Employee benefit plans industry developments - 2008; Audit risk alerts

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Employee Benefit Plans
Industry Developments

STRENGTHENING AUDIT INTEGRITY
SAFEGUARDING FINANCIAL REPORTING
Notice to Readers

This Audit Risk Alert is intended to provide auditors of financial statements of employee benefit plans with an overview of recent economic, industry, technical, regulatory, and professional developments that may affect the audits and other engagements 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 relevant to the circumstances of the audit and appropriate. The auditing guidance in this document has been 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, CPA
Technical Manager
Audit and Attest Standards
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How This Alert Helps You

.01 This Audit Risk Alert (alert) helps you plan and perform your employee benefit plan audits. This alert provides information to assist you in achieving a more robust understanding of the business, economic, and regulatory environment in which your clients operate. This alert is an important tool in helping you identify the significant risks that may result in the material misstatement of financial statements. Moreover, this alert delivers information about emerging practice issues and current accounting, auditing, and regulatory developments.

.02 This alert is intended to be used in conjunction with AICPA Audit Risk Alert—2007/08 (product no. 022338kk). This alert can be obtained by calling the AICPA at (888) 777-7077 or visiting www.cpa2biz.com. You should refer to the full text of accounting and auditing pronouncements as well as the full text of any rules or publications that are discussed in this alert.

References to Professional Standards. When referring to the professional standards, this alert cites the applicable sections as codified in 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 AICPA Professional Standards.

Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement

.04 An auditor must obtain a sufficient understanding of the entity and its environment, including its internal control, to assess the risks of material misstatement of the financial statements whether due to error or fraud, and to design the nature, timing, and extent of further audit procedures. An auditor’s understanding of the entity and its environment consists of an understanding of the following aspects:

- Industry, regulatory, and other external factors
- Nature of the entity
- Objectives and strategies and the related business risks that may result in a material misstatement of the financial statements
- Measurement and review of the entity’s financial performance
- Internal control, which includes the selection and application of accounting policies

.05 Employee benefit plans may be subject to specific risks of material misstatement arising from the nature of the business, the degree of regulation, or other external forces (for example, political, economic, social, technical, and competitive forces).

.06 The auditor should obtain an understanding of the plan’s objectives and strategies and the related business risks that may result in material misstatement of the financial statements. Business risks result from significant conditions, events, circumstances, actions, or inactions that could adversely affect the plan’s ability to achieve its objectives and execute its strategies, or through the setting of inappropriate objectives and strategies. Just as the external environment changes, the conduct of the plan’s business is also dynamic, and the plan’s strategies and objectives change over time. An understanding of business risks increases the likelihood of identifying risks of material misstatement.
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However, the auditor does not have a responsibility to identify or assess all business risks. Most business risks will eventually have financial consequences and, therefore, an effect on the financial statements. However, not all business risks give rise to risks of material misstatement.

.07 After obtaining a sufficient understanding of the plan and its environment, including its internal control, an auditor should identify and assess the risks of material misstatement at the financial statement level and at the relevant assertion level related to classes of transactions, account balances, and disclosures based on that understanding.

.08 Understanding and properly addressing, as necessary, the matters presented in this alert will help you gain a better understanding of your client’s environment, better assess risks of material misstatement of the financial statements, and strengthen the integrity of your audits.

.09 Paragraphs 5.56–.59 in the AICPA Audit and Accounting Guide Employee Benefit Plans, with conforming changes as of March 1, 2008, provide additional guidance on understanding the plan and its environment.

Hot Topics

The Subprime Mortgage Crisis and Other Market Events

.10 The repercussions of subprime mortgage events continue to be felt in the financial markets. Liquidity in the market for subprime-mortgage-backed securities has deteriorated significantly since the major rating agencies began to downgrade subprime mortgage ratings on a number of issues, including the increased numbers of delinquencies and foreclosures. Additionally, a number of highly leveraged hedge funds (and other investment vehicles) breached various borrowing and margin covenants, which resulted in portfolio liquidations both of subprime-asset-backed securities and, at times, other unrelated investments. Price quotations for subprime-asset-backed securities have become increasingly difficult to obtain and, when obtained, exhibit wide, bid-asked spreads. The auctions for the auction market preferred stock for many entities, including closed-end funds, have failed early in 2008. Further, actual transactions periodically occur at values significantly different from quoted prices, due both to the general market illiquidity and the presence of distressed sellers.

.11 One major spillover effect of these events has been in the market for short term commercial paper, particularly securities backed by various financial assets. Some of this paper, issued by structured investment vehicles, other conduit structures, and hedge funds, was supported in part by subprime mortgage securities. The paper was rated investment grade because the value of the collateralizing securities was significantly higher than the outstanding debt. In some cases, the deterioration in the subprime market caused this overcollateralization to be reduced below the levels permitted under the commercial paper issuance program, resulting in the unexpected extension of maturities or the repayment of maturing paper through drawdowns on bank lines of credit because the issuers could not sell new paper on the market. The resulting uncertainty about these issuers’ outstanding commercial paper, and the potential for other issuers to encounter the same difficulties, caused the market for asset-backed commercial paper to exhibit many of the same signs of illiquidity apparent in the subprime market. In some cases, issuers who had not breached covenants
but were perceived as having some of the same risk characteristics of troubled issuers had difficulty selling commercial paper.

.12 Various money market funds (both registered and unregistered) have acknowledged investments in troubled paper. They have enhanced their procedures to monitor the differences between net asset value as determined using amortized cost and market values of securities, as required by Rule 2a-7 under the Investment Company Act of 1940 or other equivalent regulations. Some money market funds may have material differences between amortized cost and the market value of securities, resulting in a share value reported in the audited financial statements that is different than what is used for participant transactions and reported on the trustee or custodial statements at year-end.

.13 It is important for the auditor to be aware of the increased risk posed by current market conditions and to develop or modify audit procedures accordingly. Among other things, auditors may consider the following:

- The overall effect of risk on a plan’s portfolio of subprime mortgages and related investments (for example, asset-backed commercial paper or high-yield debt or loans). The auditor should identify risks throughout the process of obtaining an understanding of the plan and its environment, including relevant controls such as controls at the plan sponsor and outside service provider, including any applicable investment service provider. The auditor may also consider the policies that affect the management and monitoring of these investments.

- The increased difficulty of obtaining reliable valuations for certain types of asset-backed securities, given the decrease in market liquidity. The auditor should obtain an understanding of the plan’s process for determining fair value measurements and disclosures and of the relevant controls sufficient to develop an effective audit approach. This would include controls over valuation at the plan sponsor and service provider, in particular the extent to which they monitor valuations obtained from brokers and external pricing services for consistency with observations of market conditions, as well as the involvement of valuation committees or other internal review groups independent of portfolio managers in assessing the day-to-day reasonableness of security valuations and overriding quotations that appear to be unrepresentative.

- The existence of financial covenants within the vehicle and its compliance with those covenants to the extent an investment vehicle has employed leverage. The auditor may obtain an understanding of management’s ongoing monitoring process. If the vehicle is no longer in compliance with the covenants, the auditor would assess the appropriate accounting and reporting implications, including AU section 341, The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern (AICPA, Professional Standards, vol. 1).

.14 In certain instances, the auditor may need special skills or knowledge to plan and perform auditing procedures for plans that hold subprime-mortgage-backed securities. AU section 332, Auditing Derivative Instruments, Hedging Activities, and Investments in Securities (AICPA, Professional Standards, vol. 1), states that for some derivatives and securities, generally accepted
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accounting principles (GAAP) may prescribe presentation and disclosure requirements. Furthermore, AU section 332 advises the auditor to consider the form, arrangement, and content of the financial statements (including the notes) when evaluating the adequacy of presentation and disclosure. Auditors may also consider using a specialist when determining how to audit a plan that deals in derivatives. AU section 336, *Using the Work of a Specialist* (AICPA, *Professional Standards*, vol. 1), provides guidance on the use of a specialist during an engagement.

Impact on Employee Benefit Plans

.15 As a result of the conditions in the subprime markets, several business and accounting issues arise, many of which relate to the measurement of the fair value of securities in the current illiquid market and the devaluation of commercial paper or other securities in money market funds or held as collateral for security lending transactions. Although the plan sponsor is responsible for establishing an accounting and financial reporting process for determining fair value measurements, the plan sponsor will typically rely on the trustee or custodian for the pricing of its investments. The trustee or custodian may use an outside service provider or pricing service for valuation of the investments. Although the valuation function may be outsourced in whole or in part, management continues to maintain ultimate responsibility.

.16 Pricing services typically used by plan trustees or custodians to provide investment prices, such as Interactive Data Pricing and Reference Data, have issued press releases to inform users that they are experiencing difficulties in obtaining consistent market information in the production of valuations of subprime-related securities. Therefore, certain service providers have enhanced their procedures to respond to these issues including, among other things, more frequent monitoring of the differences between amortized cost and the market value of securities for money market funds and close monitoring of the portfolios for exposure to these markets and the associated valuations of these securities.

.17 Accordingly, for full scope audits, auditors may consider the procedures and controls put in place by the plan sponsor and service provider to identify problem investments and pricing concerns; validate the reliability of pricing or institute fair-value procedures, or both, if necessary; monitor the collectibility of accrued income; and modify reporting and disclosures based on the exposure of these markets in their plans. Auditors may also consider the need to enhance audit procedures to ensure that prices obtained from pricing services are reasonable, including the use of multiple pricing sources or valuation experts to review any pricing models or fair value methodologies put in place, or both. Prices used to value money market type funds in trustee or custodial statements may be compared to published prices or agreed to audited financial statements of the funds.

.18 Events or transactions sometimes occur that affect the measurement of fair value of financial instruments, subsequent to the balance-sheet date but prior to the issuance of the financial statements, that have a material effect on the financial statements and therefore require adjustment or disclosure in the statements. The determination of whether such information represents a type 1 or type 2 subsequent event is highly judgmental and will be based on the specific facts and circumstances. For example, the subsequent events procedure to review trustee or custodial statements after year-end may identify pricing
adjustments to investment accounts. Auditors may consider if the adjustment resulted from specific market events occurring (1) after year-end (type 2 event) or (2) as of year-end (type 1). Type 1 subsequent events may need to be recorded as an adjustment to the year-end financial statements. See AU section 560, *Subsequent Events* (AICPA, Professional Standards, vol. 1), for further guidance. Flexibility in auditing procedures will help the auditor to respond to changes in market conditions.

.19 For limited scope audits, if the auditor becomes aware that the certified information relating to such investments is inaccurate as a result of valuation or other concerns, further inquiry may be necessary that might result in additional testing or modification to the auditor’s report. See the “Limited Scope Certifications” section of this alert for further guidance.

.20 In addition, auditors should consider the requirements of Statement of Position (SOP) 94-6, *Disclosure of Certain Significant Risks and Uncertainties* (AICPA, Technical Practice Aids, ACC sec. 10,640), regarding disclosing significant risks and uncertainties in the plan’s financial statements at year-end regarding investments affected by subprime, illiquid, or other market events. The following is an example of such a disclosure.

.21 The plan invests in securities with contractual cash flows, such as asset backed securities, collateralized mortgage obligations and commercial mortgage backed securities, including securities backed by subprime mortgage loans. The value, liquidity and related income of these securities are sensitive to changes in economic conditions, including real estate value, delinquencies or defaults, or both, and may be adversely affected by shifts in the market’s perception of the issuers and changes in interest rates.

**Help Desk**—For audits of issuers, such as Form 11-K audits, the guidance in Public Company Accounting Oversight Board (PCAOB) Staff Audit Practice Alert No. 2, *Matters Related to Auditing Fair Value Measurements of Financial Instruments and the Use of Specialists*, would be applicable.

**Additional Guidance**

.22 The following is a list of additional resources that provides guidance on auditing investments:

- AU section 328, *Auditing Fair Value Measurements and Disclosures* (AICPA, Professional Standards, vol. 1)
- AU section 332, *Auditing Derivative Instruments, Hedging Activities and Investments in Securities*
- AU section 336, *Using the Work of Specialists*
- AU section 342, *Auditing Accounting Estimates*
- AU section 560, *Subsequent Events*
- PCAOB Staff Audit Practice Alert No. 2, *Matters Related to Auditing Fair Value Measurements of Financial Instruments and the Use of Specialists*
Section 403(b) plans are also commonly known as tax-sheltered annuity plans (TSA plans). A 403(b) TSA plan is a retirement plan offered by schools, hospitals, churches, charities, and certain other tax-exempt organizations. An individual’s 403(b) annuity can be obtained only under an employer’s TSA plan. Generally, these annuities are funded by elective deferrals made under salary reduction agreements and may include nonelective employer contributions. A 403(b) plan works very similarly to a 401(k) plan.

A 403(b) plan comprises individual investment accounts that include the following types:

- Fixed and variable annuity contracts with insurance companies, [403(b)(1) annuities]
- Custodial accounts made up of mutual funds [403(b)(7) accounts]
- A retirement income account set up for church employees [403(b)(9) accounts]

Revisions to the Form 5500 for 403(b) Plans

On November 16, 2007, the Employee Benefits Security Administration (EBSA), the IRS, and the Pension Benefit Guaranty Corporation (PBGC) published in the Federal Register revisions to the Form 5500 annual report for plan year 2009. The revisions include improved financial disclosure by the approximately 16,000 403(b) TSA plans subject to Title I of Employee Retirement Income Security Act (ERISA) by making the reporting rules for those 403(b) plans on par with 401(k) plans.

This means that beginning in 2009, employee benefit plans sponsored by charitable organizations and schools under Internal Revenue Code (IRC) section 403(b) and covered under ERISA will be subject to the same reporting and audit requirements that currently exist for section 401(k) plans. This will involve the completion of the Form 5500 as a small or large pension plan, depending on the number of participants eligible to participate in the plan as of the beginning of the plan year. The Department of Labor (DOL) anticipates that most small 403(b) plans will be eligible to use the new Form 5500-SF and thus will only have to meet that limited filing obligation.

For large 403(b) plans, however, the new reporting requirements will require not only the completion of the entire Form 5500, but also the engagement of an independent qualified public accountant (IQPA) to conduct an independent audit of the plan.

The DOL intends to fully enforce this new audit requirement in 2009. Accordingly, it is critical that plan auditors educate themselves and their clients about this change and its effects on plan records that will be subject to audit. Under the current reporting model, it is not uncommon for 403(b) plans to have participant records that are difficult to “roll up” into plan-level records. Careful
consideration of such situations will be essential in 2008 to ensure that these 403(b) plans will be auditable in 2009.

.29 The 2009 Form 5500 package and the related Federal Register notices are available on the EBSA's Web site at www.dol.gov/ebsa.

First Year Auditing Considerations for 403(b) Plans

.30 If the auditor did not audit the plan’s financial statements or they have not been previously audited, the auditor should apply procedures that are practicable and reasonable in the circumstances to assure him- or herself that the accounting principles used by the plan in the current and the preceding year are consistent. See paragraphs .24–.25 of AU section 420, Consistency of Application of Generally Accepted Accounting Principles, for further guidance.

.31 Areas of special consideration in an initial audit of a plan’s financial statements include (a) the completeness of participant data and records of the prior year(s), especially as they relate to participant eligibility; (b) the amounts and types of benefits; (c) the eligibility for benefits; and (d) account balances. The nature, timing, and extent of auditing procedures applied by the auditor are a matter of judgment and will vary with factors such as the adequacy of past records, the significance of beginning balances, and the complexity of the plan’s operations. Because ERISA requires that audited plan financial statements present comparative statements of net assets available for benefits, the current year statements should be audited, and the prior year that is presented for comparative purposes may be either compiled, reviewed, or audited. Appropriate reference in the current year audit report should be made to describe the level of responsibility assumed in the prior year. However, although a compilation or review of prior year is acceptable, the auditor would apply sufficient auditing procedures on the beginning balance of net assets available for benefits to obtain appropriate evidence that there are no material misstatements to these beginning balances that may affect the current year’s statement of changes in net assets available for benefits.

Automatic Enrollment and Planning Considerations

.32 There has been a significant increase in the number of plan sponsors choosing to automatically enroll plan participants largely because the Pension Protection Act of 2006 (PPA) included provisions designed to encourage sponsors of 401(k) plans to add an automatic enrollment feature.

.33 Automatic enrollment is a mechanism under which an eligible employee who does not make an affirmative election to make pretax contributions to the plan is automatically enrolled in the plan at a specific pretax contribution percentage, unless the employee specifically opts out. Because those funds must then be invested, the PPA also included provisions to protect plan fiduciaries that invest a participant’s account in certain default investment options. Recently, the IRS issued proposed regulations regarding the implementation of automatic contribution arrangements, and the DOL issued final regulations regarding default investments.

.34 On October 24, 2007, the DOL published a final rule in the Federal Register establishing qualified default investment alternatives (QDIA), making it easier for employers to automatically enroll workers in their 401(k) and other defined contribution (DC) plans. Auditors may want to consider any
amendments made to the plan document as a result of the PPA provisions when determining the scope of the audit.

35 The IRS issued proposed regulations in November of 2007 to implement automatic enrollment. The proposed regulations describe 2 types of automatic enrollment arrangements: an eligible automatic contribution arrangement and a more complex qualified automatic contribution arrangement that passes certain nondiscrimination rules automatically.

36 The final regulation does not identify specific investment products. Rather, it describes mechanisms for investing participant contributions. The intent is to ensure that an investment qualifying as a QDIA is appropriate as a single investment capable of meeting a worker’s long term retirement savings needs.

37 A copy of the regulation and a fact sheet detailing the rule may be found at the DOL’s Web site at www.dol.gov/ebsa/regs.

AICPA Risk Assessment Standards

38 The eight SASs referred to as “the risk assessment standards” (SAS Nos. 104–111) became effective for audits of financial statements for periods beginning on or after December 15, 2006, (earlier application was permitted), which means they are effective for 2007 calendar year audits. Although the SASs include many of the underlying concepts and detailed performance requirements contained in the standards they amend or supersede, they do create significant new requirements for the auditor. The risk assessment standards provide extensive guidance on how to apply the audit risk model when planning and performing financial statement audits, focusing on identifying and assessing the risks of material misstatements, further designing and performing tailored audit procedures in response to the assessed risks at relevant assertion levels, and improving the linkage among the risks, controls, audit procedures, and conclusions. Chapter 5 of Audit and Accounting Guide Employee Benefit Plans, with conforming changes as of March 1, 2008, discusses how the risk assessment concepts may be applied in employee benefit plan audits. Auditors are encouraged to review such guidance.

Key Provisions of the Risk Assessment Standards

39 Whether due to error or fraud, the risk assessment standards require the auditor to understand and respond to the risks of material misstatement. That understanding should identify risks that may lead to a material misstatement in the plan’s financial statements and any mitigating controls in place. The risk assessment standards place an even greater emphasis on the understanding and testing of internal control. It is not acceptable to simply deem risk to be “at a maximum.” Although 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 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 auditors have previously done. Implementation of the SASs should have already been completed and has likely resulted in significant changes to firm audit methodologies and personnel training.
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.40 The AICPA issued Audit Risk Alert Understanding the New Auditing Standards Related to Risk Assessment (product no. 022526kk), which can be obtained by calling the AICPA at (888) 777-7077 or visiting www.cpa2biz.com.

Companion Audit Guide

.41 In December 2006, the AICPA published Audit Guide Assessing and Responding to Audit Risk in a Financial Statement Audit (product no. 012456kk). This authoritative guide helps auditors further understand 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 visiting www.cpa2biz.com.

Technical Questions and Answers

.42 The following Technical Questions and Answers have been developed in response to common questions received from members regarding the implementation of SAS Nos. 104–111, the risk assessment standards.

- TIS section 8200.05, "Testing the Operating Effectiveness of Internal Control"
- TIS section 8200.06, "The Meaning of Expectation of the Operating Effectiveness of Controls"
- TIS section 8200.07, "Considering a Substantive Audit Strategy"
- TIS section 8200.08, "Obtaining an Understanding of the Control Environment"
- TIS section 8200.09, "Assessing Inherent Risk"

These questions and answers are available at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Practice+Aids+and+Tools/Recently+Issued+Technical+Practice+Aids.htm.

Limited Scope Certifications

.43 When a plan administrator elects to have a limited scope audit performed, the auditor is instructed by the plan administrator to limit the scope of testing on investment information prepared and certified by a qualified trustee or custodian as complete and accurate. Typically, the trustee or custodian certifies to the completeness and accuracy of the plan’s investment assets and investment activity as contained in his or her ordinary books and records, which may or may not be fair value (for example, it may not be based on market quotations or year-end valuations). Although the DOL regulations allow the qualified trustee or custodian to report in this manner, it is the plan sponsor’s responsibility to prepare the financial statements and footnote disclosures in accordance with GAAP (that is, at fair value as of the plan year-end).

.44 The auditor’s responsibilities for investments covered by the limited scope exemption are to (1) obtain and read a copy of the certification from the plan administrator, (2) determine whether the entity issuing the certification is a qualifying institution under DOL regulations, (3) compare the certified investment information to the financial information in the financial statements and related disclosures, (4) perform the necessary procedures to become satisfied that any received or disbursed amounts reported by the trustee or custodian were determined in accordance with the plan provisions, and (5) determine whether the form and content of the financial statement disclosures related to the investment information prepared and certified by the plan’s trustee or
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custodian are in conformity with GAAP and are in compliance with DOL rules and regulations.

.45 The scope limitation and the corresponding limitation of the auditor’s work extend only to investments and related investment information certified by the qualified trustee or custodian. Plan investments not held by a qualified trustee or custodian, such as real estate, leases, mortgages, self-directed brokerage accounts, participant loans, and any other investments or assets not covered by such an entity’s certification, should be subjected to appropriate audit procedures. Moreover, the appropriate audit procedures for all noninvestment related information (for example, benefit payments, employer and employee contributions, and receivables) are the same for a limited scope audit as they are for a full scope audit.

.46 When engaged to perform a limited scope audit, the auditor has no responsibility to perform audit procedures on investments and related activity covered by the certification. Although the auditor is not required to audit certain investment information when the limited scope audit exception is applicable, if the auditor becomes aware that the certified information is incomplete, inaccurate, or otherwise unsatisfactory, further inquiry may be necessary that might result in additional testing or modification to the auditor’s report. In certain instances, a limited scope audit may no longer be appropriate (or may only be appropriate with respect to certain investments held by the plan).

.47 Because plans increasingly invest in alternative investments (including hedge funds, real estate, limited partnerships, private equity funds, and other difficult-to-value investments), care ordinarily should be taken by plan administrators when determining if certified information can be relied upon in preparing the plan’s Form 5500 and related financial statements. If, for example, the auditor becomes aware that adequate year-end valuation procedures have not been performed and therefore the financial statements may not be prepared in conformity with GAAP, the auditor would communicate those findings to the plan administrator. It is the plan administrator’s responsibility to prepare the financial statements and footnote disclosures in conformity with GAAP and in compliance with DOL rules and regulations. Accordingly, the plan administrator may request the trustee or custodian to recertify or amend the certification for such investments at their appropriate year-end values or to exclude such investments from the certification. If the trustee or custodian amends the certification to exclude such investments from the certification, or if the trustee or custodian does not recertify those investments, the plan administrator is responsible for valuing such investments as of the plan year-end and engaging the auditor to perform full audit procedures on the investments excluded from the certification. Paragraph 7.69 of Audit and Accounting Guide Employee Benefits Plans, with conforming changes as of March 1, 2008 contains an illustrative auditor’s report when plan investments have been certified and the plan administrator was unable to determine whether the investment information is valued in conformity with GAAP.

.48 Prior to being engaged to perform a limited scope audit, it is recommended that plan administrators and their auditors briefly discuss the nature of the investments held by the plan (including how those investments are valued) to help ensure that the plan administrator engages the auditor to perform the appropriate type of audit. The plan administrator’s decision regarding whether it can rely on a certification for purposes of limiting the scope of the audit has
become increasingly more challenging (especially in light of the investment-related issues previously discussed in this alert).

**Fair Value Measurements**

.49 In September 2006, the Financial Accounting Standards Board (FASB) issued FASB Statement No. 157, *Fair Value Measurements*, to provide enhanced guidance for using fair value to measure assets and liabilities. This standard defines fair value and expands disclosures about fair value measurements. The standard applies whenever other standards require (or permit) assets or liabilities to be measured at fair value. The standard does not expand the use of fair value in any new circumstances. FASB Statement No. 157 amends paragraph 11 of FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*, to change the definition of *fair value*.

.50 Prior to FASB Statement No. 157, certain fair value measurements were based on the price that would be paid to acquire an asset (an entry price). FASB Statement No. 157 clarifies the definition of *fair value* as the price that would be received to sell an asset in an orderly transaction between market participants at the measurement date (an exit price). The exit price is based on the amount that the holder of the asset or liability would receive or need to pay in an actual transaction (or in a hypothetical transaction if an actual transaction does not exist) at the measurement date. In some circumstances, the entry and exit price may be the same; however, they are conceptually different.

.51 Fair value is generally determined based on quoted market prices in active markets for identical assets and liabilities. If quoted market prices are not available, the company uses valuation techniques that place greater reliance on observable inputs (assumptions based on market data) and less reliance on unobservable inputs. In measuring fair value, the plan may make adjustments for risks and uncertainties if a market participant would include such an adjustment in its pricing. Fair value measurements for each major asset or liability are required to be disclosed under FASB Statement No. 157, categorized by where the measurement falls in the fair value hierarchy as discussed in paragraphs 22–31 of the standard.

**Effect on Employee Benefit Plans**

.52 FASB Statement No. 157 may have a significant effect on the financial reporting for employee benefit plans depending upon the types of investments held by the plan, such as investments in stocks, employer securities, corporate bonds, government securities, investment and insurance contracts, and hard-to-value alternative investments. These investments are made directly by the plan or through common/collective trusts (CCTs), pooled separate accounts, master trusts, investment entities, and registered investment companies. Plans generally report investments at fair value in their financial statements and in regulatory filings with the DOL.

.53 Preparing to meet the requirements of FASB Statement No. 157 will require coordination among plan management, custodians, investment fiduciaries, and auditors. GAAP requires plan management to take responsibility for valuation and the Form 5500 requires assets to be reported at current value. Plan administrators have a fiduciary responsibility to ensure the accuracy of the information reported on the Form 5500. Plan management can delegate but not abdicate their valuation responsibility. Although plan management can outsource the mechanics of the valuation process, they need to retain responsibility.
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for the oversight of the final valuations, including determining the adequacy of the related footnote disclosures.

.54 Because plan sponsors have historically used outside service providers to assist in the valuation of investments, they may not have full insight into the mechanics of the process. Some plan sponsors lack expertise over valuation of investments and will look to their service providers to assist in the process. Undoubtedly clients are at different levels of preparedness when it comes to meeting the requirements of FASB Statement No. 157. Regardless, FASB Statement No. 157 provides an opportunity for greater education of plan management on their responsibilities related to valuation. Service providers frequently offer different levels of services, and plan sponsors need to understand the level of information they are receiving from their service provider.

.55 FASB Statement No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. Early adoption is permitted. Generally, FASB Statement No. 157 should be applied prospectively as of the beginning of the year in which it is initially applied. Retrospective application by recognizing a cumulative effect adjustment applies only in specific circumstances as discussed in paragraph 37 of the statement. Readers can access the full text of FASB Statement No. 157 on the FASB Web site at www.fasb.org.

Fair Value Option—FASB Statement No. 159

.56 FASB Statement No. 159, The Fair Value Option for Financial Assets and Financial Liabilities, creates a fair value option under which an organization may irrevocably elect fair value as the initial and subsequent measure for many financial instruments and certain other items, with changes in fair value recognized in the statement of activities as those changes occur. An election is made on an instrument-by-instrument basis (with certain exceptions), generally when an instrument is initially recognized in the financial statements. FASB Statement No. 159 is effective as of the beginning of the first fiscal year that begins after November 15, 2007. Earlier adoption is permitted if certain conditions described in paragraph 30 of the statement are met. See FASB Statement No. 159 for further guidance, including presentation and disclosure requirements.

FASB Staff Position AAG INV-1 and SOP 94-4-1

.57 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, was effective for financial statements for plan years ending after December 15, 2006.

.58 The FSP provided (1) a definition of a fully benefit-responsive investment contract and (2) guidance with respect to the financial statement presentation and disclosure of fully benefit-responsive investment contracts. 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, (c) a synthetic GIC contract composed of a wrapper contract and the underlying wrapped portfolio of individual investments, or (d) a contract with similar characteristics (for example, insurance company general account evergreen group annuity products).
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.59 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 (CCTs) that own investment contracts. Insurance company pooled separate accounts that hold investment contracts also have similar characteristics. See Technical Questions and Answers (TIS) section 6931.08, "Types of Investments Subject to SOP 94-4, as Amended by FSP AAG INV-1 and SOP 94-4-1" (AICPA, Technical Practice Aids).

Financial Statement Presentation and Disclosure Requirements

.60 DC 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 DC plan attributable to fully benefit-responsive investment contracts. An investment contract is considered fully benefit responsive if certain criteria are met for that contract, as analyzed on an individual basis. See paragraph 3.36 of Audit and Accounting Guide Employee Benefits Plans, with conforming changes as of March 1, 2008 for such criteria.

.61 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.

.62 DC 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
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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 in which 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 the FSP AAG INV-1 and SOP 94-4-1 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.

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. See TIS section 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” (AICPA, Technical Practice Aids). See also the illustrative financial statements in appendix D of this alert.

.64 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 FSP AAG INV-1 and SOP 94-4-1 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, Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans (AICPA, Technical Practice Aids, ACC sec. 10,620), 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. See TIS section 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” (AICPA, Technical Practice Aids).

Related Auditing Issues

.65 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 ordinarily should have sufficient information to evaluate and independently challenge the valuation. Plan sponsors may need to work with the various service providers (for example, the trustee or custodian, investment advisor, or recordkeepers) surrounding the investment contracts to determine which service provider will assist in the mechanics of the valuation. Auditors may 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.

.66 For full scope audits of plans with investments in investment contracts, auditors may gain an understanding of the valuation methodology during planning through discussion with clients and service providers and review of valuation documentation. The auditor then reviews and tests 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 at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Practice+Aids+and+Tools/Alternative_investments.htm.

.67 Many plans invest in investment contracts through bank collective investment funds or CCT funds. Paragraph 7.22 of Audit and Accounting Guide Employee Benefits Plans contains examples of substantive procedures for auditing a CCT when performing a full scope audit. If the year-end of the fund...
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is different from the year-end of the plan, the auditor may obtain the financial statements as of the fund’s year-end and consider performing the following additional procedures:

- Obtain a confirmation of the plan’s position in the fund as of the plan’s year-end.
- Obtain the trial balance and portfolio listing of the fund as of the plan’s year-end.
- Obtain a SAS No. 70 report on the bank’s internal controls during the gap period.
- Perform valuation procedures on the investments held as of the plan’s year-end or perform analytical procedures based on indicative data comparing the audited financial statements as of the fund’s year-end to the unaudited information as of the plan’s year-end, or perform both procedures.

.68 The underlying investments of synthetic investment contracts may consist of investments affected by the subprime or credit crisis events previously described, resulting in an increase in the adjustment from fair value to contract value at year-end. It is important for auditors of plans with investment contracts to take into account the auditing considerations previously described for subprime and other investments affected by recent market events. Auditors may want to read the investment contract agreements and consider what effect any depreciation in value of the underlying investments has on the overall value of the contract and its ability to maintain its benefit-responsiveness features.

.69 For limited scope audits, if the auditor becomes aware that the certified information relating to such investments is inaccurate as a result of valuation or other concerns, further inquiry may be necessary that might result in additional testing or modification to the auditor’s report. See paragraphs 7.65–.69 of Audit and Accounting Guide Employee Benefits Plans for further guidance on limited scope audits.

Economic and Industry Developments

The State of the Economy

.70 When planning and performing audit engagements, an auditor should understand the economic conditions facing the industry in which the client operates. Economic activities relating to factors such as interest rates, consumer confidence, overall economic expansion or contraction, inflation, and labor market conditions are likely to have an impact on the entity’s financial statements being audited.

.71 The U.S. real gross domestic product (GDP), the broadest measure of economic activity, measures output of goods and services by labor and property within the United States and increases as the economy grows. According to the Bureau of Economic Analysis, real GDP increased at an annual rate of 2.2 percent in 2007, compared with an increase of 2.9 percent in 2006. According to 2007 fourth-quarter final estimates, real GDP increased at an annual rate of just 0.6 percent, down from third quarter real GDP growth of 4.9 percent.

.72 The unemployment rate remained relatively unchanged during 2007, holding between 4.4 percent and 5.0 percent, with an annual average rate of
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4.6 percent. As of February 2008, the unemployment rate was 4.8 percent, representing approximately 7.4 million people.

The target for the federal funds rate remained stable at 5.25 percent from June 2006 to September 2007 when the Federal Reserve began decreasing rates. Since the first rate decrease in September 2007, the Federal Reserve has decreased rates a total of 3 percent to 2.25 percent as of the end of March 2008. The Federal Reserve noted in its March press release that financial markets continue to experience considerable stress and credit continues to tighten for some businesses and households. The housing contraction continues to deepen and labor markets soften. As such, the policy actions taken to decrease rates are meant to promote moderate growth over time and mitigate risks to economic activity while moderating inflation.

Industry Trends and Conditions

Over the past year, employee benefit plans have seen a dramatic change in their portfolios as well as a new understanding of the types of investments held by plans. Due to the current credit crisis, there has been an increase in participant loans taken in 401(k) plans. Many participants are borrowing from their 401(k) plans to pay their monthly mortgage payments. Additionally, there is an increase in the number of participants that are attempting to qualify for hardship withdrawals to pay their mortgages or credit card debt. It is important for plan auditors to be aware of the increase in both participant loans as well as hardship withdrawals.

Secure client information continues to be an issue for both participants and employers who offer employee benefit plans. Stolen computers include client data and present risks not only for the participants but also for the plan sponsor, service providers, and auditors. Practitioners need to implement appropriate security procedures so that personal information such as social security numbers are not included in working papers or on computer supplied information.

New litigation in the past few months is drawing attention to timely complying with participant’s instructions. Recently, the U.S. Supreme Court issued its ruling in LaRue v. DeWolff, Boberg & Associates, Inc. The high court disagreed with the Fourth Circuit Court of Appeals' decision that a participant in a 401(k) plan is prohibited from using Section 502(a)(2) of ERISA to recover losses allegedly caused by his or her employer’s failure to carry out his or her investment instructions. It is important for auditors to be aware that plan sponsors may be liable for these types of issues.

Audit and Accounting Guide Revision as of March 1, 2008

The AICPA Audit and Accounting Guide Employee Benefit Plans has been updated with conforming changes as of March 1, 2008, and includes guidance in planning and performing audits under the risk assessment standards (SAS Nos. 104–111). It also provides additional guidance on the auditor’s responsibilities as set forth in SAS Nos. 112–114, including identifying and reporting internal control deficiencies, understanding the link between the auditor’s consideration of fraud and the auditor’s assessment of risk, and the auditor’s communications with those charged with governance.
The Audit and Accounting Guide Employee Benefits Plans has also been updated to reflect FASB Statement No. 157, Fair Value Measurements and 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.

Help Desk—To order Audit and Accounting Guide Employee Benefit Plans, with conforming changes as of March 1, 2008, call the Service Center Operations at (888) 777-7077 or go to www.cpa2biz.com and order product no. 012598kk.

Audit and Attestation Issues and Developments

Client Acceptance and Continuance

Statement on Quality Control Standard No. 2, System of Quality Control for a CPA Firm’s Accounting and Auditing Practice (AICPA, Professional Standards, vol. 2, QC sec. 20 par. .14), provides that policies and procedures should be established for deciding whether to accept or continue a client relationship and whether to perform a specific engagement for that client. Such policies and procedures should provide the audit firm with reasonable assurance that the likelihood of association with a client whose management lacks integrity is minimized. Such policies and procedures should also provide reasonable assurance that the audit firm (a) undertakes only those engagements that the firm can reasonably expect to be completed with professional competence and (b) appropriately considers the risks associated with providing professional services in the particular circumstances.

The following is a list of risk factors that engagement teams might consider during their client acceptance and continuance discussions related to an employee benefit plan engagement:

- Ineffective monitoring by management (for example, lack of oversight by plan management of outside providers [such as lack of review of reconciliations of trust assets to participant accounts or no independent records maintained by the sponsor to periodically check information provided by the custodian] or an ineffective plan oversight committee)
- Complex or unstable organizational structure (for example, turnover of plan management, oversight committee members, or outside service providers or difficulty in determining which individuals or committees have oversight or fiduciary responsibility for the plan)
- Weak financial reporting skills, failure by the plan administrator or plan management to take appropriate responsibility for the financial statements, or the plan has a material weakness or significant deficiency in its financial reporting process
- Significant related party transactions or transactions with parties in interest, or history of engaging in prohibited transactions (for example, involvement in nonexempt transactions or events or

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activities (violations of laws, regulations, or plan provisions) that could cause loss of tax-exempt status

- Plan invests in nonreadily marketable securities (such as limited partnerships and nonpublicly traded employer securities), specialized or unique investments, or engages in securities lending (regardless of the scope of the audit) and management lacks the proper oversight and understanding of such investments, including valuation
- The use of service providers that do not provide a type 2 SAS No. 70 report
- The plan is inherently more complex (such as, health and welfare plans and leveraged ESOPs) and the engagement team lacks the technical skills that are necessary to audit such a plan
- Other inherent risk factors, such as electronic payroll or human resources systems, complex-decentralized control environment, or in-house processing of complex transactions (such as benefit calculations and claims)
- The plan has significant issues with regulatory agencies, pending enforcement matters, or other investigations

**SAS No. 70 Issues**

.81 Internal control of a benefit plan consists of the controls at the sponsor as well as the controls at applicable service and subservice organizations that perform significant plan functions including but not limited to processing of participant-level transactions such as contributions and distributions, investment custody and valuation, and execution of investment transaction A report prepared in accordance with SAS No. 70, as amended, may be useful in providing user auditors with a sufficient understanding of controls at the service organization to assess the risks of material misstatement in accordance with AU section 314.

.82 It is not uncommon for the service organization’s SAS No. 70 report to cover only some of the services used by the plan (for example, the report might cover custodial services but not allocation services) or to not cover activities performed by subservice organizations (for example, the report might not cover services performed by an investment pricing service). The subservice organization may be a separate entity from the service organization or may be related to the service organization. For example, 401(k) recordkeepers often exclude the related party data processing center from their SAS No. 70 reports. The independent auditor’s report included in the SAS No. 70 report will typically include language that the report does not cover certain significant service or subservice organizations or systems. For less significant service or subservice organizations or systems, this language will not be included in the auditor’s report but will be described elsewhere in the report. In these situations, auditors would gain an understanding of the controls related to the services not covered in the SAS No. 70 report as they relate to the plan’s transactions processed by the service or subservice organization that are part of the plan’s information system. If the user auditor does not have sufficient information to assess control risk as low or moderate, the plan auditor may decide to perform additional tests of the service or subservice organization’s controls or perform additional audit procedures on the plan’s financial statements. The auditor may obtain a copy of the subservice organization’s SAS No. 70 report if one was issued. See
chapter 6 in Audit and Accounting Guide Employee Benefits Plans for further guidance.

The Auditor’s Communication With Those Charged With Governance

.83 In December 2006, the Auditing Standards Board (ASB) issued SAS No. 114, The Auditor’s Communication With Those Charged With Governance (AICPA, Professional Standards, vol. 1, AU sec. 380) which supersedes SAS No. 61, Communication With Audit Committees. This SAS establishes standards and provides guidance to auditors on matters required to be communicated with those charged with governance in relation to an audit of financial statements and became effective for audits of financial statements for periods beginning on or after December 15, 2006. SAS No. 61 established communication requirements applicable to plans that either have an audit committee or have otherwise formally designated oversight of the financial reporting process to a group equivalent to an audit committee. However, SAS No. 114 broadens the applicability of the SAS to audits of the financial statements of all nonissuers regardless of size, ownership, or organizational structure.

.84 SAS No. 114 provides a framework for the auditor’s communication with those charged with governance and identifies specific matters to be communicated, many of which are generally consistent with the requirements in SAS No. 61. However, SAS No. 114 does include certain additional matters to be communicated and provides additional guidance on the communication process. Among other matters, SAS No. 114 adds requirements to communicate an overview of the planned scope and timing of the audit. It also requires that significant matters that are communicated with those charged with governance be documented.

Identifying Those Charged With Governance

.85 The SAS uses the term those charged with governance to refer to those with responsibility for overseeing the strategic direction of the plan and obligations related to the accountability of the plan, including overseeing the plan’s financial reporting process. The SAS uses the term management to refer to those who are responsible for achieving the objectives of the plan and who have the authority to establish policies and make decisions by which those objectives are to be pursued.

.86 Governance structures vary by plan. The auditor should determine the appropriate person(s) within the plan’s governance structure with whom to communicate. The appropriate person(s) may vary depending on the matter to be communicated.

.87 Because there is such diversity, it is not possible for SAS No. 114 to specify for all audits the person(s) with whom the auditor is to communicate particular matters. Furthermore, in some cases the appropriate person(s) with whom to communicate may not be clearly identifiable from the engagement circumstances. The auditor’s understanding of the plan’s governance structure and processes obtained in accordance with AU section 314 is relevant in deciding with whom to communicate matters. When the appropriate person(s) with whom to communicate is not clearly identifiable, the auditor and the engaging party should agree on the relevant person(s) within the plan’s governance structure with whom the auditor will communicate.
For a single-employer employee benefit plan, the individual charged with governance may include the audit committee of the plan sponsor or the appropriate entity overseeing the activities of the employee benefit plan, such as the employee benefit committee, administrative committee, investment committee, plan administrator, or responsible party. For a multiemployer plan, those charged with governance will ordinarily be the board of trustees. For further guidance, see AU section 380 and paragraphs 5.05–.12 and 12.38–.46 in Audit and Accounting Guide Employee Benefit Plans.

### Auditing Plan Fees and Expenses

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 12.13–.14 of Audit and Accounting Guide Employee Benefit Plans. Typically, plan expenses are below materiality levels in a benefit plan audit and, therefore, are not subject to significant detailed testing. Often, auditors obtain reasonable assurance related to expense balances using other audit procedures such as substantive analytics. Auditors need to gain an understanding of the expenses that are allowed to be paid by the plan according to the plan document.

Auditors may also want to be aware of fees paid by one plan on behalf of another plan resulting from errors or inappropriate allocations or fees paid by the plan for certain services (actuarial fees) that may relate to services provided to the plan sponsor. Excessive fees or expenses paid by the plan that are not allowed by the plan document, no matter how immaterial, may be deemed a prohibited transaction requiring further testing and disclosure as described in paragraph 11.13 of Audit and Accounting Guide Employee Benefit Plans.

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.

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

For many years, EBSA has focused attention on the valuation of hard-to-value assets (currently, more commonly referred to as alternative investments). This year, the EBSA is reviewing alternative investments held by 103-12 investment entities (103-12 IEs) to determine how they are valued and whether they are audited in accordance with generally accepted auditing standards (GAAS).

In the initial phase of this year’s effort, EBSA has contacted twenty-four 103-12 IEs, requesting access to working papers supporting their independent audits. Review of these working papers will provide an understanding of the auditor’s approach to auditing alternative investments.
A subsequent phase of EBSA’s review will involve similar reviews of alternative investments, including investment units of 103-12IEs held directly or indirectly by employee benefit plans. Particular attention will be paid to investments that have been exempted from audit pursuant to DOL Code of Federal Regulations (CFR) Title 29, section 2520.103-8, "Limitation on scope of accountant’s examination.” EBSA intends to obtain an understanding of the procedures used by plan administrators to properly value, disclose, and monitor their plans’ alternative investments.

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 may 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 may be necessary.

The auditor may examine the definition of compensation used to determine whether the method used is allowable within the 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.

Self-Employed Persons

For plans that include self-employed persons, it is important for the auditor to gain an understanding of the plan’s definition of compensation for self-employed persons, procedures for withholding participant deferrals, and the procedures for accumulating the final measurement of net earnings from self-employment for allocations.

Often, benefit plan participants include persons who are classified as self-employed for tax purposes. This includes partners in a partnership, members in an LLC, or sole owners of unincorporated businesses. Plan compensation for these persons is defined as net earnings from self-employment. For a partner or LLC member classified as a partner, the starting point for determining compensation is to look on his or her Form 1065, Schedule K-1, “Partner’s Share of Income, Deductions, Credits, etc.” (line 14). For a self-employed person or the owner of a single-member LLC, this number is derived from information included in Schedule C, "Profit or Loss From Business (Sole Proprietorship),” of his or her Form 1040. As is the case with wages, plans may have additional provisions that affect the amount of net earnings from self-employment that is recognized for plan purposes.

A critical audit consideration is the realization that this figure will frequently vary from the amount of any periodic cash payments made to such
persons during the plan year. Salary deferrals may be withdrawn from these periodic payments, but these payments are not compensation for purposes of plan allocations or compliance testing.

Payroll Data

.100 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. Although testing of the payroll area may have been performed in conjunction with the corporate audit, relevant assertions related to payroll for the plan audit may or may not have been tested. When determining the scope of testing for the plan audit, the plan auditor may consider gaining an understanding of the assertions relevant to payroll that were tested during the corporate audit.

.101 For example, payroll testing performed for a corporate audit may not place any emphasis on individual amounts withheld 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 or may not have an appropriate SAS No. 70 report (see chapter 6 of Audit and Accounting Guide Employee Benefit Plans for further discussion of SAS No. 70 reports).

.102 If the plan sponsor has an internal audit department that has performed work on payroll data that is relevant to the audit, and it would be effective to incorporate their work into the audit, AU section 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 an audit.

Actuarial Reports for Defined Benefit Plans

.103 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. This assumption would reflect anticipated growth of the actual underlying investments in the pension trust. Many employers are changing the mix of investments that have been used historically. For employers that are changing their mix of assets, the actual history of returns is not as relevant as new expectations for the new mix of assets. When an approach of looking at the long term expected return is used, the rate selected will generally be the same as that used for funding purposes. It is important that the plan auditors 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. Therefore, auditors may want to take care when determining if the proper rate is disclosed in the benefit plan’s financial statements.

.104 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. As of December 31, 2007, long term interest rates increased significantly. This was largely due to risk factors related to the subprime mortgage crisis. Those plans that base the discount rate on a settlement type rate and that use end-of-year benefit information will see a significant increase in the discount rate. That increase will produce a gain with a resulting decrease in present value of accumulated plan benefits. Plans that use beginning of year information will not experience that impact until 2008.

.105 The most significant demographic assumptions used to determine the actuarial present value of accumulated plan benefits include mortality rates, turnover, retirement age, marriage statistics, and form of payment or type of benefit elections. With the increase in life expectancies, the mortality assumption should include improvements to longevity that were not included in earlier tables. Certain mortality tables used by actuaries include the 1983 GAM, 1994 GAM, UP 1994, and RP 2000 tables. For 2007 calendar year plans, a new mortality table is required as part of the minimum required contribution calculation. This table, which is based on the RP 2000 mortality table, has replaced the 1983 GAM table. Many actuarial reports will refer to this table as the RP 2000 Combined Mortality Table with projections as specified by IRS Regulation 1.412(1)(7)-1. 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 RP 2000 table with or without the IRS required projections will be used frequently for 2007 audits. Beginning in 2007, the new table that will be required for minimum funding purposes will be based on the RP 2000 table.

.106 Because older mortality tables such as 1983 GAM are becoming outdated and will no longer be used for funding purposes after 2006, auditors may 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.

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

- Trends and nature of benefit distributions (for example, lump sum versus annuity). A plan that predominantly pays lump sum benefits may have a higher obligation 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 may be undervalued.

- Whether there has been a shift in the plan population over time. This could warrant a different assumption for turnover or retirement, for example, if participants are retiring much earlier or later than assumed.
• Whether there have been recent plan mergers or acquisitions. In the case of a plan merger, all assumptions would 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. Changes in plan benefits available may affect anticipated turnover and retirement patterns. These assumptions would be reviewed if the plan is amended to change benefits.

• Whether consistent gains and losses are generated each year. If yes, this may indicate that one or more of the assumptions are not reasonable based on actual experience.

• When reviewing an actuarial report, consideration may be given to:
  — consistency of benefits accumulated each year (auditors would expect changes if there has been a plan merger, acquisition, a significant plan provision change, or changes to the underlying assumptions).
  — 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).
  — the asset value on the financial statements should match the asset value shown in the actuarial report.
  — inclusion of impact of a change in plan provisions and impact of merger, spin-off, or acquisition.

.108 It is also important to note that the assumption of salary increases may not be relevant for FASB Statement No. 35 because the statement is based on the disclosure of the actuarial present value of accumulated plan benefits, which does not take into account future salary increases. It may have some relevance if the actuary does not have or maintain salary histories for the plan participants and the salary increase assumption is used to estimate prior salary histories.

The Use of Beginning of Year Benefit Information Date

.109 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 Audit and Accounting Guide Employee Benefit Plans.

.110 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, 2007, and December 31, 2006, the actuarial valuation will be as of January 1, 2007. 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, 2006 (one day earlier). Typically, this will not cause a material misstatement unless there was a plan amendment that was adopted on or after January 1, 2007, with a January 1, 2007, effective date. In that case, the effect of the amendment must be removed. As shown in Audit and Accounting Guide *Employee Benefit Plans*, when beginning-of-year benefit information is used, 2 statements of net assets and 2 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 Audit and Accounting Guide *Employee Benefit Plans*.

**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. Participant activity during the year (for example, contributions, income allocations, expense allocations, and forfeiture allocations) would be taken into consideration in the determination of auditing procedures including consideration of reliance on a SAS No. 70 type 2 report, if available. Net appreciation or depreciation is typically not allocated to participant accounts but is derived by the recordkeeping system based on the end of day pricing of investments. Often, dividend and interest income is immaterial to the financial statements taken as a whole. In a limited scope audit, the allocation of investment income to individual accounts is not certified by the trustee or custodian and therefore would be considered for testing by the auditor. One method to test certain allocations is to recalculate activity for individual participants (for example, deferral or matching contributions). Other allocations may be performed electronically by the recordkeeping system, and it may be more efficient to rely on the SAS No. 70 type 2 report to reduce the scope of the substantive testing. Some of the additional substantive procedures the auditor may consider in addition to obtaining the SAS No. 70 type 2 report for participant allocations include

- reconciling the summation of participant accounts by investment option to investment balances.
- testing adjustments to participant accounts during the period.
- testing the participant complaint process including the resolution of complaints.

Based on the results of those procedures as well as the auditor’s overall risk assessment of participant accounts, the auditor can determine if additional procedures are required, such as

- performing scanning analytics of participant activity (for example, contributions, benefit payments, and income allocation) during the period or
- confirming allocation activity directly with participants.

See chapter 10 of Audit and Accounting Guide *Employee Benefit Plans* for further discussion of auditing participant data.
Missing Participant Data

.113 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.

.114 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. Prior to accepting a new benefit plan engagement, auditors may wish to take special care in determining if there are any missing participant data.

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

Auditing Health and Welfare Plans

.116 This section is intended to describe certain areas unique to health and welfare benefit plans because these 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.

.117 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 may 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
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- For self-insured claims, how the various claims are administrated and adjudicated; how fees are charged; and if the benefit payment is recognized when the check is written, when the check is presented for payment, or when the 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 voluntary employees' beneficiary association (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 would 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 is integral to developing the audit approach and the sampling methodology.

This section is intended to describe certain areas unique to health and welfare plans and in certain instances to provide examples of audit procedures.¹

HIPAA Privacy Concerns

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

The rules include standards to protect the privacy of individually 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 individuals who are the subjects of this information, procedures for the exercise of those rights, and the authorized and required uses and disclosures of this information. These are the first-ever national standards to protect medical records and other personal health information.

Business Associates Agreements

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). 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. When asked to sign a business

¹ Some of the example audit procedures may be more extensive than what is required by generally accepted auditing standards.
associates agreement, auditors need to take special care in reviewing the agreement.

.123 Sponsors of health and welfare plans frequently hire third party administrators (TPAs) to perform administrative functions for their plans, such as administration of participant claims. Generally, the plan auditor tests a sample of claims processed by the TPA as part of the audit. As a result, confidential information generally is exchanged. Before agreeing to provide this proprietary information and data, TPAs frequently request the plan sponsor or auditor, or both, to sign confidentiality agreements or nondisclosure agreements (NDAs). As with business associates agreements, auditors need to take special care in reviewing nondisclosure 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.

**Help Desk**—NDAs can take many forms and arise on the audit of all types of plans. For example, some TPAs require the auditor to agree to the terms of an NDA prior to being permitted limited access to electronic databases needed to obtain audit evidence directly from the TPAs' Web site. Acceptance of these terms would constitute an NDA.

**Audit Documentation**

.124 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, and
- reporting to the sponsor any misuse of PHI by the accounting firm.


.126 De-identified health information is not subject to HIPAA. To be considered de-identified under HIPAA, information in working papers may 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 4 digits),
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- telephone and fax numbers,
- e-mail addresses,
- medical record numbers,
- health plan beneficiary numbers, or
- account numbers.

Health and Welfare Claims and Potential Problems

When auditing claims, 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. It is important however, that the auditor have a basic understanding of the terms of the plan and have the skill and knowledge to test that claims are being properly adjudicated. The auditor may want to be aware of any processing problems that the plan is experiencing with claims and discuss what the plan is doing to correct these issues with the plan administrator. Examples of potential problems when processing claims 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, and
- improper denial of claims.

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

- 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.
- Deductibles. Deductibles are not calculated properly.
- Accumulators. Benefits are improperly totaled, which may cause the benefit amount to improperly exceed the maximum benefit.
- 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.

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).
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Contracts With Benefit Service Providers

.129 For any contracts the plan has with a benefit service provider, the auditor may examine the reconciliation of the amounts due to or from the benefit service provider to determine if the amounts are appropriate. Any amounts due from the benefit provider are typically classified as a receivable in the statement of net assets, and amounts due to the provider for benefits paid would normally be shown in the financial statements as a liability on the statement of net assets. If the benefit payment has not been disbursed, then the amount would typically be included with benefit obligations of the plan.

Rebates Receivable

.130 If there are rebates receivable from a service provider, the auditor may examine those rebates to determine if the correct amount for the appropriate period of time has been properly reflected in the financial statements. In addition, the auditor may 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. The auditor would also consider the propriety of the rebate. For example, if the payment vehicle for the claims receiving the rebate was the VEBA trust account, receipt of the rebate by the plan sponsor and deposit of such rebate into a nontrust account may not be appropriate.

Accumulated Eligibility Credits

.131 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 may determine whether the plan provides for accumulated eligibility credits and, if so, 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 (AICPA, Technical Practice Aids, ACC sec. 10,830).

Actuarial Data and Census Information

.132 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 may 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.

Stop-Loss Coverage

.133 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
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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.

.134 It is important for the auditor to gain an understanding of the stop-loss coverage that a plan has and to test that claims have been properly filed against the policy within the period specified by the policy.

Premium Stabilization Reserves

.135 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 are considered when evaluating the existence of the asset.

Health Savings Accounts and Health Reimbursement Arrangements

.136 Individuals enrolled in certain high-deductible health plans can establish health savings accounts (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. The contribution may be used for future expenses or may be used (on a tax-able 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).

.137 When HSAs or health reimbursement arrangements (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. When made a component of a health and welfare plan that is subject to audit, it is critical to obtain a clear understanding of these arrangements to determine the appropriate accounting treatment and auditing procedures. For example, understand where the sources of funding come from (employers, participants, or both), who has legal title to the amounts in these accounts, how the claims are adjudicated (by employer, self-adjudicated by participant, or other), and whether there is a carryforward provision into the next plan year for unused amounts.

.138 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 Audit and Accounting Guide Employee Benefit Plans for further information about HSAs and HRAs.
Employee Benefit Plans Industry Developments—2008

COBRA

.139 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 either FASB Statement No. 112, Employers’ Accounting for Postemployment Benefits or FASB Statement No. 106, Employers’ Accounting for Postretirement Benefits Other Than Pensions, or both, are satisfied.

.140 In many cases, the collection of COBRA contributions and payment of COBRA benefits are performed by third-party administrators. The administration of these benefits needs to 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 incurred but not reported should include COBRA participants.

Notices for COBRA Continuation Health Care Coverage

.141 The DOL has published rules clarifying the requirements for notices under COBRA for employees, employers, and plan administrators. 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.

Recent Auditing Pronouncements and Related Guidance

.142 Presented in the following table is a list of recently issued auditing pronouncements and related guidance relevant to employee benefit plans. For information on auditing and attestation standards issued subsequent to the writing of this alert, please refer to the AICPA Web site at www.aicpa.org/Professional+Resources/Accounting+and+Auditing. You may also look for announcements of newly issued standards in the CPA Letter, Journal of Accountancy, and in the quarterly electronic newsletter In Our Opinion, issued by the AICPA Auditing Standards team, available at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Opinion.
As a reminder, AICPA auditing and attestation standards are applicable only to audits and attestation engagements of nonissuers. See the “Form 11-K Audits” section of this alert for a discussion of PCAOB standards.

### Recent Auditing Pronouncements and Related Guidance

| SAS No. 114 | Issue Date: December 2006  
(Applicable to audits conducted in accordance with GAAS) | The Auditor’s Communication With Those Charged With Governance (AICPA, Professional Standards, vol. 1, AU sec. 380) |
| SAS No. 113 | Issue Date: November 2006  
(Applicable to audits conducted in accordance with GAAS) | Omnibus Statement on Auditing Standards—2006 (AICPA, Professional Standards, vol. 1) |
| SAS No. 112 | Issue date: May 2006  
(Applicable to audits conducted in accordance with GAAS) | Communicating Internal Control Related Matters Identified in an Audit (AICPA, Professional Standards, vol. 1, AU sec. 325) |
| SAS Nos. 104–111 | Issue Date: March 2006  
(Applicable to audits conducted in accordance with GAAS) | The risk assessment standards |
| Interpretation No. 1 | Issue Date: March 2007  
(Interpretive publication) | “Use of Electronic Confirmations” of AU section 330, The Confirmation Process (AICPA, Professional Standards, vol. 1, AU sec. 9330 par. .01–.06) |
| AICPA Technical Practice Aid TIS section 9100.06 | Issue Date: May 2007  
(Nonauthoritative) | “The Effect of Obtaining the Management Representation Letter on Dating the Auditor’s Report” (AICPA, Technical Practice Aids) |
| TIS section 8350.01 | Issue Date: May 2007  
(Nonauthoritative) | “Current Year Audit Documentation Contained in the Permanent File” (AICPA, Technical Practice Aids) |
| TIS section 8200  
(Nonauthoritative) | Internal Control | Several Technical Questions and Answers developed in response to common questions received from members regarding the implementation of SAS Nos. 104–111. See the section “AICPA Risk Assessment Standards” in this alert for further details. |
Communicating Internal Control Related Matters Identified in an Audit

.143 The ASB issued SAS No. 112, Communicating Internal Control Related Matters Identified in an Audit (AICPA, Professional Standards, vol. 1, AU sec. 325), which became effective for audits of financial statements for periods ending on or after December 15, 2006. SAS No. 112 establishes standards and provides guidance on communicating matters related to a plan’s internal control over financial reporting (internal control) identified in an audit of financial statements. SAS No. 112 supersedes SAS No. 60, Communication of Internal Control Related Matters Noted in an Audit, as amended. This SAS is applicable whenever an auditor expresses an opinion on financial statements (including a disclaimer of opinion). Among other things, SAS No. 112 does the following:

• Requires the auditor to communicate control deficiencies that are significant deficiencies or material weaknesses in internal control. The terms are defined in the SAS. The term reportable condition is no longer used. When SAS No. 112 was issued, the terms significant deficiencies and material weaknesses were consistent with PCAOB Auditing Standard No. 2, An Audit of Internal Control Over Financial Reporting Performed in Conjunction With an Audit of Financial Statements. However, with the adoption of PCAOB Auditing Standard No. 5, An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements (AICPA, PCAOB Standards and Related Rules, Rules of the Board, “Standards”), the PCAOB redefined these terms, which now differ from SAS No. 112.

• Provides guidance on evaluating the severity of control deficiencies identified in an audit of financial statements and requires that the auditor conclude whether prudent officials, having knowledge of the same facts and circumstances, would agree with the auditor’s classification of the deficiency.

• Identifies areas in which control deficiencies ordinarily are to be evaluated as at least significant deficiencies and identifies indicators that control deficiencies should be regarded as at least a significant deficiency and a strong indicator of a material weakness.

• Requires the auditor to communicate significant deficiencies and material weaknesses identified in the audit, in writing, to management and those charged with governance. This includes
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the significant deficiencies and material weaknesses that were communicated in previous audits if they have not yet been remediated.

- Indicates that the communication must be in writing and is best made by the report release date (the date on which the auditor grants permission for the client to use the auditor’s report in connection with the financial statements), but should be made no later than 60 days following the report release date.
- Contains illustrative written communications to management and those charged with governance.

The AICPA published Audit Risk Alert Understanding SAS No. 112 and Evaluating Control Deficiencies (product no. 022536kk) to assist in understanding the requirements of this SAS. This Audit Risk Alert provides specific case studies to help determine whether identified control weaknesses would constitute a significant deficiency or material weakness; it can be obtained by calling the AICPA at (888) 777-7077 or visiting www.cpa2biz.com.

See appendix B of this alert for further guidance specific for employee benefit plans.

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

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 the following:

- Inadequate testing of participant data
- Inadequate testing of investments, particularly when held by outside parties
- Inadequate documentation of audit procedures in areas such as payroll data, participant data, benefit payments, contributions, prohibited transactions, investment transactions, planning, understanding of internal control, and analytical procedures
- 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, including the description of the method and significant assumptions used to determine fair value, an indication of how the fair value had been determined or the net change in fair value of each significant type of investment, the average yield, a description of the basis for determining the interest rate, and whether the contracts carry a minimum crediting interest rate
Employee Benefit Plans Industry Developments—2008

• Failure to disclose the amount of forfeited nonvested accounts, party-in-interest transactions, or the reconciliation between the assets reported in the audited financial statements and the assets reported in the Form 5500
• 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

.147 The Audit and Accounting Guide Employee Benefit Plans provides guidance concerning areas of noted deficiencies.

Form 11-K Audits

.148 The Securities and Exchange Commission (SEC) requires employee stock purchase, savings, and similar plans with interests that constitute securities registered under the Securities Act of 1933 to file Form 11-K pursuant to section 15(d) of the Securities Exchange Act of 1934. Plans that are required to file a 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.

.149 The PCAOB establishes auditing and attestation standards for audits of issuers. Refer to the PCAOB Web site at www.pcaob.org for information about its activities. You may also review SEC and PCAOB Alert—2007/08 (product no. 022498kk), which summarizes recent developments at both the SEC and PCAOB. This alert can be obtained by calling the AICPA at (888) 777-7077 or by visiting www.cpa2biz.com.

Recent PCAOB Pronouncements and Related Guidance

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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 Securities Exchange Act of 1934 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, and although 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. This communication should be in writing directly to the former client, with a simultaneous copy to the Office of the Chief Accountant (OCA) of the SEC. This letter should be sent by the end of the fifth business day following the firm’s determination that the client-auditor relationship has ended (or it may be faxed to OCA at 202-772-9251 with a reference to “PCAOB Letter File”). 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 these “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**

.151 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.

.152 An employee benefit plan may be an affiliate of a registrant as its plan sponsor. The SEC’s independence rules related to preapproval surround services provided to the issuer and the issuer’s subsidiaries but not to 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 preapprove 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 preapproval 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 preapproved 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 preapproval requirements. Registrants and their auditors are reminded that the financial statements included in a Form 11-K must be audited by an independent auditor who 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**

.153 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. When the Form 11-K is filed separately (not as an exhibit to Form 10-K), it must be filed with the SEC within 90 days after the end of the plan’s fiscal year-end; however, if the plan is subject to ERISA, the Form 11-K filing deadline is increased to 180 days after the plan’s fiscal year-end.

**Applicable Audit Standards**

.154 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. 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

.155 Based on AICPA staff discussions with the SEC and PCAOB staff to seek clarification of the performance and reporting requirements for audits of Form 11-K filers, firms will need to conduct their audits of these Form 11-K plans in accordance with two sets of standards and prepare two separate audit reports: an audit report referencing PCAOB standards for Form 11-K filings with the SEC and a separate audit report referencing GAAS for DOL filings. The PCAOB and SEC staff believe that an opinion issued in accordance with 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, Rules of the Board, ”Standards”)* (www.pcaobus.org/Rules/Rules_of_the_Board/Auditing_Standards_1.pdf), does not allow a reference to GAAS; therefore, a "dual" standard report is not appropriate and will not be accepted by the SEC.

.156 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) 551-5300. See paragraph 13.19 of Audit and Accounting Guide *Employee Benefit Plans* for an example of an opinion for a Form 11-K audit.

Accounting Issues and Developments

FASB Accounting Standards Codification™

.157 On January 15, 2008, FASB launched the 1-year verification period of the *FASB Accounting Standards Codification™*. The codification is a major restructuring of accounting and reporting standards designed to simplify user access to all authoritative U.S. GAAP by providing all authoritative literature in a topically organized structure. The codification includes all accounting standards issued by a standard-setter within levels A–D of the current U.S. GAAP hierarchy, including FASB, AICPA, Emerging Issues Task Force (EITF), and related literature. The codification also includes relevant authoritative content issued by the SEC, as well as selected SEC staff interpretations and administrative guidance.

.158 The codification does not change GAAP but rather it reorganizes thousands of GAAP pronouncements into approximately 90 topics. Therefore, the 1-year verification period is not to debate the underlying requirements of GAAP but rather to verify that the codification appropriately captures them and accurately reflects existing U.S. GAAP for nongovernmental entities. The verification period is also a period for constituents to acquaint themselves with the new structure and to submit feedback regarding any issues before the codification content becomes authoritative. At the end of the 1-year verification period, FASB is expected to formally approve the codification as the single source of authoritative U.S. accounting and reporting standards, other than guidance issued by the SEC. At that time, FASB will supersede all then-existing non-SEC accounting and reporting standards. All other nongrandfathered, non-SEC accounting literature not included in the codification will become nonauthoritative. FASB expects to approve the codification in April 2009.

.159 The codification uses a topical structure in which topics, subtopics, and sections are numerically referenced. This effectively organizes the content without regard to the original standard-setter or standard from which the
Employee Benefit Plans Industry Developments—2008

content was derived. The topics of the codification reside in four main areas: presentation, financial statement accounts, broad transactions, and industry guidance. The overall presentation area addresses presentation of financial information but does not address items such as recognition, measurement, or derecognition. For example, topics in this area include income statement, balance sheet, and earnings per share. The financial statement account area presents topics in financial statement order including assets, liabilities, equity, revenue, and expenses. The broad transactions area includes topics related to multiple financial statement accounts that are transaction oriented, such as derivatives and business combinations. The industry area includes guidance unique to an industry or type of activity such as airlines, software, and employee benefit plans. Plan accounting may be found in the following sections of the codification:

- Section 960—Defined Benefit Pension Plans
- Section 962—Defined Contribution Pension Plans
- Section 965—Health and Welfare Benefit Plans

Constituents are encouraged to use FASB's online Codification Research System free of charge and provide feedback to FASB on the codification. The Codification Research System includes general information on how to use the online research system and special features such as Cross Reference Reports, which show where current standards reside in the codification. Readers are encouraged to register and access the codification at www.fasb.org/project/codification&retrieval_project.shtml. Special attention should be paid to where the FASB reconciled conflicts in existing GAAP and to identify any unintentional changes to GAAP.

Unrelated Business Income Tax and FASB Interpretation No. 48

Although qualified benefit plans are not generally subject to taxation, certain activities of a qualified plan may be taxable. In general, unrelated business taxable income (UBTI) of a tax-exempt entity is subject to taxation. UBTI is

a. gross income derived from an unrelated trade or business that is regularly carried on, less

b. allowable deductions directly connected with the trade or business.

With respect to qualified retirement plans, unrelated trade or business is defined as any trade or business regularly carried on by the trust or by a partnership of which the trust is a member. This means that a qualified plan can have UBTI due to its investments. For tax-exempt welfare plans, UBTI includes the previous examples. In addition, such plans may be subject to UBTI on their investment income if their assets exceed certain allowable reserves.

Nonleveraged investments, such as government securities, stocks and debt instruments of noncontrolled corporations, mutual funds, and insurance company annuity contracts, do not typically generate UBTI. However, other nonleveraged investments, such as investments in partnerships, real estate investment trusts, loans or mortgages, and options to buy or sell securities such as short sales or repurchase agreements, may generate UBTI. The most common plans that generate UBTI are health and welfare plans and defined benefit pension plans. However, with the increase of such investments held by DC plans, such plans may begin to be subject to UBTI also.
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**FASB Interpretation No. 48**

.164 FASB Interpretation No. (FIN) 48, *Accounting for Uncertainty in Income Taxes*, 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. See FIN 48 for further guidance.

.165 For public enterprises (including nonpublic consolidated entities of public enterprises that apply GAAP), this interpretation is effective for fiscal years beginning after December 15, 2006. For nonpublic enterprises (as defined in paragraph 289 of FASB Statement No. 109), except for nonpublic consolidated entities of public enterprises that apply U.S. GAAP, this interpretation is effective for annual financial statements for fiscal years beginning after December 15, 2007. See FSP FIN 48-2, *Effective Date of FASB Interpretation No. 48 for Certain Nonpublic Enterprises*, for further guidance on the effective date. Earlier adoption is permitted as of the beginning of an enterprise’s fiscal year.

**Considerations for Employee Benefit Plans**

.166 FSP FIN 48-2 has generally deferred the effective date of the application of FIN 48 to fiscal years commencing after December 15, 2007. However, when applied, the standard will require assessment of uncertainty of income tax positions for all open years. As such, the auditor may wish to consider the implications of this standard during 2007 benefit plan audits.

.167 Because benefit plans are generally exempt from income taxes, there are few issues that may trigger the application of FIN 48. The main concern for all plans is the retention of the plan’s tax-exempt status. For retirement plans, the existence of the IRS’s Employee Plans Compliance Resolution System under Revenue Procedure 2006-27 is generally assumed to meet the conditions of an *administrative practice or precedent* as defined in FIN 48, which can be relied upon to retain the plan’s exempt status for all but the most egregious of violations. Note that there is no such relief program for welfare benefit plans.

.168 Notwithstanding this general relief for the plan’s tax qualified status, a plan may be faced with issues under FIN 48. These potential issues include, but are not limited to, the following:

- Uncertain tax positions taken by pass-through entities in which the plan has invested that generate material unrelated business income tax to the trust
- The determination of whether a pass-through entity generates unrelated business income to the plan
- The assumptions used in determining the reserves for a welfare benefit plan that is subject to unrelated business income tax due to excess asset accumulations
- The assumptions used by an ESOP of an S corporation to demonstrate satisfaction with the “broadly held” rules of IRC Section 409(p) and the associated exemption from tax on the pass-through income
- The continuation of a welfare benefit plan’s tax exempt status
Recent AICPA Independence and Ethics Pronouncements

AICPA Independence and Ethics Alert—2007/08 (product no. 022478kk) contains a complete update on new independence and ethics pronouncements. This alert can be obtained by calling the AICPA at (888) 777-7077 or visiting www.cpa2biz.com. Readers should obtain this alert to be aware of independence and ethics matters that will affect their practice.

Recent Accounting Pronouncements and Related Guidance

Presented in the following table is a list of recently issued accounting pronouncements and related guidance. 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.

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Disclosures About Derivative Instruments and Hedging Activities

.172 In March 2008, the FASB issued FASB Statement No. 161, Disclosures about Derivative Instruments and Hedging Activities. The new standard is intended to improve financial reporting about derivative instruments and hedging activities by requiring enhanced disclosures to enable investors to better understand their effects on an entity’s financial position, financial performance, and cash flows. It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged.

Regulatory Developments

2007 Form 5500 Series

.173 On October 10, 2007, the DOL, the IRS, and the PBGC published the 2007 Form 5500 “Annual Return/Report of Employee Benefit Plan” and related instructions.

.174 Modifications to the Form 5500 for plan year 2007 are described under “Changes to Note” in the 2007 instructions. Significant changes include the following:

Modifications to the Form 5500 Annual Report for 2007

- Under the PPA, a new simplified reporting option is available for eligible plans with fewer than 25 participants as of the beginning of the plan year.
Employee Benefit Plans Industry Developments—2008

- The instructions for voluntary alternative reporting option for certain plans with fewer than 25 participants on page 8 describe this reporting option.

- Under the PPA, separate actuarial information schedules were developed for 2008 plan year filings for single employer plans (Schedule SB) and multiemployer plans (Schedule MB). Accordingly, the Schedule B is not a valid schedule to file with a plan’s 2008 Form 5500 annual return/report. A caution added to the 2007 instructions advises that filers required to file a Schedule B cannot use the 2007 forms to satisfy their 2008 filing requirements, and that short plan year filers who must file a Schedule SB or Schedule MB and/or a supplemental attachment to Schedule R for 2008 will have an automatic extension to file their complete Form 5500 until 90 days after the 2008 forms are available to use for filing.

- Under the PPA, some multiemployer pension plans will have to provide for the 2008 plan year certain PPA-required information as an attachment to the Schedule R. A caution added to the 2007 instructions advises multiemployer defined benefit pension plan filers, including short plan year filers, that they cannot use the 2007 Schedule R without the attachment to satisfy their 2008 Form 5500 filing requirements.

- For Schedule B, Section 1.412(l)(7)-1 of the Income Tax Regulations (published February 2, 2007) provides updated mortality tables to be used under IRC section 412(l)(7)(C)(ii) to determine current liability for participants and beneficiaries (other than disabled participants) for plan years beginning on or after January 1, 2007. The 2007 instructions for Schedule B, line 6d, reflect these updated mortality tables and the list of codes used for valuation purposes and for calculating current liability.

- For Schedule B, IRC section 412(l)(10) states that the unfunded mortality increase, as defined in IRC section 412(l)(10)(B), is amortized over a period of 10 years beginning with the first plan year for which new mortality tables are applicable (that is, the 2007 plan year). The amount of the unfunded mortality increase will be combined with any outstanding balance of unfunded old liability and reported on line 12g of the 2007 Schedule B. The associated amortization amount will be combined with any unfunded old liability amount and reported on line 12j of the 2007 Schedule B. Note: For most plans, the unfunded old liability is completely amortized by the first day of the 2007 plan year.

- For Form 5500, the instructions on page 3 for “Special Rules for Certain Plans of Partnerships and Wholly Owned Trades or Businesses” were revised pursuant to the PPA for 1-participant retirement plans in determining the exemption for filing a Form 5500-EZ when total plan assets are $250,000 or less at the end of the plan year beginning on or after January 1, 2007.

**Modifications to the Form 5500-EZ Annual Report for 2007**

- Under the PPA, the requirements for filing annual returns with respect to 1-participant retirement plans have been modified to ensure that such plans (and any other plans of the employer) with
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total assets of $250,000 or less as of the close of the plan year beginning on or after January 1, 2007, will not have to file a return for that year upon meeting the 5 conditions under "Who May File Form 5500-EZ" (see "General Instructions").

• Plans beginning on or before December 31, 2006, for which a Form 5500-EZ was required to be filed will not need to continue filing the Form 5500-EZ unless their total plan assets (for 1 or more 1-participant plans, separately or together) exceed $250,000 at the close of the plan year beginning on or after January 1, 2007.

.175 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.

.176 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.

2007 Form M-1 for Multiple Employer Welfare Arrangements

.177 On December 12, 2007, the DOL published in the Federal Register the 2007 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.

.178 MEWAs generally are arrangements that offer medical benefits to the employees of 2 or more employers or to their beneficiaries. The annual filing date for the 2007 Form M-1 is March 3, 2008. In addition, administrators can request an automatic 60-day extension to May 2, 2008. The 2007 form is virtually identical to last year's form.

.179 The online filing system is available on EBSA'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 be printed for the filer's records. The Web site includes a user manual, frequently asked questions (FAQs), and a link to submit questions electronically.

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

Correspondence From EFAST or the DOL OCA

.180 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, Kansas, and the DOL's Office of the Chief Accountant (OCA) in Washington,
Auditors are often asked by their clients to assist in the resolution of issues contained in these government letters.

**EFAST-Generated Correspondence**

.181 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.

.182 Once completed, the Form 5500 is filed with the DOL's EFAST processing center in Lawrence, Kansas. 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 after subjecting Form 5500 filings to these multiagency edit tests deficiencies or discrepancies are identified, the EFAST system generates a letter addressed to the plan administrator that identifies the problem(s) and provides 30 days within which 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 are said to “post” final 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**

.183 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 review the Form 5500 filings and also request 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.

.184 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 in which 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.

.185 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.
the plan administrator fails to comply with the requirements of the NOI, the penalty becomes a final DOL action, and the plan administrator forfeits all appeal rights.

.186 After the DOL reviews the statement of reasonable cause, the DOL 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**

.187 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, or both, regarding any unresolved filing issues.

.188 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**

.189 The EBSA continues its enhanced programs aimed at assessing and improving the quality of employee benefit plan audits. According to the EBSA, nearly 50 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 which perform 5 or fewer audits. The EBSA utilizes both top-down and bottom-up strategies in selecting and evaluating ERISA audits.

.190 First, the EBSA conducts periodic inspections of firms with substantial ERISA audit practices. The EBSA staff meet with firm management, review firm policies and procedures that relate to employee benefit plan audits, and conduct onsite reviews of a sample of ERISA audit engagements. This top-down approach will provide the EBSA a 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.

.191 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.

.192 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.
Finally, the EBSA has expanded its enforcement efforts dealing with fiduciary breaches to include determining whether plan auditors may be considered *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 conceal 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. The DOL’s Web site contains archived versions of webcasts of these programs.

The DOL has also developed an e-law tool to increase awareness and understanding about basic fiduciary responsibilities when operating a retirement plan. The ERISA Fiduciary Advisor provides information and answers to a variety of questions about who is a fiduciary and their responsibilities under ERISA. The ERISA Fiduciary Advisor includes links to more detailed information that may be useful to the user, such as links to regulatory text, publications, and organizations.

Also included in the DOL’s compliance assistance efforts are the following DOL-issued publications:

- *Meeting Your Fiduciary Responsibilities*
- *Understanding Retirement Plan Fees And Expenses*
- *401(k) Plan Fee Disclosure Tool*
- *Selecting An Auditor For Your Employee Benefit Plan*
- *Selecting And Monitoring Pension Consultants—Tips For Plan Fiduciaries*
- *Tips For Selecting And Monitoring Service Providers For Your Employee Benefit Plan*
- *Reporting and Disclosure Guide for Employee Benefit Plans*

### 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

The Delinquent Filer Voluntary Compliance Program (DFVCP) 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.

The address to be used for the DFVCP is

**Standard Mail**
DFVC Program—DOL
P.O. Box 70933
Charlotte, NC 28272-0933

**Private Delivery Service**
DFVC Program—DOL
QLP Wholesale Lockbox—NC 0810
1525 West WT Harris Blvd.
Charlotte, NC 28262

**Program Eligibility**

Eligibility in the DFVCP 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 DFVCP because such plans are not subject to Title I.

**Program Criteria**

Participation in the DFVCP is a 2-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 DFVCP the required documentation and applicable penalty amount. The plan administrator is personally liable for the applicable penalty amount, and, therefore, amounts paid under the DFVCP shall not be paid from the assets of an employee benefit plan.

**Penalty Structure**

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

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.

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 that are required to file annual reports under Title I of ERISA, the maximum applicable penalty amounts would apply for each plan.

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

.206 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**

.207 Although the DFVCP 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 in which the conditions of the DFVCP have been satisfied.

.208 Questions about the DFVCP 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.

**Voluntary Fiduciary Correction Program**

.209 The Voluntary Fiduciary Correction Program (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.

.210 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; and
- relief from civil penalties for transactions involving health and welfare plans.

.211 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.

.212 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.

.213 For more information about the VFCP, 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**

.214 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
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 DOL's outreach efforts continue to focus on plan audit quality, the current Form 5500, the EFAST processing system, and other DOL-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/dol/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

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

Reporting of Late Remittances

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

Information on all delinquent participant contributions should be reported on line 4a of either Schedule H, "Financial Information" or Schedule I, "Financial Information—Small Plan," 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.

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 Prohibited Transaction Exemption (PTE) 2002-51 have been satisfied, as described below) may be reported on a separate supplemental schedule to be attached to the Form 5500 and reported on by the IQPA.
- ERISA and DOL regulations require additional information to be disclosed in supplemental schedules. Some of this information is required to be covered by the auditor's report. AU section 551 (SAS No. 29), Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents (AICPA, Professional Standards, vol. 1), as amended, provides guidance on the
form and content of reporting when the auditor submits a document containing information accompanying the basic financial statements. If the auditor concludes that the plan has entered into a prohibited transaction and the transaction has not been properly disclosed in the required supplemental schedule, the auditor should (1) express a qualified opinion or an adverse opinion on the supplemental schedule if the transaction is material to the financial statements or (2) modify his or her report on the supplemental schedule by adding a paragraph to disclose the omitted transaction if the transaction is not material to the financial statements. See chapter 11, “Party in Interest Transactions,” of Audit and Accounting Guide Employee Benefit Plans for further discussion of prohibited transactions.

.220 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 PTE 2002-51

- will receive a no-action letter issued by the DOL that provides for no imposition of section 502(l) penalties;
- will receive relief from the excise tax provisions of the IRC;
- will 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); and
- are not 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.

.221 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

.222 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.

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

.224 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.

.225 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.

Proposed Safe Harbor for Employee Contributions to Small Pension and Welfare Plans

.226 On February 29, 2008, the DOL announced a proposed rule to provide greater protection for employee contributions deposited to pension and welfare benefit plans with fewer than 100 participants by proposing a safe harbor period of 7 business days following receipt or withholding by employers. The proposal is designed to protect workers by encouraging employers to deposit participant contributions to small plans in a timely manner. It also will provide employers with a higher degree of compliance certainty.

.227 Under the current rules, employers of all sizes must transmit employee contributions to pension plans as soon as they can reasonably be segregated from the general assets of the employer, but no later than the 15th business day of the month following the month in which contributions are received or withheld by the employer. The latest date for forwarding participant contributions to health plans is 90 days from the date on which such amounts are received or withheld by the employer.

.228 The proposed rule would amend the participant contribution rules for plans with fewer than 100 participants by creating a safe harbor period under which participant contributions to a small plan will be deemed to be made in compliance with the law if those amounts are deposited with the plan within seven 7 business days of receipt or withholding.

.229 Before the effective date of the final regulation, the DOL will not assert a violation regarding participant contributions where such contributions are deposited with small plans within the seven business day safe harbor period. In addition, the DOL is requesting information and data regarding a possible safe harbor for plans with 100 or more participants to enable it to evaluate the current contribution practices of these large employers.

.230 The proposed regulation may be viewed at the DOL’s Web site at www.dol.gov/ebsa.

Electronic Filing of the Form 5500 and Changes to the 2009 Form 5500

.231 On November 16, 2007, the EBSA, the IRS, and the PBGC published in the Federal Register revisions to the Form 5500 annual return/report for plan
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year 2009, including a deferral for 1 year of the move to the wholly electronic filing system.

.232 Originally proposed to take effect for plan year 2008, plans and service providers now will have additional time to comply with changes to the 2009 Form 5500 and the change to the wholly electronic filing system. Plans and service providers will not be required to comply with these changes until the due date for the plan’s 2009 Form 5500.

.233 Other highlights of the changes include the following:

- A new simplified annual reporting form for small plans with secure, easy to value investments with regulated financial institutions. The DOL estimates that approximately 594,000 of the 629,000 small plans required to file an annual report will be eligible to use the new Form 5500-SF, or short form.
- Removal of the IRS-only schedules (Schedules E and SSA) from the Form 5500 annual return/report as a result of the move to the wholly electronic filing system.
- Revision of Schedule C to clarify the reporting requirements and improve the information plan officials receive regarding amounts being received by plan service providers.
- Replacement of Schedule B with Schedule SB and Schedule MB to reflect the changes in reporting and funding requirements for single and multiemployer defined benefit pension plans under the PPA effective for the 2008 plan year.
- Modification of Schedule R to add questions required by the PPA to gather information on pension plan funding and compliance with minimum funding requirements effective for the 2008 plan year but filed as an attachment rather than as actual schedules. These modifications will be effective in standard format for the 2009 plan year.
- Modification of Schedule R to collect data needed by the PBGC to properly monitor the plans it insures effective for the 2008 plan year but filed as an attachment rather than as an actual schedule. These modifications will be effective in standard format for the 2009 plan year.
- Miscellaneous changes to the schedules and instructions to improve and clarify reporting effective for the 2009 plan year.
- Improved financial disclosure by the approximately 16,000 tax sheltered 403(b) annuity plans subject to Title I of ERISA by making the reporting rules for those 403(b) plans on par with 401(k) plans. This will involve the completion of the Form 5500 as a small or large pension plan, depending on the number of participants eligible to participate in the plan as of the beginning of the plan year. The DOL anticipates that most small 403(b) plans will be eligible to use the new Form 5500-SF, and thus will only have to meet that limited filing obligation. See the section “New Filing and Audit Requirements for ERISA-Covered 403(b) Employee Benefit Plans” in this alert for further guidance.

DOL Abandoned Individual Account Plan Final Regulations and Class Exemption

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

The regulations establish standards for determining when a plan is abandoned, establish simplified 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

A plan generally will 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 reasonable 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

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 (for example, bank, trust company, mutual fund family, or insurance company).

Termination and Winding-Up Process

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;
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- notifying participants and beneficiaries of the termination and their rights and options;
- distributing benefits to participants and beneficiaries; and
- filing a summary terminal report.

.239 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

.240 The regulations establish a fiduciary safe harbor for the investment of rollover distributions from terminated plans to individual retirement accounts (IRAs) for missing participants.

Fiduciary Liability and Annual Reporting Relief

.241 QTAs that follow the regulation will be considered to have satisfied the prudence requirements of ERISA with respect to winding-up activities.

.242 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. However, the QTA must complete and file a summary terminal report at the end of the winding-up process.

Class Exemption

.243 The exemption would cover transactions where the QTA selects and pays itself

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

Administration

.244 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

.245 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
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questions about the class exemption, contact the EBSA’s Office of Exemption Determinations at (202) 693-8540.

DOL Consultant Advisor Program

.246 The EBSA’s Consultant Advisor Program is an enforcement initiative that is among the DOL’s national priorities for 2008. It 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 DOL 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 Consultant Advisor Program will also seek to identify potential criminal violations, such as kickbacks or fraud.

Independence Request for Information

.247 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.

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

DOL Issues Rules on Selecting Annuity Providers for Benefit Distributions From Pension Plans

.249 The PPA required the DOL to issue regulations clarifying that the selection of an annuity contract as an optional form of distribution from an individual account plan is not subject to the “safest available” standard under Interpretive Bulletin 95-1, “Interpretive bulletin relating to the fiduciary standard under ERISA when selecting an annuity provider” (29 CFR 2509.95-1), but is subject to all otherwise applicable fiduciary standards. On September 12, 2007, the DOL published an interim final rule that amends Interpretative Bulletin 95-1 to limit the application of the bulletin to the selection of annuity providers for benefit distributions from defined benefit plans.

.250 In addition, the DOL announced a proposed rule to provide guidance, in the form of a safe harbor, to help fiduciaries prudently choose annuity providers for benefit distributions from individual account plans, such as 401(k) plans.

.251 Under the proposed safe harbor, fiduciaries must

- conduct an objective, thorough, and analytical search to identify and select providers;
• consider the need to engage an expert to assist in its evaluation of providers; and
• appropriately conclude that the annuity provider would be financially able to make all future payments under the contract and that the cost of the contract is reasonable in relation to the benefits and services to be provided under the contract.

A copy of both the interim final and proposed rules may be found at the DOL's Web site at www.dol.gov/ebsa.

New Disclosure Civil Penalty Rules Under ERISA Section 502(c)(7)

On August 10, 2007, the DOL published a direct final rule amending the civil penalty regulation under ERISA section 502(c)(7) to reflect amendments to this section in the PPA. The final regulation implements the DOL's authority to assess civil penalties against plan administrators that fail to give employees notice of the right to sell company stock in their pension plan accounts.

The PPA established rights of plan participants and beneficiaries to sell the company stock in their accounts and reinvest the proceeds into other investments available under a plan. It also required plan administrators to notify participants and beneficiaries of this new right and of the importance of diversifying the investment of retirement account assets.

The amendments authorize the DOL to assess civil monetary penalties against plan administrators that fail to give employees notice of the right to sell company stock in their pension plan accounts. These penalties may range as high as $100 per day against plan administrators for each violation of the new notice requirement.

The new rule may be found at the DOL's Web site at www.dol.gov/ebsa.

EBSA's Interim Final Rule for Distributions to Missing Nonspouse Beneficiaries

On February 15, 2007, the DOL issued an interim final rule requiring the distribution of 401(k)-type benefits for missing nonspouse beneficiaries from terminated plans to be rolled into IRAs.

The PPA amended the IRC to allow the rollover of certain retirement benefits of a deceased participant into a tax-favored inherited IRA created on behalf of a nonspouse beneficiary.

The new rule, and a related proposed class exemption, conforms to the PPA by amending existing distribution requirements for terminated DC plans, including abandoned plans, to require rollovers into inherited IRAs for missing nonspouse beneficiaries.

The interim final rule and model notices for notifying participants or beneficiaries of the plan's termination and distribution options may be found at the DOL's Web site at www.dol.gov/ebsa.

EBSA's Interim Final Rule on Cross-Trading

On February 12, 2007, the DOL published an interim final rule regarding the new statutory exemption on cross-trading in the PPA.
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.262 The rule implements a key provision of the PPA that allows plans to benefit from cross-trading while ensuring that fair and equitable procedures are in place to protect workers’ retirement assets. Cross-trading is a transaction in which an investment manager uses its authority to sell a security on behalf of one client and to buy that same security on behalf of another client.

.263 The statutory exemption allows investment managers of plans governed by ERISA to execute cross-trades if certain conditions are met, including the adoption of written cross-trading policies and procedures. The interim rule establishes the requirements for the policies and procedures that investment managers must adopt to engage in cross-trades.

.264 The interim final rule may be found at the DOL’s Web site at www.dol.gov/ebsa.

Multiemployer Plan Notice

.265 Sections 202 and 212 of the PPA established new funding requirements for multiemployer plans deemed to be in an endangered or critical status. No later than the 90th day of each plan year, an actuary is required to certify to treasury and the plan sponsor

• whether a plan is in endangered status for the plan year and whether the plan is or will be in critical status for the plan year, and

• in the case of a plan that is in a funding improvement or rehabilitation period, whether the plan is making the scheduled progress in meeting the requirements of its funding improvement or rehabilitation plan.

.266 Plans in critical status must include in the notice additional explanations regarding possible reduction of adjustable benefits.

.267 No later than 30 days after a multiemployer plan is certified to be in endangered or critical status, the plan sponsor must provide notice of the endangered or critical status to participants and beneficiaries, the bargaining parties, the PBGC, the IRS, and the DOL.

.268 An actuary’s failure to timely certify a plan’s status is equivalent to the plan sponsor having failed to file a Form 5500. This subjects the plan administrator to penalties of up to $1,100 per day pursuant to ERISA section 502(c)(2). Also, pursuant to ERISA section 502(c)(8), the plan administrator is subject to penalties of up to $1,100 per day for not adopting a funding or rehabilitation plan.

.269 This requirement is effective for plan years beginning after 2007.

Proposed Disclosure Rules for Multiemployer Pension Plans

.270 On September 14, 2007, the DOL published proposed rules giving participants in multiemployer pension plans, their union representatives, and contributing employers the right to request and receive copies of certain actuarial, financial, and other funding-related documents from their plans.

.271 The new disclosure rules implement provisions of the PPA that require plan administrators of multiemployer plans to furnish upon the written request of participants, beneficiaries, employee representatives, and contributing employers copies of actuarial, financial, and funding-related documents.
The plan has 30 days after a request to furnish the documents, which are limited to 1 copy per report within a 12-month period.

The proposed regulation may be found at the DOL's Web site at www.dol.gov/ebsa.

Proposed Civil Penalty Rules Under ERISA Section 502(c)(4)

On December 19, 2007, the DOL published in the Federal Register a proposed regulation for assessing civil penalties against plan administrators that fail to disclose certain documents to participants, beneficiaries, and others as required by ERISA, as amended by the PPA.

The PPA established new disclosure provisions relating to funding-based limits on benefit accruals and certain forms of benefit distributions; plan actuarial and financial reports; withdrawal liability of contributing employers; and participants' rights and obligations under automatic contribution arrangements. The PPA gives the DOL authority to assess civil monetary penalties of up to $1,000 per day against plan administrators for violations of the new disclosure requirements. The proposed regulation sets forth the administrative procedures for assessing and contesting such penalties and does not address substantive provisions of the new disclosure requirements.

The text of the proposal is available on the EBSA's Web site at www.dol.gov/ebsa.

On the Horizon

Auditors should keep abreast of auditing and accounting developments and upcoming guidance that may affect their engagements. Remember that exposure drafts are nonauthoritative and cannot be used as a basis for changing existing standards.

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 in-depth information about proposed standards and other projects in the pipeline. Readers should refer to information provided by the various standard-setting bodies for 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/Auditing+Standards+Board/">www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Auditing+Standards+Board/</a></td>
</tr>
<tr>
<td>Financial Accounting Standards Board (FASB)</td>
<td><a href="http://www.fasb.org">www.fasb.org</a></td>
</tr>
<tr>
<td>Governmental Accounting Standards Board (GASB)</td>
<td><a href="http://www.gasb.org">www.gasb.org</a></td>
</tr>
<tr>
<td>Public Company Accounting Oversight Board (PCAOB)</td>
<td><a href="http://www.pcaob.org">www.pcaob.org</a></td>
</tr>
</tbody>
</table>

(continued)
Help Desk—The AICPA’s standard-setting committees publish exposure drafts of proposed professional standards exclusively on the AICPA Web site. The AICPA will notify interested parties by e-mail about new exposure drafts. To be added to the notification list for all AICPA exposure drafts, send your e-mail address to service@aicpa.org. Indicate “exposure draft e-mail list” in the subject header field to help process your submission more efficiently. Include your full name, mailing address, and, if known, your membership and subscriber number in the message. The AICPA Web site also has connecting links to the other standard-setting bodies listed here.

Overhaul Project—AICPA Audit and Accounting Guide Employee Benefit Plans

The AICPA is continuing to make progress overhauling the AICPA Audit and Accounting Guide Employee Benefit Plans, addressing numerous accounting, auditing, industry, and regulatory issues that have transpired since this guide was originally issued in 1991. During this project, the AICPA will continue to issue annual editions of the guide, updated to reflect recent audit and accounting pronouncements.

Proposed FASB EITFs and FSPs

Proposed FASB EITF Issues. Numerous open issues are under deliberation by the EITF. Readers should visit the FASB Web site at www.fasb.org/eitf/agenda.shtml for complete information.

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.

AICPA Employee Benefit Plan Audit Quality Center

The AICPA Employee Benefit Plan Audit Quality Center is a firm-based, voluntary membership center created in March 2003 with the goal of promoting quality employee benefit plan audits. The center now has over 1,500 members in all 50 states, the District of Columbia, the U.S. Virgin Islands, and Puerto Rico.

Reviews performed by the DOL’s EBSA continue to show a difference in the quality of ERISA audits performed by center member firms compared with those performed by nonmember firms. As members of the center, firms

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have available to them tools and resources that are not available from any other source. In addition to providing periodic E-Alerts with information about recent developments affecting employee benefit plan audits, the center has recently made available to its members

- accounting and auditing resource centers in the areas of 403(b) plan audits, SAS No.103, SAS No. 112, the risk assessment standards (SAS Nos. 104–111), stable value investments, and the PPA.
- "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. As an added benefit, the center now offers a CPE option for most calls.
- two new "Topix" primers on cash balance plans and 403(b) plans to help members gain a general understanding of these types of plans.
- three new "Plan Advisories" for members to share with plan stakeholders regarding issues of importance to plan auditors, including the plan sponsor’s and trustees’ responsibility for monitoring their TPAs, the importance of internal controls, and the plan sponsor’s responsibility for valuing their plan investments.

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.

Employee Benefit Plan Resources

The following are various resources that practitioners engaged in the employee benefit plan industry may find beneficial.

Publications

Practitioners may find the following publications useful with respect to employee benefit plans:

- Audit and Accounting Guide Employee Benefit Plans with conforming changes as of March 1, 2008 (product no. 012598kk)
- Audit Guide Service Organizations: Applying SAS No. 70, as Amended (2008) (product no. 012778kk)
- AICPA Audit Risk Alert—2007/08 (product no. 022338kk)
- Audit Risk Alert Understanding the New Auditing Standards Related to Risk Assessment (product no. 022526kk)
- Audit Risk Alert Understanding SAS No. 112 and Evaluating Control Deficiencies (product no. 022536kk)
- Checklists and Illustrative Financial Statements for Defined Benefit Pension Plans (product no. 008997kk) (2008 product no. 008998kk)
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- Checklists and Illustrative Financial Statements for Defined Contribution Pension Plans (product no. 009007kk) (2008 product no. 009008kk)
- Checklists and Illustrative Financial Statements for Health and Welfare Benefit Plans (product no. 009017kk) (2008 product no. 009018kk)
- AICPA Audit Practice Aid SAS No. 70 Reports and Employee Benefit Plans (product no. 061061kk)
- Accounting Trends & Techniques—Employee Benefit Plans (product no. 006651kk)

AICPA reSOURCE: Accounting and Auditing Literature

The AICPA has created your core accounting and auditing library online. AICPA reSOURCE is now customizable to suit your preferences or your firm’s needs. Or, if you prefer to have access to the entire library, that is available too. Get access—anytime, anywhere—to the AICPAs latest Professional Standards, Technical Practice Aids, Audit and Accounting Guides (more than 20), Audit Risk Alerts (more than 15), and Accounting Trends & Techniques. To subscribe to this essential online service for accounting professionals, go to www.cpa2biz.com.

Continuing Professional Education

The AICPA offers a number of continuing professional education (CPE) courses that are valuable to CPAs working in public practice and industry. Among the many courses, the following are specifically related to employee benefit plans:

- 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

Visit www.cpa2biz.com for a complete list of CPE courses.

Online CPE

AICPA CPExpress (formerly AICPA InfoBytes), offered exclusively through CPA2Biz.com, is AICPAs flagship online learning product. AICPA CPExpress now offers a free trial subscription to the entire product for up to 30 days. AICPA members pay $149 for a new subscription and $119 for the annual renewal. Nonmembers pay $369 for each. Divided into 1-credit and 2-credit courses that are available 24 hours a day, 7 days a week, AICPA CPExpress offers hundreds of hours of learning in a wide variety of topics. To register or learn more, visit www.cpa2biz.com.

Webcasts

Stay plugged in to what is happening and earn CPE credit right from your desktop. AICPA webcasts are high quality, 2-hour CPE programs that bring you the latest topics from the profession’s leading experts. Broadcast live, they allow you to interact with the presenters and join in the discussion. If you cannot make the live event, each webcast is archived and available on CD-ROM. So far in 2008, Employee Benefit Plans Strategic Briefing has been archived and

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is available on CD-ROM. This webcast, held on April 23, 2008, was a live interactive AICPA webcast covering all the hot issues currently affecting employee benefit plans. Participants learned about current accounting, auditing, and regulatory developments, including the effect 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.

Member Service Center

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

Hotlines

Accounting and Auditing Technical Hotline

.292 Do you have a complex technical question about GAAP, other comprehensive bases of accounting, or other technical matters? If so, use the AICPA’s Accounting and Auditing Technical Hotline. AICPA staff will research your question and call you back with the answer. Beginning January 14, 2008, hotline hours were extended so that the hotline is now available from 9am to 8pm on weekdays. You can reach the Technical Hotline at (877) 242-7212 or at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+and+Auditing+Technical+Help/.

Ethics Hotline

.293 In addition to the Technical Hotline, the AICPA also offers an 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. You can reach the Ethics Hotline at (888) 777-7077.

Industry Conferences

.294 The AICPA sponsors an annual Employee Benefit Plans Accounting, Auditing and Regulatory Update Conference in the late fall. This conference is a 2-day high level forum that lets you interact with expert auditors and members of the DOL. The 2008 conference will be held December 11–12, 2008, in Washington DC.

.295 The AICPA also sponsors an annual National Conference on Employee Benefit Plans each spring. This conference is designed to update attendees on recent developments related to employee benefit plans. The 2009 National Conference on Employee Benefit Plans will be held in May 2009. For further information about the conference, call (888) 777-7077 or visit www.cpa2biz.com.

* * *

.296 This Audit Risk Alert replaces Employee Benefit Plans Industry Developments—2007.

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

Linda C. Delahanty, CPA
AICPA
220 Leigh Farm Road
Durham, NC 27707-8110
## Appendix A—IRS Limits

<table>
<thead>
<tr>
<th></th>
<th>2008</th>
<th>2007</th>
<th>2006</th>
</tr>
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<tbody>
<tr>
<td><strong>Defined benefit</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximum annual pension</td>
<td>$185,000</td>
<td>$180,000</td>
<td>$175,000</td>
</tr>
<tr>
<td><strong>Defined contribution</strong></td>
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<td></td>
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<tr>
<td>Maximum annual addition</td>
<td>46,000</td>
<td>45,000</td>
<td>44,000</td>
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<td><strong>401(k) plan</strong></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Maximum elective deferral</td>
<td>15,500</td>
<td>15,500</td>
<td>15,000</td>
</tr>
<tr>
<td><strong>403(b) plan</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximum elective deferral</td>
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<td>15,500</td>
<td>15,000</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>15,500</td>
<td>15,000</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>10,500</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>230,000</td>
<td>225,000</td>
<td>220,000</td>
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<tr>
<td>Highly compensated limits</td>
<td>105,000</td>
<td>100,000</td>
<td>100,000</td>
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<tr>
<td>Officer limits (key employee)</td>
<td>150,000</td>
<td>145,000</td>
<td>140,000</td>
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<tr>
<td>FICA taxable wage base</td>
<td>102,000</td>
<td>97,500</td>
<td>94,200</td>
</tr>
<tr>
<td>Employer and employee social security tax</td>
<td>6.20%</td>
<td>6.20%</td>
<td>6.20%</td>
</tr>
</tbody>
</table>
Appendix B—Evaluating Control Deficiencies in an Employee Benefit Plan Audit (Applying SAS No. 112)

Statement on Auditing Standards (SAS) No. 112, Communicating Internal Control Related Matters Identified in an Audit (AICPA, Professional Standards, vol. 1, AU sec. 325), 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. 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 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 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 that occurred or could have occurred</th>
<th>Likelihood of misstatement</th>
</tr>
</thead>
<tbody>
<tr>
<td>Quantitatively or qualitatively material</td>
<td>More than remote</td>
</tr>
<tr>
<td>Material weakness</td>
<td>Control deficiency but not a significant deficiency or a material weakness</td>
</tr>
<tr>
<td>Significant deficiency but not a material weakness</td>
<td>Control deficiency but not a significant deficiency or 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 affect the consideration of likelihood and magnitude.

Likelihood
In addition to the factors listed in SAS No. 112 and Audit Risk Alert Understanding SAS No. 112 and Evaluating Control Deficiencies, 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 nontimely 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
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For employee benefit plans, areas to consider include contributions, claim payments, benefit payments, and investments. When incorrectly used, the application of the definition of compensation 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

Audit Risk Alert Understanding SAS No. 112 and Evaluating Control Deficiencies provides a general list of circumstances that may be control deficiencies, significant deficiencies, or material weaknesses.

In addition to the items listed in the 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 may be used to supplement but not replace those listed in Audit Risk Alert Understanding SAS No. 112 and Evaluating Control Deficiencies. This is a companion to, but not a substitute for, the guidance in SAS No. 112 and the 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
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— 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
  - Expenses incurred but not reported (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
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— 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, Employers’ Accounting for Pensions, rather than FASB Statement No. 35, Accounting and Reporting by Defined Benefit Pension Plans, or using FASB Statement No. 106, Employers’ Accounting for Postretirement Benefits Other Than Pensions, rather than FASB Statement No. 112, Employers’ Accounting for Postemployment Benefits—an amendment of FASB Statements No. 5 and 43
— 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, these are often 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
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- 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 the following:
  - 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 recordkeeper systems)
  - SAS No. 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 the following:
  - 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, Department of Labor, and Pension Benefit Guaranty Corporation)

- 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 the following:
  - Lack of oversight by the plan sponsor of the service provider, including not obtaining and reviewing a SAS No. 70 report if available
  - For service providers with no SAS No. 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 Audit Risk Alert Understanding SAS No. 112 and Evaluating Control Deficiencies.

[Firm letterhead]
[Date]
[Addressee]
[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 our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of the plan’s internal control. Accordingly, we do not express an opinion on the effectiveness of the plan’s internal control.

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.
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 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 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 affected 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 that 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 Audit and Accounting Guide *Employee Benefit Plans* 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 therefore 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 (for example, disclosure of effect
Employee Benefit Plans Industry Developments—2008

of significant plan amendments) 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 significant deficiencies.

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 recordkeeper 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 2 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—Illustrative Financial Statements

The following 2 illustrative financial statements are for

- the hypothetical XYZ Company 401(k) plan that invests in a common/collective trust (CCT), modified to reflect the reporting and disclosure provisions of 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.

- the hypothetical XYZ Company 401(k) plan that invests in a master trust, modified to reflect the reporting and disclosure provisions of FSP AAG INV-1 and SOP 94-4-1.

These illustrations do not illustrate other provisions that might apply in circumstances other than those assumed in this example. They also do 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, Employee Retirement Income Security Act (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 note, and (3) the investment contract with insurance company note.

XYZ Company 401(k) Plan—Statement of Net Assets Available for Benefits (CCT)

<table>
<thead>
<tr>
<th>December 31</th>
<th>20X1</th>
<th>20X2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments, at fair value (See note C)</td>
<td>$9,192,000</td>
<td>$8,005,000</td>
</tr>
<tr>
<td><strong>Receivables:</strong></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><strong>Total assets</strong></td>
<td>9,258,000</td>
<td>8,065,000</td>
</tr>
</tbody>
</table>

ARA-EBP .301
Employee Benefit Plans Industry Developments—2008

Liabilities:

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X2</th>
</tr>
</thead>
<tbody>
<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><strong>Total liabilities</strong></td>
<td><strong>25,000</strong></td>
<td><strong>20,000</strong></td>
</tr>
</tbody>
</table>

**Net assets available for benefits at fair value**: 9,233,000

Adjustment from fair value to contract value for interest in collective trust relating to fully benefit-responsive investment contracts: (15,000) (10,000)

**Net assets available for benefits**: $9,218,000 $8,035,000

See accompanying notes to the financial statements.

**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-Contribution 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. The plan invests in investment contracts through a collective trust. As required by the FSP, the statement of net assets available for benefits presents the fair value of the investment in the collective trust as well as the adjustment of the investment in the collective trust from fair value to contract value relating to the investment contracts. 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 plan’s interest in the
Audit Risk Alert

A collective trust is valued based on information reported by the investment advisor using the audited financial statements of the collective trust at year-end.

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.

XYZ Company 401(k) Plan—Statement of Net Assets Available for Benefits (Master Trust)

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X2</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments in XYZ Company master trust, at fair value (See note C)</td>
<td>$9,192,000</td>
<td>$8,005,000</td>
</tr>
<tr>
<td><strong>Receivables:</strong></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><strong>Total receivables</strong></td>
<td>66,000</td>
<td>60,000</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>9,258,000</td>
<td>8,065,000</td>
</tr>
<tr>
<td><strong>Liabilities:</strong></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><strong>Total liabilities</strong></td>
<td>25,000</td>
<td>20,000</td>
</tr>
<tr>
<td><strong>Net assets available for benefits at fair value</strong></td>
<td>9,233,000</td>
<td>8,045,000</td>
</tr>
<tr>
<td>Adjustment from fair value to contract value for interest in XYZ Company master trust relating to fully benefit-responsive investment contracts</td>
<td>(15,000)</td>
<td>(10,000)</td>
</tr>
<tr>
<td><strong>Net assets available for benefits</strong></td>
<td>$9,218,000</td>
<td>$8,035,000</td>
</tr>
</tbody>
</table>

See accompanying notes to the financial statements.

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 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 (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. The plan invests in investment contracts through the XYZ Company master trust. The statement of net assets available for benefits presents the fair value of the investment in the master trust as well as the adjustment of the investment in the master trust from fair value to contract value relating to investment contracts. 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. The fair value of the plan’s interest in the master trust is based on the specific interest that each plan has in the underlying participant directed investment options. The investments held by the master trust are valued as follows.

Shares of mutual funds are valued at the net asset value of shares held at year-end. Participant loans are valued at their outstanding balances, which approximate fair value. The fair value of the guaranteed investment contract (GIC) is calculated by discounting the related cash flows based on current yields of similar instruments with comparable durations. Individual assets of the synthetic investment contract (synthetic GIC) are valued at representative quoted market prices. The fair value of the wrap contract for the synthetic GIC is determined using the market approach discounting methodology that incorporates the difference between current market level rates for contract level wrap fees and the wrap fee being charged. The difference is calculated as a dollar value and discounted by the prevailing interpolated swap rate as of period end.

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 Contracts

In 20X0, the plan entered into a benefit-responsive investment contract with National Insurance Company (National), held by the master trust. 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 GIC issuer is contractually obligated to repay the principal and a specified interest rate that is guaranteed to the plan. 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 may not be less than 4 percent. Such interest rates are reviewed on a quarterly basis for resetting.

The plan also entered into a synthetic investment contract (synthetic GIC) in 20X1, held by the master trust. A synthetic GIC is a wrap contract paired with...
an underlying investment or investments, usually a portfolio, owned by the plan, of high quality, intermediate term fixed income securities. The plan purchases a wrapper contract from financial services institution. A synthetic GIC credits a stated interest rate for a specified period of time. Investment gains and losses are amortized over the expected duration through the calculation of the interest rate applicable to the plan on a prospective basis. Synthetic GICs provide for a variable crediting rate, which typically resets at least quarterly, and the issuer of the wrap contract provides assurance that future adjustments to the crediting rate can not result in a crediting rate less than zero. The crediting rate is primarily based on the current yield-to-maturity of the covered investments, plus or minus amortization of the difference between the market value and contract value of the covered investments over the duration of the covered investments at the time of computation. The crediting rate is most affected by the change in the annual effective yield to maturity of the underlying securities, but is also affected by the differential between the contract value and the market value of the covered investments. This difference is amortized over the duration of the covered investments. Depending on the change in duration from reset period to reset period, the magnitude of the impact to the crediting rate of the contract to market difference is heightened or lessened. The crediting rate can be adjusted periodically and is usually adjusted either monthly or quarterly, but in no event is the crediting rate less than zero percent.

Certain events limit the ability of the plan to transact at contract value with the insurance company and the financial institution issuer. Such events include (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 ERISA. The plan administrator does not believe that the occurrence of any such value event that would limit the plan’s ability to transact at contract value with participants is probable.

The GIC does not permit the insurance company to terminate the agreement prior to the scheduled maturity date; however, the synthetic GICs generally impose conditions on both the plan and the issuer. If an event of default occurs and is not cured, the nondefaulting party may terminate the contract. The following may cause the plan to be in default:

- A breach of material obligation under the contract
- A material misrepresentation
- A material amendment to the plan agreement

The issuer may be in default if it breaches a material obligation under the investment contract, makes a material misrepresentation, has a decline in its long term credit rating below a threshold set forth in the contract, or is acquired or reorganized and the successor issuer does not satisfy the investment or credit guidelines applicable to issuers. If, in the event of default of an issuer, the plan were unable to obtain a replacement investment contract, withdrawing plans may experience losses if the value of the plan’s assets no longer covered by the contract is below contract value. The plan may seek to add additional issuers over time to diversify the plan’s exposure to such risk, but there is no assurance the plan may be able to do so. The combination of the default of an
issuer and an inability to obtain a replacement agreement could render the plan unable to achieve its objective of maintaining a stable contract value. The terms of an investment contract generally provide for settlement of payments only upon termination of the contract or total liquidation of the covered investments. Generally, payments will be made pro-rata, based on the percentage of investments covered by each issuer. Contract termination occurs whenever the contract value or market value of the covered investments reaches zero or upon certain events of default. If the contract terminates due to issuer default (other than a default occurring because of a decline in its rating), the issuer will generally be required to pay to the plan the excess, if any, of contract value over market value on the date of termination. If a synthetic GIC terminates due to a decline in the ratings of the issuer, the issuer may be required to pay to the plan the cost of acquiring a replacement contract (that is, replacement cost) within the meaning of the contract. If the contract terminates when the market value equals zero, the issuer will pay the excess of contract value over market value to the plan to the extent necessary for the plan to satisfy outstanding contract value withdrawal requests. Contract termination also may occur by either party upon election and notice.

As described in note B, because the GICs and synthetic GICs are fully benefit responsive, contract value is the relevant measurement attribute for that portion of the net assets available for benefits attributable to the GICs and synthetic GICs. Contract value 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.

<table>
<thead>
<tr>
<th>Average yields for GICs and synthetic GICs</th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Based on actual earnings</td>
<td>4.6%</td>
<td>4.9%</td>
</tr>
<tr>
<td>Based on interest rate credited to participants</td>
<td>4.7%</td>
<td>5.0%</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 EBSA’s views on technical applications of the Employee Retirement Income Security Act (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.

<table>
<thead>
<tr>
<th>FAB 2002-1</th>
<th>Addresses the fiduciary considerations involved with the refinancing of an employee stock ownership plan loan under section 408(b)(3) of ERISA.</th>
</tr>
</thead>
<tbody>
<tr>
<td>FAB 2002-2</td>
<td>Addresses whether the trustees of two related multiemployer plans were subject to ERISA’s fiduciary standards when they amended the plan’s trust agreements.</td>
</tr>
<tr>
<td>FAB 2002-3</td>
<td>Addresses the fiduciary considerations regarding the use of agreements in which the service provider retains the “float” on plan assets.</td>
</tr>
<tr>
<td>FAB 2003-1</td>
<td>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.</td>
</tr>
<tr>
<td>FAB 2003-2</td>
<td>Considers the application of EBSA’s participant contribution requirements to multiemployer defined contribution pension plans.</td>
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<tr>
<td>FAB 2003-3</td>
<td>Addresses the rules that apply to how expenses are allocated among plan participants in a defined contribution pension plan.</td>
</tr>
<tr>
<td>FAB 2004-1</td>
<td>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.</td>
</tr>
<tr>
<td>FAB 2004-2</td>
<td>Addresses a fiduciary’s duties with respect to missing participants in a terminated defined contribution plan.</td>
</tr>
<tr>
<td>FAB 2004-3</td>
<td>Addresses the fiduciary responsibilities of a directed trustee in the context of publicly traded securities.</td>
</tr>
<tr>
<td>FAB 2006-1</td>
<td>Addresses the distribution to plans of settlement proceeds relating to late trading and market timing.</td>
</tr>
<tr>
<td>FAB 2006-2</td>
<td>Addresses recurring questions about ERISA coverage of HSAs and evolving practices in the offering of HSAs in the workplace.</td>
</tr>
<tr>
<td>FAB 2006-3</td>
<td>Addresses interim guidance relating to individual benefit statements and notices of freedom to divest employer securities pursuant to the Pension Protection Act of 2006.</td>
</tr>
<tr>
<td>FAB 2007-1</td>
<td>Addresses guidance relating to the investment advice provisions of the Pension Protection Act of 2006.</td>
</tr>
<tr>
<td>FAB 2007-2</td>
<td>Addresses how IRS regulations governing 403(b) tax sheltered annuity programs affect the status of such programs under the Department of Labor’s (DOL’s) safe harbor regulation at 29 C.F.R. § 2510.32(f).</td>
</tr>
<tr>
<td>FAB 2007-3</td>
<td>Addresses guidance to EBSA’s national and regional offices relating to the timeframe for furnishing pension benefit statements by certain individual account plans.</td>
</tr>
<tr>
<td>FAB 2007-4</td>
<td>Addresses the circumstances under which supplemental health insurance coverage satisfies the requirements for excepted benefits under sections 732(c)(3) and 733(c)(4) of ERISA.</td>
</tr>
<tr>
<td>FAB 2008-1</td>
<td>Addresses the responsibilities of named fiduciaries and trustees of ERISA covered plans for the collection of delinquent employer and employee contributions.</td>
</tr>
<tr>
<td>FAB 2008-2</td>
<td>Addresses which types of health promotion or disease prevention programs offered by a group health plan must comply with the DOL’s final wellness program regulations and how a plan determines whether such a program is in compliance with the regulations.</td>
</tr>
</tbody>
</table>
Appendix F—Payroll Auditing

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. AICPA Audit and Accounting Guide Employee Benefit Plans, with conforming changes as of March 1, 2008, 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 an employee benefit 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 101–701 (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 Audit and Accounting Guide Employee Benefit Plans 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 em-
ployer contributions.” The Department of Labor has suggested that it is difficult
to ensure the completeness objective over employer contributions without per-
forming payroll audits and that without an effective payroll audit program, the
plan auditor may consider issuing a qualified opinion on the plan’s financial
statements.

There may be some limited circumstances where payroll audits are not neces-
sary. 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 Audit and Accounting Guide Employee Benefit Plans states
that “a representative group of contributing employers would 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
may be utilized in selecting at least some of the employers for audit. In that
way, every employer would have the opportunity of being audited.

It is important that plans monitor from year to year the effectiveness of its
payroll auditing program. The payroll audit program helps ensure the com-
pleteness objective in measuring employer contributions. The plan itself may
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 per-
formed. If revenue is declining as a percentage of costs, then consider reducing
the number of payroll audits being performed.
## Appendix G—Additional Web Resources

Here are some useful Web sites that may provide valuable information to accountants.

<table>
<thead>
<tr>
<th>Web Site Name</th>
<th>Content</th>
<th>Web Site</th>
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</table>
| American Institute of CPAs (AICPA) | Summaries of recent auditing and other professional standards as well as other AICPA activities | www.aicpa.org  
www.cpa2biz.com |
| AICPA Accounting Standards Executive Committee (AcSEC) | Issues guides, practice bulletins containing financial, accounting, and reporting recommendations, among other things | www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+Standards |
| AICPA Accounting and Review Services Committee (ARSC) | Develops and issues review and compilation standards and interpretations | www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Accounting+and+Review+Services+Committee |
| AICPA Professional Issues Task Force (PITF) | Accumulates and considers practice issues that appear to present concerns for practitioners and for disseminating information or guidance, as appropriate, in the form of practice alerts | www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Professional+Issues+Task+Force |
| Economy.com | Source for analysis, data, forecasts, and information on the United States and world economies | www.economy.com |
| The Federal Reserve Board | Key interest rates | www.federalreserve.gov |
| Financial Accounting Standards Board (FASB) | Summaries of recent accounting pronouncements and other FASB activities | www.fasb.org |
| USA.gov | Portal through which all government agencies can be accessed | www.usa.gov |
### Employee Benefit Plans Industry Developments—2008

<table>
<thead>
<tr>
<th><strong>Web Site Name</strong></th>
<th><strong>Content</strong></th>
<th><strong>Web Site</strong></th>
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<tbody>
<tr>
<td>Governmental Accounting Standards Board (GASB)</td>
<td>Summaries of recent accounting pronouncements and other GASB activities</td>
<td><a href="http://www.gasb.org">www.gasb.org</a></td>
</tr>
<tr>
<td>International Accounting Standards Board (IASB)</td>
<td>Summaries of International Financial Reporting Standards and International Accounting Standards</td>
<td><a href="http://www.iasb.org">www.iasb.org</a></td>
</tr>
<tr>
<td>International Federation of Accountants (IFAC)</td>
<td>Information on standards-setting activities in the international arena</td>
<td><a href="http://www.ifac.org">www.ifac.org</a></td>
</tr>
<tr>
<td>Private Company Financial Reporting Committee (PCFRC)</td>
<td>Information on the initiative to further improve FASB’s standard-setting process to consider needs of private companies and their constituents of financial reporting.</td>
<td><a href="http://www.pcfr.org">www.pcfr.org</a></td>
</tr>
<tr>
<td>Public Company Accounting Oversight Board (PCAOB)</td>
<td>Information on accounting and auditing the activities of the PCAOB and other matters</td>
<td><a href="http://www.pcaob.org">www.pcaob.org</a></td>
</tr>
</tbody>
</table>