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AUDITS OF PENSION FUNDS

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Preface

This guide has been prepared to provide direction to independent auditors engaged to examine and report upon financial statements of pension funds.

Generally accepted auditing standards and, for the most part, generally accepted accounting principles for commercial enterprises are applicable to pension funds covered in this guide. Not all of these standards and principles are discussed herein; rather, the guide deals with those accounting, auditing, and reporting matters unique to such funds.

Committee on Health, Welfare and Pension Funds

GENERAL

Description of Pension Plans

The term pension plan as used in this guide means an arrangement whereby a company undertakes to provide its employees with retirement, death, or disability benefits.

Such plans are either those of a single or a group of affiliated employers (single employer plans) or of several employers in one or more industries (multi-employer plans). Single employer plans are usually unilaterally established, whereas multi-employer plans are established pursuant to collective bargaining agreements and are jointly managed by representatives of labor and management. Some plans require contributions from both the employee and employer (contributory plans) while others are funded by employer contributions only (noncontributory plans). Employer contributions may be based upon actuarial calculations (defined benefit plan) or upon amounts or rates stipulated under the terms of a collective bargaining agreement (defined contribution plan).

The pension fund (or fund) represents assets held for the purpose of meeting retirement or other benefits provided under a pension plan when they become due. The fund may be held in the custody of a corporate (bank or insurance company) or individual trustee. The fund operates as a separate legal and tax entity.

Administration of Pension Funds

A pension fund is generally administered under a declaration of trust which sets forth the duties and responsibilities of the trustee(s).

Under the Welfare and Pension Plans Disclosure Act, the term "administrator" is defined to mean "(1) the person or persons designated by the terms of the plan or the collective bargaining agreement with responsibility for the control, disposition, or management of the money received or contributed; or (2) in the absence of such designation, the person or persons actually responsible for the control, disposition, or management of the money received or contributed, irrespective of whether such control, disposition or management is exercised directly, or through an agent or trustee designated by such person or persons" (Sec. 5(b) of the Act of Congress).

The day-to-day administration of a single-employer pension plan, e.g., determination of eligibility, payment of benefits, employee record maintenance, and so forth, is usually undertaken by the employer company. The benefits to be received, the conditions of eligibility to receive benefits, and other rights of participants under single-employer plans are set forth in the plan documents. Generally, single-employer pension plans have an administrative committee consisting of three or more officers and/or directors or other responsible employees. The committee makes broad policy decisions concerning the operation and interpretation of the plan and acts for, and reports to, the board of directors of the company in matters pertaining to the plan.

In the case of multi-employer funds, responsibility for determination of benefits and other rights to be received by participants under the plan, is delegated to a joint board of trustees comprised of an equal number of employer and employee representatives. The trustees of a multi-employer fund administer the collection of contributions, payment of benefits, control of cash and investments, maintenance of records and preparation of necessary reports.

The administrative committee (single employer) or the board of trustees (multi employer) have the continuing responsibility for operation of the fund in accordance with the plan, trust instrument, insurance contract, and operational guidelines as set forth in minutes of board or administrative committee meetings, and all applicable federal and state laws.

While the administrative committee or the trustees retain responsibility for the overall direction of the fund, the fund's day-to-day administration is generally delegated to one or more of the following:

1. The employer company
2. A bank trust department
3. An insurance company
4. An independent contractual administrator
5. An employed administrator

Administrative expenses of a single-employer plan are generally borne by the employer company.

Administrative fees of a multi-employer fund should be authorized by the board of trustees pursuant to a written agreement. These administrative fees may be based on a percentage of contributions received, on a specified amount per eligible member per month, or on some other basis. An administrative office may manage several multi-employer trust funds for a single industry for example, an employee health and welfare fund, a vacation fund, and a pension fund. In this instance, some provision must be made for an equitable allocation of administrative expenses among the several funds, all of which are independent entities having their own assets, records and reporting requirements.

Government Regulation of Pension Plans

Because of the significant growth of pension plans and their impact on the economy, far-reaching legislation is currently pending in Congress covering, among other things, compulsory funding, pension reinsurance, vesting of benefits, and portability of pension credits. The auditor should be aware of these developments.

The 1958 Welfare and Pension Plans Disclosure Act, as amended, requires most pension funds to file the following reports with the U.S. Department of Labor.

1. An initial description of the plan (Form D-1).
2. A description of any subsequent amendments to the plan (Form D-1A).
3. An annual report on the plan's financial and non-financial activities (Form D-2).

The Internal Revenue Code generally exempts pension funds from federal income taxes, but requires the filing of annual information returns. Such funds may also be subject to state regulations and reporting requirements. The independent public accountant should familiarize himself with applicable federal and state regulations to determine the necessary reporting requirements.

Accounting Records

As with any commercial enterprise, the records of a fund should be designed to produce information necessary for effective management as well as to provide detailed information required for financial reporting. The basic accounting records for such funds normally conform to conventional methods adopted by other organizations. However, in the case of multi-employer funds the following additional records are generally required to be maintained:

1. Employers' Contribution Reports

   Periodic contribution reports and payments are due from employers pursuant to the collective bargaining agreement in the case of negotiated plans. Separate contribution records on a cash basis are maintained for each employer for the purpose of recording all payments, determining delinquencies, and accumulating the total annual contribution to be reported for each employer on Form D-2. Records are also generally maintained to follow up on delinquent contributions, e.g., contribution reports submitted without payment and payments received without contribution reports.

2. Participant's Eligibility Records

   Employer contribution reports list the participants for whom contributions are submitted. Whether eligibility is determined by hours worked or dollars earned or contributed, separate records must be maintained for each participant to determine his eligibility for benefits. Since accumulation of pension credits usually covers a long period of time, it is important that proper record retrieval and retention systems are in effect.

The eligibility records of a single-employer plan are generally part of the payroll and personnel records maintained by the employer.

GENERALLY ACCEPTED ACCOUNTING PRINCIPLES AND FINANCIAL REPORTING

To the extent that this audit guide deals with generally accepted accounting principles it does so only where such principles,are of particular importance to pension funds and/or differ from principles which are generally accepted for profit making enterprises.

General

As discussed more fully under Section F herein, the Committee has concluded that financial statements of a pension fund should disclose the actuarially determined present value of all benefits provided by the related pension plan which relate to employee service which has been rendered and which are expected to be paid in the future.

Further, in order to present fairly financial information relative to a pension plan, financial statements of one or more funds may have to be set forth on a combined (or combining) basis.

A. Accrual Basis of Accounting

Many pension funds typically report on the cash basis or modified cash basis of accounting. Financial statements prepared on the cash basis may omit significant assets and liabilities, and their effect on changes in net assets available for pension benefits. Such omissions preclude the reader from determing a fund's financial position and changes in net assets. Accordingly, where the omission of the foregoing items have a material effect upon the financial statements of a pension fund, such statements do not present financial position or results of operations in conformity with generally accepted accounting principles.

B. Contributions Receivable

Contributions due from employers and employees at the statement date should be reflected in the financial statements of pension funds. The statement of net assets available for plan benefits of a pension fund should include as contributions receivable the amounts (including the fair value of any property) which may reasonably be expected to be contributed to the fund with respect to the year being reported upon. Appropriate consideration should be given to the collectibility of such receivables.

Multi-Employer Funds

Most employer contributions to multi-employer funds are on a self-assessment basis and are generally received the month after they accrue; that is, the employer is paying the contribution due for the work performed by the participant in the preceding month. For funds in which a limited number of employers are involved, it is relatively easy to determine the amount of the contributions due at month end. Determinations of contributions receivable at any month end may require estimates if a fund has a large number of contributing employers. Such an estimate may be based primarily on contributions received by the fund in the subsequent months and may also include an amount for contributions known to be delinquent, together with the related penalties that may be imposed. An adequate allowance should be provided for estimated uncollectible amounts.

Single-Employer Funds

In determining the amount of an employer's contributions which are to be included in the financial statements of a pension fund for a given fiscal year, the following should be considered:

1. The actuary's report.
2. The contributions authorized by the employer's management and/or board of directors.
3. The deductions for contributions claimed by the employer on its federal income tax return.
4. The legal obligation of an employer to fund the contribution.

An employer's contribution to a fund is not necessarily the same as the employer's annual pension expense as determined under Accounting Principles Board Opinion No. 8.

C. Investments

There is a fundamental distinction between the financial statements of a business enterprise and those of a pension fund. In the case of a profit-oriented entity Statement No. 4 by the Accounting Principles Board states the following:

> "The information presented in the income statement is usually considered the most important information provided by financial accounting because profitability is a paramount concern to those interested in the economic activities of the enterprise".

The purpose of a pension fund is to provide the resources from which retirement and other benefits can be paid. Therefore, the relationship of the present value of the net assets of the fund to the actuarially determined present values of the accrued benefits is of primary importance to the readers of pension fund financial statements. The Committee has therefore concluded that all investments of pension funds should be presented in the financial statements at their fair value at the statement date, and that cost should be disclosed parenthetically or by footnote.

It is realized that there are a number of practical problems in determining the fair value of certain types of investments, such as real estate, securities which are not traded, and securities whose marketability is restricted. Notwithstanding these difficulties, the committee believes that the need to present the fair value of the net assets available for plan benefits is so important as to override objections to the use of fair value to report pension fund investments.

All investments, be they equity, debt, or real estate should be reflected in the financial statements at their fair value at the date of the statement of net assets available for plan benefits. The fair value of traded securities should be based upon their published market prices. (Closing prices on the statement date or, in the event that no transactions occurred on that date, at the appropriate closing bid or ask prices.) If securities are restricted- i.e., they cannot be offered to the public without first being registered, appropriate consideration by the administrative committee or the board of trustees should be given to such restriction in determining the fair value of such securities. In the case of investments such as securities of closely-held companies or real estate, it may be necessary for the fund to obtain the opinion of independent experts who are qualified to make such valuations.

The net increase or decrease during the year in unrealized appreciation or depreciation of investments should be reported as a separate caption apart from realized gains and losses in the statement of changes in net assets available for plan benefits.

Income from investments should be recorded as earned and appropriate accruals should be made. Such income should be disclosed under a separate caption in the statement of changes in net assets.

Other financial statement disclosures with respect to investments should normally include but not be limited to the following:

1. The fair value and cost for major classes of investments, e.g., U. S. Government securities, commercial paper, common stock, mortgages, real estate, and, with respect to long-term investments with fixed dollar maturities, the aggregate principal amount (face value) thereof.
2. Methods used by the administrative committee or the Board of Trustees to determine fair value.
3. Investments in employer securities, loans to employer corporations, or real estate leased to the employers, or other interested groups when material in relation to the funds assets or of an unusual nature.
4. For each of the last five years indicate, as a percentage of total investments the investment income, appreciation or the depreciation (realized or

unrealized) and the total yield of the fund. In developing these statistics, appropriate adjustment should be made for additions and deductions of the fund during the year. This data will allow comparison of actual investment performance and the interest assumption used by the actuary.

D. Assets Held by Insurance Companies

Where assets of a pension fund are held by an insurance company, such assets should be included in the financial statements of the pension fund at their fair value. The pension fund financial statements should also include the transactions affecting these assets during the period.

E. Property and Equipment

Buildings, equipment, furniture and fixtures, and leasehold improvements used in the operations of a pension fund represent costs chargeable to future periods. Therefore, they should be carried at cost and depreciated or amortized over their useful lives.

F. Actuarially Determined Present Value of "Accrued"[1] Benefits

The financial statements of a pension fund are meaningful to the fund's beneficiaries and other readers only if appropriate disclosure is made of the amount of present value of "accrued" benefits of the plan as determined by a qualified actuary. The financial position of a fund cannot be properly evaluated, analyzed, or understood in the absence of such information.

1/ "Accrued" is here used in its actuarial rather than in its accounting sense. See Appendix B (Glossary) - APB Opinion No. 8.

Accordingly, it is the view of the Committee that in order to fairly present financial position in accordance with generally accepted accounting principles, the financial statements of a pension fund should disclose the actuarially determined present value of all "accrued" benefits. Because of its significance, this information should be shown on the same page as the statement of net assets available for plan benefits (<u>below, not within, the statement</u>) or in a separate schedule immediately following the statement of net assets available for plan benefits. The "net assets available for plan benefits" caption should be cross-referenced to this information.

The actuarially determined present value of "accrued" benefits should be shown in total and for each of the following classifications:

- Present value of accrued benefits of employees retired under the plan.
- Present value of accrued benefits which have vested other than for retired employees.
- Present value of all other accrued benefits based on employee service which has been rendered.

G. <u>Statement of Changes in Net Assets Available for Plan Benefits and Financial Statement Disclosures</u>

In addition to the statement of net assets available for plan benefits, the financial statements of a pension fund should include a statement which discloses and adequately describes all significant changes in net assets available for plan benefits.

The notes to the financial statements should disclose any matters necessary to fairly present the financial statments of the fund, such as the following:

- Major changes in fair value of investments subsequent to the date of the statement of net assets available for plan benefits.
- Whether a plan is contributory or non-contributory.
- The funding policy (including policy with respect to prior service cost), and any changes in such policies during the year.
- The most recent valuation date used to compute the present value of "accrued" benefits and the actuarial cost methods and assumptions.
- A description of changes in plan benefits made during the year and the impact of such changes on the present value of accrued benefits.
- The effect, if material, of any change in the actuarial cost method, or assumptions.
- Description of material lease commitments.
- Agreements and transactions which may involve parties in interest.
- Other commitments and contingent liabilities.
- A general description of priorities upon termination of the plan.
- The tax status of the fund, if an exemption certificate, has not been obtained.

Adoption of or Changes in Generally Accepted Accounting Principles

The committee believes that accounting changes adopted to conform to accounting principles set forth herein should be made retroactively by restating the financial statements of prior periods. Reference should be made to paragraphs 27 and 28 of APB Opinion No. 20 for a description of how to report an accounting change by retroactively restating the financial statements of prior periods.

A change in the actuarial cost method is considered to be a change in the application of accounting principles; a change in the assumptions used is considered a change in an estimate.

INTERNAL CONTROL

The basic principles of internal control have been effectively described in accounting literature and are not discussed in detail in this guide. The principles of internal control for a pension fund are not dissimilar from those found in a commercial enterprise. However, there are certain unique internal control features that warrant special discussion and should be considered by the administrators of a well-managed fund.

Contributions to Multi-Employer Funds

Contributions from employers, on a self-assessed basis, will represent the majority of the fund receipts. Contributions are generally determined by the number of hours or days worked or gross earnings of the participant at a standard contribution rate. Many funds have standard pre-printed forms that are supplied to the employers for reporting contributions. These forms generally show the employer's name, participant's name, social security number and the bases upon which the contributions are made. Initial accountability over the reporting forms should be established when received; the forms should be controlled throughout the processing operations, from the time of receipt of contributions to final postings to the participants' eligibility records and employers' contribution records.

The funds should adopt internal control procedures which are adequate for disclosing and following up delinquent employer reports and contributions as well as employer over - or under-payments. Such internal control procedures may include the auditing of employers' records on a systematic or exception basis, the mailing of periodic statements requesting participants to report any discrepancies in hours worked and/or contributions reported on their behalf by employers, or a reconciliation of employee status reports furnished by the union to employer contribution reports.

Generally, contributions are received at the fund's office or mailed directly to a bank for credit to the fund's account. When cash is received at the fund office, prenumbered receipt forms should be utilized. The numerical sequence of the forms and subsequent depositing of the cash in the bank should be subjected to internal review and checking. The fund should not utilize cash contributions for payment of fund expenses. It is important that contributions received are deposited intact on a timely basis.

A method which generally provides for good internal control over the receipt and deposit of contributions is the adoption of a "lock box" system. Under this system the remittances and contribution reports are mailed by the employers to a bank. The bank deposits all receipts, prepares a record of the deposit, and forwards the deposit record and contribution reports to the fund for further processing.

Where an office has been established to serve more than one fund, proper controls are necessary to insure that remittances are deposited to the proper accounts. The controls established should include an audit trail which can be traced through to the general ledger postings.

A cumulative record of employers' contributions should be kept since the fund should report annually on Form D-2 contributions made by employers. The totals of records maintained for cumulative employer contributions and participants' eligibility should be periodically reconciled to the cash receipts book.

Benefits

The application for retirement benefits should be initiated by the employee. An individual not involved in the original processing procedures should review the applicant's eligibility and determine that the retirement benefits have been properly determined in conformity with the plan documents. The board of trustees (multi-employer fund) or the administrative committee or its designee (single-employer fund) should approve all pension applications.

Bonding Requirements

The Welfare and Pension Plans Disclosure Act specifies minimum amounts of fidelity bond coverage for trustees, administrators and other employees of a fund. The fund must, by law, meet the minimum bonding levels required by the Act.

Multi-employer pension funds may require employers to provide, at their own expense, a performance bond or other security to cover the payment of contributions in the event of insolvency. Performance bonds or other security should be periodically reviewed for adequacy.

Administrative Expenses of Multi-Employer Funds

The trustees are responsible for the approval of all administrative expenses. However, the responsibility for approving routine expenses is usually delegated to the administrator or other responsible employees. Because of their fiduciary responsibility, the trustees should make certain that the internal control procedures for administration expenses are adequate. The board of trustees will generally also retain the authority to approve any such expenditures over a stated amount.

Contract or professional administrators are paid according to various criteria, e.g., the number of participants covered by the fund, employer's reports processed, and so forth. Therefore, it is important that the fund's records provide the information necessary to determine the reasonableness of such payments.

AUDITING

Generally accepted auditing standards apply to audits of a pension fund to the same extent they apply to the audits of a commercial enterprise. These standards are summarized and explained in the Statements on Auditing Procedure and Statements on Auditing Standards issued by the American Institute of Certified Public Accountants. The extent to which auditing procedures may apply to any particular exmination will vary depending on the size, type of organization and the existing system of internal control. Therefore, programs for each audit should be designed to meet the requirements of a particular engagement.

The second of the general standards as defined by the Institute states that "in all matters relating to the assignment, independence in mental attitude is to be maintained by the auditor or auditors." Each situation dealing with independence should be carefully weighed on its own merits. It is generally not considered an infringement upon independence if an independent public accountant is also the independent auditor for the union whose members are participants in the pension fund, or is the independent auditor for one or more of the contributing employers. An independent public accountant would not be independent if he acted in the capacity of trustee or administrator of the fund.

The examination of the financial statements of a pension fund presents certain unique problems to the independent auditor. This section is intended to outline the unusual features of such examinations.

A. <u>Contributions</u>

<u>Multi-Employer Funds</u> - The basic objective in auditing contributions is to determine that amounts due the fund have been properly recorded and that employer records and participant eliigibility records are being properly maintained. In connection with this objective, the independent public accountant may wish to obtain an official list of contributors, as at the beginning of the period under examination. The list should indicate any changes (additions and terminations) during the period. The extent of the tests of contribution revenue and of the related records should be determined by an evaluation of the system of internal control. The auditing procedures employed should normally include, but are not necessarily limited to, the following.

1. Total cash receipts shown by the cash receipts book for a selected period should be reconciled (a) to the total amount credited to the general ledger contribution accounts, (b) to the total amount posted to the employer's record, and (c) to deposits shown by the bank statements.

2. Selected individual employer contribution payments as shown by the cash receipts book should be compared (a) to the amount shown on the employer's contribution report and (b) to the amount posted to the individual employer's contribution record. Selected postings to the employer's record during the test period should be traced to the cash receipts book and to the employer's contribution report.

3. For a selected number of employers contribution reports, it should be determined that the reports are arithmetically accurate and that the correct contribution rate was used. In conjunction with the review of contribution reports, a test of the postings to participants' records should be made. Entries on the participants' records should be traced to the contribution reports on a test basis.
4. The total participants' credits posted to the records for a selected period should be reconciled to the total credits shown by employers' contribution reports.
5. Where a central bank account is used for the deposit of employer contributions to several related benefit funds, the amounts transferred to the appropriate fund's bank account should be tested.
6. To determine the reasonableness of the amount of contribution receivable at the date of the statement of net assets available for plan benefits, the independent auditor should compare the total thereof to collections received in subsequent months, and review on a test basis, the related employer contribution reports to ascertain that such receipts apply to the year under examination.
7. Contributions recorded as received or receivable during the period under audit should be confirmed on a test basis by direct correspondence with selected employers.

The extent of confirmation procedures and the type of request (positive or negative) to be used are a matter of judgement. The independent public accountant should select the accounts to the confirmed and should be sure that the preparation and mailing of the requests are adequately controlled. All exceptions reported in the confirmation replies should be carefully investigated by the independent auditor. Where positive confirmations have been used and no reply received, the independent auditor should use alternate auditing procedures to provide evidence as to the validity of significant non-responding accounts.

8. Tests should be employed as deemed appropriate in the circumstances to assure the independent auditor that the system of internal control designed to disclose delinquent or unreported contributions, is being properly maintained.

9. The adequacy of the allowance for doubtful accounts should be reviewed.

Single-Employer Funds

The auditing procedures employed in the review of a single-employer fund should often include, but not necessarily be limited to, the following:

1. Recorded contributions should be compared to the cash receipts book and to deposits shown by bank statements.

2. Contributions from the employer both received and receivable should be confirmed on a positive basis by direct correspondence with the employer company or compared to employer company records. Employee contributions should be confirmed directly with participants or compared to employer company payroll records on a test basis.
3. The propriety of the contributions receivable at the date of the statement of net assets available for plan benefits should be determined by a review of collections received in subsequent months, the actuary's report, and employer records, including federal income returns and minutes of employer company board of directors meetings.
4. The criteria used by the fund in accruing employer company contributions should be reviewed to determine that they have been consistently applied.

B. Payroll Audits: Multi-Employer Funds

There may be circumstances in which the independent auditor is engaged to conduct audits of employers' payroll records to determine the propriety of the contributions made. The following numbered items outline certain procedures which should be considered in the audits of employers selected:

1. The collective bargaining agreement should be reviewed to determine that the employer has complied with the applicable provisions and that contributions are made for only employees covered by the agreement.

2. The total gross earnings shown by the employees' earnings records should be reconciled with total wages shown by the general ledger and the payroll tax reports.

3. Information shown on the employer's contribution reports for a selected number of participants should be compared with the data shown on the employees' earnings records. In addition, a selected group of participants' earnings records should be compared with the employer's contribution reports to ascertain that they have been properly included or excluded from the reports.

4. The employer's general cash disbursements should be reviewed to ascertain whether any payments not recorded as compensation have been made to employees.

5. For a selected period of time and for a selected group of employees, the data shown in the payroll journal should be compared to the employee earnings records and time records, and the related payroll checks should be examined.

All exceptions to the foregoing tests should be cleared to the independent auditor's satisfaction.

C. Bonding

The independent auditor should determine whether the fund maintains at least the required minimum amount of fidelity insurance in accordance with provisions of the Federal Welfare and Pension Plans Disclosure Act.

D. Investments

Investments represent the major portion of the assets of a pension fund. The nature and the extent of the audit procedures followed depends upon the evaluation of the system of internal control.

The carrying amount (fair value) of securities at the date of the statement of net assets available for plan benefits and the change in unrealized appreciation or depreciation should be checked by comparison to published market quotations where available. Substantiation of the fair value of investments in real estate, securities for which published market quotations are unavailable, or those securities whose marketability is restricted may often present difficult audit problems. The independent auditor should review reports, appraisals, computations, or other data supporting fair value determinations. Written representation from qualified independent experts making such determinations should be considered.

In the case of securities for which market quotations cannot be obtained, fair values would ordinarily be determined by the administrative committee or the board of trustees. The independent public accountant does not function as an appraiser and is not expected to substitute his judgment for that of management;

rather he should review all information considered by management and ascertain that the procedures followed appear to be reasonable and adequate.*

If the independent auditor is unable to satisfy himself as to the reasonableness of the amounts at which such investments are stated, appropriate qualification of the auditors report should be made.

The cost of investments at the date of the statement of net assets available for plan benefits and the amount of realized gains and losses should be substantiated by comparison to cash records and exmination of brokers advices and other appropriate documents, e.g., notes, mortgages and closing statements.

Securities held on the date of the statement of net assets available for plan benefits should either be inspected and counted or confirmed with the custodian. In order to be able to rely upon a confirmation, the independent auditor should be satisfied with the reputation of the custodian.

The balances and terms of loans and mortgages should be confirmed and their collectibility ascertained. Deeds, title policies, and leases covering real property should also be inspected.

The independent auditor should be familiar with any restrictions and limitations on types of investments imposed by law, plan documents, or policy. He should assure himself that investments of the fund are in compliance therewith. Where investment transactions require approval of the board of trustees or administrative committee the independent auditor should examine evidence of such approvals.

*Accounting Series Release No. 113 and No. 118 of the Securities and Exchange Commission can be used as guides for valuation of securities and the auditing thereof.

Interest and dividend income received or receivable should be tested by computation or reference to appropriate published sources.

E. Assets Held by an Insurance Company

The principal audit objectives with respect to pension fund assets held by an insurance company are to establish the existence of the accounts, substantiate the fair value of the assets and compliance with the contract with the insurance company, and to ascertain that the changes in such assets during the period is fairly presented.

The audit procedures would include reading the contract between the pension fund and the insurance company and corresponding directly with the insurance company. The correspondence with the insurance company or their independent public accountants would include conformation of the following:

1. Amount of the undivided deposit fund at year-end.
2. Market unit value of participation of the undivided deposit fund at year-end.
3. Contributions (premium payments) made to the undivided deposit fund during the year, including the dates received by the insurance company.
4. Interest and dividends earned during the year.
5. Amount of insurance company fee and other expenses during the year.
6. Annuities purchased and/or benefits paid during the year.

Contributions should be reconciled to amounts the pension fund reported as received from employees and transferred to the insurance company. The interest calculation and compliance with the minimum guaranteed interest rate in the annuity contract should be tested, if applicable. Annuity purchases and benefit payments should be tested in accordance with the audit procedure of benefit payments discussed elsewhere in this Guide.

F. Actuarially Determined Present Value of Accrued Benefits

The independent auditor is responsible for obtaining sufficient competent evidential matter as a basis for forming his opinion as to the determination made by the actuary of the present value of accrued benefits. The education and professional experience of the independent auditor and/or his staff will dictate the extent to which he must utilize the services of a consulting actuary in obtaining competent evidential matter and in forming an opinion. An independent auditor who is sufficiently experienced in auditing actuarially determined amounts may be able to form an opinion by working with the actuary who was responsible for calculating such amounts. In other cases, the independent auditor may need to utilize the services of a qualified consulting actuary to assist him in auditing actuarially determined amounts.

The independent auditor should be satisfied that the fund's actuary is professionally qualified. There are no statutory qualifications required for actuaries. Membership in the American Academy of Actuaries, a comprehensive organization of the profession in the United States, is generally considered to be acceptable evidence of professional qualification.

The independent auditor should review the actuary's report. He should assure himself that the actuary is fully familiar with the terms of the pension plan and that such terms are accorded proper recognition in his calculations. He should determine that the actuary has employed an appropriate actuarial cost method and ascertain whether the same method was used in the prior period. The independent auditor should be satisfied that all pertinent factors are included in the actuarial assumption used and that such assumptions are reasonable. Consideration should be given to financial statement disclosure of the effect of changes in actuarial assumptions. The independent auditor should also perform appropriate tests to ascertain the reliability of the basic data used by the actuary in his calculations, e.g., size, age distribution, sex, and so forth, of the work force.

The auditor should ascertain that the interest assumption used by the actuary to determine the present value of accrued benefits is reasonable when compared to the funds historic and anticipated investment performance (investment income and appreciation). In addition, the auditor should determine that the interest assumption used by the actuary is consistent with the fair value presentation of investments in the balance sheet.

The independent auditor must work closely with the actuary and he should consult with him whenever necessary. He should advise the actuary of changes in conditions about which he knows and which he believes would effect the actuary's determinations. He should also ascertain whether there are any material differences between the actuarially determined present value of accrued benefits since the most recent valuation date and the date of the statement of net assets available for plan benefits.

G. Benefit Payments

The basic objective in auditing benefit payments should be to determine that the payments for the correct amount were made to eligible beneficiaries. The extent of the test of benefit payments should be determined by the evaluation of internal control. Among other things the independent auditor should:

(1) review the approved applications for benefits and ascertain that the initial benefit amount and subsequent changes have been properly approved,

(2) check the calculation of the benefit payment; ascertain that an independent review of the calculation has been made by a responsible individual,

(3) compare check endorsement to the signature file,

(4) ascertain that procedures exist for investigating all old outstanding benefit checks,

(5) confirm on a test basis payments recorded as paid during the period under review by direct correspondence with selected beneficiaries, and,

(6) confirm the establishment of procedures within the fund to check or test the eligibility of the employee for the payment of benefits and the continuation of benefits. Also procedures should be established to determine the effect on benefit payments of changes in Social Security provisions and changes in the benefit schedule.

H. Administrative Expenses

In addition to a normal test of expenses, the independent auditor should review the board of trustees' or administrative committee's minutes to determine whether administrative expenses were properly authorized. Where the fund employs a contract administrator, the basis of the contract payment should be determined and a test made to ascertain the propriety and reasonableness of the payments.

One office may function as a service organization for several funds, which requires the allocation of administrative expenses not directly associated with a specific fund. Such allocation may be based on the number of participants serviced, the amount of contributions received by the funds, or some other method or combination of methods. The method selected should be approved by the board of trustees.

The independent auditor should satisfy himself that the method of allocating the expenses is appropriate in the circumstances.

I. Other Audit Considerations

The independent auditor's program of examination should contemplate any extension of the scope of audit where a special report on Form D-2 is requested by the client.

The independent auditor should review tax returns and other reports filed pursuant to federal and state regulations.

The independent auditor should acquaint himself with the collective bargaining agreement, the declaration of trust, the insurance contract, and other plan documents, and be alert to any transactions that require the approval of the board of trustees or administrative committee.

It is desirable that, immediately prior to the completion of the field work, the independent auditor obtain a letter of representation worded to fit the individual circumstances of the engagement. The letter should be signed by the appropriate official.

THE INDEPENDENT AUDITOR'S REPORT

When an examination has been made in accordance with generally accepted auditing standards, the financial statements of the fund have been prepared in conformity with generally accepted accounting principles, and such principles have been applied on a basis consistent with the preceding period, a standard short-form auditors report is appropriate.

The following discussion is devoted to situations which may require deviation from the standard short-form auditors report. Examples of the wording of opinions which might be used in such instances are also included.

In a typical multi-employer benefit fund, employers generally determine their liability to the fund and submit reports and contributions to the fund on a self-assessement basis. It is the board of trustees' responsibility to ascertain whether the employers' contributions are being determined and made in accordance with the provisions of the applicable agreement. The contributions of employers are the principal source of revenue received by such funds; therefore, an important aspect of the fund's system of internal control involves the establishment of effective procedures (e.g., examination of employer payroll records, confirmation with participants, etc.) to determine the propriety of employer contributions. The inadequacy or absence of such procedures may prevent the independent auditor from satisfying himself that contribution revenue is fairly presented in the financial statements. In instances where there is an inadequacy or absence of such internal procedures, and where alternative audit procedures do not result in the necessary assurances, are impractical, or have been limited by the client, the independent auditor should disclaim an opinion on the financial statements. An illustration of the wording of such a disclaimer of opinion follows:

> To the Board of Trustees of
> The R. U. S. Pension Benefit Fund:
>
> We have examined the statement of net assets available for plan benefits of the R. U. S. Pension Benefit Fund as of December 31, 19__, and the related statement of changes in net assets available for plan benefits for the year then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances, except as stated in the following paragraph.
>
> The internal control procedures adopted by the Fund are not adequate to assure the propriety of employer contributions to the Fund, and it was not practicable to attempt to satisfy ourselves with respect to such contributions by means of other auditing procedures. Because such contributions enter materially into the determination of financial position and changes in net assets available for plan benefits of the fund, we do not express an opinion on the accompanying financial statements.

The actuarially determined present value of accrued benefits represents information of major importance in presenting the financial position of a pension fund: therefore, ommission of such information would require the independent auditor to give an adverse opinion on the financial statements.

Special Reports

It will not be uncommon to find that financial reports of employee pension benefit funds, upon which independent auditors are asked to report, have been prepared on an incomplete basis for special purposes. In these situations, the standard short-form opinion is not appropriate. In such case the requirements of SAP No. 33, as set forth in Chapter 13, "Special Reports," apply.

Reliance on Actuaries

The auditor should avail himself of the competence of an actuary as he would the expertise of other professionals. The auditor can neither negate nor diminish his responsibility to satisfy himself as to actuarially determined amounts by referring in his opinion to actuaries in a manner intended to indicate a division of responsibility. The use of actuarial expertise is a fulfillment of the auditor's responsibility for obtaining sufficient evidential matter in accordance with generally accepted auditing standards. The auditor must be satisfied with the actuarially determined amounts, but there is no requirement to explain how he was satisfied or to elaborate upon the steps he followed, including use of varying forms of expertise, in performing such tests of the accounting records and such other auditing procedures as he considered necessary in the circumstances. Reference to the assistance furnished by actuarial expertise in the opinion paragraph of the auditor's report should not be made. If, the auditor has not satisfied himself as to the actuarially determined amounts, he should disclaim any opinion as to the fairness of the financial statements.

ILLUSTRATIVE FINANCIAL STATEMENTS

Pension Committee of the
EJM Company Retirement Fund:

We have examined the statement of net assets available for plan benefits of the EJM Company Retirement Fund as of December 31, 19X2 and 19X1, and the related statement of changes in net assets available for plan benefits for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying financial statements identified above present fairly the financial position of the EJM Retirement Fund at December 31, 19X2 and 19X1, and the changes in net assets available for plan benefits for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

City, State
Date

Signature

EJM COMPANY RETIREMENT FUND
STATEMENT OF NET ASSETS AVAILABLE FOR PLAN BENEFITS
DECEMBER 31, 19X2 and 19X1

ASSETS	Cost 19X2	Cost 19X1	19X2	19X1
Cash			$ XX	$ XX
Contributions receivable:				
Employer			XX	XX
Employee			X	X
Accrued income on securities			X	X
Investments, at fair value (Note 2):				
U. S. Government bonds	$ XX	$ XX	$ XX	$ XX
Corporate bonds	XX	XX	XX	XX
Stocks	XXX	XXX	XXX	XXX
Common stock of employer company	X	X	X	X
Mortgages	X	X	X	X
Real estate	X	X	X	X
	XXX	XXX	XXX	XXX
Furniture and equipment, at cost less accumulated depreciation of $X in 19X2 and $X in 19X1			X	X
			$XXX	$XXX

LIABILITIES	19X2	19X1
Accounts payable and accrued expenses	$ X	$ X
Net Assets Available For Plan Benefits (See information as to actuarial determined present value of accrued benefits below)	XX	XX
	$XXX	$XXX

EJM COMPANY RETIREMENT FUND
STATEMENT OF NET ASSETS AVAILABLE FOR PLAN BENEFITS, CONTINUED
DECEMBER 31, 19X2 and 19X1

The estimated actuarially **determined present value of accrued** benefits to be paid under the plan as of June 30, 19X2 and 19X1 as calculated by consulting actuaries was as follows:

	19X2	19X1
Present value of benefits for retired employees	$ X	$ X
Present value of other vested benefits	X	X
Total present value of vested benefits	XX	XX
Present value of all other benefits attributable to service rendered through June 30	X	XXX
Total present value of accrued benefits	XXXX	XXXX
Less net assets available for plan benefits	XXX	XXX
Excess of present value of accrued benefits over net assets available for plan benefits	$ XXX	$ XXX

See notes to financial statements.

Presentation of the above information will appear at the bottom of the statement of net assets available for plan benefits in the final draft of the audit guide.

EJM COMPANY RETIREMENT FUND

Statement of Changes in Net Assets Available for Plan Benefits for the Years Ended December 31, 19X2 and 19X1

	19X2	19X1
Additions:		
Contributions:		
Employer	$ X	$ X
Employee	X	X
Dividend and interest income	X	X
Rental income	X	X
Gains realized upon disposition of investments	X	X
Unrealized appreciation of investments	X	X
	XX	XX
Deductions:		
Benefits: Retirement	X	X
Death	X	X
Administration expenses	X	X
	XX	XX
NET ADDITIONS	X	X
NET ASSETS AVAILABLE FOR PLAN BENEFITS AT BEGINNING OF YEAR	XXX	XXX
NET ASSETS AVAILABLE FOR PLAN BENEFITS AT END OF YEAR	$XXX	$XXX

See notes to financial statements.

EJM Company Retirement Fund

NOTES TO FINANCIAL STATEMENTS
for the Years Ended December, 19X2 and 19X1

1. Pension Benefits

The pension plan of EJM Company Retirement Fund is a defined benefit plan to which plan member employees contribute 3% of their salaries on a monthly basis. The EJM Company has agreed to voluntarily contribute such amounts as are necessary to provide the Fund with assets sufficient to meet the benefits to be paid to plan members. While EJM Company has not expressed any intent to discontinue its contributions, it is free to do so at any time. In such event the plan provides that the net assets of the fund would be set aside first for the return to the employees of their accumulated contribution, secondly for other vested benefits, and lastly pro rata to the remaining participants.

The contributions of EJM Company are designed to fund the plan's current service costs on a current basis and to fund over twenty years the estimated accrued benefit cost arising from qualifying service before the establishment of the plan.

The calculations of the present value of accrued benefits under the plan were made by consulting actuaries, as of June 30, 19X2 and 19X1. The actuary does not expect that there would be any material change in such amounts as computed as of June 30, 19X2, and as they would be at December 31, 19X2.

The actuarial cost method used to calculate the present value of accrued benefits is the accrued benefit cost method -- unit credit basis.

The more significant assumptions underlying the computation of the present value of accrued benefits are as follows:

Assumed rate of return on investments	- 5%
Mortality basis	- 1951 Group Annuity Table, set back 1 year
Employee turnover	- A moderate scale consistent with the EJM Retirement Company's prior experience
Salary increases	- A 5% annual rate of salary increase
Retirement	- Retirement at normal retirement age.

2. Investments

The fair value of security investments for which market price are available is based on published market prices, except for investments in restricted securities. The administrative committee has determined the fair value of restricted securities and other security investments not having an established market based upon the advice of its investment consultant; the aggregate fair value of such investments at December 31, 19x1, was $X.

The fund is authorized to invest up to 10% of the fair value of its total assets in the common stock of EJM Company. Such investment aggregated 7% and 4% at December 31, 19X2 and 19X1, respectively.

Investments in U.S. Government and corporate bonds having an aggregate principal of $XXX at December 31, 19X2 have been stated in the accompanying statement of net assets available for plan benefits at their fair value of $XXX. It is generally the policy of the fund not to dispose of bonds prior to their maturity date.

The fund's real estate investment is the ownership of land and building in which EJM Company maintains its executive offices pursuant to a 25-year non-cancellable lease. The fund has been advised by real estate appraisers, that the rent received thereunder of $XX annually, is comparable to that which it could receive if the lease were with an unrelated third party. The building was purchased in 19XX for $XXX. The real estate is carried at its fair value as determined by real estate appraisers.

Investment yield from the last five years based upon investments was as follows:

Year	Investment Income (Interest and Dividends)	Net appreciation and net realized gains	Total
19XX	%	%	%
19XX			
19XX			
19XX			
19XX			

Board of Trustees
Industry Wide Pension Trust Fund

We have examined the statement of net assets available for plan benefits of the Industry Wide Pension Trust Fund at December 31, 19X2 and 19X1, and the related statement of changes in net assets available for plan benefits for the years then ended. Our examinations were made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying financial statements identified above present fairly the financial position of the Industry Wide Pension Trust Fund at December 31, 19X2 and 19X1, and the changes in net assets available for the plan benefits for the years then ended, in conformity with generally accepted accounting principles applied on a consistent basis.

Signature

City, State
Date

INDUSTRY WIDE PENSION TRUST FUND

STATEMENT OF NET ASSETS AVAILABLE FOR PLAN BENEFITS
DECEMBER 31, 19X2 and 19X1

ASSETS	19X2	19X1	LIABILITIES AND NET ASSETS AVAILABLE FOR PLAN BENEFITS	19X2	19X1
Cash	$ XX	$ XX	Liabilities-accounts payable	$ XX	$ XX
Contributions receivable, principally representing amounts received in January from employees as contributions based on employees' earnings prior to January	XXX	XXX			
Pension fund deposit with insurance company - at fair value (cost 19X2 - $XXXX; 19X1 - $XXXX)-Note 2:	XXXX	XXXX	Net Assets Available For Plan Benefits (See information as to actuarial determined present value of accrued benefits below)	XXXX	XXXX
Due from Industry Wide Holiday Trust Fund	X	X			
Prepaid trustees' bond premium	X	X			
	$ XXXX	$ XXXX		$ XXXX	$ XXXX

See notes to financial statements.

INDUSTRY WIDE PENSION TRUST FUND

Statement of Net Assets Available for Plan Benefits, continued
DECEMBER 31, 19X2 and 19X1

The estimated present value of accrued benefits to be paid under the plan as of December 31, 19X2 and 19X1 as calculated by consulting actuaries was as follows:

	19X2	19X1
Present value of benefits for retired employees	$ XX	$ XX
Present value of other vested benefits	XX	XX
Total present value of vested benefits	XXX	XXX
Present value of all other benefits attributable to service rendered through January 1	X	X
Total present value of accrued benefits	XXXX	XXXX
Less, Net assets available for plan benefits	XXX	XXX
Excess of present value of accrued benefits over net assets available for plan benefits	$ XXX	$ XXX

See notes to financial statements.

Presentation of the above information will appear at the bottom of the statement of net assets available for plan benefits in the final draft of the audit guide.

INDUSTRY WIDE PENSION TRUST FUND

STATEMENT OF CHANGES IN NET ASSETS
for the years ended
December 31, 19X2 and 19X1

	19X2	19X1
Additions:		
Contributions from employers	$ XXXXX	$ XXXXX
Interest and dividend income	XXXX	XXXX
Collection fee income	XXX	
Unrealized appreciation of investments	XXXX	XXXX
Gain(loss) on sale of securities	XXXX	(XXXX)
	XXXXX	XXXXX
Deductions:		
Benefit payments:		
Retirement	XXXXX	XXXXX
Disability	XXX	XXX
Death	XXX	XXX
Termination	XXX	XXX
Widows' benefits	XXX	XXX
	XXXXX	XXXXX
Reciprocity payments	XXX	XXX
Insurance company fee	XXX	
Administrator's fee		
Professional fees	XXX	XXX
Conference expense	XXX	
Trustees' bond and liability insurance expenses	XXX	
Printing and miscellaneous	XX	
	XXXXX	XXXXX
NET ADDITIONS	XXX	
NET ASSETS AVAILABLE FOR PLAN BENEFITS AT BEGINNING OF YEAR	XXXX	XXXXX
NET ASSETS AVAILABLE FOR PLAN BENEFITS AT END OF YEAR	$ XXXX	$ XXXX

See notes to financial statements.

INDUSTRY WIDE PENSION TRUST FUND

NOTES TO FINANCIAL STATEMENTS
for the years ended December 31, 19X2 and 19X1

1. Pension Benefits

The Industry Wide pension plan is a defined contribution plan to which employers contribute at the rate of 6% of the base pay rate for member employees. All benefits provided by the plan are to be paid by Life Insurance Company from net assets available for pension plan benefits.

Contributions currently being received by the Industry Wide Pension Trust Fund are adequate to fund the plan's current service costs on a current basis and to fund over 30 years the estimated accrued benefit cost arising from qualifying service before the establishment of the plan. Based on the present rate of funding, it is expected that the fund assets will approximate the present value of accrued benefits as of December 31, 2000. However, amendments which increase benefits to the plan in the future, or other factors can effect this estimate and the fund assets may not approximate the accrued benefits until a date subsequent thereto.

The calculations of the present value of accrued benefits under the plan were made by consulting actuaries as of December 31, 19X2 and 19X1, using the "Attained Age Normal Method". The more significant assumptions underlying the computation of the present value of accrued benefits are as follows.

Assumed rate of return on investments	-	5%
Mortality basis after Normal Retirement Age	-	1951 Group Annuity Table
Mortality and withdrawal rates during service	-	Based on percentage of employees assumed to remain in service to age 65 ranging from 10% at age 20 to 90% at age 60.
Normal retirement age	-	65

Incidence of disability	-	Rates based on Period 4 experience under Disability Benefit 5 of 1952 Report of Society of Actuaries' Committee on Disability and Double Indemnity.
Disability Annuity	-	During disability retirement period annuity values based on Railroad Retirement Board Third Valuation

2. Pension Fund Deposit

The composition of the pension fund deposit at December 31, 19X2 and 19X1, is summarized as follows:

	Fair Value	
	19X2	19X1
Cash	$ X	$ X
U. S. Government bonds	XXX	XXX
Corporate bonds	XXX	XXX
Common stocks	XXX	XXX
Preferred stocks	XX	XX
Total	$XXXX	$XXXX

All of the investments held by the insurance company represent marketable securities and the recorded fair values are based on published market prices.

3. Investment yield from the last five years based upon investments was as follows:

Year	Investment Income (Interest and Dividends)	Net appreciation and net realized gains	Total
19XX	%	%	%
19XX			
19XX			
19XX			
19XX			