100 INTRODUCTION

Economic Significance of Employee Benefit Plans

100.1 Employee benefit plans are very significant economic entities in the United States today. According to the AICPA Audit and Accounting Guide, *Employee Benefit Plans*[1] (AEBP), there are nearly 718,000 private pension plans covering more than 125 million participants. In addition, there are over 5 million health and welfare benefit plans.

100.2 Employee benefit plans own significant amounts of investments. According to AEBP, private pension plans own nearly $6.7 trillion in assets. Plans that meet numerous and complex tax qualification requirements do not pay federal income taxes on the income their investments generate; neither do the plan participants pay taxes until they receive income in the form of distributions from the plan. Participants in qualified health and welfare benefit plans are not taxed on the value of the benefits provided by the plan. In addition, some types of employee benefit plans offer participants tax exclusions for portions of their earnings they contribute to the plan.

ERISA

100.3 In the early 1970s, there was great concern when participants in a large unfunded pension plan lost their benefits due to the plan sponsor's bankruptcy. Also, it was not uncommon for employees who worked many years to find that they could not receive any of their accumulated plan benefits upon retirement or termination because of their plans' strict vesting schedules. As a result, the Employee Retirement Income Security Act of 1974 (ERISA) was passed to provide minimum standards of vesting, funding, and fiduciary behavior for pension and welfare benefit plans. ERISA also established the Pension Benefit Guaranty Corporation (PBGC) to insure benefits in case certain types of pension plans were unable to meet benefit obligations.

100.4 In addition, ERISA established record-keeping and financial-reporting responsibilities for plans and imposed a requirement for certain plans to have an annual audit of their financial statements. ERISA gave the Department of Labor (DOL) and the Internal Revenue Service (IRS) authority to issue regulations specifying requirements for the financial records, tax return, annual report, and audit. Those requirements include financial statement requirements and audits in accordance with generally accepted auditing standards (GAAS).

Accounting, Reporting, and Auditing Standards

100.5 After ERISA was enacted, the Financial Accounting Standards Board (FASB) established financial accounting and reporting standards, that is, GAAP, for defined benefit pension plans in FASB ASC 960. The AICPA followed with accounting and reporting standards for defined contribution retirement plans and health and welfare benefit plans as well as guidance on auditing all types of plans in accordance with generally accepted auditing standards (GAAS). (See discussion beginning at paragraph 107.4.) Much of the accounting guidance originally developed by the AICPA was transferred into the FASB Codification. (See paragraph 107.2.)

Guidance Provided

100.6 This chapter describes various types of employee benefit plans, what types this *Guide* covers, how plans are administered and invest their funds, insurance arrangements they may have, and the authoritative accounting, auditing, and governmental literature that pertains to them. It also gives a brief summary of ERISA's reporting and audit requirements. The chapter makes numerous references to other sections of the *Guide* that discuss the matters in detail or present practice aids for use in the audit.

100.7 Chapter 2 gives a more detailed summary of the ERISA, IRS, and DOL laws and regulations related to plan design and operation, fiduciary responsibilities, and disclosure and reporting, and it discusses the significance of these laws and regulations in the audit of an employee benefit plan. An appendix to Chapter 2 reproduces portions of ERISA and several related DOL regulations and other DOL pronouncements. Chapter 3 discusses the GAAP accounting and financial reporting standards for employee benefit plans, and an appendix to the chapter presents illustrative financial statements. Chapters 4-7 discuss the planning, conducting, concluding, and reporting on a GAAS audit of an employee benefit plan. Chapter 8 discusses compilation and review engagements.

100.8 Finally, checklists, confirmation letters, and audit programs that implement the audit and accounting guidance are included.

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[1] Throughout this *Guide*, the authors refer to the AICPA Audit and Accounting Guide, *Employee Benefit Plans (with Conforming Changes as of January 1, 2012)*, as “AEBP.” The 2013 edition of the AICPA Audit and Accounting Guide was not available at the time this *Guide* went to press.

END OF DOCUMENT -

101 Types of Employee Benefit Plans

101.1 Employee benefit plans may be broadly classified as either retirement plans or health and welfare plans. Each of these two categories may include either defined benefit or defined contribution plans. For example, a retirement plan may be either a defined benefit retirement plan (typically called a pension plan) or a defined contribution plan. There are several specific types of defined contribution plans, such as profit-sharing plans, employee stock ownership plans (ESOPs), and 401(k) plans. Health and welfare plans may also be defined benefit or defined contribution plans and may include specific types such as medical, disability, or life insurance plans.

101.2 Other classifications of retirement and health and welfare plans include classification by type of plan sponsor, by type of funding arrangement, by whether or not plan participants make contributions to the plan, and by whether or not the plan qualifies for special tax treatment. Also, ERISA and the Internal Revenue Code (IRC) have specific classifications.

101.3 A plan's broad classification and specific type can have important implications for reporting and auditing responsibilities. For example, the financial accounting and reporting standards for defined benefit retirement plans are quite different and more complex than those for defined contribution plans. Some additional audit planning and procedures may be necessary for a plan sponsored by more than one employer than for a plan sponsored by a single employer. Exhibit 1-1 shows the broad classifications and specific types of employee benefit plans and a brief description of each. This section discusses the various classifications and specific types of plans.

Exhibit 1-1

Types of Employee Benefit Plans [a]

	Retirement Plans [b]		
	Defined Benefit	**Defined Contribution**	**Health and Welfare Benefit Plans** [c]
Purpose	Retirement income	Retirement income	

			Payment of health and welfare benefits during and after active employment
Benefit Amount	Retirement income is a guaranteed benefit usually determinable from a formula based on such factors as age, years of service, and compensation	Retirement income is not guaranteed but is based on contributions, investment results, and forfeitures	Current employees' claims or estimated postemployment and postretirement obligations
Actuary	Required	Generally not required	Normally required for calculation of incurred but not reported claims, postretirement obligations, and postemployment obligations
Contribution	Actuarially determined amount needed to fund guaranteed benefit	Amount provided for by plan document; usually at sponsor discretion or based on a specified formula	Generally as necessary to pay benefits as they become due; some amounts may be prefunded
Funded Status	Accumulated benefits are generally greater than plan assets	Accrued benefits generally equal plan assets	See “Contribution”
Individual Accounts	No individual accounts (except for “hypothetical accounts” of cash balance plans)	Individual accounts are maintained for each participant	No individual accounts (except for defined contribution health and welfare plans)
Examples	Pension plan Cash balance plan Pension equity plan	Profit sharing Money purchase Stock bonus ESOP KSOP Target benefit Thrift/savings 401(k) 403(b)	Medical, dental Other health care Life insurance Disability insurance Vacation, holiday Daycare Legal services Severance pay

Notes:

[a] Employee benefit plans may also be classified by whether they are:

- Single-employer, multiemployer, or multiple-employer plans.
- Noncontributory or contributory.
- Funded or unfunded.
- Trusteed or nontrusteed.
- Qualified or nonqualified.

[b] Referred to as “pension benefit plan” by the IRC.

[c] Referred to as “fringe benefit plan” by the IRC.

Defined Benefit Retirement (Pension) Plan

101.4 FASB ASC 960-10-05-4 defines a *defined benefit pension plan* as a plan that provides:

> a promise to pay to participants specified benefits that are determinable and are based on such factors as age, years of service, and compensation.

A plan document usually specifies a formula for determining the rate at which participants accrue benefits. For example, it may provide that upon retirement a participant will receive a monthly benefit equal to a specified percent of the participant's final salary for each year the participant has worked prior to retirement. Each year, the plan sponsor funds the plan based on estimates (actuarial determinations) of the amounts necessary to accumulate sufficient funds to pay the promised benefits. Thus, the plan sponsor bears the responsibility and investment risk related to guaranteeing a level of benefits.

101.5 Defined benefit retirement plans are relatively more expensive to sponsor than defined contribution plans because of a defined benefit plan's guarantee of a level of benefits, the need for actuarial determinations, and the more complex financial accounting for the sponsor's cost of the plan. Also, the sponsor of a defined benefit retirement plan (or, in some cases, the plan itself) must pay annual insurance premiums for the mandatory coverage by the PBGC, which insures defined benefit retirement plans. In addition, the Tax Reform Act of 1986, the Pension Protection Act of 2006, and other laws and regulations revised coverage, vesting, funding, and nondiscrimination requirements in ways that have tended to increase the cost of providing defined benefits and of recordkeeping.

101.6 **Cash Balance Pension Plan**

A cash balance plan falls into the defined benefit category because the employer promises to pay a set benefit when the participant retires and because the benefits it provides are not related to the investment experience of the plan's fund. However, unlike a typical defined benefit plan, a cash balance plan maintains a hypothetical account for each participant, which is credited with a contribution credit based on a prescribed employer contribution rate, and an interest credit as specified in the plan. When the participant retires, the benefit to be paid is the balance of the participant's hypothetical account. An advantage of a cash balance plan over a traditional defined benefit plan is the visibility of the benefit provided each year because the benefit is expressed as a “cash account.” Under a traditional defined benefit plan, the employees see only what they have accrued as a future pension benefit and a current value is not placed on the accrued benefit.

101.7 Cash balance plans have been the subject of considerable controversy for the past several years. Supporters of cash balance plans argue that younger employees are not satisfied by the long-term promise of a traditional defined benefit plan and prefer to have a more portable plan with benefits currently accruing.

Opponents argue that cash balance plans violate IRS rules by causing a reduction of benefits based on age since older employees have less time to take advantage of interest accruals. Courts, Congress, government agencies, and interested parties continue to debate the advantages and disadvantages of cash balance plans.

101.8 Past court rulings have challenged the calculation of participants' distributions under cash balance plans. As discussed in paragraph 101.6, a participant's hypothetical account in a cash balance plan is credited with a “contribution credit” based on a prescribed employer contribution rate, and an interest credit as specified in the plan. When a participant terminates, the benefit paid is the balance of the participant's hypothetical account. However, the courts have ruled that because cash balance plans are actually defined benefit plans, the calculation of the hypothetical account and thus the distribution of a participant's balance should be based on a present value calculation. That would involve projecting the participant's account balance forward and then discounting that amount back to the date of termination.

101.9 The Pension Protection Act (PPA) of 2006 protects cash balance plans from age discrimination claims with respect to new benefit accruals, and provides specific rules for the conversion of traditional defined benefit plans to cash balance plans. Under the PPA, a cash balance plan will not violate the age discrimination provisions under ERISA and other federal statutes with respect to a contribution credit that is made on or after June 29, 2005, to a participant's notional account if the contribution is greater than or equal to the contribution credit for a comparable younger person.

101.10 In addition, on August 7, 2006, the 7th Circuit Court of Appeals issued a decision in *Cooper v. IBM Personal Pension Plan*, ruling that cash balance plans do not violate the prohibitions against age discrimination under ERISA, including pre-June 29, 2005, accruals.

101.11 **Pension Equity Plans**

Another type of defined benefit pension plan is a pension equity plan. Under this type of plan, participants earn “points” based on age, years of service, or both. Upon retirement or termination, participants may receive an annuity or a lump-sum payment calculated by multiplying their “points” by their final average compensation. This type of plan generally allows participants to calculate their expected retirement amount easier than a traditional defined benefit pension plan.

Defined Contribution Retirement Plan

101.12 FASB ASC 962-10-20 defines a *defined contribution retirement plan* as one that:

> provides an individual account for each participant and provides benefits that are based on all of the following: (a) amounts contributed to the participant's account by the employer or employee, (b) investment experience, and (c) any forfeitures allocated to the account, less any administrative expenses charged to the plan.

A plan document usually specifies a formula for determining the sponsor's contribution rate. For example, it may provide that each year the sponsor will contribute a specified percentage of the participant's salary. The sponsor's contribution obligation is limited by the formula in the plan.

101.13 Although the contribution to a defined contribution plan is defined, the ultimate benefit to be received at retirement or withdrawal from the plan cannot be determined at any given point prior to retirement or withdrawal. The reason is that the ultimate benefit is limited to the amount in the participant's account at retirement or withdrawal, which will depend on the plan's investment experience (gains or losses) and possibly also on the amount of forfeitures and plan expenses between any given date and the retirement or withdrawal date. Thus, the plan sponsor guarantees no benefit and bears no investment risk while the plan participants bear all investment risk and have no guaranteed level of benefits. Also, defined contribution plans are not guaranteed by the PBGC.

101.14 Defined contribution plans are generally less complex than defined benefit plans (actuarial determinations usually are not necessary and the financial accounting for the sponsor's cost is significantly less complex) and thus less expensive to administer. Also, as discussed in the preceding paragraph, the plan sponsor's contribution rate is limited to that defined in the plan document, and the sponsor bears no risk for paying any level of benefits. These factors make defined contribution plans more popular with smaller companies than defined benefit plans and may account for their significantly greater growth during recent years.

101.15 The following plans are defined contribution retirement plans:

- 401(k) plan.
- Profit-sharing plan.
- Money purchase plan.
- Stock bonus plan.
- Employee stock ownership plan (ESOP).
- KSOP.
- Target benefit plan.
- Thrift or savings plan.

- 403(b) plan.

These plans are defined in the following paragraphs.

101.16 **401(k) Plan**

A 401(k) plan is formally called a “cash or deferred arrangement” (CODA) but is popularly known by the IRC Section that pertains to it. Such a plan gives participants the option of having a portion of their compensation received currently or contributed to the plan instead. The employer receives a tax deduction for the amount contributed, and the participant is not currently taxed on that amount. An account for each participant records the contributions, any forfeitures allocated to the account, and investment income, gains, and losses. A 401(k) plan may be incorporated into a profit-sharing or stock bonus plan, and it may also have a thrift component under which participants may make after-tax contributions that may be matched to some extent by an employer contribution.

101.17 401(k) plan sponsors have the option to include Roth 401(k) accounts as part of their plans. Such accounts allow participants to elect to be taxed currently on part or all of their contributions made to the plan. Therefore, in contrast to traditional 401(k) deferrals, contributions to Roth 401(k) accounts are made on an after-tax basis [that is, traditional 401(k) contributions are excluded from the participant's gross income while contributions to a Roth 401(k) account are included in the participant's gross income]. However, in return for being taxed currently on the contributions to a Roth 401(k) account, participants will not be taxed on future distributions of their contributions and the related earnings, if certain requirements are met.

101.18 **Profit-sharing Plan**

A profit-sharing plan is a defined contribution retirement plan providing for participation in the employer's profits based on the employer's discretionary contribution or a predetermined formula. For example, a profit-sharing plan may provide that the employer will contribute a specified percent of pre-tax profits as the plan defines profits. In spite of its name, tax rules no longer require that the contribution be made out of only current or accumulated profits. That is, a company could have a loss for the current year or an accumulated deficit and still make a contribution. The plan document need not provide a specific formula for determining the amount of any year's total contribution. For example, the plan document may simply authorize the plan sponsor's board of directors to annually decide whether to make a contribution and the amount of any contribution. However, the plan must provide a formula for allocating the total contribution among plan participants. That allocation usually is made in proportion to participants' compensation.

101.19 **Money Purchase Plan**

A money purchase plan is a defined contribution retirement plan in which the employer's contribution is “fixed.” That is, the employer's contribution is nondiscretionary and is based on a formula that is not related to profits. Usually, the contribution is based on a specified percentage of employee compensation. The plan is a defined contribution plan because the plan document must specify a contribution formula and does not define a level of

benefits as does a defined benefit plan. However, the employer designates the plan as a pension plan, and the plan is often referred to as a money purchase *pension* plan. It is a pension plan in the sense that, although the plan document does not specify a level of benefits, an actuary could estimate the ultimate benefit based on the contributions formula.

101.20 **Stock Bonus Plan**

A stock bonus plan is a defined contribution retirement plan in which the benefits to plan participants usually are in the form of stock of the employer. (The plan may provide for cash as the only form of benefit if certain requirements are met, or it may provide participants with an option to receive cash instead of stock.) The contribution may be in the form of cash or stock. If cash is contributed, the trust uses it to purchase stock issued by the sponsor, usually at a price formula specified in the plan document. A stock bonus plan is similar to a profit -sharing plan in that the contribution need not depend on profits, there need not be a formula for determining the amount of the contribution, and there must be a formula for allocating contributions among participants.

101.21 **ESOP**

An ESOP, or employee stock ownership plan, is a type of stock bonus plan. Like a stock bonus plan, an ESOP owns stock of the plan sponsor (the employer). However, an ESOP may borrow money to purchase the employer's stock from the employer. The loan is collateralized by the stock, usually is guaranteed by the employer, and is repaid with cash contributions from the employer. Thus, an ESOP is a way for the sponsor to finance the plan. Even if the ESOP is not leveraged (that is, the employer directly contributes cash or stock to the ESOP rather than the ESOP borrowing money to purchase the stock), the employer receives a tax deduction for the value of the stock contributed yet may make no cash outlay. As discussed beginning in paragraph 201.90, an ESOP that acquires certain employer securities that are not readily tradable on an established securities market must have them independently appraised, and an ESOP must give certain participants the right to diversify their account balances.

101.22 **KSOP**

A KSOP is an ESOP with salary deferral options for employees, similar to a 401(k) plan (see paragraph 101.16). Basically, a KSOP combines an ESOP and a 401(k) plan into one plan and one document. A KSOP allows employees to use pre-tax income and employer matching contributions, if any, to purchase employer securities.

101.23 **Target Benefit Plan**

A target benefit plan is a defined contribution retirement plan that specifies a formula for a target benefit to be provided by the plan. Each year, the plan sponsor contributes an actuarially determined amount necessary to fund that target benefit. The contribution is allocated to individual participant accounts, as are investment income, gains, losses, and forfeitures. The plan sponsor does not guarantee that the target benefit will actually be received at retirement. The actual retirement benefit is the amount in the individual participant's account, which may be more or less than the target benefit, depending on the investment experience.

101.24 Thus, a target benefit plan is similar to a defined benefit plan with respect to each year's contribution, but is similar to a defined contribution plan with respect to the actual retirement benefit. If, however, the substance of the plan is to provide a defined benefit (for example, if experience shows that the employer contribution is

periodically adjusted to enable the target benefit to be achieved), then, as stated in AEBP, Paragraph 3.05, it may be more appropriate to follow the accounting and financial reporting standards applicable to defined benefit plans.

101.25 **Thrift or Savings Plan**

A thrift or savings plan is a profit-sharing or stock bonus plan in which employees make after-tax contributions that are usually matched, in whole or in part, by the employer. An account is maintained for each participant to record contributions and the related investment income, gains, and losses. Thrift or savings plans may be part of a profit-sharing, 401(k), or other defined contribution retirement plan.

101.26 **403(b) Plan**

A 403(b) plan, formally called a tax deferred annuity plan, is a retirement plan available to tax-exempt organizations, such as educational institutions, hospitals, and churches. The plan is similar to a 401(k) plan in that it allows participants to make salary reduction contributions to the plan. The participant is not taxed on the amount of the contributions until distributed from the plan. 403(b) plans may also include a Roth contribution feature similar to the Roth 401(k) accounts described in paragraph 101.17. [See further discussion of 403(b) plans at paragraphs beginning at 102.3.]

Health and Welfare Benefit Plan

101.27 Health and welfare benefit plans provide benefits such as the following:

- Medical, dental, visual, psychiatric, and other health benefits.

- Dependent care.

- Life insurance.

- Accidental death or dismemberment, unemployment, and revenue benefits.

- Disability insurance.

- Vacation and holiday.

- Apprenticeships, tuition assistance, day-care, and legal services.

Health and welfare plans may continue to offer benefits to participants after they retire (such benefits are called “postretirement benefits other than pensions” or just “postretirement benefits”), or after employment, but prior to retirement (such benefits are called “postemployment benefits”).

101.28 Health and welfare plans may be defined benefit plans, which specify a determinable benefit, or they may be defined contribution plans. The necessary contribution to a defined benefit plan may be determined actuarially or may be estimated based on past actual claims experience. Defined contribution plans specify how contributions are determined but limit the benefits participants may receive to amounts contributed to the plan, adjusted for plan expenses, investment income, gains, and losses, and any forfeitures allocated to participants. Defined contribution health and welfare plans establish individual participant accounts to record the amounts allocated to each participant.

101.29 The benefits of either defined benefit or defined contribution health and welfare plans may be in the form of reimbursements to participants or payments to insurers (an insured plan) for the cost of the benefit. Uninsured plans may be funded or unfunded; an unfunded plan pays benefits from the general assets of the plan sponsor. Paragraph 101.37 discusses the distinction between funded and unfunded plans in more detail, and paragraph 101.41 discusses funding arrangements for health and welfare plans.

Other Classifications of Employee Benefit Plans

101.30 As previously mentioned, employee benefit plans may be classified in ways other than whether they are defined benefit retirement plans, defined contribution retirement plans, or health and welfare benefit plans. Plans may be further classified by the following characteristics:

- Type of plan sponsor, that is, single-employer, multiemployer, or multiple employer plan.

- Whether contributions are required only by the employer(s) (noncontributory plan) or also by plan participants (contributory plan).

- Whether the plan is funded or not, that is, funded or unfunded plan.

- For funded plans, type of funding arrangement, that is, nontrusteed or trusteed. Further, trust arrangements of trusteed plans may be classified as a discretionary (also called nondirected) trust arrangement, or nondiscretionary (also called directed) trust arrangement. Health and welfare plans may have other types of funding or insurance arrangements.

• ERISA and IRC classifications, including whether the plan qualifies for special tax treatment (qualified plan) or not (nonqualified plan), and IRC classifications of health and welfare plans (fringe benefit plans).

These classifications are explained in the following paragraphs.

101.31 **Single-employer Plan**

As its name implies, a single-employer plan is established by the management of a single company or of a controlled group of corporations, and the employer is the plan sponsor. The plan may be established by management's decision or as a result of collective bargaining. For single-employer plans, the terms “sponsor” and “employer” may be used interchangeably.

101.32 **Multiemployer Plan**

A multiemployer plan is a plan established by collective bargaining between one or more unions and more than one employer. The employers are unrelated but usually are in a specific geographic area or in a specific industry, such as construction, transportation, apparel, food, or retail trades. Multiemployer plans provide for continued plan participation to employees who retain their union membership but frequently change employers within the industry or geographic area. They also provide for uniform benefits to all members of the union, no matter which participating employer they work for, and for uniform contributions by all participating employers. The plan's assets are pooled and are available to pay benefits of any plan participant.

101.33 Although multiemployer plans typically offer a defined benefit, the contributions to them typically are of a defined contribution nature. Usually, the union negotiates a uniform benefit formula for participants and a fixed contribution rate from the employers participating in the plan based on actuarial determinations of the contribution rate necessary to fund the benefit level. The contribution rate may be specified in terms based on wages or service hours of each participating employee. If the substance of the plan is to provide a defined benefit, as it typically is, the accounting and financial reporting standards for defined benefit plans apply.

101.34 Multiemployer plans are sponsored by a joint employer/union board of trustees. Thus, the plan sponsor is not synonymous with any one participating employer. It can be more difficult to audit aspects of multiemployer plans, particularly employer contributions and participant data, than single-employer plans because supporting documents may be located at the various participating employers rather than at one place. The plan auditor may have to make special arrangements to examine necessary documents, obtain service auditor's reports (section 406), or coordinate with other auditors to apply necessary procedures.

101.35 **Multiple Employer Plan**

A multiple employer plan is a collection of single-employer plans sponsored by two or more unrelated employers who pool their resources for investment purposes and to minimize administrative costs. Unlike a multiemployer plan, the employers in a multiple employer plan are not parties to a collective bargaining arrangement, and they may have different benefit formulas for their participating employees. Also, whereas a multiemployer plan has a single reporting requirement applicable to the plan as a whole, each plan in a multiple employer plan has certain separate reporting requirements. (The IRC distinguishes between a “multiple-employer-collectively-bargained plan,” and other multiple employer plans. The distinction rests on whether the plan made certain elections not to

be treated as a multiemployer plan.) Multiple employer plans are, however, similar to multiemployer plans in that contributions from any employers may be used to pay benefits of any participant.

101.36 **Noncontributory and Contributory Plans**

In a noncontributory plan, only the employer(s) is required to contribute to the plan. However, a noncontributory plan may provide for voluntary participant contributions, for example, to a thrift or savings plan that is part of a profit-sharing plan or for participants to pay premiums to a health or welfare benefit plan in order to maintain eligibility to receive benefits during periods of unemployment. A contributory plan requires participants to share the cost of the plan by making contributions. If a plan is contributory or includes voluntary employee contributions, the auditor will have to audit employee contributions as well as the employer contributions. Employee contributions can involve relatively more audit work because they typically are made in numerous small periodic payroll deductions rather than in a few large payments, as employer contributions usually are.

101.37 **Funded versus Unfunded Plan**

A funded plan sets aside funds in a separate employee benefit trust in order to accumulate amounts necessary to pay benefits or for individual participant accounts. An unfunded plan is one for which benefits are paid out of the general assets of the plan sponsor.

101.38 Prior to ERISA, defined benefit retirement plans could be unfunded. ERISA established minimum annual funding requirements for plans subject to ERISA designed to fund the plans at a certain rate. That required annual funding must be sufficient to fully fund the plan's current service cost, to amortize the unfunded liability that existed when ERISA became effective over 30 years, and to amortize investment losses over a specified number of years. (The ERISA funding requirement for defined benefit retirement plans is discussed in more detail beginning at paragraph 201.19.) Thus, under ERISA, a defined benefit retirement plan may be underfunded if these liabilities and investment losses have not been fully amortized.

101.39 Some defined contribution retirement plans are exempt from the ERISA and tax funding requirements, and some are subject to them. Money purchase plans and target benefit plans are subject to funding requirements. These plans must make the contributions required by the plan contribution formula. Profit-sharing plans and stock bonus plans are exempt. Generally, however, profit-sharing plans specify how the plan is to be funded. Also, funding is encouraged by the fact that the plan sponsor does not receive a tax deduction unless the contribution is paid within a specified period.

101.40 ERISA does not require health and welfare benefit plans to be funded, and many are not. A health and welfare benefit plan is unfunded if benefits are paid solely and directly out of the general assets of the employer. A plan is funded if there are plan assets at any time during the year or if plan assets are segregated in a trust, or otherwise, for the payment of plan benefits. Thus, a plan that uses an IRC Sec. 501(c)(9) voluntary employees' beneficiary association (VEBA) trust is funded. Unfortunately, the distinction between a funded and unfunded plan is not always this clear, particularly if there are employee contributions or salary reduction arrangements (flexible spending accounts). Paragraph 204.10 discusses the definition of an unfunded health and welfare benefit plan. Although the distinction between a funded and unfunded health and welfare benefit plan is not always clear, the distinction is important because, as discussed more fully in section 204, unfunded plans may

be exempt from the ERISA reporting or audit requirements, while funded plans may be subject to filing and audit requirements.

101.41 **Type of Funding Arrangement**

A funded plan may administer its assets in several ways. In a nontrusteed plan, the plan sponsor or plan administrator administers investment transactions and may maintain custody of the investment securities itself or have a bank or other financial institution hold the securities as custodian. The trust arrangement for a trusteed plan may be of two broad types—a nondiscretionary (also called directed) trust arrangement or a discretionary (also called nondirected) trust arrangement. The major difference between the two types is that in a discretionary trust arrangement, the trustee has authority to make investment decisions and initiate transactions within the broad investment framework specified in the trust agreement, whereas the trustee of a nondiscretionary trust merely executes the investment transactions that the plan administrator has decided on. These types of trust arrangements are discussed further in section 104.

101.42 Most health and welfare benefit plans are funded by a combination of employee contributions and employer contributions that are provided from the employer's general assets as necessary to pay benefits as they become due or to pay premiums to an insurer or health maintenance organization. Employee contributions may include salary reduction amounts, for example, in a flexible spending arrangement under an IRC Sec. 125 cafeteria plan. Requirements for cafeteria plans and flexible spending arrangements are discussed beginning at paragraph 201.104. Funding arrangements for a health and welfare benefit plan may include a written or unwritten arrangement between a fully or partially uninsured plan and a third-party administrator or insurance company to process the claims on the plan and notify the plan sponsor of the amount of the claims to be remitted to the claims administrator's escrow account (or an escrow account maintained by the plan sponsor) from which the benefits are paid to plan participants. Some plans may be prefunded by an IRC Sec. 501(c)(9) VEBA, which is a tax-exempt trust. Paragraph 201.110 discusses requirements for a VEBA to be tax-exempt.

101.43 **ERISA and IRC Classifications of Employee Benefit Plans**

ERISA and IRS Form 5500 classify employee benefit plans as either pension benefit plans or welfare benefit plans. ERISA, Title I, Section 3, defines a pension benefit plan as a plan that:

> (i) provides retirement income to employees, or (ii) results in a deferral of income by employees for periods extending to the termination of covered employment or beyond, regardless of the method of calculating the contributions made to the plan, the method of calculating the benefits under the plan or the method of distributing benefits from the plan.

Thus, under ERISA, pension benefit plans are broadly defined to include defined benefit and defined contribution retirement plans, including profit-sharing plans, money purchase plans, stock bonus plans, 401(k) plans, and ESOPs. The generic term “retirement plan” may be used.

101.44 ERISA, Title I, Section 3, defines a welfare benefit plan as a plan that:

> provide[s] for its participants or their beneficiaries, through the purchase of insurance or otherwise, (A) medical, surgical, or hospital care or benefits, or benefits in the event of sickness, accident,

disability, death or unemployment, or vacation benefits, apprenticeship or other training programs, or day care centers, scholarship funds, or prepaid legal services . . . .

The instructions to Form 5500 further distinguish fringe benefit plans, unfunded or insured welfare plans, and group insurance arrangements for the purpose of specifying the need to file a Form 5500. The term “fringe benefit plan” is an IRC term, while the term “welfare benefit plan” is a DOL term. A fringe benefit plan may also be a welfare benefit plan. Fringe benefit plans are known by the specific IRC Sections that describe them, and include IRC Sec. 79 group term-life insurance plans, IRC Secs. 105-106 group health and accident plans, IRC Sec. 125 cafeteria plans, IRC Sec. 127 educational assistance plans, and IRC Sec. 129 dependent care plans. Fringe benefit plans are discussed beginning at paragraph 201.97. Paragraph 101.40 discusses unfunded welfare benefit plans, and paragraph 204.9 defines an insured welfare benefit plan. A group insurance arrangement provides benefits to the employees of two or more unaffiliated employers (not in connection with a multiemployer plan or multiple-employer-collectively-bargained plan) and fully insures one or more welfare plans of each participating employer.

101.45 **Qualified Plan**

ERISA requirements apply to all covered employee benefit plans as a matter of law, whether they are qualified plans for tax purposes or not. A qualified plan is one that meets the requirements of IRC Sec. 401(a) and enjoys special tax advantages. A qualified plan typically provides benefits to a broad group of employees and may not discriminate in favor of highly compensated employees in its plan coverage, benefits, or contributions. (Section 201 discusses qualification advantages and requirements, and section 601 discusses the auditor's responsibilities with respect to plan tax status.)

101.46 **Nonqualified Plan**

A nonqualified plan is one that does not meet Section 401(a) requirements or enjoy the tax advantages afforded qualified plans. It usually provides a small group of key management executives or highly compensated employees with benefits exceeding those they could obtain under the nondiscrimination rules of a qualified plan. Nonqualified plans are nonqualified forms of deferred compensation and include the following plans:

- *Stock Option Plans.*

- *Excess Benefit Plans.* These plans are established to provide certain employees with benefits in excess of the limitations on benefits and contributions imposed on qualified plans. An unfunded excess benefit plan is exempt from the participation, vesting, reporting, and other requirements of ERISA, Title I. A funded excess benefit plan is subject to ERISA disclosure, reporting, and fiduciary requirements.

- *Supplemental Executive Retirement Plans (SERPs).* These plans serve broader purposes than just making up benefits in excess of restrictions imposed on qualified plans. They can be used to provide additional benefits to employees of a particular division, to employees who lost benefits by terminating a

previous employer after a short period, etc. SERPs are not to be confused with SEPs, which are discussed in paragraph 101.48.

• *Deferred Bonus Plans.* These plans pay a significant bonus awarded in a particular year over several years to spread out the recipient's tax burden.

• *Rabbi Trusts.* These are trusts created by the employer to fund an executive's deferred compensation without subjecting the executive to taxable income prior to when he receives the deferred compensation. The executive is not currently taxed because the trust fund, although irrevocable and held for the executive's benefit, is considered to be owned by the employer and is subject to claims of the employer's general creditors in case of bankruptcy.

• *Secular Trusts.* These trusts are similar to rabbi trusts, except that the executive is currently taxed on the employer's contributions to the trust and on income the trust earns. However, the trust may pay the executive amounts to help him pay those taxes. The executive is taxed currently because, unlike a rabbi trust, a secular trust is not subject to the claims of the employer's general creditors.

101.47 If a nonqualified plan is covered by ERISA, it must meet ERISA participation, vesting, and funding requirements (but not the nondiscrimination requirements) that are virtually identical to requirements for qualified plans, even though the nonqualified plan does not enjoy the tax advantages of qualified plans. Generally, unfunded nonqualified deferred compensation plans are exempt from the vesting, funding, and fiduciary requirements of ERISA, Title I.

101.48 **Other Types of Plans**

The IRC provides for several other specific types of retirement plans, such as individual retirement accounts (IRA), Roth IRAs, simplified employee pensions (SEP), Keogh plans, and savings incentive match plans for employees (SIMPLE) retirement plans. An IRA may be established by an individual or by an employer or labor union for its employees or members. IRAs established by employers or unions file Form 5500 if they have 100 or more participants; in such cases, they must also file audited financial statements. A SEP is a simpler form of IRA or annuity established by a corporation, partnership, unincorporated business, or self-employed person. SEPs were intended to encourage small companies to adopt retirement plans, but they have not been popular because of requirements that they not discriminate in favor of highly compensated employees. However, reporting requirements are simpler than for qualified plans, and SEPs file forms other than the Form 5500 series. Keogh plans are pension, profit-sharing, or annuity plans established by, or covering, self-employed persons, that is, sole proprietors and partners. A SIMPLE plan can be either an IRA for each employee or part of a qualified cash or deferred arrangement.

101.49 **Classification Used in This *Guide***

Generally, this *Guide* refers to employee benefit plans as defined contribution retirement plans, defined benefit retirement plans, or health and welfare benefit plans. Although the ERISA and Form 5500 definition of a pension plan includes both defined benefit and defined contribution retirement plans, this *Guide* reserves the term “pension plan” for defined benefit retirement plans. Where necessary, the *Guide* distinguishes between defined contribution health and welfare plans and defined benefit health and welfare plans. Also, where appropriate, it specifies considerations unique to multiemployer plans or specific types of defined contribution retirement plans, particularly 401(k) plans.

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102 Scope of This *Guide*

102.1 The preceding section defines the various types of employee benefit plans. This *Guide* specifically covers nongovernmental plans including most defined contribution retirement plans, defined benefit retirement plans, and health and welfare benefit plans that are required to file Form 5500 and audited financial statements. The *Guide* most specifically applies to single-employer plans that are small but that have an audit requirement (generally plans with more than 100 participants). However, it does include special considerations relevant to multiemployer plans, and it may provide useful guidance on auditing any plan, whether subject to the ERISA audit requirement or not.

102.2 This *Guide* covers the accounting, financial reporting, and auditing of the *plan*, not the employer's accounting or reporting for the plan's cost in the employer's financial statements. Also, the *Guide* does not explicitly cover financial statements of a trust established to hold plan assets. (The distinction between the plan and the trust is discussed in section 301.) Neither does this *Guide* explicitly cover nonqualified deferred compensation plans such as plans described in paragraph 101.46. Finally, this is an audit guide, not a guide on tax return preparation or for plan administration. It discusses tax matters and Form 5500 requirements only to the extent of their implications for *audit* responsibility. CPAs who prepare the Form 5500 may refer to *PPC's 5500 Deskbook* for guidance on return preparation and filing. *PPC's Guide to Small Employer Retirement Plans* provides guidance on retirement plan administration.

403(b) Plans Not Specifically Covered

102.3 As discussed in paragraph 101.26, a 403(b) plan is a type of defined contribution retirement plan formally called a *tax-sheltered annuity plan*. Until recently, 403(b) plans were exempt from certain annual reporting requirements, including the requirement to engage an accountant to audit the plan's annual financial statements. However, for plan years beginning on or after January 1, 2009, that exemption no longer applies. As a result, certain 403(b) plans subject to Title I of ERISA are required to satisfy additional reporting obligations, including the requirement to file audited financial statements with the plan's Form 5500 beginning with 2009 plan years.

102.4 While 403(b) plans are similar in many respects to 401(k) plans, there are many differences that make auditing 403(b) plans particularly challenging. Further, the authors believe most 403(b) plans were not audited prior to 2009 because of the previous exemption from the annual audit requirement noted earlier. It would be

difficult to sufficiently address the various nuances that 403(b) plans present without sacrificing the efficiency of the practice aids in this *Guide*. Accordingly, this *Guide* does not explicitly cover audits of 403(b) plans. However, Thomson Reuters developed a comprehensive new tool to provide auditors with the practice aids they need to meet the expected demand for 403(b) plan audits in light of the revised regulatory requirements.

102.5 *PPC's Practice Aids for Audits of 403(b) Plans* includes comprehensive guidance, audit programs, letters, checklists, and other practice aids expressly tailored to address the unique characteristics of 403(b) plans. The practice aids may be ordered at **ppc.thomsonreuters.com** or by calling (800) 431-9025.

Governmental Plans Not Specifically Covered

102.6 This *Guide* does not give guidance specific to governmental plans because they are not subject to ERISA, Title I, or to the DOL's jurisdiction over ERISA disclosure and reporting requirements. Governmental plans are plans established by the federal government, a state or local government, or a government agency or instrumentality for the employees of that government, agency, or instrumentality. Also, governmental plans may not follow the same generally accepted accounting principles discussed in this *Guide*.

102.7 Although this *Guide* does not explicitly cover governmental plans or cover the accounting guidance in GASB Statements, its auditing guidance may be generally useful to auditors of such plans.

SEC Reporting Not Covered

102.8 Finally, this *Guide* does not cover SEC reporting for those plans that are required to file with the SEC. Plans are generally required to register with, and report to, the SEC if the amount of employer securities sold in a year exceeds certain limits specified by the SEC, even if the employer is not a publicly traded company. Some exemptions to this requirement are available, so plan sponsors need to consult with legal counsel when determining the applicability of SEC registration requirements.

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103 Administration of Employee Benefit Plans

The Plan Sponsor

103.1 FASB ASC 960-20-20 defines the *sponsor of an employee benefit plan* (called the plan sponsor) as follows:

> In the case of a pension plan established or maintained by a single employer, the employer; in the case of a plan established or maintained by an employee organization, the employee organization; in the case of a plan established or maintained jointly by two or more employers or by one or more employers and one or more employee organizations, the association, committee, joint board of trustees, or other group of representatives of the parties who have established or who maintain the pension plan.

Paragraph 202.21, item d., gives the definition of an employee organization, which includes a labor union or an employee representation committee that deals with an employer concerning a benefit plan. This definition refers specifically to the sponsor of a pension plan, but the authors believe it applies equally to the sponsor of a defined contribution retirement plan or a health and welfare benefit plan.

103.2 For a single-employer plan, the terms “plan sponsor” and “employer” are equivalent and are used interchangeably in this *Guide*. The preceding definition indicates that the plan sponsor of a multiemployer plan is a joint employer/employee organization board of trustees. Thus, any one employer participating in a multiemployer plan is not equivalent to the plan sponsor and is referred to as a “participating employer” in this *Guide*.

The Plan

103.3 An employee benefit plan has some attributes of a legal entity. For example, ERISA states that an employee benefit plan may be sued as an entity under ERISA. The plan is governed by the provisions of a plan document (also called the “plan instrument”), including amendments to it. ERISA requires a written plan document. The plan document specifies plan provisions such as who is eligible to participate in the plan, what types of benefits are provided, how benefits accrue to participants and are to be paid, how the funding policy will

be established and carried out, how responsibilities for administration of the plan will be allocated, how the plan may be amended, etc.

Named Fiduciary

103.4 ERISA also requires that the plan document designate one or more “named fiduciaries,” which may be an individual or organization, to be responsible for managing the plan's operation and administration. A “named fiduciary” is one who is so designated in the plan document or is identified as a fiduciary by the employer or employee organization. The named fiduciary of a single-employer plan is usually an officer or employee of the plan sponsor. The named fiduciary of a multiemployer plan is usually a member of the plan's board of trustees or a representative of the employee organization. If the plan document does not specify a named fiduciary, the sponsor's board of directors typically will be deemed to be the fiduciary. (Note that besides the named fiduciaries, other persons or entities may be considered to be fiduciaries for purposes of complying with ERISA's fiduciary requirements and prohibitions. Such fiduciaries are defined in section 202.)

103.5 The named fiduciary of a single-employer plan usually reports to the plan sponsor's management or board of directors. Although the named fiduciary has overall authority and responsibility for management and oversight of the plan, the day-to-day operation of the plan is assigned to an individual or group called the plan administrator.

The Plan Administrator

103.6 The plan document generally designates a plan administrator to be responsible for the plan's ongoing administration and operation. Under ERISA, the plan administrator is the plan sponsor if the plan document does not name a different administrator.

103.7 The plan administrator is equivalent to management for a business enterprise. The plan administrator is responsible for operating the plan in accordance with the plan document, trust agreement, and other documents, laws, and regulations related to the plan. The administrator's responsibilities relate to interpretation of plan provisions, determination of participant rights under the plan provisions, management of the plan's investment assets, and delegation of ongoing plan operation and administration duties. Administrative activities include collecting contributions, paying benefits, maintaining plan records, etc. Also, ERISA imposes certain responsibilities on the designated plan administrator, such as the responsibility for filing certain annual reports required by ERISA.

103.8 An individual administrator is called the plan administrator. For small plans, the administrator may be an employee of the plan sponsor. A plan may engage an independent third party (called a “third-party administrator”or TPA) to act as a professional administrator.

103.9 A group administrator is called the administrative committee. It may be a group of several officers or employees of the plan sponsor. It is equivalent to a business enterprise's board of directors.

103.10 The plan administrator or administrative committee may engage a bank or insurance company trust department, an investment advisor, etc., to perform some or all administrative duties, especially the holding or managing of plan assets or the payment of benefits. Different types of custodial and trust arrangements are discussed in section 104.

Plan Participants

103.11 FASB ASC 715-60-20 defines a *plan participant* as follows:

> Any employee or former employee, who has rendered service in the credited service period and is expected to receive employer-provided benefits under the postretirement benefit plan, including benefits to or for any beneficiaries and covered dependents.

As this definition indicates, a participant may be an active or former employee or employee organization member. A former employee or employee organization member may have terminated employment with the employer or employee organization membership, or may have retired. Also, plan participants usually designate a beneficiary to receive future benefits in case of the participant's death. However, the term “beneficiary” may also mean a person currently receiving plan benefits.

103.12 Not all employees are necessarily plan participants. For example, a plan may require, within limits specified by ERISA, a minimum age or period of employment before participation in the plan may begin. An employee not meeting such a plan requirement would not be a plan participant. Also, some defined contribution plans provide for voluntary participation. For example, a 401(k) plan gives employees the option of receiving compensation currently or having it contributed to the plan. Similarly, a salary reduction (flexible spending) arrangement under an IRC Sec. 125 cafeteria plan gives employees the option of receiving an amount as compensation or of having the amount contributed to an account for the provision or reimbursement of health or welfare benefits or expenses. [2] Employees who are eligible to contribute to such a plan may decline to do so. For such plans, the distinction between eligible and active participants can be important. For purposes of DOL filing and audit requirements (which generally differ for plans with 100 or more participants versus those with fewer than 100 participants), instructions to Form 5500 define “active participants” as those who are eligible to participate in the plan (that is, to contribute to the plan) as well as those who are participating. Paragraph 204.15 gives guidance on determining the number of participants.

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[2] In a technical advice memorandum (Ltr. Rul. 9406002), the IRS ruled that without a formal cafeteria plan document, the difference in compensation paid to an employee who elects health care coverage and compensation paid to an employee who does not elect to accept health care coverage must be included in gross income. Employers that offer employees the choice between health care coverage and more compensation therefore need to have a formal cafeteria plan document.

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104 Trust Arrangements

104.1 Trust arrangements are arrangements for the management of the assets of a funded plan. Trust arrangements establish the duties of the trustee. For example, a trust arrangement may specify the following:

- The investment powers the trustees will have.
- The types of investments the trustee may make.
- The disbursements the trustee may make from the plan to pay benefits, legal fees, etc.
- The records the trustee must maintain.
- The statements and reports the trustee must provide the plan administrator.

There are two broad types of trusts, nondiscretionary (directed) trusts, and discretionary trusts, which differ in the extent of the trustee's investment powers and are described in the following paragraphs.

Nondiscretionary (Directed) Trust

104.2 A nondiscretionary trust arrangement establishes only a custodial relationship. That is, the trustee holds plan investments, collects investment income, and makes investment transactions only as directed by the plan administrator, investment advisor, investment committee, or other party designated by the plan as having investment decision-making powers. The trustee does not have investment decision-making powers but only

follows the direction of those who do have such powers and executes their instructions. The trustee may also act as custodian, holding the plan's investment securities.

104.3 With a nondiscretionary trust arrangement, the plan administrator usually maintains independent records (and supporting documents such as brokers advices) of the transactions the trustee was directed to make. (Still, the trustee usually provides the administrator with records and reports of those transactions made as instructed and the plan assets it holds.) Because the plan administrator has independent records, the plan auditor usually can apply procedures to those records in auditing plan investments.

Discretionary Trust

104.4 In a discretionary trust arrangement, the trustee has investment decision-making powers, that is, to initiate investment transactions within the framework of the trust agreement. For example, the trust arrangement may give the trustee the power to buy and sell common stocks, with the trustee deciding when and which stocks to buy, how much, and when to sell them. The trustee may also act as custodian for the stock holdings.

104.5 The trustee of a discretionary trust usually maintains records and supporting documents relating to the transactions it initiates and the investment balances. The plan administrator receives reports summarizing the transactions and plan assets held, but usually does not receive the supporting documents. Thus, the plan auditor may not be able to examine documents relating to investment balances and transactions at the plan administrator's location, and may have to rely on a service auditor's report on the trustee's internal controls relating to investment transactions made for the plan. See discussion of service auditor's reports at section 406.

104.6 A trust arrangement may give the trustee a combination of discretionary powers over some plan assets and nondiscretionary powers over others. Also, a plan may have one or more trustees with different powers. That is, some trustees may perform only custodial duties while others may have discretionary powers or a combination of powers.

104.7 A discretionary trust arrangement may include common/collective trusts or a master trust, which are discussed in the following paragraphs.

104.8 **Common/Collective Trust**

In a common/collective trust, assets of two or more unrelated plans at a bank or similar financial institution (such as an investment firm) are pooled for investment purposes. The plan, particularly a smaller one, can obtain greater diversification of investments and lower brokerage and administrative fees by investing its assets in a common/collective trust instead of investing the assets in a separate trust.

104.9 The plan owns units of participation in the fair value of the trust's underlying assets. The bank or similar financial institution does not own the underlying assets, but only holds them in trust for the plans that are participating in the trust. The investment assets are not included in the bank's or financial institution's financial statements.

104.10 **Master Trust**

A master trust is similar to a common/collective trust, except that the two or more plans in a master trust are sponsored by a single employer or by members of a controlled group of companies. Also, the trustee of a master trust may or may not have discretionary powers.

Summary of Trust Arrangements

104.11 Exhibit 1-2 summarizes the types of trust arrangements discussed in this section.

Exhibit 1-2

Types of Trust Arrangements

Nondiscretionary (Directed)	Discretionary (Nondirected)
Trustee executes investment transactions only as directed by the plan and may hold the securities in a custodial capacity.	Trustee has authority to make investment decisions and initiate transactions within the broad framework of the trust agreement. Trustee may also hold securities in a custodial capacity. Types include: • Common/collective trust (assets of two or more unrelated plans are pooled). • Master trust (assets of two or more plans sponsored by one employer or members of a controlled group are pooled). [a]
Plan maintains independent records supporting investment transactions.	Plan does not receive independent records supporting investment transactions.
Plan reports the investments in its financial statements.	Plan reports units of participation in the fair value of the trust's underlying assets in its financial statements.

Notes:

[a] A master trust may also be nondiscretionary.

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105 Investment and Insurance Contracts

105.1 Many retirement and health and welfare benefit plans enter into contracts with insurance companies. These contracts may be investment vehicles or a means of transferring some or all benefit obligations to an insurance company. This section discusses different types of contracts for retirement plans and for health and welfare benefit plans.

Allocated Contracts

105.2 Insurance company contracts entered into by retirement plans may be broadly classified as allocated or unallocated. With an allocated contract, payments to the insurance company are used to purchase insurance or annuity contracts for specific individual plan participants. The following types of insurance or annuity contracts may be purchased:

- Individual ordinary life insurance policies, which use the policy's cash surrender value at the participant's retirement date to purchase a retirement annuity.

- Individual annuity contracts.

- Group permanent insurance contracts, which are similar to individual insurance policies, except that a group policy covering more than one plan participant is purchased. Each participant receives a certificate indicating his benefits under the group plan.

- Deferred group annuity contracts, which buy deferred annuities equal to the benefits each participant in the group has accrued at the date of purchase. Additional units are purchased for each participant as plan benefits accrue.

105.3 With an allocated contract, the plan benefits are fully guaranteed by the insurance company, which has a legal obligation to make the benefit payments to the participants covered by the allocated contract. Under GAAP and Form 5500 reporting requirements, allocated contracts and the related benefit obligations are excluded from the plan's financial statements because the purchase of the contract transfers the obligation to pay the benefits and the related risks to the insurance company. PBGC insurance does not cover such annuity contracts. Also, as discussed in paragraph 204.18, retirement plans whose only assets are insurance contracts that fully guarantee the payment of benefits are exempt from the audit requirement.

105.4 **Demutualization of Insurance Companies**

In February 2001, the Employee Benefits Security Administration (EBSA) issued guidance on accounting and reporting issues related to the receipt of demutualization distributions by ERISA-covered benefit plans. The guidance was the result of concerns raised to the EBSA regarding the potential conversion of a mutual life insurance company to a stock life insurance company (a process known as “demutualization”). At issue was the fact that many of the insurance company's policyholders were employee benefit plans traditionally exempt from the trust and reporting requirements of ERISA. In connection with the proposed demutualization, policyholders of the insurance companies (including benefit plans) could potentially receive distributions in the form of stock, cash, or policy credits. The EBSA's guidance, discussed further in paragraph 302.41 of this *Guide*, established requirements for determining whether the demutualization distributions should be treated as plan assets, and thus held in trust and subject to the reporting requirements of ERISA.

Unallocated Contracts

105.5 Unallocated contracts are contracts under which payments to the insurance company are not allocated to specific individual plan participants, but are held in an undivided fund for investment until they are used to pay benefits or to buy annuities for plan participants who retire or terminate employment with vested benefits. It is important to realize that an unallocated contract is only an investment vehicle and does not transfer any benefit obligation or related risk from the plan to the insurance company. (The only things that may be “insured” are a rate of return on the investment or a rate at which annuities may be purchased, if the contract guarantees a return or annuity purchase rate.) Thus, the term “insurance contract” can be misleading with respect to unallocated contracts. A better term might be “investment contract with an insurance company.” Unallocated contracts are included in the plan's financial statements and include the following:

- Deposit administration (DA) contracts. [3]

- Immediate participation guarantee (IPG) contracts. [3]

- Guaranteed investment contracts (GIC).

- Synthetic GICs.

- Individual (separate) separate accounts.

- Pooled separate accounts.

These types of unallocated contracts are discussed in the following paragraphs.

105.6 **Deposit Administration (DA) Contract**

In a DA contract, current contributions are not immediately applied to the purchase of single-payment deferred annuities for individual participants but instead are credited to an account for the plan. As participants retire, annuities are purchased with funds from the account. (Other incidental benefits, such as death, disability, and withdrawal, may also be disbursed directly and charged to the account.) Earnings on the account are also credited to the account. For investment purposes, the balance in the account (contributions and earnings not yet used to pay benefits or to purchase annuities) is commingled with other assets of the insurance company.

105.7 The account is credited with interest at the rate specified in the contract. Although the insurance company may guarantee a minimum interest rate that will be credited back to the account and the rates at which the annuities may be purchased, the insurance company does not generally guarantee that the account will have sufficient funds to cover the cost of the annuities when the time comes to purchase them. Thus, the plan generally retains an obligation for benefits promised under a defined benefit plan if the funds in the DA account are not sufficient.

105.8 Under DA contracts, rate credits or experience-rated interest credits (referred to as credits in this paragraph) are determined solely by the insurance company. Such credits are not guaranteed, and there is no contractual obligation that they be paid (or credited). The credits, if paid, are based on the actual investment experience of the company. A plan has no contractual right to an accounting or access to the calculations supporting the amounts. Such amounts may be paid, credited to the account referred to in paragraph 105.6, or considered in an overall dividend calculation that takes into account mortality, other actuarial experience, and the insurance reserve requirements of the company. As with the rate credits, the company is under no obligation to pay dividends.

105.9 **Immediate Participation Guarantee (IPG) Contract**

An IPG contract is similar to a DA contract, except that the insurance company does not guarantee a minimum interest rate on the account. Instead, the account is credited with interest equal to the insurance company's actual investment experience.

105.10 Another difference is that when a specific individual plan participant retires, benefits may be paid directly from the account instead of by purchasing an annuity. Also, the insurance company does not guarantee the rate at which annuities may be purchased (if that option is chosen), but charges the insurance company's actual

experience rate for annuities at the time of purchase. The account is also charged for contract administration expenses.

105.11 An IPG contract may be a general account, with the underlying assets being commingled with the insurance company's other assets, or it may be an individual or pooled separate account. Also, as with a DA contract, the insurance company does not guarantee that the account will be sufficient to meet all plan benefits. The insurance company is generally obligated only for the benefits under any annuities purchased for retired or terminated plan participants from the account.

105.12 **Guaranteed Investment Contract (GIC)**

A GIC may be used as part of a DA or IPG contract or may be separately maintained. A guaranteed investment contract is an investment vehicle that guarantees a return on principal invested in the account over a specified period. Various types of GICs may allow additions or withdrawals during certain periods of the contract life, may have multiple maturities and interest rates, may have floating rates, and may offer a combination of a guaranteed minimum interest rate and additional interest at the insurance company's discretion. A GIC may be purchased from a bank (in which case it is called a BIC) or savings and loan association (in which case it is called a SLIC) instead of from an insurance company. As discussed in Chapter 3, accounting standards may differ, depending on whether the contract is a BIC, SLIC, or GIC.

105.13 GICs normally are general accounts that are backed only by the general assets of the insurance company (although some insurance companies have introduced separate account GICs, which are backed by assets held in a separate account). Plan sponsors and participants have been concerned about the safety of GICs due to financial difficulties experienced by some insurance companies. Many plans have not renewed GICs that have matured, have switched to stronger insurance companies, or have stopped buying new GICs. These developments have audit implications—the auditor of a plan that owns GICs reported at contract value in the plan's financial statements needs to consider whether information about the issuing insurance company suggests that the contract ought to be reported at less than contract value. Section 503 discusses audit considerations with respect to valuation of GICs.

105.14 Some sponsors of defined contribution plans have previously reimbursed the plan for any losses suffered on GICs purchased from insurance companies that subsequently failed, even though in defined contribution plans, participants bear the risk of any plan investment losses. Also, even though participants of defined contribution plans bear investment losses (rather than the plan sponsor), plan fiduciaries could still be held liable for losses if it were decided that their choice of an insurance company was imprudent under ERISA's fiduciary requirements. Section 202 discusses ERISA's requirements for investment prudence.

105.15 **Synthetic GIC**

A synthetic GIC has many of the characteristics of a GIC. The primary difference is the underlying assets of a synthetic GIC are owned by the plan (or by a trust owned by the plan), whereas the underlying assets of a GIC are owned by the issuer of the investment contract. The underlying assets often include government securities, investment grade corporate obligations, and mortgage-backed or other asset-backed securities. A synthetic GIC also contains a “wrapper” contract, which the plan purchases from a third party (often the same entity that issues the investment contract). The “wrapper” contract protects the plan from the risk of declines in the market

value and cash flow potential of the covered assets. Because the plan may liquidate the underlying assets to make distributions or fund other cash needs, the risk protection provided by the “wrapper” contract is important. The accounting for synthetic GICs is discussed in Chapter 3.

105.16 **Individual (Separate) Separate Account**

An individual separate account (also called a separate-separate account) is one of two types of separate account investment vehicles at an insurance company (the other type is a pooled separate account). An individual separate account is similar to a discretionary trust at a bank. A single plan participates in the account. The investment assets are owned by the insurance company but are separately identified and are not commingled with the company's other assets.

105.17 **Pooled Separate Account**

A pooled separate account is similar to a common/collective trust discussed beginning at paragraph 104.8, except that a pooled separate account is at an insurance company rather than at a bank. Also, the assets underlying a pooled separate account are the insurance company's property, with each of the two or more unrelated participating plan's units of participation representing rights to the assets underlying the separate account.

Summary of Allocated and Unallocated Insurance Contracts

105.18 Exhibit 1-3 summarizes the types of allocated and unallocated insurance contracts discussed in the preceding paragraphs.

Exhibit 1-3

Types of Investment and Insurance Contracts

Allocated Contract (excluded from plan statements)	**Unallocated Contract (included in plan statements)**
Insurance policies or annuity contracts are purchased for individual plan participants, and the insurance company assumes the obligation to pay their benefits and the related risks. Types include:	Payments to the insurance company are investment vehicles and are not allocated to specific individual plan participants. The insurance company does not guarantee any benefits from the account.
• Individual ordinary life insurance policy.	*Deposit Administration (DA) Contract*—specifies a rate of interest and a rate at which annuities may be purchased from the account. May be a general account or separate account.
• Individual annuity contract.	*Immediate Participation Guarantee (IPG) Contract*—does not guarantee an interest rate or a rate at which annuities may be purchased from the account. May be a general account or a separate account.
• Group permanent insurance policy covering more than one participant.	*Guaranteed Investment Contract (GIC)*—an investment vehicle that guarantees a rate of return

• Deferred group annuity contract covering accrued benefits of more than one participant.

on the principal invested and does not subject the insurance company to risks arising from policyholder mortality or morbidity. Normally is a general account.

Synthetic GIC—similar to GICs, except the plan or a trust owns the underlying assets of the investment contract. A “wrapper” contract protects the plan from market value fluctuations.

General Account—the assets are commingled with the insurance company's other assets.

Separate Accounts—discretionary type investment vehicles, with the insurance company owning the assets but separately identifying them with the separate account:

• Individual (separate) separate account—assets of one plan are invested.

• Pooled separate account—assets of two or more unrelated plans are invested, with each plan having units of participation.

Health and Welfare Plan Insurance Contracts

105.19 Many health and welfare plans are insured and have a variety of arrangements with insurance companies under which the insurance company assumes all or part of the risk related to providing plan benefits. To the extent that the insurance company assumes the risk of providing benefits, the benefit obligation is not included in the plan's financial statements. Insurance arrangements of health and welfare plans include the following:

• Fully insured, pooled contract.

• Fully insured, experience-rated contract.

• Minimum premium plan arrangement.

• Stop-loss arrangement.

- Administrative services contract.

These arrangements are discussed in the following paragraphs. In addition to these arrangements, other arrangements such as health maintenance organizations (HMOs), preferred provider plans, and managed care networks are popular with plan sponsors and insurers seeking to contain skyrocketing benefit (particularly health benefit) costs.

105.20 **Fully Insured, Pooled Contract**

Under a fully insured, pooled contract with an insurance company, a health and welfare plan generally has no obligation for covered benefits, and is obligated only to pay premiums.

105.21 **Fully Insured, Experience-rated Contract**

A fully insured, experience-rated contract provides the possibility of an experience-rated refund or dividend if benefits incurred, risk charges, and administrative charges are less than premiums paid. However, in a fully insured, experience-rated arrangement (as opposed to one that is not fully insured), the insurance company generally bears any additional obligation if the benefits incurred, risk charges, and administrative charges exceed premiums paid. Accumulated losses of the insurance company may be carried forward to future years for recovery by the insurance company.

105.22 **Minimum Premium Plan Arrangement**

Under a minimum premium plan arrangement, the plan absorbs all benefit claims below an established dollar limit or “trigger point” by reimbursing the insurance company for claims the company pays below the limit. The insurance company absorbs claims incurred above the established limit, that is, the plan does not reimburse the insurance company for claims the company pays above the trigger point.

105.23 **Stop-loss Arrangement**

In a stop-loss arrangement, the plan absorbs benefit claims for any individual participant up to a fixed dollar amount. In a variation, the plan absorbs total claims up to an established percentage, for example, 125%, of an established expected claims level. In either variation, the insurance company absorbs claims in excess of the established limit.

105.24 **Administrative Services Arrangement**

A health and welfare plan's contract with an insurance company may provide for administrative services only (such as claims processing), and not provide any benefits coverage. See paragraph 101.42 for a description of such an arrangement.

105.25 **HMOs, Preferred Provider Plans, and Other Managed Care Networks**

The traditional insured medical benefit arrangement has been the “fee-for-services” arrangement, in which the covered employee is reimbursed for expenses incurred at the physician or hospital of his or her choice. However, alternatives to the traditional arrangement have become popular in an attempt to manage health

costs. A traditional HMO provides prepaid, unlimited medical care but restricts choice of physicians. Preferred provider plans and managed care networks consist of organized groups of physicians and hospitals that provide services for discounted fee amounts negotiated with the employer. The network typically is managed by an insurance company or commercial health manager. Such plans may offer employees the option of choosing their own physician or hospital at each visit, but may impose deductibles and lower reimbursement percentages if they do so. In recent years, variants of the traditional HMO have taken on some of these features.

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[3] Some DA and IPG contracts may be issued that transfer significant risk to the insurance company. Thus, some DA and IPG contracts may be allocated contracts.

END OF DOCUMENT -

106 Actuarial Concepts

106.1 Actuarial methods and assumptions are used to determine the obligation for future benefits of defined benefit retirement and health and welfare plans and to determine the amount of the sponsor's annual contribution necessary to fund those benefits. Actuarial determinations are also necessary to determine the annual contribution to target benefit plans (see paragraph 101.23) and some money purchase plans but are not required for other types of defined contribution plans.

106.2 A defined benefit plan's benefit accrual provisions are applied to census data (birth date, hire date, salary, etc.) to determine accumulated vested and nonvested plan benefits at a point in time for active, retired, and terminated plan participants. Actuarial assumptions are then applied to the accumulated plan benefits to determine the actuarial present value of accumulated plan benefits, that is, the present value of an expected future outlay or stream of outlays.

106.3 The actuarial assumptions adjust the accumulated benefit amounts for the time value of money (through discounts for interest earnings on plan investments) and the probability of payment (through reductions for factors such as mortality, withdrawals from the plan, retirements, etc.) between the actuarial valuation date and the expected payment date. Actuarial assumptions include adjustments for differences between actual experience and past assumptions about interest earnings on plan investments, mortality rates, etc. Section 304 presents examples of the calculation of accumulated plan benefits and of the determination of their present value.

106.4 Actuaries usually prepare the actuarial determinations for plans. However, the plan auditor needs to have a general understanding of actuarial concepts because FASB ASC 960 sets certain standards for the measurement of accumulated plan benefits and the actuarial present value of the benefits in defined benefit pension plan financial statements.

106.5 Also, AU-C 620, *Using the Work of an Auditor's Specialist*, and AU-C 500, *Audit Evidence*, regarding use of management's specialist, both require the auditor to gain an understanding of the methods and assumptions an actuary uses to determine whether the actuary's findings are suitable for inclusion in the plan financial statements. They also require the auditor to test the accounting (census) data the actuary uses in the actuarial determination. (These requirements are discussed in section 408 as part of audit planning.)

END OF DOCUMENT -

107 Authoritative Literature

107.1 Previous paragraphs mention several authoritative documents pertaining to employee benefit plans, for example, FASB ASC 960. This section discusses these and other authoritative accounting, auditing, peer review, ethics, and government documents that establish standards or requirements or provide guidance relevant to employee benefit plans.

Accounting Literature

107.2 **References to Accounting Standards**

FASB ASC 105, *Generally Accepted Accounting Principles*, establishes the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) as the source of generally accepted accounting principles for nongovernmental entities. The authors have included dual references in the *Guide* when referring to a specific accounting standard. That is, references are provided for the specific Codification citation, as well as the corresponding superseded accounting pronouncement that originated the accounting guidance to assist readers with their transition to the codified standards.

107.3 Accounting and financial reporting standards that specifically address employee benefit plans are located in the following topics of the FASB ASC:

- FASB ASC 960, *Plan Accounting—Defined Benefit Pension Plans*, establishes the accounting and financial reporting standards for defined benefit retirement plans.

- FASB ASC 962, *Plan Accounting—Defined Contribution Pension Plans*, includes the accounting and financial reporting standards for defined contribution retirement plans.

- FASB ASC 965, *Plan Accounting—Health and Welfare Benefit Plans*, provides the accounting and financial reporting standards for health and welfare benefit plans.

Chapter 3 discusses the applicability of these standards in more detail.

Auditing Literature

107.4 The following AICPA documents present guidance specifically applicable to audits of employee benefit plans:

• AEBP discusses aspects of auditing unique to employee benefit plans. It discusses auditing procedures and illustrates auditor's reports for audits of defined benefit retirement plans, defined contribution retirement plans, and health and welfare benefit plans. It also includes a summary of ERISA and DOL regulations.

The preface of AEBP states that it applies to audits of plans that are subject to the financial reporting requirements of ERISA, as well as those that are not. It also states that the DOL "strongly encourages the use of this guide in meeting the requirements contained in ERISA Section 103 that a plan have an audit conducted in accordance with GAAS."

• AU-C 402, *Audit Considerations Relating to an Entity Using a Service Organization*,[4] specifically applies when an employee benefit plan uses a bank trust department to invest and hold plan assets. The standard gives guidance relevant to the plan auditor's consideration of the effect of a service organization that executes and processes transactions for another entity (the plan) on the plan's internal control in planning the audit and in auditing investments and insurance contracts in trusteed arrangements. It also gives detailed guidance on the plan auditor's considerations in deciding the need for, or desirability of, obtaining a service auditor's report on the controls at the service organization and on the auditor's use of the service auditor's report.

• AU-C 620, *Using the Work of an Auditor's Specialist*, and AU-C 500, *Audit Evidence*, regarding use of management's specialist, provide guidance that applies when an auditor uses the work of an actuary in the audit of a defined benefit plan or a health and welfare benefit plan. This guidance also applies if specialists are used to value investments in an employee benefit plan's financial statements. Section 408 discusses these requirements.

• AU-C 501, *Audit Evidence—Specific Considerations for Selected Items*, provides guidance on auditing investments in debt and equity securities and equity method investments.

• AU-C 540, *Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures*, establishes standards and provides guidance on auditing fair value measurements and disclosures in financial statements. AU-C 540 is specifically applicable to audits of employee benefit plans

as all types of employee benefit plans are required, with certain exceptions, to report investments at fair value in the financial statements.

Chapters 4, 5, 6, and 7 discuss the applicability of these documents in more detail.

Peer Review Literature

107.5 All AICPA members in public practice are subject to the AICPA practice monitoring requirements. PRP 4200.22, *Engagement Selection*, in the AICPA Peer Review Manual requires that at least one employee benefit plan audit be selected for review if the firm performs such audits.

Ethics Literature

107.6 All AICPA members are required to follow the AICPA *Code of Professional Conduct*, including the following ethics rulings, which give specific guidance on independence with respect to employee benefit plans:

- Ethics Interpretation of Rule 101—“Independence” (ET 101.02).

- Ethics Ruling No. 107 (ET 191.214-.215), “Participation in Employee Benefit Plan Sponsored by Client.”

This ruling and the ethics interpretations mentioned in the following paragraph are discussed in section 401 on engagement acceptance and retention considerations.

107.7 In addition to the ethics ruling listed in the preceding paragraph, Ethics Interpretation 101-18 (ET 101.20), “Application of the Independence Rules to Affiliates,” provides guidance on which entities should be considered affiliates of a financial statement attest client and, thus, be subject to the independence rules. It specifically includes a plan sponsor, participating employer that has significant influence over a multiple or multiemployer employee benefit plan, and a plan sponsored by either a financial statement attest client or an entity controlled by the financial statement attest client. A financial statement attest client that sponsors an employee benefit plan includes, but is not limited to, a union whose members participate in the plan and participating employers of a multiple or multiemployer plan. (Ethics Interpretation 101-18 was issued in August 2011 but is not effective until January 1, 2014. Early implementation is permitted.) Ethics Interpretation 101-3 (ET 101.05), “Nonattest Services [Revised],” gives requirements for remaining independent while providing nonattest services. Ethics Interpretation 101-3 is discussed in section 401.

Government Pronouncements

107.8 ERISA established minimum standards for participation, vesting, funding, reporting and disclosure, fiduciary responsibilities, plan termination, and government insurance of employee benefit plans covered by the act. ERISA established an audit requirement for certain plans and requirements for auditors' independence, workpaper retention, and audit reports. Specific ERISA provisions are discussed in section 108 and in Chapter 2. Excerpts of ERISA particularly relevant to auditors of employee benefit plans are reproduced in Appendix 2A.

107.9 The Department of Labor has issued regulations relating to various ERISA provisions, including DOL Reg. 2520.103, which includes annual report and audit requirements. DOL audit requirements are discussed in section 108 and in section 204 and DOL Reg. 2520.103 is reproduced in Appendix 2A-2. DOL Reg. 2509.75-9, on auditor independence, is reproduced in Appendix 2A-3.

107.10 Section 101 refers to several Internal Revenue Code (IRC) sections and IRS tax forms that impose requirements that mirror ERISA legal requirements or that must be met in order for plans to be tax qualified. Section 108 discusses IRS Form 5500, and Chapter 2 discusses it in greater detail, as well as discussing relevant tax provisions and regulations.

Clarified Auditing Standards

107.11 In response to growing concerns about the complexity of auditing standards and to converge U.S. GAAS with International Standards on Auditing (ISAs), the Auditing Standards Board (ASB) has been working to revise all existing standards and to design a format under which all new standards will be issued. As of the date of this publication, new auditing standards include:

- SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification*. Issued in October 2011, this represents a completely new set of auditing standards revised in format, structure, style, and content from the existing standards. It supersedes all existing SASs through SAS No. 121, except:

  - SAS No. 51, *Reporting on Financial Statements Prepared for Use in Other Countries*. (Subsequently superseded by SAS No. 124.)

  - SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*. (Subsequently superseded by SAS No. 126.)

  - SAS No. 65, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*. (Currently being redrafted and will be superseded when the clarified version is issued.)

  - SAS No. 87, *Restricting the Use of an Auditor's Report*. (Subsequently superseded by SAS No. 125.)

  - SAS No. 117 on compliance audits and SAS Nos. 118-120 on supplementary information. These standards were previously issued in clarified format and are already effective.

• SAS No. 123, *Omnibus Statement on Auditing Standards—2011*. Also issued in October 2011, SAS No. 123 amends SAS Nos. 117, 118, and 122 to address matters that arose after the clarified standards were finalized.

• SAS No. 124, *Financial Statements Prepared in Accordance with a Financial Reporting Framework Generally Accepted in Another Country*. The third SAS issued by the ASB in October 2011, this is the clarified and recodified version of SAS No. 51, *Reporting on Financial Statements Prepared for Use in Other Countries*.

• SAS No. 125, *Alert That Restricts the Use of the Auditor's Written Communication*. In December 2011, the ASB issued SAS No. 125, which supersedes SAS No. 87, *Restricting the Use of an Auditor's Report*, and amends, among other standards, AU-C 260, *The Auditor's Communication With Those Charged With Governance*, and AU-C 265, *Communicating Internal Control Related Matters Identified in an Audit*. SAS No. 125 is effective for the auditor's written communications related to audits of financial statements for periods ending on or after December 15, 2012.

• SAS No. 126, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern (Redrafted)*. SAS No. 126 was issued in June 2012. This supersedes SAS No. 59 and amends AU-C 570. SAS No. 126 is effective for audits of financial statement periods ending on or after December 15, 2012.

• SAS No. 127, *Omnibus Statement of Auditing Standards—2013*. SAS No. 127 was issued in January 2013. This standard amends SAS No. 122, section 600 (AU-C 600), *Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors*), and section 800 (AU-C 800), *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*. SAS No. 127 is effective for audits of financial statement periods ending on or after December 15, 2012.

All auditing interpretations corresponding to a SAS were considered in the development of the clarified standards and incorporated as necessary. Generally, the interpretations have been withdrawn, except for certain interpretations that were retained and revised to reflect the issuance of SAS No. 122. Going forward, the ASB will continue to issue SASs to create, amend, or supersede the auditing standards as necessary.

107.12 **Effective Date**

With a few exceptions, all of the clarified standards became effective for audits of financial statements for periods ending on or after December 15, 2012. Generally, early adoption of the clarified standards was not permitted. This edition of the *Guide*, including all practice aids, has been updated to reflect the clarified standards as auditors using this edition typically will be performing and reporting on audits of 2012 year ends. [5]

107.13 **Form and Structure of the Standards**

The clarified standards were developed using formatting techniques, such as bullet lists, that make them easier to read and understand. In addition, each clarified standard is divided into the following topics:

- **Introduction.** Includes matters such as the purpose and scope of the guidance, subject matter, effective date, and other introductory material.

- **Objectives.** Establishes objectives that allow the auditor to understand what he or she should achieve under the standards. The auditor uses the objectives to determine whether additional procedures are necessary for their achievement and to evaluate whether sufficient appropriate audit evidence has been obtained.

- **Definitions.** Provides key definitions that are relevant to the standard.

- **Requirements.** States the requirements that the auditor is to follow to achieve the objectives unless the standard is not relevant or the requirement is conditional and the condition does not exist.

- **Application and Other Explanatory Material.** Provides further guidance to the auditor in applying or understanding the requirements. While this material does not in itself impose a requirement, auditors should understand this guidance. How it is applied will depend on professional judgment in the circumstances considering the objectives of the standard. The requirements section references the applicable application and explanatory material. Also, when appropriate, considerations relating to smaller and less complex entities are included in this section.

107.14 A standard may also contain exhibits or appendixes. Appendixes to a standard are part of the application and other explanatory material. The purpose and intended use of an appendix is explained in the standard or in the title and introduction of the appendix. Exhibits to standards are interpretive publications. Interpretive publications are not auditing standards and do not contain requirements. Rather, they are recommendations on applying the standards in particular circumstances that are issued under the authority of the Auditing Standards Board. Auditors are required to consider applicable interpretive publications when planning and performing the audit.

107.15 **New AU-C Section Organization**

Within the AICPA Professional Standards, the clarified standards (SAS Nos. 122-127) use “AU-C” section numbers instead of “AU” section numbers. “AU-C” is being used temporarily to avoid confusion with references to existing “AU” sections, which are still effective through 2013. The “AU-C” identifier will revert to “AU” in 2014, when the clarified standards are fully effective for all engagements. The organization of the new AU-C sections (which aligns with the organization of the ISAs) is as follows:

- Preface.

- Glossary.

- AU-C Section 200-299: General Principles and Responsibilities.

- AU-C Section 300-499: Risk Assessment and Response to Assessed Risks.

- AU-C Section 500-599: Audit Evidence.

- AU-C Section 600-699: Using the Work of Others.

- AU-C Section 700-799: Audit Conclusions and Reporting.

- AU-C Section 800-899: Special Considerations.

- AU-C Section 900-999: Special Considerations in the United States.

- Exhibits and Appendixes.

107.16 An exhibit to SAS No. 122 contains a complete two-part cross-reference of AU-C and AU section numbers. One part of the cross-reference shows which existing AU sections are encompassed by each new AU

-C section. The other part of the cross-reference shows, for each existing AU section, where the corresponding guidance can be found in the new AU-C sections. Exhibit 1-4, "List of AU-C Sections Designated by SAS No. 122, *Statements on Auditing Standards: Clarification and Recodification, Cross Referenced to List of AU Sections*," reproduces part of that exhibit.

Exhibit 1-4

List of AU-C Sections Designated by SAS No. 122, Statements on Auditing Standards: Clarification and Recodification, Cross Referenced to List of AU Sections

AU-C Sections Designated by SAS No. 122[a]		AU Sections Superseded by SAS No. 122 (SAS Nos. 1-121 except SAS Nos. 51, 59, 65, 87, and 117-120)		
AU-C Section	**Title**	**AU Section**	**Title**	**Paragraph**
Preface	Principles Underlying an Audit Conducted in Accordance With Generally Accepted Auditing Standards			
200-299	**General Principles and Responsibilities**			
200	Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards	110	Responsibilities and Functions of the Independent Auditor	All
		120	Defining Professional Requirements in Statements on Auditing Standards	All
		150	Generally Accepted Auditing Standards	All
		201	Nature of the General Standards	All
		210	Training and Proficiency of the Independent Auditor	All
		220	Independence	All
		230	Due Professional Care in the Performance of Work	All
210	Terms of Engagement	311	Planning and Supervision	.08-.10
		315	Communications Between Predecessor and Successor Auditors	.03-.10 and .14
220	Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards	161	The Relationship of Generally Accepted Auditing Standards to Quality Control Standards	All
230	Audit Documentation	339	Audit Documentation	All
240	Consideration of Fraud in a Financial Statement Audit	316	Consideration of Fraud in a Financial Statement Audit	All
250	Consideration of Laws and Regulations in an Audit of Financial Statements	317	Illegal Acts by Clients	All
260		380		All

AU-C Sections Designated by SAS No. 122[a]		AU Sections Superseded by SAS No. 122 (SAS Nos. 1-121 except SAS Nos. 51, 59, 65, 87, and 117-120)		
AU-C Section	**Title**	**AU Section**	**Title**	**Paragraph**
	The Auditor's Communication With Those Charged With Governance		The Auditor's Communication With Those Charged With Governance	
265	Communicating Internal Control Related Matters Identified in an Audit	325	Communicating Internal Control Related Matters Identified in an Audit	All
300-499	**Risk Assessment and Response to Assessed Risks**			
300	Planning an Audit	311	Planning and Supervision	All except .08-.10
315	Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement	314	Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement	All
320	Materiality in Planning and Performing an Audit	312[b]	Audit Risk and Materiality in Conducting an Audit	All
330	Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained	318	Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained	All
402	Audit Considerations Relating to an Entity Using a Service Organization	324[c]	Service Organizations	All
450	Evaluation of Misstatements Identified During the Audit	312[d]	Audit Risk and Materiality in Conducting an Audit	All
500-599	**Audit Evidence**			
500	Audit Evidence	326	Audit Evidence	All
501	Audit Evidence—Specific Considerations for Selected Items	331	Inventories	All
		332	Auditing Derivative Instruments, Hedging Activities, and Investments in Securities	All
		337	Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments	All except AU 337B[e]
		901[f]	Public Warehouses—Controls and Auditing Procedures for Goods Held	All
505	External Confirmations	330	The Confirmation Process	All
510	Opening Balances—Initial Audit Engagements, Including Reaudit Engagements	315	Communications Between Predecessor and Successor Auditors	All except .03-.10 and .14
520	Analytical Procedures	329	Analytical Procedures	All
530	Audit Sampling	350	Audit Sampling	All
540	Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures	328	Auditing Fair Value Measurements and Disclosures	All

AU-C Sections Designated by SAS No. 122[a]		AU Sections Superseded by SAS No. 122 (SAS Nos. 1-121 except SAS Nos. 51, 59, 65, 87, and 117-120)		
AU-C Section	**Title**	**AU Section**	**Title**	**Paragraph**
		342	Auditing Accounting Estimates	All
550	Related Parties	334	Related Parties	All
		508	Reports on Audited Financial Statements	.71-.73
		530	Dating of the Independent Auditor's Report	.03-.08
		560	Subsequent Events	All
560	Subsequent Events and Subsequently Discovered Facts	561	Subsequent Discovery of Facts Existing at the Date of the Auditor's Report	All
570[g]	The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern	341	The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern	All
580	Written Representations	333	Management Representations	All
585	Consideration of Omitted Procedures After the Report Release Date	390	Consideration of Omitted Procedures After the Report Date	All
600-699	**Using the Work of Others**			
600	Special Considerations—Audits of Group Financial Statements (Including the Work of Component Auditors)	508	Reports on Audited Financial Statements	.12-.13
		543	Part of Audit Performed by Other Independent Auditors	All
610[h]	The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements	322	The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements	All
620	Using the Work of an Auditor's Specialist	336	Using the Work of a Specialist	All
700-799	**Audit Conclusions and Reporting**			
700	Forming an Opinion and Reporting on Financial Statements	410	Adherence to Generally Accepted Accounting Principles	All
		530	Dating of the Independent Auditor's Report	.01-.02
		508	Reports on Audited Financial Statements	.01-.11, .14-.15, .19-.32, .35-.52, .58-.70, and .74-.76[i]
		431	Adequacy of Disclosure in Financial Statements	All
705	Modifications to the Opinion in the Independent Auditor's Report	508	Reports on Audited Financial Statements	.01-.11, .14-.15, .19-.32, .35-.52, .58-

AU-C Sections Designated by SAS No. 122[a]		AU Sections Superseded by SAS No. 122 (SAS Nos. 1-121 except SAS Nos. 51, 59, 65, 87, and 117-120)		
AU-C Section	**Title**	**AU Section**	**Title**	**Paragraph**
				.70, and .74 -.76[j]
706	Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report	508	Reports on Audited Financial Statements	.01-.11, .14-.15, .19-.32, .35-.52, .58-.70, and .74 -.76[k]
		420	Consistency of Application of Generally Accepted Accounting Principles	All
708	Consistency of Financial Statements	508	Reports on Audited Financial Statements	.16-.18 and .53-.57
720[l]	Other Information in Documents Containing Audited Financial Statements	550	Other Information in Documents Containing Audited Financial Statements	All
725[m]	Supplementary Information in Relation to the Financial Statements as a Whole	551	Supplementary Information in Relation to the Financial Statements as a Whole	All
730[n]	Required Supplementary Information	558	Required Supplementary Information	All
800-899	**Special Considerations**			
800	Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks	544	Lack of Conformity With Generally Accepted Accounting Principles	All
		623	Special Reports	.01-.10 and .22-.34
805	Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement	508	Reports on Audited Financial Statements	.33-.34
		623	Special Reports	.11-.18
806	Reporting on Compliance With Aspects of Contractual Agreements or Regulatory Requirements in Connection With Audited Financial Statements	623	Special Reports	.19-.21
810	Engagements to Report on Summary Financial Statements	552	Reporting on Condensed Financial Statements and Selected Financial Data	All
900-999	**Special Considerations in the United States**			
905	Restricting the Use of an Auditor's Report	532	Restricting the Use of an Auditor's Report	All
910		534		All

AU-C Sections Designated by SAS No. 122[a]		AU Sections Superseded by SAS No. 122 (SAS Nos. 1-121 except SAS Nos. 51, 59, 65, 87, and 117-120)		
AU-C Section	**Title**	**AU Section**	**Title**	**Paragraph**
	Financial Statements Prepared in Accordance With a Financial Reporting Framework Generally Accepted in Another Country		Reporting on Financial Statements Prepared for Use in Other Countries	
915	Reports on Application of Requirements of an Applicable Financial Reporting Framework	625	Reports on the Application of Accounting Principles	All
920	Letters for Underwriters and Certain Other Requesting Parties	634	Letters for Underwriters and Certain Other Requesting Parties	All
925	Filings With the U.S. Securities and Exchange Commission Under the Securities Act of 1933	711	Filings Under Federal Securities Statutes	All
930	Interim Financial Information	722	Interim Financial Information	All
935[o]	Compliance Audits	801	Compliance Audits	All
		504[p]	Association With Financial Statements	All

Notes:

[a] Statement on Auditing Standards (SAS) No. 122, Statements on Auditing Standards: Clarification and Recodification, contains “AU-C” section numbers instead of “AU” section numbers. “AU-C” is a temporary identifier to avoid confusion with references to existing “AU” sections, which remain effective through 2013. The “AU-C” identifier will revert to “AU” in 2014, by which time SAS No. 122 becomes fully effective for all engagements.

[b] AU-C section 450, *Evaluation of Misstatements Identified During the Audit*, also supersedes AU section 312, *Audit Risk and Materiality in Conducting an Audit*.

[c] Statement on Standards for Attestation Engagements No. 16, *Reporting on Controls at a Service Organization* (AT sec. 801), also supersedes AU section 324, *Service Organizations*.

[d] AU-C section 320, *Materiality in Planning and Performing an Audit*, also supersedes AU section 312.

[e] AU-C section 501, *Audit Evidence—Specific Considerations for Selected Items*, withdraws AU section 337B, *Exhibit I—Excerpts From Financial Accounting Standards Board* Accounting Standards Codification 450, *Contingencies*.

[f] AU-C section 501 withdraws AU section 901, *Public Warehouses—Controls and Auditing Procedures for*

Goods Held.

[g] In July 2012, SAS No. 126, *The Auditor's Consideration of the Entity's Ability to Continue as a Going Concern* (sec 570), was issued. The Auditing Standards Board (ASB) moved forward with the clarity redraft of AU section 341, *The Auditor's Consideration of the Entity's Ability to Continue as a Going Concern*, to be consistent with the format of the other clarified SASs that were recently issued as SAS Nos. 122-125. However, the ASB has decided to delay convergence with International Standard on Auditing (ISA) 570, *Going Concern*, pending the Financial Accounting Standards Board's anticipated development of accounting guidance addressing going concern.

[h] SAS No. 65, *The Auditor's Consideration of the Internal Audit Function in an Audit of Financial Statements*, is currently effective and codified as AU section 322. SAS No. 122 redesignates AU section 322 as AU-C section 610, which will be superseded when it is redrafted for clarity and convergence with ISA 610 (Revised), *Using the Work of Internal Auditors*, as part of the Clarification and Convergence Project of the ASB. Until such time, AU-C section 610 has been conformed to reflect updated section and paragraph cross references, but has not otherwise been subjected to a comprehensive review or revision.

[i] AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report*, and AU-C section 706, *Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report*, also supersede paragraphs .01-.11, .14-.15, .19-.32, .35-.52, .58-.70, and .74-.76 of AU section 508, *Reports on Audited Financial Statements*.

[j] AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*, and AU-C section 706 also supersede paragraphs .01-.11, .14-.15, .19-.32, .35-.52, .58-.70, and .74-.76 of AU section 508.

[k] AU-C section 700 and AU-C section 705 also supersede paragraphs .01-.11, .14-.15, .19-.32, .35-.52, .58-.70, and .74-.76 of AU section 508.

[l] To address practice issues, SAS No. 118, *Other Information in Documents Containing Audited Financial Statements*, was issued in February 2010 as a SAS resulting from the Clarification and Convergence Project of the ASB, and is effective for audits of financial statements for periods beginning on or after December 15, 2010. SAS No. 118 was originally codified as AU section 550. SAS No. 122 redesignates AU section 550 as AU-C section 720 but does not supersede SAS No. 118. AU-C section 720 contains conforming changes necessary due to the issuance of SAS No. 122.

[m] To address practice issues, SAS No. 119, *Supplementary Information in Relation to the Financial Statements as a Whole*, was issued in February 2010 as a SAS resulting from the Clarification and Convergence Project of the ASB, and is effective for audits of financial statements for periods beginning on or after December 15, 2010. SAS No. 119 was originally codified as AU section 551. SAS No. 122 redesignates AU section 551 as AU-C section 725 but does not supersede SAS No. 119. AU-C section 725 contains conforming changes necessary due to the issuance of SAS No. 122.

[n] To address practice issues, SAS No. 120, *Required Supplementary Information*, was issued in February 2010

as a SAS resulting from the Clarification and Convergence Project of the ASB, and is effective for audits of financial statements for periods beginning on or after December 15, 2010. SAS No. 120 was originally codified as AU section 558. SAS No. 122 redesignates AU section 558 as AU-C section 730 but does not supersede SAS No. 120. AU-C section 730 contains conforming changes necessary due to the issuance of SAS No. 122.

[o] To address practice issues, SAS No. 117, *Compliance Audits*, was issued in December 2009 as a SAS resulting from the Clarification and Convergence Project of the ASB, and is effective for compliance audits for fiscal periods ending on or after June 15, 2010. SAS No. 117 was originally codified as AU section 801. SAS No.122 redesignates AU section 801 as AU-C section 935 but does not supersede SAS No. 117. AU-C section 935 contains conforming changes necessary due to the issuance of SAS No. 122.

[p] The ASB has withdrawn AU section 504, *Association With Financial Statements*, and addressed its content in AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards*, AU-C section 230, *Audit Documentation*, AU-C section 260, *The Auditor's Communication With Those Charged With Governance*, AU-C section 705, and AU-C section 915, *Reports on Application of Requirements of an Applicable Financial Reporting Framework*, and through proposed amendments to Statements on Standards for Accounting and Review Services to the extent needed.

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[4] The AICPA Auditing Standards Board (ASB) has issued two standards containing guidance for user auditors and for service auditors. One of the standards is AU-C 402, *Audit Considerations Relating to an Entity Using a Service Organization*, which provides guidance for an auditor of the financial statements of an entity that uses a service organization. The second standard is Statement on Standards for Attestation Engagements (SSAE) No. 16, *Reporting on Controls at a Service Organization* (AT 801), for use by a service auditor reporting on controls at a service organization. SSAE No. 16 is beyond the scope of this *Guide*.

[5] Auditors performing and reporting on audits of 2011 or 2012 fiscal year ends other than December 31 need to comply with the pre-clarity auditing standards. For this reason, section 707 of this *Guide* illustrates several auditor's reports under the previous standards. In such situations, auditors may want to also consult a previous edition of the *Guide*.

END OF DOCUMENT -

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108 ERISA, IRS, and DOL Reporting and Audit Requirements

Organization of ERISA

108.1 The Employee Retirement Income Security Act of 1974 (ERISA) consists of four titles, each containing numerous sections. This section gives an overview of the organization of ERISA and of related reporting and audit requirements of ERISA, the IRS, and the DOL. The section also mentions DOL requirements for auditor independence and discusses DOL concerns about the quality of ERISA audits. Other chapters discuss these matters in greater detail.

108.2 **Title I**

Title I of ERISA includes the following sections and requirements for employee benefit plans covered by Title I:

- Minimum participation (Section 202), benefits accrual (Section 204), and vesting (Section 203) requirements.

- Minimum funding of plans (Section 302).

- Plan fiduciaries and their responsibilities, and prohibited transactions (Sections 401-414).

- Plan disclosures and reporting to plan participants (Sections 101-106).

- Plan annual reporting requirements, including an audit requirement for certain plans (Section 103).

Section 201 of this *Guide* lists types of plans that are covered and not covered by Title I and discusses the participation, benefit accrual, vesting, and funding requirements. Section 202 discusses fiduciary responsibilities and prohibited transactions, and section 203 and paragraph 108.17 discuss required disclosures to plan participants. Annual reporting requirements are discussed beginning in paragraph 108.6 and in greater detail in section 204.

108.3 **Title II**

Title II of ERISA contains tax provisions that are administered by the IRS. Many Title II provisions related to employee rights are the same as Title I provisions. However, whereas Title I provisions apply to all covered plans as a matter of law, whether the plans are tax-qualified or not, Title II provisions are IRC amendments made by ERISA that are imposed as a condition of plan qualification for tax purposes. (The IRC also imposes other qualification requirements relating to plan coverage, nondiscrimination of contributions or benefits in favor of highly compensated employees, limits on maximum contributions and benefits, and other matters. These IRC coverage, nondiscrimination, and limitation rules are discussed in section 201.)

108.4 **Title III**

Title III relates to jurisdiction, administration, and enforcement of ERISA by the Department of Labor (DOL), Department of Treasury (DOT), and the Pension Benefit Guaranty Corporation (PBGC).

108.5 **Title IV**

Title IV established the PBGC to provide plan termination insurance for defined benefit retirement plans. The PBGC and plan termination are discussed in section 205.

ERISA Reporting Requirements

108.6 ERISA requires an annual report to be filed with the DOL, which provides the information to the IRS and PBGC. (Section 204 lists types of plans that are exempt from the filing requirement.) The annual report consists of the Form 5500 and the appropriate schedules, financial statements, notes, and auditor's reports, if applicable.

Form 5500

108.7 The Form 5500 was developed by the IRS, DOL, and PBGC to satisfy the reporting requirements of the IRS and Titles I and IV of ERISA. The Form 5500 [6] consists of one of the following forms, and related schedules, filed in the indicated circumstances:

- Form 5500, “Annual Return/Report of Employee Benefit Plan,” is filed by all plans, except for certain exceptions to the filing requirement discussed beginning at paragraph 204.8. [7]

- Form 5500-EZ, “Annual Return of One-Participant (Owners and Their Spouses) Retirement Plan,” is a simple form filed by certain one-participant plans. Form 5500-EZ does not include any financial statements or auditor's report.

• Form 5500-SF, “Short Form Annual Return/Report of Small Employee Benefit Plan,” is a simplified form for use by certain small pension and welfare benefit plans. A plan eligible to file Form 5500-SF must (a) generally have fewer than 100 participants at the beginning of the plan year, (b) be exempt from the requirement for audited financial statements, (c) have 100% of its assets invested in certain secure investments with a readily determinable fair value, such as mutual funds, publicly traded securities held by a broker dealer, etc., (d) hold no employer securities, and (e) not be a multiemployer plan.

• Schedule A, “Insurance Information,” is required to be attached to Form 5500 when any plan benefits are provided by an insurance company or similar organization.

• Schedule C, “Service Provider Information,” is required to be attached to the Form 5500 if the plan paid $5,000 or more to individuals or companies that provided services such as accounting, auditing, brokerage, administration, investment advice, or custodial care to the plan or the plan has terminated an “enrolled actuary” or an accountant.

• Schedule D, “DFE/Participating Plan Information,” is filed with Form 5500 if a plan participated in or invested in one or more common and collective trusts, pooled separate accounts, master trusts, or 103-12 investment entities at any time during the plan year.

• Schedule G, “Financial Transaction Schedules,” is filed with Form 5500 if a plan has loans or fixed income obligations in default or determined to be uncollectible, leases in default or classified as uncollectible, or nonexempt (prohibited) transactions. If this schedule is required, the auditor must report on the schedule.

• Schedule H, “Financial Information,” is filed with Form 5500 by “large” pension plans or “large” welfare plans (see the discussion of “large” versus “small” plans beginning at paragraph 204.12), except for certain plans (see paragraph 204.30).

• Schedule I, “Financial Information—Small Plan,” is filed with Form 5500 by “small” pension plans or “small” welfare plans (see the discussion of “large” versus “small” plans beginning at paragraph 204.12). Either Schedule H or Schedule I is attached to Form 5500, not both.

• Schedule MB, “Multiemployer Defined Benefit Plan and Certain Money Purchase Plan Actuarial Information,” is required to be attached to Form 5500 if the plan is a multiemployer defined benefit plan subject to the minimum funding standards. The Schedule is also required to be attached to Form 5500 if the plan is a money purchase defined contribution plan (including a target benefit plan) that has received a waiver of the minimum funding standard, and the waiver is currently being amortized. For those money purchase plans, only certain lines of the Schedule must be completed and the Schedule does not require the signature of an enrolled actuary. Schedule MB does not have to be filed with the Form 5500-EZ, but it must be retained in accordance with the instructions for Form 5500-EZ.

• Schedule R, “Retirement Plan Information,” is filed with Form 5500 by certain defined benefit and defined contribution plans and certain other plans to report information on plan distributions, funding, and amendments that change the value of benefits in the plan.

• Schedule SB, “Single-employer Defined Benefit Plan Actuarial Information,” is required to be attached to Form 5500 by single-employer defined benefit plans (including multiple-employer defined benefit plans) that are subject to the minimum funding standards. Schedule SB does not have to be filed with the Form 5500-EZ, but it must be retained in accordance with the instructions for Form 5500-EZ.

Section 204 discusses the content of these forms and schedules in more detail.

108.8 **Financial Statements Included in Form 5500**

Schedules H and I to Form 5500 listed in the preceding paragraph include a statement of plan assets and liabilities and a statement of plan income, expenses, and changes in net assets in different degrees of detail. The statement of plan assets and liabilities in the schedules is comparative; the statement of plan income, expenses, and changes in net assets in the schedules is for the current year only.

108.9 The instructions to Schedules H and I to Form 5500 allow the cash, “modified cash,” or accrual basis of accounting but also require current value for all assets except unallocated contracts with insurance companies, which may be reported at contract value. AICPA auditing literature refers to modifications of the cash basis having substantial support. AEBP, Paragraph 13.32, indicates that financial statements based on cash transactions and that adjust investments to fair value are considered to be on the modified cash basis of accounting.

108.10 Schedules H and I to Form 5500 are discussed in more detail beginning at paragraph 204.30. Even if the client prepares the Form 5500 and related schedules, the auditor needs to be familiar with its contents because of the requirements to disclose any differences or inconsistencies between Schedule H to Form 5500 and the separate audited financial statements filed with Form 5500 (see paragraphs 108.11, 610.4, and 610.17).

108.11 **Audited Financial Statements Filed with Form 5500**

The instructions to Schedule H and DOL regulations (DOL Reg. 2520.103-1) generally require that plans with 100 or more participants attach *separate* audited financial statements (see paragraph 204.14 for certain exceptions to this audit requirement) and certain supplemental schedules. (The supplemental schedules that must be audited are those listed in paragraph 108.13.) The statement of net assets available for benefits must be comparative, but the statement of changes in net assets available for benefits may be for the current year only. The statements may be on a basis other than GAAP, that is, the cash or modified cash basis, as long as current value is used to value assets. (As indicated in AEBP, Paragraph 13.32, cash basis statements modified to present investments at fair value are considered to be on the modified cash basis.)

108.12 DOL Reg. 2520.103-1(b)(3) states that the auditor's report, audited financial statements, or notes must disclose various matters such as accounting principles; a plan description; termination priorities; tax status; errors, irregularities, and violations of laws or regulations; loss contingencies; significant real estate or other transactions between the plan and its sponsor, administrator, employer(s), or employee organization; related-party transactions; and unusual, infrequent, or subsequent events. Most, if not all, of these disclosures are required by GAAP, and all are included in the disclosure checklists at EBP-CX-13.1, EBP-CX-13.2, and EBP-CX -13.3.

108.13 **Required Supplemental Schedules**

As discussed in paragraph 108.7, applicable parts of Schedule G must be completed if certain transactions occur, as follows:

- Part I of Schedule G reports loans or fixed income obligations in default or classified as uncollectible.

- Part II of Schedule G reports leases in default or classified as uncollectible.

- Part III of Schedule G reports nonexempt transactions with parties in interest (also called prohibited transactions, these are defined in section 202).

In addition, Schedule H requires the following information to be disclosed in supplemental schedules filed with Form 5500:

- Assets (held at end of year).

- Assets (acquired and disposed of within year).

- Reportable transactions (these are certain transactions, or a series of transactions, as defined at paragraph 610.10, exceeding five percent of the current value of plan assets).

- Delinquent participant contributions (see paragraph 610.10).

Schedule H has very specific requirements for the format, title, and content of these supplemental schedules. Section 610 discusses the schedules, and the disclosure checklists at EBP-CX-13.1, EBP-CX-13.2, and EBP-CX-13.3 summarize their required form and content. As discussed in paragraph 108.26, the auditor is required to report on these supplemental schedules, including Schedule G.

108.14 **Penalties**

The IRS and DOL have the authority to assess civil penalties on plan administrators for failure to file the annual information report in a timely manner. Further, an annual report that has been rejected as incomplete can be treated as not being filed. The penalties generally accumulate on a daily basis, are subject to certain maximums, and may vary with the number of participants. Plan administrators that comply with the DOL's Delinquent Filer Voluntary Compliance (DFVC) Program may be eligible for a reduction or elimination of penalties in certain situations. The DFVC program is discussed further at paragraph 204.60.

108.15 **The “Alternative” versus “Statutory” Method of Complying with ERISA Reporting Requirements**

The reporting described in the preceding paragraphs is called the “alternative method” of financial reporting prescribed by DOL regulations (DOL Reg. 2520.103-1, which is reproduced in Appendix 2A-2). As mentioned beginning in paragraph 108.7, it satisfies all ERISA and IRS reporting requirements, that is, it satisfies the reporting requirements of ERISA, Titles I and IV, and of the IRS. Most plans use this alternative method.

108.16 A “statutory method” can also be followed, but it satisfies only Title IV of ERISA, and is not discussed in this *Guide*. Differences between the two methods include the following:

- The statutory method requires GAAP financial statements, whereas the alternative method allows the cash, modified cash, or GAAP basis.

- The statutory method does not require the statement of assets and liabilities to be comparative, whereas the alternative method does require the statement to be comparative.

- The statutory method requires a comparative schedule of assets and liabilities at current value, whereas the alternative method does not require such a schedule.

- The statutory method requires a schedule of cash receipts and payments, whereas the alternative method does not require such a schedule.

- The statutory method requires the schedule of reportable transactions to report transactions exceeding 3% of the current value of plan assets, whereas the alternative method only requires that schedule to include transactions exceeding 5% of plan assets.

Most plan administrators find that the alternative method of reporting is easier to comply with.

ERISA Disclosures to Plan Participants

108.17 **Summary Plan Description**

ERISA requires employee benefit plans to provide plan participants certain information. A summary plan description (SPD) must be provided within a specified time after a new plan is established, an established plan is amended, a participant enters a plan, or a beneficiary begins to receive benefits. The SPD describes plan provisions and participants' rights under ERISA. Section 203 gives more information on the SPD.

108.18 **Summary Annual Report**

Plan participants and beneficiaries must be given a summary annual report (SAR) annually. It provides information on plan assets, income, expenses, etc. Section 203 gives more information on the SAR.

108.19 **Other Required Disclosures to Participants**

Section 203 discusses other required disclosures to plan participants.

ERISA and DOL Audit Requirements

108.20 ERISA generally requires plans with 100 or more participants at the beginning of the plan year to have an audit of the financial statements. However, there are exceptions to this general rule. For instance, certain plans with 100 to 120 participants may be exempt from the annual audit requirement (see discussion of the 80-120 participant rule at paragraph 204.14). Additionally, some pension plans with less than 100 participants may require an annual audit (see discussion of the *Small Pension Plan Security Amendments* beginning at paragraph 204.16). Also, unfunded or fully insured welfare benefit plans, and retirement plans whose only assets are insurance contracts that fully guarantee the payment of benefits, are exempt from the audit requirement (see paragraph 204.18).

108.21 **DOL Auditor Independence Requirements**

ERISA requires the audit to be performed by an “independent qualified public accountant.” DOL Reg. 2509.75-9, which is reproduced in Appendix 2A-3, prescribes conditions for independence that are stricter, in some respects, than the AICPA's independence requirements. Specifically, the DOL regulation would not allow a CPA or his firm to provide accounting services and also audit the plan's financial statements. AICPA rules provide that performing accounting services does not necessarily impair independence. The independence requirements are discussed in section 401.

108.22 Also, as discussed in paragraph 401.27, whereas the DOL regulations state that an accountant or his firm may provide a plan with actuarial services and remain independent, it is not clear whether independence is impaired if the accountant provides a plan with valuation services, such as valuing its restricted securities. However, DOL officials have expressed concern about plan auditors also providing such services. AICPA rules allow accountants to perform both types of services without necessarily impairing their independence if certain requirements are met. It is not presently clear if, or how, these differences between AICPA and DOL independence requirements will be resolved.

108.23 **DOL Limited-scope Audit**

ERISA, Title I, Section 103(a)(3)(C), and DOL Reg. 2520.103-8 (reproduced in Appendix 2A-2) allow plan administrators to request a limited-scope audit (referred to as a “DOL limited-scope audit” in this *Guide*) of plans with assets held by a bank, similar financial institution (for example, a regulated savings and loan association or credit union), or insurance company that is regulated and supervised and subject to periodic examination by a state or federal agency. AEBP, Paragraph 5.13, indicates that the limited-scope audit exemption does not apply to investments held by a broker or dealer or an investment company. (According to an article in the Journal of Accountancy in June 1996, the limited-scope provision does not apply to mutual fund companies, broker-dealers, and other such entities unless they have set up a separate trust company or other eligible institution that has custody of any related ERISA plan assets.) Such an audit does not cover any information on plan investment assets and related transactions that is prepared and certified to as both complete *and* accurate by the financial institution. The auditor's reports for such an audit typically are a scope disclaimer of opinion on the financial statements and supplemental schedules because of the significance of the portion of the financial statements to which no audit procedures are applied. A limited-scope audit is also allowed if the plan invests in 103-12 investment entities (see paragraph 401.50). This *Guide* is appropriate for either a full-scope or DOL limited-scope audit; the audit programs clearly indicate which procedures would not be performed in a DOL limited-scope audit. [8] Unless the audit programs indicate otherwise, all applicable audit programs and program steps need to be performed in a DOL limited-scope audit. The DOL limited-scope audit is discussed in more detail beginning in paragraph 401.47. Section 706 discusses and illustrates auditor's reports on DOL limited-scope audits.

108.24 **DOL Requirements for the Auditor's Report**

DOL regulations [DOL Reg. 2520.103-1(b)(5)] state that the accountant's report must express an opinion on the accounting principles, and their consistency, used in the financial statements required to be filed with Form 5500. When SAS No. 58 eliminated the consistency reference, the DOL issued a statement that the SAS No. 58 report will meet this reporting requirement. Chapter 7 discusses and illustrates audit reports on financial statements.

108.25 In addition, the report must disclose any matters to which the auditor takes exception, including any exceptions that relate to DOL regulations, and, if practical, the effect on the financial statements. Paragraph 701.22 discusses this requirement in more detail and notes that in a GAAS audit, the auditor's report need not state that the financial statements comply with DOL filing requirements, and recommends an emphasis of a matter paragraph to disclose a departure from DOL regulations that is not also a GAAP departure.

108.26 The auditor also must report on the supplemental schedules listed in paragraph 108.13. Section 705 discusses and illustrates reports on supplemental schedules. Note that the auditor does not report on the schedules to Form 5500 that are listed in paragraph 108.7, except for the Schedule G.

108.27 Section 701 discusses DOL requirements for auditor's reports in more detail.

DOL Concerns about the Quality of ERISA Audits

108.28 The DOL reviews the Forms 5500, financial statements, schedules, and auditor's reports filed with them. All Forms 5500 undergo a computerized line-by-line check designed to identify errors or omissions. If deficiencies are found, the filing is rejected and the plan administrator is notified. The DOL can fine plan administrators civil penalties up to $1,000 per day if the deficiencies are not corrected in a timely period.

108.29 The Employee Benefits Security Administration (EBSA), which is a part of the DOL, reviews workpapers and audit reports of selected plans as part of an ongoing quality review program designed to insure the quality of ERISA audits. If the EBSA believes a substandard audit has been performed, they may reject the plan's Form 5500 filing, which could cause the plan administrator to be assessed a non-filer penalty of up to $300 per day for each day the filing is late, with a maximum annual penalty of $30,000.

108.30 The EBSA has referred some firms to state licensing boards for alleged substandard audits and to the AICPA Professional Ethics Division for further investigation. Disciplinary actions available to the Ethics Division of the AICPA include membership termination or suspension; completion of specified continuing professional education; review by the Division of additional work product, usually after a specified period of time and after completion of the specified continuing professional education; imposition of mandatory independent preissuance review of some or all plan financial statements and auditor's reports; and accelerated peer reviews.

108.31 **EBSA Study of Audit Quality**

As noted in paragraph 108.29, the EBSA has an ongoing quality review program. In January 2004, the EBSA completed a nationwide study involving the onsite review of approximately 300 randomly selected sets of audit workpapers relating to plan year 2000 Form 5500 filings. The EBSA conducted a similar study in 1997, which found that approximately 19% of plan audits failed to meet professional standards. The purpose of the 2004 study was to assess whether the quality of employee benefit plan audits had improved since the 1997 study. EBSA officials have publicly indicated in various forums, including speeches given at AICPA conferences, that the results were disappointing, that the quality of ERISA audits had deteriorated since the 1997 study, and that the deficiencies were spreading to the largest audit firms.

108.32 **Common ERISA Audit Deficiencies**

The following is a discussion of common ERISA audit deficiencies cited by EBSA officials based on the 2004 study and identified in their more recent firm inspections. For each area, discussion of how this *Guide* addresses these issues is also included.

108.33 Audit Programs.

EBSA officials have indicated that in many cases, audits were performed either using no audit programs or using audit programs that were inadequate for auditing employee benefit plans. In some cases, audit programs

for not-for-profit entities were used in lieu of audit programs specifically designed for employee benefit plan audit engagements. Further, EBSA officials indicated in some cases, auditors had appropriate employee benefit plan audit programs but the programs were used incorrectly. For instance, EBSA officials specifically noted it is not sufficient to merely have a set of audit programs in the workpapers. The audit programs must be followed and should be tailored for the particular facts and circumstances of the underlying audit engagement.

108.34 This *Guide* includes separate audit programs for each type of employee benefit plan: defined benefit plans, defined contribution plans, and health and welfare benefit plans. The audit programs, which are located in sections EBP-APDB, EBP-APDC, and EBP-APHW, are specifically tailored to meet the unique requirements of employee benefit plan audit engagements. The audit programs include basic procedures as well as additional procedures that may be warranted on some engagements. Additionally, the audit programs clearly identify those steps required for a DOL-limited scope audit and those for a full-scope audit. The audit programs also include practical considerations designed to provide useful advice that auditors need to consider in applying specific audit steps. As always, the audit programs may be customized to fit the particular requirements of a specific engagement.

108.35 Fraud.

EBSA officials also noted many auditors fail to properly assess the risk of material misstatement due to fraud. AU-C 240, *Consideration of Fraud in a Financial Statement Audit*, provides guidance on the auditor's responsibility to consider the risk of material misstatement of the financial statements due to fraud and to design the audit to provide reasonable assurance of detecting fraud that results in the financial statements being materially misstated. This *Guide* includes practice aids and audit program steps designed to assist auditors in meeting the requirements of AU-C 240. For instance, section 405 of this *Guide* includes an extensive discussion of fraud considerations and of AU-C 240. In addition, the “Understanding the Plan and Identifying Risks” form at EBP-CX-3.1, and the “Audit Program for General Planning Procedures” at EBP-APDB-1, EBP-APDC-1, and EBP-APHW-1, may be used to document the consideration of audit risk, including fraud.

108.36 Internal Controls.

Many auditors also fail to properly document an understanding of internal controls, according to EBSA officials, especially when the auditor is performing a substantive audit. Chapter 4 of this *Guide* discusses audit strategy and internal control. This *Guide* provides the following practice aids that can be used to document the auditor's understanding of internal control, including the evaluation of design and implementation:

a. “Understanding the Design and Implementation of Internal Control” (EBP-CX-4.1).

b. “Financial Reporting System Documentation Form—Significant Transaction Classes” (EBP-CX-4.2.1).

c. “Financial Reporting System Documentation Form—IT Environment and General Computer Controls” (EBP-CX-4.2.2).

d. “Walkthrough Documentation Table” (EBP-CX-4.3).

e. “Activity and Entity-level Control Forms” (EBP-CX-5).

108.37 If the auditor devotes additional attention to control activities because he or she believes an assessment of control risk below the maximum level is appropriate, the auditor will need to perform tests of controls. The authors have designed the following practice aids to facilitate documentation of the performance of tests of controls and the results of those tests:

a. The “Test of Controls Form” at EBP-CX-10.1 can be used to describe tests of controls that are to be performed and the conclusion of the tests.

b. The “Tests of Controls Sampling Planning and Evaluation Form” at EBP-CX-10.2 is used in addition to the “Tests of Controls Form” to document tests of controls that are performed by applying procedures to a sample of documents.

108.38 In addition to the improper documentation of the auditor's understanding of internal controls, the EBSA cited the improper use of a service auditor's report by auditors of employee benefit plans. Specifically, EBSA officials noted that auditors frequently do too little testing when a service auditor's report is obtained. The existence of a valid service auditor's report does not mean the auditor need not perform any tests. That is, obtaining a service auditor's report is often just a starting point, not the final step in testing the transactions performed by the service organization.

108.39 The effect of the use of service organizations on audit strategy is discussed beginning at paragraph 406.73. AU-C 402, *Audit Considerations Relating to an Entity Uing a Service Organization*, specifically applies when an employee benefit plan uses a service organization, such as a bank trust department, to invest and hold plan assets. It gives guidance relevant to the plan auditor's consideration of the effect of a service organization that executes and processes transactions for another entity (the plan) on the plan's internal control in planning the audit and in auditing investments and insurance contracts in trusteed arrangements. It also gives detailed guidance on the plan auditor's considerations in deciding the need for, or desirability of, obtaining a service auditor's report on the controls at the service organization and on the auditor's use of the service auditor's report.

108.40 As discussed at paragraph 406.84, if an auditor deems it necessary or desirable to obtain and use a service auditor's report, the most important step for the auditor after obtaining a copy of the report is to read it in its entirety, including the body of the document that details the individual tests and results. Simply obtaining a copy of the report and placing it in the workpapers by no means constitutes applying sufficient audit procedures.

Audit procedures applicable to service auditor's reports are included in EBP-APDB-4, EBP-APDC-4, and EBP-APHW-4.

108.41 **Using the Work of Specialists**

Many auditors fail to properly perform or document procedures around reliance on the work of a specialist. Specialists may be engaged by either plan management or the auditors, often in valuation, appraisal, and actuarial capacities. In some instances, a specialist may be part of the audit engagement team. Section 408 addresses the use of specialists. In addition, the audit programs at EBP-APDB-1, EBP-APDC-1, and EBP-APHW-1 provide procedures for using the work of a management's specialist, an auditor's specialist, or a specialist on the engagement team.

108.42 **Related Parties and Parties in Interest**

An area of particular concern to the DOL is that of related-party and party-in-interest transactions. Deficiencies that have been noted from recent firm inspections include failure to document related parties and parties in interest, and failure to detect prohibited transactions. Engagement team members need to have a clear understanding of who these parties are in relation to the plan under audit. Section 603 discusses related parties, parties in interest, and prohibited transactions in more detail. EBP-CX-3.1, “Understanding the Entity and Identifying Risks,” provides a space to document related parties and parties in interest during the planning stage of the audit.

108.43 Contributions.

EBSA officials noted several deficiencies in contributions testing based on their recent firm inspections. Specific areas of concern include insufficient testing of elective employee deferrals as well as calculation and allocation of employer matching contributions, and failure to test or challenge the timeliness of remittance of employee contributions by plan administrators. In the 2004 study, EBSA officials noted deficiencies in testing employer contributions in multiemployer benefit plans. Such deficiencies included improper reliance on contribution reports and failure to obtain adequate evidence for contributions by tracing back to records maintained by contributing employers. EBSA officials acknowledge that payroll audits are not required but that such audits are generally their procedure of choice to obtain the necessary audit evidence relating to contributions.

108.44 Section 501 discusses auditing employer or plan sponsor contributions and section 504 discusses auditing considerations for employee contributions. EBP-CX-11.13 is designed to aid in testing the timeliness of remittances. Multiemployer plan contributions are specifically discussed beginning at paragraph 501.16. In addition, the contributions received and receivable audit programs at EBP-APDB-5, EBP-APDC-5, and EBP-APHW-5 provide procedures for auditing employer or plan sponsor contributions received and receivable (with specific procedures relevant to multiemployer plans) including tracing certain amounts to records maintained by the employer or sponsor. The audit programs at EBP-APDB-10, EBP-APDC-10, and EBP-APHW-10 provide procedures for auditing employee contributions (with specific procedures that address multiemployer plans).

108.45 Investments.

The most often cited concern in this area is the misunderstanding and misapplication of the DOL limited-scope audit rules. The two primary deficiencies noted by EBSA officials are the improper reliance on certification of

investments by entities that are not subject to the DOL limited-scope audit provisions and improperly extending the limited-scope to transactions not covered by the limited scope provision.

108.46 As discussed at paragraph 108.23, DOL regulations allow plan administrators to request a limited-scope audit of plans with assets held by a bank, similar financial institution (for example, a regulated savings and loan association or credit union), or insurance company that meet certain requirements. The limited-scope audit provision does not apply to investments held by a broker-dealer or an investment company. (The limited-scope provision does not apply to mutual fund companies, broker-dealers, and other such entities unless they have set up a separate trust company or other eligible institution that has custody of any related ERISA plan assets.) EBSA officials have noted instances where limited-scope audits were performed when the certifying financial institution did not qualify, such as when a certification is obtained from a broker-dealer or an investment company.

108.47 The other deficiency that EBSA officials noted regarding limited-scope audits is the improper extension of the limited-scope to transactions not related to investments and investment transactions. In a DOL limited-scope audit, the auditor does not apply audit procedures to information on plan investment assets and related transactions that is prepared and certified to as both complete and accurate by a qualifying financial institution. However, the DOL limited-scope audit applies only to investment information and does not extend to participant data, contributions, benefit payments or other information, even if certified by the trustee. Audit work must still be performed on these areas. In addition, the scope limitation does not extend to plan investments not certified by a qualified trustee or custodian. For example, real estate and mortgages may not be covered by a certification. In such cases, the plan auditor is required to perform appropriate audit procedures on these assets as would be required in a full-scope audit. The audit programs in this *Guide* clearly identify those steps required for a DOL-limited scope audit and those for a full-scope audit.

108.48 Finally, EBSA officials expressed concern regarding auditing procedures performed on hard to value investments and benefit-responsive investment contracts. They noted that auditors often do not gain a sufficient understanding of a plan's hard to value investments to allow the auditor to understand how the investment was valued and how that valuation is to be audited. EBSA officials caution that book value is not always representative of an asset's fair value. Furthermore, even in a limited scope audit, if an auditor believes an asset's valuation does not seem reasonable, the auditor has an obligation to obtain a further understanding of the asset valuation. Based on that understanding, the auditor may request that the client adjust the asset's value or change the scope of the audit to a full scope engagement. Auditing hard to value investments, such as investments in real estate and limited partnerships, is discussed beginning at paragraph 502.58. In addition, the audit programs for investments and related income at EBP-APDB-7, EBP-APDC-7, and EBP-APHW-7 include procedures for auditing the valuation of investments, including hard to value investments. Benefit-responsive investment contracts are discussed beginning at paragraph 303.9, and related audit procedures are included at EBP-APDB-8, EBP-APDC-8, and EBP-APHW-8 for DOL limited scope audits and at EBP-APDB-9, EBP-APDC-9, and EBP-APHW-9 for full-scope audits.

108.49 Benefit Payments.

EBSA officials noted inadequate audit testing relating to the eligibility of claims to be covered by the plan. The EBSA suggests testing the plan's list of participants eligible for benefits and performing at least some level of detailed testing of benefit payments. The EBSA has noted that benefit payments are either not being tested or

that payment amounts are deemed reasonable based on the results of a simple analytical review. Section 505 discusses benefit payments in detail, and the audit programs for benefit payments at EBP-APDB-11, EBP-APDC-11, and EBP-APHW-11 include procedures for auditing benefit payments, including testing the eligibility and accuracy of payments.

108.50 **Participant Data**

DOL officials have also noted common deficiencies in the area of participant data testing. Specifically, they noted numerous instances of insufficient testing of payroll, demographic data, eligibility, and allocations to participant account. In addition, for defined benefit plans, they noted failures to test the data used in actuarial calculations (i.e., census data testing). Auditing participant data is discussed in detail in section 504, and audit programs are available at EBP-APDB-10, EBP-APDC-10, and EBP-APHW-10.

108.51 Sample sizes.

The EBSA noted that some audit firms reduce their sample sizes used for compliance and substantive testing to extremely low levels. Normally, the EBSA will not comment on the selection of sample sizes since that is generally considered a matter of professional judgment. However, EBSA officials noted that extremely small sample sizes, such as a single item, stand out and may result in the EBSA questioning the propriety of the amount. Section 410 includes a detailed discussion of audit sampling. Additionally, a number of practice aids are included to assist auditors with sampling in an employee benefit plan audit. EBP-CX-8.3, “Sampling Worksheet for Testing Account Coding and Classifications,” provides guidance on selecting a sample when testing the processing of information; EBP-CX-8.2, “Sampling Planning and Evaluation Form—Substantive Tests,” provides guidance on selecting a sample size for a substantive test of an account balance or transaction class; and EBP-CX-10.2, “Tests of Controls Sampling Planning and Evaluation Form,” provides guidance on selecting a sample size when using sampling to test controls.

108.52 Audit Documentation.

The adequacy of audit documentation continues to be an issue. EBSA officials acknowledge this issue is not solely related to audits of employee benefit plans but is an issue for the accounting profession in general. In many audit areas the EBSA noted instances where the mere signoff of an audit step within an audit program is the only evidence of the performance of the underlying audit procedure, such as a program step regarding inquiry of appropriate client personnel that is documented only by the auditor's initials next to the program step. If no additional notation is made in the workpapers regarding the topic of the inquiry, the personnel involved, or the information obtained, the EBSA believes that situation is not acceptable. Further, in their review of audit workpapers, if an audit procedure had not been documented, the EBSA assumed the work had not been performed.

108.53 EBSA officials also caution auditors against signing off on a single audit program step and drawing a line down through the sign off space next to the program steps included on the remainder of the page. The presumption in that situation is that each audit program step subsequent to the step adjacent to the first signoff has been completed. While EBSA officials acknowledge that may not be technically a violation of GAAS, they consider that type of documentation to be questionable and do not consider it to be a best practice.

108.54 Audit documentation is discussed in detail beginning at paragraph 411.10. In addition, several practice aids may be used to document certain procedures and inquiries, such as EBP-CX-3.1, “Understanding the Plan and Identifying Risks.”

108.55 **AICPA EBP Audit Quality Center**

The AICPA continues to work with the DOL on several initiatives to improve the quality of employee benefit plan audits. In 2004, the AICPA created the Employee Benefit Plan Audit Quality Center (the EBPAQC) to promote and improve the quality of employee benefit plan audits. The EBPAQC is a firm-based, voluntary membership center for accounting firms that audit employee benefit plans. According to the AICPA, the EBPAQC will do the following:

a. Create a community of firms demonstrating a commitment to quality in the performance of employee benefit plan audits.

b. Provide comprehensive resources for member firms.

c. Provide information about the activities of the EBPAQC to other stakeholders of employee benefit plans.

d. Increase the awareness of the importance of audits of employee benefit plans.

108.56 Membership in the EBPAQC is only open to audit firms that meet the following specific membership requirements:

a. The firm must specifically designate an audit partner to have firm-wide responsibility for the quality of the firm's ERISA employee benefit plan audit practice.

b. The firm's audit partners that reside in the United States and that are eligible for membership in the AICPA must all be members of the AICPA.

c. The firm must establish a program to ensure all individuals on ERISA employee benefit plan audit engagements possess an appropriate level of current knowledge of applicable professional standards, rules, and regulations for employee benefit plan audits. Also, certain firm personnel are required to complete a minimum number of hours of continuing professional education (CPE) specifically related to employee benefit plans.

d. The firm must establish policies and procedures specific to its ERISA employee benefit plan audit practice to comply with applicable professional standards and EBPAQC membership requirements.

e. The firm must establish annual internal inspection procedures including a review of the firm's ERISA employee benefit plan audit practice by certain qualified individuals. Internal inspection reports related to ERISA employee benefit plan engagements are to be made available to the firm's peer reviewer.

f. The firm must make certain information regarding its most recently accepted peer review publicly available.

g. The firm must have its ERISA employee benefit plan audits that are selected as part of its peer review reviewed by individuals employed by a firm that is a member of the EBPAQC.

h. The firm must periodically file certain information with the EBPAQC regarding the firm and its ERISA employee benefit plan audit practice and agree to make that information available for inspection by the public.

i. The firm must pay dues to the EBPAQC.

j. The firm must comply with any additional requirements that may be established by the Executive Committee of the EBPAQC and approved by the AICPA board of directors.

These requirements have been incorporated into the quality control policies and procedures and/or practice aids included in *PPC's Guide to Quality Control*.

108.57 The EBPAQC includes information and resources practitioners may find helpful in conducting audits of employee benefit plans. Some of the features available through the EBPAQC include an online forum for members to interact and share information; access to AICPA publications regarding employee benefit plans; periodic updates on new developments in employee benefit plan auditing; and other information relating to accounting, auditing, and DOL rules and regulations. The EBPAQC is available on the AICPA website at **http://ebpaqc.aicpa.org**.

108.58 **EBSA Assistance**

The EBSA has implemented various programs designed to help plan sponsors and auditors understand and comply with the reporting and disclosure requirements of ERISA. Interested parties are encouraged to contact the EBSA directly for assistance with ERISA-related accounting and auditing questions. The EBSA may be reached at the following numbers:

Employee and Employer Assistance Hotline	(866) 444-EBSA (3272)
Form 5500 Processing and Filing Help Line	(866) 463-3278
Office of the Chief Accountant	(202) 693-8360

The EBSA's internet site (**www.dol.gov/ebsa**) also provides a great deal of information, including an EBSA organization chart with department leaders and contact information, DOL field offices and phone numbers, current regulatory activities, and other resources.

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[6] All references to Form 5500 in this *Guide* are to the 2012 edition.

[7] The EBSA provides copies of the Form 5500 and related schedules as well as guidance for filing the Form 5500 and related schedules on its website at **www.dol.gov/ebsa**.

[8] In addition, *PPC's Practice Aids for Limited-Scope Audits of Standard 401(k) Plans*, offers a complete set of practice aids (audit programs, checklists, and letters) specifically tailored to DOL limited-scope audits of standard 401(k) plans. To order, or for more information, please call (800) 431-9025 or visit Thomson Reuters at **ppc.thomsonreuters.com**.

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109 Access by Regulators to Audit Documentation

109.1 An Auditing Interpretation at AU-C 9230.01-.15 provides guidance for auditors who are required to provide access or copies of audit workpapers to a regulator. The following summarizes the guidance provided by the interpretation.

a. If the auditor is required by law, regulation, or audit contract to provide access to workpapers to regulators, the auditor may include in the engagement letter an acknowledgment by the client that the workpapers are the property of the auditor but that regulators may be provided access. The audit engagement letters at EBP-CL-1.1 and EBP-CL-1.2 include suggested language that can be used for this acknowledgment.

b. If a regulator has requested access to workpapers pursuant to law, regulation, or audit contract, the auditor may:

(1) Consider notifying the client that a regulator has requested access (and in some cases copies of) the workpapers and the auditor intends to comply with the request.

(2) Make the necessary arrangements for the review with the regulator.

(3) Maintain control over the original workpapers. [9]

(4) Consider submitting a letter to the regulator prior to allowing access that:

(a) States the auditor's understanding of the purpose for which access has been requested.

(b) Discusses the audit process and the limitations inherent in an audit of the financial statements.

(c) Discusses the purpose for which the workpapers were prepared and explains that any individual conclusions must be read in the context of the auditor's report on the financial statements.

(d) Communicates that the audit was not planned or conducted contemplating the purpose for which access is being granted or to assess the client's compliance with laws and regulations.

(e) Communicates that workpapers and the audit should not substitute for other inquiries and procedures that should be performed by the regulator for its purposes.

(f) Requests confidential treatment under the Freedom of Information Act or similar laws or regulations when a request is made for the workpapers and that the auditor be notified in writing before any information contained in the workpapers is transmitted to others, including other governmental agencies, unless such transfer is required under law or regulation.

(g) Requests that if any copies are to be provided by the auditor, they will be identified as “Confidential Treatment Requested by [CPA Firm's Name, address, and telephone number].”

EBP-CL-16.1 and EBP-CL-16.2 present example letters the auditor can use to communicate the above information to the regulator.

c. If the auditor has been requested to grant access to workpapers by a regulator and the auditor is not required by law, regulation, or audit contract to provide such access, the auditor may wish to consult with his or her legal counsel regarding the request. In addition, the auditor needs to obtain the client's consent, preferably in writing, before granting access to the regulator.

109.2 The interpretation also provides guidance to auditors who have been requested to provide access to workpapers before the audit is complete and the report has been issued. In addition, the interpretation notes that the auditor may obtain an acknowledgment from the regulator that any third parties acting on behalf of the regulator, such as another CPA firm, are bound by the same restrictions on disclosure and use of the information in the workpapers as the regulator. The authors understand that ERISA, Section 504, gives DOL access to the audit documentation for an audit filed for the purposes of complying with ERISA.

109.3 The interpretation does not apply to requests from the IRS; practice-monitoring programs to comply with AICPA or state professional requirements (such as peer reviews); or proceedings relating to the alleged ethics violations or subpoenas.

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[9] Regulatory authorities are generally willing to accept copies of audit workpapers provided all audit notations are clearly reflected on the copy. Criminal investigative agencies, however, generally want the original workpapers, and auditors need to retain a copy for their own use.

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