Advanced Auditing for Defined Contribution Retirement Plans
## Advanced Auditing for Defined Contribution Retirement Plans

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Introduction and Overview
Assessing the Quality of Employee Benefit Plan Audits

Office of the Chief Accountant (OCA) of the EBSA
- Selected statistical sample of 400 EBP audits from the 2011 Form 5500 filing database.
  - 232 CPA firms

Results released May 2014, *Assessing the Quality of Employee Benefit Plan Audits*
- 61 percent fully complied with professional auditing standards or had minor deficiencies
- 39 percent had one or more major GAAS deficiencies
  - Rejection of the Form 5500 filing
- 17 percent audit reports failed to comply with one or more of ERISA’s reporting and disclosure requirements
Assessing the Quality of Employee Benefit Plan Audits (continued)

► **Clear link:**
  - Number of EBP audits performed by CPA firms and quality of work performed
  - EBP-specific training contributed to better work
  - Members of the EBPAQC produced audits with fewer deficiencies

► **Audit areas with more frequent deficiencies were areas unique to EBPs:**
  - Contributions
  - Benefit payments
  - Participant data
  - Party in interest/Prohibited transactions
Advanced Auditing for Defined Contribution Retirement Plans Course

► **Primary goal:**
  • To support an EBP auditor’s ability to demonstrate an understanding of, and effectively apply the guidance on accounting, auditing and reporting on the financial statements of EBPs

► **Prepare for Advanced DC Plans Audit Certificate**

► **Advanced course**
Knowledge Check 1

1. In its 2014 report, “Assessing the Quality of Employee Benefit Plan Audits,” the EBSA NOT find a clear link between?
   a. The number of EBP audits performed by a CPA and the quality of the work performed.
   b. The number of professionals assigned to an audit engagement had a direct correlation to the number of deficiencies noted. Audit engagements with five or more professionals assigned had fewer deficiencies.
   c. EBP-specific training contributed to better audit work.
   d. Firm members of the Employee Benefit Plan Audit Quality Center (EBPAQC) of the AICPA tended to produce audits with fewer deficiencies.
Chapter 1: Defined Contribution Retirement Plan Advanced Overview
Learning Objectives

▸ Recall unique characteristics of DC plans.

▸ Contrast different features of DC plans.

▸ Interpret regulatory requirements for DC plans.
Types of DC Plans

- Profit Sharing Plans
- 401(k) Plans
- 403(b) Plans
- Stock Bonus Plans (includes ESOPs)
- Money Purchase Pension Plan
- Simple 401(k) Plans
- 457 Plans
Types of Contributions to a 401(k) Plan

- Elective pre-tax
- Voluntary after-tax
- Employee catch-up
- Employer matching
- Non-elective
- Roth
- Rollover
1. **What are some common examples of contributions to 401(k) plans?**

   a. Employee voluntary, employer matching, employer involuntary.
   b. Employee catch-up, Roth, employee after-tax.
   c. Profit-sharing plans, employee stock ownership plans, 403(b) plans.
   d. IRA, Roth, employee after-tax.
2. Which type of plan contains aspects of both defined contribution and defined benefit plans?

a. 403(b).
b. ESOP.
c. Money Purchase.
d. Profit Sharing
The Plan Document

- Established and maintained by plan sponsor
- ERISA plans are required to be in writing
- Written plan document includes:
  - Eligibility
  - Contributions
  - Distributions (including loans and hardships)
  - Vesting
  - Participant loans
  - Required Contributions
  - Operation and administration
  - Plan fiduciaries and fiduciary duties, including the identification of a plan administrator
Basic types:

- Individually designed
- Prototype
  - Standardized
  - Adoption agreement
  - Nonstandardized
- VolumeSubmitter

IRS tax determination letter
The Plan Document (continued)

- Eligible Compensation
  - IRC definitions of compensation
    - Section 415(c)(3)
    - Section 414(s)
  - Annual IRS limits on compensation

- Required Contributions
  - 403(b) plans
  - Money purchase pension plans

- Vesting
  - 3 year cliff
  - 6 year graded vesting
Direct Filing Entities

- **Master Trust Investment Account (MTIA)**
  - Common control
  - Regulated financial institution

- **Common Collective Trust (CCT)**

- **Pooled Separate Account (PSA)**

- **Group Insurance Arrangement (GIA)**

- **103-12 Entity**
Single, Multi-, and Multiple Employer Plans

► **Single employer plan**
  - Maintained by one employer or one employee organization
  - Includes plan of a controlled group or common control

► **Multiemployer plan**
  - More than one employer is required to contribute
  - Plan is maintained pursuant to one or more collective bargaining agreements between one or more employee organizations and more than one employer
  - Plan sponsor is a joint employer or union board of trustees

► **Multiple employer plan**
  - Not collectively bargained
  - Allow participating employers to pool assets for investment purposes and to reduce cost of plan administration.
Unique DC Plan Considerations

See Exhibit 1-1
4. What is the annual 401(k) employee deferral limit for 2015 and 2016?

a. $16,500
b. $17,000.
c. $17,500.
d. $18,000.
Fidelity Bonding

- ERISA section 412 requires plan officials to be bonded unless covered by an exemption
- Required to be bonded for at least 10 percent of the amount handled but not $1,000.
- Maximum amount required is $500,000 per plan official or $1 million per plan official if plan holds employer securities.
- Differs from fiduciary liability insurance
- Certain exceptions to the requirement.
SEC Form 11-K

- Filed annually for plans that offer participants the option to purchase employer securities that are registered under the Securities Act of 1933.
- Issuers
- PCAOB Auditing Standards
Summary: Chapter 1—Defined Contribution Retirement Plan Advanced Overview

Many concepts and information will be expanded upon throughout the course

Recommended participants consult the following:

- Audit and Accounting Guide Employee Benefit Plans, January 1, 2016 (the guide)
- ERISA Rules and Regulations and Interpretive Bulletins
- IRC and associated IRS Publications

Also consult appendix B for a listing of additional Internet resources.
Audit Exercise 1-1: Overview

- As we get ready to begin chapter 2, review the Plan Summary Document (appendix C) for the XYZ 401(k) and Profit Sharing Plan.
- As advanced EBP auditors, you should be able to review this document, garner key information, formulate questions requiring follow up and identify missing information.
- Prepare a planning document that includes key information about the XYZ Company 401(K) and Profit Sharing Plan. Also prepare discussion points that include follow up questions and missing information for the client contact.
- Document your responses on the enclosed working paper.
Chapter 2: Planning and General Audit Considerations
Learning Objectives

- Interpret professional standards related to engagement acceptance, planning and quality control for a DC plan audit.
- Assess the scope of a DC plan audit.
- Formulate an engagement letter and communications with those charged with governance for a DC plan audit.
Planning Overview

- **EBP audit must be planned in accordance with Professional Standards**
  - AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with Generally Accepted Auditing Standards*

- **Main components of planning include:**
  - Client acceptance and continuance
  - Establishing an understanding with plan management regarding the scope of the engagement
  - Obtaining an understanding of the plan’s operations and control environment
  - Assessing and responding to the risk of material misstatement
  - Developing an overall strategy
  - Documenting the strategy in a written audit program
Quality Control Standards

Statement on Quality Control Standards No. 8, A Firms’ System of Quality Control

- AICPA, Professional Standards, QC section 10
- Firm’s responsibilities

Client acceptance and continuance

- Firm competency
  - Ability to effectively gain the necessary competencies before undertaking an EBP engagement.
  - Industry specific CPE
  - EBPAQC membership CPE requirements
Knowledge Check 1

1. What is the commonly used financial reporting framework for EBP financial statements other than GAAP?

   a. Tax.
   b. Accrual.
   c. Modified cash.
   d. ERISA.
Independence Examples

- Independence is *not* impaired when the firm’s tax department prepares the Form 5500 filing.
- Independence is impaired when the firm’s HR advisory group calculates the participant allocations and prepares participant statements.
- Independence is *not* impaired solely because the firm prepares the actuarial valuation of the sponsor’s plan benefit obligation based on assumptions provided by the sponsor.
Nonattest Services

▸ AICPA Professional Ethics Executive Committee (PEEC)

• “Nonattest Services” interpretation under the independence rules
• Financial statement preparation, cash to accrual conversions, and reconciliations are considered nonattest services.
• Independence would not be impaired provided certain requirements are met:
  - The client has assumed all management responsibilities.
  - The client properly oversees the service.
  - The client evaluates the adequacy and results of the service.
  - The client accepts responsibility for the service.
Nonattest Services (continued)

- Engagement letter

- Effective for engagements covering periods beginning on or after December 15, 2014.
Knowledge Check 2

2. Which nonattest service has been clarified by the AICPA Professional Ethics Executive Committee?

b. Compilation.
c. Form 5500 preparation.
d. Search for unrecorded liabilities.
Audit Scope

► Full-Scope

► Limited-Scope
  • Pursuant to exemption allowed under DOL rules and regulations.
  • Scope may be limited for reasons other than DOL exemption
    - Qualified or standard disclaimer of opinion

► Form 11-K
  • Only a full-scope audit can be performed
Audit Exercise 2-1

1. Using your experience auditing DC plans, prepare a list of instances where audit scope may be limited for reasons other than the DOL limited-scope exemption.

2. Share your results with the class.
ERISA Limited-Scope Audit

- Election made by plan management
- Instruct auditor not to perform any auditing procedures with respect to investment information prepared and certified by:
  - A bank
  - Similar institution (for example, trust company)
  - Insurance carrier that is regulated, supervised and subject to periodic examination by a state or federal agency
- Qualifying institution certifies
  - Accuracy AND
  - Completeness
- DOL reporting and disclosure rules
  - 29 CFR 2520.103-8
ERISA Limited-Scope Audit

**Auditor responsibilities:**

- Obtain and read the certification.
- Determine if the entity that issued the certification is eligible to provide a certification under DOL regulations.
- Compare the information certified with the financial information contained in the plan’s financial statements.
- Perform procedures necessary to become satisfied that any amounts received or disbursed that were reported by the certifying institution as trustee or custodian were determined in accordance with the plan’s provisions.
- Determine whether the form and content of the financial statement disclosures related to the certified investment information is in conformity with GAAP and in compliance with DOL rules and regulations.
- Evaluate the adequacy of disclosures related to investments and investment activity.
  - Accordingly, fair value disclosures are often overlooked when evaluating the adequacy of disclosures.
The Engagement Letter

- **AU-C section 210, Terms of Engagement (AICPA, Professional Standards)**
  - Requirement for written understanding with the client
  - Engagement letter
  - Summarizes:
    - Objectives of the engagement
    - Client's responsibilities for the audit and the financial statements, including any supplemental schedules
    - Auditor's responsibilities for the audit and the financial statements
    - Limitations of the engagement
  - See participant materials for “Items to Note Regarding the Engagement Letter”
Other Planning Considerations

Communication with those charged with governance.
- AU-C section 260
- Overview of the planned scope and timing of the audit

Those charged with governance for an EBP:
- Named trustees of the plan
- The board of directors of the plan sponsor
- The benefits, human resources or similar committee of the board of directors of the plan sponsor
- Senior management of the plan sponsor
- The named plan administrator
- Other designated responsible party
Other Planning Considerations (continued)

► Communication with those charged with governance.
  • Overview of the planned scope and timing of the audit
  • Identification of those charged with governance may require discussion with a client contact.

► Coordination of Plan Sponsor and Plan Audits
  • Efficiencies and coordination of payroll testing

► Initial Audit Procedures
  • AU-C section 510, *Opening Balances—Initial Audit Engagements, Including Reaudit Engagements* (AICPA, Professional Standards)
  • Opening balances
  • Accounting policies
  • Completeness of participant data
  • Successor auditor procedures
Considerations for payroll and demographic data
Use of internal auditors
Involvement of specialists
Financial reporting process
Communication and coordination with parties involved in plan administration
Related party and party in interest transactions
Consideration of laws and regulations and prohibited transactions
Accounting estimates
Planning materiality
Planning is an ongoing process for which decisions are reviewed and updated during the course of the audit.

Consideration of internal control and risk assessment are two integral pieces of planning that will be addressed in chapter 3.

Audit teams must remember that planning can not be sacrificed in an EBP audit.

Not only is proper planning required by GAAS, it is the first step towards performing a quality audit.
Chapter 3: Risk Assessment and Internal Control in an Employee Benefit Plan Audit
Learning Objectives

- Formulate audit risk assessments for a DC audit at the financial statement line item and the assertion level.
- Assess the control environment of a DC plan through analytics, inquiry and observation including the portion of the control environment that is at a service organization.
- Evaluate the risk of fraud in a DC plan.
Audit Risk Assessment

- Integral piece of the planning process
- EBP auditors obtain audit evidence to draw reasonable conclusions on which to base their opinion by performing the following:
  - Risk assessment procedures
  - Further audit procedures that comprise:
    - Tests of controls
    - Substantive procedures
  - Defines risk assessment procedures
Audit Risk Assessment (continued)

- Document sufficient information about the risks facing the plan in order to design appropriate responses.

- **Factors to consider:**
  - Complexity of the plan’s operation and design
  - Significance of related party and party in interest relationships and transactions
  - Extent of outsourcing
  - Recent plan transactions including mergers and service providers changes
  - Oversight by the audit committee, board of directors or others charged with governance
  - Experience and competency of key plan management including turnover
Consider the following circumstances (see participant materials) for the XYZ 401(k) and Profit Sharing Plan (the Plan).

- Information was obtained through inquiry with the plan administrator.

Then, document the EBP audit team’s risk assessment decisions for contributions and contributions receivable using the template provided.

- Risk assessment should be documented at the financial statement line item and the assertion level.
- You may also need to consult, appendix C, Plan Summary Document, and appendix D, prior year audited financial statements, audited by other auditors, to help with the risk assessment.

Also, discuss the potential effect(s) on the audit plan of the risk assessments.
Understanding the Entity and Its Environment, Including Its Internal Control

To assess the risk of material misstatement whether due to fraud or error and design further audit procedures

- Important aspect is the consideration of fraud risk.
- Procedures include:
  - Inquiries of management and others within the entity
  - Analytical procedures
  - Observation and inspection
- Consider extent of outsourcing.
Inquiries of Management and Others Within the Entity

**Extend inquiries beyond HR department:**
- Corporate treasury
- Finance
- Payroll
- Benefits committee
- Others charged with governance
- ERISA counsel
- Service Providers
Audit Exercise 3-2: Inquiries of Management

When meeting with plan management and other identified plan personnel, what types of inquiries can be made regarding the following:

- Eligibility
- Participant Data
- Contributions
- Distributions
- Forfeitures
- Participant Loans

Document your responses.
Analytical Procedures

During planning, used to assist in planning the nature, timing and extent of auditing procedures that will be used to obtain audit evidence for specific account balances and classes of transactions.

Preliminary analytical procedures include:

- Year to year comparison
- Ratios
- Trend analysis
- Benchmark comparisons

See participant material for example preliminary analytics that can be performed for a DC plan.
Operating Effectiveness of Controls

Testing the operating effectiveness of controls differs from obtaining an understanding of and evaluating the design of controls.

- Appendix B of the 2016 edition of the guide contains examples of controls.
- EBP audit team may decide that substantive procedures alone provide sufficient appropriate audit evidence to support risk assessments.
- May need to test electronic interfaces between service providers and participants.
- Type 2 SOC 1 reports tests the operating effectiveness of controls at a service organizations.
Use of a Service Organization

- **Type 2 SOC 1**
  - Supports the auditor’s understanding of the control environment.
  - May allow the EBP auditor to place reliance on controls at the service organization.
  - May reduce but not eliminate substantive procedures.

- **Services provided by service organizations.**

- **Types of third party service providers.**

- **Tools:**
  - AICPA practice aid, *Using a SOC 1® Report in Audits of Employee Benefit Plans*
  - EBPAQC tool, *Documentation of Use of a Type 2 Service Auditor’s Report in an Employee Benefit Plan Financial Statement Audit,*
Multiple SOC 1 Reports and Subservice Organization

► **Subservice organizations**
  - Service organization must indicate level of responsibility taken related to controls at a subservice organization.
  - Carve-out method.

► **Multiple SOC 1 Reports**
  - Single service organizations may have more than one SOC 1 report.
Complimentary User Entity Controls

- **User auditor must evaluate the design and implementation of relevant controls at both the service organization and the client.**

- **Definition:**
  - Controls that management at the service organization assumes, in the design of its service, will be implemented by user entities, and which, if necessary to achieve the control objectives stated in management’s description of the service organization’s system, are identified as such in that description.

- **Identify relevant complementary user entity controls.**
SOC 1 Reports and DOL Limited-Scope Audits

- A service auditor’s report is not required with respect to a service organization that properly certifies information on plan investments and investment transactions in a DOL limited-scope audit as long as the service organization is only providing investment transaction services.

- If the service organization provides other services the auditor should obtain a service auditor’s report for the other services.
1. Why is a type 2 SOC 1 report preferred in an EBP audit?

a. It supports the auditor’s understanding of the control environment at the plan sponsor.
b. It may allow the auditor to place reliance on controls at the plan.
c. It may allow the auditor to place reliance on controls at the service organization.
d. It may allow the auditor to limit its scope of testing investments.
Consideration of Fraud Risk

**Guidance**

**Primary Responsibility for prevention and detection of fraud:**
- Those charged with governance and plan management

**Two relevant types of misstatements:**
- Misstatements arising from fraudulent financial reporting
- Misstatements arising from misappropriation of assets

**Assess at the financial statement level and the assertion level for classes of transactions, account balances and disclosures.**
Consideration of Fraud Risk (continued)

- **Fraud inquiries**
  - Plan management
  - Those charged with governance

- **Brainstorming session**

- **Fraud risk factors related to service organizations:**
  - Participant identity breach
  - Fraud perpetrated within the service organization
  - Qualified service auditor opinion on SOC 1 report
  - SOC 1 report exceptions including physical and logical access exceptions
  - Change in service providers, particularly the payroll service provider.
Knowledge Check 2

2. The primary responsibility for the prevention and detection of fraud rests with whom:

a. The plan trustee and recordkeeper.
b. The recordkeeper and plan management.
c. The plan auditor and plan management.
d. Those charged with governance and plan management.
Chapter highlight the areas where weaknesses have been noted in peer reviews and the DOL study of EBP audits.

Stresses for the “advanced EPB auditor” the importance of documenting the performance of procedures pertaining to these areas.

Auditor cannot perform some of the procedures related to risk assessment and internal control and not others. All must be performed and documented.
Chapter 4: Audit Area Considerations for Defined Contribution Retirement Plans
Learning Objectives

- Formulate audit programs for DC plan audits.
- Evaluate industry-specific audit issues in a DC plan audit.
- Interpret results of audit procedures performed for DC plan audit areas.
Net Assets Available for Benefits

► **Cash Balances**
  - Non-interest bearing and interest bearing cash
  - May not be included in the trust statement
  - Limited-scope audits: covered by the certification?
  - Other auditing considerations

► **Investments and Investment Income**
  - Common investment options for DC plans:
    - Mutual funds (Registered Investment Companies (RICs))
    - Common and collective trusts (CCTs)
    - Pooled Separate Accounts (PSAs)
    - Contracts with Insurance Companies
    - Employer Securities
    - Master Trusts
  - Auditing considerations: chapter 8 of the 2016 EBP Guide
Investments, continued

- Important points:
  - Ensure that external confirmations received are on an investment by investment basis versus in the aggregate.
  - Obtaining an external confirmation from the trustee, custodian or investment manager does not constitute valuation testing.
  - External confirmations should come from the entity that is holding the plan’s investment assets.
  - A certification provided by the trustee or custodian regarding the completeness and accuracy of the investment information does not constitute a confirmation as evidence of the existence and ownership of the investments.
Net Assets Available for Benefits (continued)

**Investments, continued**

- Important points, cont’d:
  - When using an electronic confirmation process, the EBP auditor should consider risks regarding the security and control of that process.
  - If a type 2 SOC 1 report includes a description and testing of controls surrounding investment transactions, this does not eliminate the requirement to substantively test investment transactions including purchases, sales, investment income and the allocation of investment income.
  - In addition to external confirmation and testing of investment transactions and investment income, substantive testing of investments should include testing fair value by reference to market quotations or other evidence of fair value.
Investments, continued

- If obtaining the most recently audited financial statements for a PSA, CCT or a fund that is not publicly traded, the financial statements may not cover the same period covered by the plan’s financial statements; they should be sufficiently recent to satisfy the EBP auditor’s objectives.

- If the previously mentioned financial statements have not been audited, or there is a significant gap between the date of the audited financial statements and the EBP’s year-end, the procedures in paragraph .04 of AU-C section 501 may be appropriate.
Net Assets Available for Benefits (continued)

▶ Investments, continued

• Important points, continued:
  - When auditing alternative investments, such as real estate, limited partnerships, hedge funds, private equity funds or venture capital funds, often the trustee or custodian does not have timely or accurate information regarding the amount and valuation of the plan’s investment in the alternative investment.
Net Assets Available for Benefits (continued)

Investments, continued

- Participant-directed and nonparticipant-directed investments.
- Self-directed accounts
  - Plan documents should be specific and in accordance with ERISA requirements for investments
  - Considered individual investments for auditing purposes.
- Auditing considerations:
  - SOC 1 reports
  - Bridge between brokerage accounting and trust statement
  - May not be held by an institution that can provide certified information which the auditor can use to perform limited-scope procedures.
Consider the overall materiality of these types of investments, what types of investments are held and the overall activity in these accounts in order to determine the scope of the audit and audit procedures to be performed.

**Investments, continued**

- Separately managed accounts
  - *Not* a pooled investment vehicle
  - A.k.a “separate-separate accounts”
  - Considered individual investments for auditing purposes.
  - Auditing challenges similar to a self-directed accounts
- Unitized accounts
  - Recordkeeper or trustee will calculate a unit value for the account
- Participants transact at unit value
- Plan transacts at the underlying investment value
- Underlying investments and cash or money market fund are considered individual investments for auditing purposes.

**Investments, continued**

- Omnibus accounts
  - Institutional account often in the name of a custodian bank or an investment manager, in which transactions are effected on behalf of a number of beneficial owners that are aggregated for trading purposes and then are later allocated to those beneficial owners
  - Typically the only record of an individual plan’s investments and investment activity is maintained by an affiliated recordkeeper.
Net Assets Available for Benefits (continued)

- Auditing considerations:
  - See participant materials for examples of audit procedures for auditing investments in an omnibus account.

► Investments, continued

• Contracts with insurance entities
  - An insurance contract subjects the insurer to significant insurance risks such as mortality and morbidity. They may also contain interest rate guarantees, investment performance risks or both.
  - Contracts that do not have substantial mortality or morbidity risks are referred to as investment contracts.
  - Allocated vs. unallocated contracts
    - Allocated contracts are not plan investments
    - Include annuity contracts
Net Assets Available for Benefits (continued)

- Fully benefit-responsive investment contracts
  - Differ from stable value funds

**Investments, continued**

- Synthetic Guaranteed Investment Contracts (GIC)
  - Simulates the performance of a traditional GIC through the use of underlying investments and a wrapper contract issued by a third party.
  - Plan owns underlying investments.
  - Auditing considerations similar to a separately managed account
- See participant materials for example substantive audit procedures for investment contracts, traditional GICs, stable value investments or synthetic GICs.
- General account assets/Guaranteed funds
- Ultimate responsibility for determining fair value rests with plan management.
- However, the EBP auditor should test management’s process for gaining an understanding of the valuation methodology and techniques utilized.

**Investments, continued**

- Master Trust
  - For certain DC plans, master trust arrangements exist whereby the investment in the master trust represents a specific interest in certain investments and possibly participant loans and, therefore, do not represent an undivided interest.
  - EBP auditor first applies appropriate procedures to the master trust and then tests how ownership is attributed to individual plans.
    - Consult the master trust instrument.

- Auditing considerations
Net Assets Available for Benefits (continued)

Investments, continued

- Derivatives
  - Often not clearly identified on the trust statement.
  - Most common to find derivatives in a self-directed account, separately managed account, separate-separate accounts, synthetic GICs
  - Be careful not to assume that derivatives are immaterial based on unrealized gains(losses) at the end of the period.
  - Other measures of materiality: variation margin, realized gains(losses), balances at year-end.
  - Auditing considerations
1. **What should the auditor do to test the fair value of common stock?**

   a. Obtain market quotations.
   b. Obtain trust statements.
   c. Obtain confirmations from the custodian.
   d. Obtain a certification from a qualifying entity.
Knowledge Check 2

2. For which type of investment unique to DC plans is the only record of an individual plan’s investments and investment activity maintained by an affiliated recordkeeper?

a. Omnibus accounts.
b. Separately managed accounts.
c. Participant accounts.
d. Unitized accounts.
3. Which type of investment contract is not considered a plan asset?

a. Unallocated contracts.
b. Guaranteed investment contracts.
c. Allocated contracts.
d. Synthetic guaranteed investment contracts.
4. A synthetic GIC is an investment contract that simulates the performance of a traditional GIC through the use of the underlying investments and is also what?

a. A separately managed account managed by a third party.
b. A wrapper contract issued by a third party.
c. An annuity contract issued by an insurance company.
d. A pooled separate account managed by an insurance company.
Audit Exercise 4-1: Investments

- Refer to the trust statement (appendix E) as of and for the year ending December 31, 2015 for the XYZ 401(k) and Profit Sharing Plan.
  - Identify the types of investments held by the plan

- The EBP audit team has prepared a preliminary audit program for a full-scope audit of investments (See participant materials).
  - Review the excerpt of the audit program relating to the testing of the valuation of investments.
  - Discuss results with the class including items to consider in planning
Net Assets Available for Benefits

▶ Notes Receivable From Participants (Participant Loans)
  • DC Plans allow participants to borrow against their vested account balance.
  • Records are maintained by the recordkeeper.
  • Substantively test a sample of participant loans.
  • Delinquent loans
  • Deemed distributions
  • Auditing considerations
Knowledge Check 5

5. What can NOT be determined from a sample of participant loans selected from a listing of all participant loans issued during the year?

a. Whether new loans were issued in accordance with the trust document.
b. Whether participant loans were properly set up for repayment.
c. Whether the loan amortization is calculated properly.
d. Whether deemed distributions are offset against the vested balance in the participant’s account.
Knowledge Check 6

6. When a participant has a distributable event and an outstanding loan is offset against the vested portion of the participant’s account it is referred to as what?

a. Defaulted loan.
b. Deemed distribution.
c. Delinquent loan.
d. Delinquent payment.
Net Assets Available for Benefits

**Receivables**

- Contributions Receivable
  - Include those pursuant to formal commitments and legal or contractual requirements.
  - Formal commitment may include:
    - a resolution by the employer’s governing body approving a specified contribution,
    - a consistent pattern of making payments after the plan’s year-end pursuant to an established contribution policy that attributes such subsequent payments to the preceding plan year,
    - a deduction of a contribution for federal tax purposes for periods ending on or before the financial statement date, or
    - the employer’s recognition as of the plan’s financial statement date of a contribution payable to the plan.
Contributions Receivable, continued

- To determine whether a formal commitment exists:
  - Whether the contribution is related to the participant’s service or wages for that plan year.
  - Other factors to consider:
    - whether the contribution is based on criteria that existed for the plan year,
    - whether a formal resolution or plan terms require a contribution to be made for that plan year,
    - plan management’s intent to make a discretionary contribution, and
    - the timing of the decision to make the contribution being reasonably soon after year-end.
Net Assets Available for Benefits (continued)

► Contributions Receivable, continued

- Type of contributions receivable:
  - Employer matching contributions
  - Employer discretionary contributions
  - Qualified non-elective contribution (QNEC)
  - Operational defects
  - True-up contributions

- Auditing considerations

► Other Receivables

- Interest
- Dividends
- Amounts due for securities sold
- Fee reimbursements
Knowledge Check 7

7. What is typically NOT included in contributions receivable for a DC plan?

a. Employer matching contributions.
b. Qualified non-elective contributions.
c. Employer discretionary contributions.
d. Qualified domestic relations contributions.
Audit Exercise 4-2: Receivables

Review the planning documentation provided in appendixes C and D as well as information in chapter 3.

- Based upon this review, determine if any receivables are expected to be recorded to the plan.
- If so, what types of receivables?
Net Assets Available for Benefits

► Accrued Liabilities
  • Accrued administrative expenses
  • Amounts due for securities purchased
  • Other investment-related payables
  • Accrued liability relating to corrective distributions
Changes in Net Assets Available for Benefits

**Participant data and payroll**

- Participant data used to determine individual participant account balances and roll up to determine amounts presented in the financial statements.
- Overreliance on the type 2 SOC 1 report when auditing participant data and payroll is a common audit error.
- Coordinate with tests of other audit areas including contributions and distributions, plan sponsor payroll
- See participant materials for a listing of substantive tests of participant data
- IT applications
- Determine completeness of payroll records
- Reconciliation of recordkeeping reports to trust statement.
- Consider confirming selected participant data.
- Test allocations to participant accounts.
Knowledge Check 8

8. Tests of participant data typically include tests of which?

a. Eligibility in accordance with the plan document.
b. Employee satisfaction surveys.
c. The allocation of investment income to participant accounts.
d. Plan to plan transfers.
Changes in Net Assets Available for Benefits

**Contributions**

- Contributions to a DC plan:
  - Employee
  - Employer matching
  - Employer discretionary
  - Rollover
  - Corrective

- Auditing considerations
  - See participant material for examples of identified risk
  - Audit area that identifies a significant number of plan errors or defects
  - Plan document is integral to the audit
  - Timeliness of the remittance of employee salary deferrals
You are the partner on the audit of the XYZ Company 401(k) and Profit Sharing Plan. The EBP audit manager has contacted you regarding some questions noted during the testing of employee and employer contributions.

- You should refer to the Plan Summary Document in appendix C to assist in your review.
- Refer to participant materials for circumstances and items noted during your review.

The audit team is unsure as to how to proceed, if necessary, on these matters. Document and discuss the next steps for the EBP audit team. Consider the effect on the plan’s financial statements, notes to the financial statements, supplemental schedules and the auditor’s report.
9. When auditing contributions in a DC plan, the plan document usually specifies eligibility, employer contribution formulas, employee contribution formulas, contribution limits, contribution rates and what?

   a. IRS limits.
   b. Vesting.
   c. Beneficiary designation.
   d. Investment options.
Changes in Net Assets Available for Benefits (continued)

**Benefit Payments**

- Termination, death or disability
- Lump sum, rollover to another retirement plan, rollover to an IRA, immediate distribution if less than $5,000.
- Outsource the administration and processing to a third party recordkeeper
- Other types of benefit payments:
  - Hardship withdrawals,
  - In-service withdrawals
  - Required minimum distributions at age 70 and ½
  - Qualified domestic relations orders (QDROs)
- Auditing considerations/substantive testing
Changes in Net Assets Available for Benefits (continued)

- **Benefit Payments, continued**
  - Hardship withdrawals
    - Distributions from a 401(k) plan to be “made on account of an immediate and heavy financial need of the employee, and the amount must be necessary to satisfy the financial need”.
    - A plan is not required to provide hardship distributions
    - Plan must provide specific criteria used to make the determination of hardship.
      - Nondiscriminatory and objective standards
      - Includes the need of the employee, spouse, dependent, non-spouse, beneficiary
      - Immediate and heavy financial need
Changes in Net Assets Available for Benefits (continued)

**Benefit Payments, continued**

- Hardship withdrawals, continued
  - Employee has obtained all other currently available distributions and loans
  - Employee is prohibited from making contributions for at least 6 months
  - Specify information that must be provided.
  - Current trend by 3rd party service providers: electronic self-certification
Forfeitures

• Terminated participant is not fully vested in employer contributions and requests a distribution.
• Remains an asset of the plan
• Transferred to a separate account
• Can only be used or reallocated in accordance with plan document:
  - Offset future employer contributions.
  - Pay plan administrative expenses.
  - Reinstate previously forfeited amounts when a participant is rehired within a specified period (generally five years).
  - Allocated to remaining plan participants based on a specified method of allocation
• Auditing considerations/substantive procedures
Audit Exercise 4-4: Distributions

You are the partner on the audit of the XYZ Company 401(k) and Profit Sharing Plan. The EBP audit manager has contacted you regarding some questions noted during the testing of distributions.

- You should refer to the Plan Summary Document in appendix C and the Summary of Plan Operations in appendix E to assist in your review.
- Refer to participant materials for circumstances and items noted during your review.

The audit team is unsure as to how to proceed, if necessary, on these matters. Document and discuss the next steps for the EBP audit team. Consider the effect on the plan’s financial statements, notes to the financial statements, supplemental schedules and the auditor’s report.
Knowledge Check 10

10. For which do benefit payments generally NOT occur?

a. Termination.
b. Required minimum distributions.
c. Death.
d. Qualified non-elective distributions.
Knowledge Check 11

11. Which is a hardship withdrawal that is in compliance with IRS rules?

- a. The employee requested the withdrawal for use for a vacation to China.
- b. The employee requested a withdrawal. He had a $2,000 participant loan balance. The plan allows for a maximum of $5,000.
- c. The employee requested a hardship withdrawal and completed an electronic self-certification in lieu of providing documentation to the plan sponsor.
- d. The employee requested the withdrawal on January 25 and was prohibited from making contributions to the plan till November 25.
Knowledge Check  12

12. Generally, plan documents will specify that forfeitures can be used to

a. Pay plan administrative expenses.
b. Offset future employee contributions.
c. Reimburse previously paid administrative expenses.
d. Be allocated to the accounts of terminated participants.
Changes in Net Assets Available for Benefits

- Plan Expenses typically consist of the following:
  - Trustee fees
  - Recordkeeping fees
  - Attorney fees
  - Audit Fees
  - Investment Adviser Fees
  - Form 5500 preparer fees
  - Other administrative fees
Changes in Net Assets Available for Benefits (continued)

**Plan Expenses**

- Plan expenses are commonly paid in one of the following ways:
  - Fixed-dollar fee per participant
  - Asset-based fees based on a percentage of plan or investment assets
  - Specific participant activity fees
- Typically investment transaction fees are included with net appreciation (depreciation).
- DOL rules and regulations clarify what expenses can be charged to a plan.
- Auditing considerations/substantive procedures
Changes in Net Assets Available for Benefits (continued)

Revenue Sharing

- Investment manager agrees to share a portion of its investment management fees with a service organization.
- Amount shared is then passed onto the plan by offsetting the costs of administrative services provided to the plan.
- ERISA spending accounts
- Audit considerations
- DOL Advisory Opinion 2013-03A
Knowledge Check 13

13. What is a way plan expenses are NOT commonly paid?

a. Fixed-dollar fee per participant.
b. Asset-based fees.
c. Transaction-based fees.
d. Participant activity fees.
14. An ERISA spending account is

a. A separate account usually with the social security number “999-99-9999.”

b. An arrangement that is usually pursuant to a master services agreement whereby an account is established to capture revenue sharing amounts received.

c. An account that is used to allow participants to transfer balances from another qualified plan or from an IRA.

d. An account used to hold corrective contributions to ERISA.
Summary: Chapter 4—Audit Area Considerations for Employee Benefit Plans

This chapter serves as a reminder for the advanced EBP auditor of the unique aspects of DC plans and common errors found in DC Plans audits.
Chapter 5: Other Defined Contribution Retirement Plan Considerations
Learning Objectives

- Evaluate the tax status of a DC plan.
- Formulate an audit program for the audit of a 403(b) plan.
- Interpret special plan transactions and circumstances, such as plan mergers, going concern and SEC filing requirements.
- Contrast ESOPs from other DC plans
403(B) Plans

Distinct differences with audits of 401(k) plans.

- Audit requirement effective with 2009 Form 5500 filings.
- Plan document requirement by December 31, 2009
- DOL Field Assistance Bulletin (FAB) No. 2009-02, *Annual Reporting Requirements for 403(b) Plans*
  - Transition relief
  - Modified auditor’s reports
  - DOL FAB No. 2010-01, *Annual Reporting and ERISA Coverage for 403(b) Plans*
- Initial audit considerations
- Other unique 403(b) considerations
  - Universal availability
  - Joint and survivor rules for distributions
  - TIAA-CREF Traditional Annuity Investment
  - Loans to participants
1. DOL FAB No. 2009-02 provides enforcement relief for plans that would have difficulty gathering information for pre-2009 contracts or accounts, however, it does not provide relief for what requirement of ERISA and DOL regulations?
   a. The requirement to have a type 2 SOC 1 report.
   b. The requirement to have an independent audit of the plan’s financial statements.
   c. The requirement to allow all eligible employees to participate in the plan as of their employment commencement date.
   d. The requirement to identify all participant accounts and insurance annuity contracts in the plan.
Knowledge Check 2

2. Which should be recorded in the financial statements of a 403(b) plan in accordance with ERISA Opinion Letter 2010-01A?

   a. Traditional Annuity investment issued by TIAA-CREF.
   b. Loans to participants issued by TIAA-CREF.
   c. FAB No. 2009-02 issued by the DOL.
   d. Inactive contracts issued by Mass Mutual prior to 2009.
Knowledge Check  3

3. What is the fundamental requirement of the IRS’s EPCRS program?

a. That the plan does not lose its tax exempt status.
b. That the plan sponsor must correct all errors and reimburse the plan for the amount of the error plus interest.
c. That each affected participant be put in the same position that it would have been in had any error not occurred.
d. That the plan sponsor prepare a filing with the IRS detailing the error and the proposed correction for approval.
Plan Mergers, Transfers and Spin-Offs

► **Plan merger**
  - Assets of two plans are combined to form one plan
  - One plan may be a survivor or a whole new plan may be created.

► **Plan transfer**
  - Participant account assets are moved from one plan to another plan sponsored by the same entity
  - Not all the assets of a plan are transferred and the transferring plan remains in existence

► **Plan spin-off**
  - Participant accounts associated with a group of employees are transferred to a new plan or a plan of an acquiring company

► **Audit considerations/risks**
Plan Mergers, Transfers and Spin-Offs (continued)

► **Merger Date**
  - Based on facts and circumstances, review of documents
  - Final Form 5500 is required to be filed 7 months after the merger date or 9 ½ months if an extension has been obtained.
  - Plan can hold assets in more than one trust

► **Due diligence**
  - Plan sponsor responsibilities
    - Whether the prior plan was audited
    - Internal control over the prior plan
    - Potential or known deficiencies or compliance matters for the prior plan.
Plan Mergers, Transfers and Spin-Offs (continued)

► **Transfer versus Rollover**
  - Rollover occurs due to a distributable event
  - Transfer is the result of a change in employment status
  - Mass rollover
    - Absence of a formal merger resolution
    - Rollover from a predecessor plan into another existing plan
    - Recorded on the rollover line item

► **Asset transfers are recorded on the statement of changes in net assets available for benefits after the net increase or decrease for the period**

► **Q&A section 6933.06, “Audit Procedures for Plan Mergers”** (AICPA, *Technical Questions and Answers*)
Audit Exercise 5-2: Plan Merger

Upon reading the minutes of the Employee Benefit Plan Committee of the Board of Directors, the EBP audit team has noted a resolution authorizing the merger of the D&G 401(k) Plan with and into the XYZ Company 401(k) and Profit Sharing Plan effective December 1, 2015.

- Using the audit program template (see participant materials), review the draft the audit procedures to be performed regarding the plan merger.
  - Determine if they are sufficient.
- Document and discuss the possible effect that the plan merger may have on the plan’s financial statements, notes to the financial statements and the auditor’s report.
  - You may also need to reference to Summary of Plan Operations in appendix E
4. When participant account assets are moved from one plan to another plan sponsored by the same entity it is referred to as what?

a. A plan merger.
b. A plan spin-off.
c. A plan acquisition.
d. A plan transfer.
Change in Service Providers

➤ Recordkeepers, trustees, custodians or payroll providers
➤ Plan sponsor reviews and approvals
➤ “Blackout period”
  • Written notice to participants at least 30 days but not more than 60 days in advance of blackout that lasts 3 or more business days.
  • Blackout notice contents
➤ Risks/Audit Considerations/Substantive Procedures
➤ SOC 1 report
  • Specific related user control considerations
➤ Limited-scope audit considerations
Knowledge Check 5

5. Typically, for a change in service providers during a blackout, how are participants affected?

a. Participant and employer matching contributions continue to be made but there is no other activity allowed.

b. Participants can only direct the investment of their account to the new investment options but no other activity is allowed.

c. Participant contributions, loans and distributions continue to be made but no other activity is allowed.

d. Participant and employer contributions are temporarily suspended.
Terminating Plans

Any plan about which a termination decision has been made regardless of whether the terminating plan will be replaced.

• Full or partial terminations
• Participants fully vested

Partial termination

• Approximately 20 percent or more of plan participants are terminated by the plan sponsor as a result of a corporate action such as a layoff or plant closure.
• Can accumulate over 1 or more plan years
• Indicator: significant fluctuations in benefit payment line item
Terminating Plans (continued)

**Guidance:**
- FASB ASC 962-40, *Terminating Plans*
- Liquidation Basis of Accounting
- AICPA Technical Questions and Answers 6931.18—.29 (nonauthoritative guidance)
- Audit and reporting considerations
6. In accordance with FASB ASC 205-30, when should a plan’s year-end financial statements be prepared using the liquidation basis of accounting?

a. When liquidation of a plan is completed.
b. When liquidation of a plan is approved by the board of directors of the plan sponsor.
c. When liquidation of a plan is commenced.
d. When liquidation of a plan is deemed to be imminent.
Going Concern

► **Substantial doubt about the plan sponsor’s ability to continue as a going concern.**
  - DC plans may not necessarily be affected by the plan sponsor’s financial condition

► **Guidance:**
  - AU-C section 570, *The Auditor’s Consideration of an Entity’s Ability to Continue as a Going Concern* (AICPA, *Professional Standards*)
    - Effective for annual reporting periods ending after December 15, 2015.
SEC Requirements

► Annual reporting on Form 11-K

- Plan is both voluntary and contributory.
- Contributions used to acquire employer securities.
- Audit is in accordance with two sets of standards:
  - PCAOB Standards for Form 11-K filing
  - GAAS for DOL filings.
- Two separate audit reports
  - Limited-scope audit is prohibited
  - 11-K is filed 90 days after the end of the fiscal year
    - Regulation S-X, Rule 6A contains special rules.
    - If filing ERISA financial statements, may file within 180 days after the plan’s fiscal year-end.
SEC Auditor Independence

- SEC independence rules are more restrictive than AICPA independence rules.
- Accountant is prohibited from providing bookkeeping or other services related to the accounting records or financial statements of the audit client.
  - Includes preparing financial statements or information that forms the basis of financial statements filed with the SEC.
- SEC staff: Auditor should not provide typing and word processing services or financial statement templates that are not publicly available.
ESOPs

**Employee Stock Ownership Plans**
- Company sets up a trust fund, into which it contributes new shares of its own stock or cash to buy existing shares

**Leverage ESOP**
- ESOP borrows money to buy new or existing shares, with the company making cash contributions to the plan to enable it to repay the loan.
- Debt is collateralized by the employer’s shares.
- Unallocated shares: Shares initially held in a suspense account.
- As the ESOP debt is repaid from employer contributions and dividends on the employer stock, shares are released from the unallocated account and allocated to individual participant accounts.
ESOPs (continued)

► Invest in employer stock
  • Publicly traded or privately held
  • IRS requires that the valuation of employer stock held by an ESOP for which there is no active market be performed by a qualified appraiser.
    - Employer stock traded on the OTC
    - Convertible preferred stock in a C corporation

► Unique attributes of ESOPs
  • Leveraged ESOP obligations
  • Participant allocations
  • Rebalancing

► Additional presentation and disclosure requirements for ESOPs
ESOPs (continued)

Additional presentation and disclosure requirements for ESOPs

  - Defers indefinitely the effective date of the disclosure of quantitative information about the significant unobservable inputs used in Level 3 fair value measurements.
- Disclose the amount of unallocated assets, as well as, the basis used to allocate asset values to participant accounts if that basis differs from the one used to record assets in the financial statements.
- Leveraged ESOP presentation and disclosure requirements
ESOPs (continued)

- **ESOP audit considerations**
  - Limited-scope audit may not be appropriate
  - May not be covered by type 2 SOC 1 report
  - May need to use a valuation specialist in performing the audit of the appraisal of employer stock

- **Working papers should include:**
  - A discussion and evaluation of the qualifications of the independent appraiser
  - Verification of key financial data used in the appraisal to the plan sponsor’s audited financial statements.
  - The agreement of the stock value to the appraisal as well as testing of the key assumptions that drive the value of the employer stock.
Summary: Chapter 5—Other DC Plan Considerations

- Several transactions and situations affect DC plans that are very unique to EBPs.
- Experienced, advanced DC plan auditors should be able to properly recognize these transactions and situations.
- Experienced, advanced DC plan auditors should be familiar with the related GAAP, GAAS and regulatory requirements and know where to properly locate guidance.
Chapter 6:
Financial Statements and Disclosures
Learning Objectives

- Assess presentation and disclosure requirements in accordance with GAAP for a DC plan.
- Interpret recent FASB ASU’s and their applicability to DC plans.
- Apply FinREC recommendations for DC plans.
Financial Statements and Disclosures

- The major source of GAAP for DC plan financial statements is FASB ASC 962, *Plan Accounting—Defined Contribution Pension Plans*.
- Other FASB ASC topics may be applicable.
- Statement of Net Assets Available for Benefits
- Statement of Changes in Net Assets Available for Benefits
- Notes to the financial statements
- ERISA requirements
Recent Accounting Standards Updates

- FASB Simplification Project
- FASB ASU No. 2015-07, *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*
  - CCTs, PSAs, REITs, LPs
  - Removes the requirement to categorize within the fair value hierarchy investments for which fair values are measured at NAV per share using the practical expedient.
  - Amount should be disclosed to permit reconciliation
  - Eliminates diversity in practice.
  - Continue to disclose information regarding the nature and risks and whether the investments, if sold, are probable of being sold at amounts different from NAV.
  - Effective for fiscal years beginning after 12/15/2015 for public entities and 12/15/2016 for all other entities.
Recent Accounting Standards Updates (continued)


**Part I**

- Fully benefit-responsive investment contracts (FBRICs) are to be measured, presented and disclosed only at contract value.
- Applies to DC plans and defined contribution health and welfare plans.
- Such plans will continue to disclose information regarding the nature and risks of FBRICs.
Recent Accounting Standards Updates (continued)

FASB ASU No. 2015-12, continued

Part II:

- Eliminates the requirement for both participant-directed investments and nonparticipant-directed investments to disclose:
  - Individual investments that represented 5 percent or more of net assets available for benefits; and
  - The net appreciation (depreciation) of investments by general type
- Total net appreciation (depreciation) is still required to be disclosed.
- Requires that investments (both participant-directed and nonparticipant-directed) of EBPs be grouped only by general type, eliminating the need to disaggregate the investments in multiple ways.
Recent Accounting Standards Updates (continued)

▶ **FASB ASU No. 2015-12, continued**
  • If an investment is measured using the NAV per share (or its equivalent) practical expedient and that investment is in a fund that files a Form 5500, as a direct filing entity, disclosure of that investment's strategy is no longer required.

▶ **Part III:**
  • Provides a practical expedient that allows EBPs to measure investments and investment-related accounts as of a month-end date that is nearest to the EBP’s fiscal year-end when that does not coincide with a month-end.
    - Alternative measurement date.
    - Required to be applied consistently from year to year.
    - Disclose
Recent Accounting Standards Updates (continued)

► FASB ASU No. 2015-12, continued
- Material contributions, distributions or significant events that occur between the alternative measurement date and the EBP’s year end, and the related amounts.
- The accounting policy election and the date used to measure investments and investment-related accounts

► Effective Dates:
• Amendments in Parts I, II and III are effective for fiscal years beginning after December 15, 2015.
• Earlier adoption is permitted.
• Amendments in Parts I and II should be applied retrospectively for all financial statement periods presented.
• Amendments in Part III should be applied prospectively.
• Plans may early adopt any of the three parts of this ASU individually, without early adopting the other parts but once a part is adopted it must be done so in its entirety
Knowledge Check 1

1. Which is NOT an amendment in parts I, II and III of FASB ASU No. 2015-12?
   a. Provides an alternative measurement date for investments and investment-related accounts.
   b. Eliminates the requirement to disclose investments by general type.
   c. Requires FBRICs are to be measured, presented and disclosed only at contract value only.
   d. Eliminates the requirement to disclose individual investments that represent 5 percent or more of net assets available for benefits.
FBRIC that does not qualify for contract value reporting in Form 5500 but is reported at contract value in the financial statements

- Contract value does not approximate fair value
- DOL rules and regulations require a note to the financial statements explaining the differences.
Revenue Sharing and ERISA Accounts

- Investment manager may agree to pay a portion of its fees to a service organization to help offset the plan’s costs.
  - 12b-1 fees
  - Sub-transfer agency fees
  - Administrative servicing fees
  - Shareholder servicing fees
- Structure of the agreement is important in determining correct financial reporting
  - Excess amounts held in an unallocated account
  - Excess amounts credited to a hypothetical account.
2. Which is a key consideration in determining the appropriate financial reporting for revenue sharing?

a. Obtaining an understanding of the expenses allowed under the plan
b. The agreement to pay a portion of its investment management fees to a service organization
c. The structure of the agreement for amounts in excess of recordkeeping or other administrative charges
d. The hypothetical account from which the plan sponsor can authorize disbursements to pay plan expenses.
Form 5500 Schedules

**Supplemental schedules**

- DOL rules and regulations require the auditor to form an opinion on the financial statements AND the supplemental schedules.
- Supplemental schedules are NOT part of the financial statements.
- Not a substitute for GAAP required disclosures and vice-versa.
- Schedules are prepared in accordance with the instructions to Form 5500.
- Most common DC schedules
  - Schedule H line 4i—Schedule of Assets (Held at End of Year)
  - Schedule H line 4a—Delinquent Participant Contributions
- Best practices
For the XYZ Company 401(k) and Profit Sharing Plan, the annual plan financial statements are drafted by the CFO’s department and are reviewed by the CFO, the VP of HR and the HR Manager. After their review, a draft has been forwarded to the EBP audit team for review.

The draft financial statements are in appendix F. Information obtained in exercises and cases studies in chapters 1 through 5, as well as appendixes C, D, and E, is to be considered during your review.

See participant materials for additional circumstances.

Review and comment on the draft financial statements.
Summary: Chapter 6—Financial Statements and Disclosures

- Knowledge of applicable GAAP presentation and disclosure requirements is vital for DC plan auditors.
- There are many resources available to assist the DC plan auditor with his or her review of DC plan financial statements.
Chapter 7: The Auditor’s Report
Learning Objectives

- Interpret relevant guidance when preparing an auditor’s report for a DC plan
- Assess the results of the audit in order to prepare the auditor’s report for a DC plan.
Background

AU-C sections of the AICPA Professional Standards for the Auditor’s Report:

- AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*
- AU-C section 705, *Modifications to the Opinion in the Independent Auditor’s Report*
- AU-C section 800, *Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks*
Report Modifications

► Report modification, other matter or emphasis of matter paragraphs
  • See participant materials for listing of potential report modification situations.

► Professional judgement and type of opinion expressed:
<table>
<thead>
<tr>
<th>Nature of Matter Giving Rise to the Modification</th>
<th>Auditor’s Professional Judgment About the Pervasiveness of the Effects or Possible Effects on the Financial Statements</th>
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</thead>
<tbody>
<tr>
<td>Financial statements are materially misstated</td>
<td>Material but Not Pervasive</td>
</tr>
<tr>
<td>Inability to obtain sufficient appropriate audit evidence</td>
<td>Material and Pervasive</td>
</tr>
<tr>
<td>Financial statements are materially misstated</td>
<td>Qualified opinion</td>
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<tr>
<td>Inability to obtain sufficient appropriate audit evidence</td>
<td>Qualified opinion</td>
</tr>
<tr>
<td>Financial statements are materially misstated</td>
<td>Adverse opinion</td>
</tr>
<tr>
<td>Inability to obtain sufficient appropriate audit evidence</td>
<td>Disclaimer of opinion</td>
</tr>
</tbody>
</table>
Report Modifications (continued)

DOL will reject Form 5500 filings that contain modified opinions,

- Except:
  - The disclaimer of opinion issued in connection with a limited-scope audit; or
  - A disclaimer of opinion issued in connection with a 403(b) audit that has elected to exclude certain pre-2009 contracts in accordance with DOL FAB 2009-02.
Supplemental Schedules

- ERISA and DOL regulations require additional information to be disclosed in the financial statements or presented in the supplemental schedules.

- Some of this information is required to be covered by the auditor’s report.

- Supplemental Schedules
  - AU-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole* (AICPA, *Professional Standards*)
    - Requires certain audit procedures in addition to the procedures performed during the audit.
    - Provides guidance in the form and content of the auditor's report.
Supplemental Schedules (continued)

► Auditor’s report
  • Other-matter paragraph (AU-C section 706), or
  • Separate report on the supplemental schedules
  • Disclaimer or adverse opinion on the financial statements
    - Auditor is precluded from expressing an opinion on the supplementary information (paragraph .11 of AU-C section 725)

► The following table illustrates various scenarios that may be considered by the auditor for reporting on the supplementary information when the DOL-required information contains, errors, omissions or inconsistencies.
## Supplemental Schedules (continued)

<table>
<thead>
<tr>
<th>Error, Omission, or Inconsistency</th>
<th>Effect on Report</th>
</tr>
</thead>
<tbody>
<tr>
<td>DOL-required information is omitted from the supplemental schedule (for example, historical cost information for nonparticipant-directed transactions), and the omission or inconsistency is not considered a material misstatement.</td>
<td>Other-matter paragraph</td>
</tr>
<tr>
<td>The required schedule is omitted for example, Form 5500, Schedule H, line 4j—Schedule of Reportable Transactions), and the omission or inconsistency is not considered a material misstatement.</td>
<td>Other-matter paragraph</td>
</tr>
<tr>
<td>The required schedule is materially misstated in relation to the financial statements as a whole (full-scope audit).</td>
<td>Qualified or adverse regarding schedules</td>
</tr>
</tbody>
</table>
Supplemental Schedules (continued)

**DOL limited-scope audits**

- Auditor is not permitted to issue an opinion on the supplemental schedules
- Follow guidance in AU-C section 720, *Other Information in Documents Containing Audited Financial Statements* (AICPA, *Professional Standards*)
- The following table illustrates the report modifications in a limited-scope audit that an auditor might consider appropriate when DOL-required information is omitted from the supplemental schedule, a required DOL supplemental schedule is omitted, or required information included in the DOL supplemental schedule, is materially inconsistent with the financial statements, or contains a material misstatement of fact.
# Supplemental Schedules (continued)

<table>
<thead>
<tr>
<th>Error, Omission, or Inconsistency</th>
<th>Effect on Report</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>DOL Limited-Scope Audit</strong></td>
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<tr>
<td><strong>Exception in Information</strong></td>
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<tr>
<td>Certified by Trustee or Custodian</td>
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<tr>
<td><strong>Exception in Information</strong></td>
<td></td>
</tr>
<tr>
<td>Not Certified by Trustee or Custodian but Other Procedures Have Been Performed</td>
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</tr>
<tr>
<td>DOL-required information is omitted from supplemental schedule (for example, historical cost information for nonparticipant-directed transactions).</td>
<td>Other-matter paragraph</td>
</tr>
<tr>
<td>The required schedule is omitted (for example, Schedule H, line 4j—Schedule of Reportable Transactions).</td>
<td>Other-matter paragraph</td>
</tr>
<tr>
<td>The required schedule is materially inconsistent with financial statements or contains a material misstatement of fact.</td>
<td>Other-matter paragraph</td>
</tr>
</tbody>
</table>
Knowledge Check 1

1. When performing a full-scope audit of an EBP, what is the auditor typically engaged to report on regarding the supplemental schedules?

   a. The auditor has issued an unqualified report on the financial statements of the EBP.
   b. The supplemental schedules are fairly presented in relation to the financial statements as a whole.
   c. The form and content of the supplemental schedules is in accordance with GAAP.
   d. Certain audit procedures have been performed in addition to the procedures performed during the audit of the financial statements.
Audit Exercise 7-1: Draft Auditor’s Report

Based on the information contained in the exercises in chapters 1 through 5 and the draft financial statements in chapter 6, use the space below to draft the auditor’s report for the audit of the XYZ Company 401(k) and Profit Sharing Plan as of and for the year ended December 31, 2015.

Document the circumstances that should be considered when drafting the auditor’s report following:
Chapter 7—The Auditor’s Report

- Chapter 11 of the 2016 edition of the guide contains illustrative auditor reports.
- DC plan auditors should keep in mind that while the financial statements are the responsibility of plan management, the audit report is the responsibility of the plan auditor.
- The auditor’s report represents the end product of the audit process.
- Important that audit teams make sure that they are using the correct report in the circumstances.
- Sources for the form of the report, additional paragraphs and modifications, if any, should be clearly documented in the working papers of the audit.
Chapter 8: Concluding the Audit and Other Auditing Situations
Learning Objectives

- Assess the results of audit procedures performed.
- Evaluate the documents and other information obtained at or near the end of the audit.
- Formulate a draft of a management representation letter.
Concluding the Audit

Procedures typically performed in concluding the audit:

• Review Form 5500.
• Review for any commitments and contingencies.
• Obtain a legal letter, if applicable.
• Review for any subsequent events.
• Consider other matters that have occurred during the audit, such as plan mergers, plan terminations, changes in service providers, related party transactions, prohibited party in interest transactions, plan amendments or going concern considerations.
Concluding the Audit (continued)

Procedures typically performed in concluding the audit (continued):

- Review journal entries, if any, and subsequent trust statements.
- Summarize audit misstatements.
- Perform final analytics.
- Obtain management representation letter.
- Date the auditor’s report, and assemble and archive working papers.
- Communicate with those charged with governance.
- Communicate internal control matters identified in an audit.
Journal Entries

- Annual accruals
- Top side journal entries.
- Reconciliation of trust statements to participant accounts or participant loans.
Parties In Interest

- Not all transactions with parties in interest are prohibited transactions.
  - Exemptions to the prohibited transaction rules of ERISA.
    - Plan is allowed to make reasonable
- Always at least one party in interest
  - Plan auditor
Management Representations

- The date of the auditor’s report should be the same as the date of the management representation letter and should be for all financial statements and periods referred to in the auditor’s report.

- AU-C section 580, *Written Representations*
  - Specific representations

- Maintain listing of potential management representations that are noted during the audit.

- Scope limitation may occur if the auditor is unable to obtain appropriate representations.

- Additional representations may be required.

- Normally obtained from the plan administrator or other parties performing the plan’s management function.
Knowledge Check 1

1. Which is a possible effect on the auditor’s report if the auditor is unable to obtain appropriate representations from management?

   a. Disclaim an opinion.
   c. Other–matter paragraph.
   d. Unqualified opinion.
Legal Letters

Paragraph .24 of AU-C section 501 states that the auditor should modify the opinion in the auditor’s report, in accordance with AU-C section 705, *Modifications to the Opinion in the Independent Auditor’s Report* (AICPA, *Professional Standards*), if

- The entity’s legal counsel refuses to respond appropriately to the letter of inquiry, and the auditor is unable to obtain sufficient appropriate audit evidence by performing alternative audit procedures, or
- Management refuses to give the auditor permission to communicate or meet with the entity’s external legal counsel.
Legal Letters (continued)

- If the plan sponsor has not utilized the services of a lawyer, encouraged to include such a statement in the management representation letter.
- If the auditor obtains an oral response concerning matters covered by the legal letter, the auditor should document this response and consider the need for disclosure of items related to litigation, claims and assessments.
Subsequent Events

- FASB ASC 855, *Subsequent Events* and AU-C section 560, *Subsequent Events and Subsequently Discovered Facts* (AICPA, *Professional Standards*)
  - Accounting and disclosure requirements.
  - Performed to the date of the auditor’s report.
  - Examine interim financial information.
  - Fraud indicators
  - Effect of current economic conditions
  - Management’s review of subsequent events should be performed to the date the financial statements are issued or *available to be issued*
  - Disclosed in the noted to the financial statements.
Communications with Those Charged with Governance

- AU-C section 260, *The Auditor’s Communication With Those Charged With Governance* (AICPA, Professional Standards)
  - Communications are applicable regardless of a plan’s governance structure or size.
  - May be with management if all of those charged with governance are involved in management of the plan.
  - Preferably, should be written.
    - If oral, it should be documented including when and to whom
  - Should be performed at or near the conclusion of the audit.
  - May need to discuss and agree on the relevant person(s) within the entity’s governance structure with whom the auditor will communicate.
Knowledge Check 2

2. Which may NOT be a person or persons charged with governance with whom an EBP auditor will communicate?

   a. Audit committee.
   b. Third party service provider.
   c. Plan administrator.
   d. Employee benefit committee of the board of directors.
Communicating Internal Control Related Matters Identified in an Audit

- AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit* (AICPA, *Professional Standards*)
  - In writing to those charged with governance on a timely basis significant deficiencies and material weaknesses identified during the audit, including those that were remediated during the audit.
  - Also other control-related matters, including deficiencies.
  - No later than 60 days following the report release date.
  - Consider situations at the service organization or with the use of a service organization.
  - Could also be operational defects.
Regulatory Impact of Internal Control Matters Noted During the Audit

When exceptions are noted during the course of the audit, they may be immaterial for financial statements auditing purposes but they may not be immaterial operational defects.

- DOL and IRS: No materiality level for matters that affect participants and participant accounts.

When errors or differences are noted:

- Evaluation of the error or difference in light of the financial statements and if such error or difference could materially misstate the financial statements.
- Consideration of the regulatory effect.
- Plan administrator should make a determination as to whether such error or difference represents an operational defect or prohibited transaction.
- Proper correction method decided by the plan administrator.
Correction Programs

**DOL:**
- Assesses penalties in the event of a failure to file or refusal to file reports in accordance with the statutory and regulatory requirements.
- Penalties may be waived or reduced if it is determined that there was reasonable cause for the failure to comply.
- Other DOL penalties
- Responsibility of plan sponsor to pay penalties
- Voluntary Fiduciary Correction Program (VFCP)
  - Voluntary compliance by self-correcting violations
  - Immediate relief from payment of excise taxes
  - 19 categories of transactions and methods of correction
Correction Programs (continued)

• Delinquent Filer Voluntary Compliance Program (DFVCP)
  - Voluntary compliance with ERISAs annual reporting requirements
  - Gives plan administrators a way to avoid higher civil penalty assessments & voluntarily paying a reduced penalty.

► IRS: Employee Plans Compliance Resolution System (EPCRS)
  • May allow plan sponsor’s to avoid the consequences of plan disqualification.
  • Correction for a mistake should:
    - Be reasonable and appropriate.
    - Correction method should resemble one already provided for in the IRC
    - Consider all facts and circumstances.
Correction Programs (continued)

3 ways to correct mistakes:

- Self-Correction Program (SCP)
- Voluntary Correction Program (VCP)
- Audit Closing Agreement Program (Audit CAP)
Knowledge Check 3

3. Which is NOT a correction program sponsored by the DOL or IRS?

   a. Voluntary Fiduciary Correction Program.
   b. Audit Closing Agreements Program.
   c. Delinquent Filer Voluntary Compliance Program.
   d. Voluntary Fiduciary Program.
Audit Exercise 8-1: Draft Internal Control Related Matters

Based on the information contained in the exercises in chapters 1 through 5 and the draft financial statements in chapter 6, draft internal control related matters for the audit of the XYZ Company 401(k) and Profit Sharing Plan as of and for the year ended December 31, 2015.

• Note: You are not required to draft the entire communication, just the matters noted during the course of the audit.
Summary: Chapter 8—Concluding the Audit and Other Audit Considerations

- It is important that an EBP audit be properly completed in accordance with GAAS.
- It is equally important that the regulatory aspects of an EBP audit be properly completed as well.
- This highlights the unique aspect of EBP audits and the importance of specialized knowledge for the EBP auditor.
Course Conclusion

- An audit of a DC plan is an audit that should be completed in accordance with GAAS.
- All applicable GAAS is required. In no way should any aspect of planning, execution or completion be sacrificed because of budgetary concerns, client pressure or lack of knowledge.
- DC plan auditors, not only need to be knowledgeable of GAAS requirements but also DOL and IRS rules and regulations.
- Audit documentation should be clear and complete.
There are many resources available to aid the DC plan auditor. Take advantage of them.

If you or your firm do not possess sufficient knowledge or are not able to obtain it prior to commencement of the DC plan engagement, do not accept the engagement. A deficient audit could result in the loss of your CPA license.

Achieving quality EBP audits is an important priority of the AICPA. Thank you for your time and attention.
Questions, Wrap-Up, and Key Points/Lesson Review
Users of this course material are encouraged to visit the AICPA website at www.aicpa.org/CPESupplements to access supplemental learning material reflecting recent developments that may be applicable to this course. The AICPA anticipates that supplemental materials will be made available on a quarterly basis.
Advanced Auditing for Defined Contribution Retirement Plans