Employee benefit plans industry developments - 2009; Audit risk alerts

American Institute of Certified Public Accountants

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

Part of the Accounting Commons, and the Taxation Commons

Recommended Citation
https://egrove.olemiss.edu/aicpa_indev/1081

This Book is brought to you for free and open access by the American Institute of Certified Public Accountants (AICPA) Historical Collection at eGrove. It has been accepted for inclusion in Industry Guides (AAGs), Risk Alerts, and Checklists by an authorized administrator of eGrove. For more information, please contact egrove@olemiss.edu.
Employee Benefit Plans
Industry Developments

A U D I T  R I S K  A L E R T

STRENGTHENING AUDIT INTEGRITY
SAFEGUARDING FINANCIAL REPORTING

AICPA®
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

Acknowledgments

The AICPA staff gratefully acknowledges the Employee Benefit Plans Guide Task Force; the Office of the Chief Accountant, the Employee Benefits Security Administration; and JulieAnn Verrekia for their essential contributions in creating this publication.
## Table of Contents

### Employee Benefit Plans Industry Developments—2009
- How This Alert Helps You .................................... .01
- Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement ............... .02
- Economic and Industry Developments ........................ .03-.28
  - The Current Economic Crisis ............................... .03-.08
  - Government Intervention to Curtail the Economic Crisis ..... .09-.13
  - Effect on Employee Benefit Plans ........................... .14-.28
- Hot Topics ................................................... .29-.101
  - Fair Value Measurements and Disclosures .................. .29-.51
  - Limited Scope Audits .................................... .52-.60
  - Stable Value Funds ........................................ .61-.64
  - Going Concern Matters .................................... .65-.70
  - ERISA-Covered 403(b) Employee Benefit Plans ............. .71-.85
  - Client Acceptance and Continuance Considerations ....... .86-.88
  - The Pension Protection Act and Other 2008 Legislation ..... .89-.101
- Audit and Accounting Guide Revision as of March 1, 2009 ........................................ .102
- Audit and Attestation Issues and Developments .............. .103-.145
  - SAS No. 70 Issues ........................................ .103-.106
  - Auditing Plan Fees and Expenses .......................... .107-.108
  - Payroll Data ............................................... .109-.111
  - Actuarial Reports for Defined Benefit Plans .............. .112-.119
  - Allocation Testing for Defined Contribution Plans ....... .120-.123
  - Missing Participant Data ................................... .124-.129
  - Securities Lending ........................................ .130-.132
  - Form 11-K Audits .......................................... .133-.134
  - Auditing Accounting Estimates ............................. .142-.143
  - Management Letter of Representations ...................... .144-.145
  - Accounting Issues and Developments ......................... .146-.159
    - Unrelated Business Income Tax and FASB Interpretation No. 48 ........................................ .146-.153
    - FASB Accounting Standards Codification™ .................. .154-.159
- Recent Pronouncements ...................................... .160-.166
- Regulatory Developments ..................................... .167-305
  - The DOL Provides Guidance on Fiduciary Duties in Response to Abuses Involving the Madoff Investment Firm .......... .167-.169
  - IRS Enhances Employee Plans Compliance Resolution System ........................................ .170-.173
  - 2008 Form 5500 Series ................................... .174-.184
  - Electronic Filing of Form 5500 and Changes to the 2009 Form 5500 ........................................ .185-.187

### Contents
# Table of Contents

**Employee Benefit Plans Industry Developments—2009—continued**

<table>
<thead>
<tr>
<th>Paragraph</th>
<th>Page</th>
</tr>
</thead>
<tbody>
<tr>
<td>Correspondence From EFAST or the DOL OCA</td>
<td>188-197</td>
</tr>
<tr>
<td>The EBSA’s Inspection Programs to Assess Plan Audit Quality</td>
<td>198-204</td>
</tr>
<tr>
<td>DOL Fiduciary Education Campaign</td>
<td>205-207</td>
</tr>
<tr>
<td>Delinquent Filer Voluntary Compliance Program</td>
<td>218-230</td>
</tr>
<tr>
<td>Voluntary Fiduciary Correction Program</td>
<td>231-235</td>
</tr>
<tr>
<td>DOL Outreach and Customer Service Efforts</td>
<td>236-237</td>
</tr>
<tr>
<td>Timeliness of Remittance of Participant Contributions</td>
<td>238-249</td>
</tr>
<tr>
<td>Remains an Enforcement Initiative for the EBSA</td>
<td>250-253</td>
</tr>
<tr>
<td>The DOL Issues Final Rule on Investment Advice Exemption for 401(k) Plans</td>
<td>254-256</td>
</tr>
<tr>
<td>and Individual Retirement Accounts</td>
<td>257-260</td>
</tr>
<tr>
<td>New Civil Penalty Rules Regarding Disclosures to Participants (ERISA Section 502[c][4])</td>
<td>261-263</td>
</tr>
<tr>
<td>The DOL Issues Final Rule for Distributions to Missing Nonspouse Beneficiaries</td>
<td>264-267</td>
</tr>
<tr>
<td>The DOL Issues Final Rules on Selecting Annuity Providers for Benefit Distributions From Pension Plans</td>
<td>268-271</td>
</tr>
<tr>
<td>The DOL Issues Final Rule on Cross Trading</td>
<td>272-275</td>
</tr>
<tr>
<td>The DOL Proposes Regulations to Improve Disclosure of Fees and Expenses to Workers With 401(k)-Type Benefit Plans</td>
<td>276-284</td>
</tr>
<tr>
<td>The DOL Issues Guidance on Reporting Service Provider Fee and Compensation Information (Schedule C) Reporting for 2009 Form 5500</td>
<td>285-296</td>
</tr>
<tr>
<td>Multiemployer Plan Notices</td>
<td>297-300</td>
</tr>
<tr>
<td>EBSA’s Final Rule on Default Investment Alternatives for Participant-Directed Plans</td>
<td>301-302</td>
</tr>
<tr>
<td>Civil Penalty Rules For Failure to Provide Diversification Notices (ERISA Section 502[c][7])</td>
<td>303-305</td>
</tr>
<tr>
<td>Investments Reported as 103-12 Entities as Required by the DOL</td>
<td>306</td>
</tr>
<tr>
<td>EBSA Technical Guidance</td>
<td>307-313</td>
</tr>
<tr>
<td>Recent AICPA Independence and Ethics Pronouncements</td>
<td>314-335</td>
</tr>
<tr>
<td>Overhaul Project—AICPA Audit and Accounting Guide Employee Benefit Plans</td>
<td>315-317</td>
</tr>
<tr>
<td>Auditing Pipeline—Nonissuers</td>
<td>318</td>
</tr>
<tr>
<td>Auditing Pipeline—Issuers</td>
<td>319-320</td>
</tr>
<tr>
<td>Accounting Pipeline</td>
<td>321</td>
</tr>
<tr>
<td>Employee Benefit Plan Resources</td>
<td>322-325</td>
</tr>
<tr>
<td>AICPA Employee Benefit Plan Audit Quality Center</td>
<td>326-328</td>
</tr>
<tr>
<td>Resource Central</td>
<td>329-330</td>
</tr>
<tr>
<td>Publications</td>
<td>331-332</td>
</tr>
<tr>
<td>AICPA reSOURCE: Accounting and Auditing Literature</td>
<td>333-334</td>
</tr>
<tr>
<td>Continuing Professional Education</td>
<td>335-336</td>
</tr>
</tbody>
</table>
# Table of Contents

| Paragraph || vii |
|---|---|
| **Employee Benefit Plans Industry Developments—2009—continued** | |
| Webcasts | .326-.327 |
| Member Service Center | .328 |
| Hotlines | .329-.330 |
| Industry Conferences | .331-.332 |
| AICPA Industry Expert Panel—Employee Benefit Plans | .333-.335 |
| Appendix A—IRS Limits | .336 |
| Appendix B—Definitions of Certain Investments | .337 |
| Appendix C—Auditing Health and Welfare Plans | .338 |
| Appendix D—Resources for Economic Information | .339 |
| Appendix E—Additional Web Resources | .340 |

---

## Contents
How This Alert Helps You

.01 This Audit Risk Alert helps you plan and perform your employee benefit plan audits and also can be used by an entity’s internal management to address areas of audit concern. This alert provides information to assist you in achieving a more robust understanding of the business, economic, and regulatory environments in which your clients operate. This alert is an important tool to help you identify the significant risks that may result in the material misstatement of financial statements and delivers information about emerging practice issues and current accounting, auditing, and regulatory developments. 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.

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

.02 Paragraph .01 of AU section 314, Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement (AICPA, Professional Standards, vol. 1), establishes requirements and provides guidance about implementing the second standard of field work, as follows: “The 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.” Just as the external environment changes, the handling of the entity’s business is also dynamic, and the entity’s strategies and objectives change over time. An understanding of business risks increases the likelihood of identifying risks of material misstatement. 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.

Economic and Industry Developments

The Current Economic Crisis

.03 When planning and performing an audit of an employee benefit plan, an auditor should understand the economic conditions facing the industry in which the plan sponsor operates as well as the effects of these conditions on the employee benefit plan. Economic activities relating to factors such as interest rates, availability of credit, consumer confidence, overall economic expansion or contraction, inflation, and labor market conditions are likely to have an effect on the audit of the plan’s financial statements. Although it is impossible to predict and include all accounting, auditing, and attestation issues that may affect employee benefit plan audits, the primary areas of concern given the current economic conditions are described in this alert. As always, continue to remain alert to changes in economic, legislative, and regulatory developments as well as the associated accounting, auditing, and attestation issues as you perform your engagements.

.04 Recent economic conditions and regulatory actions may cause additional risk factors that had not previously existed or did not have a material
Audit Risk Alert

effect on the audit of the plan in prior years. Some challenges that may affect the plan in the current economic conditions are as follows:

- Constraints on the availability of capital and credit
- The credit crisis, which results in significant measurement uncertainty, including accounting estimates and fair value measurements
- Operations that are exposed to volatile markets, such as currency markets
- Volatile real estate markets
- Severely underfunded defined benefit plans
- Downsizing causing significant layoffs
- Going concern and liquidity issues
- Fraudulent internal and external transactions

.05 Although many of these risks are not new for plan audits, consideration of the ways an employee benefit plan is affected by external forces is part of obtaining an understanding of the plan and its environment and will allow the auditor to plan and perform the audit to address those risks. As noted in paragraph .17 of AU section 312, Audit Risk and Materiality in Conducting an Audit (AICPA, Professional Standards, vol. 1), some possible audit responses to a significant risk of material misstatement include increasing the extent of audit procedures, performing procedures closer to year-end, or increasing audit procedures to obtain more persuasive evidence. Additionally, given the constant changing status of economic conditions that could affect your plan audit, auditors should consider modifying audit procedures to ascertain that risks are still adequately addressed.

.06 Currently, the U.S. economy continues to experience severe instability. The National Bureau of Economic Research officially declared that, as of December 2007, the United States slid into a recession. The length of the recession and whether the United States will enter into a depression are yet to be determined. Some key occurrences that exhibit the gravity of the economic crisis include the following:

- Government intervention in the private sector has increased. Numerous financial institutions and automakers have received a bailout from the government.
- Millions of households owe more on their mortgages than their homes are currently worth. The number of residential home foreclosures has increased to record levels; in January 2009, foreclosures were up 18 percent from January 2008.
- The number of jobless claims has continued to increase; the economy has experienced the biggest job loss since the end of World War II.
- U.S. real gross domestic product (GDP), the broadest measure of economic activity, continues to decrease at an increasing rate.
- The financial markets continue to experience instability. At the end of February 2009, the S&P 500 hit a 12-year low. Likewise, the Dow Jones Industrial Average and NASDAQ also continue to hit long-time lows.
The Federal Reserve has continued to decrease the federal fund interest rate. The demand for U.S. Treasury bills has increased at a staggering rate, which drove the interest rate for these Treasury bills to less than 1 percent in February 2009. The Treasuries Over Eurodollar Spread reached 4.63 percent in October 2008, a historic high. The discovery of alleged frauds in hedge funds or in other alternative investments has caused investors to lose millions of dollars. Certain investments that were once considered safe investments, such as money market funds and securities lending activities, have “broken the buck” and are now experiencing write downs.

Some experts have attributed the current situation with the residential real estate industry to the perfect storm of circumstances: rising home values, historically low interest rates, loosening underwriting and lending standards, and the notion that housing was a fail-safe investment. As these problems with the real estate market became evident, they have had a significant effect on the credit market. As the credit markets have become frozen and banks have become unwilling to lend to consumers or to one another, the downward sloping cycle perpetuates, resulting in continued stress on the overall economy.

One major spillover effect of these events has been in the market for short term commercial paper, particularly securities backed by various financial assets. 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.

Government Intervention to Curtail the Economic Crisis

Due to the economic crisis, the U.S. government has taken unprecedented actions to prevent worsening economic conditions, including passing the American Recovery and Reinvestment Act of 2009 (ARRA) in February 2009 and the Emergency Economic Stabilization Act of 2008 (EESA), facilitating the sale of ailing banks, and dramatically increasing the monetary programs available from the Federal Reserve.

The EESA was signed into law in October 2008. As stated in Section 2 of the EESA bill, it “provide[s] authority and facilities that the Secretary of the Treasury can use to restore liquidity and stability to the financial system of the United States” to ensure the economic wellbeing of Americans. Certain components of the EESA bill include the following:

- An allocation of $700 billion to stabilize the U.S. financial system
- Thecreation of an oversight board
- A temporary increase of Federal Deposit Insurance Corporation insurance limits
Audit Risk Alert

- The restatement of the Securities and Exchange Commission’s (SEC’s) authority to suspend the application of Financial Accounting Standards Board (FASB) Statement No. 157, *Fair Value Measurements*, (which is codified at FASB Accounting Standards Codification [ASC] 820, *Fair Value Measurements and Disclosures*)

.11 In February 2009, President Obama signed legislation designed to work hand in hand with the EESA to stimulate the U.S. economy. The ARRA is designed primarily to combat the rising unemployment trend, put more money in the hands of consumers, and reduce the likelihood that state and local governments will need to raise taxes significantly.

.12 Many of the provisions of this legislation took effect immediately in an effort to stimulate consumer spending and boost the economy. The total cost of the spending in the ARRA is $787 billion, which is in addition to the $700 billion in the EESA. Many economists are concerned that further financial support may be necessary before an economic recovery is possible. Additionally, the federal government developed the Web site www.recovery.gov to facilitate a transparent process to ensure accountability for the execution of the package.

.13 The complete effects of the ARRA as well as the other government interventions will take time to be felt throughout the economy; however, the primary goal is to first increase market confidence and liquidity.

**Effect on Employee Benefit Plans**

.14 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.

.15 Additionally, the risks related to securities lending have become too great for the incremental income that can be earned. These risks recently surfaced in investment vehicles where managers of securities lending programs invest the cash collateral they receive from borrowers. That collateral was typically 102 percent of domestic shares and 105 percent of the value of non-U.S. shares. Institutional investors thought the collateral was invested in “safe” securities. Unfortunately, the range of permissible investments expanded into asset-backed securities and home equity loans. Both of these events are causing liquidity issues for plans and plan sponsors. See paragraphs .130–.132 for further discussion of securities lending.

.16 The credit crisis also raises concerns among plan sponsors about the ability for insurance companies to pay out claims on the annuity products sold to benefit plans and the safety of guaranteed annuities. Insurance companies are now hoping that the government has funds for a bail out program for them.

.17 Also, due to the significant upheaval in the current market, auditors may want to pay particular attention to the plan’s liquidity, and whether the
current conditions could affect the plan sponsor and plan’s ability to continue as a going concern. AU section 341, *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern* (AICPA, *Professional Standards*, vol. 1), requires auditors to evaluate whether there is substantial doubt about an entity’s ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being audited. AU section 380, *The Auditor’s Communication With Those Charged With Governance* (AICPA, *Professional Standards*, vol. 1), requires that auditors communicate with those charged with governance events or conditions that lead the auditor to believe there is substantial doubt about the entity’s ability to continue as a going concern. See paragraphs .65–.70 for further discussion of going concern matters in an employee benefit plan audit.

.18 Events or transactions sometimes occur that affect the 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 (a) after year-end (type 2 event) or (b) 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 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), about 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:

- 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.

.20 Additional disclosures may also be required related to defined benefit plans due to the deficit between plan assets and the plan’s accumulated plan benefit obligations and funding requirements.

.21 The current economic crisis may result in unexpected losses and possibly cause financing or liquidity difficulties for many plans and plan sponsors. Additionally, plan sponsors may be valuing illiquid securities using inherently subjective methodologies. These situations may provide plan management additional opportunity and incentive to commit fraud.

.22 As seen in the news recently, a number of frauds allegedly have occurred. One of those frauds is that of Bernard Madoff Investment Securities.
Audit Risk Alert

Although the details of this fraud are just beginning to be investigated, the planning and design of testing for the existence of assets, such as investments, is important. In addition, the requirements in AU section 314 are further emphasized in light of this alleged scenario. In this scenario, auditors are being probed about failing to question the strong, consistent annual returns by these investment funds that lacked a clear investment strategy. Because of the characteristics of fraud, the auditor's exercise of professional skepticism is important when considering the risk of material misstatement due to fraud.

Professional skepticism is an attitude that includes a questioning mind and a critical assessment of audit evidence. The auditor should conduct the engagement with a mindset that recognizes the possibility that a material misstatement due to fraud could be present, regardless of any past experience with the entity and regardless of the auditor's belief about management's honesty and integrity. Furthermore, professional skepticism requires an ongoing questioning of whether the information and evidence obtained suggests that a material misstatement due to fraud has occurred. AU section 316, Consideration of Fraud in a Financial Statement Audit (AICPA, Professional Standards, vol. 1), provides additional information including ways for the auditor to respond to the risk of material misstatement due to fraud.

Due to the current economic crisis and the recent developments involving financial frauds in managed investment funds, the U.S. Department of Labor (DOL) is expanding the scope of its inspection programs to consider the current status of the investments being reviewed. The DOL plans to emphasize its focus on how plan management determines that investments exist and that their values have been adjusted to reflect the current market conditions.

Additional areas of fraudulent transactions could result due to the economic crisis related to the operation of the plan. Defalcations, inappropriate vesting of participants, ineligible participants included in the plan, and inappropriate assumptions for Defined Benefit and Health and Welfare plan obligations are possible areas to consider.

AU section 316 is the primary source of authoritative guidance about an auditor's responsibilities concerning the consideration of fraud in a financial statement audit. AU section 316 establishes standards and provides guidance to auditors in fulfilling their responsibility to plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement (whether the material misstatement was caused by error or fraud as stated in paragraph .02 of AU section 110, Responsibilities and Functions of the Independent Auditor [AICPA, Professional Standards, vol. 1]).

In addition, the significant number of lay-offs at plan sponsors will affect employee benefit plans. For a defined benefit pension plan, this may add to the liquidity issues that the plan faces. For a defined contribution plan, a provision of the Internal Revenue Code (IRC) requires that all participants be fully vested in the event of a partial termination. This is a technical term that does not have a clear definition. It has been interpreted to apply where 20 percent or more of the workers have lost their jobs due to an event such as a plant closing or economic downturn. Because many plans use forfeitures to reduce employer contributions or to pay expenses, it is important for the...
Employee Benefit Plans Industry Developments—2009

client to properly identify when such a partial termination has occurred. See paragraph 12.21 of the Audit and Accounting Guide Employee Benefit Plans for further guidance.

Resources for Economic Information

.28 The Internet covers a vast amount of information that you may find valuable. See appendix E for some of the sites not previously mentioned in this section and links to relevant documents regarding economic information.

Hot Topics

Fair Value Measurements and Disclosures

FASB Statement No. 157

.29 In September 2006, FASB issued FASB Statement No. 157 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.

.30 For plan assets and liabilities that are traded in active markets, fair value is determined based on quoted market prices. If quoted market prices for identical assets and liabilities are not available, the plan uses valuation techniques that should maximize the use of observable inputs (assumptions based on market data) and minimize the use of unobservable inputs. In measuring fair value, the plan should make adjustments for risks and uncertainties if a market participant would include such an adjustment in its pricing. FASB Statement No. 157 requires entities to make certain disclosures for each major category of assets and liabilities that are measured at fair value, including the level within the fair value hierarchy in which the fair value measurements fall as discussed in paragraphs 22–31 of the standard. Please refer to paragraphs 32–35 of the standard for disclosure requirements.

.31 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. A contention with FASB Statement No. 157 is in regard to lack of guidance in applying fair value in an illiquid or distressed market, such as the current one. To respond to this concern, in October 2008, FASB issued FASB Staff Position (FSP) FAS 157-3, Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active, which clarifies FASB Statement No. 157’s application in an inactive market and also amends the standard to include an illustrative example. In March 2009, FASB posted for comment, proposed FSP FAS 157-e, Determining Whether a Market Is Not Active and a Transaction Is Not Distressed, which would provide additional guidance on determining whether a market for a financial asset is not active and a transaction is not distressed for fair value measurements under FASB Statement No. 157. Readers can access the full text of FASB Statement No. 157 and the previously referenced FSPs and proposed FSP on the FASB Web site at www.fasb.org.
Audit Risk Alert

Effect on Employee Benefit Plans and Plan Sponsors

Preparing to meet the requirements of FASB Statement No. 157 will require coordination among plan management, custodians, investment fiduciaries, and auditors. Generally accepted accounting principles (GAAP) require plan management to take responsibility for valuation and the Form 5500, Annual Return/Report of Employee Benefit Plan, 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. The nonauthoritative practice aid *Alternative Investments—Audit Considerations* states that "management of the investor entity is responsible for the valuation of alternative investment amounts as presented in the investor entity's financial statements" and "this responsibility cannot, under any circumstances, be outsourced or assigned to a party outside of the investor entity's management." Therefore, plan management can delegate but not abdicate its valuation responsibility. 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. Because many plans outsource investment management activities to third party service providers, information regarding the pricing and valuation of the plan's investments may not be fully transparent to those responsible for financial reporting.

Plan management is ultimately responsible for the fair values reported in the financial statements and is obligated to carefully consider how third-party input is used in estimating fair value. Accordingly, plan management needs to understand and document the pricing inputs used by plan custodians and others used to value each plan investment in order to properly classify each investment into the appropriate level within the FASB Statement No. 157 hierarchy. Service providers are not typically making the hierarchy level decisions for plans. Plan management will need to obtain pricing service documentation describing the valuation methods they or their custodians use to support their fair value hierarchy. Pricing services typically used by plan trustees or custodians to provide investment prices, such as Interactive Data Pricing and Reference Data, have prepared this information.

Accordingly, for full scope audits, auditors may consider the procedures and controls put in place by the plan sponsor and service provider to identify hard to value investments; validate the reliability of pricing or institute fair value procedures, or both, if necessary; monitor the collectability 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 ascertain 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.

Additional time may be needed this year to prepare and audit the investment information. Implementation issues will vary based on the types of investments held and the availability of information. Valuing different types of financial instruments, including understanding whether the valuation assumptions and methods used are appropriate under FASB Statement No. 157, and obtaining additional information about valuation inputs to make the appropriate note disclosures may present plan sponsors and administrators with significant challenges.
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 (AICPA, PCAOB Standards and Related Rules, PCAOB Staff Guidance, sec. 400.02), would be applicable.

.36 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 Audits” section (paragraphs .52–.60) of this alert for further guidance.

.37 The AICPA Employee Benefit Plan Audit Quality Center (EBPAQC) has developed the following documents to assist readers, plan sponsors, and administrators with implementing FASB Statement No. 157:

- Getting Started: Applying New Accounting Rules for Measuring and Reporting Fair Value of Plan Investments
- Assessing the Fair Values of Your Plan Investments
- Alternative Investments in Employee Benefit Plans

Auditing Fair Value Measurements

.38 As was stated previously, it is plan management’s responsibility to make the fair value measurements and disclosures. When auditing these fair values to ensure they are in conformity with GAAP, auditors should consult AU section 328, Auditing Fair Value Measurements and Disclosures (AICPA, Professional Standards, vol. 1), which establishes standards and provides guidance for auditors. Specific types of fair value measurements are not covered by AU section 328. For example, when auditing the fair value of derivatives and securities, refer to AU section 332, Auditing Derivative Instruments, Hedging Activities, and Investments in Securities (AICPA, Professional Standards, vol. 1).

.39 The strongest audit evidence to support a fair value is an observable market price in an active market. If that is not available, a valuation method may incorporate market assumptions. If market assumptions are not available or require significant adjustments, the entity may use its own assumptions. The auditor should obtain an understanding of the entity’s process for determining fair values, as well as whether the fair value measurements and disclosures are in accordance with GAAP. During this testing, the auditor also may identify possible indicators of impairment. According to paragraph .23 of AU section 328, “Substantive tests of the fair value measurements may involve (a) testing management’s significant assumptions, the valuation model, and the underlying data; (b) developing independent fair value estimates for corroborative purposes; or (c) reviewing subsequent events and transactions.” Paragraph .26 also notes when testing the fair value measurements and disclosures, the auditor evaluates whether management’s assumptions are reasonable and reflect market information, or are not consistent with market information. In relation to FASB Statement No. 157, this might include whether the market is distressed, whether the transaction was an orderly transaction, the reasonableness of the
determination within the fair value hierarchy of inputs, and the reasonableness of the underlying assumptions.

.40 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 illiquid 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 also may 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.

- Swap or derivative contracts are often written using the International Swap and Derivatives Association Master Agreement (ISDA) protocol. ISDA contracts include events of default and termination events, similar to bank loan covenants. The effect of a violation could be the acceleration or termination of the agreement, the requirement to post additional collateral, or the violation could effect the valuation of the derivative instrument. 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.

.41 In certain instances, the auditor may need special skills or knowledge to plan and perform auditing procedures for privately held employee stock ownership plans (ESOPs) or plans that hold alternative investments and subprime-mortgage-backed securities. AU section 332 states that for some derivatives and securities, 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 includes hard to value investments. 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.
Employee Benefit Plans Industry Developments—2009

Fair Value of Securities

.42 The guidance in AU section 332 relating to auditing the fair value of securities is fairly similar to the guidance in AU section 328; however, some items of note exist for the auditor. As previously mentioned, quoted market prices in active markets are the best available audit evidence to support a fair value; however, when they are unavailable and the valuations of securities are obtained from a broker or dealer or another pricing service based on valuation models, it is important for the auditor to understand the underlying valuation method used (such as a cash flow projection). These valuations also may be based on quoted prices from an active market or other observable inputs that would be considered by the auditor when developing audit procedures.

.43 The process used by the pricing service to measure fair value should be evaluated to determine that the resulting measurement is in accordance with the requirements of FASB Statement No. 157. The auditor also may determine it is necessary to obtain quotes from more than one pricing source based on circumstances such as an existing relationship between the entity and the valuing entity, which could inhibit objective pricing or underlying valuation assumptions that are highly subjective. In the context of FASB Statement No. 157, quoted prices in active markets for identical assets or liabilities are considered level 1 inputs.

.44 When an entity performs its own valuation, value testing procedures for the auditor to consider include assessing the reasonableness, comparing the assumptions to industry reports or benchmarks, assessing the appropriateness of the model, calculating the value using his or her own model, and comparing the fair value with subsequent or recent transactions. Whether or not the inputs to the entity’s valuation model are observable or not determines their characterization as level 2 or level 3 inputs, respectively, within the FASB Statement No. 157 fair value hierarchy. When extensive judgment is needed, consider using a specialist or refer to AU section 342, Auditing Accounting Estimates (AICPA, Professional Standards, vol. 1). Additionally, when the underlying collateral of a security significantly contributes to its fair value and collectability of the security, evidence of the collateral also should be examined for existence, fair value, transferability, and the investor’s right to the collateral.

Using the Work of a Specialist

.45 It may be necessary to use a specialist (such as a securities valuation expert) to assist in auditing complex or subjective matters. Examples of matters in which an auditor may engage a specialist are valuation issues; reasonableness of determination of amounts derived from specialized techniques or models; or implementation of technical requirements, regulations, or legal documents. AU section 336 provides guidance to auditors in using specialists. The guidance in AU section 336 is applicable when the specialist is hired by management or if the auditor engages the specialist. However, if a specialist employed by the auditor’s firm participates in the audit, AU section 311, Planning and Supervision (AICPA, Professional Standards, vol. 1), is applicable rather than AU section 336.

.46 When using the work of a specialist, the auditor should evaluate the specialist’s professional qualifications, obtain an understanding of the nature of the work performed or to be performed, and evaluate the relationship of the specialist to the client in terms of objectivity. Although the appropriateness and reasonableness of the methods and assumptions employed by the specialist are
Audit Risk Alert

his or her responsibility, the auditor should obtain an understanding of these qualities, test the underlying data provided to the specialist, and evaluate the specialist’s findings in the context of the audit and related assertions in the financial statements.

Alternative Investments

.47 The AICPA practice aid Alternative Investments—Audit Considerations is a useful tool for auditors that focuses on the existence and valuation assertions associated with alternative investments but also discusses general considerations pertaining to auditing alternative investments, management representations, disclosure of certain significant risks and uncertainties, and reporting. As defined in the foreword of the practice aid, alternative investments are “investments for which a readily determinable fair value does not exist . . . including private investment funds meeting the definition of an investment company . . . such as hedge funds, private equity funds, real estate funds, venture capital funds, commodity funds, offshore fund vehicles, and funds of funds, as well as bank common/collective trust funds.” You can access the full text of this practice aid on the AICPA’s Web site at www.aicpa.org/download/members/div/auditstd/Alternative_Investments_Practice_Aid.pdf.

.48 Further, as discussed in a meeting of FASB’s Valuation Resource Group, net asset value of a fund may not represent fair value under FASB Statement No. 157. Given the state of the economy, many funds are imposing limitations on redemptions and some are even unwinding. To assist with the estimation of fair value of interests in alternative investments, the Accounting Standards Executive Committee (AcSEC) of the AICPA has issued the draft issues paper FASB Statement No. 157 Valuation Considerations for Interests in Alternative Investments. The draft issues paper discusses how to estimate the fair value of alternative investments (such as interests in hedge funds, private equity funds, or real estate funds) in accordance with the provisions of FASB Statement No. 157. Among other things, the draft issues paper discusses the role of net asset value (NAV) in estimating fair value. The draft issues paper can be found at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+Standards/AcSEC+Issues+Draft+Issues+Paper+on+Valuation+of+Interests+in+Alternative+Investments.htm.

.49 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 (AICPA, Professional Standards, vol. 1)
- AU section 336, Using the Work of Specialists (AICPA, Professional Standards, vol. 1)
- AU section 342, Auditing Accounting Estimates (AICPA, Professional Standards, vol. 1)
- AU section 560, Subsequent Events (AICPA, Professional Standards, vol. 1)
- PCAOB Staff Audit Practice Alert No. 2, Matters Related to Auditing Fair Value Measurements of Financial Instruments and the
Employee Benefit Plans Industry Developments—2009

Use of Specialists (AICPA, PCAOB Standards and Related Rules, PCAOB Staff Guidance, sec. 400.02)

- PCAOB Staff Audit Practice Alert No. 3, Audit Considerations in the Current Economic Environment (AICPA, PCAOB Standards and Related Rules, PCAOB Staff Guidance, sec. 400.03)
- Center for Audit Quality (CAQ) white paper Measurement of Fair Value in Illiquid (or Less Liquid) Markets
- AICPA Practice Aid Alternative Investments—Audit Considerations
- AICPA Accounting Standards Executive Committee and the Alternative Investments Task Force draft white paper FASB Statement No. 157 Valuation Considerations for Interests in Alternative Investments

Master Trust Fair Value Disclosures

AICPA Issues Technical Practice Aid

The AICPA recently issued an employee benefit plan related Technical Practice Aid (TPA) to provide guidance on the required fair value measurement disclosures to be made when a plan holds investments in a master trust. Technical Questions and Answers (TIS) section 6931.11, “Fair Value Measurement Disclosures for Master Trusts” (AICPA, Technical Practice Aids), is available on the AICPA’s Web site www.aicpa.org and is also provided in the following section.

Fair Value Measurement Disclosures for Master Trusts

Inquiry—Employee benefit plans often hold investments under master trust arrangements. According to the Department of Labor’s Form 5500 instructions, a master trust is a trust for which a regulated financial institution 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.

In a typical master trust arrangement, the plan does not hold units or shares of the master trust but has an undivided interest in the assets of the master trust. However, for participant directed defined contribution plans, the plan typically has a divided interest in the individual assets of the master trust based upon participant direction. The “Additional Financial Statement Disclosures” section in chapters 2 and 3 of the AICPA Audit and Accounting Guide Employee Benefit Plans (guide) requires investments in master trusts to be shown as a single line item on the statement of net assets available for benefits; however, the plan does not “purchase” and “dispose” of its interest in the master trust but is allocated an interest once the plan sponsor chooses to transfer the plan’s assets into the master trust. The guide also requires the master trust investments to be shown by general type in the footnotes.

For employee benefit plan financial statements, are the disclosure requirements of paragraphs 32–34 of Financial Accounting Standards Board (FASB) Statement No. 157, Fair Value Measurements, required for the plan’s total interest in the master trust or the individual investments under the master trust arrangement?
Audit Risk Alert

Reply—The disclosures required by paragraphs 32–34 of FASB Statement No. 157 are required for individual investments under a master trust arrangement and are not required for the plan’s total interest in the master trust.

According to paragraph 32 of FASB Statement No. 157, for assets that are measured at fair value on a recurring basis in periods subsequent to initial recognition, the reporting entity shall disclose information that enables users of its financial statements to assess the inputs used to develop those measurements, and for recurring fair value measurements using significant unobservable inputs (level 3), the effect of the measurements on earnings (or changes in net assets) for the period.

Because of the nature of the plan’s ownership interest in the master trust—that is, the plan does not hold units or shares of a master trust—FASB Statement No. 157 disclosures should be presented for the underlying master trust investments. Therefore, the plan should disclose separately the following information for each period for each major category of master trust assets and liabilities (quantitative disclosures should be made in tabular format):

a. The fair value measurements recorded during the period and the reasons for the measurements

b. The level within the fair value hierarchy in which the fair value measurements in their entirety fall, segregating fair value measurements using quoted prices in active markets for identical assets or liabilities (level 1), significant other observable inputs (level 2), and significant unobservable inputs (level 3)

c. For fair value measurements using significant unobservable inputs (level 3), a description of the inputs and the information used to develop the inputs

d. In annual periods only, the valuation technique(s) used to measure fair value and a discussion of changes, if any, in the valuation technique(s) used to measure similar assets or liabilities, or both, in prior periods.

Consideration should be given to combining, or reconciling, or both, the master trust FASB Statement No. 157 disclosures as described previously with the current master trust disclosures as required in chapters 2 and 3 of the guide.

Limited Scope Audits

.52 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. The trustee or custodian certifies to the “completeness and accuracy” of the plan’s investment assets and investment activity as contained in the institution’s ordinary books and records, which may or may not be fair value in accordance with GAAP. Although 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’s year-end).

ARA-EBP .52
Employee Benefit Plans Industry Developments—2009

**Practice Tip:** Plan administrators should review their trustee or custodial arrangements to determine the nature of the financial information that will be provided by the trustee or custodian, or both. For instance, in cases where the plan invests in assets without readily determinable market values, the reported values may be based on the best information available to the trustee or custodian at the time the certification is prepared, which may or may not be fair value as of the plan’s year end.

.53 The auditor’s responsibilities for investments covered by the limited scope exemption are to (a) obtain and read a copy of the certification from the plan administrator, (b) determine whether the entity issuing the certification is a qualifying institution under DOL regulations, (c) compare the certified investment information to the financial statements and related disclosures, (d) 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 (e) 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 custodian are in conformity with GAAP and are in compliance with DOL rules and regulations. See paragraphs 7.65–.69 of AICPA Audit and Accounting Guide *Employee Benefits Plans* for further guidance on limited scope audits.

.54 The scope limitation extends 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 a certification, should be subjected to appropriate audit procedures. Moreover, the appropriate audit procedures for all noninvestment related information (for example, contributions and distributions) are the same for a limited scope audit as they are for a full scope audit.

.55 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).

.56 Plan management’s decision to rely on a certification for purposes of limiting the scope of the audit has become increasingly more challenging, especially in light of recent economic events as well as the issuance of FASB Statement No. 157. Because plans increasingly invest in alternative investments (including hedge funds, real estate, limited partnerships, private equity funds, and other hard-to-value investments), care should be taken by plan management when determining if certified information can be relied upon in preparing the plan’s Form 5500 and related financial statements.

.57 Plan management will need to have sufficient understanding of the nature of the plan’s investments and the valuation methodologies, key
Audit Risk Alert

Assumptions, and inputs used to determine fair value. Plan management cannot outsource or assign its responsibility for properly reporting fair value of the plan’s investments, even in situations where the plan’s trustee or custodian certifies the completeness and accuracy of the plan’s investments for a limited scope audit. Therefore, prior to being engaged to perform a limited scope audit, it is recommended that plan management and the auditor briefly discuss the nature of the investments held by the plan, including how those investments are valued and where they fall in the fair value hierarchy, to help ensure that plan management engages their auditor to perform the appropriate type of audit.

Practice Tip: FASB Statement No. 157 does not change the auditor’s responsibility in a limited scope audit. Third parties may provide pricing methodology information that assists plan management in determining the fair value hierarchy levels, or may provide preliminary suggestions of the fair value hierarchy levels. It is ultimately the responsibility of the plan’s management to understand the basis for the designations to determine whether the plan’s investments have been valued and disclosed in accordance with GAAP or whether revisions are necessary.

.58 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. For example, when a plan has significant interests in alternative investments, that are hard to value or fall within level 3 of the fair value hierarchy, this may prompt the auditor to inquire whether these investments are covered by the certification, the method used to value these investments, and whether they are reflected in the certification at fair value in accordance with GAAP. Upon further inquiry, if 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 management. It is the plan management’s responsibility to prepare the financial statements and footnote disclosures in conformity with GAAP and in compliance with DOL rules and regulations. Accordingly, plan management 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, plan management is responsible for valuing such investments as of the plan year-end and engaging the auditor to perform full scope audit procedures on the investments excluded from the certification. Paragraph 7.69 of Audit and Accounting Guide Employee Benefit Plans contains an illustrative auditor’s report when plan investments have been certified and plan management was unable to determine whether the investment information is valued in conformity with GAAP.

.59 If the trustee or custodian excludes certain investments from the certification, this ordinarily would not affect the limited scope language in the auditor’s report. Accordingly, the footnote pertaining to certified information should only reflect the investment information that was included or derived from the certified information.
In the event that the audit changes from a limited scope in the prior year to a full scope in the current year, the auditor would perform full scope audit procedures regarding the beginning balances of investments. See paragraph 13.28 of Audit and Accounting Guide Employee Benefit Plans for an illustrative auditor's report when the scope of the audit in the prior year was limited in accordance with DOL rules and regulations.

Practice Tip: After the issuance of the auditor's report, if the auditor subsequently discovers that certain or all investment information should have been subjected to full scope audit procedures in the prior year, the auditor may be required to perform additional procedures and to consider whether to recall, restate, or reissue the prior auditor's report. For further guidance, refer to AU section 390, Consideration of Omitted Procedures After the Report Date, and AU section 561, Subsequent Discovery of Facts Existing at the Date of the Auditor’s Report (AICPA, Professional Standards, vol. 1).

Stable Value Funds

Some employer-sponsored defined contribution plans offer an investment alternative often referred to as a stable value fund. These funds primarily invest in guaranteed investment contracts (GICs) issued by insurance companies and other financial services institutions, referred to as traditional GICs and synthetic GICs. Synthetic contracts often invest in mortgage related fixed income investments. 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, allows such contracts to be presented at contract value for purposes of determining the net assets available for benefits for a defined-contribution plan if the contract meets the definition of benefit responsiveness according to the FSP. An investment contract is considered fully benefit-responsive for purposes of the FSP, if all of the following criteria are met for that contract:

- The investment contract is effected directly between the plan and the issuer and prohibits the plan from assigning or selling the contract or its proceeds to another party without the consent of the issuer.

- Either (a) the repayment of principal and interest credited to participants in the plan is a financial obligation of the issuer of the investment contract or (b) prospective interest crediting rate adjustments are provided to participants in the plan on a designated pool of investments held by the plan or the contract issuer, whereby a financially responsible third party, through a contract generally referred to as a wrapper, must provide assurance that the adjustments to the interest crediting rate will not result in a future interest crediting rate that is less than zero. If an event has occurred such that realization of full contract value for a particular investment contract is no longer probable (for example, a significant decline in creditworthiness of the contract issuer or wrapper provider), the investment contract shall no longer be considered fully benefit-responsive.
A u d i t R i s k A l e r t

The terms of the investment contract require all permitted participant-initiated transactions with the plan to occur at contract value with no conditions, limits, or restrictions. Permitted participant-initiated transactions are those transactions allowed by the plan, such as withdrawals for benefits, loans, or transfers to other funds within the plan.

An event that limits 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) that also limits the ability of the plan to transact at contract value with the participants in the plan must be probable of not occurring.

The plan itself must allow participants reasonable access to their funds.

As a result of recent credit market events, some of the issuers of these contracts may have experienced a decline in credit worthiness. In addition, as a result of depreciation in the mortgage back securities and related markets, the difference between fair value and contract value for synthetic GIC contracts has increased risk relating to these contracts. Certain issuers are requesting to terminate contracts, limit future contributions or redemptions, or increase wrap fees. In addition, certain issuers are deciding to no longer offer stable value products or exiting the business altogether thereby limiting the number of stable value alternatives for plan sponsors. Also, these contracts typically have certain investment guidelines that need to be followed in order to maintain the stable value protection by the wrap provider.

Reading stable value contracts would enable auditors to understand the terms for (a) 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 fund, plant closings, layoffs, plan termination, bankruptcy, mergers, and early retirement incentives), and (b) events and circumstances that would allow issuers to terminate fully benefit-responsive investment contracts with the fund and settle at an amount different from contract value (for example, breaches of investment guidelines, investments in default, and so on). For appropriate financial statement accounting and reporting, it is important for the auditor to give careful consideration to the ability of the issuer to comply with the terms of the contracts, the benefit-responsive provisions of the FSP, and the credit worthiness of the wrap provider.

Plans may hold stable value investments through direct contracts with issuers or through a separately 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 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), for further guidance that includes financial statement presentation and disclosure guidance for CCTs and master trusts.

Going Concern Matters

Many plan sponsors are currently experiencing, or may experience in the near term, conditions and events that may raise substantial doubt about their ability to continue as a going concern for a reasonable period of time.
Employee Benefit Plans Industry Developments—2009

(not to exceed one year beyond the date of the financial statements being audited). Substantial doubt raised about the plan sponsor may also raise concerns about the ability of the plan to continue as a going concern. Given the current volatile economic environment, management's evaluation of the plan's ability to continue as a going concern for a reasonable period of time may require more extensive analysis. It may be necessary for the auditor to obtain additional information about such conditions and events, as well as the appropriate audit evidence to support information that mitigates the auditor's doubt.

.66 If the auditor believes there is substantial doubt about the plan's ability to continue as a going concern for a reasonable period of time, he should (a) obtain information about management's plans that are intended to mitigate the effect of such conditions or events, and (b) assess the likelihood that such plans can be effectively implemented. The assessment of the plan's ability to continue as a going concern is the responsibility of the plan's management. The auditor's responsibility, as described in AU section 341 is to consider, when planning and performing audit procedures and evaluating their results, the appropriateness of management's use of the going concern assumption in the preparation of the financial statements.

.67 Additionally, current market conditions have heightened the expectations of financial statement users that entities, including benefit plans, will be providing a more thorough and transparent analysis of risks and uncertainties in accordance with SOP 94-6, which requires management to make certain disclosures of risks and uncertainties facing the entity. In many cases, those are the same risks and uncertainties that management and the auditor need to assess in evaluating the entity's ability to continue as a going concern. It is important for the auditor to have discussions with management about the plan's significant risks and uncertainties and the adequacy of disclosures about them in current year financial statements.

.68 Conditions or events that raise doubt about the plan sponsor's ability to continue as a going concern are significant in evaluating the ability of an employee benefit plan to continue as a going concern for a reasonable period of time. Factors that may be relevant to management's use of the going concern assumption or, conversely, events or conditions that may cast substantial doubt on the going concern assumption include, but are not limited to, financial events that are becoming more prevalent in the current environment, such as the following:

- Substantial doubt about the plan sponsor's ability to continue as a going concern
- The ability of the plan sponsor to continue funding the plan
- The plan's lack of liquidity
- The plan's ability to continue paying benefits when due to participants

.69 For defined contribution plans, the financial condition of the plan sponsor typically does not affect the plans' ability to meet its obligations as they become due; however, consideration should be given to the level of company stock held by the plan, restrictions on withdrawals from certain investments held by the plan due to liquidity concerns, and plan terminations (see paragraphs 3.36–39 of Audit and Accounting Guide Employee Benefit Plans for guidance regarding terminating plans).
After the auditor has evaluated management’s plans, the auditor concludes whether he or she has substantial doubt about the plan’s ability to continue as a going concern for a reasonable period of time. If the auditor concludes there is substantial doubt, the auditor should (a) consider the adequacy of disclosure about the plan’s possible inability to continue as a going concern for a reasonable period of time, and (b) include an explanatory paragraph (following the opinion paragraph) in his audit report to reflect his conclusion. If the auditor concludes that substantial doubt does not exist, he or she should consider the need for disclosure. When, primarily because of the auditor’s consideration of management’s plans, he or she concludes that substantial doubt about the entity’s ability to continue as a going concern for a reasonable period of time is alleviated, the auditor should consider the need for disclosure of the principal conditions and events that initially caused him or her to believe there was substantial doubt. The auditor’s consideration of disclosure should include the possible effects of such conditions and events, and any mitigating factors, including management’s plans.

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 may 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

On July 23, 2007, the IRS issued the first comprehensive regulations for 403(b) plans in 43 years. The IRS’s new rules bring 403(b) plans closer to the standards set for 401(k) plans and may result in significant changes for tax-exempt organizations and their employees. The new IRS regulations clarify several points on employer responsibility and require all organizations to have a written plan document in place. Additionally, in an effort to ease the administrative burden, the new IRS rules have the effect of encouraging employers to limit the number of investment vendors offered to employees while introducing due-diligence expectations that affect daily plan management. The new IRS rules were effective for 403(b) plan years beginning on or after January 1, 2009; however, the IRS provided some relief to the written plan document requirement when they issued IRS Notice 2009-3, Relief From Immediate Compliance With 2009 § 403(b) Written Plan Requirement, indicating they will treat plans as meeting the requirements of 403(b) and the regulations during the 2009 calendar year if
by December 31, 2009, the plan sponsor has adopted a written 403(b) plan that is intended to satisfy the requirements of 403(b) and the regulations;

during 2009, the plan sponsor operates the plan in accordance with a reasonable interpretation of 403(b) and the related regulations; and

by the end of 2009, the plan sponsor makes its best effort to retroactively correct any operational failure during the 2009 calendar year to conform to the written plan.

New Filing and Audit Requirements for ERISA-Covered 403(b) Plans

.74 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 for plan year 2009. The revisions include improved financial disclosure by the approximately 16,000 403(b) TSA plans subject to Title I of the Employee Retirement Income Security Act of 1974 (ERISA) by making the reporting rules for those 403(b) plans on par with 401(k) plans. A 403(b) plan generally will be covered under ERISA if there are employer contributions or employer involvement in the plan exceeds the limitations permitted under the DOL’s safe harbor regulations, or both. (For further information, see DOL Field Assistance Bulletin No. 2007-02 online at www.dol.gov/ebsa/regs/fab2007-2.html.)

.75 Beginning with 2009 Form 5500 filings, employee benefit plans under Section 403(b) of the IRC covered under ERISA that are sponsored by charitable organizations will be subject to the same Form 5500 reporting and audit requirements that currently exist for Section 401(k) plans. The new DOL amended regulations eliminated a previous exemption granted to IRC Section 403(b) plans from the annual Form 5500 reporting, disclosure, and audit requirements under Part 1 of Subtitle B of Title I of ERISA. Generally, 403(b) plans sponsored by charities and schools are subject to ERISA whereas 403(b) plans sponsored by religious organizations and governments are not covered under ERISA.

.76 For large 403(b) plans (generally plans with 100 or more eligible participants at the beginning of the plan year), the new reporting requirements include 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.

.77 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

.78 Although the new, large-plan audit requirement will not be in effect until the 2009 plan year, ERISA requires the presentation of comparative statements of net assets. As such, when a plan’s financial statements have not been previously audited, the auditor should apply procedures to assure himself that the accounting principles used by the plan in both the current and preceding year are consistent. (See paragraphs .24–.25 of AU section 420, Consistency of Application of Generally Accepted Accounting Principles [AICPA, Professional Standards, vol. 1], for further guidance.) The initial audit of the plan will likely require significant audit effort as the auditor will need to perform procedures
Audit Risk Alert

to test the completeness and accuracy of plan and participant-level information going back numerous years.

.79 Many plans may face significant challenges in establishing plan accounting records and proper controls, such as identifying all participant accounts to be included as plan assets, determining beginning account balances (that is, comparative balances are also required as of December 31, 2008, for calendar year plans), and obtaining other financial information to be included in the plan’s financial statements, which could hinder an auditor’s capability of issuing an unqualified opinion on the plan’s financial statements. For example, plans may have multiple third-party administrator (TPA) vendors (nonexclusive administration), orphan contracts (old accounts and contracts that were not transferred to the current TPA), missing participants, or participants with multiple annuity contracts. Also, historical plan records may not be readily available or may be nonexistent for previous years.

.80 For many 403(b) plans, the individual account plan status goes further than what auditors may be accustomed to seeing. The assets attributable to a participant’s vested interest may be held in a custodial account or in an annuity contract that is issued in the participant’s name, rather than the plan’s name. This industry practice raises critical plan reporting issues and associated audit issues including the following questions:

- What are the plan’s assets?
- When does a terminated employee cease to be a plan participant?
- Does the plan report distributions?

.81 During this transition period, it is important for auditors to work with their clients to determine the kind of contracts held by the plan and the ownership of those contracts.

.82 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.

.83 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, the complexity of the plan’s operations, and controls covered by Statement on Auditing Standards (SAS) No. 70, Service Organizations (AICPA, Professional Standards, vol. 1, AU sec. 324), reports.

.84 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 no material misstatements to these beginning balances exist that may affect the current year’s statement of changes in net assets available for benefits.
The DOL intends to fully enforce this new audit requirement. 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. Auditors should carefully consider whether to accept the audit of a 403(b) plan. For example, they should consider:

- independence under the DOL and AICPA independence standards (for example, has the auditor provided management functions or other nonaudit services to help prepare the plan for audit such that independence may be impaired?); and
- risks associated with the engagement and if they have the requisite skills and competence to complete the engagement (see the "Client Acceptance and Continuance" section that follows for further information).

Help Desk—The EBPAQC has created a 403(b) Resource Center at the EBPAQC Web site www.aicpa.org/EBPAQC (under the "Resources" tab), which has helpful resources and links to additional information to help practitioners with the new requirements.

Client Acceptance and Continuance Considerations

Statement on Quality Control Standards No. 7, A Firm’s System of Quality Control (AICPA, Professional Standards, vol. 2, QC sec. 10 par. .27), provides that policies and procedures should be established for the acceptance and continuance of client relationships and specific engagements. Such policies and procedures should provide the audit firm with reasonable assurance that it will undertake or continue relationships and engagements only where the firm

- has considered the integrity of the client, including the identity and business reputation of the client’s principal owners, key management, related parties, and those charged with its governance, and the risks associated with providing professional services in the particular circumstances;
- is competent to perform the engagement and has the capabilities and resources to do so; and
- can comply with legal and ethical requirements.

The firm should obtain such information as it considers necessary in the circumstances before accepting an engagement with a new client, when deciding whether to continue an existing engagement, and when considering acceptance of a new engagement with an existing client.

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)
24

Audit Risk Alert

- Complex or unstable organizational structure (for example, turnover of plan management, oversight committee members, or outside service providers or difficulty in determining what 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 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

The Pension Protection Act and Other 2008 Legislation

Effects of the Pension Protection Act on Defined Benefit Plans

The Pension Protection Act (PPA) has affected many aspects of plan design, administration, and funding. For defined benefit plans, the PPA focuses on the funded percentage as the trigger point to activate additional funding requirements and benefit limitations. These rules are very complex and this discussion will not address all of those complexities but rather will provide an overview of the key features.

New minimum funding standards were fully operational for 2008 plan years. Minimum funding standards are established based on a plan’s funded status. The funding target is the present value of accrued benefits. If the assets equal the present value of accrued benefits, the plan’s funding target percentage will be 100 percent. The minimum required contribution for plans with a funded percentage of 100 percent or greater will be the plan’s normal cost. This is the actuarially determined amount necessary to fund the benefits that have accrued in the current year. For plans with a funded percentage of less than 100 percent, the minimum required contribution will be the plan’s normal cost plus
an additional payment that will amortize the shortfall over 7 years. Funding waivers may be requested in cases of business hardship. As in prior years, the minimum required contribution will be part of the actuarial report.

.91 Each year the actuary is required to certify to the plan’s funded percentage. Plans with a funding percentage below 80 percent will be required to implement certain benefit limitations. Further limitations will be required when the percentage falls below 60 percent. Plans with a funded percentage more than 60 percent but less than 80 percent may not amend the plan to provide additional or increased benefits. They must also place a limit on accelerated benefits such as lump sums and annuity purchases. This limit is 50 percent of the full amount allowed by the plan. If the funded percentage falls below 60 percent, the plan must freeze the accrual of all future benefits until such time as the percentage increases to more than 60 percent. The plan will also not be allowed to make any accelerated payments. The auditor will need to determine if the plan is being operated in accordance with any limitations that apply based on these rules.

**Automatic Enrollment and Planning Considerations**

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

.93 Automatic enrollment is a mechanism where 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. The IRS issued proposed regulations regarding the implementation of automatic contribution arrangements, and the DOL issued final regulations regarding default investments.

.94 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 plans. Auditors may want to consider any amendments made to the plan document as a result of the PPA provisions when determining the audit approach.

.95 The IRS issued proposed regulations in November 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.

.96 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.

.97 It is important for auditors to be aware of the rules governing an employee’s right to withdraw from the plan following his or her automatic enrollment. An eligible automatic contribution arrangement may allow employees to...
Audit Risk Alert

elect permissible withdrawals of amounts that were automatically contributed to the plan on behalf of the employee. To be effective, the election must be made within 90 days after the date of the first automatic contribution made for the employee under the arrangement. This distribution is permissible in spite of the normal 401(k) plan restrictions on in-service distributions. If the plan wants to include this privilege, which is very popular as it eliminates the accounting for very small balances, the plan must provide for this privilege. In addition, the plan must provide participants with a notice describing this right upon initial enrollment in the plan and at least annually thereafter.

.98 Because of the current economic conditions, more and more plans may be faced with employees electing out of plan participation and wanting their money back. A significant risk of an operational error exists in the implementation of this new rule. 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.

COBRA Premium Assistance Under the ARRA

.99 The Consolidated Omnibus Budget Reconciliation Act (COBRA) provides employees and their dependents with the right to continue access to certain types of healthcare coverage once eligibility is otherwise terminated for a variety of reasons. A new subsidy for COBRA premiums has been provided under the ARRA. In tough economic times, many employees are losing their healthcare coverage and they find that they cannot afford the cost of coverage under COBRA. The ARRA will subsidize 65 percent of this coverage for eligible persons. An eligible person is someone who involuntarily lost his or her job between September 1, 2008, and December 31, 2009. A new COBRA election period must be made available for persons who were terminated prior to the effective date of the legislation and whose normal COBRA election period has expired and for those who had elected coverage but subsequently lost coverage due to inability to pay.

.100 Employers can recover this cost through a credit to their payroll taxes. This first applies to coverage period beginning on or after February 17, 2009. For welfare benefit plans subject to audit, this law change presents interesting financial reporting issues which could affect the post employment benefit obligation at the plan level. The employee pays only a portion of the premium while the plan pays the full benefit, but the employer’s reimbursement for its share of the costs is recorded as a reduction in the employer’s obligation for payroll taxes. The Form 941, Employer’s Quarterly Federal Tax Return, instructions explain how to complete lines 12a and 12b, which address the COBRA premium assistance payments.

.101 For a summary of the law change, see www.dol.gov/ebsa/newsroom/fsCOBRApremiumreduction.html. This law change may affect the measurement of benefit obligations for health and welfare plans.

Audit and Accounting Guide Revision as of March 1, 2009

.102 Audit and Accounting Guide Employee Benefit Plans has been updated with conforming changes as of March 1, 2009, and includes updates required by FASB Accounting Standards Codification™ (ASC). The Audit and Accounting Guide Employee Benefit Plans has also been updated to reflect FASB Statement No. 157, including summaries of the statement, disclosure requirements, and illustrative disclosures.
Audit and Attestation Issues and Developments
SAS No. 70 Issues

.103 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 transactions. 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.

.104 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) record keepers often exclude the related 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.

.105 During 2008, the Auditing Standards Board (ASB) proposed two exposure drafts that related to SAS No. 70. First, the proposed SAS Audit Considerations Relating to an Entity Using a Service Organization (Redrafted) would supersede SAS No. 70. Currently, SAS No. 70 contains guidance for auditors auditing the financial statements of entities that use a service organization (user auditors) and for auditors reporting on controls at a service organization (service auditors). The proposed SAS will only contain guidance for user auditors. Guidance for service auditors will be contained in the new Statement on Standards for Attestation Engagements (SSAE) Reporting on Controls at a Service Organization that is being exposed for comment concurrently with the proposed SAS. The comment period for both exposure drafts ended February 17, 2009.
Audit Risk Alert

.106 See chapter 6, "Internal Control," in the Audit and Accounting Guide Employee Benefit Plans for further guidance regarding SAS No. 70.

Auditing Plan Fees and Expenses

.107 Administrative expenses are often paid 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. Auditors need to gain an understanding of the expenses that are allowed to be paid by the plan according to the plan document. 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 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.

.108 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 resulting in expenses not being apparent on the service provider statements. 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. Consideration should be given to disclosing the terms of expense offset arrangements with third parties, whereby fees (for example, recordkeeping and so on) are reduced by a specified or readily ascertainable amount for services provided. Also, refer to the DOL-issued publication Understanding Retirement Plan Fees and Expenses and DOL Letter 2001-O1A to better understand and evaluate plan fees and expenses.

Payroll Data

.109 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.

.110 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).
Employee Benefit Plans Industry Developments—2009

1.111 If the plan sponsor has an internal audit department that has performed procedures 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

1.112 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. Two approaches exist 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 has generally been the same as that used for funding purposes. However, the PPA has changed the funding rate. The funding rate is no longer an appropriate rate for use in the plan’s financial statements under FASB Statement No. 35. Plans using “expected return on plan assets” as the basis for choosing the discount rate will now have to find a new benchmark. One of the most common approaches has been to use the FASB Statement No. 87, Employers’ Accounting for Pensions, assumed return on plan assets. It is important to note that this is not the FASB Statement No. 87 discount rate. Therefore, auditors will need to take care when determining if the proper rate is disclosed in the benefit plan’s financial statements.

1.113 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. Throughout 2008 long term interest rates increased significantly. This was largely due to risk factors related to the subprime mortgage crisis. However, rates dropped sharply in December. At December 31, 2008, long term interest rates had decreased by 150 basis points from November. Because of the volatility in rates, those plans that base the discount rate on a settlement type rate and that use end-of-year benefit information may see either increases or decreases in the discount rate compared to a year earlier. Plans that use beginning of year information will experience increases in the discount rate that will provide for gains.

1.114 The most significant demographic assumptions used to determine the actuarial present value of accumulated plan benefits include mortality rates, retirement age, form of payment or type of benefit elections and cash balance crediting rates if applicable. 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. Auditors may consider challenging the use of such tables for purposes of determining the FASB Statement No. 35 liability beginning in 2007. For 2007 calendar year plans and beyond, 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 2008 valuations. 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. It is expected that plan sponsors will consider the demographics of their participant population prior to utilizing a mortality table in determining the actuarial present value of accumulated plan benefits.

The medical trend assumption is unique to postretirement health and welfare plans. This assumption is intended to project the current cost of health care benefits to future periods when those benefits will be paid. Health care costs have traditionally increased at a faster rate than general inflation. In addition to general inflation, health care costs are affected by increased utilization of plan benefits, rising cost of medical technology, and the leveraging effect of plan provisions such as copays and deductibles. Taken together, these factors contribute to cost increases well above the rate of general inflation. Most actuaries assume that these excess cost increases will continue in the near term but will ultimately merge with general inflation rates. Therefore, a common approach is to assume a higher trend rate for the current year and grade down to the general inflation rate after several years. An example is a trend rate of 9 percent for 2009 grading down by 0.50 percent each year until the ultimate rate of 5 percent is reached for 2017 and beyond. Auditors should question trend assumptions that only reflect general inflation for all years.

Regardless of the assumption used, each assumption must be individually reasonable. Plan management 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 only assumptions exist 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
Employee Benefit Plans Industry Developments—2009

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, which 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, which should match the asset value shown in the actuarial report.
  - inclusion of the effect of a change in plan provisions and the effect of merger, spin-off, or acquisition.

.117  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 that 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

.118  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 end-of-year is presented, 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.

.119  However, if beginning-of-year benefit information is used, the date of the benefit information in the actuarial report may not match the date that net assets are presented. For example, for financial statements presented as of December 31, 2008, and December 31, 2007, the actuarial valuation will be as of January 1, 2008. 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, 2007 (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, 2008, with a January 1, 2008, 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, two statements of net assets and two statements of changes would be presented. 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 Defined Contribution Plans

One of the objectives of auditing procedures applied to individual participant accounts of a defined contribution plan is to provide the auditor with a reasonable basis for concluding whether net assets and transactions have been properly allocated (sometimes referred to as credited or charged, as applicable) to participant accounts in accordance with the plan documents. In some cases, the plan documents specify how certain plan activity is to be allocated. After the auditor obtains an understanding of what and how allocations are made, participant account 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.

Help Desk—Investment income (loss) has several components, not all of which are always allocated at individual participant accounts. For example, 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. Dividend and interest income is often times immaterial to the financial statements taken as a whole, yet it is typically allocated.

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
Employee Benefit Plans Industry Developments—2009

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

Help Desk—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.


Missing Participant Data

.124 Plan sponsors and service providers have significant data storage burdens given the volume of paper and electronic records associated with ERISA plans and a number of plan sponsors have experienced difficulty 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 (for example, eligibility records, individual census data, compensation records, employee work history, and so on). Lapses in maintaining data can be caused for various reasons, such as

- the result of a corporate transaction (for example, plan merger, spinoff, change in sponsorship, and so on).
- a change in service providers (for example, actuaries or other third-party administrators).
- a natural disaster (for example, a fire, flood, and so on).
- the inadvertent destruction or disposal of records.

.125 Irrespective of the various document retention requirements under federal and individual state laws, two basic record retention provisions under ERISA exist:

- Section 107 of ERISA requires anyone who must file a report (such as Form 5500) or certify information under Title 1 of ERISA to maintain sufficient records to verify, explain, or clarify the information contained in such reports for not less than 6 years after the filing of the report.
- Section 209 of ERISA requires every employer to maintain records necessary to determine benefits due or that may become due to each of its employees.

.126 As a result, employers should assume that records regarding plan benefits must be maintained indefinitely (either in their original paper form or electronically under certain conditions), or at least long enough such that they will never be needed to determine the eligibility for, or the amount of, a benefit. Failure to retain necessary documents, even if not specifically required to be kept by law, can result in very unfortunate consequences including significant costs and fees (for example, recreation of records, litigation defense, and so on).
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.

The missing participant data issue is exacerbated when a change in auditor occurs, 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 any missing participant data exists.

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.

**Securities Lending**

Many employee benefit plans take part in securities lending programs. Often it is not evident from the trustee or custodial investment reports that the securities lending arrangements exist. Identification of such arrangements can be achieved through discussions with (a) those responsible at the plan sponsor for investment decisions or (b) investment service providers (for example, investment advisors, trustees/custodians, and so on) or review of all investment related agreements.

Under FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities*—a replacement of FASB Statement No. 125, plans that engage in securities lending should present the assets received in return for the securities, as well as the exchanged securities, on the statement of net assets available for benefits. The exchanged securities, as well as the assets received for them (if an investment) should be reported on the ERISA required supplemental schedule of assets (held at end of year) with the appropriate disclosures. Also refer to paragraphs 2.32–35, 3.39–43, and 4.57–61 of Audit and Accounting Guide *Employee Benefit Plans* for further information.

Employee benefit plans that participate in securities lending programs through security lending agents typically receive cash collateral for security loans. The cash is often invested in security lending cash collateral funds that are managed by the agent or parties affiliated with the agent. Although some collateral funds are money market funds registered with the SEC and subject to Rule 2a-7 under the Investment Company Act of 1940, many—even some holding themselves out as managed in a way similar to Rule 2a-7—are not registered. Unregistered collateral funds often invest in securities with longer maturity and higher risk than typical short-term “money market” type securities. Accordingly, it is important for benefit plans to verify the exact nature of the collateral funds used for investment of cash collateral. As a result of financial market conditions, many unregistered collateral funds have a net asset...
value per unit/participation interest (NAV) based on current fair values of underlying assets significantly less than $1, yet the collateral funds continue to issue and redeem their units/participation interests (units) at $1, as may be allowed by the relevant legal agreements. A number of those collateral funds have placed restrictions on redemption. Examples of audit procedures the auditor may perform regarding management’s determination of the fair value of the collateral fund at year-end, may include obtaining a copy of the collateral fund audited financial statements, if available, and comparing the value to what was reported in the benefit plan financial statements.

Form 11-K Audits
.133 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. 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.

Practice Tip: Instructions for completing Form 11-K can be accessed under topic 15 of the SEC manual located on www.sec.gov.

.134 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 Audit Risk Alert SEC and PCAOB Developments—2008 (product no. 022499kk), 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
Public Company Accounting Oversight Board (PCAOB) Auditing Standard No. 6, Evaluating Consistency of Financial Statements (AICPA, PCAOB Standards and Related Rules, Rules of the Board, “Standards”) Issue Date: September 2008 (Applicable to audits conducted in accordance with PCAOB standards) This standard and its related amendments update the auditor’s responsibilities to evaluate and report on the consistency of a company’s financial statements and align the auditor’s responsibilities with FASB Statement No. 154, Accounting Changes and Error Corrections—a replacement of APB Opinion No. 20 and FASB Statement No. 3, which is codified at FASB Accounting Standards Codification (ASC) 250, Accounting Changes and Error Corrections. This standard also improves the auditor reporting requirements by clarifying that the auditor’s report should indicate whether an adjustment to previously issued financial statements results from a change in accounting principles or the correction of a misstatement. It is effective November 15, 2008.

(continued)
### Audit Risk Alert

#### Recent PCAOB Pronouncements and Related Guidance

<table>
<thead>
<tr>
<th>PCAOB Rule 3526, Communication with Audit Committees Concerning Independence (AICPA, PCAOB Standards and Related Rules, Rules of the Board, “Rules”)</th>
<th>Rule 3526 requires the registered public accounting firm to</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issue Date: August 2008 (Applicable to audits conducted in accordance with PCAOB standards)</td>
<td>• describe in writing, to the audit committee of the issuer, all relationships between the registered public accounting firm or any affiliates of the firm and the potential audit client or persons in financial reporting oversight roles at the potential audit client that, as of the date of the communication, may reasonably be thought to bear on independence.</td>
</tr>
<tr>
<td></td>
<td>• discuss with the audit committee of the issuer the potential effects of any relationships that could affect independence, should they be appointed as the issuer’s auditor.</td>
</tr>
<tr>
<td></td>
<td>• document the substance of these discussions. These discussions should occur at least annually.</td>
</tr>
<tr>
<td>The board also adjusted the implementation schedule for Rule 3523, Tax Services for Persons in Financial Reporting Oversight Roles (AICPA, PCAOB Standards and Related Rules, Rules of the Board, “Rules”), as it applies to tax services.</td>
<td></td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>SEC Release 2008-234, Office of the Chief Accountant and FASB Staff Clarifications on Fair Value Accounting</th>
<th>This press release was provided jointly by the Securities and Exchange Commission (SEC) and FASB staffs and was intended to help preparers, auditors, and investors address fair value measurement questions based on the fair value measurement guidance in FASB Statement No. 157, Fair Value Measurements, that have been cited as most urgent in the current environment.</th>
</tr>
</thead>
</table>

<table>
<thead>
<tr>
<th>PCAOB Staff Audit Practice Alert No. 3, Audit Considerations in the Current Economic Environment (AICPA, PCAOB Standards and Related Rules, PCAOB Staff Guidance, sec. 400.03)</th>
<th>This practice alert is designed to assist auditors in identifying matters related to the current economic environment that might affect audit risk and require additional emphasis. The practice alert addresses the following six main areas: overall audit considerations, auditing fair value measurements, auditing accounting estimates, auditing the adequacy of disclosures, auditor’s consideration of a company’s ability to continue as a going concern, and additional audit considerations for selected financial reporting areas.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issue Date: December 2008 (Applicable to audits conducted in accordance with PCAOB standards)</td>
<td></td>
</tr>
</tbody>
</table>
Employee Benefit Plans Industry Developments—2009

**Recent PCAOB Pronouncements and Related Guidance**

<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Issue Date: November 15, 2008 (Applicable to audits conducted in accordance with PCAOB standards)</td>
<td></td>
</tr>
</tbody>
</table>

**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 of 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 the 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 “5-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**

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. 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...
Audit Risk Alert

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.

.137 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 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

.138 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 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

.139 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 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

.140 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/Standards/
Standards and Related Rules/Auditing Standard No.1.aspx), does not allow a reference to GAAS; therefore, a "dual" standard report is not appropriate and will not be accepted by the SEC.

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.

### Auditing Accounting Estimates

As noted in paragraph .04 of AU section 342, the auditor is responsible for evaluating the reasonableness of accounting estimates made by management in the context of the financial statements taken as whole. Although this alert has discussed fair value measurements at length, it is important to remember that many types of accounting estimates exist in client financial statements. Some examples include the allowance for uncollectible accounts receivable, impairment analysis and estimated useful lives of long-lived assets, valuation allowance for deferred tax assets, and actuarial assumptions in pension and other postretirement benefit costs. Given the current economic climate, additional skepticism should be exercised when considering management’s underlying assumptions used in accounting estimates. When evaluating accounting estimates, the auditor should consider both the subjective and objective factors, with professional skepticism. As discussed in paragraph .09 of AU section 342, key factors and assumptions that the auditor normally concentrates on include the assumptions that are significant to the estimate, sensitive to variations, deviate from historical patterns, or are particularly subjective and susceptible to misstatement and bias; however, it is important to consider whether historical patterns are still applicable. For example, in the current slow market, new patterns may emerge. A key aspect of AU section 342 in this economy is for an auditor to determine the reasonableness of management’s accounting estimates with an extra degree of professional skepticism, given the current economic climate and possible increases of pressure on management to meet earnings. As noted by AU section 316, when assessing audit differences between client estimates and audit estimates, even if they are individually reasonable, an auditor should consider whether these differences are indicative of possible bias by management. If so, the auditor should reconsider the estimates taken as a whole.

The auditor should obtain an understanding of how management develops estimates and should employ one of the approaches outlined in AU section 342 paragraph .10 in testing that process. In reviewing and testing management’s process, the auditor may consider identifying controls around this process and determining if the underlying data used for the estimate are reliable and used appropriately. An auditor also may develop an estimate and compare it to management’s estimate. Lastly, the auditor may review subsequent events or transactions occurring prior to the date of the auditor’s report. Further, as noted in AU section 316, hindsight may provide the auditor additional insight into the existence of management bias. For further details on auditing estimates, see AU section 342.

### Management Letter of Representations

As discussed in AU section 333, Management Representations (AICPA, Professional Standards, vol. 1), in some circumstances, audit evidence
Audit Risk Alert

that can be obtained by the application of auditing procedures other than in-
quiry is limited; therefore, the auditor obtains written representations to pro-
vide additional audit evidence. This may be the case for assumptions used in fair
value measurements or the entire measurement or claims around an entity's
ability to continue as a going concern.

.145 According to paragraph .48 of AU section 328, “[t]he auditor should
ordinarily obtain written representations from management regarding the rea-
sonableness of significant underlying assumptions, including whether they ap-
propriately reflect management’s intent and ability to carry out specific courses
of action on behalf of the entity where relevant to the use of fair value measure-
ments or disclosures.” Additionally, depending on the nature, materiality, and
complexity of fair values, representations may be included in regard to the ap-
propriateness of the measurement methods and consistency in the application
of these methods, the completeness and adequacy of disclosures related to fair
values, and whether subsequent events require adjustment to the fair value
measurements and disclosures included in the financial statements. When sig-
nificant assumptions are used or they are highly subjective, and the items be-
ing measured at fair value are material, the auditor considers discussing these
items with those charged with governance of the entity.

Accounting Issues and Developments

Unrelated Business Income Tax and FASB Interpretation No. 48

.146 Although qualified benefit plans are not generally subject to tax-
ation, 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

- gross income derived from an unrelated trade or business that is
  regularly carried on, less
- allowable deductions directly connected with the trade or busi-
  ness.

.147 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.

.148 Nonleveraged investments, such as government securities, stocks,
and debt instruments of noncontrolled corporations, mutual funds, and insur-
ance company annuity contracts, do not typically generate UBTI. However,
other nonleveraged investments, such as investments in partnerships, real es-
tate 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.

FASB Interpretation No. 48

.149 FASB Interpretation No. (FIN) 48, Accounting for Uncertainty in
Income Taxes—an interpretation of FASB Statement No. 109, clarifies the
Employee Benefit Plans Industry Developments—2009

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.

.150 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, 2008. See FSP FIN 48-3, 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

.151 FSP FIN 48-3 has generally deferred the effective date of the application of FIN 48 for nonpublic companies to fiscal years commencing after December 15, 2008. 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 2008 benefit plan audits.

.152 Because benefit plans are generally exempt from income taxes, few issues exist 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 2008-50 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 no such relief program exists for welfare benefit plans.

.153 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
- Where UBTI is material, all aspects of FASB Statement No. 109, including an analysis of any book or tax differences, is required
FASB Accounting Standards Codification™

.154 FASB is expected to issue FASB ASC as authoritative effective July 1, 2009, at which time it will become the source of authoritative U.S. accounting and reporting standards, in addition to guidance issued by the SEC, for non-governmental entities. FASB ASC will supersede all then-existing, non-SEC accounting and reporting standards for nongovernmental entities. Once effective, all other nongrandfathered, non-SEC accounting literature not included in FASB ASC will become nonauthoritative. This change will affect accountants and auditors alike.

.155 FASB ASC 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. FASB ASC disassembled and reassembled thousands of nongovernmental accounting pronouncements (including those of FASB, the Emerging Issues Task Force (EITF), and the AICPA) to organize them under approximately 90 topics. FASB ASC includes all accounting standards issued by a standard setter within levels A–D of the current U.S. GAAP hierarchy, including FASB, EITF, AICPA, and related literature. FASB ASC also includes relevant portions of authoritative content issued by the SEC, as well as selected SEC staff interpretations and administrative guidance issued by the SEC; however, FASB ASC is not the official source of SEC guidance and does not contain the entire population of SEC rules, regulations, interpretive releases, and staff guidance.

.156 After the effective date of FASB ASC, FASB will no longer consider new standards authoritative in their own right. Instead, new standards will serve only to update FASB ASC and provide the historical basis for conclusions of a new standard.

.157 FASB ASC uses a topical structure in which guidance is organized into areas, topics, subtopics, sections, and subsections. Topics, subtopics, and sections are numerically referenced. The topics of FASB ASC pertaining to employee benefit plans are the following:

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

.158 Constituents are encouraged to begin using FASB ASC, which can be accessed at http://asc.fasb.org/home.

.159 The AICPA has published Financial Reporting Alert FASB Codification Developments—2008 (product no. 029209kk). This Financial Reporting Alert is intended to provide a better understanding of FASB ASC, outline its structure, as well as provide case studies on navigating FASB ASC Research System and performing accounting research.

Recent Pronouncements

.160 The following tables present a list of recently issued audit and attestation pronouncements and related guidance as well as a list of accounting pronouncements and related guidance. As a reminder, AICPA auditing and attestation standards are applicable only to audits and attestation engagements of nonissuers. The PCAOB establishes auditing and attestation standards for audits of issuers. For information on pronouncements issued subsequent to the writing of this alert, please refer to the AICPA Web site at www.aicpa.org, the

### Recent Auditing and Attestation Pronouncements and Related Guidance

<table>
<thead>
<tr>
<th>Statement on Auditing Standards (SAS) No. 116, <em>Interim Financial Information</em> (AICPA, <em>Professional Standards</em>, vol. 1, AU sec. 722)</th>
<th>This standard amends AU section 722 to accommodate reviews of interim financial information of nonissuers, including companies offering securities pursuant to SEC Rule 144A or participating in private equity exchanges. It is effective for reviews of interim financial information for interim periods beginning after December 15, 2009. Earlier application is permitted.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Issue Date: February 2009 (Applicable to audits conducted in accordance with generally accepted auditing standards [GAAS])</td>
<td></td>
</tr>
<tr>
<td>SAS No. 115, <em>Communicating Internal Control Related Matters Identified in an Audit</em> (AICPA, <em>Professional Standards</em>, vol. 1, AU sec. 325)</td>
<td>Replacing SAS No. 112, <em>Communicating Internal Control Related Matters Identified in an Audit</em> (AICPA, <em>Professional Standards</em>, vol. 1, AU sec. 325A), this standard defines the terms deficiency in internal control, significant deficiency, and material weakness; provides guidance on evaluating the severity of deficiencies in internal control identified in an audit of financial statements; and requires the auditor to communicate, in writing, to management and those charged with governance, significant deficiencies and material weaknesses identified in an audit. It is effective for audits of financial statements for periods ending on or after December 15, 2009. Earlier implementation is permitted.</td>
</tr>
<tr>
<td>Issue Date: October 2008 (Applicable to audits conducted in accordance with GAAS)</td>
<td></td>
</tr>
<tr>
<td>Technical Questions and Answers (TIS) section 1900.01, “Condensed Interim Financial Reporting by Nonissuers” (AICPA, <em>Technical Practice Aids</em>)</td>
<td>This question and answer indicates that when preparing condensed interim financial statements, nonissuers may analogize to the guidance in Article 10 of SEC Regulation S-X regarding form and content because Accounting Principles Board (APB) Opinion No. 28, <em>Interim Financial Reporting</em>, does not provide a reporting framework. APB Opinion No. 28 is codified primarily at FASB Accounting Standards Codification (ASC) 270, <em>Interim Reporting</em>.</td>
</tr>
<tr>
<td>Issue Date: January 2009 (Nonauthoritative)</td>
<td>(continued)</td>
</tr>
</tbody>
</table>
### Audit Risk Alert

**Recent Auditing and Attestation Pronouncements and Related Guidance**

| TIS section 9150.25, "Determining Whether Financial Statements Have Been Prepared by the Accountant" (AICPA, Technical Practice Aids) | This question and answer discusses what an accountant should consider in determining whether he or she has prepared the financial statements of a nonissuer.
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Issue Date: December 2008 (Nonauthoritative)</td>
<td></td>
</tr>
</tbody>
</table>

| TIS section 1100.15, "Liquidity Restrictions" (AICPA, Technical Practice Aids) | This question and answer discusses auditing and accounting issues related to withdrawal restrictions placed on short term investments by a money market fund or its trustee.
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Issue Date: October 2008 (Nonauthoritative)</td>
<td></td>
</tr>
</tbody>
</table>

| TIS sections 8200.05–.16 (AICPA, Technical Practice Aids) | These questions and answers in TIS section 8200, *Internal Control*, were developed in response to common questions received from members regarding the implementation of SAS Nos. 104–111. Some of the topics include the following:
| --- | --- |
| Issue Date: April and May 2008 (Nonauthoritative) | • Consideration of internal controls that are less formal or not documented by the client
• Whether the auditor may suggest improvements to a client’s internal control
• Assessing inherent risk in relation to the consideration of control risk
• The frequency of walkthroughs that are used as the basis for the auditor’s understanding of internal control
• Considerations in obtaining an understanding of, evaluating, and documenting controls that the auditor believes are nonexistent or ineffective
• Assessing control risk at the maximum level
• Considerations for developing a substantive audit strategy

| TIS section 9120.08, "Part of an Audit Performed in Accordance With International Standards on Auditing" (AICPA, Technical Practice Aids) | This question and answer discusses the implications to the principal auditor’s report when part of an audit is conducted by other independent auditors in accordance with International Standards on Auditing or another country’s auditing standards.
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Issue Date: April 2008 (Nonauthoritative)</td>
<td></td>
</tr>
</tbody>
</table>
Communicating Internal Control Related Matters Identified in an Audit

The ASB issued SAS No. 115, Communicating Internal Control Related Matters Identified in an Audit (AICPA, Professional Standards, vol. 1, AU sec. 325), which will become effective for audits of financial statements for periods ending on or after December 15, 2009. SAS No. 115 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. 115 supersedes SAS No. 112 of the same title. SAS No. 115 was issued to eliminate differences within the AICPA’s Audit and Attest Standards resulting from the issuance of SSAE No. 15, An Examination of an Entity’s Internal Control Over Financial Reporting That Is Integrated With an Audit of Its Financial Statements (AICPA, Professional Standards, vol. 1, AT sec. 501). SAS No. 115 aligns the definitions and related guidance for evaluating deficiencies in internal control with the definitions and guidance in SSAE No. 15. Specifically, SAS No. 115 does the following:

- Contains revised definitions of the terms material weakness and significant deficiency
- Revises the list of deficiencies in internal control that are indicators of material weaknesses
- No longer includes a list of deficiencies that ordinarily would be considered at least significant deficiencies
- Contains a revised illustrative written communication to management and those charged with governance of material weaknesses and significant deficiencies

Recent Accounting Pronouncements and Related Guidance

<table>
<thead>
<tr>
<th>Recent Accounting Pronouncements and Related Guidance</th>
</tr>
</thead>
<tbody>
<tr>
<td>FASB Statement No. 162² (May 2008)</td>
</tr>
<tr>
<td>FASB Statement No. 161 (March 2008)</td>
</tr>
<tr>
<td>FASB Emerging Issues Task Force (EITF) Issues (Various dates)</td>
</tr>
<tr>
<td>FASB Staff Positions (FSPs) (Various dates)</td>
</tr>
</tbody>
</table>

¹ At the date of this writing, this guidance has not yet been included in Financial Accounting Standards Board Accounting Standards Codification™ (FASB ASC). Readers are encouraged to visit the FASB ASC Web site at http://asc.fasb.org/home and monitor updates.

² See footnote 1.
Recent Accounting Pronouncements and Related Guidance

**Disclosures About Derivative Instruments and Hedging Activities**

.162 In March 2008, FASB issued FASB Statement No. 161, *Disclosures about Derivative Instruments and Hedging Activities—an amendment of FASB Statement No. 133*. 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.

.163 The new standard improves transparency about the location and amounts of derivative instruments in an entity’s financial statements; how derivative instruments and related hedged items are accounted for under FASB Statement No. 133, *Accounting for Derivative Instruments and Hedging Activities*; and how derivative instruments and related hedged items affect financial position, financial performance, and cash flows.

.164 FASB Statement No. 161 achieves these improvements by requiring disclosure of the fair values of derivative instruments and their gains and losses in a tabular format. It also provides more information about an entity’s liquidity by requiring disclosure of derivative features that are credit risk related. Finally, it requires cross-referencing within footnotes to enable financial statement users to locate important information about derivative instruments.

.165 It is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged.

**Other Accounting Pronouncements**

.166 In September 2008, FASB issued FSP FAS 133-1 and FIN 45-4, *Disclosures about Credit Derivatives and Certain Guarantees: An Amendment of FASB Statement No. 133 and FASB Interpretation No. 45; and Clarification of the Effective Date of FASB Statement No. 161*. This pronouncement addresses certain matters related to credit default swaps that may be held by large master trusts. Refer to the full text of FSP FAS 133-1 and FIN 45-4 at www.fasb.org/project/recent_effective_dates.shtml for further information.

**Regulatory Developments**

**The DOL Provides Guidance on Fiduciary Duties in Response to Abuses Involving the Madoff Investment Firm**

.167 On February 5, 2009, the DOL announced guidance on the duties of employee benefit plan fiduciaries in light of abuses involving Bernard L. Madoff Investment Securities LLC.
Employee Benefit Plans Industry Developments—2009

.168 This guidance is intended to assist fiduciaries, investment managers, and other investment service providers to plans who believe they may have exposure to losses on investments with entities related to the Madoff firm. The guidance also provides steps that can be taken to assess and protect the interests of plans, participants, and beneficiaries under ERISA.

.169 The guidance is available on EBSA’s Web site at www.dol.gov/ebsa under “Compliance Assistance.”

IRS Enhances Employee Plans Compliance Resolution System

.170 For many years, the IRS has sponsored a program granting plan sponsors a means of retaining a qualified retirement plan’s exempt status in spite of document or operating defects. This is the Employee Plans Compliance Resolution System (EPCRS). This program was updated in the spring of 2008, and announced in Revenue Procedures 2008-50. A complete discussion of the program, as well as some helpful tips, can be found at www.irs.gov/retirement/article/0,,id=96907,00.html.

.171 The 2008 revision to the compliance program continues the pattern of expanding the amount of relief available to plan sponsors. Areas under which correction relief has been enhanced include the following:

- Participant loans
- Failure to implement participant deferral elections
- Failure to recognize right to a catch-up correction
- Correction of an excess employer or employee contributions
- Use of the DOL’s online calculator for measuring lost income, if actual calculation is not feasible
- Disregard for corrections for former participants if $75 or less and costs of processing payment exceed that amount (prior rule was $50 or less)

.172 In addition to these enhancements, there has also been a procedural enhancement for requests for formal relief. Certain types of errors are eligible for a streamlined submission process, which should speed up the time from submission to formal approval.

.173 Familiarity with this program is important for benefit plan auditors as operational defects are frequently discovered during the course of the audit and an assessment must be made of whether corrections, if any, may be material. The full text of the revenue procedure includes a discussion of many common defects and the required correct, along with examples which are helpful in this assessment.

2008 Form 5500 Series

.174 On November 25, 2008, the DOL, IRS, and PBGC published the 2008 Form 5500 and related instructions.

.175 Modifications to Form 5500 for plan year 2008 are described under “Changes to Note” in the 2008 instructions. Significant changes include those covered in the following sections.
Audit Risk Alert

Modifications to the Form 5500 Annual Report for 2008

.176 Under the PPA, separate actuarial information schedules were developed for 2008 plan year filings. Single-employer and multiple-employer plans now will use Schedule SB and multiemployer and certain money purchase plans will now use Schedule MB. Schedule B is not a valid schedule to file with a plan's 2008 Form 5500. Filers required to file an actuarial report cannot use the 2007 forms, including the 2007 Schedule B (Form 5500), to satisfy their 2008 filing requirements.

.177 The PPA requires filers of certain pension plans to provide additional new information beginning with the 2008 plan year. For the 2008 plan year, this new information will be filed as attachments to Schedule R. All multiemployer defined benefit plans are required to file attachments providing the information specified in the Schedule R instructions. In addition, all defined benefit plans (single-employer, multiple-employer, and multiemployer) with 1,000 or more participants are required to provide financial asset breakout information as an attachment to Schedule R.

.178 Under the PPA, a new simplified reporting option that was first available for 2007 plan year filings is also available for eligible plans for 2008 plan year filings for plans with fewer than 25 participants as of the beginning of the plan year. The instructions for “Voluntary Alternative Reporting Option for Certain Plans with Fewer than 25 Participants” on page 9 of the 2008 Instructions for Form 5500 describe this reporting option.

.179 Short 2009 plan year filers whose due date to submit their 2009 filing is before January 1, 2010, will be given an automatic extension to electronically file their complete Form 5500 within 90 days after the 2009 filing system is available on the DOL Web site. See the “When to File” section of the 2008 Instructions for Form 5500 for more information on due dates for short plan year filers.

Modifications to the Form 5500-EZ Annual Report for 2008

.180 Pursuant to the PPA, the filers of Form 5500-EZ are no longer required to file any schedules or attachments with Form 5500-EZ. They must, however, collect and retain a completed Schedule MB or a completed and signed Schedule SB, if applicable.

.181 To satisfy their 2009 Form 5500-EZ filing requirement, short plan year filers can choose to file electronically using what is expected to be an electronic 2009 Form 5500-SF, Short Form Annual Return/Report of Small Benefit Plan. More information is available at the IRS Web site at www.irs.gov.

.182 As with filers of the Form 5500, short 2009 plan year filers whose due date to submit their 2009 filing is before January 1, 2010, will also be given an automatic extension to electronically file their complete Form 5500 within 90 days after the 2009 filing system is available on the DOL Web site.

.183 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 EBSAs Web site at www.efast.dol.gov.

.184 Filers should monitor the EFAST Web site for information on approved software vendors when completing 2008 Forms 5500 by computer and
for electronic filing options. Filers may contact the EFAST Help Line for general assistance by calling (866) 463-3278.

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

.185 On November 16, 2007, the EBSA, the IRS, and the PBGC published in the Federal Register revisions to the Form 5500 for plan year 2009, including a deferral for one year of the move to the wholly electronic filing system. Plans and service providers will be required to comply with these changes on the due date for the plan’s 2009 Form 5500.

.186 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 Form 5500 as a result of the move to the wholly electronic filing system.

- Revision of the 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 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.
Audit Risk Alert

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 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. It is not uncommon for 403(b) plans, under the current reporting model, 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.

The 2009 Form 5500 package and the related Federal Register notices will be available on the EBSA EFAST Web site at www.efast.dol.gov.

Help Desk—In February 2008, the DOL selected a contractor, Vangent, Inc., to develop and build the new EFAST2 processing system. The new, wholly electronic processing system is expected to be operational on January 2, 2010, to process 2009 Form 5500 filings. Plan administrators and service providers are cautioned that the new EFAST2 processing system will not accept paper filings. Any such paper filings are not able to be processed and will be returned to the filer. To help the plan filing community understand the new EFAST2 system, the DOL has scheduled a series of webcasts during 2009.

Correspondence From EFAST or the DOL OCA

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

Processing-Related Correspondence—Changes are Coming on July 1, 2009

Since 2000, Form 5500 filings have been filed with the DOL’s EFAST processing center in Lawrence, KS. EFAST uses sophisticated electronic technologies to review each filing before acceptance. The DOL, IRS, and the PBGC have created a variety of edit tests designed to check for things such as completeness, accuracy, timeliness, internal consistency, missing schedules or attachments, and failure to answer mandatory questions.

Since EFAST’s inception, the DOL has sent out “edit test” letters (also known as, the “30 day letters” from Lawrence, KS) addressed to plan administrators when deficiencies or discrepancies have been identified during processing. Plan administrators have been provided this opportunity to voluntarily correct deficiencies in their Form 5500 filings before any enforcement actions are taken by the DOL. At the end of this correspondence period, the data contained in the Form 5500 filings will have been distributed to the respective federal agencies regardless of whether deficiencies identified during processing have been resolved.
Beginning July 1, 2009, the current EFAST processing system will no longer generate written “edit test” correspondence to plan administrators on Form 5500 filings containing deficiencies or discrepancies identified during processing, with one exception—the lack of a valid signature(s) on the Form 5500.

Help Desk—It is important to note that Form 5500 filings will continue to be subjected to the same edit tests notwithstanding the fact that EFAST will no longer correspond with plan administrators. In addition, those filings containing errors or omissions will continue to be subject to further review and possible civil penalties by the DOL, IRS, and PBGC. Plan auditors should communicate this processing change to their benefit plan clients and encourage them to take extra care when completing their Form 5500 filings.

Correspondence From the OCA

The DOL’s OCA has the responsibility for enforcing ERISA reporting and disclosure requirements. This includes ensuring that 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.

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

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

After the DOL reviews the statement of reasonable cause, the agency issues a notice of determination that contains the final penalty amount assessed against the plan administrator. The plan administrators may choose to pay the penalty amount or, within 35 days as provided for in the letter, file an answer with the administrative law judge, appealing the penalty.
Important Reminders

Given that the EFAST processing center will end its issuance of letters to plan administrators (with the one exception previously noted) on July 1, 2009, plan administrators should make all efforts to file accurate and complete Form 5500. Failure to do so may result in future enforcement correspondence from the DOL, IRS, or PBGC.

Any questions regarding the DOL penalty process should be directed to the OCA at (202) 693-8360.

The EBSA’s Inspection Programs to Assess Plan Audit Quality

The DOL’s EBSA continues its enhanced programs aimed at assessing and improving the quality of employee benefit plan audits. According to the EBSA, 68 public accounting firms audit more than 100 plans that cover approximately 28,000 audits. The remaining 48,000 plan audits are performed by nearly 10,000 different CPA firms, 8,200 of whom perform five or fewer audits. The EBSA utilizes both top-down and bottom-up strategies in selecting and evaluating ERISA audits.

First, the EBSA conducts periodic inspections of firms with substantial ERISA audit practices—those with greater than 200 benefit plan clients. The EBSA staff meets with firm management, review firm policies and procedures that relate to employee benefit plan audits, and conduct on-site reviews of a sample of ERISA audit engagements. This “top-down” and “bottom-up” approach provides the EBSA a more efficient means of evaluating the quality of audit work performed by these large firms and ensuring that findings and recommendations are communicated to those in a position to effect any necessary changes. To date, the EBSA has completed 14 such reviews.

Next, for firms that audit between 100 and 200 employee benefit plans, the EBSA carries out what it refers to as a mini-inspection program. This program is similar to the inspection program for larger firms, except that the work is performed in the EBSA’s Washington, D.C. office. The top-level communications with firm management and personnel are conducted using a firm questionnaire (also used in the larger inspection program) and telephone interviews. A sample of benefit plan engagements is also sampled, and firms are asked to make the audit workpapers available for review in the EBSA’s office. To date, the EBSA has completed mini-inspections of 15 firms.

The “top-down” and “bottom-up” approach utilized in both the inspection and mini-inspection programs provides the EBSA an efficient means of evaluating the quality of audit work performed by these large firms and ensures that findings and recommendations are communicated to those in a position to effect any necessary changes.

Finally, for firms with employee benefit plan audit practices of 50 or less plans, 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 over 1,600 of these desk reviews.

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 Campaign**

The Fiduciary Education Campaign, a compliance assistance initiative of the DOL, is designed to improve workers' health and retirement security by educating employers and service providers about their fiduciary responsibilities under ERISA. Such information and guidance is a cornerstone of the DOL's mission.

The program emphasizes the obligation of plan sponsors and other fiduciaries to

- understand the terms of their plans;
- select and monitor service providers carefully;
- make timely contributions to fund benefits;
- avoid prohibited transactions; and
- make timely disclosures to workers and their beneficiaries and reports to the government.

The Fiduciary Education Campaign includes nationwide educational seminars and webcasts 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 these programs. The campaign also includes educational materials on topics such as understanding fees and selecting an auditor.

**ERISA Fiduciary Advisor**

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 his or her responsibilities under ERISA. The advisor includes links to more detailed information that may be useful to the user, such as links to regulatory text, publications, and organizations.

This tool may be found at www.dol.gov/ebsa/fiduciaryeducation.html.

**Publications**

Included in the DOL's Fiduciary Education Campaign are the following DOL-issued publications:

*Meeting Your Fiduciary Responsibilities*. To meet their responsibilities as plan sponsors, employers need to understand some basic rules, specifically ERISA, which sets standards of conduct for those who manage an employee benefit plan and its assets (called fiduciaries). This publication provides
Audit Risk Alert

an overview of the basic fiduciary responsibilities applicable to retirement plans under the law.

.212 Understanding Retirement Plan Fees And Expenses. This booklet helps retirement plan sponsors better understand and evaluate their plan’s fees and expenses. Although the focus is on fees and expenses involved with 401(k) plans, many of the principles discussed in the booklet are applicable to all types of retirement plans.

.213 401(k) Plan Fee Disclosure Tool. This form provides employers with a handy way to make cost-effective decisions and compare the investment fees and administrative costs of competing providers of plan services.

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

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

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

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

**Help Desk**—Further information regarding DOL publications and the dates and locations of upcoming educational programs may be found at [www.dol.gov/ebsa/fiduciaryeducation.html](http://www.dol.gov/ebsa/fiduciaryeducation.html).

**Delinquent Filer Voluntary Compliance Program**

.218 The Delinquent Filer Voluntary Compliance Program (DFVCP) is designed to encourage voluntary compliance with the annual reporting requirements under ERISA. The program gives delinquent plan administrators a way to avoid potentially higher civil penalty assessments by satisfying the program’s requirements and voluntarily paying a reduced penalty amount. To increase incentives for delinquent plan administrators to voluntarily comply, the department has reduced penalties and simplified the rules governing participation in the program.
Address to be used for the DFVCP:

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

DFVCP Penalty Calculator and Online Payment Option

The DOL provides two Web based options that make participating in the DFVCP easy, quick, and error-free. An online DFVCP penalty calculator is available to help plan administrators accurately calculate the payment needed to participate in the program. In addition, plan administrators who use the online calculator now have the option of paying the penalty electronically over the Internet.

Additional details on the online calculator and online payment option may be found in the DFVCP Frequently Asked Questions (FAQs) at www.dol.gov/ebsa/calculator/dfvcpmain.html.

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 U.S. Code of Federal Regulations [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 two-part process. First, plan administrators file with the EBSA a complete Form 5500, 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, plan administrators 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

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

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

Per plan cap. This cap is designed to encourage reporting compliance by plan administrators who have failed to file an annual report for a plan for multiple years. The per plan cap limits the penalty to $1,500 for a small plan and $4,000 for a large plan, regardless of the number of late annual reports.
filed for the plan at the same time. No "per administrator" or "per sponsor" cap exists. 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.

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

.228 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

.229 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.

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

Voluntary Fiduciary Correction Program

.231 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.

.232 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.

.233 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.

.234 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.
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.

DOL Outreach and Customer Service Efforts

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

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

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

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 (a) for pension plans, the 15th business day of the month following the month in which the participant contributions are withheld or received by the employer, and (b) for welfare plans, 90 days from the date on which such amounts are withheld or received by the employer.

Reporting of Late Remittances

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

Information on all delinquent participant contributions should be reported on line 4a of either Schedule H, Financial Information, or Schedule I, Financial Information—Small Plan, of Form 5500, regardless of the manner in which they have been corrected. In addition, plan administrators should correct the prohibited transaction with the IRS by filing 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
Audit Risk Alert

described in the following) may be reported on a separate supplemental schedule to be attached to 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, Reporting on Information Accompanying the Basic Financial Statements in Auditor-Submitted Documents (AICPA, Professional Standards, vol. 1), provides guidance on the form and content of reporting when the auditor submits a document containing information accompanying the basic financial statements. If the auditor concludes that the plan has entered into a prohibited transaction and the transaction has not been properly disclosed in the required supplemental schedule, the auditor should (a) express a qualified opinion or an adverse opinion on the supplemental schedule if the transaction is material to the financial statements or (b) 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.

.242 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 Schedules H or 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.


Reporting of Delinquent Loan Repayments

.244 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 Schedules H or I. However, delinquent remittance of participant loan repayments is a prohibited transaction.

.245 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.

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 Schedules H or 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.

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.

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

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.

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

The DOL Issues Final Rule on Investment Advice Exemption for 401(k) Plans and Individual Retirement Accounts

On January 21, 2009, the DOL published a final rule to make investment advice more accessible for participants in 401(k) type plans and individual retirement accounts (IRAs). The rule includes a regulation that implements the new statutory exemption for investment advice added to ERISA by the PPA.

The PPA amended ERISA by adding a new prohibited transaction exemption that allows greater flexibility for investment advisers to give advice to participants of 401(k) plans and IRAs. One of the ways in which investment advice may be given under the exemption is through the use of a computer model certified as unbiased; the other way is through an advisor compensated on a level-fee basis. Several other requirements also must be satisfied, including disclosure of fees the advisor is to receive.

The final regulation provides general guidance on the exemption’s requirements, including computer model certification and disclosures by fiduciaries. The regulation also includes a model form to assist advisors in satisfying...
the exemption’s fee disclosure requirement. In addition, the final rule includes a class exemption expanding the availability of investment advice.

.253 The final rule may be viewed at www.dol.gov/ebsa/pensionreform.html.

New Civil Penalty Rules Regarding Disclosures to Participants (ERISA Section 502(c)(4))

.254 On January 2, 2009, the DOL published a final regulation under ERISA Section 502(c)(4), implementing the department’s authority to assess civil penalties against plan administrators who fail to disclose certain documents to participants, beneficiaries, and others as required by ERISA, as amended by the PPA.

.255 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.

.256 The text of the final regulation is available on the EBSA’s Web site at www.dol.gov/ebsa.

The DOL Issues Final Rule for Distributions to Missing Nonspouse Beneficiaries

.257 On October 7, 2008, the DOL issued a final rule requiring the distribution of 401(k) type benefits for missing nonspouse beneficiaries from terminated plans to be rolled into IRAs.

.258 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.

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

.260 The final rule and model notices for notifying participants or beneficiaries of the plan’s termination and distribution options may be found at www.dol.gov/ebsa/regs.

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

.261 On October 7, 2008, the DOL published two final rules on selection of annuity providers. One rule limits the application of the “safest available” standard of Interpretative Bulletin 95-1 to defined benefit plans. The rule limits the application of the bulletin to the selection of annuity providers for benefit distributions from defined benefit plans.
The DOL also announced a final regulation to provide guidance, in the form of a safe harbor, for the selection of annuity providers by fiduciaries for benefit distributions from individual account plans, such as 401(k) plans.

The final rules may be viewed at www.dol.gov/ebsa/regs.

The DOL Issues Final Rule on Cross Trading

On October 7, 2008, the DOL published a final rule regarding the new statutory exemption on cross-trading in the PPA.

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.

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 rule establishes the requirements for the policies and procedures investment managers must adopt to engage in cross-trades.

The rule may be found at www.dol.gov/ebsa/regs.

The DOL Proposes Regulations to Improve Disclosure of Fees and Expenses to Workers With 401(k)-Type Benefit Plans

On July 23, 2008, the DOL published a proposed rule that will make it easier for workers covered by 401(k)-type plans to make informed retirement savings decisions by providing them with useful summary information, including fee and expense information, for investment options available under their plans.

The centerpiece of the proposed regulation is a requirement to provide investment-related information in a comparative chart or similar format. As part of the proposal, the DOL has developed a model chart for complying with this requirement, while giving plan fiduciaries the flexibility to design their own charts or comparative formats.

The proposal would also require plan fiduciaries to disclose basic information about the plan and its investment options, such as what options are available under the plan, how to give investment instructions, investment returns, fees and expenses, and how to obtain more detailed information. This information would be given to participants on a regular and periodic basis.

The proposed rule and model comparative chart are available at www.dol.gov/ebsa.

The DOL Issues Guidance on Reporting Service Provider Fee and Compensation Information (Schedule C) Reporting for 2009 Form 5500

On July 14, 2008, the DOL published guidance to help plan administrators and service providers comply with the new requirements for reporting service provider fee and compensation information applicable to Form 5500 filed for plan years beginning on or after January 1, 2009.
Audit Risk Alert

.273 The EBSA released 40 FAQs developed in response to questions from the employee benefit community on the new Schedule C requirements. The FAQs cover such issues as the alternative reporting option for eligible indirect compensation; electronic disclosure of fee information by service providers; fee reporting for brokerage window options in participant directed plans; and reporting on gifts, entertainment, and other nonmonetary compensation.

.274 In response to concerns expressed by service providers trying to make changes to their recordkeeping and information management systems in order to provide their employee benefit plan clients with fee and compensation information required for 2009 reports, the department is not requiring plan administrators to report service providers on the Schedule C as failing to provide fee and compensation information if the service provider furnishes the plan administrator with a written statement that (a) the service provider made a good faith effort to make any necessary recordkeeping and information system changes in a timely fashion and (b) despite such efforts, the service provider was unable to complete the changes for the 2009 plan year.

.275 The FAQs on Schedule C reporting can be found at www.dol.gov/ebsa.

Multiemployer Plan Notices

The DOL Issues Model Notice for Multiemployer Plans in Critical Status

.276 On March 25, 2008, the DOL published a proposed regulation providing a model notice for use by multiemployer defined benefit pension plans to notify plan participants and others that their plan is in critical funding status. The proposed regulation is the result of the PPA.

.277 The PPA amended ERISA and the IRC to require that sponsors of multiemployer defined benefit pension plans in critical status for a plan year provide notice of this status to participants, beneficiaries, the bargaining parties, the PBGC, and the DOL. The PBGC, created under ERISA to insure defined benefit pension plans, guarantees payment of basic pension benefits of affected workers and retirees.

.278 The notice must inform participants that their plan is in critical status and of the possibility that adjustable benefits may be reduced or even eliminated. The proposed regulation contains a model notice that may be used by plans to satisfy the notice requirement.

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

Multiemployer Plan Notice

.280 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 the Treasury and the plan sponsor both of the following:

- Whether or not a plan is in endangered status for the plan year and whether or not the plan is or will be in critical status for the plan year
- In the case of a plan that is in a funding improvement or rehabilitation period, whether or not the plan is making the scheduled progress in meeting the requirements of its funding improvement or rehabilitation plan
.281 Plans in “critical” status must include in the notice additional explanations regarding possible reduction of adjustable benefits.

.282 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, IRS, and DOL.

.283 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.

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

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

.285 On October 24, 2007, the DOL published a final rule in the Federal Register establishing qualified default investment alternatives, making it easier for employers to automatically enroll workers in their 401(k) and other defined-contribution plans. The PPA directed the DOL to issue a regulation to assist employers in selecting default investments that best serve the retirement needs of workers who do not direct their own investments.

.286 By facilitating the adoption of automatic enrollment plans, and by encouraging investments appropriate for long-term retirement savings, the DOL estimates the rule will result in between $70 billion and $134 billion in additional retirement savings by 2034.

Overview of the Final Regulation

.287 The final regulation provides the following conditions that must be satisfied in order to obtain safe harbor relief from fiduciary liability for investment outcomes:

- Assets must be invested in a QDIA as defined in the regulation.
- Participants and beneficiaries must have been given an opportunity to provide investment direction, but have not done so.
- A notice generally must be furnished to participants and beneficiaries in advance of the first investment in the QDIA and annually thereafter. The rule describes the information that must be included in the notice.
- Material, such as investment prospectuses, provided to the plan for the QDIA must be furnished to participants and beneficiaries.
- Participants and beneficiaries must have the opportunity to direct investments out of a QDIA as frequently as from other plan investments, but at least quarterly.
- The rule limits the fees that can be imposed on a participant who opts out of participation in the plan or who decides to direct their investments.
- The plan must offer a “broad range of investment alternatives” as defined in the DOL’s regulation under Section 404(c) of ERISA.
The final regulation does not absolve fiduciaries of the duty to prudently select and monitor the QDIAs.

Qualified Default Investment Alternatives

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. The final regulation identifies two individually-based mechanisms and one group-based mechanism—it also provides for a short-term investment for administrative convenience.

The final regulation provides for four types of QDIAs:

- A product with a mix of investments that takes into account the individual's age or retirement date (an example of such a product could be a life-cycle or targeted-retirement-date fund)
- An investment service that allocates contributions among existing plan options to provide an asset mix that takes into account the individual's age or retirement date (an example of such a service could be a professionally managed account)
- A product with a mix of investments that takes into account the characteristics of the group of employees as a whole, rather than each individual (an example of such a product could be a balanced fund)
- A capital preservation product for only the first 120 days of participation (an option for plan sponsors wishing to simplify administration if workers opt-out of participation before incurring an additional tax)

A QDIA must either be managed by an investment manager, plan trustee, or plan sponsor who is a named fiduciary, or be an investment company registered under the Investment Company Act of 1940.

A QDIA generally may not invest participant contributions in employer securities.

Other Significant Provisions

Recognizing that some plan sponsors adopted stable value products as their default investment prior to passage of the PPA and this final regulation, the regulation provides a transition rule. The regulation grandfathers these arrangements by providing relief for contributions invested in stable value products prior to the effective date of the final rule. The transition rule does not provide relief for future contributions to stable value products.

The final regulation clarifies that a QDIA may be offered through variable annuity contracts or other pooled investment funds.

The rule provides that ERISA supersedes any state law that would prohibit or restrict automatic contribution arrangements, regardless of whether such automatic contribution arrangements qualify for the safe harbor.

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.
Civil Penalty Rules For Failure to Provide Diversification Notices (ERISA Section 502(c)(7))

.297 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 who fail to give employees notice of the right to sell company stock in their pension plan accounts.

.298 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.

.299 The amendments authorize the DOL to assess civil monetary penalties against plan administrators who 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.

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

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

.301 For many years, the 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 looking at alternative investments held by plans and master trusts where these investments have not been subject to plan audit procedures.

.302 Due to the current economic crisis and the recent developments involving financial frauds in managed investment funds, the agency is expanding its scope to consider the current status of the investments being reviewed. EBSA plans to emphasize its focus on how plan management determines that investments exist and that their values have been adjusted to reflect the current market conditions.

EBSA Technical Guidance

Field Assistance Bulletins

.303 In the course of audits and investigations by EBSA field enforcement staff, difficult legal issues often arise. In an effort to provide the regional office staff with prompt guidance, the 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 ERISA. All the FABs are posted on the EBSA’s Web site and available to the public. Currently, 21 FABs are outstanding. They cover many topics of current interest such as refinancing ESOP loans (FAB 2002-1), ERISA rules on participant loans where securities law might otherwise limit such loans (FAB 2003-1), duties to lost participants in a terminated plan (FAB 2004-2), interaction between IRS rules and DOL provisions for 403(b) plans (FAB 2007-2), and the responsibilities for ERISA fiduciaries to collect delinquent contributions (FAB 2008-1).
Exempt Transaction Opinions

.304 Auditors are required to perform certain procedures with respect to party-in-interest transactions under chapter 11 of Audit and Accounting Guide Employee Benefit Plans. It is frequently difficult to assess whether a particular transaction is exempt from the prohibited transaction rules of ERISA. EBSA provides some assistance in that area with respect to common transactions through granting class exemptions for specific business relationships between a plan and a party-in-interest. These are referred to as prohibited transaction class exemptions (PTCE). A complete, searchable list of such transactions is available on EBSA's Web site.

Advisory Opinions

.305 EBSA uses the advisory opinion program to provide fairly rapid responses to timely questions that are not part of a regulation project such as the AICPA's 2002 request for clarification on the treatment of participant loan repayments under the plan asset regulations (DOL Advisory Opinion 2002-2a). Opinions issued since 1999 are summarized on EBSA's Web site for easy research.

Recent AICPA Independence and Ethics Pronouncements

.306 Audit Risk Alert Independence and Ethics Developments—2008 (product no. 022479kk) 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.

On the Horizon

.307 Auditors should keep abreast of auditing and accounting developments and upcoming guidance that may affect their engagements. The following sections present brief information about some ongoing projects that have particular significance to employee benefit plans or that may result in significant changes. Remember that exposure drafts are nonauthoritative and cannot be used as a basis for changing existing standards.

.308 The following table lists the various standard setting bodies' Web sites, through which information may be obtained on outstanding exposure
Employee Benefit Plans Industry Developments—2009

drafts, including downloading exposure drafts. These Web sites contain in-depth information about proposed standards and other projects in the pipeline. Many more accounting and auditing projects exist in addition to those discussed here. Readers should refer to information provided by the various standard setting bodies for further information.

<table>
<thead>
<tr>
<th>Standard-Setting Body</th>
<th>Web Site</th>
</tr>
</thead>
<tbody>
<tr>
<td>AICPA Auditing Standards Board</td>
<td><a href="http://www.aicpa.org/Professional+Resources/Accounting+andAuditing/Audit+andAttest+Standards+Board/">www.aicpa.org/Professional+Resources/Accounting+andAuditing/Audit+andAttest+Standards+Board/</a></td>
</tr>
<tr>
<td>Financial Accounting Standards Board</td>
<td><a href="http://www.fasb.org">www.fasb.org</a></td>
</tr>
<tr>
<td>Governmental Accounting Standards Board</td>
<td><a href="http://www.gasb.org">www.gasb.org</a></td>
</tr>
<tr>
<td>Professional Ethics Executive Committee</td>
<td><a href="http://www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics/">www.aicpa.org/Professional+Resources/Professional+Ethics+Code+of+Professional+Conduct/Professional+Ethics/</a></td>
</tr>
<tr>
<td>Public Company Accounting Oversight Board</td>
<td><a href="http://www.pcaob.org">www.pcaob.org</a></td>
</tr>
<tr>
<td>Securities and Exchange Commission</td>
<td><a href="http://www.sec.gov">www.sec.gov</a></td>
</tr>
</tbody>
</table>

Overhaul Project—AICPA Audit and Accounting Guide

Employee Benefit Plans

.309 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.

Auditing Pipeline—Nonissuers

ASB Clarity Project

.310 In response to growing concerns about the complexity of standards, the ASB has commenced a large-scale clarity project to revise all existing auditing standards so they are easier to read and understand. Over the next two or three years, the ASB will be redrafting all of the existing auditing sections contained in the Codification of Statements on Auditing Standards (AU sections of the AICPA's Professional Standards) to apply the clarity drafting conventions and converge with the International Standards on Auditing issued by the International Auditing and Assurance Standards Board (IAASB). The ASB proposes that, except to address current issues, all redrafted standards will become effective at the same time. Only those standards needing to address current issues would have earlier effective dates. The ASB believes that a single effective date will ease the transition to, and implementation of, the redrafted standards. The effective date will be long enough after all redrafted statements
are finalized to allow sufficient time for training and updating of firm audit methodologies. Currently, the date is expected to be for audits of financial statements for periods beginning no earlier than December 15, 2010. This date depends on satisfactory progress being made, and will be amended should that prove necessary. See the explanatory memorandum “Clarification and Convergence” and the discussion paper Improving the Clarity of ASB Standards at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Audit+and+Attest+Standards/Improving+the+Clarity+of+ASB+Standards.htm.

Auditing Pipeline—Issuers

**PCAOB Risk Assessment Standards**

.311 In October 2008, the PCAOB proposed seven new auditing standards to update and supersede the current risk assessment standards. The PCAOB chairman noted that the proposals demonstrate the view that the risk of fraud is a central part of the audit process and not a separate consideration. The proposed standards integrate the risk assessment standards with the standard for the audit of internal control over financial reporting. In February 2009, the CAQ issued a comment letter on the proposed standards. Readers can review the full text of the comment letter at http://thecaq.org/newsroom/pdfs/CAQCommentLetter-PCAOBRiskAssessmentAuditStds.pdf. The comment period for these proposed standards ended February 2009. As with any new auditing standard or amendment to a PCAOB standard, after adoption by the PCAOB the standards will be submitted to the SEC for approval.

**Engagement Quality Review**

.312 In March 2009, the PCAOB reproposed an auditing standard on engagement quality review for public comment. The PCAOB made substantial changes to the proposed auditing standard since it was first proposed in February 2008. The proposal would supersede the PCAOB’s current audit quality control standard and would apply to all audit engagements and engagements to review interim financial information conducted pursuant to the standards of the PCAOB. The proposed standard provides a framework for an engagement quality reviewer to objectively evaluate the significant judgments made by the engagement team and the conclusions reached in forming an overall conclusion about the engagement.

**Accounting Pipeline**

.313 FASB has the following projects underway that may affect employee benefit plans:

- Going concern
- Subsequent events
- Credit crisis projects that include the following:
  - Measuring liabilities under FASB Statement No. 157
  - Embedded credit derivatives scope exceptions
  - Determining when a market for an asset or liability is active or inactive and determining when a transaction is distressed
  - Improving disclosures about fair value measurements
  - Applying fair value to interests in alternative investments
Employee Benefit Plans Industry Developments—2009

- Phase 2 of the applicability of FIN 48 for private entities (FIN 48 is codified at FASB ASC 740, *Income Taxes*)
- An amendment to FASB Statement No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, and approval of FASB ASC
- Disclosure of certain loss contingencies
- Phase 2 of postretirement benefit obligations, including pensions

Employee Benefit Plan Resources

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

AICPA Employee Benefit Plan Audit Quality Center

.315 The AICPA EBPAQC, a firm-based, voluntary membership center with the goal of promoting quality employee benefit plan audits, celebrated its fifth anniversary in March. An indicator of the EBPAQC’s success comes from the DOL, which is finding through its audit quality monitoring program a demonstrable difference between the quality of audits performed by EBPAQC firms and those audits performed by nonmembers. Reviews performed by the DOL’s EBSA continue to show fewer audit deficiencies in audits performed by EBPAQC member firms. In addition, where deficiencies are noted they tend to be less severe for EBPAQC member firms.

.316 As members of the EBPAQC, firms 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 EBPAQC has recently made available to its members

- new resource centers, including a plan investments resource center that includes valuable new tools and resources to help auditors and plan sponsors understand and implement FASB Statement No. 157, and a health and welfare plan resource center that centralizes resources useful to auditors of those plans.
- live forum, member-only conference calls to share important information and answer participant questions on a wide range of technical and practice topics. These calls are free to members, and as an added benefit, the EBPAQC offers a continuing professional education (CPE) option for a small fee.
- new tools to help sponsors of 403(b) plans now subject to audit understand what questions they may expect from their plan auditors and what information they might be expected to provide.
- a “Topix” primer on alternative investments in employee benefit plans to help members gain a general understanding of these types of investments.

.317 Visit the EBPAQC Web site at www.aicpa.org/ebpaqc to see a complete list of the more than 1,700 EBPAQC members and to preview benefits. For more information, contact the EBPAQC at ebpaqc@aicpa.org.

3 See footnote 1.
The following are various resources that practitioners auditing employee benefit plans may find beneficial.

Publications

Practitioners may find the following publications useful. Choose the format best for you—online, print, or CD-ROM.

- Audit and Accounting Guide Employee Benefit Plans (2009) (product no. 012599kk [paperback], WEBXX12 [online], or DEBXX12 [CD-ROM])
- Audit Guide Analytical Procedures (2008) (product no. 012558kk [paperback], WAN-XX [online], or DAN-XX [CD-ROM])
- Audit Guide Auditing Derivative Instruments, Hedging Activities, and Investments in Securities (2008) (product no. 012528kk [paperback], WDI-XX [online], or DDI-XX [CD-ROM])
- Audit Guide Audit Sampling (2008) (product no. 012538kk [paperback], WAS-XX [online], or DAS-XX [CD-ROM])
- Audit Guide Service Organizations: Applying SAS No. 70, As Amended (2008) (product no. 012779kk [paperback], WSV-XX [online], or DSV-XX [CD-ROM])
- Audit Risk Alert Current Economic Crisis: Accounting and Auditing Considerations—2009 (product no. 0223308kk [paperback], WGE-XX [online], or DGE-XX [CD-ROM])
- Audit Risk Alert Independence and Ethics Developments—2008 (product no. 022479kk [paperback], WIA-XX [online], or DIA-XX [CD-ROM])
- Audit Risk Alert Understanding the New Auditing Standards Related to Risk Assessment (product no. 022526kk [paperback])
- Audit Risk Alert Communicating Internal Control Related Matters in an Audit—Understanding SAS No. 115 (product no. 022539 [paperback])
- Checklists and Illustrative Financial Statements for Defined Benefit Pension Plans (product no. 008998kk [paperback] or WDB-CL [online])
- Checklists and Illustrative Financial Statements for Defined Contribution Pension Plans (product no. 009008kk [paperback] or WDC-CL [online])
- Checklists and Illustrative Financial Statements for Health and Welfare Benefit Plans (product no. 009018kk [paperback] or WHW-CL [online])
- Accounting Trends & Techniques, 62nd Edition (product no. 009900kk [paperback] or WAT-XX [online])
- Accounting Trends & Techniques—Employee Benefit Plans, 2nd Edition (product no. 006651kk [paperback])
Employee Benefit Plans Industry Developments—2009

- Audit and Accounting Manual (2008) (product no. 005138kk [paperback], WAM-XX [online], or AAM-XX [loose leaf])
- AICPA Audit Practice Aid SAS No. 70 Reports and Employee Benefit Plans (product no. 061061kk [paperback or CD-ROM])

Additional resources for accountants in business and industry are the Financial Reporting Alert series, designed to be used by members of an entity’s financial management and audit committee to identify and understand current accounting and regulatory developments affecting the entity’s financial reporting.

- Financial Reporting Alert FASB Codification Developments—2008 (product no. 029209kk [paperback])
- Financial Reporting Alert Not-for-Profit Organizations: Accounting Issues and Risks—2008 (product no. 029207kk [paperback])

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, you can sign up for access to the entire library. Get access—anytime, anywhere—to the AICPA’s latest Professional Standards, Technical Practice Aids, Audit and Accounting Guides, Audit Risk Alerts, Accounting Trends & Techniques, and more. To subscribe to this essential online service for accounting professionals, visit www.cpa2biz.com.

Continuing Professional Education

The AICPA offers a number of 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 CPEExpress, offered exclusively through CPA2Biz, is the AICPA’s flagship online learning product. AICPA members pay $180 for a new subscription and $149 for the annual renewal. Nonmembers pay $435 for a new subscription and $375 for the annual renewal. Divided into 1-credit and 2-credit courses that are available 24 hours a day, 7 days a week, AICPA CPEExpress 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, two-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.

In particular, Employee Benefit Plans Strategic Briefing has been archived and is available on demand. This webcast, held on April 22, 2009, 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

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

Hotlines

Accounting and Auditing Technical Hotline

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. The hotline is available from 9 a.m. to 8 p.m. EST on weekdays. You can reach the Technical Hotline at (877) 242-7212 or online at www.aicpa.org/Professional+Resources/Accounting+and+Auditing/Accounting+and+Auditing+Technical+Hotline/.

Ethics Hotline

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 or by e-mail at ethics@aicpa.org.

Industry Conferences

The AICPA sponsors an annual Employee Benefit Plans Accounting, Auditing and Regulatory Update Conference in the late fall. This conference is a two-day high level forum that lets you interact with expert auditors and members of the DOL. The 2009 conference will be held December 7–8, 2009.

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 2010 conference will be held in May 2010. For further information about the conference, call (888) 777-7077 or visit www.cpa2biz.com.

AICPA Industry Expert Panel—Employee Benefit Plans

Employee Benefit Plans Industry Developments—2009

* * * *

.334 This Audit Risk Alert replaces Employee Benefit Plans Industry Developments—2008.

.335 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 with us. Any other comments that you have about the Audit Risk Alert also would 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>Plan Type</th>
<th>2009</th>
<th>2008</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Defined Benefit Plans</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximum annual pension</td>
<td>$195,000</td>
<td>$185,000</td>
<td>$180,000</td>
</tr>
<tr>
<td><strong>Defined Contribution Plans</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximum annual addition</td>
<td>49,000</td>
<td>46,000</td>
<td>45,000</td>
</tr>
<tr>
<td><strong>401(k) Plans</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximum elective deferral</td>
<td>16,500</td>
<td>15,500</td>
<td>15,500</td>
</tr>
<tr>
<td><strong>403(b) Plan</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximum elective deferral</td>
<td>16,500</td>
<td>15,500</td>
<td>15,500</td>
</tr>
<tr>
<td><strong>457 Plans</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>16,500</td>
<td>15,500</td>
<td>15,500</td>
<td></td>
</tr>
<tr>
<td><strong>SIMPLE Plans</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>11,500</td>
<td>10,500</td>
<td>10,500</td>
<td></td>
</tr>
<tr>
<td><strong>Qualified Plans</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maximum compensation limits</td>
<td>245,000</td>
<td>230,000</td>
<td>225,000</td>
</tr>
<tr>
<td>Highly compensated limits</td>
<td>110,000</td>
<td>105,000</td>
<td>100,000</td>
</tr>
<tr>
<td>Officer limits (key employee)</td>
<td>160,000</td>
<td>150,000</td>
<td>145,000</td>
</tr>
<tr>
<td>Federal Insurance Contributions</td>
<td>106,800</td>
<td>102,000</td>
<td>97,500</td>
</tr>
<tr>
<td>Act taxable wage base</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employer and employee social security tax</td>
<td>6.2%</td>
<td>6.20%</td>
<td>6.20%</td>
</tr>
</tbody>
</table>
Appendix B—Definitions of Certain Investments

The following list includes certain investments as defined by the instructions to the Form 5500, Annual Return/Report of Employee Benefit Plan.

**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 or 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 or 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 U.S. Code of Federal Regulations (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 C—Auditing Health and Welfare Plans

This section is intended to describe certain audit challenges unique to health and welfare benefit plans and how these challenges cause health and welfare plans to be more complex and expensive to audit than other types of benefit plans. The operations surrounding the administration of health claims payments have always been complex and difficult for auditors to fully understand and document. 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 the complexity and therefore, the difficulty.

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, are self-employed, or 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, known collectively as "covered entities") 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 (BAA) 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 BAA, 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 BAA, auditors need to take special care in reviewing the agreement.

Help Desk—The American Recovery and Reinvestment Act of 2009 (ARRA) includes changes to HIPAA. In the past, HIPAA was only applicable to the use and disclosure of the PHI by covered entities. Vendors who provided administrative services to covered entities (for example, those providing legal, accounting, IT, financial support, or other similar services) were required to sign BAAs, which, by contract, they then agreed to maintain the privacy and security of the PHI. However, under the ARRA, several of the HIPAA security and privacy requirements have been expanded, including business associates being subject to civil and criminal penalties and enforcement proceedings for violations of HIPAA.

For more information on the ARRA’s changes to HIPAA, including data restrictions, disclosure and reporting requirements as well as various applicable effective dates, see www.rules.house.gov/111/LegText/111_hr1_text.pdf.
Nondisclosure Agreements

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 TPA’s Web site. Acceptance of these terms would constitute an NDA.

Audit Documentation

As previously noted, HIPAA requires that plan sponsors enter into a business associates’ agreement with any of their service providers that have access to the 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 the PHI; however, the 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 the PHI, and
- reporting to plan management any misuse of the PHI by the accounting firm.

AU section 339, Audit Documentation (AICPA, Professional Standards, vol. 1), provides guidance to auditors on documentation requirements. See paragraphs 5.80–5.87 of Audit and Accounting Guide Employee Benefit Plans for guidance. “De-identified” health information is not subject to HIPAA. To be considered de-identified under HIPAA, information in working papers may not contain the following:

- Names
- Dates (such as birth date, admission date, discharge date, and date of death)
- Age, if age 90 or older
- Complete social security numbers

1 Including complete social security numbers in working papers is not permissible under HIPAA. Auditors should consider blocking out all digits except the last four in a social security number if this information is necessary for identification purposes.
Considerations When Planning a Health and Welfare Plan Audit

Before performing a health and welfare plan audit, it is critical for the auditor to obtain a clear understanding of the plan. Plan sponsors commonly wrap multiple benefits together into a single plan entity, and don’t always run the contribution and distribution activity for every benefit through a trust (for example, the contributions and premiums associated with insured life benefits are frequently processed through the general assets of the sponsor). In addition, given that many health and welfare plan benefits are negotiated annually, items such as eligibility criteria and benefit coverage can change from year to year. Because the majority of today’s TPAs utilize systems focused on automation and speed, a key element in the claims administration process is the proper accumulation and installation of plan data by the TPA. Plan data includes, but is not limited to, key benefit provisions, participant information, providers (both network and nonnetwork), and rate structure. Once the TPA has compiled the information and has input it into their system, plan management should ensure they have controls in place to review all key plan parameters input into the TPA system.

When planning a health and welfare plan audit, the auditor needs to have a clear understanding of the following:

- Which plan benefits are fully insured versus self-insured
- The identity of the plan’s various benefit providers and the elements of the contractual arrangements between the plan and those providers
- For self-insured claims:
  - How and by whom the various claims are administrated and adjudicated
  - How administrative fees are charged by the provider
  - Whether the benefit payment is accounted for by the provider 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
- The funding arrangements for the plan and which benefits are employer paid versus participant paid, and how associated contributions are calculated, accumulated, and remitted or utilized to pay benefits
- If benefits paid from a trust (like a voluntary employees’ beneficiary association [VEBA] trust or a taxable trust), a 401(h) account, or from the general assets of the plan’s sponsor
Employee Benefit Plans Industry Developments—2009

- The frequency of benefit payments (daily, monthly, quarterly, or annually)
- Information systems used to support the plan operations and which systems are in-house systems versus outsourced

While gaining their understanding of the preceding, it is recommended that auditors consider the responses with regard to all covered participants. All covered participants include active participants, former employees under the Consolidated Omnibus Budget Reconciliation Act (COBRA), eligible dependents of active and former employees, and retirees. Understanding the various benefits offered, the service providers, the various transaction flows and related control environment is integral to developing the audit approach and the sampling methodology. Standard audit programs for employee benefit plans should be tailored to the unique nature of health and welfare plans.

Unique Health and Welfare Plan Audit Areas

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

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 has a basic understanding of the terms of the plan and has 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 should be billed per American Medical Association guidelines) 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. 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. Note that the 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
Audit Risk Alert

coverage elected by the participant at the date of service. Many plans allow coverage for a spouse, dependents, or other family members.

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

**Contracts With Benefit Service Providers**

For any contract 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 by any party, then the amount would typically be included with benefit obligations of the plan. The auditor may want to consider the role played by the TPA. Often, the TPA directly pays the claim and then the plan reimburses the TPA. If the TPA pays the claim, then the claim would be recorded as benefits paid and a "due to the TPA" liability may need to be recorded on the statement of net assets.

**Rebates Receivable**

If rebates receivable from a service provider exist, 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**

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

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 developed level II and level III codes in its Healthcare Common Procedure Coding System to bill for supplies and services not covered by a CPT code (level I).
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 Statement of Position (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

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 that the actuarial data and census information furnished to the actuary is complete and accurate.

Stop-Loss Coverage

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, $100,000) are normally reimbursed to the plan at 100 percent up to a limit contained in the contract. Aggregate stop-loss coverage reimburses the plan when total eligible claims exceed a predetermined aggregate, such as 125 percent of expected claims.

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.

Claims Incurred but Not Reported

Benefit obligations for a self-funded plan should present the amount of claims payable and currently due for active and retired participants, dependents, and beneficiaries, and claims incurred but not reported (IBNR) for active participants. IBNR for retired participants is generally included in the postretirement benefit obligation.

For a self-funded plan, the cost of IBNR should be measured at the present value, as applicable, of the estimated ultimate cost to the plan of settling the claims (including those associated with terminal diseases and catastrophic accidents) beyond the measurement date pursuant to the plan’s provisions and regulatory requirements, regardless of employment status. Note that the ultimate cost to the plan may be limited to the maximum coverage specified in the plan document, stop-loss coverage, Medicare, and so on. Auditors will want to consider who calculated the IBNR estimate (calculated by sponsor, an actuary, claims administrator, and so on), the appropriateness of assumptions used, and integrity of underlying data utilized for developing the estimate. In addition, the scope of procedures performed on the IBNR estimate as part of the sponsor’s financial statement audit will likely be different than that which is appropriate for the plan. So, caution should be taken when relying on audit work performed during the sponsor entity audit.
Premium Stabilization Reserves

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

Health Savings Accounts and Health Reimbursement Arrangements

Individuals enrolled in certain high-deductible health plans (HDHPs) 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 taxable basis) for nonhealth purposes. Funds held in the HSA can be used to pay premiums for long term care insurance and health insurance premiums while receiving unemployment benefits or continuation benefits under COBRA. The HSA’s funds are required to be held by an insurance company or trustee (bank). HSAs are not “use-it-or-lose-it” plans, and the participant owns the account and is responsible for substantiating distributions from their HSA account.

A Health Reimbursement Arrangement (HRA) is similar to an HSA; however, HRAs are funded solely through employer contributions and may not be funded by the employee through a voluntary salary reduction agreement. No requirement exists for the arrangement to be part of an HDHP, and the funds can be held by the employer or a VEBA trust. Employees are reimbursed tax free for qualified medical expenses up to a maximum dollar amount for a coverage period. Although HRA amounts are not portable, unused amounts in an HRA can generally be carried over to the next year. The employer is not permitted to refund any part of the balance to the employee, the account cannot be used for anything other than reimbursements for qualified medical expenses, and the plan must substantiate distributions made from the HRA account.

Should an HSA or HRA be wrapped into an audited welfare plan, consultation with the plan’s legal counsel may be needed to determine the appropriate accounting and auditing procedures, and whether the associated activity should be included in the audited plan’s financial statements. Possible considerations in that determination might include where the sources of funding come from (for example, employers, participants, or both), who has legal title to the amounts in these accounts, how the claims are adjudicated (for example, by employer, self-adjudicated by participant, or other), whether a carry-forward provision exists into the next plan year for unused amounts, and so on.
In Field Assistance Bulletins 2004-1 and 2006-2, the Department of Labor (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.

COBRA

Many health and welfare plans are required to provide continuation of benefits upon termination of employment through COBRA. This continuation of benefits may be considered a postemployment or postretirement obligation, depending upon the terms of participation. In accordance with SOP 01-2, the benefit obligation associated with COBRA would be equal to the actuarial present value of the cost of such benefits, less the present value of expected participant contributions for such benefits. Many plans require that participants pay the estimated full cost of health benefits provided under COBRA. In such situations, the net cost to the plan sponsor for such benefits is zero, thus the plan would not recognize an obligation. If the plan sponsor subsidizes the cost of health benefits under COBRA, an obligation should be recognized by the plan to the extent that all criteria required by either Financial Accounting Standards Board (FASB) Statement No. 112, Employers’ Accounting for Postemployment Benefits—an amendment of FASB Statements No. 5 and 43, or FASB Statement No. 106, Employers’ Accounting for Postretirement Benefits Other Than Pensions, or both, are satisfied.

In many cases, the collection of COBRA contributions and payment of COBRA benefits are performed by TPAs. 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 IBNR claims should include COBRA participants.

Additional detailed information on COBRA continuation health coverage can be found on the DOL’s Web site at www.dol.gov/ebsa/faqs/faq_consumer_cobra.html.

Notices for COBRA Continuation Health Care Coverage

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.
Help Desk—Normally COBRA allows out-of-work employees to keep their former health coverage for up to 18 months by letting them pay their share as well as the amount the employers used to pay, as well as an administrative free. The ARRA, signed into law on February 17, 2009, includes provisions to directly provide relief to millions on the COBRA plan or ex-employees who need COBRA coverage. This "COBRA stimulus plan" will provide

- a COBRA premium subsidy. People who are currently enrolled in the COBRA plan will get a 65 percent reduction in the amount the employee pays for premium costs (that is, the employee’s out-of-pocket cost without regard to employer paid amounts). Those eligible are employees terminated between September 1, 2008, and December 31, 2009. The subsidy is limited to 9 months and is available only to those without another source of group health insurance. No premium reduction exists for periods of coverage that began prior to February 17, 2009.

- COBRA benefits to ex-employees who are denied coverage. Individuals who lost jobs after September 1, 2008, but who didn’t sign up for COBRA at the time will get a second chance to do so. Employers must send these former workers a notice by mid-April. The former employees will then have 60 days after that date to act.

For more information on COBRA Continuation Coverage Assistance under the ARRA, visit www.dol.gov/ebsa/COBRA.html.
Appendix D—Resources for Economic Information

The Internet covers a vast amount of information that you may find valuable. Some of the sites not previously mentioned in this alert and links to relevant documents regarding economic information include those shown in the following table:

<table>
<thead>
<tr>
<th>Organization/Topic</th>
<th>Web Site</th>
</tr>
</thead>
<tbody>
<tr>
<td>Chartered Accountants of Canada Canadian Performance Reporting (CPR) Alert MD&amp;A</td>
<td><a href="http://www.cica.ca/download.cfm?ci_id=47101&amp;la_id=1&amp;re_id=0">www.cica.ca/download.cfm?ci_id=47101&amp;la_id=1&amp;re_id=0</a></td>
</tr>
<tr>
<td>Disclosures in Volatile and Uncertain Times</td>
<td></td>
</tr>
<tr>
<td>and Freddie Mac Preferred Stock</td>
<td></td>
</tr>
<tr>
<td>Public Company Accounting Oversight Board (PCAOB) Staff Audit Practice Alert No.</td>
<td><a href="http://www.pcaobus.org/Standards/Staff_Questions_and_Answers/2008/12-05_AP_A.3.pdf">www.pcaobus.org/Standards/Staff_Questions_and_Answers/2008/12-05_AP_A.3.pdf</a></td>
</tr>
<tr>
<td>3, Audit Considerations in the Current Economic Environment (AICPA, PCAOB</td>
<td></td>
</tr>
<tr>
<td>Standards and Related Rules, sec. 400.03)</td>
<td></td>
</tr>
<tr>
<td>PCAOB Standing Advisory Group Meeting Emerging Issue-Audit Considerations in the</td>
<td><a href="http://www.pcaobus.org/Standards/Standing_Advisory_Group/Meetings/2008/10-22/BP_Audit_Considerations.pdf">www.pcaobus.org/Standards/Standing_Advisory_Group/Meetings/2008/10-22/BP_Audit_Considerations.pdf</a></td>
</tr>
<tr>
<td>Current Economic Environment</td>
<td></td>
</tr>
</tbody>
</table>
Appendix E—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>
</tr>
</thead>
<tbody>
<tr>
<td>AICPA</td>
<td>Summaries of recent auditing and other professional standards, as well as other AICPA activities</td>
<td><a href="http://www.aicpa.org">www.aicpa.org</a>&lt;br&gt;www.cpa2biz.com&lt;br&gt;www.ifrs.com</td>
</tr>
<tr>
<td>AICPA Accounting Standards Executive Committee</td>
<td>Summaries of recently issued guides, technical questions and answers, and practice bulletins containing financial, accounting, and reporting recommendations, among other things</td>
<td><a href="http://www.aicpa.org/Professional+">www.aicpa.org/Professional+</a> Resources/Accounting+ and+Auditing/Accounting +Standards</td>
</tr>
<tr>
<td>AICPA Accounting and Review Services Committee</td>
<td>Summaries of review and compilation standards and interpretations</td>
<td><a href="http://www.aicpa.org/Professional+">www.aicpa.org/Professional+</a> Resources/Accounting+and+Auditing/Audit+and+Attest+ Standards/Accounting+and+ Review+Services+Committee</td>
</tr>
<tr>
<td>AICPA Professional Issues Task Force</td>
<td>Summaries of practice issues that appear to present concerns for practitioners and disseminate information or guidance, as appropriate, in the form of practice alerts</td>
<td><a href="http://www.aicpa.org/Professional+">www.aicpa.org/Professional+</a> Resources/Accounting+and+ Auditing/Audit+and+Attest+ Standards/Professional+ Issues+Task+Force</td>
</tr>
<tr>
<td>Economy.com</td>
<td>Source for analyses, data, forecasts, and information on the U.S. and world economies</td>
<td><a href="http://www.economy.com">www.economy.com</a></td>
</tr>
<tr>
<td>The Federal Reserve Board</td>
<td>Source of key interest rates</td>
<td><a href="http://www.federalreserve.gov">www.federalreserve.gov</a></td>
</tr>
<tr>
<td>Financial Accounting Standards Board (FASB)</td>
<td>Summaries of recent accounting pronouncements and other FASB activities</td>
<td><a href="http://www.fasb.org">www.fasb.org</a></td>
</tr>
</tbody>
</table>
# Employee Benefit Plans Industry Developments—2009

<table>
<thead>
<tr>
<th><strong>Web Site Name</strong></th>
<th><strong>Content</strong></th>
<th><strong>Web Site</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>USA.gov</td>
<td>Portal through which all government agencies can be accessed</td>
<td><a href="http://www.usa.gov">www.usa.gov</a></td>
</tr>
<tr>
<td>Government Accountability Office</td>
<td>Policy and guidance materials and reports on federal agency major rules</td>
<td><a href="http://www.gao.gov">www.gao.gov</a></td>
</tr>
<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</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 Auditing and Assurance Standards Board</td>
<td>Summaries of International Standards on Auditing</td>
<td><a href="http://www.iaasb.org">www.iaasb.org</a></td>
</tr>
<tr>
<td>International Federation of Accountants</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</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.pcfre.org">www.pcfre.org</a></td>
</tr>
<tr>
<td>Public Company Accounting Oversight Board (PCAOB)</td>
<td>Information on accounting and auditing activities of the PCAOB and other matters</td>
<td><a href="http://www.pcaob.org">www.pcaob.org</a></td>
</tr>
</tbody>
</table>