

Employee Benefit Plan Audit Quality Center



Defined Benefit Plan Audits Live Forum

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Presenters



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Moderator



Marilee Lau, CPA
Chair
EBPAQC Executive
Committee

Objectives


- 
- **History of Defined Benefit Plans (DBP)**
 - Accounting Pronouncements
 - Types of Plans
 - **Actuarial Basics**
 - **Accounting and Financial Reporting for DBP**
 - **Unique Auditing Issues**
 - **Questions and Answers**

Background



Carl Kampel
Partner
Ellin and Tucker,
Chartered

Defined Benefit Plans Definition

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- **FASB ASC 960-10-05-4: Defined benefit pension plans provide a promise to pay to participants specified benefits that are determinable and are based on such factors as age, years of service, and compensation.**
 - **How do they work**
 - **Who is involved**
 - **What are the different types of plans**

How Do They Work



- **Provide benefits that are defined in terms of a percentage of final average compensation or career average compensation, or as a flat dollar per year of service.**
- **These future benefits are funded by the employer.**
- **Minimum funding contributions as required by ERISA are determined annually using actuarial assumptions**
- **Various benefit payment options are available to participants such as lump sum payment, life annuity and survivor annuity**

How Do They Work




- **Subject to the rules and regulations of ERISA, IRS, DOL, and PBGC**
- **Premiums must be paid annually to the Pension Benefit Guaranty Corporation (PBGC)**

Who's Involved



- **Trust Company /Custodian**
 - May manage investments, keep records, distribute payments to participants, and perform other fiduciary functions
- **Actuary**
 - Provides an annual valuation and review of the plan in accordance with **Generally Accepted Actuarial Principles and Practices**
- **Independent Auditor**
 - Performs an audit of the plan
 - Review actuarial report, including assumptions in accordance with **SAS 73 (Using the work of a specialist)**
- **Plan Sponsor**

Traditional Plans

- 
- **Traditional retirement plans have been maintained by companies for many years**
 - **Employees were paid a defined benefit, usually based on their earnings and the plan usually invested the plan assets in marketable securities**
 - **More recently, significant amounts of plan assets have been invested in alternative investments in the hope of getting better investment returns and plans have been modified in an attempt to reduce overall costs**

Cash Balance Plans



- **Maintains hypothetical accounts for participants**
- **Employer credits participants' accounts with a certain number of dollars each plan year and promises earnings at a specified rate**
- **Interest is credited to the account balances annually at a stated rate**
- **Interest rate credited is often different from the plan's actual investment rate of return**
- **Interest rate to be credited can be changed year to year, if the employer properly amends the plan prior to the beginning of the year and complies with the notice requirements of ERISA**

Cash Balance Plans



- **Advantage for participants is that they bear no investment risk**
- **Employer assumes investment risk that the plan's actual rate of return will fall below the stated rate of return.**

Pension Equity Plans

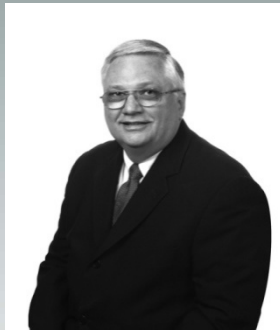
- **Has the advantages of a cash balance plan, but the benefit formula is similar to a final pay program rather than a career average cash balance program**
- **Participant is credited with “points” based on age, service or both**
- **Upon termination a participant’s final average compensation is multiplied by their accumulated points to determine the account balance**

Multiple Formula Plans



- **A voluntary contributory-defined benefit cash balance plan that provides for pension and death benefits.**
- **Differences between a cash balance plan and a multiple formula plan**
 - **Contributing employees – employees who elect to participate must contribute a certain % every year**
 - **The plan also allows for eligible non-contributing employees to participate in the Plan and receive a reduced rate of benefit accrual**
 - **Employer may “match” the contributing and non-contributing participants at different rates or not at all**

Actuarial Basics



**Raymond Berry, ASA,
EA**

**Senior Manager and
Consulting Actuary
Grant Thornton LLP**

Types of Defined Benefit Plans




- **Single employer – one plan, one sponsor**
- **Multiple employer – “one plan”, several sponsors**
- **Multiemployer plans – one plan, “union sponsor”**
- **Single and Multiple – PPA changed funding rules**
- **Multi – Minimal funding changes, data issues**

Actuarial Valuation Reports




- **Minimum required contributions**
- **Maximum deductible contributions**
- **Annual year-end disclosures for corporate statements**
- **Sometimes various combinations of these**

Actuarial Valuation Reports

- 
- **Present value of accumulated benefits (PVAB) (FASB ASC Topic 960 or FAS 35) usually included with required minimum contribution report**
 - **Particularly for 2008 plan years, review assumptions used for PVAB. PPA 3-tiered rates are not acceptable**
 - **Do not confuse assumptions with PPA funding rates, or corporate financial valuations**

Interest Rate Used for Determining PVAB

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- **Ongoing plan basis – (ASC 960-20-35-35-1)**
 - “old” funding rate
 - Similar to expected ROA for FAS 87
 - **Settlement basis – (ASC 960-20-35-35-1A)**
 - Similar to discount rate for FAS 87
 - Likely to change each year
 - **Change from one method to the other is change in accounting. Preferability standard**

PPA Funding



- **Target Normal Cost plus 7 year amortization of funding target less assets**
- **Larger cushion for maximum deductible**
- **Many additional details**
- **Multiemployer plans similar to pre-PPA**

PPA Benefit Restrictions



- **Funded percentage less than 80%**
 - Only ½ of lump sum payable
 - No amendments increasing benefits
- **Funded percentage less than 60%**
 - No lump sums payable
 - Future benefit accruals frozen
- **Funded percentage determined by Enrolled Actuary**

PPA Benefit Restrictions



- **For multiemployer plans there are funding zones – based on funded percentage and other conditions**
- **Different benefit restrictions also apply for significantly underfunded multiemployer plans**

PPA Miscellaneous

- **Actuarial certifications of funding percentage may be required more frequently (for calendar year plans: April 1 and October 1)**
- **Annual funding notice replaced SAR (for PBGC covered plans). Need a cover letter to fully explain**
- **Form 5500 Schedule B has become**
 - **Schedule SB**
 - **Schedule MB**

Reporting & Disclosure



Heidi LaMarca
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Standard Full-Scope Auditor's Report General Considerations

- **Language modified based on date of actuarial valuation**
- **Beginning of Year Valuation**
 - **Opine on net assets in current year and financial status in prior year**
 - **Include comparative statements of changes**
- **End of Year Valuation**
 - **Opine on financial status in both years**
 - **Comparative statements of changes not required**

Standard Full-Scope Auditor's Report Actuarial Information Considerations



Actuarial information presented in notes (versus primary financial statements)

- Scope paragraph of auditor's report should only refer to the financial statements presented**
- Opinion paragraph would still refer to financial status**

Minimum Financial Statement Presentation Requirements



<i>Financial Statements</i>	Minimum Presentation Requirements	
	<i>Beginning of Year Benefit Information Date</i>	<i>End of Year Benefit Information Date</i>
Statement of net assets available for benefits	Comparative	Comparative
Statement of changes in net assets available for benefits	Comparative	Single
Accumulated plan benefits (in the notes or in separate financial statements)	Single	Comparative
Changes in accumulated plan benefits	Single	Single

Accumulated Plan Benefits (APB)



- **Include benefits for:**
 - Retired, terminated employees
 - Beneficiaries of deceased employees
 - Current employees
- **Exclude benefits guaranteed through allocated insurance contracts**
 - Not considered a Plan liability

Accumulated Plan Benefits (APB)



- **Include the following classifications:**
 - **Vested benefits of participants currently receiving benefits**
 - **Other vested benefits**
 - **Nonvested benefits**


Accrued Liabilities



- **Amounts owed for securities purchased**
- **Liability to return collateral under securities lending arrangement**
- **Income taxes payable by the Plan (UBIT)**
- **Other expenses (i.e. third party administrative fees)**

Note: Benefit amounts should NOT be accrued as liabilities

Footnotes Overview

- 
- **Description of Plan**
 - **Summary of Accounting Policies**
 - **Funding Policy**
 - **Plan Termination and PBGC matters**
 - **Investments and FASB ASC 820 (SFAS 157)**
 - **Tax Status**
 - **Risk and Uncertainties**
 - **Other**

Footnotes

Description of Plan



- **General Information**
- **Description of plan provisions**
 - **Eligibility**
 - **Benefit provisions**
 - **Vesting**
- **Plan amendments**

Footnotes

Summary of Accounting Policies



- Basis of accounting
- Use of estimates
- Investment valuation & income recognition
- Actuarial present value of accumulated plan benefits
- Payment of benefits

Summary of Accounting Policies

Actuarial Present Value (PV) of Accumulated Plan Benefits (APB)

- **Significant assumptions**
- **Disclose impact of:**
 - **Amendments**
 - **Assumption changes**
 - **Changes in nature of the plan**

Matrix for Recognition of Plan Amendments



<i>Effective Date</i>	<i>Amendments Adopted</i>	
	<i>within reporting year</i>	<i>after the reporting year</i>
<i>Effective date within the reporting year</i>	Effect of amendment should be included in the actuarial present value of accumulated plan benefits presented as of the end of the reporting year ⁴	Effect of amendment should not be included in the actuarial present value of accumulated plan benefits presented as of the end of the reporting year ⁵
<i>Effective date after the reporting year</i>	Effect of amendment should be included in the actuarial present value of accumulated plan benefits presented as of the end of the reporting year ⁶	Effect of amendment should not be included in the actuarial present value of accumulated plan benefits presented as of the end of the reporting year ⁷


Footnotes Funding Policy

- **Description of Company's funding policy (e.g., make the necessary contributions to meet minimum funding requirements) and any changes therein**
- **Whether voluntary employee contributions are required or permitted (and how determined)**
- **Whether the plan was in compliance with applicable ERISA minimum funding requirements**
- **Disclosures for plans not meeting PPA minimum funding requirements**

Accounting For Contributions

- **GAAP accrual for sponsor is actuarially determined**
 - **ERISA sets minimum required contribution and IRC sets deductible contribution**
- **Plan recognizes amount sponsor is committed to fund**
 - **Employer contributions are due by the filing of the corporate tax return**

Accounting For Contributions

- 
- **Contributions receivable (FASB ASC 960-310-25-2) - amounts due to the Plan as a result of legal or contractual obligations or formal commitment. See Actuarial report, Schedule SB or MB, minutes and corporate tax deduction**
 - **Consider estimated uncollectible amounts**

Minimum Funding Waivers



- **Record minimum required contribution that is not received within the statutory funding deadline**
- **Include allowance for estimated uncollectable amounts**

Footnotes

Plan Termination and PBGC Matters

- **Whether company intends to terminate the plan**
- **Company's rights under the plan (e.g., to discontinue contributions at any time and to terminate the Plan subject to the provisions set forth in ERISA)**
- **How plan assets would be distributed in the event of plan termination (including PBGC priorities)**

Footnotes

Investments & FASB ASC 820 (SFAS 157)




- **5% Investments**
- **Realized and unrealized appreciation- segregate by type of asset**
- **Fair Value Measurements (FASB ASC 820)**
- **Contracts with insurance companies (as applicable)**
- **Limited scope audits – identify any information not certified**

Contracts with Insurance Companies

- **Common types**
 - **Deposit administration (DA)**
 - **Immediate participation guarantee (IPG)**
- **Should be valued at fair value (limited exception for certain old contracts) and relevant contract terms disclosed**
- **Nature of funding arrangement affects accounting-allocated vs. unallocated**

Footnotes Tax Status

- 
- **Disclose whether or not a favorable ruling has been made:**
 - **Determination letter for DB plans**
 - **Modify if potential qualification errors have been detected**

Footnotes


Risks and Uncertainties



- **Risk of changes in investment values**
- **Risk of changes in actuarial assumptions**
 - **Affects obligations**
 - **Affects funding requirements**

Footnotes

Reconciliation to Form 5500

- 
- **Identify differences in net assets**
 - **Common differences stem from:**
 - **Difference in basis of accounting**
 - **Benefits payable**
 - **401(h) accounts**
 - **Not a requirement to reconcile every line item**


Footnotes

Related Parties / Parties-In-Interest

- **Significant related party transactions should be disclosed in accordance with FASB ASC 820**
- **Nonexempt transactions:**
 - **Could give rise to significant receivable**
 - **Consider disclosure requirements of FASB ASC 450, Accounting for Contingencies (if material)**
 - **Report on supplemental schedule (regardless of materiality)**



Footnotes Other Disclosures

- 
- **Master trust investments**
 - **Securities lending arrangements**
 - **Derivatives**
 - **401(h) accounts**

401(h) Accounts


- **Assets used for welfare benefits, but held by defined benefit plan**
- **Reporting governed by FASB ASC 965-205-05**
- **Defined benefit plan**
 - **Disclosure describing the account**
 - **Separately identify assets with a related obligation**
- **Health and welfare plan**
 - **Separately identify assets held by pension plan**
 - **Disclose details of investments and activities in footnotes**
- **Requires reconciliation footnote – investment and activities reported on DB Form 5500**

Other Special Considerations




- **Plan Freezes**
- **Mergers**
- **Terminations**
- **Spin-offs**

Plan Terminations

- 
- **Potential subsequent event**
 - **Liquidation basis of accounting**
 - **Disclose change in basis and impact on net assets**
 - **Requires full vesting**
 - **Partial plan terminations:**
 - **Also require full vesting**
 - **Do not change to liquidation basis of accounting**

Supplemental Schedules

- 
- **Format defined in Form 5500 instructions**
 - **Attach only required schedules**
 - **Most common schedules**
 - **Schedule of Assets Held (at end of year)**
 - **Schedule of Reportable Transactions**
 - **Schedule of Nonexempt Transactions**

Common Pitfalls

Reports

- Full-GAAS DB plan audit report without financial status references
- Opinion does not cover proper periods

Financials

- Vested benefits not broken down between those receiving payments and other participants
- Benefits paid per stmt of changes in NAs does not agree to amount per applicable stmt of changes in accumulated plan benefits


Footnotes

- No funding deficiency f/n
- FAS 87 info presented vs. FAS 35
- Disclosure of assumptions relevant to FAS 35 obligation calc
- Plan freeze not adequately disclosed

Schedules

- No reportable transactions schedule when required
- No identification of parties-in-interest
- Historical cost info not disclosed for non-participant directed investments

Resources Available to You

- 
- **AICPA Audit and Accounting Guide, *Employee Benefit Plans*, with conforming changes as of March 1, 2009**
 - **AICPA Audit Risk Alert *Employee Benefit Plans Industry Developments – 2009***
 - ***Accounting Trends & Techniques – Employee Benefit Plans***
 - **Journal of Accountancy - January 2009, *Plan Design in the Balance***
 - **EBPAQC Primer, *Cash Balance Plans*, issued February 2007**
 - **AICPA Checklists and Illustrative Financial Statements for DB plans**

Unique Auditing Issues



Alice Wunderlich
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What Can Go Wrong? (Significant Risks)



Bad census data

Benefit payment errors

Going concern

Cash balance plan

lack of records to test benefit payments

Frozen plan

lack of records to test census data and
benefit payments

First year audit



Use of Specialist - Actuary



AU section 336 of AICPA professional standards:

- **evaluate professional qualifications of specialist**
- **obtain understanding of specialist's work**
- **evaluate relationship of specialist to client**
- **use the findings:**
 - **Methods and assumptions used**
 - **Test the data used by actuary**

Census Data What Can Go Wrong?

- ✓ Census omitted participants in one location
- ✓ Incorrect classifications as active, deferred vested or retired
- ✓ Deceased participants included in census data
- ✓ Missing participant census data for acquired company – actuary estimates
- ✓ Company gave wrong file to actuary
- ✓ Demographic data is wrong (wrong hire date, date of birth, salary, gender)
- ✓ Actuary gave wrong file to auditor (partial or preliminary file, wrong year)

Benefit Payments

- **Annuity (monthly) payment**

- Applying the benefit formula
- More than one benefit formula
- Testing the inputs (e.g., years of service, compensation, benefit rate)

Benefit Payments



- **Lump-sum payment**
 - Methodology
 - Inputs: discount rate, years of service, age, mortality

Benefit Payments



- **Cash Balance Plan**

- Balance is built up each year:

- Beginning balance

- + service credit

- + interest earned on balance

- = Ending balance

Going Concern



What conditions and events may raise **substantial doubt** about the ability of an employee benefit plan to continue as a going concern?

✓ Plan sponsor's ability to continue the plan.

If the plan sponsor goes away, the plan will ultimately go away or be taken over by the PBGC.

Going Concern Considerations for EBPs



If opinion on plan sponsor financial statements has a going concern uncertainty paragraph, the report on the plan's financials might also.

Going Concern Considerations for EBPs



Audit situations:

- We audit plan sponsor which is a public company
- We audit plan sponsor which is not a public co.
- We don't audit the plan sponsor
- Multiemployer plan
- Benefit plan audit report issued up to 9.5 months after year-end

Frozen Plan Audit Strategy



- **Roll-forward of census data showing changes from prior year**
- **Test only the changes (for both inclusion and exclusion)**

First Year Audit



- **You are the successor auditor for a plan frozen in 1990.**
- **How to test census data?**


Question & Answer Session



Please submit questions



EBPAQC Upcoming Events

- 
- **August 27 – *Understanding Actuarial Valuations and Their Unique Issues Live Forum***
 - **November 12 – *403(b) Plan Audits Update Live Forum***

AICPA Upcoming Events



- **December 7 - 8, AICPA *Employee Benefit Plans Accounting, Auditing and Regulatory Update Conference*, Washington, DC**

Evaluation



We welcome your feedback on today's live forum

Please complete the online evaluation

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Thank you!!!

Employee Benefit Plan Audit Quality Center

Thanks for Participating!