 5500 filings are subject to rejection, and auditors potentially face referral to the AICPA’s Professional Ethics Division or State Board of Public Accountancy.

.176 Finally, the EBSA has expanded its enforcement efforts dealing with fiduciary breaches to include determining whether plan auditors may be considered as *knowing participants*. An
auditor is considered a knowing participant if at least one of the three following elements is present:

- The plan auditor took affirmative action to further the violation.
- The plan auditor helped in concealing the violation.
- The plan auditor failed to act when required to do so by applicable professional standards.

**DOL Fiduciary Education Initiatives**

The DOL is committed to providing employers and service providers with clear and easy-to-access information on how to comply with federal employment laws. Such information and guidance are often referred to as **compliance assistance**, which is a cornerstone of the DOL's mission.

The DOL's fiduciary education initiatives include nationwide educational seminars to help plan sponsors understand rules and meet their responsibilities to workers and retirees, thereby improving their financial security. Also included are the following DOL-issued publications:

*Meeting Your Fiduciary Responsibilities.* To meet their responsibilities as plan sponsors, employers need to understand some basic rules, specifically ERISA. ERISA sets standards of conduct for those who manage an employee benefit plan and its assets (called fiduciaries). This publication provides an overview of the basic fiduciary responsibilities applicable to retirement plans under the law.

*Understanding Retirement Plan Fees and Expenses.* This booklet will help retirement plan sponsors better understand and evaluate their plan’s fees and expenses. While the focus is on fees and expenses involved with 401(k) plans, many of the principles discussed in the booklet will also have application to all types of retirement plans.

*401(k) Plan Fee Disclosure Tool.* This is a form that provides employers with a handy way to make cost-effective decisions.
and compare the investment fees and administrative costs of competing providers of plan services.

Selecting an Auditor for Your Employee Benefit Plan. Federal law requires employee benefit plans with 100 or more participants to have an audit as part of their obligation to file the Form 5500. This booklet will assist plan administrators in selecting an auditor and reviewing the audit work and report.

Selecting and Monitoring Pension Consultants—Tips for Plan Fiduciaries. ERISA requires that fiduciaries of employee benefit plans administer and manage their plans prudently and in the interest of the plan’s participants and beneficiaries. In carrying out these responsibilities, plan fiduciaries often rely heavily on pension consultants and other professionals for help. To encourage the disclosure and review of more and better information about potential conflicts of interest, the DOL and the SEC have developed a set of questions to assist plan fiduciaries in evaluating the objectivity of the recommendations provided, or to be provided, by a pension consultant.

Tips for Selecting and Monitoring Service Providers for Your Employee Benefit Plan. Business owners are responsible for ensuring that their 401(k) plans comply with federal law and rely on other professionals to assist them with their plan duties. Selecting a service provider is one of the most important responsibilities of a plan sponsor. The EBSA has prepared this set of tips to assist business owners in carrying out these responsibilities.

Reporting and Disclosure Guide for Employee Benefit Plans. This Guide is intended to be used as a quick reference tool for certain basic reporting and disclosure requirements under ERISA.

Help Desk—Further information regarding DOL publications and the dates and locations of upcoming educational programs may be found on the EBSA’s Web site at www.dol.gov/ebsa.
Delinquent Filer Voluntary Compliance Program

.179 The Delinquent Filer Voluntary Compliance (DFVC) Program is designed to encourage plan administrators to file overdue annual reports by paying reduced penalties. Established in 1995 and revised in March 2002, the program offers incentives for delinquent plan administrators to voluntarily comply with ERISA’s annual reporting requirements.

Change in Mailing Address

.180 In April 2006, the DOL announced new addresses to be used for the DFVC Program. The new addresses are provided in the following table. Mail submitted to the former address will be returned, unopened, to the sender.

<table>
<thead>
<tr>
<th>Standard Mail</th>
<th>Private Delivery Service</th>
</tr>
</thead>
<tbody>
<tr>
<td>DFVC Program—DOL</td>
<td>DFVC Program—DOL</td>
</tr>
<tr>
<td>P.O. Box 70933</td>
<td>QLP Wholesale Lockbox—NC 0810</td>
</tr>
<tr>
<td>Charlotte, NC 28272-0933</td>
<td>1525 West WT Harris Blvd.</td>
</tr>
<tr>
<td></td>
<td>Charlotte, NC 28262</td>
</tr>
</tbody>
</table>

Program Eligibility

.181 Eligibility in the DFVC Program continues to be limited to plan administrators with filing obligations under Title I of ERISA who comply with the provisions of the program and who have not been notified in writing by the DOL of a failure to file a timely annual report under Title I of ERISA. Form 5500-EZ filers and Form 5500 filers for plans without employees (as described in 29 CFR 2510.3-3(b) and (c)) are not eligible to participate in the DFVC Program because such plans are not subject to Title I.

Program Criteria

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

Penalty Structure

.183

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

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

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

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

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

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

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

VFCP

.185 The VFCP encourages voluntary compliance by self-correcting violations of the law. The program also helps plan officials understand the law and gives immediate relief from payment of excise taxes under a class exemption.

.186 In April 2006, the EBSA expanded and simplified the VFCP to help employers and their professional advisors voluntarily correct violations of the law for employee benefit plans. This update to the VFCP reflects public comments and includes:

- Expansion and simplification of eligible transactions
- Streamlined documentation and clarified eligibility requirements
- A model application form
- Clarification of what constitutes under investigation, allowing more entities to qualify for the program
- Relief from civil penalties for transactions involving health and welfare plans

.187 Under the VFCP, employers may voluntarily correct specific ERISA violations. Applicants must fully correct any violations, restore to the plan any losses or profits with interest, and distribute any supplemental benefits owed to eligible participants.
and beneficiaries. A “no action” letter is given to plan officials who properly correct violations.

.188 The DOL also provides applicants conditional relief from payment of excise taxes for certain VFCP transactions under a class exemption related to the VFCP. The amended class exemption was also published in the Federal Register in April 2006.

Help Desk—For more information about the VFCP Program, contact a local EBSA regional office through its toll-free number (866) 444-EBSA (3272) or visit the DOL online at www.dol.gov/ebsa.

EBSA Outreach and Customer Service Efforts

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

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

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

.190 The EBSA continues to focus on the timeliness of remittance of participant contributions in contributory employee benefit plans. Participant contributions are plan assets on the earliest
date that they can reasonably be segregated from the employer’s general assets. The latest date that pension plans can be segregated is the 15th business day of the month following the month in which the participant contributions are withheld or received by the employer. The latest date that welfare plans can be segregated is 90 days from the date on which such amounts are withheld or received by the employer.

**Reporting of Late Remittances**

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

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

.193 Beginning with the 2003 Form 5500, information on delinquent participant contributions is no longer required to also be reported on line 4d of Schedule G. For large plans that are subject to the audit requirement, delinquent participant contributions reported on line 4a that constitute prohibited transactions (excluding those that have been corrected under the VFCP and for which the conditions of PTE 2002-51 have been satisfied) may be reported on a separate supplemental schedule to be attached to the Form 5500 and reported on by the Independent Qualified Public Accountant (IQPA).

.194 ERISA and DOL regulations require additional information to be disclosed in supplemental schedules. Some of this information is required to be covered by the auditor’s report. AU section 551, *Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents* (AICPA, *Professional Standards*, vol. 1), provides guidance on the
form and content of reporting when the auditor submits a document containing information accompanying the basic financial statements. If the auditor concludes that the plan has entered into a prohibited transaction and the transaction has not been properly disclosed in the required supplemental schedule, the auditor should (1) express a qualified opinion or an adverse opinion on the supplemental schedule if the transaction is material to the financial statements or (2) modify his or her report on the supplemental schedule by adding a paragraph to disclose the omitted transaction if the transaction is not material to the financial statements. See Chapter 11, “Party in Interest Transactions,” of the EBP Guide for further discussion of prohibited transactions.

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

- To receive a “no action” letter issued by the DOL that provides for no imposition of Section 502(l) penalties
- To receive relief from the excise tax provisions of the IRC
- To continue to report the occurrence and amount of the corrected delinquent remittances on line 4a of either Schedule H or Schedule I (but not on line 4d or Schedule G)
- To not be required to report such transactions as supplemental information if the plan is required to be audited because the transactions are not considered to be prohibited transactions

.196 The EBSA’s Web site, www.dol.gov/ebsa, contains useful information about the VFCP, including a fact sheet, an FAQ section, and a sample “no action” letter.

**Reporting of Delinquent Loan Repayments**

.197 Generally speaking, participant loan repayments are not subject to the DOL’s participant contribution regulation (29 CFR 2510.3-102). Accordingly, their delinquent remittance is not
reported on line 4a of either Schedule H or Schedule I. However, delinquent remittance of participant loan repayments is a prohibited transaction.

.198 In Advisory Opinion 2002-2A, the DOL concluded that, while not subject to the participant contribution regulation, participant loan repayments paid to or withheld by an employer for purposes of transmittal to an employee benefit plan are sufficiently similar to participant contributions to justify, in the absence of regulations providing otherwise, the application of principles similar to those underlying the final participant contribution regulation for the purpose of determining when such repayments become assets of the plan. Specifically, the Advisory Opinion concluded that participant loan repayments paid to or withheld by an employer for purposes of transmittal to the plan become plan assets as of the earliest date on which such repayments can reasonably be segregated from the employer’s general assets.

.199 Accordingly, the DOL will not reject a Form 5500 report based solely on the fact that delinquent forwarding of participant loan repayments is included on line 4a of the Schedule H or Schedule I. Filers that choose to include such participant loan repayments on line 4a must apply the same supplemental schedule and IQPA disclosure requirements to the loan repayments as apply to delinquent transmittals of participant contributions.

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

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

DOL Final Rule on Electronic Filing of the Form 5500 and Proposed Changes to the 2008 Form 5500

.201 On July 21, 2006, the EBSA published in the Federal Register a final regulation requiring plans to file Form 5500 annual reports electronically, beginning with 2008 plan year filings.
due in 2009. Simultaneously, the EBSA, along with the IRS and the PBGC, proposed changes to the forms that will be processed under the new electronic system.

.202 The wholly electronic filing system will be streamlined, cost effective, and more efficient for plans. It will also increase the accuracy of information used by the public and the government. Under the final rule, the electronic filing requirement will be effective for plan years starting on or after January 1, 2008. This will give plans and service providers time to adapt to the new electronic system and any changes to the Form 5500.

.203 Among the proposed revisions to the Form 5500 are (1) creation of a new short form for small plans whose assets are held in easy-to-value investments with regulated financial institutions, (2) increased transparency of plan-related fees and expenses, (3) improved information on the funding of defined benefit plans, and (4) realignment of the reporting rules of 403(b) plans (subject to Title I) to be compatible with those of 401(k) plans. The new system will also customize the information required to be filed to the type of plan involved in each filing.

Help Desk—The text of the final rule and the proposed changes to the Form 5500 are available on the EBSA Web site at www.dol.gov/ebsa.

DOL Proposes PPA Revisions to the Form 5500 Annual Report for 2008

.204 On December 8, 2006, the EBSA, IRS, and PBGC announced proposed supplemental revisions to the 2008 Form 5500.

.205 The proposed revisions implement amendments to ERISA’s annual reporting and pension funding requirements and the IRC enacted them as part of the PPA. The proposal supplements a more general revision of the 2008 Form 5500 proposed by the agencies in July 2006. The supplemental proposal would replace the Schedule B, Actuarial Information, filed by defined benefit pension plans with separate actuarial schedules for multi-employer plans and single-employer plans.
.206 The supplemental proposal would also add questions to the Schedule R, *Retirement Plan Information*, to collect new information on defined benefit pension plans required under the PPA.

.207 Finally, the supplemental proposal would establish the Form 5500-SF, which was part of the agencies’ July 2006 proposal, as the simplified report required by PPA for plans with fewer than 25 participants.

.208 These proposed revisions would be effective for 2008 plan year filings.

**DOL Abandoned Individual Account Plan Final Regulations and Class Exemption**

.209 On April 21, 2006, the DOL published in the Federal Register three regulations to facilitate the termination of, and distribution of benefits from, individual account pension plans that have been abandoned by their sponsoring employers. Significant business events, such as bankruptcies, mergers, acquisitions, and other similar transactions affecting the status of an employer, too often result in employers, particularly small employers, abandoning their individual account pension plans (for example, 401(k) plans). When this happens, custodians such as banks, insurers, and mutual fund companies are left holding the assets of these abandoned plans but do not have the authority to terminate such plans and make benefit distributions, even in response to participant demands. In these situations, participants and beneficiaries have great difficulty accessing the benefits they have earned.

**Overview of Regulations**

.210 The regulations establish standards for determining when a plan is abandoned, simplify procedures for winding up the plan and distributing benefits to participants and beneficiaries, and provide guidance on who may initiate and carry out the winding-up process.

**Plan Abandonment**

.211 A plan will generally be considered abandoned if no contributions to or distributions from the plan have been made for a period of at least 12 consecutive months and, following rea-
sonable efforts to locate the plan sponsor, it is determined that the sponsor no longer exists, cannot be located, or is unable to maintain the plan.

**Determinations of Abandonment**

.212 Only a qualified termination administrator (QTA) may determine whether a plan is abandoned under the regulations. To be a QTA, an entity must hold the plan’s assets and be eligible as a trustee or issuer of an individual retirement plan under the IRC (bank, trust company, mutual fund family, or insurance company).

**Termination and Winding-Up Process**

.213 The regulations establish specific procedures that QTAs must follow, including:

- Notifying the EBSA prior to and after terminating and winding up a plan
- Locating and updating plan records
- Calculating benefits payable to participants and beneficiaries
- Notifying participants and beneficiaries of the termination and their rights and options
- Distributing benefits to participants and beneficiaries
- Filing a summary terminal report

.214 A QTA is not required to amend a plan to accommodate the termination, and the rules include model notices that the QTA may use.

**Rollover Safe Harbor for Missing Participants**

.215 The regulations establish a fiduciary safe harbor for the investment of rollover distributions from terminated plans to IRAs for missing participants.

**Fiduciary Liability and Annual Reporting Relief**

.216 QTAs that follow the regulation will be considered to have satisfied the prudence requirements of ERISA with respect to winding-up activities.
The regulations provide annual reporting relief, under which QTAs are not responsible for filing a Form 5500 Annual Report on behalf of an abandoned plan, either in the terminating year or any previous plan years. The QTA must complete and file a summary terminal report at the end of the winding-up process.

Class Exemption

The exemption would cover transactions where the QTA selects and pays itself for the following:

- Services rendered prior to becoming a QTA
- Services in connection with terminating and winding up an abandoned plan
- Distributions from abandoned plans to IRAs or other accounts maintained by the QTA resulting from a participant’s failure to provide direction

Administration

The Abandoned Plan Program is administered by the EBSA’s national and regional offices. Notifications under the program should be sent by e-mail to qtanotices@dol.gov or by mail to:

Abandoned Plan Coordinator
U.S. Department of Labor
Employee Benefits Security Administration
Office of Enforcement
200 Constitution Avenue, NW, Suite 600
Washington, DC 20210
Tel. (202) 693-8466

Contact Information

For information regarding the Abandoned Plan Program, contact the DOL at (866) 444-EBSA (3272). For questions about the regulations, contact the EBSA’s Office of Regulations and Interpretations at (202) 693-8500. For questions about the class exemption, contact the EBSA’s Office of Exemption Determinations at (202) 693-8540.
**DOL Consultant Advisor Program**

.221 The EBSA has initiated a new enforcement project, the Consultant Advisor Program (CAP), that focuses on the receipt of improper, undisclosed compensation by pension consultants and other investment advisers. The EBSA’s investigations will seek to determine whether the receipt of such compensation violates ERISA because the adviser or consultant used its position with a benefit plan to generate additional fees for itself or its affiliates. The agency may also need to investigate individual plans to address such potential violations as failure to adhere to investment guidelines and improper selection or monitoring of the consultant or adviser. The CAP will also seek to identify potential criminal violations such as kickbacks or fraud.

**Independence Request for Information**

.222 On September 11, 2006, the EBSA published in the Federal Register a Request for Information (RFI) concerning whether the DOL should amend its guidelines on the independence of accountants who audit employee benefit plans. The RFI contained a list of 15 specific questions. Recognizing that these questions may not address all issues relevant to the independence of accountants who audit employee benefit plans, interested parties were invited to submit comments on other issues that they believe are pertinent to the DOL’s consideration of new or additional independence guidelines.

.223 The DOL comment period for the RFI closed on December 11, 2006, and the DOL has received 27 comments to date. The DOL continues to evaluate the comments to identify common themes, and the project remains an important DOL initiative.

**EBSA’s Proposed Rule on Default Investment Alternatives for Participant-Directed Plans**

.224 On September 27, 2006, the DOL published a proposed rule in the Federal Register to make it easier for fiduciaries of 401(k) plans and other participant-directed defined-contribution plans to adopt automatic enrollment design features. The proposed
rule is the first major regulation resulting from the PPA signed into law by President Bush on August 17, 2006.

.225 The proposal implements provisions of the PPA to provide relief to plan fiduciaries who invest the assets of participants in qualified default investment alternatives in the absence of participant investment direction.

.226 Upon adoption, the rule will remove a major impediment to automatic enrollment programs created by employers. Default investment alternatives under the proposed regulation are intended to encourage the investment of employee assets in appropriate investment vehicles for long-term retirement savings.

.227 The proposed rule and a fact sheet detailing the proposed rule can be found on the EBSA’s Web site at www.dol.gov/ebsa.

EBSA’s Final Amendment on Securities Lending Exemption

.228 On October 30, 2006, the EBSA adopted a final class exemption expanding the opportunities for securities lending between employee benefit pension plans and banks and broker-dealers. The exemption consolidates two existing class exemptions and provides conditions to safeguard the assets of plans involved in securities lending transactions. The updated requirements will permit pension plans to earn additional income by lending securities from their portfolios to a greater universe of permissible borrowers.

.229 Under the exemption, the categories of permissible borrowers have been expanded to include broker-dealers and banks of the United Kingdom, Canada, and certain other foreign broker-dealers and banks. In addition, the types of collateral that may be offered to plans for securities lending transactions have been broadened to include negotiable certificates of deposits payable in the United States, mortgage-backed securities, the British pound, the Canadian dollar, the Swiss franc, Japanese yen, the Euro, securities issued by Multilateral Development Banks, rated foreign sovereign debt, and irrevocable letters of credit issued by certain foreign banks.
.230 If the plan’s U.S.-domiciled lending agent agrees to indemnify the plan against losses resulting from a borrower’s default, the final exemption permits a plan to accept any other type of collateral currently permitted by the SEC under Rule 15c3-3 of the Securities and Exchange Act of 1934.

.231 The final exemption revokes and replaces Prohibited Transaction Exemptions 81-6 and 82-63.

**Model Notice of Pending Election of Multiemployer Plan Status**

.232 On December 1, 2006, the DOL published in the Federal Register a model notice that may be used by employee benefit plans that elect to be treated as multiemployer plans under the ERISA.

.233 The PPA amended ERISA to permit certain plans that elected to be single-employer plans to revoke that election and allow other plans to elect to be treated as multiemployer plans provided that notice of the election is furnished to participants and other interested parties no later than 30 days before the election. The notice must describe, among other things, the principal differences between ERISA’s guarantee programs and benefit restrictions for single-employer and multiemployer plans.

.234 Plan administrators may use the model notice to fulfill their notice obligations when making an election, and elections must be made with the PBGC within one year after the enactment of the PPA.

.235 A copy of the model notice is available through the EBSA’s Web site at www.dol.gov/ebsa.

**EBP Resources**

.236 These are employee benefit plan-related educational courses, Web sites, publications, and other resources available to CPAs.

**Related Publications**

.237 The following are some of the AICPA publications that deliver valuable guidance and practical assistance as potent tools to be used on your employee benefit plan engagements:
AICPA Audit and Accounting Guide Employee Benefit Plans, with conforming changes as of March 1, 2007 (product no. 012597kk) provides easy-to-follow guidance to prepare, audit, and report on financial statements of employee benefit plans.

Accounting Trends & Techniques—Employee Benefit Plans, second edition (product no. 006624kk) offers the same kind of powerful help that the AICPA's Accounting Trends and Techniques, 60th Edition (product no. 009898kk) does. This comprehensive book illustrates a wide range of employee benefit plan financial statement disclosures and auditors' reports for both full-scope and limited-scope audits. The publication also includes a chapter dedicated to illustrative management letters and management letter comments. Look for a revised second edition to be released this summer.

SAS No. 70 Reports and Employee Benefit Plans (product no. 061061kk) provides you with guidance on the use of SAS No. 70 reports in your employee benefit plan audits. In practice, auditors of employee benefit plans have continued to raise questions about how SAS No. 70 reports should be considered in their audits and the auditing procedures that should be applied to these reports to increase their reliability as audit evidence.

These practice aids, developed by the AICPA’s Accounting and Auditing Publications staff, are invaluable to anyone who prepares financial statements and reports (the 2007 checklists will be available this summer):


Web Casts

238 Strategic Industry Briefing—Employee Benefit Plans. The April 30, 2007, Web cast Strategic Industry Briefing—Employee Benefit Plans was an AICPA strategic briefing that addressed current industry developments and emerging practice issues relating to employee benefit plans. Participants learned about current accounting, auditing, and regulatory developments, including the impact of recently issued pronouncements on both preparers and auditors of employee benefit plans. Speakers included Marcus J. Aron, CPA; Marilee Lau, CPA; and Michele Weldon, CPA. This Web cast is available on CDROM (product no. 780102kk).

Conferences

AICPA Employee Benefit Plans Accounting, Auditing and Regulatory Update Conference

239 This high level forum lets you interact with expert auditors and members of the DOL. The 2007 Employee Benefit Plan Accounting, Auditing and Regulatory Update Conference will be held December 12 through 13, 2007, in Washington, DC. For more information, visit the Web site at www.cpa2biz.com/conferences.

National Conference on Employee Benefit Plans

240 Each spring, the AICPA sponsors a National Conference on Employee Benefit Plans that is specifically designed to update auditors, plan administrators, and plan sponsors on various topics, including recent and proposed employee benefit plan legislative and regulatory issues, and significant accounting, auditing, and tax developments. The 2008 National Conference on Employee Benefit Plans will be held May 12 through 15, 2008, in Las Vegas, NV. For a conference brochure, please call (888) 777-7077 and request brochure G50038. For more information, visit the Web site at www.cpa2biz.com/conferences.
Education Courses

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

- Audits of 401(k) Plans
- Employee Benefit Plans: Audit and Accounting Essentials
- Form 5500: Prepare It Fast—File It Right…The 1st Time
- SAS No. 70 Auditing Guidance
- Online CPE: AICPA InfoBytes

Service Center Operations

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

Hotlines

Accounting and Auditing Technical Hotline

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

Ethics Hotline

Members of the AICPA’s Professional Ethics Team answer inquiries concerning independence and other behavioral issues related to the application of the AICPA Code of Professional Conduct. Call (888) 777-7077.

Web Sites

AICPA Online and CPA2Biz

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

Other Helpful Web Sites

.246 Additional information on matters addressed in this Alert is available through various publications and services offered by a number of organizations. Some of those organizations are listed in the table at the end of this Alert.

.247 This Audit Risk Alert replaces Employee Benefit Plans Industry Developments—2006.

.248 The Audit Risk Alert Employee Benefit Plans Industry Developments is published annually. As you encounter audit and industry issues that you believe warrant discussion in next year’s Audit Risk Alert, please feel free to share them with us. Any other comments that you have about the Audit Risk Alert would also be greatly appreciated. You may e-mail these comments to ldelahanty@aicpa.org or write to:

Linda C. Delahanty
AICPA
1211 Avenue of the Americas
New York, NY 10036-8775
### INFORMATION SOURCES

<table>
<thead>
<tr>
<th>Organization</th>
<th>General Information</th>
<th>Fax Services</th>
<th>Web Site Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>American Institute of Certified Public Accountants</td>
<td>Order Department (888) 777-7077</td>
<td>24-Hour Fax Hotline (201) 938-3787</td>
<td><a href="http://www.aicpa.org">www.aicpa.org</a></td>
</tr>
<tr>
<td>Financial Accounting Standards Board</td>
<td>Order Department P.O. Box 5116 Norwalk, CT 06856-5116</td>
<td>24 Hour Fax-on-Demand (203) 847-0700, menu item 14</td>
<td><a href="http://www.fasb.org">www.fasb.org</a></td>
</tr>
<tr>
<td>Public Company Accounting Oversight Board</td>
<td>1666 K Street, NW Washington, DC 20006-2803</td>
<td></td>
<td><a href="http://www.pcaob.org">www.pcaob.org</a> or <a href="http://www.pcaob.com">www.pcaob.com</a></td>
</tr>
<tr>
<td>Department of Labor Employee Benefits Administration</td>
<td></td>
<td></td>
<td><a href="http://www.dol.gov/dol/EBSA">www.dol.gov/dol/EBSA</a></td>
</tr>
<tr>
<td>Office of the Chief Accountant</td>
<td>(202) 693-8360</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Division of Accounting Services</td>
<td>ERISA related accounting and auditing questions</td>
<td>(202) 693-8360</td>
<td></td>
</tr>
<tr>
<td>Division of Reporting Compliance</td>
<td>Form 5500 preparation and filing requirements</td>
<td>(202) 693-8360</td>
<td></td>
</tr>
<tr>
<td>Office of Regulations and Interpretations</td>
<td>(202) 693-8500</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
## IRS Limits on Benefits and Compensation

<table>
<thead>
<tr>
<th></th>
<th>2007</th>
<th>2006</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Defined benefit</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximum annual pension</td>
<td>$180,000</td>
<td>$175,000</td>
<td>$170,000</td>
</tr>
<tr>
<td><strong>Defined contribution</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximum annual addition</td>
<td>45,000</td>
<td>44,000</td>
<td>42,000</td>
</tr>
<tr>
<td><strong>401(k) plan</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximum elective deferral</td>
<td>15,500</td>
<td>15,000</td>
<td>14,000</td>
</tr>
<tr>
<td><strong>403(b) plan</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximum elective deferral</td>
<td>15,500</td>
<td>15,000</td>
<td>14,000</td>
</tr>
<tr>
<td><strong>457 plans</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximum elective deferral</td>
<td>15,500</td>
<td>15,000</td>
<td>14,000</td>
</tr>
<tr>
<td><strong>SIMPLE plans</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximum elective deferral</td>
<td>10,500</td>
<td>10,000</td>
<td>10,000</td>
</tr>
<tr>
<td><strong>Qualified plans</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximum compensation limits</td>
<td>225,000</td>
<td>220,000</td>
<td>210,000</td>
</tr>
<tr>
<td>Highly compensated limits</td>
<td>100,000</td>
<td>100,000</td>
<td>95,000</td>
</tr>
<tr>
<td>Officer limits (key employee)</td>
<td>145,000</td>
<td>140,000</td>
<td>135,000</td>
</tr>
<tr>
<td>FICA taxable wage base</td>
<td>97,500</td>
<td>94,200</td>
<td>90,000</td>
</tr>
<tr>
<td>Employer and employee social security tax</td>
<td>6.20 percent</td>
<td>6.20 percent</td>
<td>6.20 percent</td>
</tr>
</tbody>
</table>

1. Catch-up contributions for individuals over age 50 increased to $3,000 in 2004, to $4,000 in 2005, and to $5,000 in 2006 and 2007.
APPENDIX B

Evaluating Control Deficiencies in an Employee Benefit Plan Audit (Applying SAS No. 112)

SAS No. 112 provides guidance to enhance your ability to identify and evaluate control deficiencies during an audit and then communicate to management and those charged with governance those deficiencies that you believe are significant deficiencies or material weaknesses. Auditors should be aware that the nature of the employee benefit plan environment is likely to give rise to the written communications required by SAS No. 112.

The standard has two unconditional requirements:

- The auditor must evaluate identified control deficiencies and determine whether those deficiencies, individually or in combination, are significant deficiencies or material weaknesses.

- The auditor must communicate, in writing, significant deficiencies and material weaknesses to management and those charged with governance. This communication includes significant deficiencies and material weaknesses identified and communicated to management and those charged with governance in prior audits but not yet remediated.

A control deficiency 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 misstatements on a timely basis.

When conducting an audit of historical financial statements, you are not required to perform procedures to identify control deficiencies. However, during the course of the audit, you may become aware of deficiencies in the design or operation of the entity’s internal control. Your awareness of control deficiencies
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 your substantive procedures may cause you to reevaluate your earlier assessment of internal control.

Evaluating Internal Control Deficiencies
A control deficiency may be considered just a deficiency. More severe deficiencies are significant deficiencies, and the most severe deficiencies are material weaknesses.

Definitions of Significant Deficiency and Material Weakness
A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity’s ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles (GAAP) such that there is more than a remote\(^1\) likelihood that a misstatement of the entity’s financial statements that is more than inconsequential will not be prevented or detected.

A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected.

Help Desk—SAS No. 112 includes a list of areas in which control deficiencies ordinarily are at least significant deficiencies

---

1. The term remote likelihood as used in the definitions of the terms significant deficiency and material weakness has the same meaning as the term remote as used in Financial Accounting Standards Board (FASB) Statement No. 5, Accounting for Contingencies. Paragraph 3 of FASB Statement No. 5 states:

   When a loss contingency exists, the likelihood that the future event or events will confirm the loss or impairment of an asset or the incurrence of a liability can range from probable to remote. This Statement uses the terms probable, reasonably possible, and remote to identify three areas within that range, as follows:

   a. Probable. The future event or events are likely to occur.

   b. Reasonably possible. The chance of the future event or events occurring is more than remote but less than likely.

   c. Remote. The chance of the future events or events occurring is slight.

   Therefore, the likelihood of an event is “more than remote” when it is at least reasonably possible.
and a list of indicators that a control deficiency should be regarded as at least a significant deficiency and a strong indicator of a material weakness. A material financial statement misstatement that was not identified by management is a strong indicator of a material weakness. SAS No. 112 also contains an appendix that provides examples of circumstances that may be control deficiencies, significant deficiencies, or material weaknesses.

The Evaluation Process

You must evaluate the control deficiencies that you have identified and determine whether these deficiencies, individually or in combination with other control deficiencies, rise to the level of significant deficiencies or material weaknesses.

The factors that you should consider when evaluating control deficiencies are likelihood and magnitude. *Likelihood* refers to the probability that a control, or combination of controls, could have failed to prevent or detect a misstatement in the financial statements being audited. *Magnitude* refers to the extent of the misstatement that could have occurred or that actually occurred because misstatements include both potential and actual misstatements.

The following table summarizes how you consider the significance of a deficiency to determine whether it is a control deficiency, a significant deficiency, or a material weakness.

<table>
<thead>
<tr>
<th>Magnitude of misstatement</th>
<th>Likelihood of misstatement</th>
</tr>
</thead>
<tbody>
<tr>
<td>that occurred, or could have occurred</td>
<td>More than Remote</td>
</tr>
<tr>
<td>Quantitatively or qualitatively material</td>
<td>Material weakness</td>
</tr>
<tr>
<td>More than inconsequential but less than material</td>
<td>Significant deficiency but not a material weakness</td>
</tr>
<tr>
<td>Inconsequential (in other words, clearly immaterial)</td>
<td>Control deficiency but not a significant deficiency or a material weakness</td>
</tr>
</tbody>
</table>
The “Prudent Official” Test
When you evaluate the significance of a deficiency, the last step in your evaluation is to conclude whether a “prudent official,” having knowledge of the same facts and circumstances, would agree with your classification of the deficiency.

Help Desk—See the AICPA Audit Risk Alert Understanding SAS No. 112 and Evaluating Control Deficiencies (product no. 022536kk) to assist you in the implementation of this standard and to provide additional guidance on communication requirements including the form, content, and timing of the communication and the discussion with management and others.

SAS No. 112 includes examples of factors that impact the consideration of likelihood and magnitude.

Likelihood
In addition to the factors listed in SAS No. 112 and Understanding SAS No. 112 and Evaluating Control Deficiencies (SAS No. 112 Alert), the following are examples of factors for employee benefit plans that may affect the likelihood that a control or combination of controls could fail to prevent or detect a misstatement:

The nature of the financial statements accounts, disclosures, and assertions involved
• For example, related party transactions may be prohibited transactions and involve greater risk

The susceptibility of the related assets or liability to loss or fraud
• Investments and benefits paid have a higher susceptibility to loss or fraud

The subjectivity and complexity of the amount involved and the extent of judgment necessary to determine that amount
• For example, the calculation of the present value of accumulated plans benefits

The cause and frequency of any known or detected exceptions relating to the operating effectiveness of a control
• Health benefit payments have a higher likelihood of fraud or irregularity
• Operational deficiencies, such as non-timely contributions

The interaction or relationship of the control with other controls

• Effective monitoring controls at the plan sponsor level and how they interact with the service provider (as outlined in the SAS No. 70 report)

Magnitude

Factors that may affect the magnitude of a misstatement that could result in a deficiency or deficiencies in controls 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 account balance or class of transactions exposed to the deficiency in the current period or expected in future periods

For employee benefit plans, areas to consider include contributions, claim payments, benefit payments, and investments. The application of the definition of compensation, when incorrectly used, can result in a higher magnitude (for example, the exclusion of a certain earnings code in error over a period of years could have a material impact).

Generally, the recorded amount is the maximum amount by which an account balance or total of transactions can be overstated. However, because of the potential for unrecorded amounts, there is no upper limit on the amount of potential understatement.

Control Deficiencies, Significant Deficiencies, or Material Weaknesses

The SAS No. 112 Alert provides a general list of circumstances that may be control deficiencies, significant deficiencies, or material weaknesses.

In addition to the items listed in the SAS No. 112 Alert, the following paragraphs describe circumstances for employee benefit plans that may be control deficiencies, significant deficiencies, or
material weaknesses depending upon the likelihood and magnitude of the deficiency.

**Help Desk**—The items listed here should be used to supplement but not replace those listed in the SAS No. 112 Alert. This is a companion to but not a substitute for, the guidance in SAS No. 112 and the SAS No. 112 Alert. Also, when a control deficiency has been identified, management and the auditor should also evaluate the possible mitigating effects of compensating controls. See the SAS for further guidance.

**Significant Deficiencies**

Deficiencies in the following areas are ordinarily at least significant deficiencies in internal control:

- **Controls over the selection and application of accounting principles that are in conformity with GAAP (having sufficient expertise in selecting and applying accounting principles is an aspect of such controls)**
  - Improper valuation of investments, especially alternative investments
  - Plan management must have the ability (methodology and process) to determine reasonableness of actuarial assumptions

- **Controls over nonroutine and nonsystematic transactions**
  - Lack of controls over plan mergers and spin-offs
  - Lack of controls over plan terminations and liquidation accounting
  - Lack of controls over accounting for plan amendments
  - Lack of controls when changing service providers and ensuring proper information has been transferred to the new service provider

**Material Weaknesses**

Each of the following circumstances is an indicator of a control deficiency that should be regarded as at least a significant deficiency and a strong indicator of a material weakness in internal control:
Ineffective oversight by those charged with governance of the entity's financial reporting and internal control, or an ineffective overall governance structure

- Plan sponsor has outsourced the administrative functions of the plan with no oversight by management
- Plan sponsor does not have the ability to prepare or review the financial statements
- Health and welfare plan utilizes a cash account only for the activity of the plan and neither the outside service provider nor the plan sponsor can prepare the financial statements
- Ineffective communication of plan changes between plan management and human resources or payroll department resulting in significant GAAP deficiencies such as not adjusting the plan financial statements for plan merger or other significant transactions
- Lack of documentation of meetings held by those charged with governance (making decisions without documentation)
- Appropriateness of plan expenses (if material)

Restatement of previously issued financial statements to reflect the correction of a material misstatement

The correction of a misstatement includes misstatements due to error or fraud but not restatements to reflect a change in accounting principle to comply with a new accounting principle or a voluntary change from one GAAP to another. For employee benefit plans, the following situations may cause restatement of the financial statements if material:

- For health and welfare plans, auditing and reporting only on the trust activity rather than the plan
- IBNR not accurately calculated or recorded
- Failure to record discretionary employer contributions especially in profit-sharing plans
- Errors in census data that result in a material misstatement of obligation information
• Benefit payments not calculated in accordance with plan documents
• Not recording demutualizations of insurance companies in the proper period
• Failure to properly present and disclose investments (such as securities lending activities, master trusts, and alternative investments)
• Incorrect income and expense allocations within a master trust
• Cash held on deposit by service providers and not recorded for a health and welfare plan
• Inappropriate accounting and disclosure for allocated and unallocated contracts
• Improper expenses paid by the plan
• Medicare subsidy not properly reflected in the financial statements
• Incorrect reporting of 401(k) accounts
• Use of incorrect actuarial information in the plan financial statements, for example the use of FASB Statement No. 87 rather than FASB Statement No. 35 or using FASB Statement No. 106 rather than FASB Statement No. 112
• Inappropriate expense allocation between multiemployer plans or the sponsoring union
• Improper booking of premium stabilization reserves

Identification by the auditor of a material misstatement in the financial statements for the period under audit that was not initially identified by the entity's internal control

This includes misstatements involving estimation and judgment for which the auditor identifies likely material adjustments and corrections of the recorded amounts, which is a strong indicator of a material weakness even if management subsequently corrects the misstatement. For employee benefit plans often, these are due
to changes in plan design or the implementation of new pronouncements.

- IBNR not accurately calculated or recorded
- Not reflecting securities lending in the financial statements due to the lack of understanding of such activity and or the lack of understanding of GAAP requirements surrounding such investments
- Lack of having the financial expertise in the financial reporting process
- For plan mergers, the recording of net appreciation and transfer amounts may be incorrect due to timing of the accounting of the merger

An ineffective internal audit function or risk assessment function at an entity for which such functions are important to the monitoring or risk assessment component of internal control, such as for very large or highly complex entities

For employee benefit plans, this may include:

- Investing in alternative or complex investments without proper due diligence or consideration for the accounting, reporting, or regulatory requirements
- No oversight for monitoring claims paid in a health and welfare plan
- For multiemployer plans, improper monitoring of cash received from contributing employers
- Ineffective IT controls
- For plans with multiple payroll locations, failure to understand the components of eligible compensation or failure to understand the procedures related to timeliness of participant contributions
- Failure to understand the complex nature of the relationships between the plan’s systems and the service provider’s systems (for example, payroll systems to actuary or record-keeper systems)
• SAS 70 report with significant testing exceptions that are not mitigated by controls at the plan sponsor

For complex entities in highly regulated industries, an ineffective regulatory compliance function

This relates solely to those aspects of the ineffective regulatory compliance function for which associated violations of laws and regulations could have a material effect on the reliability of financial reporting. When evaluating the severity of such control deficiencies, the auditor should consider whether the entity has controls in place to monitor the impact on the financial statements of laws and regulations relevant to the conduct of the entity’s business, and should evaluate the severity of the absence of such controls based on the entity’s potential to misstate obligations that may arise from such laws or regulations. For employee benefit plans, this may include:

• Lack of performance of tax compliance testing such as discrimination testing or lack of taking appropriate corrective action when errors are found in such testing

• Prohibited transactions such as timeliness of employee contributions or improper transactions with parties-in-interest and fiduciaries

• Lack of timely reporting to regulatory agencies (such as the IRS, DOL, and PBGC)

Failure by management or those charged with governance to assess the effect of a significant deficiency previously communicated to them and either correct it or conclude that it will not be corrected (see paragraph 23 of SAS No. 112 for communication requirements in these circumstances)

• This could occur if, for example, one individual is primarily responsible for the accounting and internal controls over all cash receipt and cash disbursement transactions. Having one individual with access to the receipt and disbursement of monies does not provide adequate protection over the plan’s assets. Management should consider hiring
additional staff or reassign some responsibilities to others to ensure proper segregation of duties is maintained. Given the limited nature of accounting procedures necessary on a monthly basis, management may not feel it is cost effective to add staff to these functions.

An ineffective control environment
Control deficiencies in various other components of internal control could lead the auditor to conclude that a significant deficiency or material weakness exists in the control environment.
For employee benefit plans this may include:

- Lack of oversight by the plan sponsor of the service provider including not obtaining and reviewing a SAS 70 report if available
- For service providers with no SAS 70 reports, no procedures in place at the plan sponsor to monitor and assess control risk at the service provider

Evaluation Questions
In evaluating the severity of a control deficiency, the first step is to determine whether the deficiency is at least a significant deficiency. Some questions to ask yourself when making this determination include the following:

- Is the likelihood that a misstatement of any magnitude could occur and not be detected by the client’s controls at least reasonably possible?
- Is the magnitude of a potential misstatement inconsequential or less than inconsequential to the financial statements? A misstatement is inconsequential if a reasonable person would conclude, after considering the possibility of further undetected misstatements, that the misstatement, either individually or when aggregated with other misstatements, would clearly be immaterial to the financial statements.
- Are there complementary or redundant controls that were tested and evaluated that achieve the same control objective?
• Are there compensating controls that were tested and evaluated that limit the magnitude of a misstatement of the financial statements to inconsequential?

If the answers to these questions are all no, then the deficiency is at least a significant deficiency. If the answer to any question is yes, before concluding that the control deficiency is not at least a significant deficiency, ask yourself if prudent officials, having your knowledge of the facts and circumstances, would agree with your conclusion that the deficiency is not at least a significant deficiency.

If a prudent official would consider the control deficiency to be at least a significant deficiency, then you would conclude that the deficiency is at least a significant deficiency.

The next step is to assess whether the deficiency is a material weakness. Some questions to ask yourself in making this determination include the following:

• Is the magnitude of the potential misstatement less than material to the financial statements?

• Are there compensating controls that were tested and evaluated that limit the magnitude of a misstatement of the financial statements to less than material but more than inconsequential?

• Does additional evaluation result in a judgment that the likelihood of a material misstatement of the financial statements is remote?

If the answers to these questions are all no, then the deficiency is a material weakness. If the answer to any question is yes, before concluding that the deficiency is not a material weakness, ask yourself if prudent officials, having your knowledge of the facts and circumstances, would agree with your conclusion that the deficiency is a significant deficiency and not a material weakness, considering the financial statements.

If a prudent official would consider the control deficiency to be a material weakness, then you would conclude that the deficiency is a material weakness.
Illustrative Letter

The following is an illustrative letter for ABC 401(k) Plan with significant deficiencies and material weaknesses. This letter is 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. For guidance, see the SAS No. 112 Alert.

[Firm letterhead]

[Date]

[Addressee]²

[Address]

Ladies and Gentlemen:

In planning and performing our audit of the financial statements of ABC 401(k) Plan (the “Plan”) as of and for the year ended December 31, 20XX, in accordance with auditing standards generally accepted in the United States of America, (“US GAAS”) we considered the Plan’s internal control over financial reporting (internal control) as a basis for designing our auditing procedures 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.

Our Responsibilities

Our consideration of internal control was for the limited purpose described in the preceding paragraph and would not necessarily identify all deficiencies in internal control that might be significant deficiencies or material weaknesses. However, as discussed below, we identified certain deficiencies in internal control that we consider to be significant deficiencies and other deficiencies that we consider to be material weaknesses.

² The addressee should be the plan oversight entity such as the board of trustees, the board of directors, or the audit committee.
Definitions Related to Internal Control Deficiencies

A control deficiency 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 misstatements on a timely basis. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects a Plan's ability to initiate, authorize, record, process, or report financial data reliably in accordance with generally accepted accounting principles such that there is more than a remote likelihood that a misstatement of the Plan's financial statements that is more than inconsequential will not be prevented or detected by the Plan's internal control. A material weakness is a control deficiency, or combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected by the Plan's internal control.

Identified Deficiencies in Internal Control

We consider the following deficiencies to be significant deficiencies in internal control.

Employer Matching Contributions

During our audit procedures, we noted that the plan sponsor, ABC Company, incorrectly calculated the employer match for one participant, causing the participant to receive an excess match for the plan year. Upon further investigation, it was determined that the entire XYZ division was impacted by this error. The plan sponsor intends to correct these errors by reducing the next employer match calculation for the affected participants by the amount of the excess match and earnings thereon. We recommend the plan sponsor develop and execute policies and procedures to ensure the proper calculation of employer matching contributions and that these calculations are reviewed by someone other than the individual performing the calculation.

Employee Deferral Contributions

During our audit procedures, we noted that 401(k) deferrals were not withheld from several participants' paychecks during the year
due to the timing of the paycheck, setup of pay types in the ADP payroll software, or because the check was a manual check. The plan sponsor will correct these errors by increasing the participant’s next deferral by the missed contribution amount along with remitting the missed employer match and lost earnings in the next monthly remittance. We recommend that the plan sponsor develop and execute policies and procedures to ensure the proper calculation of employee deferrals and that these calculations are reviewed by a knowledgeable individual at the plan sponsor because the calculations are performed by a third-party payroll service provider.

It was also noted during our audit procedures that there is some inconsistency in the application of the terms in the Plan document relating to the definition of eligible compensation for the purposes of calculating the employee's contribution and the employer's contribution. One participant in our sample made and received contributions based on his compensation including fringe benefits, although fringe benefits are not included in the definition of compensation in the Plan document. We noted this error existed on all participants receiving fringe benefits at that location. The plan sponsor will correct this error by reducing the participant's next deferral by the excess contributions along with reducing the next match for the excess match and earnings thereon. We recommend that the plan sponsor review the setup of the payroll system to ensure all locations are operating in the same manner and are consistent with the Plan document.

It was also noted during audit procedures that the rules for hardship distributions were not applied appropriately as required by the Plan document. One participant in our contribution sample was required to stop making contributions for the next twelve months after receiving a hardship distribution, but then was allowed to continue making contributions when the Plan switched recordkeepers. Upon further investigation, it was determined that a control feature at the recordkeeper had not been put in place to stop the deferral contributions where a hardship distribution had been taken. This is not allowable because the Plan document states a participant must cease making contributions for twelve
months after a hardship distribution is made. We recommend that the plan sponsor review the policies and procedures surrounding the hardship distribution process to ensure all appropriate controls are in place and are operating in accordance with the Plan document.

We believe the following deficiencies constitute material weaknesses.

**Investments**

During our audit, we noted that the client personnel (such as the assistant controller or human resource supervisor), who prepares the financial statements, is not knowledgeable regarding the various investment arrangements entered into on behalf of the plan and the financial statement implications of those arrangements. The treasury department has significant knowledge regarding the types of investment arrangements but is not involved in the accounting and reporting functions for the plan. As a result, the plan financial statements prepared did not contain the proper accounting for plan investments and required disclosures under generally accepted accounting principles. For example, it was necessary for the auditor to propose adjustments to the statement of net assets and revisions to the footnote disclosures relating to the plan's security lending arrangement with the trustee.

It is recommended that either (1) the client personnel increase his or her knowledge of the investment arrangements by working with the treasury department or (2) the treasurer become more involved in the financial statement preparation process. In addition, those individuals responsible for preparing the plan's financial statements should increase their knowledge of employee benefit plan accounting and reporting specifically surrounding investments through the use of the AICPA Employee Benefit Plan Audit Guide or taking outside learning and education courses surrounding employee benefit plan accounting and reporting.

**Lack of Financial Statement Knowledge**

During our audit, we noted that the client personnel (such as the assistant controller or human resource supervisor) prepares the financial
statements using the year-end trial balance provided by the record-keeper. However, the trial balance prepared by the record keeper is not prepared on the accrual basis and it was necessary for the auditor to propose adjusting journal entries to record the contributions receivable and expenses payable at year-end. In addition, it was necessary for the auditor to propose a number of revisions to the footnotes to the financial statements (e.g., disclosure of effect of significant plan amendments, etc.) to enable the disclosures to be in accordance with generally accepted accounting principles. The client personnel does not appear to have the necessary knowledge and skill to prepare employee benefit plan financial statements in accordance with generally accepted accounting principles.

We recommend that the company utilizes individuals from the corporate finance department with the requisite knowledge and skill in employee benefit plan generally accepted accounting principles to prepare the financial statements. In addition, we recommend that a current disclosure checklist from the AICPA be used to ensure propriety and completeness of the footnotes.

Review of Information Prepared by Third-Party Service Providers

During our audit procedures, we noted that the plan sponsor, ABC Company, did not perform timely reviews of certain information prepared or provided by its third-party service providers. ABC Company is responsible for the prudent oversight and review of all services provided by third parties to the Plan. We recommend that the plan sponsor perform various periodic reviews and reconciliations of information provided by your third-party service providers including (a) reconciling total Plan assets per the participant detail (the sum of the individual participant account balances) provided by the Plan recordkeeper to total plan assets reported by the Plan trustee, (b) reconcile total contributions made to the Plan per ABC Company’s general ledger or payroll register to total contributions received by the Plan per the trustee, and (c) agree individual demographic data included in new employee personnel files to the corresponding information included in the participant detail provided by the Plan recordkeeper.
Securities Lending
During our audit procedures, we noted that there was ineffective design and operation of the financial closing and reporting process, resulting in the misapplication of the accounting and disclosure requirements related to securities lending transactions, as governed by FASB Statement of Financial Accounting Standards No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*. We recommend that the plan sponsor review all security lending transactions to ensure that they are properly presented in the Plan's financial statements and accompanying footnotes in accordance with FASB Statement No. 140.

We further consider the following matters to be control deficiencies that are of a lesser magnitude than a significant deficiency.

Disbursements
During our audit procedures, we noted one participant in our sample who was paid a distribution based on the account valuation prior to all earnings and contributions being credited to a participant’s account and another participant had an error in the calculation of his forfeited balance. The plan sponsor will correct the first error by distributing the remaining balance in the participant’s account to him, but the sponsor is not required to make a further distribution related to the second error due to the immateriality of the underpayment. We recommend that the plan sponsor review all distribution requests for accuracy and periodically spot-check reports received from the third-party record-keeper for any distribution errors.

Plan Management Response
[Insert “Plan Management Response” section if management issues a written response to this communication and such response will be included in a document containing this communication. If this section is included, the following sentence should also be included: “Plan management’s written response to the control
deficiencies identified herein has not been subjected to our audit procedures, and, accordingly, we express no opinion on it.”

* * *

We have previously discussed our observations and suggestions with the plan sponsor personnel and would be pleased to discuss them in further detail at your convenience, to perform any additional study of the matter, or to assist you in implementing the recommendations to the extent our independence is not impaired.

This communication is intended solely for the information and use of management, those charged with governance, and others within the Plan sponsor [and if applicable, identify any specified regulatory agency] and is not intended to be and should not be used by anyone other than these specified parties.

Very truly yours,

[Firm name]
APPENDIX C

Definitions of Certain Investments

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

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

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

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

- **103-12 Entity.** An entity that is not a master trust, CCT, or PSA whose underlying assets include plan assets within the meaning of 29 CFR 2510.3-101 of two or more plans that are not members of a related group of employee benefit plans.

- **Registered investment company.** An investment firm that is registered with the Securities and Exchange Commission and complies with certain stated legal requirements for the collective investment and reinvestment of assets contributed thereto from investors (employee benefit plans and nonemployee benefit plans).
APPENDIX D

FSP AAG INV-1 and SOP 94-4-1
Technical Practice Aids

TPA 6931.08, *Types of Investments Subject to SOP 94-4*, as Amended by FSP AAG INV-1 and SOP 94-4-1

**Inquiry:** What types of investments are subject to the financial statement presentation and disclosure requirements of SOP 94-4, *Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined- Contribution Pension Plans*, as amended by Financial Accounting Standards Board (FASB) staff position (FSP) AAG INV-1 and SOP 94-4-1, *Reporting of Fully Benefit-Responsive Investment Contracts Held by Certain Investment Companies Subject to the AICPA Investment Company Guide and Defined- Contribution Health and Welfare and Pension Plans*?

**Reply:** FSP AAG INV-1 and SOP 94-4-1 defines an investment contract as (a) a traditional or separate account guaranteed investment contract (GIC), (b) a bank investment contract (BIC), (c) a synthetic GIC composed of a wrapper contract and the underlying wrapped portfolio of individual investments, or (d) a contract with similar characteristics.

Plans may hold stable value investments through direct contracts with issuers or through a specifically plan-managed account. Plans may also hold stable value investments through beneficial ownership of bank collective funds, which own investment contracts. Insurance company pooled separate accounts that hold investment contracts also have similar characteristics.

It is important for the auditor to gain an understanding of the types of investments being held by the plan; this can be achieved by obtaining the underlying documents for the investments. Typically, investments have some form of underlying documentation to help determine the type of investment. For example, if a plan...
is invested in common collective trust funds (CCTs), there should be a trust declaration for that CCT, which would generally have audited financial statements.

**TPA 6931.09, Financial Statement Presentation When a Plan Invests in a Common Collective Trust Fund or in a Master Trust That Holds Fully Benefit-Responsive Investment Contracts**

**Inquiry:** Do the financial statement presentation requirements in paragraph 15 of SOP 94-4, as amended by FSP AAG INV-1 and SOP 94-4-1, apply to a plan's investment in a CCT or master trust that holds fully benefit-responsive investment contracts?

**Reply:** Yes. Paragraph 15 of SOP 94-4, as amended by FSP AAG INV-1 and SOP 94-4-1, requires the following presentation for fully benefit-responsive investment contracts.

The statement of net assets available for benefits of the plan shall present amounts for (1) total assets, (2) total liabilities, (3) net assets reflecting all investments at fair value, and (4) net assets available for benefits. The amount representing the difference between (3) and (4) shall 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.

When the plan invests in a CCT (or similar vehicle), or a master trust that holds fully benefit-responsive investment contracts, the fair value of the investment in the CCT or master trust should be reported in investments on the face of the statement of net assets available for benefits. The amount representing the difference between the fair value and the contract value of the fully benefit-responsive investment contracts held by the CCT or master trust should be presented on the face of the statement of net assets available for benefits and calculated as the sum of the amounts necessary to adjust the portion of net assets attributable to the plan's investment in the CCT or master trust from fair value to contract value. For the master trust, the adjustment only relates to the plan's portion of the master trust invested in the fully benefit-responsive investment contracts.
A CCT is a trust for a collective investment and reinvestment of assets contributed from employee benefit plans maintained by more than one employer or a controlled group of corporations that is maintained by a bank, trust company, or similar institution that is regulated, supervised, and subject to periodic examination by a state or federal agency. Such CCTs allow several smaller unaffiliated plans to gain the economies of scale necessary to participate in the stable value marketplace. These CCTs generally issue separate standalone financial statements and are considered investment companies subject to the AICPA Audit and Accounting Guide Investment Companies.

TPA 6931.10, Financial Statement Disclosure Requirements When a Plan Invests in a Common Collective Trust Fund or in a Master Trust That Holds Fully Benefit-Responsive Investment Contracts

Inquiry: Do plans that directly invest in CCTs or in master trusts that hold fully benefit-responsive investment contracts need to include in the plan financial statements the disclosures in paragraph 15 of SOP 94-4, as amended by FSP AAG INV-1 and SOP 94-4-1?

Reply: Plans that directly invest in CCTs or similar vehicles that hold fully benefit-responsive investment contracts do not need to include the disclosures detailed in the FSP in the plan’s financial statements. Such disclosures would be included in the financial statements of the CCT, in accordance with paragraph 11 of the FSP.

For plans that invest in a master trust that holds fully benefit-responsive investment contracts, the notes to the financial statements should include the disclosures required in paragraph 15 of SOP 94-4, as amended by FSP AAG INV-1 and SOP 94-4-1, related to the fully benefit-responsive investment contracts held by the master trust. These disclosures are necessary because, unlike a CCT (as discussed in TPA 6931.09), master trust financial statements are not required, and the related disclosure information would not be readily available.
Illustrative Financial Statements

The following illustrative financial statements are for the hypothetical XYZ Company 401(k) plan, modified to reflect the reporting and disclosure provisions of FSP AAG INV-1 and SOP 94-4-1. It does not illustrate other provisions that might apply in circumstances other than those assumed in this example. It also does not illustrate all disclosures required for a fair presentation in conformity with generally accepted accounting principles (GAAP). The presented formats and the wording of accompanying notes are only illustrative and are not necessarily the only possible presentations.

Although GAAP does not require comparative financial statements, ERISA requires a comparative statement of net assets available for benefits. The illustrative financial statements are intended to comply with the requirements of ERISA.

Help Desk—This is not a set of full financial statements but rather just those portions of the financial statements impacted by FSP AAG INV-1 and SOP 94-4-1. For this example, the following items are presented: (1) The Statement of Net Assets Available for Benefits, (2) the Summary of Accounting Policies footnote, and (3) the Investment Contract With Insurance Company footnote.

XYZ Company 401(k) Plan Statements of Net Assets Available for Benefits

<table>
<thead>
<tr>
<th>Asset Description</th>
<th>December 31, 20X1</th>
<th>December 31, 20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Investments, at fair value (see Note C)</td>
<td>$9,192,000</td>
<td>$8,005,000</td>
</tr>
<tr>
<td>Receivables</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employer contribution</td>
<td>14,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Participant contributions</td>
<td>52,000</td>
<td>50,000</td>
</tr>
<tr>
<td>Total receivables</td>
<td>66,000</td>
<td>60,000</td>
</tr>
<tr>
<td>Total assets</td>
<td>9,258,000</td>
<td>8,065,000</td>
</tr>
<tr>
<td>Liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts payable</td>
<td>10,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Accrued expenses</td>
<td>15,000</td>
<td>—</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>25,000</td>
<td>20,000</td>
</tr>
</tbody>
</table>

(continued)
XYZ Company 401(k) Plan Notes to Financial Statements

B. Summary of Accounting Policies

Use of Estimates and Basis of Accounting

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

As described in Financial Accounting Standards Board Staff Position, FSP AAG INV-1 and SOP 94-4-1, Reporting of Fully Benefit-Responsive Investment Contracts Held by Certain Investment Companies Subject to the AICPA Investment Company Guide and Defined-Contributions Health and Welfare and Pension Plans (the FSP), 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. As required by the FSP, the Statement of Net Assets Available for Benefits presents the fair value of the investment contracts as well as the adjustment of the fully benefit-responsive investment contracts from fair value to contract value. The Statement of Changes in Net Assets Available for Benefits is prepared on a contract value basis.
Investment Valuation and Income Recognition

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

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

Payment of Benefits

Benefits are recorded when paid.

E. Investment Contract with Insurance Company

In 20X0, the Plan entered into a benefit-responsive investment contract with National Insurance Company (National). National maintains the contributions in a general account. The account is credited with earnings on the underlying investments and charged for participant withdrawals and administrative expenses. The guaranteed investment contract issuer is contractually obligated to repay the principal and a specified interest rate that is guaranteed to the Plan.

As described in Note B, 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. 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 crediting interest rate is based on a formula agreed upon with the issuer, but it may not be less
than four percent. Such interest rates are reviewed on a quarterly basis for resetting.

Certain events limit the ability of the Plan to transact at contract value with the issuer. Such events include the following: (1) amendments to the plan documents (including complete or partial plan termination or merger with another plan), (2) changes to 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 Employee Retirement Income Security Act of 1974. The Plan administrator does not believe that the occurrence of any such value event, which would limit the Plan’s ability to transact at contract value with participants, is probable.

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

<table>
<thead>
<tr>
<th>Average yields:</th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Based on actual earnings</td>
<td>4.68%</td>
<td>4.90%</td>
</tr>
<tr>
<td>Based on interest rate credited to participants</td>
<td>4.68%</td>
<td>4.90%</td>
</tr>
</tbody>
</table>
APPENDIX E

Employee Benefits Security Administration
Field Assistance Bulletins

In the course of audits and investigations by Employee Benefits Security Administration (EBSA) field enforcement staff, difficult legal issues often arise. In an effort to provide the regional office staff with prompt guidance, EBSA has developed a vehicle for communicating technical guidance from the national office. Field Assistance Bulletins (FABs) ensure that the law is applied consistently across the various regions. They also provide the regulated community with an important source of information about the agency’s views on technical applications of the Employee Retirement Income Security Act of 1974 (ERISA). All FABs are posted on EBSA’s Web site and available to the public.

Help Desk—FABs are available at www.dol.gov/ebsa under Compliance Assistance.

The following is a listing and brief description of the FABs.

| FAB 2002-1 | Addresses the fiduciary considerations involved with the refinancing of an ESOP loan under section 408(b)(3) of ERISA |
| FAB 2002-2 | Addresses whether the trustees of two related multiemployer plans were subject to ERISA fiduciary standards when they amended the plan’s trust agreements |
| FAB 2002-3 | Addresses the fiduciary considerations regarding the use of agreements in which the service provider retains the “float” on plan assets |
| FAB 2003-1 | Addresses the issue of whether corporate directors and officers may be denied participant loans that might violate securities laws when ERISA requires that such loans be made available to all participants on a reasonably equivalent basis |
| FAB 2003-2 | Considers the application of EBSA’s participant contribution requirements to multiemployer defined-contribution pension plans |

(continued)
| FAB 2003-3 | Addresses the rules that apply to how expenses are allocated among plan participants in a defined-contribution pension plan |
| FAB 2004-01 | Addresses whether health savings accounts (HSAs) established in connection with employment-based group health plans constitute employee welfare benefit plans for purposes of Title I of ERISA |
| FAB 2004-02 | Addresses a fiduciary’s duties with respect to missing participants in a terminated defined-contribution plan |
| FAB 2004-03 | Addresses the fiduciary responsibilities of a directed trustee in the context of publicly traded securities |
| FAB 2006-01 | Addresses the distribution to plans of settlement proceeds relating to late trading and market-timing |
| FAB 2006-02 | Addresses recurring questions about ERISA coverage of health savings accounts (HSAs) and evolving practices in the offering of HSAs in the workplace |
| FAB 2006-03 | Addresses interim guidance relating to individual benefit statements and notices of freedom to divest employer securities pursuant to the Pension Protection Act of 2006 |
| FAB 2007-01 | Addresses guidance relating to the investment advice provisions of the Pension Protection Act of 2006 |
Analytical Procedures as Substantive Tests

For all audits of financial statements in accordance with generally accepted auditing standards (GAAS), analytical procedures should be applied to some extent for the purposes of assisting the auditor in planning the nature, timing, and extent of other auditing procedures, and as an overall review of the financial information in the final review stage of the audit. In some cases, however, analytical procedures can be more effective or efficient than tests of details for achieving particular substantive testing objectives. Analytical procedures may be used as substantive tests to obtain evidential matter about particular assertions related to account balances or classes of transactions.

AU section 329, *Analytical Procedures* (AICPA, *Professional Standards*, vol. 1), as amended, provides guidance on the use of analytical procedures and requires the use of analytical procedures in the planning and overall review stages of all audits.

Because the planning for employee benefit plan audits is often done after year end, preliminary analytics are performed using year-end numbers with minimum subsequent adjustment. In such instances, final analytics can be documented on the same schedule; however, because each type of analytic is done for a different purpose, different purposes, expectations, and conclusions need to be documented. There may be certain areas where the auditor knows during planning that substantive analytics will be performed. For these areas, it may be efficient to document preliminary, substantive, and final analytics on the same schedule, making sure the purpose of each test, expectation, and conclusion is documented appropriately. If there are any audit adjustments, a separate and final analytic would need to be performed.
Analytical Procedures in Planning the Audit

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

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

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

Analytical Procedures Used as Substantive Tests

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

The auditor considers the level of assurance, if any, he or she wants from substantive testing for a particular audit objective and decides, among other things, which procedure or combination of procedures can provide that level of assurance. For some assertions, analytical procedures are effective in providing the appropriate level of assurance. For example, the auditor may be able to obtain a moderate-to-high level of assurance over the accuracy of insurance premiums by performing an analytic regarding monthly premium amounts using the rates in the insurance agreement to set the expectation. For other assertions, however, analytical procedures may not be as effective or as efficient as tests of details in
providing the desired level of assurance. For example, for a plan with multiple payroll locations, it may be difficult to obtain disaggregated information regarding participant contributions; therefore, substantive analytics may not be effective or efficient.

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

Documentation of Substantive Analytical Procedures

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

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

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

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

See AU section 329 for further guidance.

Examples of Analytical Procedures

Auditors should be aware that the examples contained in this section typically would not eliminate the need for detailed testing but may be used to supplement such testing.

- **Investments.** Investment balances may fluctuate during the year based on changes in (1) investment strategy resulting from management decisions (or resulting from participant decisions, in the case of a defined-contribution participant-directed plan), (2) market trends, or (3) other plan changes
(for example, merger or termination). Once the auditor understands what types of changes have occurred, an expectation can be developed. Review market trends for similar types of investments and determine expectations based on plan activity (level of contributions or distributions), taking into account plan changes. Often the recordkeeper or investment manager prepares quarterly investment return reports that can be used to assist in developing an expectation. In addition, benchmarks for yields and total return can be obtained for asset classes or specific investments (for example, mutual funds).

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

**Participant Contributions Example**

Prior-year headcount per the Form 5500 = 130 people

Prior-year participant contributions balance = $401,828

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

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

$3,091 × 50 people = $154,550 expected contribution
Often, the recordkeeper prepares quarterly reports that include headcount and contribution rate information that can be used to assist in developing an expectation.

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

- **Payroll.** For single employer plans, develop an expectation for current-year gross wages using prior-year gross wages and taking into account change in number of employees, average percentage pay increases, and addition and termination of highly compensated employees.
There are three sources that the auditor may need to consult when testing claims. They are the sources that contain Current Procedural Terminology (CPT) codes, Healthcare Common Procedure Coding System (HCPCS) codes, and International Classification of Diseases, Ninth Edition (ICD-9) codes.

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

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

The ICD-9-CM is published by the United States government and is the classification employed for cause-of-death coding. The ICD-9 coding system is recommended for use in all clinical settings and is required for reporting diagnoses and diseases to the U.S. Public Health Service.

If medical claims are not submitted electronically, they are submitted on one of two types of forms. All hospital bills, both outpatient and inpatient, are submitted on a form UB92. All other bills are submitted on a form HCFA 1500.
APPENDIX H
Payroll Auditing

AU section 316, *Consideration of Fraud in a Financial Statement Audit* (AICPA, *Professional Standards*, vol. 1), states that the auditor should assume that revenue recognition is an area where fraud could occur in any entity. For employee benefit plans, the primary sources of revenue are income from investments and employer and employee contributions. The AICPA Audit and Accounting Guide *Employee Benefit Plans* (EBP Guide), with conforming changes as of March 1, 2007 (product no. 012597kk), contains chapters detailing audit procedures for investments and employer and employee contributions.

In single-employer employee benefit plans, the auditor can test payroll audits directly. Often, the auditor performs the audit for both the employer and the employee benefit plan, and this enables the auditor to do the testing of the employer’s payroll without a great deal of difficulty.

For multiemployer benefit plans, employers contribute to a multiemployer plan based on the provisions of a collective bargaining agreement (CBA) negotiated between a union representing employees in a specified trade or industry and their employers. A multiemployer plan may be local, regional, or national in scope and may bind a few employers or several thousand employers.

What Is a Payroll Audit?

A payroll or compliance audit is an audit of a contributing employer to determine whether the employer has contributed the amount specified by the CBA to a multiemployer plan. Although they are called payroll audits, these examinations are actually agreed-upon procedure engagements. When a plan uses a CPA to perform payroll audits, the plan trustees will agree with the auditor about the records to examine and the steps to perform. The
CPA will perform the agreed-upon procedures specified and will write a report addressed to the trustees of the multiemployer plan detailing the findings of the engagement. The agreed-upon procedures report issued will typically be in accordance with AT sections 101 to 701 Attestation Standards: Revision and Recodification (AICPA, Professional Standards, vol. 1), as amended.

**Purpose of a Payroll Audit**

There are two primary purposes of a payroll audit. First is to determine that the employer is complying with the CBA. Only those employees covered by the CBA should be reported. The payroll audit helps ensure that all wages and hours for all covered employees are reported.

The second purpose of a payroll audit is to determine the accuracy of employer contributions. Only by having a payroll audit program of contributing employers can an independent auditor gain assurance that the completeness objective has been fulfilled for employer contributions to the multiemployer plan.

**Who Should Perform the Payroll Audits?**

Payroll audits can be performed internally by the staff of the multiemployer plan or externally by the auditors performing the audit of the plan, another CPA firm, or another entity specializing in payroll auditing. It does not matter who performs the payroll audits if the CPA firm conducting the audit of the plan has the opportunity to review the working papers of the payroll audits performed to the extent necessary to gain assurance regarding the completeness of employer contributions.

Payroll auditing done in-house can be less expensive if the plan can use its own employees to do the audits. In-house auditors can also be used effectively to educate contributing employers regarding their reporting responsibilities in complying with the CBA.

Other plans prefer to hire outsiders to perform payroll audits. These plans prefer to have someone else handle the employment and training issues of payroll auditors.
Are Payroll Audits Required?
Paragraph 10.09 of the EBP Guide states that in a multiemployer environment “plan sponsors or trustees may engage the employer’s auditor, other outsider auditors, in-house compliance personnel, or others to perform agreed upon procedures to test the completeness of employer contributions.” The Department of Labor has suggested that it is difficult to ensure the completeness objective over employer contributions without performing payroll audits and that without an effective payroll audit program, the plan auditor should consider issuing a qualified opinion on the plan’s financial statements.

There may be some limited circumstances where payroll audits are not necessary. For example, some plans cover only a few contributing employers and the control system for those employers is effective and can give the external auditor confidence that all employer contributions are being collected.

How Often Should Payroll Audits Be Performed?
Paragraph 10.09 of the EBP Guide states that “a representative group of contributing employers should be tested each year.” Does this mean that every contributing employer will be audited within a 3- or 4-year cycle? While a 3- or 4-year cycle might be acceptable in a small plan, a national plan with thousands of contributing employers would have difficulty in auditing all contributing employers. A random sample program should be utilized in selecting at least some of the employers for audit. In that way, every employer would have the opportunity of being audited.

The plan should monitor from year to year the effectiveness of its payroll auditing program. The payroll audit program should help ensure the completeness objective in measuring employer contributions. The plan itself should also be able to conclude that the payroll audit program is operating on a cost-effective basis. If revenue from employer contributions generated as a result of the payroll audit program increases from year to year as a percentage of the costs of the program, then consider increasing the number of audits performed. If revenue is declining as a percentage of costs, then consider reducing the number of payroll audits being performed.