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Auditing multiemployer plans

American Institute of Certified Public Accountants. Accounting and Auditing Publications Team

Auditing Multiemployer Plans

AICPA

AICPA Practice Aid Series

Auditing Multiemployer Plans

American Institute of Certified Public Accountants

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NOTICE TO READERS

Auditing Multiemployer Plans is intended to provide guidance on accounting, auditing, and reporting on financial statements of multiemployer employee benefit plans. This Practice Aid is intended to complement the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans*. This document has been prepared by the AICPA staff and a task force of the 1998-1999 AICPA Employee Benefit Plans Committee. It has not been approved, disapproved, or otherwise acted on by a senior technical committee of the AICPA. Therefore, the contents of this publication have no official or authoritative status.

AICPA Practice Aid Series

Auditing Multiemployer Plans

Edited by
Accounting and Auditing Publications Staff

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PREFACE

The publications that constitute the AICPA Practice Aid Series have been designed to address a broad range of topics that affect today's CPA. From enhancing the efficiency of your practice to developing the new skill sets required for a successful transition to meet the challenges of the new millennium, this series provides practical guidance and information to assist in making sense out of a changing and complex business environment. The talents of many skilled professionals have been brought together to produce what we believe will be valuable additions to your professional library.

The series includes the following:

- *Preparing and Reporting on Cash– and Tax–Basis Financial Statements* (006701)
- *Auditing Recipients of Federal Awards: Practical Guidance for Applying OMB Circular A-133,* Audits of States, Local Governments, and Non-Profit Organizations (June 1997 revisions) (006607)
- *Considering Fraud in a Financial Statement Audit: Practical Guidance for Applying SAS No. 82* (008883)
- *Auditing Estimates and Other Soft Accounting Information* (010010)
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- *Financial Statement Presentation and Disclosure Practices for Not-for-Profit Organizations* (006605)
- *CPA Performance View Services: A Practitioner's Guide to Providing Performance Measurement Engagements* (006606)
- *CPA WebTrust: Practitioner's Guide* (006604)
- *Financial Statement Reporting and Disclosure Practices for Employee Benefit Plans,* Second Edition (006608)

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Chapter 1

INTRODUCTION

WHAT IS THE PURPOSE OF THIS PRACTICE AID?

This publication is intended to provide guidance on accounting, auditing, and reporting on financial statements of multiemployer employee benefit plans. It is intended to complement the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans* (the Guide). It has been issued by the Accounting and Auditing Publications group of the AICPA and is intended to provide practitioners with nonauthoritative practical guidance on such matters.

This publication applies to multiemployer—

- Defined benefit pension plans.
- Defined contribution pension plans.
- Defined benefit and defined contribution health and welfare benefit plans.
- Other plans, such as apprentice training benefit plans, legal service plans, and vacation plans.

Generally accepted auditing standards (GAAS) and generally accepted accounting principles (GAAP) are applicable in the auditing and reporting of all employee benefit plans, including multiemployer plans. The broad application of those standards and principles is not discussed here. Rather, this Practice Aid focuses on the special problems in auditing and reporting on financial statements that are unique to multiemployer employee benefit plans. This Practice Aid contains certain suggested auditing procedures; however, detailed internal control questionnaires and audit programs are not included. The nature, timing, and extent of auditing procedures are a matter of professional judgment and vary depending on the size, organizational structure, internal control, and other factors in a specific engagement.

The Practice Aid also includes information regarding statutory rules and regulations applicable to multiemployer employee benefit plans and illustrations of plan financial statements and auditors' reports. The guidance presented is not all-inclusive, but rather is limited to matters that warrant special emphasis or that the authors' experiences have indicated may be useful to auditors of multiemployer employee benefit plans. This publication is based on the assumption that the readers are generally familiar with accounting and auditing of employee benefit plans. This publication is not a substitute for the authoritative pronouncements. Users of this publication should refer directly to applicable authoritative pronouncements when appropriate.

WHAT IS A MULTIEMPLOYER PLAN?

A *multiemployer plan* is a plan (1) in which more than one employer is required to contribute, (2) that is maintained pursuant to one or more collective bargaining agreements, and (3) that had not made the election under Internal Revenue Code (IRC) section 414(f)(5) and Employee Retirement Income Security

Act of 1974 (ERISA) section 3(37)(E). Often a multiemployer plan is confused with a multiple employer plan. A multiple employer plan is a plan that involves more than one employer, is not one of the plans described in paragraphs A.43 and A.44 of the Guide, and includes only plans whose contributions from individual employers are available to pay benefits to all participants. Participating employers do not file individually for these plans. Multiple employer plans can be collectively bargained and collectively funded, but if covered by Pension Benefit Guaranty Corporation (PBGC) termination insurance, must have properly elected before September 27, 1981, not to be treated as a multiemployer plan under IRC section 414(f)(5) or ERISA sections 3(37)(E) and 4001(a)(3).

This publication addresses multiemployer plans only.

A multiemployer plan is adopted and is generally administered by a joint union and employer board of trustees. It provides benefits, contributions, or both that are negotiated under a collective bargaining agreement (CBA) between one or more unions and at least two employers. CBAs are negotiated between a union and individual employers, or an association bargaining for a group of employers. CBAs are not the plan documents but only authorize adoption of retirement and welfare plans and establish the contribution rates for each employer or class of employers. The agreements are analogous to board resolutions adopting plans maintained by corporations. Contributions are made to the trust periodically based on a flat amount, hours worked, hours paid, or percentage of payroll by employees, employers, or both who are subject to the collective bargaining agreement. Multiemployer plans may enter into reciprocity agreements with other multiemployer plans in different locations that cover similar types of jobs. These agreements allow participants to aggregate their service under several plans to qualify for a benefit or to receive a larger benefit.

The joint board of trustees comprises both management and labor, equally represented to administer the plan. Responsibility for daily plan administration may be delegated to either the sponsoring union (more common in smaller plans), a joint labor-management committee, or a professional plan administrator. Trustees, although legally responsible for plan administration, recognize that they cannot personally handle the numerous tasks that must be performed. In addition, they generally do not have the skills and experience required for effective plan administration. Within the legislative framework and the common law of trusts, trustees can employ qualified third parties to assist with the operation of the plan. They should be selected with "reasonable care" and must be "independent."

Multiemployer plans are often concentrated in industries with high worker mobility or seasonal employment (for example, the construction industry) or where companies are too small to justify single-employer plans, such as textile trades. Some plans are industry-wide, such as the communications industry, and some cover only a particular trade or craft (for example, electrical workers). Traditionally the construction industry has had the highest concentration of multiemployer plans.

Regulations Affecting Multiemployer Plans

The passage of the Labor-Management Act of 1947, commonly referred to as the Taft-Hartley Act (Taft-Hartley), established the legal requirements of a joint labor-management trust fund. (Multiemployer employee benefit plans are commonly referred to as Taft-Hartley funds.) Failure to comply with the Taft-Hartley law renders the parties liable to criminal sanctions and makes the trust illegal. If the trust is not in compliance with Taft-Hartley, payments by employers violate the law. The conditions set forth in section 302(c)(5) of the Taft-Hartley Act are as follow:

- The payments should be held in trust for the sole and exclusive benefit of eligible employees and their families.
- A joint board of trustees on which management and labor are equally represented and have equal powers should administer the fund.
- Generally, an independent accountant should annually audit plans that have more than 100 participants.
- An impartial arbitrator should be provided for to break a deadlock in case the trustees do not agree and a stalemate occurs.
- The basis on which benefit payments are made is set forth in a written agreement.
- The purpose of the trust is limited to certain specific functions. It can exist to pay for—

  —Health, hospital, and disability or life insurance.

  —Pensions or annuities.

  It can provide for—

  —Apprenticeship training.

  —Vacation or holiday funds.

  —Day care centers.

  —Scholarships and group legal services.

ACCOUNTING AND AUDITING ISSUES

As noted earlier, GAAS and GAAP are applicable to all employee benefit plans, including multiemployer plans. In addition to the general standards, the following is a list of accounting related pronouncements that are specific to all employee benefit plans:

- Financial Accounting Standards Board (FASB) Statements of Financial Accounting Standards No. 35, *Accounting and Reporting by Defined Benefit Pension Plans,* as amended by FASB Statement No. 110, *Reporting by Defined Benefit Pension Plans of Investment Contracts*, which establishes standards of financial accounting and reporting for the annual financial statements of defined benefit pension plans. (FASB Statement Nos. 35 and 110 do not apply to defined contribution plans and employee health and welfare benefit plans.)
- AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans* (the Guide) provides guidance on accounting, auditing, and reporting on the financial statements of employee benefit plans, including specialized accounting principles and practices for defined contribution plans and employee health and welfare benefit plans. The accounting guidance relating to defined contribution pension plans and health and welfare benefit plans contained in the Guide is consistent with the accounting and reporting standards in FASB Statement No. 35 to the extent appropriate. The following summarizes the accounting standards specific to employee benefit plans that have been integrated into the Guide:

—AICPA Statement of Position (SOP) 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans*, as amended by SOP 94-4, *Reporting of Investment Contracts Held by Health and Welfare Benefit Plans and Defined-Contribution Pension Plans,* and SOP 99-3, *Accounting for and Reporting of Certain Defined Contribution Plan Investments and Other Disclosure Matters,* clarifies several accounting and reporting requirements set forth in chapter 4 of the Guide and updates the Guide to incorporate new statements issued by the FASB. (In March 2000 the AICPA issued an exposure draft for a proposed SOP, *Accounting for and Reporting of Certain Health and Welfare Benefit Plan Transactions,* that would amend SOP 92-6. Be alert for the issuance of the final SOP. For a summary of the proposed SOP, see the section, "Exposure Draft—Proposed Statement of Position to Amend SOP 92-6" in chapter 2 of this Practice Aid.)

—SOP 94-4 as amended by SOP 99-3. SOP 94-4 specifies the accounting for health and welfare benefit plans and defined contribution plans for investment contracts issued by either an insurance enterprise or other entity. SOP 94-4 amends SOP 92-6 and the Guide.

—SOP 99-2, *Accounting for and Reporting of Postretirement Medical Benefit (401(h)) Features of Defined Benefit Pension Plans,* specifies the accounting for and disclosure of 401(h) features of defined benefit pension plans, by both defined benefit pension plans and health and welfare benefit plans.

—SOP 99-3 simplifies disclosures for certain investments and supersedes AICPA Practice Bulletin 12 (PB 12), *Reporting Separate Investment Fund Option Information of Defined-Contribution Pension Plans*. (SOP 99-3 amends SOP 94-4, SOP 92-6, and the Guide.)

Employee Retirement Income Security Act of 1974

The intent of ERISA is to protect the well-being and security of millions of employees and their dependents affected by the operation of employee benefit plans. Administrators of employee benefit plans are required to file numerous disclosure and tax reports, such as Form 5500 and Form 990, to the Department of Labor (DOL), the Internal Revenue Service (IRS), and the PBGC. In addition, ERISA requires that plan administrators disclose certain plan information to plan participants and beneficiaries, such as the summary annual report (SAR).

ERISA establishes—

- Minimum standards for participation, vesting, and benefit accrual.
- Minimum funding standards for plans.
- The PBGC to insure defined benefit pensions in the event a covered pension plan terminates without sufficient funds to meet its vested obligations.
- Federal standards for fiduciary conduct and procedures for their enforcement.

Essentially, the language of ERISA requires that the trustees function solely as fiduciaries in the interest of the plan participants and beneficiaries. Auditors of employee benefit plans need to be aware of the impact of ERISA on the plan audit as well as other accounting and auditing issues that are unique to multiemployer benefit plans.

Overview of the Audit

The audit of a multiemployer plan may be performed at the administrator's location instead of at the plan. The auditor may also need to perform agreed-upon procedures, commonly referred to as "payroll audits," at various employer locations to test participant data and employer contributions. Due to multiple contributing employers, the unique portability of service, and the political relationship between the employers and the union, multiemployer plan administrators should take extra care that the contributing employers provide the proper participant information. Generally, the administrator of a multiemployer plan uses an employer transmittal or remittance report to receive information from each employer containing the name, Social Security number, and hours worked for each employee, as well as for support for the monthly contributions. Because this information is essential for maintaining qualified status, it is important to visit the contributing employers to compare the reports with their payroll and other personnel records, and with records maintained by the plan. Payroll procedures, including agreed-upon procedures to test the completeness of employer contributions, may be performed by the employer's auditor, other outside auditors, in-house compliance personnel, or others. (See chapter 4 of this Practice Aid, "Employer Payroll Audits," for guidance on performing such payroll procedures.)

In addition to the plan administrator, the plan trustees hire other service providers, such as actuaries, attorneys, investment advisers, custodians, and other consultants. It is critical in the planning stage of the audit to coordinate the information needed from each of the service providers to ensure that the audit is completed efficiently. (See chapter 5 of the Guide, "Planning," for further guidance on planning audits of all employee benefit plans, including multiemployer plans.) The plan administrator retains all of the permanent records of the plan; however, in certain circumstances, documents may need to be obtained from the other service providers.

Auditing Investments

Multiemployer pension plans may have significant investment balances, and to help meet their fiduciary responsibilities, the trustees may hire investment advisers to assist them in developing an investment policy. One aspect of this policy is to determine an appropriate asset allocation, and under what circumstances the plan may enter into derivative or more risky investments. Trustees generally delegate investment duties to an investment manager, who has discretion over investment of the funds subject to overall policy guidelines. Many funds have more than one investment manager, allocating the investments to provide diversification. Due to the nature of the investment arrangements, auditors should consider obtaining reports from the investment managers as well as the custodian. Investment management reports should be reviewed for valuation of investments, asset allocations, commissions, and proxies. As noted in the general auditing procedures in chapter 7 of the Guide, "Auditing Investments," the auditor should, among other things, analyze the investments and perform procedures to verify that investment transactions are recorded in appropriate amounts and in the appropriate period and that investments are measured at fair value. The auditor should also determine that investment strategies are executed in accordance with the investment policy. Chapter 7 of the Guide also provides auditing procedures specific to certain types of investments, such as investments in common and commingled trust funds, mutual funds, and participant loans. In September 2000, the AICPA Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 92, *Auditing Derivative Instruments,* *Hedging Activities, and Investments in Securities* (AICPA, *Professional Standards,* vol. 1, AU sec. 391).[1] SAS No. 92 supersedes SAS No. 81, *Auditing Investments* (AICPA, *Professional Standards,* vol. 1, AU sec. 332), and is effective for audits of financial statements for fiscal years ending on or after June 30, 2001, with early application permitted. SAS No. 92 helps auditors plan and perform auditing procedures for financial statement assertions about derivative instruments, hedging activities, and investments in securities.

Internal Control

Internal control of a benefit plan consists of controls at the sponsor as well as the controls at applicable service organizations that perform significant plan functions including, but not limited to, investment custody, investment management, and payment of benefits. In some cases, a third-party administrator or service organization, such as a bank trustee, insurance company, or contract administrator, process certain transactions on behalf of the plan administrator. It is important in the audit of a multiemployer plan to understand the internal control and systems in place at the third-party administrator(s) or service organization(s). The most efficient means of obtaining this understanding is by obtaining and reading a report prepared in accordance with SAS No. 70, *Service Organizations* (AICPA, *Professional Standards,* vol. 1, AU sec. 324), as amended, for the service organization, if one is available. Service providers are not required to furnish a SAS No. 70 report; however, if a SAS No. 70 report covering controls at the plan administrator is available, the auditor may rely on the results of the SAS No. 70 report to modify the nature, timing, and extent of audit procedures to be performed. See chapter 6 of the Guide, "Internal Control," for a further discussion of internal control, and SAS No. 70 reports and chapter 5 of this Practice Aid, "Internal Control Testing," for specific steps to be performed if a SAS No. 70 report is not available.

Multiemployer plans may include a vacation fund or an apprentice training fund. Vacation funds require auditing procedures similar to those on a single employer defined contribution plan. Apprentice training funds may require auditing procedures, including testing of property and equipment or lease arrangements, wages paid to coordinators and instructors, payroll filings, and training expenses.

Typically multiemployer health and welfare benefit plans are defined benefit plans that may require an actuarial determination of the plan's benefit obligations. (However, increasingly multiemployer plans are being structured as defined contribution health and welfare benefit plans.) Defined benefit pension plans need to have an actuarial valuation done annually to determine the actuarial present value of accumulated plan benefits and changes therein. The auditor may have a general awareness and understanding of actuarial concepts and practices, however, he or she cannot act in the capacity of an actuary. The auditor therefore needs to follow the guidance of SAS No. 73, *Using the Work of a Specialist* (AICPA, *Professional Standards,* vol. 1, AU sec. 336), to rely on the actuary's report.

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[1] The Auditing Standards Board (ASB) has developed a companion Audit Guide to help practitioners implement the new Statement on Auditing Standards (SAS). That Guide provides practical guidance for implementing SAS No. 92, *Auditing Derivative Investments, Hedging Activities, and Investments in Securities* (AICPA, *Professional Standards,* vol. 1, AU sec. 391), on all types of audit engagements. To order, contact the AICPA order department at (888) 777-7077, and ask for product number 012520.

IRS AND DOL EXAMINATIONS

You should be aware that there are many other aspects of auditing multiemployer employee benefit plans. In addition to being familiar with Taft-Hartley Act and ERISA, you need to be familiar with IRS and DOL regulations affecting plans and trusts. The scope of an IRS exam for a multiemployer plan is broader than a single employer plan due to unique issues resulting from the collective bargaining process and multiple employers. The IRS announcement 96-25 (1996—17 I.R.B. 13 [4/22/96]) describes multiemployer plans examination guidelines. These guidelines provide technical background and guidance on issues that are considered by the IRS during an examination. Some of these issues include required amendments and effective dates of legislation, minimum participation and nondiscrimination rules, IRS limits on contributions and benefits, minimum funding requirements, eligibility, participation and coverage rules, and distribution calculations and vesting.

The scope of a DOL audit generally focuses on fiduciary issues. Some areas of interest to the DOL include determining that—

- Expenses paid by the plan are in the best interest of the participants.
- Investments are properly diversified.
- All service providers have approved contracts.
- Trustee expenses are properly documented.
- No prohibited transactions exist between the plan and a party in interest.

Chapter 2

APPLYING SOP 92-6 TO MULTIEMPLOYER HEALTH AND WELFARE BENEFIT PLANS

Note: At the time this Practice Aid went to press the AICPA Accounting Standards Executive Committee had an exposure draft outstanding of a proposed Statement of Position (SOP), *Accounting for and Reporting of Certain Health and Welfare Benefit Plan Transactions*, that would amend SOP 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans*. You should be alert to the issuance of this SOP, as it may change some of the guidance contained in this chapter. See the section, "Exposure Draft — Proposed Statement of Position to Amend SOP 92-6," at the end of this chapter for a further discussion of this proposed SOP.

BACKGROUND

In August 1992, the AICPA issued SOP 92-6. SOP 92-6 defines generally accepted accounting principles (GAAP) for health and welfare benefit plans, and conforms plan accounting to Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions.* This chapter will highlight the provisions of SOP 92-6 and provide examples of its application. Plan benefit obligation information is relevant to defined benefit health and welfare plans. The SOP differentiates between defined contribution (DC) and defined benefit (DB) health and welfare benefit plans.

Defined contribution health and welfare benefit plans are characterized as follows:

- DC health and welfare benefit plans maintain an individual account for each participant. Under this arrangement, the benefits participants will receive are limited to the amounts contributed to these accounts, investment experience, expenses, and forfeiture allocations. The financial statements of a DC health and welfare benefit plan prepared in accordance with GAAP should be prepared on the accrual basis and include—

  —A statement of net assets available for benefits as of the end of the plan year (should be comparative as required by Employee Retirement Income Security Act of 1974 (ERISA) regulations).

  —A statement of changes in net assets available for benefits for the year then ended.

- A DC plan's obligations to provide benefits are limited to the amounts accumulated in individual participant accounts; therefore, information regarding estimated or projected benefit obligations is not applicable.
- Examples of DC health and welfare benefit plans are flexible spending account arrangements and vacation plans.

Defined benefit health and welfare benefit plans are characterized as follows:

- DB health and welfare benefit plans specify a determinable benefit, which may be in the form of a reimbursement to the covered plan participant or a direct payment to providers or third-party insurers for the cost of specified services.
- Individual participant accounts are not maintained.

Although the SOP was effective for financial statements of multiemployer health and welfare benefit plans prepared for plan years beginning after December 15, 1995, applying the provisions of this SOP will be new to many multiemployer plans starting in plan year 2000. On November 25, 1998, the Department of Labor (DOL) announced that it will not adopt the proposed nonenforcement policy. This proposed policy stated that the DOL would not reject the Form 5500 annual report of a multiemployer welfare benefit plan solely because the accountant's opinion accompanying such report is qualified or adverse due to a failure to comply with the financial statement disclosure requirements of SOP 92-6. To ensure that multiemployer welfare plans have an adequate opportunity to prepare their recordkeeping and other related systems to comply with SOP 92-6, the DOL also stated that these plans may continue to rely on its previously announced interim nonenforcement relief for their 1999 Form 5500 reports. Accordingly, annual reports of multiemployer health and welfare benefit plans filed for plan years beginning on or after January 1, 2000, are subject to rejection if there is any material qualification in the accountant's opinion accompanying the annual report due to a failure to comply with the requirements of SOP 92-6. In other words, annual reports of multiemployer health and welfare benefit plans will be subject to rejection if the accountant issues a qualified or adverse opinion due to not adopting SOP 92-6 starting with plan year 2000.

Employee health and welfare benefit plans that prepare financial statements in accordance with GAAP should follow the accounting and reporting requirements set forth in chapter 4, "Accounting and Reporting by Health and Welfare Benefit Plans," of the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans,* which incorporates the guidance of SOP 92-6. Among other requirements, SOP 92-6 requires plans that provide postretirement benefits to include in their financial statements the amount of the accumulated postretirement benefit obligation representing the actuarial present value of all future benefits attributed to plan participants' services rendered to date. Accounting changes adopted to conform to the provisions of the SOP should be made retroactively. Because ERISA requires comparative statements of net assets available for plan benefits, it will be necessary to restate the prior year's statement of net assets in the year of adoption in an ERISA audit to comply with the provisions of the SOP.[1] A failure to disclose the benefit obligations in comparative format will render the filing subject to rejection by the DOL. (Note: The statement of changes in net assets available for benefits and information on changes in plan obligations can be prepared in a single year presentation.)

Statement on Auditing Standards (SAS) No. 58, *Reports on Audited Financial Statements* (AICPA, *Professional Standards,* vol. 1, AU sec. 508), provides guidance when an auditor has previously qualified his or her opinion or expressed an adverse opinion on financial statements of prior periods because of a departure from GAAP and the prior period financial statements are restated in the current period to conform with GAAP. See SAS No. 58 (AU sec. 508.68–.69) for such guidance.

[1] If accounting changes were necessary to conform to the provisions of Statement of Position (SOP) 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans,* that fact should be disclosed when financial statements for the year in which the SOP is first applied are presented either alone or with financial statements of prior years.

If a plan does not adopt all of the provisions of SOP 92-6, including presenting the postretirement benefit obligation amount in the statement of plan's benefit obligations and statement of changes in plan's benefit obligations, which is required to fairly present the plan's financial statements in conformity with GAAP, the auditor should consider the effect of this departure from GAAP on his or her report.[2] SAS No. 58 (AU secs. 508.35–.60) describes the circumstances that may require a qualified or adverse opinion when the financial statements contain a departure from a generally accepted accounting principles. A qualified opinion is expressed when the auditor believes, on the basis of his or her audit, that the financial statements contain a departure from GAAP, the effect of which is material, and he or she has concluded not to express an adverse opinion. An auditor should express an adverse opinion when, in the auditor's judgment, the financial statements taken as a whole are not presented fairly in conformity with GAAP.

The remainder of this chapter will focus on DB health and welfare benefit plans, because SOP 92-6 has the greatest impact on these types of plans.

Disclosures Unique to Defined Benefit Health and Welfare Benefit Plans

Financial statements for DB health and welfare benefit plans that have adopted SOP 92-6, and are prepared in accordance with GAAP, require many of the same disclosures as other employee benefit plans. Refer to chapter 4 of the Guide, "Audits of Employee Benefit Plans," for further details of basic plan financial statement disclosures.

SOP 92-6 requires the following disclosures:

1. Benefit obligation information as of the end of the plan year (ERISA regulations require this information to be comparative), detailed as follows:

   —Premiums payable

   —Amounts currently payable to or for participants, beneficiaries, and dependents

   —Other obligations, including claims incurred but not reported (IBNR) (see below) for current benefit coverage, at present value of estimated amounts. Depending on the terms of the plan, these amounts may not have to be actuarially calculated.

   —Postretirement benefit obligations

[2] The AICPA exposure draft of a proposed SOP, *Accounting for and Reporting of Certain Health and Welfare Benefit Plan Transactions,* would amend SOP 92-6. Among other things, this proposed SOP would allow the information about benefit obligations to be presented in a separate statement, combined with other information on another financial statement, or presented in the notes to the financial statements. (You should be alert for the issuance of the final standard, because it may differ from the proposed SOP.)

Help Desk—Information regarding benefit obligations should be presented on the face of the financial statements. Note disclosure is not appropriate.[3] Note disclosure regarding explanations of benefit obligation information presented in the financial statements is acceptable. Such presentation may be made on a separate statement or with other information on another financial statement. Benefit obligations are discussed in detail in the "Analysis of Benefit Obligations" section of this chapter. Examples of the two disclosure methods are provided in the "Financial Statement Disclosure Formats" section of this chapter.

2. Details of changes in benefit obligations since the prior year. Minimum disclosure requirements regarding changes in benefit obligations should include the significant effects of plan amendments, changes in the nature of the plan (mergers or spinoffs), or changes in actuarial assumptions.
3. Additional financial statement disclosures,[4] including—

—A description of the methods and significant actuarial assumptions used to determine the plan's benefit obligations. Any significant changes in the assumptions made between financial statement dates and their effects should be disclosed.

—For plans providing postretirement benefits, the assumed health care cost-trend rate(s) used to measure the expected cost of benefits covered by the plan for the next year, a general description of the direction and pattern of change in the assumed trend rates thereafter, the ultimate trend rate(s), and when that rate is expected to be achieved.

—For plans providing postretirement benefits, the effect of a one-percentage-point increase in the assumed health care cost-trend rates for each future year on the postretirement benefit obligation.

ANALYSIS OF BENEFIT OBLIGATIONS

The objective of financial reporting by DB health and welfare benefit plans is the same as that of DB pension plans; both types of plans provide a determinable benefit. Accordingly, the primary objective of the financial statements of a DB health and welfare benefit plan is to provide financial information that is useful in assessing the plan's present and future ability to pay its benefit obligations.

To achieve this goal, the cost of a plan's benefit obligations should be measured and estimated. Plan obligations represent the cost of the future benefits "promised" by the plan sponsor(s) and earned by the participants up to a particular measurement date. This measurement date is generally the plan's year end. If used consistently, however, postretirement benefit obligations may be determined as of a date not more than three months before plan year end. In such circumstances however, the auditor should consider a roll-forward of the information to year end.[5]

[3] See footnote 2.

[4] The AICPA exposure draft of the proposed SOP adds additional required disclosures, including disclosure of information about the participant's relative share of the plan's estimated cost of providing contributions toward the current cost of postretirement benefits. (You should be alert for the issuance of the final standard, because it may differ from the proposed SOP.)

[5] The AICPA exposure draft of the proposed SOP clarifies the measurement date for benefit obligations. (You should be alert for the issuance of the final standard, because it may differ from the proposed SOP.)

The calculation of benefit obligations is dependent on the accuracy of the claims summary information prepared by the claims processors and demographic information maintained by the sponsor, third-party administrators, or both. An auditor should understand and evaluate the system of internal accounting controls relating to recordkeeping and report generation. This is all the more critical in a multiemployer plan environment, where participants are often transient between employers and multiple plan recordkeepers exist.

Some plans provide alternative benefits in addition to health and life coverage, such as vacation pay or education reimbursements, the obligations for these benefits should be calculated and reported in the financial statements.

Benefit obligations for DB health and welfare benefit plans include the estimated present value, as applicable, for the following sections.

Claims Payable and Currently Due for Active and Retired Participants

Claims payable represents those claims reported to the plan or the plan's third-party administrator that have been processed and will be paid after year end. Due to the high volume of claims processed by health and welfare plans, claims payable is usually estimated as the total unpaid claims as of the plan's year end.

Example 2-1

The National Paper Supply Workers Union has established a self-funded DB health and welfare plan. The plan is covered by a stop-loss insurance contract. On December 31, 20X1, the claims processors have determined that $1,675,000 in health claims and $100,000 of death and disability benefits have been reported and are expected to be paid in January. Of the health claims, $400,000 pertain to claims that have exceeded the stop-loss threshold and will be borne by an insurance company rather than the plan. Therefore, the plan will report health claims payable of $1,275,000 and death and disability benefits payable of $100,000 as of December 31, 20X1, in its statement of benefit obligations.

Premiums Due Under Insurance Arrangements

Many health and welfare plans provide coverage under group health insurance contracts and other insurance arrangements. Unpaid premiums due for insurance coverage should be included in benefit obligations. Additional amounts due, such as retrospective premiums and premium deficits as a result of experience ratings, should be considered in calculating plan obligations as well. Refer to paragraphs 4.44 through 4.46 of the Guide and chapter 3 of the AICPA Audit and Accounting Guide *Audits of Property and Liability Insurance Companies* for further information regarding insurance premiums and ratings.

Example 2-2

The premium structure of the stop-loss insurance contract in Example 2-1 has been determined based on a loss ratio of 65 percent (covered claims as a percentage of premiums). Retrospective premiums of $2,000 for every 1 percent the loss ratio exceeds 65 percent (up to a cap of 90 percent) are charged to the plan at the end of the contract year. The contract year is July 1 through June 30. Actual claims above the stop-loss threshold as a percentage of premiums paid for the six-month period ended December 31, 20X1, was 73 percent and premiums are expected to remain at that level for the remainder of the contract year. The plan will report premiums due of $16,000 ([73 percent minus 65 percent] times $2,000) as of December 31, 20X1, in its statement of benefit obligations.

IBNR for Active Participants

IBNR are those claims that have been incurred by participants during the current period but are reported to the claims administrator in a future period. The plan's obligation to pay these claims depends on the affected participants' and beneficiaries' eligibility to receive plan benefits when incurred.

IBNR should also reflect the present value of significant, long duration payouts for claims incurred before the plan's year end. Examples of these include long-term disability benefits and the effects of "shock claims" for catastrophic illnesses and injuries. Estimating these requires specific knowledge of the nature of the claims and actuarial assumptions, such as life expectancy and projected changes in medical costs. In such cases, a qualified actuary should usually be engaged to estimate the present value of the future costs of these extended claims.

Help Desk—An auditor should be familiar with the nature of the claims typically incurred by the plan, and inquire of the claims processor, plan administrator and actuary, whether they are aware of the possibility for the existence of "shock claims." The auditor should also assess the reasonableness of any actuarial assumptions and calculation methods used in determining IBNR.

Example 2-3

Fieldwork for the plan's 20X1 audit began in June 20X2, which allows for a six-month hindsight of claims activity since the plan's year end. To estimate IBNR, the plan sponsor requested its claims administrator to generate a "lag report." This summarizes 20X2 payments for claims incurred during 20X1. This analysis suggests that most claims tend to be paid by three months after the month incurred. See "Exhibit of Lag Report," in this example.

The result of this analysis is compared with other analyses and information provided by the plan sponsor and third-party administrator. The actuary has been informed that one long-term care claim has been reported in December 20X1 whose estimated present value, given the expected duration of future medical costs and life expectancy, is $100,000. Therefore, total IBNR to be reported by the plan is $895,000.

For purposes of this example, the actuary has also estimated the present value of incurred long-term disability benefits of $800,000 to be paid by the plan in the future. The estimates for these benefits have been adjusted for life expectancies and other assumptions.

Exhibit of Lag Report

Using a loss estimation method similar to those described in chapter 4 of the AICPA Audit and Accounting Guide *Audits of Property and Liability Insurance Companies*, the sponsor projected the ultimate claims costs by month incurred, based on payments summarized in the lag report as follows:

Month Incurred in 20X1	***Projected Ultimate Costs***	***Projected Unpaid Costs***
January	1,333,332	1,332
February	1,677,348	3,348
March	901,592	3,592
April	1,344,345	9,345
May	1,217,050	12,050
June	1,038,325	13,325
July	1,020,075	15,075
August	1,226,690	21,690
September	1,090,824	58,824
October	1,160,100	260,100
November	1,107,702	888,702
December	797,128	782,328
Subtotals	13,914,511	2,069,711
Less: Claims currently due and payable (see Example 2-1)		1,275,000
Net estimated IBNR (rounded)		$ 795,000

Accumulated Eligibility Credits for Active Participants

Plans may provide for the payment of insurance premiums or benefits for a period of time for those participants who have accumulated a sufficient number of eligibility credits or hours. This is particularly significant in a multiemployer environment, where workers may have gaps of unemployment as they wait to be assigned to new jobs with different employers.

Example 2-4

It is not uncommon for participants to periodically be without work as they move from job to job. Therefore, the union has negotiated a provision in the plan whereby participants can earn insurance coverage during the periods of unemployment based on months of service. Each participant earns one-quarter credit for every forty hours worked, including overtime. One full credit is needed for a single month's coverage under the plan. The actuary has determined the following costs of coverage per participant per month:

Average current monthly premium paid to insurance carrier for stop-loss coverage for participants and enrolled dependents	$ 10.00
Average monthly plan administrative cost per participant	.50
Average monthly plan benefit cost per participant [(20X1 benefits paid $16,770,000 divided by 12 months) divided by approximately 12,700 participants]	110.00
Total estimated cost per covered participant	$120.50

The actuary has multiplied the number of accumulated eligibility credits earned through December 31, 20X1, by the total estimated cost per covered participant. This quotient is then adjusted for mortality, expected employee turnover, and present value considerations, to arrive at an estimate of $200,000.

Postretirement Benefits

Health and welfare benefit plans may continue to provide benefits to participants after retirement. Postretirement benefit obligations are calculated in a manner consistent with FASB Statement No. 106. Under SOP 92-6, postretirement benefit obligations are estimated for[6]—

- Retired participants, including their beneficiaries and covered dependents.
- Active or terminated participants who are fully eligible to receive benefits.
- Active participants not yet fully eligible to receive benefits.

In calculating postretirement benefit obligations, consideration should be given to the benefits currently provided to employees and the history of making such related payments to retirees. The fact that benefits may be reduced or even potentially eliminated would not ordinarily affect the promise made at the end of the plan year unless the change meets the substantive plan criteria of FASB Statement No. 106 (see "Help Desk" in exhibit 2-5 for further explanation of the term *substantive plan*). Additionally, expected future retired participant contributions to the plan are not considered in calculating postretirement benefits.

[6] The AICPA exposure draft of the proposed SOP would amend this requirement such that, at a minimum, information about the postretirement benefits be presented in two categories: (1) obligations related to plan participants fully eligible for benefits, and (2) obligations related to plan participants not yet fully eligible for benefits. (You should be alert for the issuance of the final standard, because it may differ from the proposed SOP.)

Example 2-5

The National Paper Supply workers' DB health and welfare benefit plan provides postretirement benefits for workers who have provided twenty-four years of service. To calculate the postretirement obligation, the actuary obtains the following information from the union, third-party administrators, and sponsoring companies:

- Plan document and any other relevant documents for pertinent coverage and eligibility provisions, including amendments.
- Indications of provided benefits or other continued plan practices, though not incorporated in the plan document, suggest the existence of a "substantive plan." Such benefits and practices should be considered in the calculation of benefit obligations.

Help Desk—In a multiemployer plan environment, an employer does not have the unilateral right to change a collectively bargained plan. Therefore, if the postretirement benefits are the subject of collective bargaining, the extant written plan shall be the substantive plan unless the employer can demonstrate its ability to making changes in such items as deductibles, coinsurance provisions, or cost-sharing provisions. Generally, an employer demonstrates its ability by implementing such changes.

- Demographic information of all plan participants, including birth dates, hire dates, termination or retirement dates, hire and termination trend analyses, and dependency status data. Such information should be prepared for active, inactive, and retired employees and their beneficiaries.
- Participation rates (for contributory plans).
- Detailed claims information of the plan.
- Salaries (for pay-related plans).

The actuary gathers other information that is pertinent to the assumptions used in calculating postretirement benefits, including—

- Geographic location of participants and retirees. Different areas of the country may have different health care costs and types of illnesses.
- Medicare and other supplemental health insurance benefits and reimbursement rates.
- Health care cost trends.
- Data necessary to calculate an assumed discount rate, which measures the time value of money.

Using this information, explicit assumptions are formulated that measure the plan's postretirement benefit obligations. Each assumption individually represents the actuary's best estimate of a future event. All assumptions should presume that the plan will continue in its present form, unless there is evidence to the contrary. Principal assumptions include—

- Discount rates, used to reflect the time value of money in determining the present value of future cash outflows currently expected to be required to satisfy the liability in the due course of business.

- The timing and amount of future postretirement benefit payments (taking into consideration per capita claims cost by age, health care cost-trend rates, current Medicare reimbursement rates, retirement age, dependency status, and mortality).
- Salary progression (for pay-related plans).
- The probability of payment (considering turnover, retirement age, dependency status, and mortality).
- Participation rates (for contributory plans).

Based on an analysis of the data collected, the actuary has determined the plan's postretirement benefit obligations as follows:

Current retirees	$ 3,900,000
Other participants fully eligible for benefits	2,100,000
Other participants not yet fully eligible for benefits	5,000,000
	$11,000,000

As this example demonstrates, information gathered that is accurate and complete is key to the fair calculation of a plan's obligations at the financial statement date. An auditor should review, evaluate, and test internal control policies and procedures that exist over the systems that generate the information supplied to the actuary. Additionally, the auditor should test the information made available to the actuary and assess the reasonableness of the assumptions made by the actuary. Benefit obligations should not include death benefits actuarially expected to be paid during the active service period of participants.

FINANCIAL STATEMENT DISCLOSURE FORMATS[7]

SOP 92-6 prescribes two formats for plans:

- Benefit obligation information is displayed in separate financial statements.
- Benefit obligation information is included on the face of the financial statements of the plan, along with net asset information.

See exhibits 1 and 2, which follow, for illustrations of financial statements prepared in accordance with the provisions of SOP 92-6.[8] The data in these examples are taken from examples 2-1 through 2-5.

[7] See footnote 2.

[8] These exhibits do not illustrate other provisions that might apply in circumstances other than those assumed in the examples. The formats presented are only illustrative and are not necessarily the only possible presentations. These exhibits may not include all presentation items promulgated, nor do they represent minimum requirements.

EXHIBIT 1 — Benefit Obligation Information Displayed in Separate Financial Statements

National Paper Supply Workers Benefit Plan
Statements of Net Assets Available for Benefits
December 31, 20X1 and 20X0

	20X1	*20X0*
Assets		
Investments, at fair value (see note 3)		
U.S. government securities	$ 5,000,000	$ 4,000,000
Corporate bonds and debentures	2,000,000	1,600,000
Common stock	1,000,000	600,000
Total investments	8,000,000	6,200,000
Receivables		
Participating employers' contributions	500,000	430,000
Participants' contributions	100,000	80,000
Accrued interest and dividends	50,000	40,000
Total receivables	650,000	550,000
Cash	140,000	115,000
Total assets	8,790,000	6,865,000
Liabilities		
Due to broker for securities purchased	250,000	240,000
Accounts payable for administrative expenses	25,000	25,000
Total liabilities	275,000	265,000
Net assets available for benefits	$ 8,515,000	$ 6,600,000

The accompanying notes are an integral part of the financial statements.

EXHIBIT 1 — continued

National Paper Supply Workers Benefit Plan
Statements of Changes in Net Assets Available for Benefits
December 31, 20X1 and 20X0

	20X1	*20X0*
Contributions		
Participating employers	$15,000,000	$ 14,500,000
Participants	3,000,000	2,800,000
Total contributions	18,000,000	17,300,000
Investment income		
Net appreciation in fair value of investments	300,000	200,000
Interest	500,000	450,000
Dividends	50,000	50,000
	850,000	700,000
Less: Investment expenses	15,000	25,000
Net investment income	835,000	675,000
Total additions	18,835,000	17,975,000
Benefits paid to participants		
Health care	16,000,000	15,750,000
Disability care	770,000	750,000
	16,770,000	16,500,000
Administrative expenses	150,000	175,000
Total deductions	16,920,000	16,675,000
Net increase during year	1,915,000	1,300,000
Net assets available for benefits		
Beginning of year	6,600,000	5,300,000
End of year	$ 8,515,000	$ 6,600,000

The accompanying notes are an integral part of the financial statements.

EXHIBIT 1 — continued

National Paper Supply Workers Benefit Plan
Statements of Plan's Benefit Obligations
December 31, 20X1 and 20X0

	20X1	*20X0*
Amounts currently payable to or for participants, beneficiaries and dependents:		
Health claims payable	$ 1,100,000	$ 975,000
Death and disability benefits payable	100,000	85,000
Premiums payable	16,000	15,000
	1,216,000	1,075,000
Other obligations for current benefit coverage, at present value of estimated amounts:		
Claims incurred but not reported	895,000	925,000
Accumulated eligibility credits	200,000	225,000
Long-term disability benefits	800,000	485,000
	1,895,000	1,635,000
Total obligations other than postretirement benefit obligations	3,111,000	2,710,000
Postretirement benefit obligations:		
Current retirees	3,900,000	3,500,000
Other participants fully eligible for benefits	2,100,000	2,000,000
Other participants not yet fully eligible for benefits	5,000,000	4,165,000
	11,000,000	9,665,000
Total benefit obligations	$14,111,000	$12,375,000

The accompanying notes are an integral part of the financial statements.

EXHIBIT 1 — continued

National Paper Supply Workers Benefit Plan
Statements of Changes in Plan's Benefit Obligations
December 31, 20X1 and 20X0

	20X1	*20X0*
Amounts currently payable to or for participants, beneficiaries, and dependents:		
Balance at beginning of year	$ 1,075,000	$ 850,000
Claims reported and approved for payment	16,911,000	16,725,000
Claims paid (including disability)	(16,770,000)	(16,500,000)
Balance at end of year	1,216,000	1,075,000
Other obligations for current benefit coverage, at present value of estimated amounts:		
Balance at beginning of year	1,635,000	775,000
Net change during the year:		
Long-term disability benefits	315,000	50,000
Other	(55,000)	810,000
Balance at end of year	1,895,000	1,635,000
Total obligations for current benefit coverage	3,111,000	2,710,000
Postretirement benefit obligations		
Balance at the beginning of year	9,665,000	8,665,000
Increase (decrease) during the year attributable to:		
Benefits earned and other changes	1,250,000	1,000,000
Plan amendment	(175,000)	—
Changes in actuarial assumptions	260,000	—
	11,000,000	9,665,000
Total benefit obligations	$ 14,111,000	$12,375,000

The accompanying notes are an integral part of the financial statements.

EXHIBIT 1 — continued

National Paper Supply Workers Benefit Plan
Notes to Financial Statements

[This example includes only those notes pertinent to the application of SOP 92-6.]

NOTE 2: SUMMARY OF ACCOUNTING POLICY

B. Postretirement Benefits

The postretirement benefit obligation represents the actuarial present value of those estimated future benefits that are attributed to employee service rendered to December 31. Postretirement benefits include future benefits expected to be paid to or for (1) currently retired or terminated employees and their beneficiaries and dependents and (2) active employees and their beneficiaries and dependents after retirement from service with the participating employers. Before an active employee's full eligibility date, the postretirement benefit obligation is the portion of the expected postretirement benefit obligation that is attributed to that employee's service in the plan rendered to valuation date.

The actuarial present value of the expected postretirement benefit obligation is determined by an actuary and is the amount that results from applying actuarial assumptions to historical claims-cost data to estimate future annual incurred claims costs per participant and to adjust such estimates for the time value of money through discounts for interests and the probability of payment (by means of decrements such as those for death, disability, withdrawal, or retirement) between the valuation date and the expected date of payment.

For measurement purposes, a 9.5 percent annual rate of increase in the per-capita cost of covered health care benefits was assumed for 20X0; the rate was assumed to decrease gradually to 8.0 percent for 20X7 and to remain at that level thereafter. These assumptions are consistent with those used to measure the benefit obligation at December 31, 20X1.

The following were other significant assumptions used in the valuations as of December 31, 20X0 and 20X1.

Weighted-average discount rate	8.0%-20X1; 8.25%-20X0
Average retirement age	60

The foregoing assumptions are based on the presumption that the Plan will continue. Were the Plan to terminate, different actuarial assumptions and other factors might be applicable in determining the actuarial present value of the postretirement benefit obligation.

(continued)

EXHIBIT 1 — continued

C. Other Plan Benefits

Plan obligations at December 31 for health claims incurred by active participants but not reported at that date, for accumulated eligibility of participants, and for future disability payments to members considered permanently disabled at December 31 are estimated by the Plan's actuary in accordance with accepted actuarial principles. Such estimated amounts are reported in the accompanying statements of the Plan's benefit obligations at present value, where applicable, based on an 8 percent discount rate. Health claims incurred by retired participants but not reported at the year end are included in the postretirement benefit obligation.

NOTE 4: BENEFIT OBLIGATIONS

The Plan's deficiency of net assets over benefit obligations at December 31, 20X1 and 20X0, relates primarily to the postretirement benefit obligation, the funding of which is not covered by the contribution rate provided by the current bargaining agreement. It is expected that the deficiency will be funded through future increases in the collectively bargained contribution rates.

The weighted average health care cost-trend rate assumption (see note 2B) has a significant effect on the amounts reported in the accompanying financial statements. If the assumed rates increased by one percentage point in each year, it would increase the obligation as of December 31, 20X1 and 20X0 by $2,600,000 and $2,500,000, respectively.

EXHIBIT 2 — Benefit Obligation Information Included on the Face of the Financial Statements of the Plan, Along With Net Asset Information

National Paper Supply Workers Benefit Plan
Statements of Net Assets Available for Benefits
December 31, 20X1 and 20X0

	20X1	*20X0*
Assets		
Investments, at fair value (see note 3)		
U.S. government securities	$ 5,000,000	$ 4,000,000
Corporate bonds and debentures	2,000,000	1,600,000
Common stock	1,000,000	600,000
Total investments	8,000,000	6,200,000
Receivables		
Participating employers' contributions	500,000	430,000
Participants' contributions	100,000	80,000
Accrued interest and dividends	50,000	40,000
Total receivables	650,000	550,000
Cash	140,000	115,000
Total assets	8,790,000	6,865,000
Liabilities		
Due to broker for securities purchased	250,000	240,000
Accounts payable for administrative expenses	25,000	25,000
Total liabilities	275,000	265,000
Net assets available for benefits	8,515,000	6,600,000
Benefit Obligations (note 4)		
Amounts currently payable to or for participants, beneficiaries, and dependents	1,216,000	1,075,000
Other obligations for current benefit coverage, at present value or estimated amounts	1,895,000	1,635,000
Postretirement benefit obligations	11,000,000	9,665,000
Total benefit obligations	14,111,000	12,375,000
Excess of benefit obligations over net assets available for benefits	$ (5,596,000)	$ (5,775,000)

The accompanying notes are an integral part of the financial statements.

EXHIBIT 2 — continued

National Paper Supply Workers Benefit Plan
Statements of Changes in Net Assets Available for Benefits
December 31, 20X1 and 20X0

	20X1	*20X0*
Contributions		
Participating employers	$ 15,000,000	$ 14,500,000
Participants	3,000,000	2,800,000
Total contributions	18,000,000	17,300,000
Investment income		
Net appreciation in fair value of investments	300,000	200,000
Interest	500,000	450,000
Dividends	50,000	50,000
	850,000	700,000
Less: Investment expenses	15,000	25,000
Net investment income	835,000	675,000
Total additions	18,835,000	17,975,000
Benefits paid to participants		
Health care	16,000,000	15,750,000
Disability care	770,000	750,000
	16,770,000	16,500,000
Administrative expenses	150,000	175,000
Total deductions	16,920,000	16,675,000
Net increase during year	1,915,000	1,300,000

(continued)

EXHIBIT 2 — continued

National Paper Supply Workers Benefit Plan
Statements of Changes in Net Assets Available for Benefits
December 31, 20X1 and 20X0

Net increase in benefit obligations		
Increase (decrease) attributable to:		
Additional claims payable to or for participants, dependents, and beneficiaries	141,000	225,000
Additional other obligations for current benefit coverage, at present value of estimated amounts	260,000	860,000
Postretirement benefit obligations:		
Benefits earned and other changes	1,250,000	1,000,000
Plan amendment[9]	(175,000)	—
Changes in actuarial assumptions	260,000	—
Net increase in benefit obligations	1,736,000	2,085,000
(Decrease) increase in benefit obligations over net assets available for benefits	(179,000)	785,000
Excess of benefit obligations over net assets available for benefits		
Beginning of year	5,775,000	4,990,000
End of year	$ 5,596,000	$ 5,775,000

The accompanying notes are an integral part of the financial statements.

[9] There should be disclosure of the description of significant plan amendments adopted during the period, and the effects of such amendments on net assets if significant either individually or in the aggregate. (Audit and Accounting Guide, *Audits of Employee Benefit Plans*, pars. 2.27b, 3.28b, and 4.59). This illustration does not include such disclosure.

EXHIBIT 2 — continued

National Paper Supply Workers Benefit Plan
Notes to Financial Statements

[This example includes only those notes pertinent to the financial statement disclosures under SOP 92-6, when benefit obligation information is included on the face of the financial statements.]

NOTE 4: BENEFIT OBLIGATIONS

The Plan's deficiency of net assets over benefit obligations at December 31, 20X1 and 20X0, relates primarily to the postretirement benefit obligation, the funding of which is not fully covered by the contribution rate provided by the current bargaining agreement. It is expected that the deficiency will be funded through future increases in the collectively bargained contribution rates. The postretirement benefit obligation at December 31, 20X1 and 20X0, principally health benefits, related to the following categories of participants (including their beneficiaries and dependents):

	20X1	*20X0*
Current retirees	$ 3,900,000	$ 3,500,000
Other participants fully eligible for benefits	2,100,000	2,000,000
Other participants not yet eligible for benefits	5,000,000	4,165,000
	$11,000,000	$ 9,665,000

The weighted average health care cost-trend rate assumption (see note 2B) has a significant effect on the amounts reported in the accompanying financial statements. If the assumed rates increased by one percentage point in each year, it would increase the obligation as of December 31, 20X1 and 20X1, by $2,600,000 and $2,500,000, respectively.

Exposure Draft — Proposed Statement of Position to Amend SOP 92-6 and the Guide

In March 2000 the AICPA Accounting Standards Executive Committee issued an exposure draft for a proposed SOP, *Accounting for and Reporting of Certain Health and Welfare Benefit Plan Transactions*. This proposed SOP amends chapter 4 of the Guide, and SOP 92-6. This proposed SOP—

- Specifies the presentation requirements for benefit obligation information.
- Requires disclosure of information about the participant's relative share of the plan's estimated cost of providing postretirement benefits.
- Clarifies the measurement date for benefit obligations.
- Establishes standards of financial accounting and reporting for postemployement benefits provided by health and welfare benefit plans.
- Requires the identification of investments representing 5 percent or more of the net assets available for benefits.

This SOP would be effective for financial statements for plan years beginning after December 15, 2000, with earlier application encouraged. Financial statements presented for prior plan years would be required to be restated to comply with the provisions of this SOP.

Help Desk—The comment period for this exposure draft ended June 22, 2000. You should be alert to the issuance of this SOP because it may change some of the guidance provided in this chapter. In addition, the final SOP may differ from the draft used in this chapter. You should note that the purpose of AICPA exposure drafts is to solicit comments from preparers, auditors, users of financial statements, and other interested parties. They are nonauthoritative and cannot be used as a basis for changing GAAP.

Chapter 3

INVESTMENTS

AUDITING MULTIEMPLOYER PLAN INVESTMENTS

General

Contributions and the resulting investments are generally the cornerstone of every retirement plan and are the basis from which benefits are paid. Investments, which are typically the most significant item in a plan's financial statements, demand the prudent oversight of plan fiduciaries and require careful planning and consideration of plan auditors. In general, procedures performed to audit investments in a multiemployer plan do not differ from those procedures performed in single employer plan. This chapter focuses on those unique aspects of investments held in a multiemployer plan.

Unique Aspects of Multiemployer Plan Investments

Typically multiemployer plans have a large portion of plan assets allocated to traditional, readily marketable investments whose existence is simple to confirm and value. However, such plans also tend to invest in economically targeted projects and loans that may benefit unionized labor. Auditors should be alert also to Employee Retirement Income Security Act of 1974 (ERISA) rules regarding such investments. These investments, which may prove to be difficult to value, tend to have a high level of investment risk. This is because multiemployer plans accumulate large sums of money and are commonly viewed as a financing alternative to banks and other more conservative, traditional lenders. Because of the size and complexity of multiemployer plans, the auditor should be familiar with the nature of the plan's investments. The auditor should develop an understanding of the plan's assets and may need to modify the audit procedures, such as those outlined in chapter 7, "Auditing Investments," of the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans* (the Guide) accordingly. The characteristics of the investments may increase audit risk due to challenges in valuation, confirmation of existence, and appropriateness (in terms of a qualified plan environment).

Help Desk — In September 2000, the AICPA Auditing Standards Board (ASB) issued Statement on Auditing Standards (SAS) No. 92, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* (AICPA, *Professional Standards,* vol. 1, AU sec. 391).[1] SAS No. 92 supersedes SAS No. 81, *Auditing Investments* (AICPA, *Professional Standards,* vol. 1, AU sec. 332), and is effective for audits of financial statements for fiscal years ending on or after June 30, 2001, with early application permitted. SAS No. 92 helps auditors plan and perform auditing procedures for financial statement assertions about derivative instruments, hedging activities, and investments in securities.

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[1] The Auditing Standards Board (ASB) has developed a companion Audit Guide to help practitioners implement Statement on Auditing Standards (SAS) No. 92, *Auditing Derivative Instruments, Hedging Activities, and Investments in Securities* (AICPA, *Professional Standards,* vol. 1, AU sec. 391). That Guide provides practical guidance for implementing this SAS on all types of audit engagements. To order, contact the AICPA order department at (888) 777-7077, and ask for product number 012520.

Investment complexities reside in both the composition of the investments themselves as well as how they are managed. Even though plans still largely invest in such traditional investment vehicles as mutual funds, stocks, bonds, and government securities, many plans have adopted aggressive investment strategies that incorporate a variety of techniques or specialized, nonreadily marketable products to increase investment returns. Plan administrators frequently delegate their fiduciary responsibilities of managing these investments to paid investment advisers. In planning the audit, the auditor should possess or obtain an understanding of the plan investments and their audit implications. The auditor should also have or obtain an understanding of the role of the investment manager or adviser and how that role interrelates to the plan, the trustee, the administrator, or custodian with respect to investment decisions or plan administration. Auditors should consider who is monitoring the investments (to ensure that they are allowable and are not too high risk), and the investment objectives of the trustees or fiduciaries as they pertain to the plan audit.

Multiemployer plans may invest in nontraditional investments, such as mortgage loans, joint venture limited partnerships, and various types of real estate investments. Due to the large amount of plan assets involved, multiemployer plans tend to have structured investment policies and asset allocation guidelines. Therefore, you should understand the unique investment policies and characteristics of the plans for which you are engaged to audit. You also need to identify and directly coordinate with the third parties, such as investment managers, who play key roles in the investments of the audited plans.

Regulations Relating to Investments

The Guide also requires the auditor to possess sufficient knowledge of matters affecting employee benefit plans, including such government regulations as ERISA regulations. ERISA provides for multiple reporting requirements depending on the nature of a plan's investments, which in some cases significantly affect the scope of an auditor's work, and these requirements are equally applied to multiemployer plans. The following are some examples of ERISA requirements unique to plan investments that an auditor should consider throughout an engagement:

- ERISA requires fiduciaries of a plan to act "with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with, such matters would use in the conduct of an enterprise of a like character and with like aims." This "prudent man standard" applies to all trustees and investment managers in the following ways:

  —The composition of the investment portfolio is sufficiently diversified.

  —The liquidity and current return of the investment portfolio is sufficient to support anticipated cash flow requirements of the plan.

  —The projected return of the portfolio relates to the funding objectives of the plan.

  —The investment objective or investment strategy is reasonably designed to further the purposes of the plan, taking into consideration the risk of loss and the opportunity for gain associated with the investment or investment strategy.

  —Plan assets can be used only for the sole interests of the plan's participants and beneficiaries for the exclusive purpose of providing benefits for participants and their beneficiaries.

Help Desk—In the multiemployer environment, the relationship of the various plans maintained with each other and in relation to the underlying labor union(s) may increase risk in this area. Any other action with investments, such as lending them to the plan sponsor, without specific exemption provided by the U.S. Department of Labor (DOL), should be reported as a prohibited transaction and corrected as provided for by ERISA in the Internal Revenue Code (IRC). In multiemployer plans, this could include such issues as the way the plan's fiduciaries execute their proxy voting authority with regard to corporate equities held by the plan. To avoid the risk of plan fiduciaries voting on behalf of the plan in any way not representing the best interest of the plan and the plan beneficiaries, some multiemployer plans have engaged firms specializing in voting proxies. In lieu of such an arrangement, the auditor may wish to review the plan's proxy voting procedures.

- ERISA requires the auditors' report to extend to certain investment information detailed in schedules that are supplemental to the financial statements. The new Form 5500 (to be used starting with the 1999 plan year filings) continues to require that certain supplemental schedules be attached to the annual Form 5500 filing. The information reported in these schedules has not been changed from the prior years; however, reporting has now been standardized so some of these schedules are now required to be reported on Schedule G, "Financial Transactions Schedules," of Form 5500. These schedules are illustrated in the instructions to the Form 5500. Appendix A of the Guide also provides illustrations of the required supplemental schedules and chapter 13 provides guidance for reporting on these schedules.
- Although this situation is rare in the multiemployer plan environment, a plan administrator may elect to limit the scope of the audit with respect to investment information reported by a custodian or trustee—that is, either a bank or insurance carrier (or similar entity)—provided that the custodian or trustee certifies that the investment information it provides the plan administrator is both complete and accurate (ERISA Rules and Regulations for Reporting and Disclosure, CFR 2520.103-8). Refer to paragraph 7.51 of the Guide (with conforming changes as of May 1, 2000) for more information.

Although the audit requirement in ERISA is an important part of the total process designed to protect plan participants, a generally accepted auditing standards (GAAS) audit is not designed to ensure compliance with ERISA's provisions. Nevertheless, ERISA's reporting requirements do directly affect the auditor's report and the financial statement package to which it is attached. Additionally, Statement on Auditing Standards (SAS) No. 54, *Illegal Acts by Clients* (AICPA, *Professional Standards,* vol. 1, AU sec. 317), does require an auditor to be alert to party in interest transactions, such as transactions with the plan fiduciary or other plan service providers, and other breaches of fiduciary duties that may be prohibited by ERISA, and report any findings accordingly.

Getting Started

The auditor may begin by considering the plan's investment policy. An investment policy prescribes acceptable courses of action that an investment manager may take and are believed to offer a reasonable likelihood of achieving an investment objective. Investment policies may specify asset allocation, including the distribution of assets among classes of securities (for example, bonds, cash equivalents, mortgages, and real estate), or among parameters of risk. The auditor should determine whether controls have been designed and implemented to ensure that a plan's investment policy is adhered to. Such controls may include—

- Clearly written plan investment objectives and policies. Such investment objectives and policies should be approved by the plan's trustees and attorneys and communicated to all parties responsible for the investment of the plan's assets. The plan's investment objectives should also comply with ERISA and DOL rules and regulations.
- Regular meetings of a board of plan trustees or investment committee to consider the adequacy of the objectives and policies, and to compare these with the actual performance of the investment portfolio. Any changes are recommended and implemented in a timely manner. All such meetings should be summarized in minutes.
- Periodic evaluations of the performance of investment managers based on the stated policies and objectives. Many multiemployer plans use performance monitoring firms or services to aid in this evaluation. In this case, the plan's fiduciaries should be using such information as part of the basis for any changes in investment management, strategy policies, or objectives.
- Fiduciary and board of trustee written approvals for significant changes to portfolio composition or risk characteristics.
- Regular meetings of the board of trustees or an investment committee to consider the prudence of certain individual, nontraditional investments that have a higher degree of risk, such as mortgages, limited partnerships, and derivatives. The committee should also ensure that such investments do not violate any asset allocation guidelines.
- With regard to nontraditional investments, establish policies to ensure that these investments are properly valued (both upon initiation as well as on a regular basis) and continue to meet the plan's investment policy and objectives.

Help Desk—Once the auditor understands the investment policy and procedures, the auditor should gain an understanding of the relationships and obligations of all parties responsible for the investment of plan assets and the trust arrangements. In multiemployer plans this is accomplished by reviewing all trust agreements, collective bargaining agreements, investment policies, investment manager and adviser contracts, and minutes of trustee meetings. Futher, auditors may wish to note to what extent investment decision-making authority has been delegated to third parties and what kind of investment records are made available to the plan administrator.

Internal Control

In reviewing the investment service agreements and contracts, the auditor may note that the trustees have delegated much of the authority to execute investment transactions to third parties. Nevertheless, the auditor has a responsibility to obtain a sufficient understanding of internal control of the plan to be able to properly plan the audit and to determine the nature, timing, and extent of tests to be performed (see SAS No. 55, *Consideration of Internal Control in a Financial Statement Audit* (AICPA, *Professional Standards,* vol. 1, AU sec. 319), as amended by SAS No. 78, *Consideration of Internal Control in a Financial Statement Audit: An Amendment to SAS No. 55* (AICPA, *Professional Standards,* vol. 1, AU sec. 319). The internal control of a benefit plan consists of the controls at the sponsor as well as the controls at applicable service organizations who perform significant plan functions including but not limited to investment custody, investment management, and payment of benefits. This understanding is particularly critical in a high volume transaction environment, such as a participant directed plan, in which the plan administrator has little or no control over the investment transactions.

Chapter 6 of the Guide, "Internal Control," suggests that the most efficient means of gaining this understanding is by obtaining and reading a report prepared in accordance with SAS No. 70, *Service Organizations* (AICPA, *Professional Standards,* vol. 1, AU sec. 324), as amended, for the service organization. Under SAS No. 70, as amended, two types of reports may be issued by a service auditor, Type I, *A Report on Controls Placed in Operation*, or Type II, *A Report on Controls Placed in Operation and Tests of Operating Effectiveness*. The type of report provided by the service organization may affect the nature, timing, and extent of the audit procedures to be performed. SAS No. 70 reports generally cover the relevant operations of a service organization; however, certain operations of the service organization may not be addressed in the SAS No. 70 report, and those operations may be significant to the plan audit. In these instances, the engagement team will need to obtain an understanding of the controls in the relevant areas excluded from the scope of the SAS No. 70 report. In some cases, a provider may choose to engage an auditor to prepare a SAS No. 70 report on a rotating basis instead of annually. If this occurs, the engagement team should contact the service organization and discuss with them any system changes, major changes in controls, or mergers and acquisitions that occurred during the year. If these changes have occurred, the engagement team should obtain an understanding of the changes.

Service providers are not required to furnish SAS No. 70 reports. If the SAS No. 70 report is unavailable, the auditor should consider other appropriate procedures to obtain sufficient evidence to achieve the audit objectives. Information about the nature of the services provided by the service organization that are part of the plan's information system and the service organization's controls over those services may be available from a wide variety of sources, such as user manuals, system overviews, technical manuals, the contract between the plan and the service organization, reports by internal auditors, and regulatory authorities on the service organization's controls. If the services and the service organization's controls over those services are highly standardized, information obtained through the user auditor's prior experience with the service organization may be helpful in planning the audit. If the plan auditor concludes that the available information is not adequate to obtain a sufficient understanding of the service organization's controls to plan the audit, consideration should be given to contacting the service organization through the plan to obtain information or to request that a service auditor be engaged to perform procedures at the service organization. If the plan auditor is unable to obtain sufficient evidence to achieve the audit objectives, the plan auditor should qualify the audit opinion or disclaim an opinion on the financial statements because of a scope limitation. (Historically, the DOL has rejected Form 5500 filings that contain either qualified opinions, adverse opinions, or disclaimers of opinion on plan financial statements other than those issued in connection with a limited scope audit pursuant to 29 CFR 2520.103-8 or 12.)

If an investment service organization executes and does the accounting processing of transactions initiated by the plan trustees or administrator of the plan, there may be a high degree of interaction between the activities at the plan and those at the service organization and, in these circumstances, it may be practicable for the plan to implement effective controls for those transactions. Accordingly, the plan may be able to maintain independent records of transactions authorized to be executed by the service organization. For example, the trustees or administrator may be able to maintain independent records of the investment transactions authorized to be executed by the service organization. In those circumstances, the auditor may be able to obtain a sufficient understanding of internal control relevant to transactions executed by the service organization to plan the audit and to determine the nature, timing, and extent of tests to be performed without considering those components of internal control maintained by the service organization. See chapter 6 of the Guide for a more detailed discussion of SAS No. 70 reports.

TYPES OF MULTIEMPLOYER PLAN INVESTMENTS

As noted earlier, qualified plans, including multiemployer plans, generally allocate a large portion of plan assets to traditional, readily marketable investments whose existence is simple to confirm and value. Multiemployer plans, however, tend also to invest in economically targeted projects and loans that may benefit unionized labor. You should also be alert to ERISA rules regarding such investments. These investments, which may prove to be difficult to value, tend to have a high level of investment risk. This is because multiemployer plans accumulate large sums of money and are commonly viewed as a financing alternative to banks and other more conservative, traditional lenders.

Some of the more common nontraditional investments typically found in a multiemployer plan portfolio include—

- *Mortgages and other loans.* Some plans offer loans for business and nonparticipant residential properties in a manner similar to a bank or other lending institution, usually through a separate pooled account of an insurance company or other service provider, but possibly even directly through the plan. Internal controls, such as loan committees, standard application processes, and credit checks, should exist to assess the creditworthiness of the borrowers. The value of a mortgage is dependent on the adequacy of the collateral. Since collateral, once established, is usually beyond the plan trustee's direct control, procedures should be in place to have the collateral appraised periodically. Such appraisal may affect the valuation of the loan as a plan asset. Even in cases where loans do not contain a collateral provision or requirement, the plan should be aware of the various market factors that may affect the collateral.

> **Help Desk**—The auditor may wish to take market factors into account when determining whether plan loans are being presented at fair market value. The auditor should also consider contacting the party that services the mortgages, if any, to assess the adequacy of how loan payments and defaults are processed and whether the value of the loans are adjusted accordingly. The auditor should also be aware of certain characteristics of the outstanding loan portfolio that may suggest collection problems, including poor payment histories and loans whose terms are frequently renegotiated.

- *Limited partnerships, joint venture arrangements, and economically targeted investments.* Usually, these involve joint-venture, large-property-development projects. These ventures tend to be risky, and at times traditional banks refuse to fund them. The ventures are commonly organized to fund larger scale construction projects, such as strip malls, hotels, and condominium developments. Typically the trustees consult with qualified pension asset managers or investment managers on such investments. If, however, the trustees do not have an investment adviser, procedures should be in place at the trustee that ensure the propriety of these investments and make sure they are consistent with the plan's investment objectives and policies. Such procedures may include feasibility studies, contact with authorities for zoning permits and approval of the project as intended, the use of project budgets, and their frequent comparison with job cost progress reports. There should also be procedures in place that regularly assess the projects' market values by a qualified third party. With respect to economically targeted investments, there should be no direct local relationship to the projects funded by the entity and the multiemployer fund's investment in the entity.
- *Real estate holding corporations and real estate held directly by the plan.* Real estate held directly or indirectly by any plan should have a long-term investment purpose or a short-term earnings effect and not be held only for operational ease. Any real estate used by related parties, plans, or labor

unions should be under documented arms'-length written lease agreements. Not only should the property itself be appraised regularly, but the fair market value of the rental rates should be documented in such appraisals. Interim valuation procedures, such as appraiser or real estate professional comfort letters, should also be used in the intervening years to assess whether any valuation or rental rate adjustments are necessary. This concept extends to the annual valuation of stock in a real estate holding corporation owned by a plan.

As in all cases, plan assets should be invested solely for the benefit of plan participants and their beneficiaries. A plan's investment selection process should ensure that none of the investments made result from prohibited transactions. Therefore, transactions should be arms' length at fair interest rates or purchase prices to parties independent of the plan. The DOL has issued exemptions from the prohibited transaction rules for certain investment scenarios; however, careful interpretation of these exemptions should be made before a plan proceeds with questionable investments.

Chapter 7 of the Guide, "Auditing Investments," provides further details of investment arrangements, including contracts with insurance companies and common and commingled trust funds and mutual funds. The chapter defines the audit objectives relevant to investments and presents recommended procedures and considerations that may apply to multiemployer plan audits. Auditors should also look to SAS No. 92[2] for guidance on planning and performing auditing procedures for financial statement assertions about derivative instruments, hedging activities, and investments in securities. SAS No. 92 supersedes SAS No. 81, *Auditing Investments,* and is effective for audits of financial statements for fiscal years ending on or after June 30, 2001, with early application permitted.

[2] See footnote 1.

Chapter 4

EMPLOYER "PAYROLL AUDITS"

WHAT IS A "PAYROLL AUDIT"?

When auditing participant data in a multiemployer benefit plan, the auditor is often unable to test payroll records directly. Plan sponsors or trustees may engage the employer's auditor, other outside auditors, in-house compliance personnel, or others to perform agreed-upon procedures to test the completeness of employer contributions. These agreed-upon procedures are commonly referred to as *"payroll audits."* The procedures should be designed to test that all employees working for a contributing employer performing covered work (covered work is defined under the collective bargaining agreement) have been properly reported and that any subcontracting work performed on behalf of a contributing employer is also being reported. When an outside auditor performs these procedures, he or she will typically issue an agreed-upon procedures report in accordance with Statements on Standards for Attestation Engagements (SSAE) No. 4, *Agreed-Upon Procedures Engagements* (AICPA, *Professional Standards,* vol. 2, AT sec. 600).

Help Desk—At the time this publication went to press, the Auditing Standards Board expected to issue SSAE No. 10, *Attestation Standards: Revision and Recodification,* in January 2001. SSAE No. 10 will (1) change the title of AT section 101 to *Attest Engagements;* (2) change the definition of an attest engagement into a statement of applicability of the standard; (3) revise the third general standard to focus on the essential elements of criteria (the criteria must be suitable and must be available to users; the subject matter also must be capable of reasonably consistent evaluation against the criteria); (4) enable true direct reporting on subject matter by eliminating the requirement to make reference to the assertion in the practitioner's report; and (5) provide expanded guidance on the circumstances in which the use of attest reports should be restricted to specified parties. SSAE No. 10 will supersede SSAE Nos. 1 through 9 and will renumber the AT sections. The new SSAE will also eliminate the requirement in AT section 201, *Agreed-Upon Procedures Engagements*, for the practitioner to obtain a written assertion in an agreed-upon procedures attest engagement. It also incorporates changes needed as a result of the rescission of Statement on Auditing Standards (SAS) No. 75, *Engagements to Apply Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement* (AICPA, *Professional Standards,* vol. 1, AU sec. 622). This is reflected in SAS No. 93, *Omnibus Statement on Auditing Standards—2000* (AICPA, *Professional Standards,* vol. 1, AU secs. 622, 508, and 315). SSAE No. 10 is effective when the subject matter or assertion is as of or for a period ending on or after June 1, 2001 with early application permitted.

If the payroll procedures are performed by in-house compliance personnel, the plan's auditors should review and test the compliance procedures. If the auditor is not satisfied that the procedures being performed are acceptable, he or she may adjust and correct the internal auditor's payroll procedures or perform additional procedures as part of the independent audit. If a multiemployer benefit plan does not have annual employer payroll procedures performed, and if the auditor is unable to obtain the necessary assurance by other means, then the auditor would either issue a qualified opinion or disclaim an opinion on the financial statements because of the limitation on the scope of the audit.[1]

In addition to the routine "payroll audit," plan sponsors or trustees may also request other agreed-upon procedures. Such other special engagements may include—

- *Withdrawing employer audit*—To ensure that before it leaves, an employer withdrawing from the plan is in compliance with its contribution requirements as set forth in the summary plan document.
- *New employer audit*—To ensure compliance with the complexities of the trust agreements and summary plan documents in the first year an employer becomes part of the plan (usually near the end of the employer's first year). Because such employers are audited on a cycle, it is possible that a new employer would not be selected for a few years. It is better to discover reporting errors in the first year than for them possibly not be chosen by the random process until a later year.
- *Special requests*—To ensure an employer is properly reporting the required contributions. Trustees may request such an audit of the contributing employer when they suspect the employer is not properly reporting required contributions.

This chapter will focus on performing a routine "payroll audit."

PLANNING THE "PAYROLL AUDIT"

"Payroll audits" should have an engagement letter distinct from the plan's financial statement audit engagement letter. See appendix 4-1, exhibit 2, for an illustrative "payroll audit" engagement letter.

Employer "payroll audits" are typically performed annually or over a period of years until all the contributing employers have been audited. When starting a "payroll audit" program, you should consider the number of years in which it will take to audit all the contributing employers. This number varies by client. Typically, plans use a four-year cycle, although some plans use three years and others as many as ten. In a national plan covering thousands of employers, it may not be possible to audit all employers. In that case, a representative group of employers should be audited each year.

The next step is to determine the reporting period to be audited for each employer within the sample. This time period typically varies from one to three years and can be extended for more years (depending upon state regulations) if deficiencies are found.

Help Desk—State regulations may limit the number of prior years for which a plan may assess back contributions when deficiencies are discovered in the "payroll audit." You should be aware of these limits.

Once the annual cycle is chosen and an audit period is determined, you should select the employers to be audited during the year. If the cycle chosen is four years, every employer that contributes to the plan should be audited within four years. Note that some employers will be audited more frequently than

[1] See Statement on Auditing Standards (SAS) No. 58, *Reports on Audited Financial Statements* (AICPA, *Professional Standards,* vol. 1, AU sec. 508), as amended by SAS No. 79 (AU sec. 508.22-.34) and paragraphs 13.26 through 13.30 of the Guide, *Audits of Employee Benefit Plans,* for further guidance.

every four years if they are selected for other special engagements. Once all employers have been audited, the cycle starts over again.

When planning "payroll audits," you should consider the following:

- Sending letters to the contributing employers who are in the current year cycle (typically called a letter of introduction). The letter should address the records that need to be made available. The letter should indicate that the plan's board of trustees has authorized the "payroll audit" in accordance with the trust agreement. In addition, it should indicate that the accounting firm will be contacting the employer shortly, to set up a mutually agreed-upon time to perform the "payroll audit." Attached to the letter should be a listing of the items that the accounting firm will need to have made available to them at the time of the audit, for example, the quarterly state unemployment returns, payroll records, accounting records, and job descriptions. If an employer refuses entry or access to the records requested, you should notify the plan's counsel. See exhibit 3 in appendix 4-1 for an illustrative letter of introduction.
- Obtaining a copy of the trust agreement for the plan in question and a copy of the collective bargaining agreement (CBA) signed by the employer being audited. These are the contractual terms and obligations that the employer has agreed to for making timely contributions to the plan. These documents will indicate what is considered covered work, the contribution rate (either per hour, a flat rate, or a percentage of gross wages, that should agree to the rate listed on the employer remittance report), the minimum or maximum hours for which the employer is required to contribute, and what is considered reportable hours to the plan (for example, vacation, sick leave, holiday, and jury duty).
- Obtaining copies of the remittance reports (also called transmittals), or a summary of the reports, filed by the employer during the period to be audited. See exhibit 1 in appendix 4-1 for an illustrative employer's report of contributions.

Before Beginning Fieldwork

Before the start of fieldwork, you should consider preparing certain working paper files. Such files may include the following:

- A copy of the letter from the plan to the employer notifying the employer of the audit
- A letter of introduction from the plan to the employer identifying the auditor
- A copy of all communications with the employer setting up the date, time, and place of the audit, including directions to the place of the audit
- A copy of the CBA, or a summary thereof
- A copy of appropriate sections of the plan's agreement and declaration of trust containing authorization for records that may be examined as part of the agreed-upon procedures
- An audit program specific to the plan
- Copies (or summaries) of the remittance reports (also called transmittals) submitted by the employer to the plan

Beginning Fieldwork

Upon arriving at the employer to be audited, you want to ensure that all of the records requested in the letter of introduction are available. The plan attorney can often be helpful at this stage if the employer refuses to provide all the requested records.

Help Desk—If the employer does not have all records available upon commencement of the audit, you should make a list of those records and provide a copy of the list to the employer.

As noted earlier, the primary purpose of a "payroll audit" is to determine whether all employees who are performing covered work are being reported by the employer to the plan in accordance with the CBA. To gain an understanding of how the employer's payroll system works, you may want to consider tracing the hours (or wages) of several employees who have been regularly reported from the payroll records to the remittance reports. To place reliance on the employer's payroll records, consider tracing a sample of hours worked from the employee time cards to the employer's payroll journal.

Help Desk—You should pay careful attention to how overtime hours are recorded in the payroll system. For example, a payment for forty-two hours (forty hours at regular rates and two hours at time and one-half) may be recorded in the payroll system as forty-three hours. The CBA specifies whether hours worked or paid should be reported. If you are concerned with actual hours worked, those would be forty-two, not forty-three.

Early in fieldwork you should compare copies of the employer's remittance reports to those copies (or a summary thereof) furnished by the plan to the auditors. Any differences should be resolved immediately.

Procedures

You should first determine which employees are covered by the CBA. Job descriptions, rates of pay, discussions with the employer, and examination of remittance records can be used to eliminate those employees not covered by the CBA. If you are uncertain whether some employees are covered, the hours or gross wages for those employees should be recorded. A later determination can be made based on plan records whether the hours for these employees should be shown as deficiencies in the "payroll audit" report.

Often in a "payroll audit" of a small employer, it is possible to examine 100 percent of the payroll records. However, when it is not practicable for 100 percent of the payroll records to be examined other methods may be used. One method would be to select a statistical sample of the payroll records and project the dollar amount of the deficiencies found to the population total (which is the total amount of remittances by the employer for the period). Unfortunately, this method does not allow the auditor to show the exact deficiency amount for each covered employee and, therefore, this may be unacceptable to the plan or the employer being audited.

Another method is to judgmentally select and test payroll records spanning the entire period covered by the audit. Such a method helps ensure that you include in your testing any changes in conditions such as changes in the employer's accounting personnel, in terms of the CBA, and any others in how the payroll records are kept and how employees are reported. At this point, you are searching for deficiencies.

Common areas an employer may fail to report include—

- New employees.
- Terminating employees.
- Part-time employees.
- Apprentices.
- Overtime.
- Vacation hours paid.
- Fractional hours paid.

You should test each area where a deficiency is likely to occur. If a deficiency is found, such as a failure to report overtime hours, the sample should be expanded to determine whether the error was clerical in nature or whether the employer routinely failed to report the overtime hours. If overtime hours were routinely not being reported, the auditor should expand his or her sampling until the total deficiency is identified for each employee.

Other Fieldwork Steps[2]

Other procedures to be performed in a "payroll audit" include reviewing the cash disbursement journals to identify individuals who were paid by check outside the payroll system or the names of subcontracting firms that should be reporting the employees in their offices who are performing covered work in the jurisdiction of the plan. Key points to remember are that generally anyone performing covered work is required to be reported on, and contributions are due to the plan regardless of whether the individual is a member of the union or not.

In addition, you should consider comparing a sample of the names on the employer's state quarterly tax returns with the employer transmittals. Any names found on the quarterly tax returns but not on the employer transmittals should be researched and the type of work that individual has been performing should be determined.

The above procedures represent a few of the key procedures that should be performed on all "payroll audits." There are many different circumstances that can arise at each employer's place of business, and the records can range from "shoe-box accounting" to computerized accounting records that are in very good condition. That is why judgment is needed to know what additional steps and records need to be reviewed. (See exhibit 2 of appendix 4-1 for additional records that should be available for review.)

Conclusion of Fieldwork

At the conclusion of fieldwork, the preliminary findings should be discussed with the appropriate level of employer management. At the conclusion of this meeting, the individual from the employer's office should sign an exit interview working paper for proof of the meeting. Such a working paper typically includes a summary of what was discussed and with whom.

2 All of the procedures listed in this section should be agreed upon by the plan trustee.

Agreed-Upon Procedures Report

The report being written and the procedures that are being followed are based on agreed upon procedures in accordance to SSAE No. 4.[3] (See exhibit 4 of appendix 4-1 for an illustrative agreed-upon procedures report). The written agreed-upon procedure report is typically first sent to the employer, and the employer is given a period of time (for example, thirty days) to comment or accept the report. At the end of this time period the report is sent to the plan administrator.

[3] At the time this publication went to press, the Auditing Standards Board expected to issue SSAE No. 10, *Attestation Standards: Revision and Recodification,* in January 2001. SSAE No. 10 will supersede SSAE Nos. 1 through 9 and will renumber the AT sections. SSAE No. 10 will be effective when the subject matter or assertion is as of or for a period ending on or after June 1, 2001 with early application permitted.

Appendix 4-1

PRACTICE TOOLS—ILLUSTRATIVE FORMS, LETTERS AND REPORTS FOR "PAYROLL AUDITS"

This appendix contains the following practice tools to illustrate certain types of reports discussed throughout chapter 4:

- Exhibit 1—Illustrative Employer's Report of Contributions
- Exhibit 2—Illustrative Engagement Letter
- Exhibit 3—Illustrative Letter of Introduction
- Exhibit 4—Illustrative Agreed-Upon Procedures Letter

Exhibit 1

ILLUSTRATIVE EMPLOYER'S REPORT OF CONTRIBUTIONS

(Employer billing document)

Sample Company

ABC Street

City, State 99999   Month worked performed ____________

Employee Social Security Number	*Employee Name*	*Rate*	*Hours Worked*	*Job Class*

Benefit	Hours	Date	Amount	Total flat rate amount	
Welfare					
Vacation				Total hourly contributions	
Pension					
Total				TOTAL	

Exhibit 2

ILLUSTRATIVE ENGAGEMENT LETTER

January 13, 20XX
Sample Company
ABC Street
City, State 99999

Dear Trustee:

We are pleased to confirm our understanding of the nature and limitations of the services we are to provide for Sample Company.

We will apply the agreed-upon procedures listed in the *attached schedule* to the payroll and related records (*see inventory of records*) for the period required by the Trust Fund. This engagement is solely to assist you in evaluating the fringe benefit contributions submitted by the employer. Our engagement to apply agreed-upon procedures will be performed in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of the procedures is solely the responsibility of the specified user(s) of the report. Consequently, we make no representation regarding the sufficiency of the procedures described in the attached schedule either for the purpose for which this report has been requested or for any other purpose. If, for any reason, we are unable to complete the procedures, we will not issue a report as a result of this engagement.

Because the agreed-upon procedures listed in the attached schedule do not constitute an audit, we will not express an opinion on the contributing employer's financial statements or any elements, accounts, or items thereof. In addition, we have no obligation to perform any procedures beyond those listed in the attached schedule. If, however, as a result of the procedures or through other means, any material matters come to our attention, we will disclose those matters in our report.

We will submit a report listing the procedures performed and the results of those procedures. This report is solely for the use of Sample Company, and should not be used by those who did not agree to the procedures. Our report will contain a paragraph indicating that had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

Sample Company
January 13, 20XX
Page Two

Our fees for these services, including related expenses and travel costs, will be billed monthly as follows:

Partners	$
Supervisor	$
Field auditors	$

Our invoices for these fees will be rendered each month as work progresses and are payable on presentation. In accordance with our firm policies, work may be suspended if your account becomes ninety days or more overdue and will not be resumed until your account is paid in full.

We appreciate the opportunity to assist you and believe this letter accurately summarizes the significant terms of our engagement. If you have any questions, please let us know. If you agree with the terms of our engagement as described in this letter, please sign the enclosed copy and return it to us. If the need for additional services arises, our agreement with you will be revised. It is customary for us to enumerate these revisions in an addendum to this letter.

Very truly yours,

Accountant

AWM:rcl

encls.

APPROVED:

By: ____

Date: ____

Sample Company
January 13, 20XX
Page Three

PROCEDURES

Our inspection will include but not be limited to the procedures listed below. In addition, we will perform procedures requested by John Doe, attorney for the Trust. Additional procedures may be deemed necessary once field work begins, and we will review such additional procedures.

1. We will inspect the collective bargaining agreement and, if applicable, related contract or subscriber agreement.

2. We will compare the hours reported to the Trust Fund with the employer's compensation records.

3. We will compare the employees appearing on the employer's compensation records, annual federal tax return (Form W-2), and quarterly state tax returns with the Trust Fund contribution reports.

4. We will inspect payroll journal classification codes and Trust Fund reports for other trades for all employees not appearing on the contribution reports to ascertain whether the employee is working in a classification covered by the collective bargaining agreement.

5. We will inspect employer's compensation records and report to you whether wages are being paid according to the collective bargaining agreement.

6. We will inspect the cash disbursements journal and accounts payable records and Form 1099s for compensation paid outside the payroll system to employees, owner operators, and nonsignatory subcontractors.

Sample Company
January 13, 20XX
Page Four

INVENTORY OF RECORDS

- Quarterly state tax returns
- Federal payroll—Form 941
- Time cards for all employees
- Payroll journal
- Workers' compensation reports
- Individual earnings records
- Forms W-2, W-4, 1096, and 1099
- Trust Fund reports for other trades
- General check register
- Cash disbursements journal
- Check stubs or vouchers
- Bank statements, canceled checks
- Job costs records and copies of all contracts
- General ledger and cash receipts journal
- Individual, corporate, and partnership tax returns
- Vendor's invoices (to identify subcontracting work that is considered covered work)
- Records of related entities
- Other books and records as may be necessary to conduct appropriate testing to verify the accuracy of records that have been reviewed

Exhibit 3

ILLUSTRATIVE LETTER OF INTRODUCTION

January 13, 20XX
Sample Company
ABC Street
City, State 99999

Dear Sir/Madam:

We are currently conducting agreed-upon procedures on behalf of the XYZ Trust Funds. We have been requested to perform routine procedures relating to your payroll and related records to verify that fringe benefit contributions have been made in accordance with the collective bargaining agreement.

The procedures will include a review of the following records for the period January 1, 20X2 through December 31, 20X2. We will require access to the following records:

1. Individual compensation records, payroll registers, and payroll journals

2. Time cards

3. Federal and state tax forms: W-2's, 1099's, and state quarterly tax returns

4. Personnel records of employees documenting job classifications and principal duties/activities

5. Copies of reporting forms to any other Trust Funds

6. Job cost records

7. General ledger, cash disbursements journal, and supporting documentation (for example, accounts payable invoices and check stubs)

8. Any other financial data the audit may require

A representative of our firm will call you in the near future to schedule an appointment. Your cooperation is requested so that this review may be completed in a timely and efficient manner with a minimum of inconvenience to you and your staff. In the meantime, please do not hesitate to call if you have any questions.

Sincerely,

Auditor

Exhibit 4

ILLUSTRATIVE AGREED–UPON PROCEDURES LETTER[4]

INDEPENDENT ACCOUNTANT'S REPORT

Board of Trustees

ABC Plan

Employer:	**ABC Development, Inc.**
Location:	San Jose
Contact Person (Title):	John Doe, CPA
District/Audit Type:	District 90 (San Jose)/Special

We have performed the procedures enumerated below, which were agreed to by ABC Plan, solely to assist you in evaluating the fringe benefit contributions submitted by **ABC Development, Inc.**, Account **99999-99** for the period **September 1, 20X1 through August 31, 20X3.** This agreed-upon procedures engagement was performed in accordance with standards established by the American Institute of Certified Public Accountants. The sufficiency of these procedures is solely the responsibility of the specified users of the report. Consequently, we make no representation regarding the sufficiency of the procedures described below either for the purpose for which this report has been requested or for any other purpose.

Our procedures and findings are as follows:

1. Inspected the collective bargaining agreement

2. Compared the hours reported to the Trust Fund with employer's compensation record. (See footnote 1.)

3. Compared employees appearing on the employer's federal tax reports W-2 and state quarterly reports DE-6 with the Trust Fund contribution reports

[4] See footnote 3.

—We inspected wage rates, department codes, and personnel files for all employees not appearing on the contribution reports to ascertain whether the employee is working in a classification covered by the collective bargaining agreement.

(See footnotes 1 and 2.)

4. Inspected the check register and supporting vendor invoices as documentation for nonsignatory subcontractors and compensation for bargaining unit work paid outside the payroll system (No exceptions were found.)

5. Inspected compensation records to determine whether wages were paid in accordance with the collective bargaining agreement (See footnote 3.)

Our procedures disclosed the following:

FOOTNOTE 1

Unreported overtime hours for one reported employee in November 20X2: Hours worked by John Doe for the week ending November 13, 20X2, were not reported.

FOOTNOTE 2

Nineteen unreported employees working for a subcontractor (ABC Development, Inc.) were not reported to the Trust Fund.

FOOTNOTE 3

Wage rates for unreported employees working for a related company of ABC Development, Inc., were less than the wage rates indicated in the master agreement. We have calculated an employer liability of wage violations of $403,250 for ABC Development, Inc., for the period inspected.

We were not engaged to, and did not, perform an examination, the objective of which would be the expression of an opinion on the fringe benefit contributions submitted by **ABC Development, Inc.** Accordingly, we do not express such an opinion. Had we performed additional procedures, other matters might have come to our attention that would have been reported to you.

This report is intended solely for the use of ABC Plan and should not be used by those who have not agreed to the procedures and taken responsibility for the sufficiency of the procedures for their purposes.

City

November 18, 20XX

Chapter 5

INTERNAL CONTROL TESTING

Chapter 6, "Internal Control," of the AICPA Audit and Accounting Guide *Audits of Employee Benefit Plans* (the Guide) discusses internal control when auditing employee benefit plans. The second standard of fieldwork, as amended, states that a sufficient understanding of internal control should be obtained to plan the audit and to determine the nature, timing, and extent of tests to be performed. Internal control of a multiemployer benefit plan consists of the controls at the plan administrator as well as the controls at applicable service organizations that perform significant plan functions. Statement on Auditing Standards (SAS) No. 70, *Service Organizations* (AICPA, *Professional Standards,* vol. 1, AU sec. 324), as amended by SAS No. 78, provides guidance on the factors an independent auditor should consider when auditing the financial statements of an entity, such as an employee benefit plan that uses a service organization to process certain transactions that are part of the plan's information system. The most efficient way to obtain this understanding is through a SAS No. 70 report.

USE OF SAS NO. 70 REPORTS

SAS No. 70, as amended, provides guidance on the factors an independent auditor should consider when auditing the financial statements of an employee benefit plan that uses a service organization to process certain transactions. Under SAS No. 70, as amended, two types of reports may be issued by a service auditor:

- Type I Report – Report on Controls Placed in Operation
- Type II Report – Report on Controls Placed in Operation and Tests of Operating Effectiveness

The type of the report (Type I or II) provided by the service organization may affect the nature, timing, and extent of audit procedures performed by the auditor of an employee benefit plan.

If a SAS No. 70 report is not available, the auditor should obtain and document the relevant controls of the service organization. This understanding should be gained through inquires, review of policy or procedures manuals, system documentation, and flowcharts. If significant deficiencies are noted as a result of gaining this understanding, determining the impact of control deficiencies, and expanding the scope of audit work in applicable sections would be appropriate.

If only a Type I SAS No. 70 report is available, you should review the narrative of controls. If significant controls are excluded from the scope of the SAS No. 70 report, you should obtain and document an understanding of the relevant controls. The scope of audit work may need to be expanded where control deficiencies are noted as well as for those controls applicable to the plan. Type I reports may be useful in providing user auditors with an understanding of the service organization's controls sufficient to plan the audit and to design effective tests of controls and substantive tests at the user organization. They are not, however, intended to provide user auditors with a basis for reducing their assessment of control risk below the maximum for financial statement assertions affected by the controls. See chapter 6 of the Guide for a more in-depth discussion of the different types of SAS No. 70 reports.

If a Type II SAS No. 70 report is available, you should review the narrative of controls to determine whether relevant controls are addressed. If areas significant to the plan's control environment are not included in the SAS No. 70 report, obtain and document an understanding of relevant controls. You should determine the impact of control deficiencies noted and expand the scope of audit work in applicable areas. If material control deficiencies exist or were identified, determine the impact on the plan's financial statements and expand the scope of work on applicable sections. The SAS No. 70 report should be retained to document your understanding of the external component of the control environment.

TESTING INTERNAL CONTROLS

Service providers are not required to furnish SAS No. 70 reports. If a SAS No. 70 report is not available, or does not cover the applicable internal controls, then in addition to the guidance contained in chapter 6 of the Guide, when performing the annual audit of a multiemployer plan, a decision should be made whether to test internal control at the plan administrator, or to perform substantive testing on the cash receipts and disbursements systems. If the auditor determines to test internal control and place reliance on the administrator's system, consider the following areas to be tested as applicable:

1. Employer contributions
2. Cash disbursements—operating expenses
3. Cash disbursements—benefit expenses
4. Benefit claims
5. Payroll testing
6. Participant account testing (defined contribution plans)
7. Participant loan testing (defined contribution plans)
8. Distribution testing (defined contribution plans)
9. Pension claims
10. Trustee reimbursement expenses

Illustrative Audit Procedures

1. Employer Contributions

Randomly select a sample of employer billing documents and perform the following tests:

- Foot and crossfoot employer billing document.
- Trace contract rate and rate code to employer's contract.
- Trace billing document total to deposit tag.
- Trace deposit tags to deposit summary sheets and to bank statements.
- Select a sample of participants from each billing document and trace participant's eligibility and hours worked to administrator's eligibility report.

- Trace total amount per employer billing document to individual employer report.
- Trace participant from administrator's eligibility report to employer billing document.
- Send confirmations to the contributing employers in your sample for the year under audit.

2. Cash Disbursements—Operating Expenses

Randomly select a sample of the operating expenses paid during the audit year and perform the following tests:

- Compare date, amount, authorization, and payee on cancelled check with invoice.
- Verify that invoice is marked paid.
- Trace classification of expense to general ledger.
- Determine reason for gaps in any check sequence.
- Verify that voided checks have been properly defaced.

3. Cash Disbursements—Benefit Expenses

Help Desk: The testing of benefit expenses and benefit claims may be performed at the same time or separately.

Randomly select a sample of the benefit claims paid during the audit year and perform the following tests:

- Compare date, amount, authorization, and payee on cancelled check with claim invoice.
- Verify that the claim invoice is marked paid.
- Trace a sample of months of claim benefits from the check register to the general ledger and foot the claims benefits for the months selected.
- Determine reasons for gaps in check sequence.
- Verify that voided checks have been properly defaced.
- For pension checks, compare endorsement on check with signature on file at the administrator.

4. Benefit Claims

Randomly select a sample of the claims paid within the plan's audit year and verify that—

- Claimant was eligible for benefits.
- Claims were filed within time limit set by the trust.
- Documents contained required signatures.
- Benefits were paid in proper amount in accordance with the plan document.
- Benefits were sent to the assigned payee.
- Claim payment was supported by sufficient documentation.

- Duplicate claims payments were not being made.
- Charges were reduced to contract rate, if applicable, or reasonable and customary rate was applied on non-PPO providers.
- Third-party liability claims were identified and investigated.

5. Payroll Testing

Compare beginning of year salaries approved by the board of trustees with year-end W-2s. Determine reasons why the W-2 amounts at year end exceed beginning of the year approved salaries. (This may be due to overtime hours and bonuses.)

6. Participant Account Testing (Defined Contribution Plans)

Randomly select a sample of the active participants:

- Trace monthly contributions from the employer billing document to the participant's account.
- Recalculate investment earnings and test allocation among the participants accounts based on the plan's policy.
- Test the allocation of operating expenses among the participant's account based on the plan's policy.
- Agree total participant account balances to audited financial statements.

7. Participant Loan Testing (Defined Contribution Plans)

Randomly select a sample of the active participants:

- Trace name and Social Security number (SSN) to annuity loan application in participant's file.
- Trace name and SSN from the loan application to the individual's record valuation printout as of the preceding quarters valuation date (participant's file).
- Ensure that the loan amount was not greater than half of the individual's account balance as of the preceding quarter valuation date.
- Check individual's file to see that the administrator sent them a receipt of application and a federal loan disclosure statement (FLDS), if applicable. Make sure that the individual returns the FLDS and that it was properly notarized.
- Ensure that the individual's loan was properly authorized.
- If the loan defaulted and is deemed a distribution, trace to issuance of a 1099 to the Internal Revenue Service and check that the defaulting of the loan was treated as an expense (benefit paid to participants)
- Determine that loan requests meet approval requirement listed in the summary plan document (SPD).

8. Distribution Testing (Defined Contribution Plans)

Randomly select a sample of active participants:

- Trace name and SSN to the individual's account printout as of the preceding fiscal quarter's valuation date.
- Verify that the participant's account for the period subsequent to the termination date reflects the distribution.
- Verify that the disbursement was authorized by the participant.
- Verify the accuracy of the distribution.
- Ensure that termination was approved by the Benefit Approval Committee or that incremental distribution has been deducted from balance (Loan Approval Report).

9. Pension Claims

Randomly select a sample of the new pensions approved and paid in the plan's audit year and also select a sample of the current pensioners receiving benefits and determine that—

- Members are eligible to receive a pension.
- All necessary documents have been filed with the application.
- Past and future credited service are verified.
- The calculation of the benefit amount is correct.
- Benefits are paid to the proper party.
- Benefit increases agree to plan amendments.
- The administrator has procedures in place to determine that all retirees are alive.

10. Trustee Reimbursement Expenses

Select a sample of trustee reimbursement expenses paid to each trustee during the audit year and determine that it has been reimbursed in accordance with the plan's reimbursement policy.

Chapter 6

OTHER ISSUES UNIQUE TO MULTIEMPLOYER PLANS

There are many other issues unique to multiemployer plans that auditors should be aware of. This chapter discusses some of these issues.

PERMANENT RECORDS OF THE PLAN

As the auditor of the plan, you should become familiar with the basic aspects of the plan. This can be achieved by reviewing permanent records, such as—

- A list of the plan trustees.
- The plan document and subsequent amendments.
- Summary plan descriptions.
- Summary of material modifications.
- Trust agreement.
- Collective bargaining agreement with current rates.
- Internal Revenue Service (IRS) determination letter.
- Insurance policies and contracts.
- Agreements with service providers
- Policies and procedures of the fund.
- Correspondence with the IRS, Department of Labor (DOL), or other regulatory agencies.
- Legal interpretations

ANALYTICAL PROCEDURES

Certain analytical procedures may enable the auditor to reduce the scope of substantive testing and enhance his or her ability to understand the plan's operations. (See Statement on Auditing Standards (SAS) No. 56, *Analytical Procedures* (AICPA, *Professional Standards,* vol. 1, AU sec. 329), for guidance on the use of analytical procedures and when they are required. Such analytical procedures may include—

- Comparing current financial statement balances with prior-year balances.
- Comparing investment returns or fees with benchmarks, using reports obtained from managers and the plan's investment policy guidelines.
- Comparing the current year asset allocation with the prior year. This helps assess the changes in investment types during the year.

- Comparing employer contributions to prior years and hours worked during the year, on a monthly or annual basis.
- Analyzing benefit payments by using the number of participants receiving benefits, the average benefit payments, and other information obtained from the plan records and actual valuation report.

TESTING INSURANCE PREMIUMS

If a health and welfare benefit plan is insured, you should obtain a copy of the insurance contract that lists the provisions of coverage and premium rates. You should then determine whether the proper amount of premiums has been remitted to the insurance company, and whether any obligation for unpaid insurance premiums has been properly recorded. Insurance premium payments are generally determined from the plan's participant eligibility records and the premium rates in the insurance contracts. In testing premium payments and the related obligation, procedures that should be considered include—

- Comparing the number of eligible participants with the premium computation and the applicable premium rates with the insurance contract.
- Tracing participants listed in the premium computation list to the eligibility records.
- Comparing premiums paid, including subsequent payments and prior-year premiums, and investigating the reasons for significant changes.
- Requesting direct confirmation from the insurance company of the total amount of premiums paid during the year, premiums payable to the insurance company and other obligations are assets of the plan at year end.

TRUSTEE EXPENSES

Trustee expenses are a very small expense item in the plan's financial statements; however, they are one of the first areas that the DOL reviews in an audit. Plans should have a written trustee expense reimbursement policy. You should consider reviewing documentation of a sample of trustee expenses, including the trustee's name, the meeting date for which the expense was paid, the date the expense report was received by the plan, the amount of any advance received, and receipts documenting all expenses.

COLLECTION OF EMPLOYER CONTRIBUTIONS

Under the Employee Retirement Income Security Act of 1974 (ERISA), the status of "fiduciary" of an employee benefit plan carries with it significant responsibilities and exposure to potential liabilities in the event of adverse consequences to the plan. A fundamental obligation of a fiduciary of an employee benefit plan is to collect all monies due and owing to the plan. In the context of multiemployer plans, this duty requires fiduciaries to establish procedures for the timely collection of employer contributions and to make reasonable, diligent, and systematic efforts to collect amounts due to the plan. (Many plans change employers' interest on delinquent accounts.) Where necessary, fiduciaries may be required to start legal proceedings to collect delinquent contributions.

Amendment Effective Dates

For a plan to be qualified, the plan document should be amended timely to reflect any changes enacted to the qualification requirements of the Internal Revenue Code (IRC). In determining the effective dates for changes in the law, Congress permits collectively bargained plans to reach the next collective bargaining cycle before making the required amendments. When there are staggered termination dates, the measuring date is the last termination date of the agreements in effect on the law's enactment without regard to subsequent extensions of any of the agreements.

Minimum Participation and Nondiscrimination Rules

Multiemployer plans automatically satisfy the rules governing nondiscrimination in coverage and accruals of IRC sections 410(b) and 401(a)(4), and the minimum participation rules of IRC section 401(a)(26), for those participants who are collectively bargained. The regulations divide a plan into two parts: one portion for employees covered by a collective bargaining agreement, to which the exception applies, and a second portion for participants not covered by a collective bargaining agreement that should satisfy the general rules on an employer by employer basis, as though it were a multiple employer plan. Disaggregation of the collectively bargained employees is mandatory rather than at the discretion of the plan sponsor.

Voluntary Employee Beneficiary Associations

A trust may be established to hold the assets of an employee welfare benefit plan, which may or may not be tax-exempt. A common form of tax-exempt trust is an IRC section 501(c)(9) trust, referred to as a voluntary employee beneficiary association (VEBA). VEBA trusts generally have no language covering the plan's operations. The governing instrument is limited to the investment and management of plan assets. Participation should be voluntary and is usually established under the collective bargaining agreement. The participation requirements of a VEBA are that it must have 90 percent employees (10 percent may be nonemployees). Nonemployees must have an employment-related bond and include owners. Employee includes those on leave of absence, on layoff, disabled, retired, or those who are surviving spouses and dependents subject to certain restrictions. The 90 percent test must be met on one day of each quarter of the year.

Appendix A

ILLLUSTRATIVE FINANICAL STATEMENTS

This appendix illustrates certain applications of generally accepted accounting principles (GAAP) that apply for the annual financial statements of the following hypothetical plans:

- Sample & Participating Employers Preapprentice, Apprentice, and Journeyman Affirmative Action Training Trust Fund
- Sample Defined Benefit Plan
- Sample Legal Services Trust Fund
- Sample Vacation and Holiday Pay Plan
- Sample Health and Welfare Trust Fund

Note: These illustrative financial statements and reports have been taken from actual examples of audited multiemployer employee benefit plans whose names, locations, and numbers have been changed to protect confidentiality. (The names are the product of the staff's imagination. Any resemblance to real companies is entirely coincidental and beyond the intent of the staff.) These financial statements do not illustrate other provisions that might apply in circumstances other than those assumed in the examples. The formats presented and the wording of accompanying notes are illustrative only and are not necessarily the only possible presentations. The illustrative financial statements do not include all disclosure and presentation items promulgated, nor do they represent minimum requirements. The Employee Retirement Income Security Act of 1974 (ERISA) and Department of Labor (DOL) requirements require that certain information be included in supplemental schedules, which are not required under GAAP, and reported on by the independent auditor. Many of these examples are intended for the trustees only and may not include such supplemental schedules.

Help Desk: In October 2000 the ASB issued Statement on Auditing Standards (SAS) No. 93, *Omnibus Statement on Auditing Standards—2000* (AICPA, Professional Standards, vol. 1, AU secs. 622, 508, and 315). Among other things, this standard amends SAS No. 58, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 508), to include an identification in the auditor's report of the country of origin of the accounting principles used to prepare the financial statements and the auditing standards that the auditor followed in performing the audit. This amendment withdraws Auditing Interpretation No. 13, "Reference to Country of Origin in the Auditor's Standard Report," of SAS No. 58, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 9508.53-.55). This amendment is effective for reports issued or reissued on or after June 30, 2001, with earlier application permitted.

SAMPLE & PARTICIPATING EMPLOYERS PREAPPRENTICE, APPRENTICE, AND JOURNEYMAN AFFIRMATIVE ACTION TRAINING TRUST FUND

FINANCIAL STATEMENTS

AND

AUDITORS' REPORT

DECEMBER 31, 20X2 AND 20X1

SAMPLE & PARTICIPATING EMPLOYERS PREAPPRENTICE, APPRENTICE, AND JOURNEYMAN AFFIRMATIVE ACTION TRAINING TRUST FUND

FINANCIAL STATEMENTS
December 31, 20X2 and 20X1

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INDEPENDENT AUDITORS' REPORT

Board of Trustees
Sample & Participating
Employers Preapprentice, Apprentice,
and Journeyman Affirmative Action
Training Trust Fund

We have audited the statements of net assets available for benefits of the Sample & Participating Employers Preapprentice, Apprentice, and Journeyman Affirmative Action Training Trust Fund as of December 31, 20X2 and 20X1, and the related statements of changes in net assets available for benefits for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the Sample & Participating Employers Preapprentice, Apprentice, and Journeyman Affirmative Action Training Trust Fund as of December 31, 20X2 and 20X1, and the changes in its net assets available for benefits for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

[*Signature*]

[*City, State*]

July 16, 20X3

SAMPLE & PARTICIPATING EMPLOYERS PREAPPRENTICE, APPRENTICE, AND JOURNEYMAN AFFIRMATIVE ACTION TRAINING TRUST FUND
STATEMENTS OF NET ASSETS AVAILABLE FOR BENEFITS

	December 31,	
	20X2	***20X1***
ASSETS		
Investments (Note 2D and 7):		
Money market funds	$ 5,047,969	$ 3,596,704
Receivables:		
Due from employers, less allowance for doubtful accounts of $32,901 (20X2) and $36,856 (20X1) (Notes 1B and 2B)	593,648	484,846
Due from other trusts and affiliates	64,429	24,403
Accrued interest	7,880	5,730
	665,957	514,979
Cash and operating accounts	967,326	1,144,585
Property and equipment, at cost (Note 5):		
Construction equipment	3,337,781	2,787,708
Office furniture, equipment, and improvements	694,517	460,489
Automobiles	326,090	211,954
Trailer	47,233	47,233
	4,405,621	3,507,384
Less: accumulated depreciation (Notes 2C and 5)	(2,185,334)	(2,029,038)
	2,220,287	1,478,346
Other assets	156,815	201,253
Total assets	9,058,354	6,935,867
LIABILITIES		
Liabilities:		
Accounts payable	250,564	239,076
Due to other trusts and affiliates	6,689	5,205
Capital lease obligations (Note 5)	6,432	9,089
Total liabilities	263,685	253,370
Net assets available for benefits	$ 8,794,669	$ 6,682,497

The accompanying notes are an integral part of the financial statements.

SAMPLE & PARTICIPATING EMPLOYERS PREAPPRENTICE, APPRENTICE, AND JOURNEYMAN AFFIRMATIVE ACTION TRAINING TRUST FUND
STATEMENTS OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS

	For the Years Ended December 31,	
	20X2	20X1
Additions:		
Employer contributions (Notes 1B and 2B)	$7,538,235	$6,107,443
Instruction fees	175,397	111,408
ABC reimbursement of expenses	14,130	12,744
Interest income	199,984	168,933
Gain on sale of equipment	54,270	49,445
Liquidated damages	10,833	7,239
Manning violations	228	1,051
Donated equipment	20,000	—
Total additions	8,013,077	6,458,263
Deductions:		
Joint Apprenticeship Committee:		
Salaries and allowances	1,856,079	1,643,480
Office operations	616,922	516,283
Insurance, taxes, and employee benefits	1,051,687	963,865
Equipment maintenance and operating expenses	295,783	278,568
Seminar and instructional materials	49,707	54,882
Training center maintenance and operating expenses	270,592	148,379
Rent	2,396	—
Promotion and development	5,169	2,656
Government Property Program	7,200	8,000
Data processing	102,031	98,429
Facilities lease expense (Note 4C)	160,000	236,636
Depreciation (Note 2C)	261,068	224,390
Total Joint Apprenticeship Committee	4,678,634	4,175,568
Other fees	269,260	256,640
General and administrative expenses	953,011	445,047
Total deductions	5,900,905	4,877,255
Increase in net assets	2,112,172	1,581,008
Net Assets:		
Beginning of year	6,682,497	5,101,489
End of year	$8,794,669	$6,682,497

The accompanying notes are an integral part of the financial statements.

SAMPLE & PARTICIPATING EMPLOYERS PREAPPRENTICE, APPRENTICE, AND JOURNEYMAN AFFIRMATIVE ACTION TRAINING TRUST FUND NOTES TO THE FINANCIAL STATEMENTS

NOTE 1 - DESCRIPTION OF THE FUND

A. General:

The Sample & Participating Employers Preapprentice, Apprentice, and Journeyman Affirmative Action Training Trust Fund (the Fund) was organized on November 1, 1980, for the purpose of providing a journeyman and apprentice training program for the participants covered by the collective bargaining agreement between the Sample Local Union, and the Sample Association, the Sample Council, and individual employers signatory to the agreements. The Fund is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and is exempt from federal and California taxes on income under the current provisions of the Internal Revenue Code and the California Revenue and Taxation Code, respectively.

B. Contributions:

The Fund received contributions at the following hourly rates:

January 1, 20X1 – June 30, 20X1	$.45
July 1, 20X1 – March 30, 20X2	.50
April 1, 20X2 – June 30 20X2	.51
July 1, 20X2 – December 31, 20X2	.55

C. Fund Termination:

In the event the Fund terminates, the net assets of the Fund shall be paid out to an exempt trust fund established for the same or similar purposes as this Fund.

NOTE 2 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Accounting:

The Fund's financial statements are prepared on the accrual basis of accounting.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions and deductions during the reporting period. Actual results could differ from those estimates.

B. Employer Contributions:

Employer contributions reported in the financial statements include amounts relating to hours worked by participants through December 31 and reported to the Fund through January 31 of the following year, plus delinquent contributions, together with related liquidated damages that may be imposed. Allowances are made for uncollectible amounts.

C. Depreciation:

Depreciation is computed on a straight-line basis over estimated useful lives of three years for automobiles not to exceed luxury automobile depreciation limitations set forth by the Internal Revenue Code, four to ten years for construction equipment, five to ten years for office furniture and equipment, and fifteen years for the trailer.

D. Valuation of Investments:

Cash and cash equivalents and mutual funds are valued at cost, which approximates fair value.

NOTE 3 - EQUITY IN SAMPLE SERVICES ACCOUNT

The Fund and a group of related employee benefit plans jointly sponsored by the union and the employers have established bank accounts to serve as central collecting and disbursing facilities for administrative services common to all funds. Advances in excess of the amounts required for operating expenses are placed in short-term investments.

The Fund's equity in the Services Account is determined by taking the excess of advances over the proportionate share of expenses incurred by the specific program and is accounted for as "Equity in Services Account."

NOTE 4 - AGREEMENTS AND TRANSACTIONS WITH PERSONS KNOWN TO BE PARTIES IN INTEREST

A. Sample Local Union:

Sample Local Union, a party to the collective bargaining agreement, is a contributing employer to the Fund. In addition, Local Union provides fringe benefit and collection services to the Fund, which reimburses it for salaries and related costs, travel, rental facilities, and supplies. Reimbursements by the Fund through the Services Account (see Note 3) were $17,759 and $16,927 for the years 20X2 and 20X1, respectively.

B. Sample Association, Inc.:

Sample Association, Inc., a party to the collective bargaining agreement, received cost reimbursements from the Fund in the amount of $135,500 for 20X2 and 20X1, for expenses incurred in maintaining compliance offices.

C. Pension Trust Fund for Sample:

The Sample & Participating Employers Preapprentice, Apprentice, and Journeyman Affirmative Action Training Trust Fund leased an administration facility from Pension Trust Fund for Sample in the amount of $160,000 for 20X2 and of $236,636 for 20X1. The lease agreement is based on a fiscal year ending November 30.

NOTE 5 - PROPERTY AND EQUIPMENT

Following are property and equipment categories and related accumulated depreciation as of December 31, 20X2 and 20X1:

	20X2			*20X1*		
	Cost	*Accumulated Depreciation*	*Net*	*Cost*	*Accumulated Depreciation*	*Net*
Construction equipment	$ 3,337,781	$ 1,810,111	$ 1,527,670	$ 2,787,708	$ 1,745,881	$ 1,041,827
Automobiles	326,090	150,633	175,457	211,954	93,356	118,598
Office furniture and equipment	694,517	178,735	515,782	460,489	162,522	297,967
Trailer	47,233	45,855	1,378	47,233	27,279	19,954
	$ 4,405,621	$ 2,185,334	$ 2,220,287	$ 3,507,384	$ 2,029,038	$ 1,478,346

In August, 20X1, the Fund purchased office equipment, which contained a purchase option and was capitalized at $12,865, requiring monthly installments of $214. At December 31, 20X2, the remaining balance was $6,432.

NOTE 6 - PENSION PLANS

The Fund contributes to four multi-employer pension plans on behalf of employees who are participants in the following plans:

- Sample Plan A
- Sample Plan B
- Sample Plan C
- Sample Plan D

Amounts contributed to the plans in 20X2 totaled $638,287, and amounts in 20X1 totaled $638,287 totaled $606,246.

NOTE 7 - INVESTMENTS

Sample Company manages assets invested in Sample Funds, a registered investment company. The Plan Administrator has obtained certification from the company that such information is complete and accurate at December 31, 20X2 and 20X1.

The following investments are included in the Trust's financial statements as of December 31, 20X2 and 20X1:

	20X2		*20X1*	
	Fair Value	***Cost***	***Fair Value***	***Cost***
Mutual Fund	$5,047,969	$5,047,969	$ 3,596,704	$ 3,596,704

SAMPLE DEFINED BENEFIT PLAN

FINANCIAL STATEMENTS

AND

AUDITORS' REPORT

DECEMBER 31, 20X2 AND 20X1

ABC TRADE UNION AND INDUSTRY PENSION PLAN
FINANCIAL STATEMENTS
December 31, 20X2 and 20X1

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INDEPENDENT AUDITORS' REPORT

The Board of Trustees
ABC Trade Union and
Industry Pension Plan

We have audited the accompanying statements of net assets available for benefits of the ABC Trade Union and Industry Pension Plan as of December 31, 20X2 and 20X1, and the related statements of changes in net assets available for benefits for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the ABC Trade Union and Industry Pension Plan as of December 31, 20X2 and 20X1, and the changes therein for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

[*Signature*]

[*City, State*]

July 16, 20X3

ABC TRADE UNION AND INDUSTRY PENSION PLAN
STATEMENTS OF NET ASSETS AVAILABLE FOR BENEFITS
DECEMBER 31, 20X2 AND 20X1

	20X2	*20X1*
ASSETS		
Investments – at fair value	$ 1,076,986,461	$ 1,018,824,302
Receivables		
Employer contributions	6,366,183	6,677,274
Accrued investment income	4,752,816	5,211,047
Due from merged funds	14,170,000	—
Due from European Plan	70,053	68,621
Other	21,630	46,811
	25,380,682	12,003,753
Prepayments and other assets	127,704	103,575
Fixed assets		
Office furniture, equipment, and leasehold improvements	679,358	721,515
Accumulated depreciation and amortization	(551,409)	(571,488)
	127,949	150,027
Cash – Operating funds	3,972,016	3,193,427
TOTAL ASSETS	1,106,594,812	1,034,275,084
LIABILITIES		
Payables and accrued expenses	328,216	249,686
NET ASSETS AVAILABLE FOR BENEFITS	$ 1,106,266,596	$ 1,034,025,398

The accompanying notes are an integral part of the financial statements.

ABC TRADE UNION AND INDUSTRY PENSION PLAN
STATEMENTS OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS
DECEMBER 31, 20X2 AND 20X1

	20X2	20X1
ADDITIONS TO PLAN ASSETS ATTRIBUTED TO		
Net appreciation in fair value of investments	$ 32,338,188	$ 93,546,320
Interest, dividends, and other investment income	34,149,653	33,689,688
	66,487,841	127,236,008
Investment expenses	(2,323,272)	(1,812,028)
	64,164,569	125,423,980
Employer contributions	51,920,655	46,992,066
	116,085,224	172,416,046
DEDUCTIONS FROM PLAN ASSETS ATTRIBUTED TO		
Benefits paid directly to participants	62,320,416	54,184,860
Administrative expenses	1,963,152	1,922,569
Professional fees	319,791	332,282
	64,603,359	56,439,711
NET ADDITIONS	51,481,865	115,976,335
NET ASSETS TRANSFERRED IN FROM MERGED FUNDS	20,759,333	17,146,759
NET INCREASE	72,241,198	133,123,094
NET ASSETS AVAILABLE FOR BENEFITS AT BEGINNING OF YEAR	1,034,025,398	900,902,304
NET ASSETS AVAILABLE FOR BENEFITS AT END OF YEAR	$ 1,106,266,596	$ 1,034,025,398

The accompanying notes are an integral part of the financial statements.

ABC TRADE UNION AND INDUSTRY PENSION PLAN
NOTES TO FINANCIAL STATEMENTS
FOR THE YEARS ENDED DECEMBER 31, 20X2 AND 20X1

NOTE 1: DESCRIPTION OF PLAN

General

The ABC Trade Union and Industry Pension Plan (the Plan) is a multiemployer defined benefit pension plan subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA). It is financed by negotiated employer contributions typically set for multiyear periods under collectively bargained agreements. Contributions for 20X2 and 20X1 exceeded the minimum funding requirements of ERISA. The benefits earned depend on the duration of participation in the Plan and the level of a member's employment and contributions. The Plan operates as a trust to provide retirement benefits to participants who are covered employees of participating employers under contracts with the ABC Trade Union or its affiliates and to provide death benefits to beneficiaries.

Plan Administration

The administration of the Plan is the responsibility of a board of trustees comprising Union Trustees and Employer Trustees. The Union Trustees and Employer Trustees have equal voting rights. The investments of the Plan are managed by investment advisers and maintained by a separate Plan custodian.

Pension Benefits

Generally, participants with five years of vested service (ten years prior to January 1, 20X2) are entitled to pension benefits beginning at age sixty-five. The Plan permits early retirement at ages fifty-five through sixty-four. The pension benefit amount varies depending on units of pension credits and the benefit rates per unit based on employer's contribution rate.

Participants may elect to receive benefits under various husband and wife options, which guarantee payments of benefits during the lives of both the participant and the participant's spouse. Alternatively, a participant may elect other options whereby pension payments are guaranteed for a certain period from the effective date of the pension and if the pensioner dies prior to the end of the period, his or her beneficiary receives the remaining payments.

If an active employee dies, a death benefit equal to 50 percent of the employee's accumulated pension benefits will be paid to the participant's designated beneficiary. An active employee who becomes totally disabled and has at least ten years of credited service receives disability benefits that are equal to the normal retirement benefits accumulated as of the time of becoming disabled, with reductions based on a disability reduction factor for a participant who begins collecting benefits before attaining age sixty-five.

A full description of plan benefit provisions is available in the Rules and Regulations of the ABC Union and Industry Pension Plan as amended and restated through January 1, 20X2.

NOTE 2: SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Accounting Method

The Plan's financial statements are prepared on the accrual basis of accounting.

Accounting Estimates

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingencies at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

Valuation of Investments

Common stocks and bonds traded on a national securities exchange are valued at the last reported sales price on the last business day of the year, and bonds traded in the over-the-counter market, and listed securities for which no sale was reported on that date, are valued at the last reported bid price.

Index funds, building investment trust units, and housing investment trust units are valued at their market value on the last business day of the year, as established by the investment manager.

Real estate mortgages and participation loans are valued at cost, except for the real estate investment in default, which is valued at the estimated realizable value as established by management. Real estate equity investments are valued at appraised value. The most recent appraisal for each property was:

21 Pearl Street, Middletown, NJ	1994
719 N. Beers Street, Suffern, NY	1998

Purchases and sales of securities are reflected on a trade-date basis.

In accordance with the policy of stating investments at fair value, changes in net unrealized appreciation are reflected as additions in the statement of changes in net assets available for benefits.

Employer Contributions Receivable

Employer contributions receivable as of December 31 are accrued based on analysis of subsequent employer reports and remittances.

Fixed Assets

Fixed assets are stated at cost. Depreciation is computed using the straight-line method and is based on estimated useful lives of between five and ten years.

Net Assets Available for Benefits

Under the terms of the Trust Agreement, the net assets available for benefits are restricted to the payment of pension, severance and death benefits, and administrative fees and expenses.

NOTE 3: INVESTMENTS

Summary of Investments

The following summary reflects investments held at December 31, 20X2 and 20X1:

	20X2		*20X1*	
	Cost	***Fair Value***	***Cost***	***Fair Value***
Investments at fair value as determined by quoted market prices				
Building investment trust	$ 63,242,147	$ 77,074,464	$ 50,356,930	$ 58,998,692
Housing investment trust	15,017,610	14,342,379	8,935,010	9,061,187
Stocks	456,223,107	531,033,723	406,008,833	495,279,337
Short-term investments	34,812,775	34,812,776	67,076,707	67,077,151
Bond index funds	31,925,759	29,788,529	—	—
Equity index funds	50,464,053	59,742,671	10,213,038	10,213,038
Government securities	197,075,658	191,114,066	201,544,309	207,446,592
Corporate bonds	131,096,784	124,394,068	138,190,399	141,249,361
	979,857,893	1,062,302,676	882,325,226	989,325,358
Investments at estimated fair value				
Real estate mortgages and participation loans	4,383,271	4,383,272	8,433,604	9,164,071
Real estate investments	195,313	203,143	113,144	121,024
Insurance company contracts	10,097,370	10,097,370	20,213,849	20,213,849
	14,675,955	14,683,785	28,760,597	29,498,944
	$ 994,533,848	$ 1,076,986,461	$ 911,085,823	$1,018,824,302

The fair value of individual investments that represent 5 percent or more of the Plan's net assets are as follows:

	20X2	*20X1*
Building Investment Trust – A	$ 77,074,464	$ 58,998,691
U.S. Market Cap Equity Index Fund	$ 59,740,089	$ —

Accrued Investment Income

Investment income receivable at December 31, 20X2 and 20X1 consists of accrued interest and dividend income on the following:

	20X2	*20X1*
Short-term investments	$ 319,527	$ 293,851
Stocks	485,558	353,471
Government securities	2,189,295	2,585,982
Corporate bonds	1,758,436	1,977,743
	$ 4,752,816	$ 5,211,047

Net Appreciation (Depreciation) in Fair Value of Investments

The following summarizes net appreciation (depreciation) in fair value of investments by investment type at December 31, 20X2 and 20X1:

	20X2	*20X1*
Investments at fair value as determined by quoted market prices		
Building investment trust	$ 5,262,478	$ 4,667,356
Housing investment trust	(850,025)	10,701
Stocks	17,610,659	74,688,255
Short-term investments	33,366	(13,472)
Government securities	(14,685,534)	7,261,045
Bond index funds	(2,143,905)	—
Equity index funds	37,355,088	5,182,038
Corporate bonds	(9,743,637)	2,513,319
	32,838,490	94,309,242
Investments at estimated fair value		
Real estate mortgages and participation loans	(497,318)	(274,882)
Real estate investments	(2,984)	(693,030)
Insurance company contracts	—	(625,989)
Other investments	—	830,979
	(500,302)	(762,922)
	$ 32,338,188	$ 93,546,320

NOTE 4: DUE FROM EUROPEAN PLAN

At December 31, 20X2 and 20X1, the ABC Trade Union and Industry Pension Plan (Europe) owed the Plan $140,106 and $137,241, respectively, for payroll, data processing, and other administrative expenses incurred by the Plan on behalf of the European Plan.

NOTE 5: EMPLOYER'S WITHDRAWAL LIABILITY

The Plan is in conformity with the Multiemployer Pension Plan Amendments Act of 1980 (the Act). One provision of the Act imposes a withdrawal liability on a contributing employer who partially or totally withdraws from the Plan.

The Trustees have adopted the statutory method to compute "Withdrawal Liability" for both construction and nonconstruction contributing employers in accordance with ERISA section 4211(b). Basically, a portion of the Plan's actuarially determined, unfunded vested liability, if any, is allocated to a withdrawing employer in proportion to the employer's contribution in a fixed period before withdrawal compared with total employers' contributions during the same period.

It is the Plan's policy to recognize collections of Withdrawal Liability as employer contributions income when received. During 20X2 and 20X1, the Plan received $-0- and $1,612, respectively, as a result of the assessment of Withdrawal Liability.

NOTE 6: BENEFITS

The Plan is a defined benefit plan to which employers contribute at a contractual rate per employee working unit.

Employer contributions are designed to fund the defined benefit plan's current service costs on a current basis and past service costs over a period of not more than forty years. The yield on investments of the Plan serves to reduce future contributions that would otherwise be required to provide for the defined level of benefits under the Plan.

As of January 1, 20X2 and 20X1, the dates of the most current valuations, the actuarial present values of accumulated plan benefits for the defined benefit plan are as follows:

	January 1,	
	20X2	***20X1***
Actuarial present value of accumulated plan benefits		
Vested benefits		
Pensioners and beneficiaries currently receiving payments	$ 435,818,500	$ 411,498,500
Other vested benefits	461,909,000	359,310,000
	897,727,500	770,808,500
Nonvested benefits	128,033,500	106,752,000
	$ 1,025,761,000	$ 877,560,500

The changes in the actuarial present value of accumulated plan benefits from the previous benefit information date were as follows:

Actuarial present value of accumulated plan benefits at January 1, 20X1 and 20X0	$ 877,560,500	$ 768,681,000
Increase (decrease) during the year attributable to		
Plan amendments including benefit rate changes	174,883,500	49,000,000
Benefits accumulated and experience	—	35,205,200
Benefits paid	(59,941,000)	(49,940,800)
Interest	59,331,500	52,059,700
Change in assumptions	(26,073,500)	(2,444,600)
Mergers	—	25,000,000
Net increase	148,200,500	108,879,500
Actuarial present value of accumulated plan benefits at January 1, 20X2 and 20X1	$ 1,025,761,000	$ 877,560,500

Accumulated plan benefits are those future periodic payments, including lump-sum distributions, that are attributable under the defined benefit plan's provisions to the service that participants have rendered. Benefits payable under all circumstances (retirement, death, disability, and termination of employment) are included to the extent that they are attributable to participant service rendered to the valuation date.

The actuarial present value of accumulated plan benefits is determined by the plan's actuary and is that amount that results from applying actuarial assumptions to adjust the accumulated plan benefits to reflect the time value of money (through discounts for interest) and the probability of payment (by means of decrements such as for death, disability, withdrawal, or retirement) between the valuation date and the expected date of payment.

The significant actuarial assumptions used in the valuations as of January 1, 20X2 and 20X1 were—

(a) Life Expectancy of Participants—The 1971 Group Annuity Mortality Table was used

(b) Retirement Age Assumptions—Age sixty-four, or completion of the service requirement if later, but not later than normal retirement age.

(c) Investment Return—The 20X2 and 20X1 valuations included assumed average rates of return of 7.25 percent, including reductions of $2,250,000 per year to reflect anticipated administrative expenses associated with providing benefits.

The foregoing actuarial assumptions are based on the presumption that the defined benefit plan will continue. Were the defined benefit plan to terminate, different actuarial assumptions and other factors might be applicable in determining the actuarial present value of plan benefits.

NOTE 7: PARTIES IN INTEREST TRANSACTIONS AND LEASE COMMITMENTS

Lease Commitments

The Plan subleases office space from the ABC Trade Union under a month-to-month lease which requires minimum monthly lease payments of $8,669 and requires the Plan to pay a pro rata share of any increase in operating expenses, improvements, real estate taxes, and Consumer Price Index adjustments paid by the Union. The Plan paid the Union $111,512 in 20X2 and $101,619 in 20X1 for office rent, operating expenses, and improvements.

NOTE 8: TERMINATION PRIORITIES

In the event the Plan terminates, the net assets of the Plan will be allocated, as prescribed by ERISA and its related regulations, generally to provide the following benefits in the order indicated:

1. Vested benefits insured by the Pension Benefit Guaranty Corporation (PBGC) up to the applicable limitations.

2. All nonvested benefits.

Benefits under the plan are insured by the PBGC. Should the Plan terminate at some future time, its net assets generally will not be available on a pro rata basis to provide participants' benefits. Whether a particular participant's accumulated plan benefits will be paid depends on both the priority of those benefits and the level of benefits guaranteed by the PBGC at that time. Some benefits may be fully or partially provided for by the then existing assets and the PBGC guaranty, whereas other benefits may not be provided for at all.

A full description of the Plan's termination priorities is available in the Plan's rules and regulations, as amended and restated through June 1, 19X5.

NOTE 9: TAX STATUS

The Plan is a qualified trust under section 401(a) of the Internal Revenue Code (IRC) and is exempt from federal income taxes under provisions of IRC section 501(a). The Internal Revenue Service has determined and informed the Plan by a letter dated July 6, 19X5, that the Plan and related trust are designed in accordance with applicable sections of the IRC. The Plan has been amended since receiving the determination letter. However, the Plan administrator and the Plan's tax counsel believe that the Plan is designed and is currently being operated in compliance with the applicable requirements of the IRC.

NOTE 10: RETIREMENT PLAN

The Plan provides retirement benefits to its employees. Essentially all full-time Plan employees are eligible to participate. Retirement plan expenses were $98,767 for 20X2 and $87,954 for 20X1.

NOTE 11: RECLASSIFICATION

Certain items in the financial statements for 20X1 have been reclassified to conform with the 20X2 presentation.

REPORT OF INDEPENDENT CERTIFIED PUBLIC ACCOUNTANTS ON SUPPLEMENTAL INFORMATION

The Board of Trustees
ABC Trade Union and
Industry Pension Plan

Our audits of the financial statements of the ABC Trade Union and Industry Pension Plan for the years ended December 31, 20X1 and 20X2 were made for the purpose of expressing an opinion on the financial statements taken as a whole. The schedules attached are presented for purposes of additional analysis and are not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audits of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

[*Signature*]

[*City, State*]

July 16, 20X3

ABC TRADE UNION AND INDUSTRY PENSION PLAN
INTEREST, DIVIDENDS, AND OTHER INVESTMENT INCOME
FOR THE YEARS ENDED DECEMBER 31, 20X2 AND 20X1

SCHEDULE 1

	20X2	*20X1*
Short-term obligations	$ 3,743,467	$ 2,017,554
Building Investment Trust	91,702	16,159
Housing Investment Trust	800,156	375,934
Stocks	6,750,556	3,619,583
Equity index funds	662,771	2,599,300
Government securities	10,079,752	11,601,587
Corporate bonds	8,373,640	10,199,114
Bond index funds	1,736,126	—
Real estate investments	597,935	1,132,178
INSURANCE COMPANY CONTRACTS		
Allamerican	—	76,646
Aetna	(89,263)	—
American Life	(1,543)	11,944
Mutual Life	621,737	869,729
Union Life	—	12,585
Omega Insurance	375,768	329,243
Delta Insurance	125,084	694,367
	1,031,783	1,994,514
Other investment income	281,764	133,765
TOTAL INTEREST, DIVIDENDS, AND OTHER INVESTMENT INCOME	$ 34,149,652	$ 33,689,688

ABC TRADE UNION AND INDUSTRY PENSION PLAN
EXPENSES
FOR THE YEARS ENDED DECEMBER 31, 20X2 AND 20X1

SCHEDULE 2

	20X2	*20X1*
Investment expenses		
Investment advisory fees	$ 2,214,443	$ 1,672,617
Investment appraisal fees	—	26,447
Investment custodian fees and expenses	82,310	82,905
Investment performance appraisal fees	26,519	30,059
	$ 2,323,272	$ 1,812,028
Administrative expenses		
Salaries	$ 747,015	$ 727,469
Payroll taxes	60,542	59,748
Medical insurance premiums	124,463	100,580
Pension fund contributions	98,767	87,954
Administrative travel	49,123	42,868
Bank fees	46,032	51,983
Data processing	70,965	67,489
Delivery and freight	11,091	10,683
Depreciation and amortization	21,168	22,040
Insurance	43,619	45,334
Leases and maintenance	24,921	20,437
Microfilming services	12,733	16,473
Miscellaneous	13,542	18,872
Coordinating Committee for Multiemployer Plans fees	7,039	7,086
Office supplies and expenses	10,570	11,198
Pension benefit guaranty premium	73,373	72,553
Pension newsletter	92,940	94,493
Postage	62,207	74,078
Rent	101,114	101,219
Sales and promotion	62,779	94,867
Social Security Administration fees	2,446	1,749
Stationery and printing	68,153	32,297
Taxes—sales and personal property	9,430	8,426
Telephone	16,723	21,269
Training and education	8,381	9,507
Trustee meetings	124,016	121,896
	$ 1,963,152	$ 1,922,568
Professional fees		
Actuarial and consultant	$ 46,010	$ 88,930
Audit and accounting	50,516	43,120
Audit—payrolls	82,031	66,343
Legal retainer fee and expenses	36,837	37,758
Litigation fees—retained counsel	47,078	50,256
Litigation fees—outside counsel	57,319	45,876
	$ 319,791	$ 332,283

SAMPLE LEGAL SERVICES

TRUST FUND

FINANCIAL STATEMENTS

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SAMPLE LEGAL SERVICES TRUST FUND

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees

Sample Legal Services Trust Fund

We have audited the accompanying statements of net assets available for benefits and of benefit obligations of the Sample Legal Services Trust Fund as of September 30, 20X2 and 20X1, and the related statements of changes in net assets available for benefits and of changes in plan benefit obligations for the years then ended. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial status of the Sample Legal Services Trust Fund as of September 30, 20X2 and 20X1, and the changes in its financial status for the years then ended in conformity with accounting principles generally accepted in the United States of America.

[*Signature*]

[*City, State*]

December 16, 20X2

EXHIBIT A

SAMPLE LEGAL SERVICES TRUST FUND
STATEMENTS OF NET ASSETS AVAILABLE FOR BENEFITS AND OF BENEFIT OBLIGATIONS
September 30, 20X2 and 20X1

	20X2	*20X1*
ASSETS		
Investments (Notes 2C and 3):		
Fixed income securities	$ 1,835,811	$ 1,295,549
Cash equivalents	1,094,984	219,659
	2,930,795	1,515,208
Receivables:		
Due from employers (Notes 1C and 2B)	420,128	500,442
Accrued interest	24,194	19,532
Miscellaneous	—	122
	444,322	520,096
Cash operating accounts	38,703	59,524
Other assets:		
Prepaid insurance	4,062	3,034
Total assets	3,417,882	2,097,862
LIABILITIES		
Liabilities:		
Accounts payable	31,792	19,278
Total liabilities	31,792	19,278
Net assets available for benefits	3,386,090	2,078,584
Legal benefits payable (Note 4)	895,340	1,052,874
Total benefit obligations	895,340	1,052,874
Excess of net assets available for benefits over benefit obligations	$ 2,490,750	$ 1,025,710

The accompanying notes are an integral part of the financial statements.

EXHIBIT B

SAMPLE LEGAL SERVICES TRUST FUND
STATEMENTS OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS AND OF CHANGES IN PLAN BENEFIT OBLIGATIONS
For the Years Ended September 30, 20X2 and 20X1

	20X2	*20X1*
Additions:		
Employer contributions (Notes 1C and 2B)	$ 4,557,423	$ 2,664,637
Investment income:		
Net appreciation in fair value of investments (Note 3)	36,393	6,908
Interest	104,578	126,689
	140,971	133,597
Less: investment fees	(8,334)	(9,312)
	132,637	124,285
Total additions	4,690,060	2,788,922
Deductions:		
Benefits (Notes 1B and 2D):		
Panel provider fees	3,002,941	3,088,001
	3,002,941	3,088,001
General administrative expenses	222,193	241,712
Professional fees	157,421	138,646
Total operating expenses	379,614	380,358
Total deductions	3,382,555	3,468,359
Increase (decrease) in net assets	1,307,505	(679,437)
Increase (decrease) in benefit obligations:		
Panel provider fees	(18,535)	(18,832)
Estimated liability for incurred but unreported claims	(139,000)	87,000
Total increase (decrease) in benefit obligation	(157,535)	68,168
Increase (decrease) in net assets available for benefits over benefit obligations	1,465,040	(747,605)
Excess of net assets available for benefits over benefit obligations:		
Beginning of year	1,025,710	1,773,315
End of year	$ 2,490,750	$ 1,025,710

The accompanying notes are an integral part of the financial statements.

SAMPLE LEGAL SERVICES TRUST FUND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1—DESCRIPTION OF THE FUND

The following brief description is provided for general information purposes only. Participants should refer to the Summary Plan Description for more complete information.

A. General:

The Sample Legal Services Trust Fund (the Fund) was established on May 8, 1980, for the purpose of providing group legal service benefits to eligible participants covered by collective bargaining agreements between the other Trust and employer associations and individual employers signatory to the agreements. The Fund is subject to the provisions of the Employee Retirement Income Act of 1974 (ERISA) and is exempt from federal and California tax on income under the current provisions of the Internal Revenue Code and the California Revenue and Taxation code respectively.

B. Benefits:

Initial eligibility will be granted to all regular and part-time employees who have acquired seniority, for each month for which contributions have been paid to the Fund in accordance with a collective bargaining agreement approved by the Trustees.

Initial eligibility is available to those employees who work for a subscribing employer in a job classification covered by the terms of the collective bargaining agreement that requires contributions to the Fund subject to the following:

1. The effective date of coverage will be the first of any month if the participant worked at least 110 hours in the preceding month with a Subscribing Employer. (The participant must work 110 hours in the preceding month and have contributions made on his or her behalf to remain eligible.)

2. Eligible dependents are entitled to the same benefits as participants.

3. Participants and their eligible dependents who cease to be eligible due to illness, death, or disability that prevents gainful employment will continue to receive benefits for a period not to exceed three months from the date coverage would otherwise terminate.

4. Participants and their eligible dependents who cease to be eligible due to a termination of a duration which would normally and customarily occur because of the type of industry, will continue to receive benefits for a period not to exceed six months from the date coverage would otherwise terminate.

C. Contributions:

The Fund received contributions at an hourly rate for part time and per month for full time employees. Effective August 1, 20X1, the rates increased for Employees as follows:

	Part-Time	*Full-Time*
October 1, 19X8—July 31, 20X1	$1.10	$3.30
August 1, 20X1—September 30, 20X2	$1.25	$3.75

D. Fund Termination:

In the event the Fund terminates, the Trustees shall make provisions out of the Fund for the payment of any and all obligations of the Fund, including expenses incurred up to the date of termination, and the expenses incidental to such termination, and distribute the remaining assets among the participants and beneficiaries of the Plan, in accordance with ERISA and other applicable laws.

NOTE 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Accounting:

The Fund's financial statements are prepared on the accrual basis of accounting.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions and deductions during the reporting period. Actual results could differ from those estimates.

B. Employer Contributions:

Employer contributions reported in the financial statements include amounts relating to hours worked by participants through September 30, as reported by employers to the Fund.

C. Valuation of Investments:

Cash equivalents are stated at cost, which approximates fair value. Fixed income securities are stated at fair value, based on closing market quotations at year end.

D. Benefits:

As a result of the eligibility provisions of the Fund, hours worked by participants through September 30 produced eligibility for legal services provided through October 31.

NOTE 3—INVESTMENTS

Investment assets of the Fund are managed and held by the Bank under the terms of a custodial agreement. The following information, included in the Fund's financial statements as of September 30, 20X2 and 20X1, was prepared by the Bank and furnished to the Trust Administrator. The Administrator has obtained certification from the Bank that such information is complete and accurate.

	20X2		*20X1*	
	Fair Value	***Cost***	***Fair Value***	***Cost***
Fixed income securities	$1,835,811	$1,790,472	$1,295,549	$1,286,062
Cash equivalents	1,094,984	1,094,984	219,659	219,659
	$2,930,795	$2,885,456	$1,515,208	$1,505,721

During the years ended September 30, 20X2 and 20X1, the Trust investments, including investments bought, sold, and held during the respective years, appreciated in value as follows:

	20X2	*20X1*
Fair value as determined by quoted market price:		
Fixed income securities	$ 36,393	$ 6,900

The following individual fixed income securities represent 5 percent or more of the total plan assets at September 30, 20X2:

Description	***Rate***	***Maturity***	***Fair Value***	***Cost***
Tech Capital	5.650%	01/15/01	253,830.00	249,532.50
Bank Corp	6.200%	02/15/06	257,197.50	251,647.50
Kale Mine Fin	5.560%	02/15/99	200,248.00	195,232.00
Sears Roebuck Mtn	6.125%	01/09/06	259,742.50	250,520.00
Ford Motor Credit	6.875%	07/15/01	260,395.00	251,807.50
State Street Finl Co	6.000%	03/01/04	253,770.00	250,672.50
General Motors Accep	6.000%	03/20/03	258,187.50	250,430.00

NOTE 4—LEGAL BENEFITS PAYABLE

The self-funded benefit claims liability, which includes reported and unreported claims, is calculated on the basis of claims incurred through October 31, 20X2, relating to employer contributions for hours worked by participants through September 30, 20X2. Claims reported through October 31, 20X2, total $245,340, and through 20X1 total $263,874. The liability for future payment of claims incurred but unreported at October 31, 20X2, in the amount of $650,000, and at October 31, 20X1, in the amount of $789,000, have been estimated on the basis of statistical lag analysis studies. Because these statistical analyses are necessarily inexact, it is reasonable that the actual amount of such claims filed during the next year might differ materially from this estimate.

SAMPLE VACATION AND HOLIDAY PAY PLAN

FINANCIAL STATEMENTS

MARCH 31, 20X2 AND 20X1

SAMPLE VACATION AND HOLIDAY PAY PLAN
FINANCIAL STATEMENTS
March 31, 20X2 and 20X1

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees

Sample Vacation and

Holiday Pay Plan

We have audited the accompanying statements of net assets available for benefits of the Sample Vacation and Holiday Pay Plan as of March 31, 20X2 and 20X1 and the related statements of changes in net assets available for benefits for the years then ended. These financial statements are the responsibility of the Plan's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits of the Sample Vacation and Holiday Pay Plan as of March 31, 20X2 and 20X1 and the changes in net assets available for benefits for the years then ended, in conformity with accounting principles generally accepted in the United States of America.

[*Signature*]

[*City, State*]

October 6, 20X2

EXHIBIT A

SAMPLE VACATION AND HOLIDAY PAY PLAN
STATEMENTS OF NET ASSETS AVAILABLE FOR BENEFITS
March 31, 20X2 and 20X1

ASSETS

	20X2	*20X1*
Investments (Note 2C):		
Time certificates of deposit:		
General funds	$ 3,386,548	$ 2,298,004
Escrow funds	293,629	236,826
	3,680,177	2,534,830
Receivables:		
Due from employers, less allowance for doubtful accounts of $35,630 (20X2) and $39,425 (20X1)	2,815,730	2,619,993
Accrued interest	69,404	51,782
Due from other vacation and holiday pay plans (Note 4)	16,800	6,464
	2,901,934	2,678,239
Cash and cash equivalents	2,371,435	1,805,811
Other assets:		
Prepaid insurance	7,240	7,240
Total assets	8,960,786	7,026,120
LIABILITIES		
Self-funded benefits:		
Vacation distributions payable:		
Deposits to the credit of individual employees, net of overpayments (Note 1B)	8,753,859	6,988,371
Sample Local Union		
Credit union escrow funds to be distributed	234,140	183,226
Unclaimed vacation distributions (Note 3)	46,262	34,258
	9,034,261	7,205,855
Other liabilities:		
Dues payable	76,040	—
	76,040	—
Total liabilities	9,110,301	7,205,855
Net assets available for benefits	$ (149,515)	$ (179,735)

The accompanying notes are an integral part of the financial statements.

EXHIBIT B

SAMPLE VACATION AND HOLIDAY PAY PLAN
STATEMENTS OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS
For the Years Ended March 31, 20X2 and 20X1

	20X2	*20X1*
Additions:		
Employer contributions (Notes 1C and 2B)	$ 40,894,155	$ 33,997,219
Interest	299,422	233,889
Total additions	41,193,577	34,231,108
Deductions:		
Vacation distributions (Note 1B)	41,004,353	33,845,297
Professional fees	134,144	134,144
General expenses	24,860	26,154
Total professional and general expenses	159,004	160,298
Total deductions	41,163,357	34,005,595
Net increase	30,220	225,513
Net assets available for benefits		
Beginning	(179,735)	(405,248)
Ending	$ (149,515)	$ (179,735)

The accompanying notes are an integral part of the financial statements.

SAMPLE VACATION AND HOLIDAY PAY PLAN

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1—DESCRIPTION OF THE PLAN

A. General:

The following brief description is provided for general information purposes only. Participants should refer to the Summary Plan Description for more complete information.

Sample Vacation and Holiday Pay Plan is a defined contribution plan that was organized July 1, 1966, for the purpose of providing vacation payments to Sample Union of Northern Sample State and Sample State covered by collective bargaining agreements between the ABC Trade Union and employers or employer associations signatory to the agreements. Participating employers include members of the Sample State and Sample State Divisions of the Sample Union.

The Plan is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and is exempt from federal and California taxes on income under the current provisions of the Internal Revenue Code and the California Revenue and Taxation Code, respectively.

B. Vacation Distributions:

In November and May, payments are made to members submitting requests. The payments are based on hours worked by participants, plus an allocated portion of the interest earned by the Plan, less prior withdrawals and administrative expenses.

Advance payments are made by the Plan directly to members during each year upon receipt of a properly approved emergency withdrawal request. Additionally, monthly transfers to the Sample Local Union Credit Union are made on behalf of those members who so authorize.

C. Employer Contributions:

The Plan received contributions from employers at the rate of $2.70 for each hour worked during the years ended March 31, 20X2 and 20X1.

NOTE 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Accounting:

The Plan's financial statements are prepared on the accrual basis of accounting.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions and deductions during the reporting period. Actual results could differ from those estimates.

B. Employer Contributions:

Employer contributions and related vacation distributions, operating expenses, and other revenue are accounted for based on hours worked by participants through March 31, plus delinquent contributions.

The collective bargaining agreement provides that hours worked by an employee through February 28 of each year and reported to the Plan Administrator by employers before March 31 shall serve as the basis of the semi-annual vacation payments to be made on November 15 of the same year and May 15 of the following year.

C. Valuation of Investments:

Time certificates of deposit are valued at cost, which approximates fair market value.

NOTE 3—DUE TO OR FROM OTHER VACATION AND HOLIDAY PLANS

The Sample Vacation and Holiday Pay Plan pays the operating expenses for all of the Local Vacation Plans. This plan is reimbursed by the Sample State and Sample State Sample Vacation and Holiday Pay Plans for their pro rata share of the expenses, plus the Sample State Sample Vacation Plan also reimburses the Plan for vacation benefits.

SAMPLE HEALTH AND WELFARE TRUST FUND

FINANCIAL STATEMENTS

AND

AUDITORS' REPORT

DECEMBER 31, 20X2 AND 20X1

SAMPLE HEALTH AND WELFARE TRUST FUND FINANCIAL STATEMENTS December 31, 20X2 and 20X1

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INDEPENDENT AUDITOR'S REPORT

Board of Trustees

Sample Health and

Welfare Trust Fund

We have audited the accompanying statements of net assets available for benefits and the statements of XYZ Plan's benefit obligations of the Sample Health and Welfare Trust Fund as of December 31, 20X2 and 20X1, and the related statement of changes in net assets available for benefits and statement of changes in XYZ Plan's benefit obligations for the years ended December 31, 20X2 and 20X1. These financial statements are the responsibility of the Fund's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with auditing standards generally accepted in the United States of America. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets and the benefit obligations of the Sample Health and Welfare Trust Fund as of December 31, 20X2 and 20X1 and the changes in its net assets and its benefit obligations for the years ended December 31, 20X2 and 20X1 in conformity with accounting principles generally accepted in the United States of America.

[*Signature*]

[*City, State*]

May 27, 20X2

EXHIBIT A

SAMPLE HEALTH AND WELFARE
TRUST FUND
STATEMENTS OF NET ASSETS AVAILABLE FOR BENEFITS
December 31, 20X2 and 20X1

	20X2	*20X1*
ASSETS		
Investments (Notes 2C and 3):		
U. S. Government obligations	$ 18,603,907	$ 20,111,225
Corporate debt securities	11,886,956	9,491,191
Mutual funds	6,052,039	5,565,686
Cash equivalents	3,704,122	3,377,377
	40,247,024	38,545,479
Receivables:		
Due from employers, less allowance for doubtful accounts of $169,335 (20X2) and $178,382 (20X1) (Notes 1C and 2B)	1,662,587	1,374,319
Due from other trusts	1,441,945	1,246,521
Due from participants	148,685	119,024
Accrued interest	346,914	310,888
Due from other participating plans	43,595	221,154
	3,643,726	3,271,906
Cash and cash equivalents	1,709,674	1,293,064
Other assets	26,839	(56,669)
Total assets	45,627,263	43,053,780
LIABILITIES		
Accounts payable	105,159	183,046
Total liabilities	105,159	183,046
Net assets available for benefits	$ 45,522,104	$ 42,870,734

The accompanying notes are an integral part of the financial statements.

EXHIBIT B

SAMPLE HEALTH AND WELFARE
TRUST FUND
STATEMENTS OF CHANGES IN NET ASSETS AVAILABLE FOR BENEFITS
For the Years Ended December 31, 20X2 and 20X1

	20X2	*20X1*
Additions:		
Contributions (Notes 1C and 2B):		
Employer	$ 17,310,271	$ 15,458,869
Participant	17,261,758	16,429,189
	34,572,029	31,888,058
Investment income:		
Net appreciation on fair value of investments (Note 3)	1,899,400	1,685,653
Interest and dividends	1,988,313	2,141,741
	3,887,713	3,827,394
Less investment expenses	(116,264)	(105,833)
	3,771,449	3,721,561
Total additions	38,343,478	35,609,619
Deductions:		
Self-funded Benefits (Note 1B)	31,108,027	26,793,603
Insured benefits (Note 1B)	2,149,202	2,172,476
Total benefits	33,257,229	28,966,079
Operating expenses	1,441,940	1,406,126
Professional fees	529,092	497,823
General and administrative expenses	463,847	439,870
Total operating expenses	2,434,879	2,343,819
Total deductions	35,692,108	31,309,898
Increase in net assets available for benefits	2,651,370	4,299,721
Net assets available for benefits:		
Beginning	42,870,734	38,571,013
Ending	$ 45,522,104	$ 42,870,734

The accompanying notes are an integral part of the financial statements.

EXHIBIT C

SAMPLE HEALTH AND WELFARE TRUST FUND
STATEMENTS OF XYZ PLAN'S BENEFIT OBLIGATIONS
December 31, 20X2 and 20X1

	20X2	*20X1*
Amounts currently payable to or for participants, beneficiaries, and dependents (Note 4):		
Self-funded benefit claims payable	$ 6,191,413	$ 5,433,323
Group insurance premiums payable	302,576	417,578
	6,493,989	5,850,901
Other obligations for current benefit coverage:		
Claims incurred but not reported	3,842,000	3,300,000
Total obligations other than postretirement benefit obligations	10,335,989	9,150,901
Postretirement benefit obligations (Notes 2D and 6):		
Current retirees	296,853,000	206,344,000
Other participants fully eligible for benefits	175,007,000	91,889,000
Other participants not yet fully eligible for benefits	209,037,000	172,875,000
	680,897,000	471,108,000
PLAN'S TOTAL BENEFIT OBLIGATIONS	$ 691,232,989	$ 480,258,901

The accompanying notes are an integral part of the financial statements.

EXHIBIT D

SAMPLE HEALTH AND WELFARE
TRUST FUND
STATEMENT OF CHANGES IN XYZ PLAN'S BENEFIT OBLIGATIONS
For the Years Ended December 31, 20X2 and 20X1

	20X2	*20X1*
Amounts currently payable to or for participants, beneficiaries, and dependents (Note 4):		
Balance at beginning of year	$ 5,850,901	$ 4,634,934
Claims reported and approved for payment	33,900,317	30,182,046
Claims paid	(33,257,229)	(28,966,079)
Balance at end of year	6,493,989	5,850,901
Other obligations for current benefit coverage, at estimated amounts:		
Balance at beginning of year	3,300,000	4,272,000
Net change during year:	542,000	(972,000)
Balance at end of year	3,842,000	3,300,000
Total obligations for current benefit coverage	10,335,989	9,150,901
Postretirement benefit obligation (Notes 2D and 6):		
Balance at beginning of year	471,108,000	493,251,000
Increase (decrease) during the year attributable to:		
Benefits earned and other changes	46,235,000	31,644,000
Plan amendment	45,435,000	—
Experience gain (loss)	(28,635,000)	14,231,000
Changes in actuarial assumptions	146,754,000	(68,018,000)
Balance at end of year	680,897,000	471,108,000
PLAN'S TOTAL BENEFIT OBLIGATIONS AT YEAR END	$ 691,232,989	$ 480,258,901

The accompanying notes are an integral part of the financial statements.

SAMPLE HEALTH AND WELFARE

TRUST FUND

NOTES TO THE FINANCIAL STATEMENTS

NOTE 1—DESCRIPTION OF THE FUND

The following brief description is provided for general information purposes only. Participants should refer to the Summary Plan Description for more complete information.

A. General:

The Sample Health and Welfare Trust Fund (the Fund) was established on June 29, 1985, for the purpose of providing health care benefits during retirement to eligible Sample Employees covered by collective bargaining agreements between the Fund, the Sample Union Organization, and employer associations and individual employers signatory to the agreements. The Fund is subject to the provisions of the Employee Retirement Income Security Act of 1974 (ERISA) and is exempt from federal and California taxes on income under the current provisions of the Internal Revenue Code and the California Revenue and Taxation Code, respectively.

B. Health Care Benefits:

During the years ended December 31, 20X2 and 20X1, the following insured benefits were in effect:

		Monthly Per Capita Premium	
Coverage	***Provider***	***20X2***	***20X1***
Medical	Kramer Foundation Health Plan – California	$123.10–$246.20	$123.10–$246.20
Medical	Kramer Foundation Health Plan – Alaska	208.28	208.28
Medical	Health Service	78.20	56.82
Medical	Oceancare	40.52	23.47
Dental	Lifeguard	17.40	16.60
Dental	Alaska Dental Service	32.65	33.28

During the years ended December 31, 20X2 and 20X1, the following self-funded benefits were in effect:

Medical
Prescription drug
Vision
Health exams
Dental
Addiction recovery
Hearing aids

C. Retiree Coverage

A pensioner who meets the eligibility requirements of the Plan is initially covered on the first day of the month during which his or her application for a pension has been submitted, immediately before the effective date of his or her pension award, or upon the date his or her eligibility under the Sample Health and Welfare Plan for active employees terminates, if such date is later. Legal spouses are entitled to the same benefits as the participants, except for burial coverage.

D. Contributions:

During the years ended December 31, 20X2 and 20X1, the Fund received contributions from employers for each hour worked by active Sample Employees at the average rate of $.84 and $.79 per hour, respectively.

For the years ended December 31, 20X2 and 20X1, the self-pay contribution for all regular retirees was $175 and $150 per month, respectively.

E. Fund Termination:

The Plan document provides that upon the termination of the Fund, any monies remaining after the payment of all expenses and obligations shall be paid or used for the continuance of one or more benefits in accordance with the provisions of the Plan document until the Fund is exhausted.

NOTE 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

A. Basis of Accounting:

The Fund's financial statements are prepared on the accrual basis of accounting.

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, benefit obligations, and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of additions and deductions during the reporting period. Actual results could differ from those estimates.

B. Employer Contributions:

Employer contributions reported in the financial statements include amounts relating to hours worked by Sample Employees through December 31, plus liquidated damages and manning violations that may be imposed. Allowances are made for uncollectible amounts.

C. Valuation of Investments:

Cash equivalents are stated at cost, which approximates fair value. U.S. government obligations, corporate debt securities, and mutual fund investments are stated at fair value, based on closing market quotations at year end.

D. Postretirement Benefits:

Statement of Position (SOP) 92-6, *Accounting and Reporting by Health and Welfare Benefit Plans,* requires the plan to present a postretirement benefit obligation as described below. That obligation is computed without reduction for any future employer and employee contributions or investment earnings which are expected to fund payments of the obligation.

The postretirement benefit obligation represents the actuarial present value of those estimated future benefits that are attributed to employee service rendered to December 31. Postretirement benefits include future benefits expected to be paid to or for (1) currently retired or terminated employees and their beneficiaries. and dependents and (2) active employees and their beneficiaries and dependents after retirement from service with the participating employers. Before an active employee's full eligibility date, the postretirement benefit obligation is the portion of the expected postretirement benefit obligation that is attributed to that employee's service in the industry rendered to the valuation date.

The actuarial present value of the expected postretirement benefit obligation is determined by an actuary and is the amount that results from applying actuarial assumptions to historical claims-cost data to estimate future annual incurred claims costs per participant and to adjust such estimates for the time value of money (through discounts for interest) and the probability of payment (by means of decrements such as those for death, disability, withdrawal, or retirement) between the valuation date and the expected date of payment.

For measurement purposes, claim costs were developed from retiree claims experience from January 1, 1996 through December 31, 20X2. Claims were trended and a weighted average was used to determine the gross claim costs.

Actuarial factors were applied to estimate gross retiree health care costs by age and sex (excluding vision care). These factors take into account the cost relationships among the sexes and ages and between costs over and under age sixty-five.

The following were other significant assumptions used in the valuations as of December 31, 20X2 and 20X1:

Weighted-average discount rate:	6.75%–20X2; 7.5%–20X1
Average retirement age:	61 – 20X2; 60.92 – 20X1
Mortality Rates:	1983 Group Annuity Mortality Table (without margins)

The foregoing assumptions are based on the presumption that the Fund will continue. Were the Fund to terminate, different actuarial assumptions and other factors might be applicable in determining the actuarial present value of the postretirement benefit obligation.

Valuation assumption changes increased obligations by $146,754,000. This was the net result of revisions to the discount rate, valuation-year health costs, and trend on health costs. The discount rate is reset each year based on the market value of high-quality, long-term corporate bonds as of the valuation measurement date.

A plan amendment expanding spousal benefits increased obligations by $45,435,000.

NOTE 3—INVESTMENTS

Investment assets of the Fund are held by Sample 1 Bank under the terms of a corporate co-trustee agreement. The investment program is directed by Sample 3, investment managers.

The following information, included in the Fund's financial statements as of December 31, 20X2 and 20X1, was prepared by Sample 1 Bank and furnished to the Administrator.

The Administrator has obtained certification from the bank that such information is complete and accurate:

	20X2		20X1	
	Fair Value	*Cost*	*Fair Value*	*Cost*
U. S. Government obligations	$ 18,603,907	$ 18,289,338	$ 20,111,225	$ 19,686,677
Corporate debt securities	11,886,956	11,636,783	9,491,191	9,383,668
Mutual funds	6,052,039	3,625,053	5,565,686	3,893,113
Cash equivalents	3,704,122	3,704,122	3,377,377	3,377,377
	$ 40,247,024	$ 37,255,296	$ 38,545,479	$ 36,340,835

The following investments, included above, represent 5 percent or more of total assets of the Fund:

Description	***Maturity***	***Cost***	***Fair Value***
U.S. Treasury Note, 6.875%	4/30/03	$3,121,875	$3,122,820
Sample Fds, Cusip #55267LI05	—	3,625,053	6,052,039

During the years ended December 31, 20X2 and 20X1, the Fund's investments (including investments bought, sold, as well as held during the year) appreciated in value as follows:

	20X2	*20X1*
U.S. Government obligations	$ 287,135	$ 313,144
Corporate obligations	192,711	90,479
Mutual funds	1,419,554	1,282,030
	$ 1,899,400	$ 1,685,653

NOTE 4—SELF-FUNDED BENEFIT CLAIMS LIABILITY

The self-funded benefit claims liability, which includes reported and unreported claims, is calculated on the basis of claims incurred through February 28, 20X3 and 20X2, relating to employer contributions for hours worked by Sample Employees through December 31, 20X2 and 20X1, respectively. Claims reported through February 28, 20X3 and 20X2 total $6,191,413 and $5,433,323, respectively. The liability for future payment of claims incurred but unreported at February 28, 20X3 and 20X2 in the amounts of $3,842,000 and $3,300,000 have been estimated on the basis of statistical lag analysis studies.

A comparison of the self-funded benefit claims liability composition at December 31, 20X2 and 20X1 follows:

	20X2	*20X1*
Medical	$ 5,766,251	$ 5,036,691
Prescription drug	3,371,214	2,930,815
Vision care	389,631	351,884
Chemical dependency	657	6,538
Dental	505,660	407,395
	$ 10,033,413	$ 8,733,323

NOTE 5—AGREEMENTS AND TRANSACTIONS WITH PERSONS KNOWN TO BE PARTIES IN INTEREST

Sample Local is a party to the collective bargaining agreement that provides for health and welfare benefits for its eligible members, as covered under the Fund.

Local Union provides fringe benefit and collection services to the Fund, which reimburses it for salaries and related costs, travel, rental facilities, and supplies. During the year ended December 31, 20X2 and 20X1, the Fund paid Local Union a total of $100,183 and $107,746, respectively.

NOTE 6—BENEFIT OBLIGATIONS

The weighted-average health care cost-trend rate assumption (see Note 2D) has a significant effect on the amounts reported to the accompanying financial statements. If the assumed rates increased by one percentage point in each year, that would increase the obligation as of December 31, 20X2 and 20X1 by $153,677,000 and $84,151,000, respectively.


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