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Preface

This working draft of the AICPA Audit and Accounting Guide *Employee Benefit Plans* has been developed by the AICPA Employee Benefit Plans Guide Task Force to assist preparers of financial statements in preparing financial statements in conformity with U.S. generally accepted accounting principles (GAAP) and to assist auditors in auditing and reporting on such financial statements in accordance with generally accepted auditing standards. Certain topics not previously included in the 1991 AICPA Audit and Accounting Guide *Employee Benefit Plans* have been included in this working draft.

Please note that certain chapters of the guide that contain auditing guidance are not included in this working draft. In addition, this working draft does not include general and specific auditing considerations, analytical procedures, internal control considerations, and reporting.

The financial accounting and reporting guidance contained in this guide has been approved by the affirmative vote of at least two-thirds of the members of the AICPA Financial Reporting Executive Committee (FinREC). However, the views and opinions expressed by FinREC are not an authoritative source of U.S. GAAP. The Financial Accounting Standards Board (FASB) *Accounting Standards Codification™* (ASC) is the sole source of U.S. GAAP for nongovernmental entities and is discussed subsequently.

FinREC has found this guide to be consistent with existing standards and principles covered by Rule 202, *Compliance With Standards* (AICPA, *Professional Standards*, ET sec. 202 par. .01), and Rule 203, *Accounting Principles* (AICPA, *Professional Standards*, ET sec. 203 par. .01), of the AICPA Code of Professional Conduct. AICPA members should be prepared to justify departures from U.S. GAAP. Members should be alert to significant developments in the accounting standards that define the source of authoritative accounting standards, a discussion of which can be found later in this preface.

The purpose of the working draft is to solicit comments from preparers, auditors, and users of employee benefit plan financial statements and other interested parties. FinREC invites comments on all matters in the proposed guide. In their comments, respondents should refer to specific paragraph numbers and include reasons for any suggestions or comments.

Comments should be received by June 10, 2011, and sent by electronic mail to Sherry Hazel at shazel@aicpa.org, or you can send them by mail to Sherry Hazel, Audit and Attest Standards, AICPA, 1211 Avenue of the Americas, 19th Floor, New York, NY 10036.
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FinREC, the EBP Guide Task Force, and the AICPA also thank John Althoff, Neri Bukspan, Brett Cohen, Pascal Desroches, Faye Feger, Robert Gonzales, Melissa Hooley, Rich Jones, Carl Kampel, Lisa Kelly, Peter Knutson, James Kroeker, Steve Lilien, David Morris, Holly Nelson, Benjamin S. Neuhausen, Rick Petersen, Roy Rendino, Barb Saxton, Randall Sogoloff, Enrique Tejerina, Beth Thompson, Robert Uhl, MaryAnne Watson, Dan Weaver, and The Office of the Chief Accountant, Employee Security Benefits Administration, U.S. Department of Labor for their assistance in the development of this proposed guide.

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Guidance Considered in This Edition
Authoritative accounting guidance issued through September 28, 2010, has been considered in the development of this working draft of the guide. This includes relevant guidance and FASB Accounting Standards Updates (ASUs) issued through September 28, 2010. Users of this guide should consider guidance issued subsequent to this date to determine its effect on entities covered by this guide. In determining the applicability of recently issued guidance, the effective date also should be considered.

**FASB Accounting Standards Codification™**

Released on July 1, 2009, FASB ASC is a major restructuring of accounting and reporting standards designed to simplify user access to all authoritative U.S. GAAP by topically organizing the authoritative literature. FASB ASC disassembled and reassembled thousands of nongovernmental accounting pronouncements (including those of FASB, the Emerging Issues Task Force, and the AICPA) to organize them under approximately 90 topics.

FASB ASC also includes relevant portions of authoritative content issued by the Securities and Exchange Commission (SEC), as well as select SEC staff interpretations and administrative guidance issued by the SEC; however, FASB ASC is not the official source of SEC guidance and does not contain the entire population of SEC rules, regulations, interpretive releases, and SEC staff guidance. Moreover, FASB ASC does not include governmental accounting standards.

FASB published a notice to constituents (NTC) that explains the scope, structure, and usage of consistent terminology of FASB ASC. Constituents are encouraged to read this NTC because it answers many common questions about FASB ASC. FASB ASC, and its related NTC, can be accessed at http://asc.fasb.org/home and are also offered by certain third party licensees, including the AICPA. FASB ASC is offered by FASB at no charge in a Basic View and for an annual fee in a Professional View.

**Issuance of New Standards**

New standards are now issued by FASB through ASUs and serve only to update FASB ASC. FASB does not consider the ASUs authoritative in their own right; new standards become authoritative when they are incorporated into FASB ASC.

New standards will be in the form of ASU No. 20YY-XX, in which, “YY” is the last two digits of the year and “XX” is the sequential number for each update. For example, ASU No. 2011-01 is the first update in the calendar year 2011. New standards will include the standard and an appendix of FASB ASC update instructions. ASUs will also provide background information about the standards and provide the basis for conclusions on changes made to FASB ASC.

**Pending Content in FASB ASC**

New guidance from ASUs (or other authoritative accounting guidance issued prior to the release date of FASB ASC) issued that are not fully effective or became effective within the last six months for all entities or transactions within its scope are reflected as “Pending Content” in FASB ASC. This pending content is shown in text boxes below the paragraphs being amended in
FASB ASC and includes links to the transition information. The pending content boxes are meant to provide users with information about how a paragraph will change when new guidance becomes authoritative. When an amended paragraph has been fully effective for six months, the outdated guidance will be removed, and the amended paragraph will remain without the pending content box. FASB will keep any outdated guidance in the applicable archive section of FASB ASC for historical purposes.

Because not all entities have the same fiscal year-ends and certain guidance may be effective on different dates for public and nonpublic entities, the pending content will apply to different entities at different times. As such, pending content will remain in place within FASB ASC until the “roll off” date. Generally, the roll-off date is six months following the latest fiscal year-end for which the original guidance being amended or superseded by the pending content could be applied as specified by the transition guidance. For example, assume an ASU has an effective date for fiscal years beginning after November 15, 2010. The latest possible fiscal year-end of an entity still eligible to apply the original guidance being amended or superseded by the pending content would begin November 15, 2010, and end November 14, 2011. Accordingly, the roll-off date would be May 14, 2011.

Entities cannot disregard the pending content boxes in FASB ASC. Instead, all entities must review the transition guidance to determine when the pending content is applicable to them. This audit and accounting guide identifies pending content where applicable.
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Chapter 1

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Chapter 2

Defined Contribution Retirement Plans

Introduction and Background

2.01 Defined contribution retirement plans\(^1\) provide an individual account for each participant and provide benefits that are based on all of the following: (a) amounts contributed to the participant's account by the employer or employee, (b) investment experience, and (c) any forfeitures allocated to the account, less any administrative expenses charged to the plan.

2.02 Under a defined contribution retirement plan, the employer contribution rate is generally determined at the discretion of the employer or by contractual agreement, or both. When a participant withdraws from the plan, the amount allocated to the participant's account (if fully vested) represents the participant's accumulated benefit. That amount may be paid to the participant or used to purchase a retirement annuity, as defined by the plan agreement. The benefit a participant will ultimately receive is based upon his or her account balance at the time of payment. By contrast, in a defined benefit plan, benefits are determinable based on factors, such as age, years of service, and salary, and the contribution necessary to provide those benefits is actuarially determined.

2.03 Three general types of tax qualified defined contribution retirement plans under Section 401(a) of the Internal Revenue Code (IRC) exist: profit-sharing plans, money purchase pension plans, and stock bonus plans.

a. A profit-sharing plan is a defined contribution retirement plan that is not a pension plan or a stock bonus plan and is designated as such in the plan document. Employer contributions may be discretionary or may be based on a formula related to profits, compensation, or other factors, as defined in the plan document.

b. A money purchase pension plan is a defined contribution retirement plan under which employer contributions are based on a fixed formula that is not related to profits and that is designated as a pension plan by the plan sponsor.

c. A stock bonus plan is a defined contribution retirement plan under which distributions are normally made in stock of the employer, unless the participant or beneficiary elects otherwise.

\(^1\) The term defined contribution retirement plan used in this guide is intended to encompass all defined contribution plans (except for health and welfare defined contribution plans that are covered in chapter 4, “Health and Welfare Benefit Plans.”). The Financial Accounting Standards Board (FASB) Accounting Standards Codification\(^{\text{TM}}\) (ASC) uses the term defined contribution pension plan. The authors of this guide believe that, often, the term pension plan is used interchangeably to refer to all types of defined contribution plans. This guide has elected to use the term defined contribution retirement plan because it more accurately reflects all types of defined contribution plans.
403(b) plans (also known as tax-sheltered annuities) are also considered tax qualified defined contribution plans and are provided for under Section 403(b) of the IRC. A 403(b) plan is a retirement plan for certain employees of public schools, employees of certain tax-exempt organizations, and certain ministers. Generally, these plans may invest in annuity contracts or mutual funds, and contributions may include employee elective deferrals, employer nonelective contributions, or after-tax contributions (that are not Roth contributions).

2.04 Within these general types of plans, a number of more specialized plans exist that often include employee contributions, such as the following:

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<th>Stock bonus plan</th>
<th>Other</th>
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<td>A thrift plan (also called a “savings plan”)</td>
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<td>An employee stock ownership plan (an ESOP)</td>
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<td>A target benefit plan</td>
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<td>A SIMPLE plan, or savings incentive match plan for employees.</td>
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<td>A 403(b) plan (tax sheltered annuity plan)</td>
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**Accounting, Reporting, and Auditing Defined Contribution Retirement Plans**
This chapter describes accounting principles generally accepted in the United States of America (U.S. GAAP) for accounting and financial reporting for defined contribution retirement plans as set forth in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 962, Plan Accounting—Defined Contribution Pension Plans. Other GAAP may also apply. FASB ASC contains all authoritative U.S. GAAP. This chapter also provides guidance that has been supported by the Financial Reporting Executive Committee (FinREC) on the accounting, reporting, or disclosure treatment of transactions or events that is not set forth in FASB ASC and describes related auditing procedures and guidance for defined contribution retirement plans.

The primary users of a defined contribution retirement plan's financial statements include plan sponsors, plan participants, the Department of Labor (DOL), the IRS, and the Securities and Exchange Commission (SEC). Information that is useful to defined contribution retirement plan participants includes the amount they would receive currently if they were to withdraw or borrow funds from or transfer funds within the plan, as well as the results of transactions and events that affect those amounts. Accordingly, participants generally have a greater interest in monitoring the financial condition and operations of the plan because they bear more investment risk than they would in a defined benefit retirement plan.

Financial Statements

In accordance with FASB ASC 962-10-10-1, the primary objective of a defined contribution retirement plan's financial statements is to provide information that is useful in assessing the plan's present and future ability to pay benefits when they are due. In a defined contribution retirement plan, the plan's net assets available to pay benefits equal the sum of participants' individual account balances. Accordingly, benefits that can be paid by the plan when they are due relate to the value of the net assets that may currently be made available to the individual participants. It should be recognized that (a) information in addition to that contained in a plan's financial statements is needed in assessing the plan's present and future ability to pay benefits when due, and (b) comparative financial statements can provide more useful information for assessing the plan’s future ability to pay benefits.

The financial statements of a defined contribution retirement plan prepared in accordance with U.S. GAAP should be prepared on the accrual basis of accounting and should include (a) a statement of net assets available for benefits as of the end of the plan year (The Employee Retirement Income Security Act of 1974 [ERISA] requires that this statement be presented in comparative form), and (b) a statement of changes in net assets available for benefits for the year then ended. Appendix C provides illustrative financial statements for defined contribution retirement plans.

---

2 FASB ASC 230-10-15-4 states that a statement of cash flows is not required to be provided by a defined benefit plan that presents financial information in accordance with the provisions of FASB ASC 960, Plan Accounting—Defined Benefit Pension Plan. Other employee benefit plans that present financial information similar to that required by FASB ASC 960 (including the presentation of plan investments at fair value) also are not required to provide a statement of cash flows. Employee benefit plans are encouraged to include a statement of cash.
Net Assets Available for Benefits

2.09 In accordance with FASB ASC 962-205-45-2, the statement of net assets available for benefits of the plan should present amounts for all of the following:

   a. Total assets
   b. Total liabilities
   c. Net assets reflecting all investments at fair value
   d. Net assets available for benefits

2.10 In accordance with FASB ASC 962-205-45-3, the amount representing the difference between net assets reflecting all investments at fair value and net assets available for benefits should be presented on the face of the statement of net assets available for benefits as a single amount, calculated as the sum of the amounts necessary to adjust the portion of net assets attributable to each fully benefit-responsive investment contract to contract value. See paragraph 2.32 for further guidance on fully benefit-responsive investment contracts.

Cash Balances

2.11 Noninterest-bearing cash balances of defined contribution retirement plans typically represent residual amounts not otherwise invested and are typically shown as a separate line item on the financial statements. Interest bearing cash balances often relate to investment or participant transactions in process. FinREC recommends that interest-bearing cash be included with investments in the financial statements. The Form 5500 also requires interest-bearing cash to be reported as an investment on Schedule H, line 4i—Schedule of Assets (Held At End of Year).

2.12 According to FASB ASC 230-10-15-4, a statement of cash flows is not required to be provided by a defined benefit pension plan that presents financial information in accordance with the provisions of FASB ASC 960, Plan Accounting—Defined Benefit Pension Plans. Other employee benefit plans that present financial information similar to that required by FASB ASC 960 (including the presentation of plan investments at fair value) also are not required to provide a statement of cash flows.

2.13 A definition of a cash equivalent need not be disclosed as required by FASB ASC 230-10-45-6, when a cash flow statement is not presented.

Investments

2.14 According to FASB ASC 962-325-35-1, plan investments should generally be presented at their fair value at the reporting date. See paragraphs 2.32–2.35 and chapter 7, “Investments,” for special provisions concerning the valuation of fully benefit-responsive investment contracts and insurance contracts, respectively. Fair value of plan investments flows with their annual financial statements when that statement would provide relevant information about the ability of the plan to meet future obligations (for example, when the plan invests in assets that are not highly liquid or obtains financing for investments).
is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

2.15 Original cost of investments is not required to be disclosed in the financial statements; however, the Form 5500 requires disclosure of original cost for nonparticipant-directed investments on Schedule H, line 4i—Schedule of Assets (Held at End of Year) (see paragraph 2.20 for further guidance on nonparticipant-directed investments).

2.16 Typically for defined contribution retirement plans, participants are offered an array of investment options in which to direct their account balances and have different methods of holding those investments. Some of these investment options or methods of holding investments include common collective trusts (CCTs), registered investment companies, contracts with insurance companies, pooled separate accounts (PSAs) and master trusts. These types of investments or methods of holding investments are also found in other types of benefit plans. In addition, certain defined contribution retirement plans may have investments that are managed by an investment manager, similar to a defined benefit plan.

Practice Tip

Readers of this guide should refer to chapter 7 for a more in-depth discussion of certain investments unique to defined contribution retirement plans that are described in this chapter, as well as for other investments not covered in this chapter.

2.17 Some of the more common investment types or methods of holding investments that present unique accounting and auditing issues for defined contribution retirement plans are discussed in the following sections.

- Participant-directed and nonparticipant-directed investments
- Self-directed accounts
- Separately managed accounts
- Unitized trusts
- Omnibus accounts
- Investment contracts
- Master trusts
- Participant loans

Participant-Directed and Nonparticipant-Directed Investments

Participant-Directed Investments

2.18 A defined contribution retirement plan may offer a participant-directed program whereby participants choose among various investment alternatives and may periodically change their selections. The available alternatives are usually pooled fund vehicles (such as registered investment companies, CCTs, or PSAs), employer securities, and separately managed accounts. See chapter 7 for further guidance on certain of these investments.
According to FASB ASC 962-325-45-3, participant-directed plan investments may be shown in the aggregate as a one-line item in the statement of net assets available for benefits. Participant-directed plan investments, including self-directed investments held in brokerage accounts that individually exceed 5 percent of net assets available for benefits, must be separately disclosed pursuant to paragraph 2.65(j).

Nonparticipant-Directed Investments

According to paragraphs 5–6 of FASB ASC 962-325-45, the presentation of nonparticipant-directed investments in the statement of net assets available for benefits or in the notes should be detailed by general type, such as registered investment companies, government securities, CCTs, PSAs, short-term securities, corporate bonds, common stocks, mortgages, and real estate. The presentation should indicate whether the fair values of the investments have been measured by quoted market prices in an active market or were otherwise determined. See paragraphs 2.65(j)–2.65(k) for required disclosures specific to nonparticipant-directed investments.

Self-Directed Accounts

Many defined contribution retirement plans with participant-directed investment programs also offer a self-directed program to participants. A self-directed program is one that allows participants to invest their account balances in any investment, as permitted by the plan and in accordance with ERISA. Under this type of arrangement, participants can direct investments into the self-directed program in addition to, or in lieu of, the various investment alternatives offered by the plan. There can be defined contribution retirement plans that are completely self-directed, not offering any formal participant-directed investment programs. The self-directed account does not represent a pooled investment vehicle but is an account that comprises individual investments owned by the plan. Often, the self-directed accounts contain other investments that may be hard-to-value, such as limited partnerships, real estate, and mortgages.

Practice Tip

The fair value measurement requirements and disclosures of FASB ASC 820, Fair Value Measurements and Disclosures, apply to the individual investments of the self-directed account.

Differences in Form 5500 Reporting

Although self-directed accounts are viewed as individual investments for auditing and reporting purposes, the instructions to Form 5500 Schedule H, Financial Information, permit aggregate reporting of certain self-directed accounts (also known as "participant-directed brokerage accounts"), on the Form 5500 and related Schedule of Assets (Held at End of Year). Investments made through participant-directed brokerage accounts may be reported either (a) as individual investments in the applicable categories in Parts I and II of Schedule H, or (b) by reporting the aggregate amount on line 1c(15), "Other," and the aggregate investment income (loss) before expenses on line 2c. This aggregate reporting is not available for loans, partnerships or joint ventures, real property, employer securities,
or investments that could result in a loss in excess of the account balance of the individual who directed the transaction.

2.23 Investments made through participant-directed brokerage accounts reported in the aggregate on line 1c(15) of Schedule H may be treated as one asset on Schedule H, line 4i—Schedule of Assets (Held at End of Year), except that investments in tangible personal property must continue to be separately reported on this schedule.

2.24 This Form 5500 reporting creates differences between the U.S. GAAP requirements for reporting and disclosure of investments and the Form 5500 reporting for participant-directed brokerage account investments. The following table summarizes these differences.

<table>
<thead>
<tr>
<th>Form 5500—Alternative Reporting</th>
<th>U.S. GAAP—Required Reporting and Disclosures</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Certain investments and related income (see previous text) made through participant-directed brokerage accounts may be shown as a single line item on Schedule H.</td>
<td>• Identification of investments representing 5 percent or more of plan net assets in the plan's footnotes. (See paragraph 2.65(j))</td>
</tr>
<tr>
<td>• Certain investments listed on the Schedule of Assets (Held at End of Year) may be shown as a single line item.</td>
<td>• Reporting of investment income, exclusive of changes in fair value, in the statement of changes in net assets or the footnotes. (See paragraph 2.56(b))</td>
</tr>
<tr>
<td></td>
<td>• Reporting of change in fair value by investment type in the plan's footnotes. (See paragraph 2.56(a))</td>
</tr>
</tbody>
</table>

2.25 The plan sponsor may experience difficulty in obtaining self-directed investment information by individual investment categories (such as common stocks and registered investment companies) and self-directed investment income (such as net appreciation or depreciation by type) from plan service providers. If the financial statements fail to disclose information that is required by U.S. GAAP, the auditor should consider the guidance in paragraphs .35–.37 of AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*). If the information is not available, then there may be a limitation on the scope of the audit. Restrictions on the scope of the audit, whether imposed by the client or by circumstances, such as the inability to obtain sufficient appropriate audit evidence, may require the auditor to qualify his or her opinion or to disclaim an opinion (see AU section 508, paragraphs .22–.26).

*Separately Managed Accounts*

2.26 Some plans have investment accounts at a trust company or similar institution consisting of individual plan assets that are managed by an investment manager specifically for the plan, which may or may not be offered as a participant-directed investment alternative. Often these separately managed investment accounts are mistaken for pooled investment vehicles (for example, CCTs and PSAs). A review of the underlying investment
agreement with the investment manager will typically reveal whether the investment is a pooled or separately managed vehicle. Individual assets of a separately managed investment account are held in the name of the plan. See chapter 7 for further guidance on accounting, reporting, and auditing of the underlying investments in a separately managed investment account.

**Unitized Trusts**

2.27 In certain instances, the recordkeeper or trustee of a separately managed account will maintain a net asset value per unit or unitization for the account. Purchases and sales of the account will be transacted at that net asset value per unit. The fund may incur investment management fees that affect the net asset value per unit. See paragraphs 2.60–2.62 for further discussion on plan expenses.

2.28 Some defined contribution retirement plans hold employer securities either as participant-directed or nonparticipant-directed investments. When employer securities are offered as an investment option in defined contribution retirement plans, unitization is commonly used. When unitization is used, the plan owns the underlying investments of the unitized account. The unitized trust typically includes the employer securities and cash or a money market type fund, which generally are reported separately as individual investments.

2.29 If participants can elect to invest their account in employer securities, then the plan may be subject to SEC reporting rules (such as 11-K reporting).

**Omnibus Accounts**

2.30 An omnibus account is an institutional account, often in the name of a custodian bank or an investment advisor, in which transactions are effected on behalf of a number of beneficial owners that are aggregated for trading purposes and are later allocated to those beneficial owners. Traditionally, although the bank or the investment advisor is expected to maintain records that reflect the transactions allocated amongst the beneficial owners or customers, any information regarding the identity of the customers for whom transactions were executed is frequently maintained by an affiliated recordkeeper. The recordkeeper system is the only record of an individual plan’s activity within the investment fund.

**Investment Contracts**

2.31 Chapter 7 defines different types of investment contracts and insurance contracts and discusses the related accounting, reporting, and auditing of such contracts. Defined contribution retirement plans can invest in fully benefit-responsive investment contracts either directly or through CCTs. Direct investments that are held in a separately managed account are often mistaken for a CCT. See paragraph 2.26 for further guidance on separately managed accounts.

**Fully Benefit-Responsive Investment Contracts**

2.32 FASB 962-325-35-5 states that defined contribution retirement plans should report all investments (including derivative contracts) at fair value. However, FASB ASC 962-10-
05-5 states that, consistent with the objective of a defined contribution retirement plan’s financial statements, net assets available for benefits of defined contribution plans should be measured and reported at values that are meaningful to financial statement users. Therefore, contract value is the relevant measurement attribute for that portion of the net assets available for benefits of a defined contribution retirement plan attributable to fully benefit-responsive investment contracts. As defined by the FASB ASC glossary, the contract value of a fully benefit-responsive investment contract held by a plan is the amount a participant would receive if he or she were to initiate transactions under the terms of the ongoing plan. In accordance with paragraphs 2–3 and 6 of FASB ASC 962-205-45, the statement of net assets available for benefits of the plan should present amounts for (a) total assets, (b) total liabilities, (c) net assets reflecting all investments at fair value, and (d) net assets available for benefits. The amount representing the difference between (c) and (d) should be presented on the face of the statement of net assets available for benefits as a single amount, calculated as the sum of the amounts necessary to adjust the portion of net assets attributable to each fully benefit-responsive investment contract from fair value to contract value. The statement of changes in net assets available for benefits should be prepared on a basis that reflects income credited to participants in the plan and net appreciation or depreciation in the fair value of only those investment contracts that are not deemed to be fully benefit-responsive.

Practice Tip

Plans may hold stable value investments through direct contracts with issuers or through a specifically plan-managed account. Plans may also hold stable value investments through beneficial ownership of bank collective funds (which own investment contracts). Insurance company PSAs that hold investment contracts also have similar characteristics. See AICPA Technical Questions and Answers (TIS) section 6931.08, “Types of Investments Subject to FASB ASC 962” (AICPA, Technical Practice Aids).

When the plan invests in a CCT (or similar vehicle) or a master trust that holds fully benefit-responsive investment contracts, the fair value of the investment in the CCT or master trust should be reported in investments on the face of the statement of net assets available for benefits. The amount representing the difference between the fair value and the contract value of the fully benefit-responsive investment contracts held by the CCT or master trust should be presented on the face of the statement of net assets available for benefits and calculated as the sum of the amounts necessary to adjust the portion of net assets attributable to the plan’s investment in the CCT or master trust from fair value to contract value. For the master trust, the adjustment only relates to the plan’s portion of the master trust invested in the fully benefit-responsive investment contracts. See TIS section 6931.09, “Financial Statement Presentation When a Plan Invests in a Common Collective Trust Fund or in a Master Trust That Holds Fully Benefit-Responsive Investment Contracts” (AICPA, Technical Practice Aids).

2.33 In accordance with the FASB ASC glossary, an investment contract is considered fully benefit-responsive, if all of the following criteria, analyzed on an individual basis, are met for that contract:
a. The investment contract is effected directly between the plan and the issuer and prohibits the plan from assigning or selling the contract or its proceeds to another party without the consent of the issuer.

b. Either (1) the repayment of principal and interest credited to participants in the plan is a financial obligation of the issuer of the investment contract, or (2) prospective interest crediting rate adjustments are provided to participants in the plan on a designated pool of investments held by the plan or the contract issuer, whereby a financially responsible third party, through a contract generally referred to as a wrapper, must provide assurance that the adjustments to the interest crediting rate will not result in a future interest crediting rate that is less than zero. If an event has occurred such that realization of full contract value for a particular investment contract is no longer probable (for example, a significant decline in creditworthiness of the contract issuer or wrapper provider), the investment contract should no longer be considered fully benefit-responsive.

c. The terms of the investment contract require all permitted participant-initiated transactions with the plan to occur at contract value with no conditions, limits, or restrictions. Permitted participant-initiated transactions are those transactions allowed by the plan, such as withdrawals for benefits, loans, or transfers to other funds within the plan.

d. An event that limits the ability of the plan to transact at contract value with the issuer (for example, premature termination of the contracts by the plan, plant closings, layoffs, plan termination, bankruptcy, mergers, and early retirement incentives), and that also limits the ability of the plan to transact at contract value with the participants in the plan, must be probable of not occurring. (The term probable is used in this paragraph consistent with its use in FASB ASC 450-20-25.)

e. The plan itself must allow participants reasonable access to their funds.

2.34 Additionally, as stated in the FASB ASC glossary, if access to funds is substantially restricted by plan provisions, investment contracts held by those plans may not be considered to be fully benefit-responsive. For example, if plan participants are allowed access at contract value to all or a portion of their account balances only upon termination of their participation in the plan, it would not be considered reasonable access and, therefore, investment contracts held by that plan would generally not be deemed to be fully benefit-responsive. However, in plans with a single investment fund that allow reasonable access to assets by inactive participants, restrictions on access to assets by active participants consistent with the objective of the plan (for example, retirement or health and welfare benefits) will not affect the benefit responsiveness of the investment contracts held by those single-fund plans. Also, if a plan limits participants' access to their account balances to certain specified times during the plan year (for example, semiannually or quarterly) to control the administrative costs of the plan, that limitation generally would not affect the benefit responsiveness of the investment contracts held by that plan. In addition, administrative provisions that place short-term restrictions (for
example, three or six months) on transfers to competing fixed-rate investment options to limit arbitrage among those investment options (equity wash provisions) would not affect a contract's benefit responsiveness. See paragraphs 3–15 of FASB ASC 962-325-55 for examples of fully benefit-responsive investment contracts.

2.35 According to paragraphs 9–10 of FASB ASC 962-325-35, if a plan holds multiple contracts, each contract should be evaluated individually for benefit responsiveness. If a plan invests in pooled funds that hold investment contracts, each contract in the pooled fund should be evaluated individually for benefit responsiveness. However, if the pooled fund places any restrictions on access to funds for the payment of benefits, the underlying investment contracts should not be considered fully benefit-responsive. Contracts that provide for prospective interest adjustments may still be fully benefit-responsive provided that the terms of the contracts specify that the crediting interest rate cannot be less than zero.

Synthetic Guaranteed Investment Contracts

2.36 A synthetic guaranteed investment contract is a variation of a traditional guaranteed investment contract (GIC) (see chapter 7 for a discussion on traditional GICs). It is an investment contract that simulates the performance of a traditional GIC through the use of financial instruments. A key difference between a synthetic GIC and a traditional GIC is that the plan owns the underlying assets of the synthetic GIC. With a traditional GIC, the plan owns only the investment contract itself that provides the plan with a call on the contract issuer's assets in the event of default. The underlying assets of the synthetic GIC may be held in a trust owned by the plan and typically consist of government securities, private and public mortgage-backed and other asset-backed securities, and investment grade corporate obligations. To enable the plan to realize a specific known value for the assets if it needs to liquidate them to make benefit payments, synthetic GICs utilize a benefit responsive wrapper contract issued by a third party that provides market and cash flow risk protection to the plan. (The third-party issuer of the wrapper is an entity other than the plan sponsor, administrator, or trustee and, in certain situations, may be the entity that issues the investment contract.) Individual assets underlying a synthetic GIC are typically held in the name of the plan and operate similar to a separately managed account. See chapter 7 for further guidance on accounting and reporting of the underlying investments in a separately managed account.

Form 5500 Reporting

2.37 Because the assets underlying a synthetic GIC are owned by the plan, those assets and the wrapper should be separately valued and disclosed in the Form 5500 Schedule H, line 4i—Schedule of Assets (Held at End of Year).

Master Trusts

2.38 A master trust is a trust account made up of assets of some or all of the employee benefit plans of a company that sponsors more than one plan or a group of corporations under common control. Typically, each plan has an undivided interest in the assets of the trust,
and ownership is represented by a record of proportionate dollar interest or by units of participation. However, for certain defined contribution retirement plans, master trust arrangements exist whereby the investment in the master trust represents a specific interest in certain investments and, therefore, do not represent an undivided interest. Investments in a master trust should be presented in accordance with paragraph 2.19. See chapter 7 for further guidance on accounting and reporting of investments held in master trusts.

**Practice Tip**

*Form 5500 Reporting for Participant Loans in a Master Trust*

In practice, many master trusts for defined contribution retirement plans include participant loans (paragraph 2.39) as part of their master trust agreement. However, even though these loans may be included as part of the master trust agreement, the Form 5500 instructs the preparer not to include them as part of the master trust assets. Thus, the plan’s financial statements would require Schedule H, line 4i—Schedule of Assets (Held at End of Year) to report participant loans as a nonmaster trust investment. The plan’s Form 5500 filing would require the participant loans to be broken out separately from the investment in the master trust on the Schedule H.

**Loans to Participants**

2.39 Certain defined contribution plans allow participants to borrow against their vested account balance. Such participant loans are an extension of credit to a plan participant by the plan in accordance with the plan document or the plan’s written loan policy. The loan is secured by the participant’s vested account balance. In accordance with FASB ASC 962-310-45-2, for reporting purposes, participant loans should be classified as notes receivable from participants. Participant loans should be measured at their unpaid principal balance plus any accrued but unpaid interest in accordance with FASB ASC 962-310-35-2. In addition, FASB ASC 962-310-50-1 states that the fair value disclosures for financial instruments prescribed in paragraphs 10–16 of FASB ASC 825-10-50 are not required for participant loans. However, participant loans continue to be considered an investment for Form 5500 reporting purposes.

**Practice Tip**

Reporting participant loans as a note receivable from participants rather than an investment typically will not result in a difference between total net assets reported in the plan’s financial statements and in the Form 5500.

**Contributions and Contributions Receivable**

2.40 The most common source of contributions made to a defined contribution retirement plan include employer, employee, and rollover contributions. These contributions may be discretionary or mandatory and may be cash or noncash, as well as pretax or after tax.
2.41 According to the FASB ASC glossary, *contributions receivable* are the amounts due, as of the date of the financial statements, to the plan from employers, participants, and other sources of funding (for example, state subsidies or federal grants). According to FASB 962-310-45-1, contributions receivable should be separately identified. When applicable, contributions receivable should include an allowance for estimated uncollectible amounts in accordance with FASB ASC 962-310-35-1. According to FASB ASC 962-310-25-1, contributions receivable include those pursuant to formal commitments as well as legal or contractual requirements. With respect to an employer's contributions, evidence of a formal commitment may include any of the following: (a) a resolution by the employer's governing body approving a specified contribution, (b) a consistent pattern of making payments after the plan's year-end pursuant to an established contribution policy that attributes such subsequent payments to the preceding plan year, (c) a deduction of a contribution for federal tax purposes for periods ending on or before the financial statement date, or (d) the employer's recognition as of the plan's financial statement date of a contribution payable to the plan.\(^3\)

2.42 Often, discretionary employer contributions for defined contribution retirement plans are not finalized until after the plan's year-end because information required to determine the specific amount may not be known until the company's financial statements are finalized. See FASB ASC 855, *Subsequent Events*, for the principles and requirements for subsequent events.

2.43 In determining when a formal commitment exists as of the plan's year-end, an important factor to consider is whether the contribution is for the participants for that plan year. Other factors to consider include (a) whether the contribution is based on criteria (for example, company performance, participant compensation, or years of service) that existed for the plan year, (b) whether a formal resolution or plan terms require a contribution to be made for that plan year, (c) plan management's intent to make a discretionary contribution, and (d) the timing of the decision to make the contribution being reasonably soon after year-end. Typically, an employer contribution receivable for a defined contribution retirement plan is recorded when the eligibility to receive the contribution is based on service or other criteria that existed as of the plan's year-end. This differs from a defined benefit retirement plan, in which contributions (in excess of the minimum funding) are to fund future benefit payments under the plan.

2.44 Other contributions may be determined after year-end but are based on facts that existed at year-end. For example, the employer may be required to contribute a qualified nonelective contribution (QNEC) because of a failure of a 401(k) plan to pass the average deferral percentage test; a targeted contribution for the benefit of certain otherwise ineligible participants to satisfy the coverage rules; or other contributions due to operational defects that require a contribution to correct. Similar to discretionary contributions, a contribution receivable may be recorded. Some operational defects may also require reinstatement of lost earnings. FinREC recommends that these amounts be presented as other employer

\(^3\) In accordance with FASB ASC 962-310-25-1(d), the existence of an accrued contribution payable in the employer's financial statements does not, by itself, provide sufficient support for recognition of a contribution receivable by the plan.
contributions in the statement of changes in net assets available for benefits. Any associated receivable would be presented as an other employer contribution receivable.

Rollover Contributions

2.45 Many plans allow participants to transfer contributions into the plan from another qualified plan or from an individual retirement account. Such transfers are referred to as rollover contributions. If a rollover results from a significant transaction, such as a plan sponsor acquisition or other plan amendments, FinREC recommends that such rollover contributions be presented as a separate line item on the statement of changes in net assets available for benefits. If the contributions are a result of a merger and are initiated by the plan sponsor, they would not be considered rollover contributions. See paragraph 2.81 for a discussion of transfers in and out of a plan as a result of a merger.

Other Receivables

2.46 Defined contribution retirement plans may have other receivables, including those associated with contractual relationships. Other receivables may include the following:

• Investment related receivables, such as the following:
  — Interest and dividend income
  — Securities lending income
  — Due from brokers for securities sold
  — Derivative related activity (for example, receivable for variation margin and foreign currency forward contracts)
• Fee reimbursements (from plan sponsor or service providers)
• Amounts due from plan sponsors or others relating to operational defects, for example, a refund of a distribution in excess of a participant’s interest in the plan
• Reimbursement for nonexempt transactions or lost income (due to late deposits or other investment losses arising from a fiduciary breach)
• Legal settlements

Forfeitures

2.47 When a participant terminates employment with the plan sponsor, the participant may not be fully vested in the employer’s contributions that have been allocated to his or her account. The forfeited nonvested portion of the participant’s account remains as a plan asset in a suspense account held and maintained by the plan. The forfeitures account may only be used or allocated in accordance with the plan document. FinREC recommends that forfeitures not be shown separately on the face of the financial statements but rather be combined in the appropriate investment classification.

2.48 Forfeitures can be material, and the potential for improper use of such funds exists. The plan document generally specifies how forfeitures are to be used, for example
a. to offset future employer contributions (see the accounting and reporting requirements in paragraph 2.56(c)).

b. to pay plan administrative expenses.

c. to reinstate the previously forfeited account balance of a terminated employee when that participant is rehired within a specified period of time (generally 5 years).

d. to allocate to the remaining plan participants based on each participant’s compensation as a percentage of the total compensation.

2.49 If the plan document allows for forfeitures to be offset against future employer contributions and the plan administrator does so with the next employer contribution, the forfeiture balance at year-end is typically offset against the year-end employer contribution receivable balance. See paragraph 2.65(b) and (q) for disclosures related to forfeitures.

**Practice Tip**

IRS Revenue Ruling 80-155 provides that most defined contribution retirement plans will not satisfy plan qualification requirements unless all funds are properly allocated to participants' accounts under the plan in accordance with the plan document (certain exceptions are allowed, such as the use of a suspense account in accordance with the requirements of Section 415 of the IRC). Therefore, all forfeitures would need to be allocated each year. If the forfeitures are not allocated, this may be an operational defect for the plan.

**Operating Assets**

2.50 In accordance with FASB ASC 962-205-45-5, plan assets used in plan operations (for example, buildings, equipment, furniture and fixtures, and leasehold improvements) should be reported at cost less accumulated depreciation or amortization. This is in contrast to the Form 5500 reporting requirement that calls for plan assets to be reported at fair value. Resulting differences should be presented in a note to the financial statements that reconciles the differences between amounts reported in the financial statements and Form 5500.

2.51 FASB ASC 360, *Property, Plant, and Equipment*, addresses accounting for the impairment of long-lived assets for assets to be held and used and assets to be disposed of. FASB ASC 360-10-35-21 requires that long-lived assets to be held and used by the plan, such as real estate owned by the plan for plan operations, be tested for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Long-lived assets to be abandoned or exchanged for a similar productive asset should be considered held and used until disposed of. FASB ASC 360-10-35-43 states that long-lived assets classified as held for sale should be measured at the lower of its carrying amount or fair value less cost to sell. A long-lived asset should not be
depreciated while it is held for sale. See FASB ASC 360 for further accounting and disclosure requirements.\textsuperscript{4}

**Accrued Liabilities**

2.52 A plan may have liabilities (other than for benefits) that should be accrued. Such liabilities may include the following:

- Accrued expenses, (for example, third-party administrator, investment management, trustee, recordkeeping, and professional fees incurred during the period)
- Amounts owed for securities purchased or other investment-related payables
- Obligations to return securities lending collateral
- Derivative-related payables
- Refund of excess contributions (for example, corrective distributions)
- Income taxes payable by the plan
- Federal and state withholding taxes payable on distributions
- Amounts due to the plan sponsor (for example, the reimbursement of plan expenses as permitted by the plan document)

2.53 These liabilities should be deducted to arrive at net assets available for benefits. The plan should not reflect as liabilities amounts allocated to accounts of persons who have elected to withdraw from the plan but have not yet been paid (see the required disclosure in paragraph 2.65(p)). Benefits payable are not accrued because all assets are available to pay benefits.

**Practice Tip**

A footnote to reconcile the audited financial statements to the Form 5500 may be necessary.

2.54 Corrective distributions may be required in the event that employee contributions exceed contribution limitations of the plan. These amounts should be recorded as a liability in the year in which they were initially contributed to the plan. FinREC recommends that these amounts be netted against contributions received in the statement of changes in net assets available for benefits because the contributions were ineligible for that plan year. See paragraph 2.66(b) for recommended disclosures.

**Changes in Net Assets Available for Benefits**

2.55 As previously discussed in paragraph 2.32, the statement of changes in net assets available for benefits should be prepared on a basis that reflects income credited to participants in

\textsuperscript{4} See also AICPA TIS section 6931.03, “Should the Sale of Real Estate Investments Held by Employee Benefit Plans Be Treated as Discontinued Operations?,” (AICPA, Technical Practice Aids).
the plan and net appreciation or depreciation in the fair value of only those investment contracts that are not deemed to be fully benefit-responsive.

2.56 According to FASB ASC 962-205-45-7, information regarding changes in net assets available for benefits is intended to present the effects of significant changes in net assets during the year and should present at a minimum all of the following:

a. The change in fair value of each significant type of investment including participant-directed and self-directed investments held in brokerage accounts (see paragraph 2.19).

Gains and losses from investments sold need not be segregated from unrealized gains and losses relating to investments held at year-end.\(^5\) This information may be presented in the accompanying footnotes (see exhibit C-3, note C, in appendix C for an illustration). In accordance with FASB ASC 962-205-45-6, this amount includes net appreciation or depreciation in the fair value of only those investment contracts that are not deemed to be fully-benefit responsive. Also see chapter 7 for further guidance on fair value disclosures.

b. Investment income, exclusive of changes in fair value described in (a) preceding.

**Practice Tip**

For fully benefit-responsive investment contracts, this amount reflects interest income credited to participants in the plan.

Certain registered investment companies and other investment funds pay dividends or capital gain distributions that are reinvested into the plan. FinREC recommends dividends be considered investment income and shown separately from changes in fair value. FinREC recommends capital gain distributions be considered either investment income and shown separately from changes in fair value or included as part of the net change in fair value. “Participant-directed” and “self-directed” are considered investment programs and, therefore, such presentation relates to their underlying investments.

c. Contributions from employers, segregated between cash and noncash contributions (a noncash contribution should be recorded at fair value; the nature of noncash contributions should be described either parenthetically or in a note). For example, the employer match may be made as a noncash contribution of employer securities. (See paragraph 2.66b for recommended disclosures for employer contributions relating to the correction of operational defects or other nonrecurring items.)

FinREC recommends that contributions be shown net of forfeitures used to reduce contributions. See paragraph 2.47 for discussion of forfeitures.

\(^5\) In accordance with FASB 962-205-45-7, realized gains and losses on investments that were both bought and sold during the period should be included.
d. Contributions from participants, including those transmitted by the sponsor.

FinREC recommends significant rollover contributions from a participant’s other qualified employee benefit plan be shown as a separate line item from participant contributions and that corrective distribution amounts be netted against contributions received. See paragraph 2.54 for a discussion of corrective distribution disclosures.

e. Contributions from other identified sources (for example, state subsidies or federal grants).

f. Benefits paid to participants.

g. Payments to insurance companies to purchase contracts that are excluded from plan assets.

h. Administrative expenses. See DOL Advisory Opinion No. 2001-01A for guidance on expenses that are considered proper.

2.57 The minimum presentation items listed in the preceding paragraph should be made to the extent that they apply to the plan. In accordance with FASB 962-205-45-8, the list of minimum presentation items is not intended to limit the amount of detail or the manner of presenting the information, and subclassifications or additional classifications may be useful. Other changes in net assets available for benefits (for example, transfers of assets to or from other plans or proceeds from demutualization) should also be presented separately in the financial statements if they are significant.

2.58 FinREC also recommends that the following items be presented separately, if they are significant:

a. Other income, including fee income from securities loaned and from miscellaneous sources, such as reimbursements for lost income or operational defects

b. Income tax expense (for example, unrelated business taxable income)

c. Other expenses, such as interest expense on debt or short sales, bank borrowings, margin accounts, and reverse repurchase agreements

Participant Benefits, Distributions, and Withdrawals

2.59 The amount, timing, and form of participant benefits, distributions, and withdrawals are determined in accordance with the plan document. The plan administrator, or his or her agent, is responsible for assuring that any disbursements of plan assets satisfy the requirements set forth in the plan instrument and related documents and are otherwise consistent with ERISA.

Plan Expenses
2.60 Certain expenses may be paid on behalf of the plan by the plan sponsor. However, some defined contribution retirement plans pay administrative and investment-related expenses out of plan assets provided that the plan document allows for such payments. DOL rules and regulations and DOL Advisory Opinion No. 2001-01A, help clarify what expenses can be charged to a plan. Payment of improper expenses from a qualified plan is a breach of fiduciary duties and may be considered a nonexempt transaction. For example, according to the DOL Advisory Opinion No. 2001-01A, expenses incurred relating to the formation of the plan (such as settlor functions) would not be considered reasonable for the plan. Settlor functions include decisions relating to the formation, design, and termination of the plan. Expenses incurred related to implementing settlor decisions may be reasonable expenses of the plan. See the DOL-issued publication, Understanding Retirement Plan Fees and Expenses, and the DOL Advisory Opinion No. 2001-01A to better understand and evaluate plan fees and expenses.

2.61 In certain instances, it may be difficult to understand the nature of the plan expenses because they are often netted against income, or there may be other arrangements resulting in expenses not being apparent on the service provider statements. Plan expenses are typically paid directly from trust earnings, employer contributions, employee reimbursements, or forfeitures, as permitted by the plan document. See paragraphs 2.65(u) and 2.66d) for guidance on the financial statement disclosures related to expenses.

2.62 Typical plan expenses may include the following:

- Investment management
- Investment advice and education
- Trustee
- Custodian
- Recordkeeping and compliance
- Professional fees
- Loan processing fees
- Reimbursement of plan sponsor direct costs, such as plan administrative salaries and other administrative expenses
- Other transaction or processing fees

2.63 Eligible compensation. The plan document specifies the various components of compensation (for example, base wages, overtime, and bonuses) that are considered in the calculation or allocation of plan contributions for defined contribution retirement plans.

Allocation of Net Assets to Individual Participant Accounts

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6 Plan sponsors may want to consult with legal counsel when determining whether fees are considered settlor fees.
2.64 The net assets available for benefits for defined contribution retirement plans are normally allocated to individual participant accounts according to procedures set forth in the plan document and service provider agreements.

Practice Tip

Plan assets of defined contribution retirement plans are generally presented at their fair value at the reporting date (see paragraphs 2.32–2.35 and chapter 7 for special provisions concerning the valuation of fully benefit-responsive investment contracts and insurance contracts, respectively. See paragraph 2.39 for financial accounting for participant loans). Such plans typically permit periodic contributions, withdrawals, loans, and changes in investment elections. Transactions can be executed by the plan participant at varying frequencies depending upon the plan’s provisions; however, many plans allow transactions on a daily basis. Thus, the determination of the value of plan assets on the dates throughout the year in which the plan permits transactions is important.

When an investment option in a defined contribution retirement plan contains hard-to-value investments, such as limited partnerships, periodic valuation is more difficult, but nonetheless important. Failure to properly value plan assets on the date of a participant-directed transaction can result in such transaction being executed at an inappropriate amount and, consequently, result in a misstatement of plan assets and related activity.

Financial Statement Disclosures

2.65 According to FASB 962-205-50-1 (unless otherwise noted), the financial statements should disclose, if applicable, all of the following:

a. Disclosure of the plan's accounting policies, in accordance with FASB ASC 962-325-50-1. These disclosures should include a description of the methods and significant assumptions used to determine the fair value of investments and the reported value of insurance contracts (if any). These disclosures should also include:

1. Basis of accounting (if other than GAAP)
2. Use of estimates
3. Investment valuation and income recognition
4. Payment of benefits
5. Risks and uncertainties

b. A brief, general description of the plan agreement including, but not limited to, vesting and allocation provisions and the disposition of forfeitures. If a plan agreement or a description providing this information is otherwise published and made available, this description may be omitted from the financial statement provided that reference to the other source is made.

7 See FASB ASC 235, Notes to Financial Statements, for further information regarding financial statement disclosures.
Practice Tip

The description of the plan generally includes who may participate and when a participant becomes eligible to enter the plan (see the illustrative financial statement disclosures in exhibit C-3, note A, in appendix C).

c. A 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.

d. The amount of unallocated assets, as well as the basis used to allocate asset values to participants' accounts when that basis differs from the one used to record assets in the financial statements.

e. The basis for determining contributions by employers and, for a contributory plan, the method of determining participants' contributions.

f. Plans subject to the minimum funding requirements of ERISA, such as money purchase pension plans, should disclose whether those requirements have been met. If a minimum funding waiver has been granted by the IRS, or if a request for waiver is pending before the IRS, that fact should be disclosed.

g. If significant costs of plan administration are being absorbed by the employer, that fact should be disclosed in the notes to the financial statements.

h. The policy regarding the purchase of contracts with insurance entities that are excluded from plan assets. (See paragraphs 3.23–3.27 for a description of allocated and unallocated funding arrangements and when such arrangements should be excluded from plan assets.)

i. The federal income tax status of the plan, if a favorable determination letter has not been obtained or maintained. Note that reports filed in accordance with the requirements of ERISA must include disclosure of "information concerning whether a tax ruling or determination letter has been obtained," which is more than is required by FASB ASC 960.

j. In accordance with FASB ASC 962-325-45-7, in addition to the requirement to identify those investments (including self-directed and participant-directed

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8 A plan’s tax exempt status is a position that may be subject to uncertainty. In September 2009, FASB issued Accounting Standards Update (ASU) No. 2009-06, Income Taxes (Topic 740)—Implementation Guidance on Accounting for Uncertainty in Income Taxes and Disclosure Amendments for Nonpublic Entities. ASU No. 2009-06 provides implementation guidance on accounting for uncertainty in income taxes and eliminates the disclosure requirements of paragraphs 15(a)–15(b) of FASB ASC 740-10-50 for nonpublic entities, as defined in FASB ASC 740-10-20. The implementation guidance in ASU No. 2009-06 also expands the FASB ASC glossary definition of a tax position. In addition, TIS section 5250.15, “Application of Certain FASB Interpretation No. 48 (codified in FASB ASC 740-10) Disclosure Requirements to Nonpublic Entities That Do Not Have Uncertain Tax Positions” (AICPA, Technical Practice Aids), clarified that the description of open tax years that remain subject to examination is a required disclosure for a nonpublic entity even if the entity has no uncertain tax positions.
investments) that represent 5 percent or more of the net assets available for benefits, specifically identify those investments that represent 5 percent or more of net assets available for benefits that are nonparticipant-directed. (Listing all investments in Schedule H, line 4i—Schedule of Assets (Held at End of Year) required by ERISA does not eliminate the requirement to include this disclosure in the financial statements.)

*k.* In accordance with FASB ASC 962-325-45-8, if a defined contribution retirement plan provides for participant-directed and nonparticipant-directed investment programs, the plan should disclose information in the financial statements about the net assets and significant components of the changes in net assets relating to the nonparticipant-directed program with such reasonable detail, either in the financial statements or accompanying notes, as is necessary to identify the types of investments and changes therein. (See paragraph 2.20 and notes C and D in appendix C for an illustration.)

*l.* In accordance with FASB ASC 962-205-45-7, if not shown on the statement of changes, the change in fair value (or estimated fair value) of each significant type of investment, including participant-directed and self-directed investments held in brokerage accounts. (See paragraph 2.56(a).)

*m.* In accordance with FASB ASC 850, *Related Party Disclosures,* significant related-party transactions, for example, employer stock or transfers between related plans. For plan expenses, see (u) that follows.

*n.* An explanation of the differences, if any, between the information contained in the financial statements and the amounts reported on Schedule H, Form 5500.

*o.* Guarantees by others of debt of the plan.

*p.* Amounts allocated to accounts of persons who have elected to withdraw from the plan but have not yet been paid.

*q.* The amount and disposition of forfeited nonvested accounts. Specifically, identification of those amounts that are used to reduce future employer contributions, expenses, or reallocated to participant’s accounts, in accordance with plan documents.

*r.* In accordance with FASB ASC 855, *Subsequent Events,* significant subsequent events that may affect the usefulness of the financial statements.

*s.* Commitments and contingencies in accordance with FASB ASC 440, *Commitments,* and FASB ASC 450, *Contingencies* (for example, future capital commitments for investments).

*t.* In accordance with FASB 962-325-50-3, for fully benefit-responsive investment contracts, in the aggregate:
1. A description of the nature of those investment contracts, how they operate, and the methodology for calculating the interest crediting rate, including the key factors that could influence future average interest crediting rates, the basis for and frequency of determining interest crediting rate resets, and any minimum interest crediting rate under the terms of the contracts. This disclosure should explain the relationship between future interest crediting rates and the amount reported on the statement of net assets available for benefits representing the adjustment for the portion of net assets attributable to fully benefit-responsive investment contracts from fair value to contract value.

2. The average yield earned by the plan for all fully benefit-responsive investment contracts (which may differ from the interest rate credited to participants in the plan) for each period for which a statement of net assets available for benefits is presented. This average yield should be calculated by dividing the annualized earnings of all fully benefit-responsive investment contracts in the plan (irrespective of the interest rate credited to participants in the plan) by the fair value of all fully benefit-responsive investment contracts in the plan.

3. The average yield earned by the plan for all fully benefit-responsive investment contracts with an adjustment to reflect the actual interest rate credited to participants in the plan for each period for which a statement of net assets available for benefits is presented. This average yield should be calculated by dividing the annualized earnings credited to participants in the plan for all fully benefit-responsive investment contracts in the plan (irrespective of the actual earnings of those investments) by the fair value of all fully benefit-responsive investment contracts in the plan.

4. A description of the events that limit the ability of the plan to transact at contract value with the issuer (for example, premature termination of the contracts by the plan, plant closings, layoffs, plan termination, bankruptcy, mergers, and early retirement incentives), including a statement about whether the occurrence of those events that would limit the plan’s ability to transact at contract value with participants in the plan is probable or not probable. [The term probable is used in this paragraph consistent with its use in FASB ASC 450-20-25.]

5. A description of the events and circumstances that would allow issuers to terminate fully benefit-responsive investment contracts with the plan and settle at an amount different from contract value.

**Practice Tip**

As described in TIS section 6931.09, plans that directly invest in CCTs or similar vehicles that hold fully benefit-responsive investment contracts do not need to include the disclosures detailed in FASB ASC 962-325-50-3 in the plan’s financial statements. Such disclosures
would be included in the financial statements of the CCT, in accordance with FASB ASC 946-210-45-18 and 946-210-50-14.

For plans that invest in a master trust that holds fully benefit-responsive investment contracts, the notes to the financial statements should include the disclosures required in FASB ASC 962-325-50-3 related to the fully benefit-responsive investment contracts held by the master trust. These disclosures are necessary because, unlike a CCT (as discussed in TIS section 6931.09), master trust financial statements are not required, and the related disclosure information would not be readily available.

In accordance with FASB ASC 962-325-50-4, if a fully benefit-responsive investment contract does not qualify for contract-value reporting in the Form 5500 but is reported in the financial statements at contract value, and the contract value does not approximate fair value, the DOL’s rules and regulations require that a statement explaining the differences between the amounts reported in the financial statements and Form 5500 be added to the financial statements.

\[u.\] Amounts paid to affiliates or related parties (such as advisory fees, administration fees, brokerage commissions, and sales charges) should be disclosed in accordance with FASB ASC 850. Significant provisions of related-party agreements, including the basis for determining management, advisory, administration, and also other amounts paid to affiliates or related parties, should be described in a note to the financial statements.

\[v.\] Other disclosures elsewhere in the guide (for example, see the master trust disclosures in chapter 7).

Note: This list does not include information required by ERISA to be disclosed in the schedules filed as part of a plan's annual report. In this connection, it is important to note that disclosure of this information only on the face of the financial statements or in the notes to the financial statements, or both, but not in the schedules is not acceptable under ERISA reporting standards.

2.66 FinREC also recommends that the following disclosures be made, if significant:

\[a.\] The accounting policy for corrective distributions as discussed in paragraph 2.54.

\[b.\] Employer contributions relating to the correction of operational defects or other nonrecurring items. See the discussion of employer contributions in paragraph 2.56(c).

\[c.\] Along with the disclosures relating to forfeitures in paragraph 2.65(q), include the amount of forfeitures available as of the end of the year and the amount of forfeitures used or allocated during the year. (See preceding paragraphs 2.47–2.49 for a discussion of forfeitures.)

\[d.\] The significant terms of expense offset arrangements with third parties whereby expenses are netted against income. Expense offset arrangements generally
consist of fees being paid to a third-party service provider (for example, recordkeeper) directly through the use of investment fee rebates made available by the plan’s separate third-party investment manager.

**Fair Value Measurements**

2.67 See chapter 7 for required disclosures relating to fair value measurements in accordance with FASB ASC 820.

**Derivatives and Hedging**

2.68 FASB ASC 815, *Derivatives and Hedging*, addresses accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as *derivatives*), and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. FASB ASC 815 applies to certain contracts that meet the definition of *derivative instrument*, as defined in FASB ASC 815-10-15-83. See FASB ASC 815-10-15 for further information on certain contracts that are not subject to the requirements of FASB ASC 815. Also, see chapter 7 for more information regarding accounting and reporting for derivatives.

**Master Trusts**

2.69 Investments in a master trust should be presented in accordance with paragraphs 6–8 of FASB ASC 962-325-50. In the notes\(^9\) to the financial statements, the investments of the master trust should be detailed by general type, such as government securities, short-term securities, corporate bonds, common stocks, mortgages, and real estate, as of the date of each statement of net assets available for benefits is presented. The net change in the fair value of each significant type of investment of the master trust and total investment income of the master trust by type, for example, interest and dividends, should also be disclosed in the notes for each period for which a statement of changes in net assets available for benefits is presented. The notes to the financial statements should also include a description of the basis used to allocate net assets, net investment income, gains and losses to participating plans, and the plan's percentage interest in the master trust as of the date of each statement of net assets available for benefits presented. Also, see chapter 7 for further guidance on accounting and reporting investments held in master trusts.

**Financial Instruments**

\(^9\) The AICPA issued TIS section 6931.11, “Fair Value Measurement Disclosures for Master Trusts” (AICPA, *Technical Practice Aids*) to provide guidance on the required fair value measurement disclosures to be made when a plan holds investments in a master trust. This question and answer assists with the implementation of FASB ASC 820, *Fair Value Measurements and Disclosures*, for employee benefits plans that have investments in a master trust. This guidance states that the disclosure requirements of FASB ASC 820 should be made for each major category of master trust assets and liabilities. In addition, consideration should be given to combining or reconciling, or both, the master trust FASB ASC 820 disclosures with the master trust disclosures as required by paragraphs 6–8 of FASB ASC 962-325-50.
FASB ASC 825, Financial Instruments, requires all entities, except for those covered by an exemption for which the disclosure is optional,\(^{10}\) to disclose within the body of the financial statements or in the accompanying notes the fair value of financial instruments for which it is practicable to estimate fair value.\(^{11}\) An entity should also disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments. Generally, financial instruments of a defined-contribution pension plan are included in the scope of FASB ASC 825 and are subject to the disclosure requirements in FASB ASC 825-10-50. In addition, the disclosure requirements of FASB ASC 820 may also apply.

**Practice Tip**

According to FASB ASC 962-310-50-1, the fair value disclosures prescribed in FASB ASC 825-10-50-10 through 825-10-50-16 are not required for participant loans. See paragraph 2.39 for a discussion of the financial accounting for participant loans.

FASB ASC 825-10-50-20 requires disclosure of all significant concentrations of credit risk arising from all financial instruments. In accordance with FASB ASC 825-10-50-21, the following information should be disclosed about each significant concentration:

- Information about the (shared) activity, region, or economic characteristic that identifies the concentration
- The maximum amount of loss due to credit risk that, based on the gross fair value of the financial instrument, the entity would incur if parties to the financial instruments that make up the concentration failed completely to perform according to the terms of the contracts and the collateral or other security, if any, for the amount due proved to be of no value to the entity
- The entity’s policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the entity’s access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments
- The entity’s policy of entering into master netting arrangements to mitigate the credit risk of financial instruments, information about the arrangements for which the entity is a party, and a brief description of the terms of those arrangements,

\(^{10}\) According to FASB ASC 825-10-50-3, the disclosures are optional for plans that meet all of the following criteria:

  a. The plan is a nonpublic entity.
  b. The plan’s total assets are less than $100 million on the date of the financial statements.
  c. The plan has no instrument that, in whole or in part, is accounted for as a derivative instrument under FASB ASC 815, Derivatives and Hedging, during the reporting period.

\(^{11}\) Fair value disclosed in the notes should be presented together with the related carrying amount in a form that makes it clear whether the fair value and carrying amount represent assets or liabilities and how the carrying amounts relate to what is reported in the statement of net assets available for benefits.
including the extent to which they would reduce the entity’s maximum amount of loss due to credit risk

Risks and Uncertainties

2.72 FASB ASC 275, Risks and Uncertainties, requires plans to include in their financial statements disclosures about (a) the nature of their operations, and (b) use of estimates in the preparation of financial statements. In addition, if specific criteria are met, FASB ASC 275 requires plans to include in their financial statement disclosures about (a) certain significant estimates, and (b) current vulnerability due to certain concentrations.

2.73 In accordance with FASB ASC 275-10-50-8, certain significant estimates should be disclosed when known information available prior to the financial statements being issued or being available to be issued (appropriate date determined in accordance with FASB ASC 855-10-25) indicates that both (a) it is at least reasonably possible that the estimate of the effect on the financial statements of a condition, situation, or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events, and (b) the effect of the change would be material to the financial statements.

2.74 Vulnerability from concentrations arises when a plan is exposed to risk of loss greater than it would have had it mitigated its risk through diversification. Many plan's participants may be concentrated in a specific industry that carries with it certain risks. Plans may also hold investments and other assets (other than financial instruments for which concentrations are covered by FASB ASC 825 rather than FASB ASC 275) that are concentrated in a single industry or in a single geographic area. The financial statements should disclose the concentrations if, based on information known to management before the financial statements are issued or are available to be issued (as discussed in FASB ASC 855-10-25), all of the following criteria are met: (a) the concentration exists at the date of the financial statements, (b) the concentration makes the plan vulnerable to the risk of a near-term severe impact, and (c) it is at least reasonably possible that the events that could cause the severe impact will occur in the near term. For example, if the plan owns several investment properties (that is, apartment buildings) located in a geographic area that has only one significant employer and that employer announced last year that it is considering leaving the area, and it is reasonably possible that it will do so within the next year, this could significantly affect the plan's future cash flows from rents and the value of the investment properties.

2.75 Because the disclosure requirements of FASB ASC 275 in many circumstances are similar to or overlap the disclosure requirements in certain FASB ASC sections (for example, FASB ASC 450), the disclosures required by FASB ASC 275 may be combined in various ways, grouped together, or placed in diverse parts of the financial statements or included as part of the disclosures made pursuant to the requirements of other FASB ASC sections.

Employee Stock Ownership Plans
2.76 An employee stock ownership plan (ESOP) is a unique form of defined contribution plan. Under the prohibited transaction statutory exemptions, an ESOP has the ability to borrow money and to concentrate plan investments in *qualifying employer securities*. Frequently, these securities are not publicly traded. These circumstances can increase the auditor's risk in reporting on an ESOP.

2.77 The following items are unique to ESOPs:

- Typically, the plan obtains an annual appraisal of the securities. FASB ASC 820-10-35-44 provides guidance for when the use of a blockage factor is prohibited.\(^{12}\)
- Leveraged ESOPs will have obligations to a financial institution or a related party lender. FASB ASC 820 would be applicable if the ESOP debt is reported at fair value.
- ESOP documents frequently reflect specific tax code restrictions, such as on the use of dividends.

### 403(b) Plans or Arrangements

2.78 These are retirement savings arrangements sponsored by certain nonprofit organizations (such as hospitals and private colleges) and public schools. They are defined contribution plans with individual salary deferral limits that are similar, but not identical to, 401(k) programs. Contributions typically include employee salary deferrals. Nonprofit organizations often establish a 401(a) plan that funds employer-matching contributions to a 403(b) plan. Auditors should obtain an understanding of the deferrals made under the 403(b) plan in order to determine if the employer match under the 401(a) plan is properly determined.

2.79 Investments held in these arrangements are typically restricted by law to annuity contracts or custodial accounts holding units of participation of regulated investment companies (for example, mutual funds).

2.80 Beginning with the 2009 Form 5500 filings, 403(b) plans became subject to the same Form 5500 reporting and audit requirements that currently exist for 401(k) plans. These requirements eliminate a previous exemption granted to 403(b) plans from the annual Form 5500 reporting, disclosure, and audit requirements of ERISA. For large 403(b) plans, as defined by ERISA, the 2009 reporting requirements include not only the completion of the entire Form 5500 but also the engagement of an independent qualified public accountant to conduct an independent audit of the plan.

### Plan Mergers

2.81 Company mergers and acquisitions, or other events, may result in employee benefit plan mergers. The effective date of a merger, according to the relevant plan merger documents, often is prior to the actual transfer date of the related plan assets. Plan amendments and

\(^{12}\) See footnote 11.
merger documentation should be reviewed to determine the effective date of the transaction and the appropriate period to record the transfer of the applicable plans’ net assets to the successor plan. FinREC recommends that the net assets transferred into or out of the plan be recorded on the statement of changes in net assets available for benefits, after the net increase or decrease for the period.

Terminating Plans

2.82 FASB ASC 962-40 provides guidance for terminating plans that are defined contribution plans. A terminating plan includes any plan about which a termination decision has been made regardless of whether the terminating plan will be replaced.

2.83 In accordance with FASB ASC 962-40-50-1, when the decision to terminate a plan has been made, or a wasting trust (that is, a plan under which participants no longer accrue benefits but that will remain in existence as long as necessary to pay already accrued benefits) exists, the relevant circumstances should be disclosed in all subsequent financial statements issued by the plan.

2.84 In accordance with FASB 962-40-25-1, if the decision to terminate a plan is made before the end of the plan year, the plan's year-end financial statements should be prepared on the liquidation basis of accounting.

2.85 In accordance with FASB 962-40-35-1, for terminating plan assets, changing to the liquidation basis will usually cause little or no change in values, most of which are at current market values. Assets that may not be carried at market values include operating assets, insurance and certain investment contracts carried at contract values, or large blocks of stock or other assets that cannot be readily disposed of at their quoted market prices.
Chapter 3

Defined Benefit Pension Plans

Introduction and Background

3.01 Defined benefit pension plans are employee benefit plans that promise to pay to the plan participants, upon retirement, a specific benefit determined by a formula as defined in the plan document. The benefit formula may include such factors as a participant’s age and years of service with the employer and the amount of compensation the participant earned while serving as an active employee of the plan sponsor.

3.02 In order to fund the benefits that are to be paid to the plan participants, the plan’s investments are held in a trust. The specific benefit that is payable to a participant is generally not determined until the participant ceases employment with the plan sponsor through retirement, termination, disability, or death.

3.03 A plan’s obligation to pay future benefits is estimated as the present value of future benefit payments attributable under the plan’s provisions to employee service up to the measurement date. The obligation is known as the “actuarial present value of accumulated plan benefits,” and is determined based upon the benefit formula defined in the plan document; the plan’s demographics; mortality statistics; the plan’s expected turnover rates; the expected retirement age for plan participants; and the interest or discount rate (see paragraphs 3.66–3.73). The actuarial model is described in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 960, Plan Accounting—Defined Benefit Pension Plans, and considers only employee service rendered to date and not future service. The model also uses current compensation levels and does not assume future compensation changes. See paragraphs 3.68–3.69 for further guidance.

3.04 Traditional defined benefit pension plans provide benefits that are defined in terms of a percentage of average compensation (final, career, or other average compensation) or as a flat dollar benefit per year of service or fixed monthly benefit. Other types of benefit formulas include the following:

   a. Cash balance plans. A cash balance plan is a special form of career average compensation plan. Typically, a cash balance defined benefit pension plan maintains hypothetical “accounts” for participants. The employer credits participants’ “accounts” with a certain number of dollars each plan year and promises earnings at a specified rate. Interest on the “account” balance is credited at a stated rate, which may be, and is often, different from the plan’s actual rate of investment return. The interest rate may be modified prospectively, as long as there are no reductions in the participant’s benefit accrued to date. The formula for determining the amount to be credited to participants’ “accounts” can be changed from year to year, if the employer properly amends the plan prior to the
beginning of the year and complies with notice requirements under the Employee Retirement Income Security Act of 1974 (ERISA). A change in the interest rate would also require a plan amendment and compliance with notice requirements under ERISA. The principal advantage to participants of a cash balance plan is the ability to watch their hypothetical “account balances” grow (similar to a defined contribution retirement plan), while providing certainty about the interest to be credited. The participants bear no investment risk. The employer bears the risk that the plan’s actual rate of return may fall below the stated rate of interest to be credited to participants’ accounts. Additionally, if a vested participant switches careers or retires, the lump sum payment equals the hypothetical “account balance” and, in some cases, may be taken as a distribution prior to retirement; in a traditional plan, a participant would not be able to compute the lump sum he or she is entitled to and generally would not have access to the benefit until normal or early retirement.

b. Pension equity plans. A pension equity plan is a defined benefit pension plan that has many of the advantages of the cash balance plan, but the benefit formula is similar to a final pay program rather than a career average cash balance program. Under this arrangement, a participant is credited with “points” based on age, service, or both. On termination of employment, a participant’s final average compensation is multiplied by his or her accumulated points to determine a hypothetical account balance. This balance normally may be distributed as a lump sum or converted to an annuity.

Accounting, Reporting, and Auditing Defined Benefit Pension Plans

3.05 This chapter describes generally accepted accounting principles (GAAP) for accounting and financial reporting for defined benefit pension plans as set forth in FASB ASC 960. Other GAAP may also apply. FASB ASC contains all authoritative U.S. GAAP. This chapter also provides guidance that has been supported by the Financial Reporting Executive Committee (FinREC) on the accounting, reporting, or disclosure treatment of transactions or events that is not set forth in FASB ASC and describes related auditing procedures and guidance for defined benefit pension plans. GAAP other than those discussed in this chapter may also apply to defined benefit pension plans.

Financial Statements

3.06 In accordance to FASB 960-205-10-1, the primary objective of a defined benefit pension plan's financial statements is to provide financial information that is useful in assessing the plan's present and future ability to pay benefits when they are due. In that regard, both of the following are recognized:

a. Information in addition to that contained in a plan's financial statements is needed in assessing the plan's present and future ability to pay benefits when due.
b. Financial statements for several plan years can provide information more useful in assessing the plan's future ability to pay benefits than the financial statements for a single plan year.

3.07 In accordance with FASB ASC 960-205-10-3, to accomplish its primary objective, a plan's financial statements should provide information about all of the following: (a) plan resources and how the stewardship responsibility for those resources has been discharged, (b) the participants' accumulated plan benefits, (c) the results of transactions and events that affect the information about those resources and benefits, and (d) other factors necessary for users to understand the information provided.

3.08 The financial statements of a defined benefit pension plan prepared in accordance with U.S. GAAP should be prepared on the accrual basis of accounting and, in accordance with FASB ASC 960-205-45-1, should include the following:

a. A statement that includes information regarding the net assets available for benefits as of the end of the plan year (ERISA requires that this statement be presented in comparative form)

b. A statement that includes information regarding the changes during the year in net assets available for benefits

c. Information regarding the actuarial present value of accumulated plan benefits as of either the beginning or end of the plan year

d. Information regarding the effects, if significant, of certain factors affecting the year-to-year change in actuarial present value of accumulated plan benefits

Information regarding the actuarial present value of accumulated plan benefits and changes therein, however, may be presented in the financial statements or in the notes. Appendix D provides illustrative financial statements for defined benefit pension plans.

3.09 As described in paragraphs 3.73–3.74, the actuarial present value of accumulated plan benefits may be presented in the financial statements as of the beginning of the plan year or as of the end of the plan year. The following table summarizes the minimum financial statement presentation requirements when the plan uses a beginning of the year benefit information date versus the end of the year benefit information date.

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1 Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 230-10-15-4 states that a statement of cash flows is not required to be provided by a defined benefit pension plan that presents financial information in accordance with the provisions of FASB ASC 960, Plan Accounting —Defined Benefit Pension Plans. Employee benefit plans are encouraged to include a statement of cash flows with their annual financial statements when that statement would provide relevant information about the ability of the plan to pay benefits (for example, when the plan invests in assets that are not highly liquid or obtains financing for investments).
<table>
<thead>
<tr>
<th>Financial Statements</th>
<th>Beginning of Year Benefit Information Date</th>
<th>End of Year Benefit Information Date</th>
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<tbody>
<tr>
<td>Statement of net assets available for benefits</td>
<td>Comparative</td>
<td>Comparative</td>
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<tr>
<td>Statement of changes in net assets available for benefits</td>
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<td>Single</td>
</tr>
<tr>
<td>Accumulated plan benefits (in the notes or in separate financial statements)</td>
<td>Single</td>
<td>Comparative</td>
</tr>
<tr>
<td>Changes in accumulated plan benefits</td>
<td>Single</td>
<td>Single</td>
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</tbody>
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**Practice Tip**

When using the beginning of the year benefit information date, if the plan sponsor chooses to present more than the minimum presentation requirements, then they would also need to present the comparable presentation for each financial statement. For example, if the plan sponsor chooses to present comparative statements of accumulated plan benefits, then they would also need to present 3 years of the statement of net assets available for benefits. See paragraph 3.74 and FASB ASC 960-205-45-4 for appropriate guidance.

**Net Assets Available for Benefits**

**Cash Balances**

3.10 Noninterest-bearing cash balances of defined benefit pension plans typically represent residual amounts not otherwise invested and are not classified as an investment, but are typically shown as a separate line item on the financial statements (see the illustrative financial statements in appendix D).

3.11 Interest-bearing cash is often maintained for liquidity for benefit payments or other plan transactions. FinREC recommends that investments in short-term, highly liquid investments, such as interest-bearing cash, be included as an investment rather than a cash equivalent. The current Form 5500 requires interest-bearing cash to be reported as an investment on Schedule H, line 4i—Schedule of Assets (Held At End of Year).

3.12 A definition of a cash equivalent need not be disclosed as required by FASB ASC 230-10-45-6, when a cash flow statement is not presented.
3.13 According to FASB ASC 960-325-35-1, plan investments should be presented at their fair value at the reporting date (see paragraph 3.21 for special provisions concerning the valuation of insurance contracts). The FASB ASC glossary defines *fair value of plan investments* as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

3.14 Plan investments should be measured by quoted prices in an active market when available. Although GAAP does not require disclosure of original cost of investments in the financial statements, original cost of investments is required to be disclosed on certain supplemental schedules to the Form 5500. (The accounting for assets used in the administration of the plan is discussed in paragraph 3.56.)

3.15 Typically, defined benefit pension plans may hold a wide array of investments, such as public and private common stock of domestic and foreign companies, preferred stock, domestic and foreign government bonds, corporate bonds, asset backed securities, including those issued by government agencies, guaranteed investment contracts, insurance contracts, real estate, and derivatives, as well as registered investment companies (for example, mutual funds), collective investment funds that invest in equities or fixed income, partnerships, common or collective trusts (CCTs), pooled insurance company separate accounts (PSAs), unit investment trusts, real estate investment trusts, and others. These types of investments are also found in other types of benefit plans. In addition, many of these investments are managed by an investment manager.

*Practice Tip*

Readers of this guide should refer to chapter 7, “Investments,” for a more in-depth discussion of the investments unique to defined benefit pension plans that are described in this chapter, as well for a discussion of investments not covered in this chapter.

3.16 Some of the more common investment types or methods of holding investments that present unique accounting and auditing issues for defined benefit pension plans are discussed in the following sections:

- Investment contracts
- Insurance contracts
- 401(h) accounts
- Master trusts

*Investment and Insurance Contracts*

3.17 The terms *insurance contract* and *investment contract* are used in this chapter because those terms are described for accounting purposes in FASB ASC 944, *Financial Services—Insurance*. Paragraphs 5–6 of FASB ASC 944-20-05 describe insurance contracts as follows:

Insurance Contracts
The primary purpose of insurance is to provide economic protection from identified risks occurring or discovered within a specified period.

Insurance transactions may be characterized generally by both of the following:

a. The purchaser of an insurance contract makes an initial payment or deposit to the insurance entity in advance of the possible occurrence or discovery of an insured event.

b. When the insurance contract is made, the insurance entity ordinarily does not know if, how much, or when amounts will be paid under the contract.

3.18 According to FASB ASC 340-30-15-4, a long-duration life and health insurance contract that does not indemnify against mortality or morbidity risk should be accounted for as investment contracts under FASB ASC 944.

3.19 Paragraphs 16–19 of FASB ASC 944-20-15 describe insurance and investment contracts as follows:

A mortality or morbidity risk is present if, under the terms of the contract, the entity is required to make payments or forego required premiums contingent on the death or disability (in the case of life insurance contracts) or the continued survival (in the case of annuity contracts) of a specific individual or group of individuals.

A contract provision that allows the holder of a long-duration contract to purchase an annuity at a guaranteed price on settlement of the contract does not entail a mortality risk until the right to purchase is executed. If purchased, the annuity is a new contract to be evaluated on its own terms.

Annuity contracts may require the insurance entity to make a number of payments that are not contingent on the survival of the beneficiary, followed by life-contingent payments.

Such contracts are considered insurance contracts under FASB ASC 944-20 unless either of the following conditions exist:

a. The probability that life-contingent payments will be made is remote.

b. The present value of the expected life-contingent payments relative to the present value of all expected payments under the contract is insignificant.

*Investment Contracts*

3.20 A defined benefit pension plan should report investment contracts at fair value in accordance with FASB ASC 960-325-35-1.

*Insurance Contracts*
3.21 Whether or not the plan is subject to ERISA, FASB ASC 960-325-35-3 states that insurance contracts (as defined in the FASB ASC glossary) should be presented in the same manner as specified in the annual report filed by a plan with certain governmental agencies pursuant to ERISA. This is consistent with the requirements of Form 5500. The current Form 5500 permits unallocated insurance contracts to be reported at either current value or as determined on the Schedule A, Insurance Information, that is, contract value. This is an exception to the general requirement of FASB ASC 960 that plan investments be presented at fair value.

3.22 In accordance with FASB ASC 960-325-35-3, a plan not subject to ERISA should present its insurance contracts as if the plan were subject to the reporting requirements of ERISA.

Allocated and Unallocated Funding Arrangements

3.23 A plan may invest assets with an insurance company pursuant to any of a number of different types of contracts. The nature and funding of the contract will determine the related accounting and regulatory reporting requirements.²

3.24 Allocated funding arrangements include annuity contracts. In accordance with the FASB ASC glossary, an allocated contract is a contract with an insurance entity under which contributions paid to the insurance entity are currently used to purchase deferred or immediate annuities for individual participants. As defined in the FASB ASC glossary (definition 1), an annuity contract is a contract in which an insurance entity unconditionally undertakes a legal obligation to provide specified benefits to specific individuals in return for a fixed consideration or premium. This arrangement is irrevocable and involves the transfer of significant risk from the plan to the insurance entity. As such, investments in allocated contracts are not assets of the defined benefit pension plans.

3.25 An unallocated contract, as defined in the FASB ASC glossary, is a contract with an insurance entity under which related payments to the insurance entity are accumulated in an unallocated fund to be used to meet benefit payments when employees retire, either directly or through the purchase of annuities. Funds in an unallocated contract may also be withdrawn and otherwise invested.

3.26 Unallocated funding ordinarily is associated with a group deposit administration contract (DA) and an immediate participation guarantee contract (IPG). For investment purposes, unallocated funds may be commingled in a general or pooled separate account or held in an individual separate account. These contracts generally should be included in the plan’s financial statements.

3.27 Determining whether insurance contract assets and related obligations should be reported in the plan’s financial statements requires a careful review of the contract.

Presentation of Plan Investments

² Plans funded solely with certain types of insurance contracts are not required under the Employee Retirement Income Security Act of 1974 to prepare financial statements or engage an independent auditor.
3.28 FASB ASC 960-325-45-1 states that information regarding a plan’s investments should be presented in enough detail to identify the types of investments.

3.29 FinREC recommends that defined benefit pension plans classify investments in 1 of 2 ways in the statement of net assets available for benefits. The employer may choose, but is not required, to use the classification of plan assets as reported in the employer’s financial statements under “Pending Content” in FASB ASC 715-20-50-1 (see (a) that follows) or may classify such plan investments as recommended in FASB ASC 962-325-45-5 and FASB ASC 965-325-45-2 (see (b) that follows). FinREC believes that the classification, as set forth in “Pending Content” in FASB ASC 715-20-50-1, is consistent with FASB ASC 820, *Fair Value Measurements and Disclosures*, and would also meet the requirements for disclosing plan investments by type under FASB ASC 960-325-45-1. The examples of classifications, as described in “Pending Content” in FASB ASC 715-20-50-1, provides a greater detail of investments by type than what is currently required under FASB ASC 962-325-45-5 and FASB ASC 965-325-45-2. If the defined benefit pension plan continues to classify investments in accordance with FASB ASC 962-325-45-5 and FASB ASC 965-325-45-2, then the plan also needs to comply with the fair value disclosure classifications for FASB ASC 820. The following examples are ways to classify such investments.

a. According to “Pending Content” in FASB ASC 715-20-50-1(d), an employer should disclose separately for pension plans and other postretirement benefit plans the fair value of each class of plan assets as of each date for which a statement of financial position is presented. Asset classes should be based on the nature and risks of assets in an employer’s plan(s). For additional guidance on determining appropriate classes of plan assets, see FASB ASC 820-10-50-2A. Examples of classes of assets could include, but are not limited to, cash and cash equivalents; equity securities (segregated by industry type, company size, or investment objective); debt securities issued by national, state, and local governments; corporate debt securities; asset-backed securities; structured debt; derivatives on a gross basis (segregated by type of underlying risk in the contract, for example, interest rate contracts, foreign exchange contracts, equity contracts, commodity contracts, credit contracts, and other contracts); investment funds (segregated by type of fund); and real estate. These examples are not meant to be all inclusive. An employer should consider the overall objectives in FASB ASC 715-20-50-1(d)(1) through 715-20-50-1(d)(5) in determining whether additional classes of plan assets or further disaggregation of classes should be disclosed.

b. In accordance with FASB ASC 962-325-45-5 and FASB ASC 965-325-45-2, the presentation of plan investments in the statement of net assets available for benefits detailed by general type may include government securities, short-term securities, corporate bonds, common stocks, mortgages, real estate, investments in bank common or collective trust funds, registered investment companies (for example, mutual funds), and investments in contracts with insurance companies, including separate accounts and immediate participation guarantee contracts. Other general types may include master trusts, deposit administration contracts, and immediate participation guarantee contracts.
3.30 The presentation should indicate whether the fair values of the investments have been measured by quoted prices in an active market or are fair values otherwise determined. (See also the fair value disclosures in chapter 7 required by FASB ASC 820.)

**Securities Lending**

3.31 Securities custodians commonly carry out securities lending activities on behalf of their employee benefit plan clients. The borrowers of securities generally are required to provide collateral to the lender (the plan). This collateral is typically cash, but sometimes it may be other securities or standby letters of credit, with a value slightly higher than that of the securities borrowed. If the collateral is cash, the lender typically earns a return by investing that cash at rates higher than the rate paid or rebated to the borrower. If the collateral is other than cash, the lender typically receives a fee. FASB ASC 860, *Transfers and Servicing*, provides accounting and reporting guidance for transfers of financial assets, including accounting for securities lending activities. FASB ASC 860 addresses:

- whether the transaction is a sale of the loaned securities for financial reporting purposes.
- if the transaction is not a sale, how the lender should report the loaned securities.
- whether and how the lender should report the collateral.
- how the lender should record income earned as a result of securities lending transactions.

3.32 If the securities lending transaction includes an agreement that entitles and obligates the plan (the transferor) to repurchase the transferred securities under which the plan maintains effective control over those securities, then the plan must account for those transactions as secured borrowings (not sales) and continue to report the securities on the statement of net assets.

3.33 Typically, in a securities lending arrangement, the transferee has the right by custom or contract to sell or repledge the security loaned. In these instances, the securities loaned

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3 In June 2009, FASB issued FASB Statement No. 166, *Accounting for Transfers of Financial Assets—an amendment of FASB Statement No. 140*. Among other guidance relating to transfer of financial assets, FASB Statement No. 166 (a) clarifies that the objective of paragraph 9 of FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities—a replacement of FASB Statement No. 125*, is to determine whether a transferor has surrendered control over transferred financial assets; (b) defines the term *participating interest* to establish specific conditions for reporting a transfer of a portion of a financial asset as a sale; and (c) requires that a transferor recognize and initially measure at fair value all assets obtained and liabilities incurred as a result of a transfer accounted for as a sale. In addition, FASB Statement No. 166 requires enhanced disclosures to provide financial statements to users with greater transparency about the transfers of financial assets and the transferor’s continuing involvement with transferred financial assets. FASB Statement No. 166 is effective as of the beginning of reporting periods that begin after November 15, 2009. Earlier application is prohibited. The recognition and measurement provisions of FASB Statement No. 166 should be applied to transfers that occur on or after the effective date. The disclosure provisions of FASB Statement No. 166 should be applied to transfers that occurred both before and after the effective date of the statement. Disclosure of comparative information for periods earlier than the effective date is encouraged, but not required. FASB Statement No. 166 has been codified in FASB ASC 860, *Transfers and Servicing*. 

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should be reclassified and reported by the plan (the transferor) separately from other assets not so encumbered (for example, as security pledged to creditors) pursuant to FASB ASC 860-30-25-5. Alternatively, if the transferee does not have the right by custom or contract to sell or repledge the security loaned, the plan should disclose in the notes to the financial statements the carrying amount and classification of any assets pledged as collateral, associated liabilities, and qualitative information about the relationship between those assets and associated liabilities as of the date of the latest statement of net assets presented pursuant to “Pending Content” in FASB ASC 860-30-50-1A. The plan should record the cash collateral received as an asset—and any investments made with that cash, even if made by agents or in pools with other securities lenders—along with the obligation to return the cash (considered the amount borrowed).

3.34 Generally, if the plan receives securities (instead of cash) that may be sold or repledged, the plan accounts for those securities in the same way as it would account for cash received, that is, the plan recognizes in the statement of net assets the securities received as collateral and the obligation to return that collateral.

3.35 However, pursuant to “Pending Content” in FASB ASC 860-30-50-1A, the plan must also disclose the fair value as of the date of each statement of net assets presented of that collateral and of the portion of that collateral that it has sold or repledged and information about the sources and uses of that collateral.

3.36 Because FASB ASC 860-30-25-5 requires that only the lender recognize securities collateral received in its statement of net assets, it is important to accurately identify the lender and borrower in securities lending transactions. One indicator that the plan is the lender is that the collateral received by the lender generally has a value slightly higher (for example, 2 percent) than that of the securities being borrowed.

3.37 The plan must disclose its policy for requiring collateral or other security in accordance with “Pending Content” in FASB ASC 860-30-50-1A.

3.38 According to FASB ASC 960-30-25-2, the interest income earned and rebate interest paid as a result of securities lending activity should be recorded on the statement of changes in net assets available for benefits.

Master Trusts

3.39 A master trust is a trust account made up of assets of some or all of the employee benefit plans of a company that sponsors more than one plan or a group of corporations under common control. Typically, each plan has an undivided interest in the assets of the trust, and ownership is represented by a record of proportionate dollar interest or by units of participation.

3.40 In accordance with FASB ASB 960-30-45-11, investments in master trusts are presented as a single line item in the statement of net assets available for benefits. See chapter 7 for further guidance on accounting and reporting for investments held in master trusts.

401(h) Accounts
3.41 Some defined benefit pension plans provide a postretirement medical benefit component in addition to the normal retirement benefits of the plan, pursuant to Section 401(h) of the Internal Revenue Code (IRC). Employers may fund a portion of their postretirement medical benefit obligations related to their health and welfare benefit plans through a health benefit account (401(h) account) in their defined benefit pension plans, subject to certain restrictions and limitations. Funding can be accomplished through a qualified transfer of excess pension plan assets or through additional contributions. Any assets transferred to a 401(h) account in a qualified transfer of excess pension plan assets (and any income allocable thereto) must be used only to pay qualified current retiree health benefits for the taxable year of the transfer (whether directly or through reimbursement). Any assets transferred to a 401(h) account in a qualified transfer of excess pension plan assets (and any income allocable thereto) that are not used in the year must be transferred out of the account to the pension plan.

3.42 The 401(h) assets may be used only to pay current retiree health benefits, which generally are obligations of a separate health and welfare benefit plan or health benefit arrangement. They may not be used to satisfy pension obligations. Although the assets may be invested together with assets that are available to pay pension benefits, a separate accounting must be maintained for all qualified transfers, contributions, distributions or expenses, and income earned thereon.

3.43 The IRC allows employers to allocate up to 25 percent of total contributions to the plan, subject to certain limitations, to the 401(h) account. If the full amount of these contributions is not used during the year, they may be accumulated for future retiree medical expenses in the 401(h) account. The deductibility of employer contributions to a 401(h) account is subject to separate limitations and, therefore, such contributions have no effect on the amount of deductible contributions an employer can make to fund pension benefits under the plan. The earnings on the 401(h) account are ignored for minimum funding purposes. Additionally, under the IRC, qualified transfers are not treated as prohibited transactions for purposes of Section 4975.

3.44 The plan sponsor has discretion in making contributions to the 401(h) account. A pension or annuity plan may provide for payment of medical benefits for retired employees, their spouses, and their dependents if all of the following conditions are met:

a. Benefits are subordinate (as defined in Section 401(h) of the IRC) to the retirement benefits provided by the plan.

b. A separate account is established and maintained for such benefits.

c. The employer’s contributions to the separate account are reasonable and ascertainable.

d. It is impossible, at any time prior to the satisfaction of all obligations under the plan to provide such benefits, for any part of the corpus or income of the separate account to be (within the taxable year or thereafter) used for, or diverted to, any purpose other than the providing of such benefits.
e. Notwithstanding the provisions of certain IRC sections, upon satisfaction of all obligations under the plan to provide such benefits, any amount remaining in the separate account must, under the terms of the plan, be returned to the employer.

f. In the case of an employee who is a key employee (as defined in Section 416(i)), a separate account is established and maintained for such benefits, which are payable to such employee (and the spouse and dependents), and such benefits (to the extent attributable to plan years beginning after March 31, 1984, for which the employee is a key employee) are payable only to that employee (and the spouse and dependents) from the separate account.

3.45 As stated in paragraphs 4–10 of FASB ASC 960-30-45, because the 401(h) net assets may not be used to satisfy pension obligations, the total of net assets available for pension benefits should not include net assets held in the 401(h) account related to obligations of the health and welfare benefit plan. The 401(h) account assets less liabilities (net assets of the 401(h) account) are required to be shown in defined benefit pension plan financial statements as a single line item on the face of the statements (as illustrated in FASB ASC 960-205-55-1). Those net assets related to the 401(h) account also should be deducted before arriving at the total of net assets available for pension benefits. In deducting those net assets, the amount related to the 401(h) features should be presented as a separate line item in the liabilities section of the statement of net assets available for pension benefits. The financial statement caption should clearly denote that the net assets held in the 401(h) account relate to obligations of the health and welfare benefit plan or arrangement. The statement of changes in net assets should show only the changes in net assets of the pension plan and not any of the components of the changes in the net assets in the 401(h) account. The only amounts that should be reported in the statement of changes in net assets are qualified transfers to the 401(h) account or any unused or unspent amounts (including allocated income), or both, in the 401(h) account at the end of the year that were qualified transfers of excess pension plan assets that should have been, but were not, transferred back to the defined benefit pension plan.

3.46 In accordance with FASB ASC 960-20-45-5, information regarding accumulated plan benefits should relate only to pension obligations. Even in situations in which separate financial statements are not prepared for a related health and welfare benefit plan, obligations related to retiree health benefits should not be reported in the statement of accumulated plan benefits of the defined benefit pension plan financial statements.

3.47 In accordance with FASB ASC 960-205-50-4, defined benefit pension plans should disclose in the notes to the financial statements the nature of the assets and the fact that the 401(h) account assets are available only to pay retiree health benefits.

3.48 In accordance with FASB ASC 960-205-50-5, because ERISA requires 401(h) accounts to be reported as assets of the pension plan, a reconciliation of the net assets reported in the financial statements to those reported in Form 5500 is required. Additionally, any assets held for investment purposes in the 401(h) account should be shown on Schedule H, line 4i—Schedule of Assets (Held at End of Year) and Schedule H, line 4j—Schedule of Reportable Transactions for the pension plan.
Contributions and Contribution Receivable

3.49 The most common source of contributions made to a defined benefit pension plan is employer contributions. Certain defined benefit pension plans may also have employee contributions and rollover contributions.

3.50 In accordance with FASB ASC 960-310-25-1, contributions receivable are amounts due as of the reporting date to the plan from employer(s), participants, or other sources of funding (for example, state subsidies or federal grants, which should be separately identified). Amounts due include those pursuant to formal commitments as well as legal or contractual requirements. With respect to employer’s contributions, evidence of a formal commitment may include any of the following: (a) a resolution by the employer’s governing body approving a specified contribution, (b) a consistent pattern of making payments after the plan’s year-end pursuant to an established funding policy that attributes such subsequent payments to the preceding plan year, (c) a deduction of a contribution for federal tax purposes for periods ending on or before the reporting date, or (d) the employer’s recognition, as of the reporting date, of a contribution payable to the plan.\(^4\) FASB ASC states that an adequate allowance should be provided for estimated uncollectible amounts. The Form 5500 Schedule SB, Single-Employer Defined Benefit Plan Actuarial Information or MB, Multiemployer Defined Benefit Plan and Certain Money Purchase Plan Actuarial Information, may provide useful information in determining the contribution receivable at year-end. Form 5500 reporting for contributions may differ from GAAP. Such differences should be disclosed as a reconciling item in the notes to the financial statements.

3.51 Plan sponsors are required to contribute at least a minimum as determined each year under ERISA and may contribute more than the minimum required by ERISA to (a) avoid restrictions on plan distributions or benefit accruals; (b) decrease Pension Benefit Guarantee Corporation (PBGC) variable premium expense; or (c) decrease current or future pension expense. Contributions made to a plan are reported for ERISA funding purposes in a way that attributes them to a particular plan year, typically consistent with the attribution made by the plan sponsor for federal income tax purposes. Contributions may be considered for funding purposes and are tax deductible for the plan sponsor up to the date of the extended corporate tax return, typically September 15 of the following plan year for a calendar year-end plan.

3.52 For defined benefit pension plans, FinREC recommends that the ERISA minimum required contribution determined by the actuary be recorded as a contribution receivable in the plan’s financial statements if not paid by year-end. Sometimes a contribution made after year-end that was not the result of a formal commitment at year-end is later recharacterized for funding and tax purposes by the plan sponsor as a contribution attributable to the plan year being reported on. This recharacterization may constitute a nonrecognized (type 2) subsequent event (an event occurring after the reporting date that

\(^4\) The existence of accrued costs in the employer’s financial statements or a deficit in net assets of the plan does not, by itself, provide sufficient support for recognition of a contribution receivable by the plan.
is indicative of conditions [for example, a formal commitment] that did not exist at the reporting date) and, consequently, would not be recorded as a contribution receivable.

3.53 **Funding waivers.** In certain situations of business hardship, plan sponsors may be unable to satisfy the minimum funding standard for a plan year without temporary substantial hardship. In these cases, the plan sponsor may apply to the Secretary of the Treasury for a waiver of the minimum funding standard. Such application must be filed no later than 2 ½ months after the plan’s year-end. The Secretary of the Treasury cannot waive the minimum funding standard with respect to a plan for more than 3 of any 15 consecutive plan years. If granted, waivers generally permit a plan sponsor to amortize the ERISA minimum contribution, including interest as defined under the IRC over a period of 5 years. FinREC recommends that a receivable be recorded for the minimum required contribution that is not received within the statutory funding deadline and consider whether an allowance for estimated uncollectable amounts is necessary.

3.54 **Multiemployer plans.** According to FASB ASC 960-310-25-3A, a multiemployer plan may also have a receivable for a withdrawing employer's share of the plan's unfunded liability. The plan should record the receivable, net of any allowance for an amount deemed uncollectible, when entitlement has been determined.

**Other Receivables**

3.55 Defined benefit pension plans may have other receivables, including those associated with contractual relationships. Other receivables may include the following:

- Investment related receivables, such as the following:
  - Interest and dividend income
  - Securities lending income
  - Due from brokers for securities sold
  - Derivative-related activity (for example, receivable for variation margin and foreign currency forward contracts)
- Fee reimbursements (from plan sponsor or service providers)
- Amounts due from plan sponsors or others relating to operational defects
- Reimbursement for nonexempt transactions or lost income
- Legal settlements

**Operating Assets**

3.56 In accordance to FASB ASC 960-360-35-1, plan assets used in plan operations (for example, buildings, equipment, furniture and fixtures, and leasehold improvements) should be presented at cost less accumulated depreciation or amortization. This is in contrast to the Form 5500 reporting requirement that calls for plan assets to be reported at fair value. Resulting differences should be presented in a note to the financial statements.
that reconciles the differences between amounts reported in the financial statements and Form 5500.

3.57 FASB ASC 360, *Property, Plant, and Equipment*, addresses accounting for the impairment of long-lived assets for assets to be held and used and assets to be disposed of. FASB ASC 360-10-35-21 requires that long-lived assets to be held and used by the plan, such as real estate owned by the plan for plan operations, be tested for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Long-lived assets to be abandoned or exchanged for a similar productive asset should be considered held and used until disposed of. FASB ASC 360-10-35-43 states that long-lived assets classified as held for sale should be measured at the lower of its carrying amount or fair value less cost to sell. A long-lived asset should not be depreciated while it is held for sale. See FASB ASC 360 for further accounting and disclosure requirements.

Accrued Liabilities

3.58 A plan may have liabilities (other than for benefits) that should be accrued. Such liabilities may include the following:

- Accrued expenses, (for example, third-party administrator, investment management, trustee, recordkeeping, actuarial, PBGC, and professional fees incurred during the period)
- Amounts owed for securities purchased or other investment-related payables
- Obligations to return securities lending collateral
- Derivative related payables
- Income taxes payable by the plan
- Amounts due to the plan sponsor (for example, the reimbursement of plan expenses as permitted by the plan document)

3.59 Current benefits payable should not be accrued as liabilities because the liability for benefits to be paid by the plan is already reflected in the actuarial present value of accumulated plan benefits.

3.60 Accordingly, a legal settlement against the plan for benefits and errors in determining plan obligations should be reported as an increase in the actuarial present value of accumulated plan benefits instead of as a liability in the statement of net assets available for benefits. Such amounts would be recorded as a decrease in the statement of changes in net assets available for benefits and in the statement of changes in accumulated plan benefits in the year in which they are paid by the plan. See FASB ASC 450, *Contingencies*, for further guidance when reporting on contingencies.

Changes in Net Assets Available for Benefits
According to paragraphs 1–3 of FASB ASC 960-30-45, information regarding changes in net assets available for benefits should be presented in enough detail to identify the significant changes during the year and should present, at a minimum, all of the following:

a. The net appreciation (depreciation) in fair value for each significant class of investments, segregated between investments whose fair values have been measured by quoted prices in an active market and those whose fair values have been otherwise determined. (See paragraph 3.30). Gains and losses from investments sold need not be segregated from unrealized gains and losses relating to investments held at year-end. This information may be presented in the accompanying footnotes. (See exhibit D-8, note E, in appendix D for an illustration.)

b. Investment income, exclusive of changes in fair value described in (a) preceding.

Certain registered investment companies and other investment funds pay dividends or capital gain distributions that are reinvested into the plan. FinREC recommends that the dividends be considered investment income and shown separately from changes in fair value. FinREC recommends that capital gain distributions be considered investment income and shown separately from changes in fair value or included as part of the net change in fair value.

c. Contributions from employers, segregated between cash and noncash contributions. A noncash contribution should be recorded at fair value. The nature of noncash contributions should be described either parenthetically or in a note.

d. Contributions from participants, including those transmitted by the plan sponsor.

e. Contributions from other identified sources (for example, state subsidies or federal grants).

f. Benefits paid to participants.

g. Payments to insurance companies to purchase contracts that are excluded from plan assets. FASB ASC 960-205-50-1(e) requires disclosure of the plan’s dividend income related to excluded contracts and permits that income to be netted against this item.

h. Administrative expenses.

**Practice Tip**

See paragraph 3.63 and Department of Labor (DOL) Advisory Opinion No. 2001-01A for guidance on reasonable expenses of administering a plan.

FinREC also recommends that the following items be presented separately, if they are significant:
a. Other employer contributions (if coming from the employer) or other income, including fee income from securities loaned and from miscellaneous sources, such as reimbursements for lost income or operational defects

b. Income tax expense (for example, unrelated business taxable income)

c. Other expenses, such as interest expense on debt or short sales, bank borrowings, margin accounts, and reverse repurchase agreements

d. Transfers of assets to or from other plans

Plan Expenses

3.63 Certain expenses may be paid on behalf of the plan by the plan sponsor. Defined benefit pension plans may pay administrative and investment-related expenses out of plan assets provided the plan document allows for such payments. In addition, DOL rules and regulations and DOL Advisory Opinion No. 2001-01A help clarify what expenses can be paid by the plan. Payment of improper expenses from a qualified plan is a breach of fiduciary duties and may be considered a nonexempt transaction. For example, according to the DOL Advisory Opinion No. 2001-01A, expenses incurred relating to the formation of the plan (such as settlor functions) would not be considered reasonable for the plan. Settlor functions include decisions relating to the formation, design, and termination of the plan.\(^5\) Expenses incurred related to implementing settlor decisions may be reasonable expenses of the plan. See the DOL-issued publication *Understanding Retirement Plan Fees and Expenses* and the DOL Advisory Opinion No. 2001-01A to better understand and evaluate plan fees and expenses.

3.64 In certain instances, it may be difficult to understand the nature of the plan expenses because they are often netted against income, or there may be other arrangements resulting in expenses not being apparent on the service provider statements. Plan expenses may be paid from plan assets as permitted by the plan documents. See paragraph 3.79(o) and 3.80 for guidance on the financial statement disclosures related to expenses.

3.65 Typical plan expenses may include the following:

- Investment management
- Trustee
- Investment custodian fees
- Recordkeeping and compliance
- Professional fees
- Reimbursement of plan sponsor direct costs, such as plan administrative salaries and other administrative expenses, subject to ERISA rules
- Other transaction or processing fees

Accumulated Plan Benefits

\(^5\) Plan sponsors may want to consult with legal counsel when determining whether fees are considered settlor fees.
3.66 Accumulated plan benefits are to be presented as the present value of future benefits attributable under the plan's provisions to service rendered to the date of the actuarial valuation. The actuarial present value of accumulated plan benefits may be presented as of the beginning or the end of the plan year; under FASB ASC 960-205-45-4, however, an end-of-year benefit information date is considered preferable. See paragraph 3.09.

3.67 In accordance with the FASB ASC glossary, accumulated plan benefits include benefits to be paid to (a) retired or terminated employees or their beneficiaries, (b) beneficiaries of deceased employees, and (c) present employees or their beneficiaries. To the extent possible, plan provisions should apply in recognizing accumulated plan benefits. A general method for measurement is provided in FASB ASC 960-20-25-4. Projected years of service should be a factor only in determining an employee's expected eligibility for particular benefits. Automatic benefit increases specified by the plan (for example, automatic cost-of-living increases) that are expected to occur after the benefit information date should be recognized. Plans providing death and disability benefits should consider these factors in the calculation.

3.68 Defined benefit pension plan actuarial valuations are prepared for different purposes and may use different actuarial methods and assumptions. There may be at least three different valuations performed annually for a single plan: a valuation for (a) determining the ERISA and IRS funding requirement; (b) determining the pension obligation and expense recorded in the plan sponsor's financial statements following the guidance of FASB ASC 715, Compensation—Retirement Benefits; and (c) determining the pension obligation recorded or disclosed in the plan's financial statements following the guidance of FASB ASC 960.

3.69 A projected unit credit actuarial cost method is required by FASB ASC 715 for use in preparing the plan sponsor financial statements, whereas FASB ASC 960 describes a unit credit method for the plan. The projected unit credit method may project salary and service and prorate the benefit based on service, whereas the unit credit method does not consider future salary or future service.

3.70 As shown in the following table, plan amendments adopted before the measurement date of the actuarial valuation should be given effect in the valuation, even if some provisions take effect only in future periods. For example, a plan amendment may provide for a change in the benefit formula that includes a retroactive component, and it may also include provisions to increase the benefit formula in future plan years. Plan amendments adopted after the benefit information date should not be recognized.
Matrix for Recognition of Plan Amendments

<table>
<thead>
<tr>
<th>Effective Date</th>
<th>Amendments Adopted within reporting year</th>
<th>Amendments Adopted after the reporting year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effective date within the reporting year</td>
<td>Effect of amendment should be included in the actuarial present value of accumulated plan benefits presented as of the end of the reporting year⁶</td>
<td>Effect of amendment should not be included in the actuarial present value of accumulated plan benefits presented as of the end of the reporting year⁷</td>
</tr>
<tr>
<td>Effective date after the reporting year</td>
<td>Effect of amendment should be included in the actuarial present value of accumulated plan benefits presented as of the end of the reporting year⁸</td>
<td>Effect of amendment should not be included in the actuarial present value of accumulated plan benefits presented as of the end of the reporting year⁹</td>
</tr>
</tbody>
</table>

3.71 As in the presentation of plan assets, benefits that are guaranteed by a contract with an insurance company, that is, *allocated contracts*, should be excluded from the actuarial present value of accumulated plan benefits.

3.72 The assumptions used in calculating accumulated plan benefits are to be based on the premise of an ongoing plan. Accordingly, the interest rates used for discounting expected future payments should reflect the rates of return expected on plan investments during the periods for which the benefits are deferred. See also FASB ASC 960-20-35-1 for information regarding assumptions used in determining benefit information. An appropriate allowance for future employee mortality and turnover should be provided. The significant assumptions used in the calculation must be developed using an *explicit*...

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⁶ For example, if benefit information is presented as of the beginning of year, the financial statements for 2008 and 2007 will only show benefit information as of 12/31/07 based on a 1/1/08 actuarial valuation. If an amendment was adopted on 11/30/07 with an effective date of 12/15/07, it should be included in the 12/31/07 benefit obligations.

⁷ For example, if the benefit information is presented as of the beginning of the year, the financial statements for 2008 and 2007 will only show benefit information as of 12/31/07 based on a 1/1/08 actuarial valuation. If an amendment was adopted on January 15, 2008, with an effective date retroactive to January 1, 2007, it should not be included in the 12/31/07 benefit information. Even though the effective date is retroactive, it is not accounted for until 2008 when first adopted. The actuarial valuation at 1/1/08 may or may not include this amendment. If it has been included, the effect should be removed from the valuation and disclosed in the notes to the financial statements as an unrecognized (type 2) subsequent event.

⁸ For example, if benefit information is presented as of the beginning of year, the financial statements for 2008 and 2007 will only show benefit information as of 12/31/07 based on a 1/1/08 actuarial valuation. If an amendment was adopted on 11/30/07 with an effective date of 1/1/08, it should be included in the 12/31/07 benefit obligations. The actuarial valuation would be expected to include this.

⁹ For example, if the benefit information is presented as of the beginning of year, the financial statements for 2008 and 2007 will only show benefit information as of 12/31/07 based on the 1/1/08 actuarial valuation. If an amendment was adopted on January 15, 2008, with an effective date of January 1, 2008, it should not be included in the 12/31/07 benefit obligations. The 1/1/08 actuarial valuation may or may not include the effect of this amendment. If it has been included, the effect of the amendment should be removed from the valuation and disclosed in the notes to the financial statements as an unrecognized (type 2) subsequent event.
approach, whereby each assumption, standing alone, represents the best estimate of the plan's future experience. These assumptions may differ from those used in the determination of the plan's funding and the plan sponsor's pension costs.

3.73 As noted previously, the benefit information may be presented in a separate statement, combined with other information in a financial statement, or presented in a note to the financial statements. The information, however, must all be located in one place and should be classified as follows, in accordance with FASB ASC 960-20-45-3:

   a. Vested benefits of participants currently receiving payments, including benefits due and payable as of the benefit information date

   b. Other vested benefits

   c. Nonvested benefits

If the plan is contributory, accumulated contributions of active employees including, if applicable, interest credited on those contributions, should be disclosed. If interest is credited on the contributions, the interest rate should also be disclosed. (See disclosures in paragraph 3.79(e).)

Changes in Accumulated Plan Benefits

3.74 Information regarding the change in actuarial present value of accumulated plan benefits from the preceding benefit information date to the current benefit information date should be presented to identify significant factors affecting the comparability of the year-to-year accumulated benefits. As with the accumulated benefit information, the change may be presented in the body of the financial statements or in the notes; they may be presented in either a reconciliation or a narrative format. In either presentation, the actuarial present value of accumulated plan benefits as of the preceding benefit information date should be presented. FASB ASC 960-20-45-6 states that the effects that are individually significant should be separately identified. In accordance with FASB ASC 960-20-50-3, minimum disclosures should include the significant effects of factors, such as (a) plan amendments, (b) changes in the nature of the plan, and (c) changes in actuarial assumptions. Changes in actuarial assumptions are to be viewed as changes in accounting estimates and, therefore, previously reported amounts should not be restated. FASB ASC 960-20-45-9 states that if only the minimum required disclosure is presented, presentation in a statement format will necessitate an additional unidentified other category to reconcile the beginning and ending amounts.

Practice Tip

If an end-of-year benefit information date is used, the present value of accumulated plan benefits will be as of the same date as the net assets. In this case, at a minimum, there will be two statements of net assets available for benefits and one statement of changes in net assets. There will be two corresponding statements (or disclosure in the footnotes) of the present value of accumulated plan benefits and one statement of changes. Examples of this are shown in exhibits D-1, D-2, D-3, and D-4 in appendix D of this guide.
If the information is as of the beginning of the year, the date of the benefit information in the actuarial report may not match the date at which net assets are presented. For example, for financial statements presented as of December 31, 2007 and December 31, 2006, the actuarial valuation will be as of January 1, 2007. For the benefit information to match the statement of net assets, the present value of accumulated plan benefits should be presented as of December 31, 2006 (one day earlier). Typically, this will not cause a material misstatement unless there was a plan amendment that was adopted on or after January 1, 2007, with a January 1, 2007 effective date. In that case, the effect of the amendment should be removed. When beginning-of-year benefit information is used, two statements of net assets and two statements of changes would be included. Only a single year of present value of accumulated plan benefits is required with a reconciliation from the prior year. Examples of this are shown in appendix D of this guide. See the table in paragraph 3.09.

**Frozen Defined Benefit Pension Plans**

**3.75** Defined benefit pension plans may be amended to no longer allow new participants to enter the plan or to cease benefit accruals for existing participants. Either or both amendments serve to “freeze” a plan. The plan will stay in existence as long as necessary to pay already accrued benefits. Once a plan has been frozen regarding participation or benefit accrual, complete and prominent disclosure of the relevant circumstances is essential in all subsequent financial statements issued by the plan.

**3.76** Upon full or partial termination of a plan, affected participants become fully vested in accrued benefits at the termination date. A partial termination can occur if approximately 20 percent or more of plan participants are terminated by the plan sponsor as a result of an action, such as a plant closure, a decision to downsize, or the termination of a product line. The reduction can accumulate over one or more plan years and still be classified as a partial termination. Judgment is needed to determine whether a partial termination has occurred. Consultation with the IRS or qualified legal counsel may be necessary if questions arise regarding the occurrence of a partial plan termination. Consideration also may be given to determine that terminated participants received their fully vested benefits and that there were no forfeited amounts.

**Financial Statement Disclosures**

**3.77** The financial statements should disclose, if applicable, all of the following:

- In accordance with FASB ASC 960-325-50-1, the method(s) and significant assumptions used to determine the fair value of investments and the reported value of contracts with insurance entities

- In accordance with paragraphs 8–9 in FASB ASC 960-20-50, the method and significant assumptions used in determining the actuarial present value of accumulated plan benefits, including any significant changes in the method or assumptions during the year
3.78 These disclosures should also include the following:

a. Basis of accounting (if other than GAAP)
b. Use of estimates
c. Investment valuation and income recognition
d. Payment of benefits
e. Risks and uncertainties (see paragraphs 3.87–3.91 that follow)

3.79 In accordance with FASB ASC 960-205-50-1, defined benefit pension plans should also disclose the following:

a. A brief general description of the plan agreement, including its vesting and benefit provisions. If a plan agreement, or a description thereof, providing this information is otherwise published and made available, this description may be omitted provided that reference to such other source is made.

b. A description of significant plan amendments adopted during the year ending on the latest benefit information date. If significant amendments were adopted between the latest benefit information date and the plan's year-end, it should be indicated that the actuarial present value of accumulated plan benefits does not reflect those amendments.

c. A brief general description of the priority order of participants’ claims to the assets of the plan upon plan termination and benefits guaranteed by the PBGC, including a discussion of the application of its guaranty to any recent plan amendment. See FASB ASC 960-205-50-1(c) for further guidance related to this disclosure.

d. The funding policy and any changes in such policy during the plan year. For a contributory plan, the disclosure should state the method of determining participants’ contributions. Plans subject to ERISA should disclose whether the minimum funding requirements of ERISA have been met. If a minimum funding waiver has been granted by the IRS or if a request for a waiver is pending before the IRS, that fact should be disclosed.

e. If the plan is contributory, FASB ASC 960-20-50-2 requires the present employees’ accumulated contributions as of the benefit date (including interest, if any) to be disclosed. If interest has been credited on employees’ contributions, the rate(s) should also be disclosed.

f. If significant costs of plan administration are being absorbed by the employer(s), that fact should be disclosed.

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10 See FASB ASC 235, Notes to Financial Statements, for further information regarding financial statement disclosures.
g. The policy regarding the purchase of contracts with insurance entities that are excluded from plan assets and the plan’s dividend income for the period, if any, related to the excluded contracts.

**Practice Tip**

Once an allocated contract is purchased, the subsequent benefit payments to participants would not be considered plan activity.

h. The federal income tax status of the plan if a favorable letter of determination has not been obtained or maintained. Note that reports filed in accordance with the requirements of ERISA must include disclosure of "information concerning whether or not a tax ruling or determination letter has been obtained," which is more than is required by FASB ASC 960.

i. Investments that represent 5 percent or more of total net assets available for benefits, in accordance with FASB ASC 960-325-50-2. Listing all investments in Schedule H, line 4i—Schedule of Assets (Held at End of Year) required by ERISA does not eliminate the requirement to include this disclosure in the financial statements.

j. 401(h) disclosures, in accordance with FASB ASC 960-205-50-4, if applicable, as discussed in paragraphs 3.41–3.48.

k. Significant related-party transactions, for example employer stock or transfers between related plans. This also includes significant real estate or other transactions in which the plan and any of the following parties are jointly involved: (a) the sponsor; (b) the employer(s); and (c) the employee organization(s). For plan expenses, see paragraphs 3.63–3.65 and (o) that follow.

l. Significant subsequent events that may affect the usefulness of the financial statements in accordance with FASB ASC 855, *Subsequent Events*.

m. Unusual or infrequent events or transactions occurring after the latest benefit information date but before the financial statements are issued, or available to be issued, that might significantly affect the usefulness of the financial statements in an assessment of the plan’s present and future ability to pay benefits. For example, a plan amendment adopted after the latest benefit information date that significantly increases future benefits that are attributable to employees' service rendered before that date should be disclosed. If reasonably determinable, the effects of such events or transactions should be disclosed. If such effects are not

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11 A plan’s tax exempt status is a position that may be subject to uncertainty. In September 2009, FASB issued FASB ASU No. 2009-06, *Income Taxes (Topic 740)—Implementation Guidance on Accounting for Uncertainty in Income Taxes and Disclosure Amendments for Nonpublic Entities*. ASU No. 2009-06 provides implementation guidance on accounting for uncertainty in income taxes and eliminates the disclosure requirements of paragraphs 15(a)–15(b) of FASB ASC 740-10-50 for nonpublic entities, as defined in FASB ASC 740-10-20. The implementation guidance in ASU No. 2009-06 also expands the FASB ASC glossary definition of a *tax position*. In addition, TIS section 5250.15, “Application of Certain FASB Interpretation No. 48 (codified in FASB ASC 740-10) Disclosure Requirements to Nonpublic Entities That Do Not Have Uncertain Tax Positions” (AICPA, *Technical Practice Aids*), clarified that the description of open tax years that remain subject to examination is a required disclosure for a nonpublic entity even if the entity has no uncertain tax positions.
quantified, the reasons why they are not reasonably determinable should be disclosed. This guidance does not contemplate disclosure of normal changes after the benefit information date, such as benefits attributable to service rendered after that date.

n. Commitments and contingencies in accordance with FASB ASC 440, *Commitments*, and FASB ASC 450 (for example, future capital commitments for investments).

o. Amounts paid to affiliates or related parties (such as advisory fees, administration fees, brokerage commissions, and sales charges) should be disclosed in accordance with FASB ASC 850, *Related Party Disclosures*. Significant provisions of related-party agreements, including the basis for determining management, advisory, administration, and also other amounts paid to affiliates or related parties, should be described in a note to the financial statements.

p. Other disclosures elsewhere in this guide (for example, see the sections, “Master Trust” and “Fair Value Disclosures” in chapter 7).

Note: This list is not intended to modify the disclosure requirements of FASB ASC 960, but rather to serve as a reference to the major requirements. This list does not include information required by ERISA to be disclosed in the schedules filed as part of a plan’s annual report. In this connection, it is important to note that disclosure of this information only on the face of the financial statements or in the notes to the financial statements, but not in the schedules, is not acceptable under ERISA reporting standards. As required by ERISA, an explanation of the differences, if any, between the information contained in the financial statements and the amounts reported on the Form 5500 should be disclosed.

3.80 FinREC also recommends that the terms of expense offset arrangements with third parties, whereby expenses are netted against income, be disclosed in the notes to the financial statements, if significant. Expense offset arrangements generally consist of fees being paid to a third-party service provider (for example, recordkeeper) directly through the use of investment fee rebates made available by the plan’s separate third-party investment manager.

Fair Value Measurements

3.81 See chapter 7 for required disclosures related to fair value measurements in accordance with FASB ASC 820, including the fair value measurement of investments in certain entities that calculate net asset value per share (NAV).

Derivatives and Hedging

3.82 FASB ASC 815, *Derivatives and Hedging*, provides accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. FASB ASC 815 applies to certain contracts that meet the definition of *derivative instrument*, as defined in FASB
ASC 815-10-15-83. See FASB ASC 815-10-15-13 for further information on certain contracts that are not subject to the requirements of FASB ASC 815.\textsuperscript{12}

3.83 FASB ASC 815-10-50 requires enhanced disclosures about derivative instruments and hedging activities, which include (a) how and why an entity uses derivative instruments; (b) how derivative instruments and related hedged items are accounted for under Topic 815, and (c) how derivative instruments and related hedging items affect an entity’s financial position, financial performance, and cash flows. Additionally, the following disclosures are required: qualitative disclosures about objectives and strategies for using derivatives; quantitative disclosures about fair value amounts of, and gains and losses on, derivative instruments; and disclosures about credit risk related contingent features in derivative agreements. These further disclosures are intended to improve the transparency of financial reporting.

Master Trusts

3.84 As indicated in FASB ASC 960-30-45-11, investments in master trusts are presented in a single line item in the statement of net assets available for benefits. In addition, paragraphs 1–3 of FASB ASC 960-30-50 state that in the notes\textsuperscript{13} to the financial statements, the investments of the master trust should be detailed by general type, such as government securities, short-term securities, corporate bonds, common stocks, mortgages, and real estate, as of the date of each statement of net assets available for benefits presented. The net change in the fair value of each significant type of investment of the master trust and total investment income of the master trust by type, for example, interest and dividends, should also be disclosed in the notes for each period for which a statement of changes in net assets available for benefits is presented. The notes to the financial statements should also include a description of the basis used to allocate net assets, net investment income, gains and losses to participating plans, and the plan’s percentage interest in the master trust as of the date of each statement of net assets available for benefits presented.

Financial Instruments

\textsuperscript{12} The AICPA issued a series of Technical Questions and Answers (TIS) to provide nonauthoritative guidance that is intended to assist reporting entities when implementing the provisions of FASB ASC 820, \textit{Fair Value Measurements and Disclosures} (specifically, ASU No. 2009-12), to estimate the fair value of investments in certain entities that calculate net asset value per share (NAV). TIS sections 2220.18–.27 (AICPA, \textit{Technical Practice Aids}), apply to investments that are required to be measured and reported at fair value and are within the scope of paragraphs 4–5 of FASB ASC 820-10-15.

\textsuperscript{13} The AICPA issued TIS section 6931.11, “Fair Value Measurement Disclosures for Master Trusts” (AICPA, \textit{Technical Practice Aids}) to provide guidance on the required fair value measurement disclosures to be made when a plan holds investments in a master trust. This question and answer assists with the implementation of FASB ASC 820 for employee benefit plans that have investments in a master trust. This guidance states that the disclosure requirements of FASB ASC 820 should be made for each major category of master trust assets and liabilities. In addition, consideration should be given to combining or reconciling, or both, the master trust FASB ASC 820 disclosures with the master trust disclosures as required by paragraphs 1–3 of FASB ASC 960-30-50.
FASB ASC 825-10-50-10 requires all entities, except for those covered by an exemption\(^\text{14}\) for which the disclosure is optional, to disclose within the body of the financial statements or in the accompanying notes the fair value of financial instruments for which it is practicable to estimate fair value.\(^\text{15}\) An entity should also disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments. According to “Pending Content” in FASB ASC 825-10-50-8, financial instruments of a pension plan other than (a) employers’ and plans’ obligations for pension benefits, other postretirement benefits, including health care and life insurance benefits, postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation agreements; and (b) insurance contracts, other than financial guarantees and investment contracts, are included in the scope of FASB ASC 825, Financial Instruments, and are subject to its disclosure requirements. In addition, the disclosure requirements of FASB ASC 820 may also apply.

FASB ASC 825-10-50-1 requires disclosure of all significant concentrations of credit risk arising from all financial instruments. In accordance with FASB ASC 825-10-50-21, the following information should be disclosed about each significant concentration:

- Information about the (shared) activity, region, or economic characteristic that identifies the concentration
- The maximum amount of loss due to credit risk that, based on the gross fair value of the financial instrument, the entity would incur if parties to the financial instruments that make up the concentration failed completely to perform according to the terms of the contracts and the collateral or other security, if any, for the amount due proved to be of no value to the entity
- The entity’s policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the entity’s access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments
- The entity’s policy of entering into master netting arrangements to mitigate the credit risk of financial instruments, information about the arrangements for which the entity is a party, and a brief description of the terms of those arrangements,

\(^\text{14}\) According to FASB ASC 825-10-50-3, the disclosures are optional for plans that meet all of the following criteria:

\begin{itemize}
  \item a. The plan is a nonpublic entity.
  \item b. The plan’s total assets are less than $100 million on the date of the financial statements.
  \item c. The plan has no instrument that, in whole or in part, is accounted for as a derivative instrument under FASB ASC 815, Derivatives and Hedging, during the reporting period.
\end{itemize}

\(^\text{15}\) In accordance with FASB ASC 825-10-50-11, fair value disclosed in the notes should be presented together with the related carrying amount in a form that makes it clear whether the fair value and carrying amount represent assets or liabilities and how the carrying amounts relate to what is reported in the statement of net assets available for benefits.
including the extent to which they would reduce the entity’s maximum amount of loss due to credit risk

Risks and Uncertainties

3.87 FASB ASC 275-10-50-1 requires plans to make disclosures in their financial statements about the risks and uncertainties existing as of the date of those financial statements in the following areas: (a) the nature of their operations, (b) the use of estimates in the preparation of financial statements, (c) certain significant estimates, and (d) current vulnerability due to certain concentrations.

3.88 In accordance with FASB ASC 275-10-50-8, certain significant estimates should be disclosed when known information available prior to issuance of the financial statements indicates that (a) it is at least reasonably possible that the estimate of the effect on the financial statements of a condition, situation, or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events, and (b) the effect of the change would be material to the financial statements.

3.89 For example, the present value of accumulated plan benefits could be subject to a material change when

- employees covered by the plan work in an industry that experienced a significant economic downturn in the previous year, and it is reasonably possible that in the subsequent period, a significant number of employees will retire early without a monetary incentive to do so in order to avoid being laid-off with nominal benefits. This could significantly increase the present value of accumulated plan benefits and possibly cause the plan to be underfunded.

- employees covered by the plan are party to a collective bargaining agreement, which was up for renegotiation at year-end, and it is reasonably possible that management's offer to significantly increase pension benefits in lieu of granting the union's request for a significant increase in cash compensation will be accepted within the next year. This could significantly increase the present value of accumulated plan benefits.

- prior to year-end, the employer announced a planned downsizing but had not decided on the number of employees to be terminated, and it is reasonably possible that when the decision is made during the next year, it will result in employees receiving pension benefits earlier than expected and in an amount greater than originally projected.

- it is reasonably possible that there will be a significant decline in the fair value of investments (that is, financial instruments) during the next year, which would change the assumed rates of return used to discount the benefit obligation and, therefore, could significantly affect the present value of accumulated plan benefits.
Many plan's participants may be concentrated in a specific industry that carries with it certain risks. Plans may also hold investments and other assets (other than financial instruments for which concentrations are covered by FASB ASC 825, as amended, rather than FASB ASC 275, Risks and Uncertainties) that are concentrated in a single industry or in a single geographic area. In accordance with FASB ASC 275-10-50-16, vulnerability from concentrations arises when a plan is exposed to risk of loss greater than it would have had it mitigated its risk through diversification. Concentrations should be disclosed if based on information known to management before the financial statements are issued or are available to be issued and (a) the concentration exists at the date of the financial statements, (b) the concentration makes the plan vulnerable to the risk of a near-term severe impact, and (c) it is at least reasonably possible that the events that could cause the severe impact will occur in the near term. For example, if the plan owns several investment properties (that is, apartment buildings) located in a geographic area that has only one significant employer and that employer announced last year that it is considering leaving the area, and it is reasonably possible that it will do so within the next year, this could significantly affect the plan's future cash flows from rents and the value of the investment properties.

Because the disclosure requirements of FASB ASC 275 in many circumstances are similar to or overlap the disclosure requirements in certain other FASB ASC topics (for example, FASB ASC 450), in accordance with FASB ASC 275-10-50-1, the disclosures required by FASB ASC 275 may be combined in various ways, grouped together, or placed in diverse parts of the financial statements, or included as part of the disclosures made pursuant to the requirements of other FASB ASC topics.

Plan Mergers and Spinoffs

Company mergers and acquisitions, or other events, may result in employee benefit plan mergers or spinoffs. Merger and spin-off documentation and plan documents should be reviewed to determine the effective merger date and the appropriate timing of the transfer of the benefit obligations, in addition to any applicable assets, to the successor plan. FinREC recommends that the net assets transferred be recorded as a transfer in or out, as applicable, on the statement of changes in net assets, below the net increase or decrease for the period prior to plan transfer.

Additionally, the plan sponsor of the predecessor plan should consider the need for determining obligations as of the merger date, with the statement of changes in benefit obligations reflecting the transfer of such amounts to the successor plan. Further spin-off considerations include determination of the amount of assets that would also be transferred to the successor plan in addition to the identified benefit obligations. Such amounts are normally described in the spin-off agreement.

Terminating Plans

FASB ASC 960-40 provides guidance for terminating plans that are defined benefit plans. According to the FASB ASC glossary, terminating plans include any plan about which a
decision to terminate has been made, regardless of whether the terminated plan will be replaced.

3.95 According to FASB ASC 960-40-50-1, when the decision to terminate a plan has been made, or when a wasting trust (that is, a plan under which participants no longer accrue benefits but that will remain in existence as long as necessary to pay already accrued benefits) exists, the relevant circumstances should be disclosed in all subsequent financial statements issued by the plan.

3.96 According to FASB ASC 960-40-25-1, if the decision to terminate a plan is made before the end of the plan year, the plan's year-end financial statements should be prepared on the liquidation basis of accounting.

3.97 According to FASB ASC 960-40-35-1, for terminating plan assets, changing to the liquidation basis will usually cause little or no change in values, most of which are current market values. Assets that may not be carried at market values include operating assets, insurance contracts carried at contract values, or large blocks of stock or other assets that cannot be readily disposed of at their quoted market prices.

3.98 According to FASB ASC 960-40-35-2, accumulated plan benefits should be determined on a liquidation basis, and their value may differ from the actuarial present value of accumulated plan benefits reported for an ongoing plan. In general, upon termination, all benefits should be reported as vested.
Chapter 4

Health and Welfare Benefit Plans

Introduction and Scope

4.01 As defined by the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) glossary, health and welfare benefit plans include plans that provide the following:

- Medical, dental, prescription drugs, vision, psychiatric, long-term health care, life insurance, or accidental death or dismemberment benefits
- Benefits for postemployment (benefits for former or inactive employees after employment but before retirement), such as Consolidated Omnibus Budget Reconciliation Act (COBRA) benefits, severance, or disability (both long- and short-term)
- Other benefits, such as sick leave, vacation, holiday, apprenticeship, tuition assistance, day care, dependent care, housing subsidies, or legal services
- Postretirement benefits, such as medical, dental, prescription drugs, vision, and life insurance benefits

4.02 Benefits may be provided through insurance contracts, from net assets accumulated in a trust or the general assets of the employer, or a combination thereof. Regardless of the funding arrangement, the ultimate reporting entity under the Employee Retirement Income Security Act of 1974 (ERISA) is the plan and not the underlying trust(s).

4.03 This chapter applies to both defined benefit and defined contribution health and welfare benefit plans (referred to hereafter as health and welfare benefit plans).

a. Defined benefit health and welfare benefit plans. As defined in the FASB ASC glossary, a defined-benefit health and welfare benefit plan specifies 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. Such plans may also include benefits that are payable as a lump sum, such as death benefits. The level of benefits may be defined or limited based on factors such as age, years of service, and salary. Contributions may be determined by the plan's actuary or be based on premiums, actual claims paid, hours worked, or other factors determined by the plan sponsor and may be based on cost of insurance, actual claims paid, hours worked, or other factors determined by the plan sponsor. Even when a plan is funded pursuant to agreements that specify a fixed rate of employer contributions (for example, a collectively bargained multiemployer plan), such a plan may, nevertheless, be a
defined benefit health and welfare benefit plan if its substance is to provide a defined benefit.

b. **Defined contribution health and welfare benefit plans.** As defined by the FASB ASC glossary, a defined contribution health and welfare benefit plan maintains an individual account for each plan participant. They have terms that specify the means of determining the contributions to participants’ accounts, rather than the amount of benefits the participants are to receive. The benefits a plan participant will receive are limited to the amount contributed to the participant’s account, investment experience, expenses, and any forfeitures allocated to the participant’s account. These plans also include flexible spending arrangements (FSA).

**Practice Tip**

Defined contribution health and welfare plans may also include vacation plans and health reimbursement accounts (HRAs).

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4.04 Certain health and welfare benefit plans may contain both defined benefit and defined contribution features in one plan, such as the inclusion of flexible spending arrangements in a defined benefit health and welfare benefit plan. Some of the more common types of health and welfare arrangements are described in more detail in appendix 4B.

**Trust Arrangements**

4.05 Health and welfare benefit plans are subject to the fiduciary, reporting, and other requirements of ERISA. Generally, no regulatory funding requirements exist; however, a plan may establish a trust to hold assets to pay all or part of the covered benefits, and the trust may or may not be tax-exempt. Assets may be segregated and legally restricted under various types of trust arrangements (or a combination of these), such as

- a voluntary employee beneficiary association (VEBA), a 501(c)(9) trust that is generally tax exempt (see paragraphs 4.140–4.145).
- a taxable trust, such as a grantor trust.
- a 401(h) account.
- other funding vehicles.

4.06 Generally, if a trust exists, audited financial statements may be required under ERISA. In certain instances, when a separate fund or account is in the name of the plan to hold contributions and make distributions, the plan may be deemed funded under ERISA even if that was not the intent. A trust always exists for a multiemployer plan.

4.07 A trust may cover more than one plan, which may be the case if one or more plans are utilizing a VEBA trust. These arrangements may also be master trusts subject to the Department of Labor’s (DOL’s) master trust filing requirements.

**Defining the Reporting Entity**
4.08 The reporting entity for a health and welfare benefit plan can take many forms. Employers may sponsor multiple individual welfare benefit plans, and others may sponsor individual health and welfare benefit programs, which are included in a single plan (for example medical, dental, and vision). For ease of regulatory reporting, some plan sponsors may decide to combine their individual plans or programs into a single plan using a wrapper plan document (wrapper plans are also known as “omnibus” or “umbrella” plans). Although the wrapper plan document generally does not define plan terms or describe plan benefits, it does provide the important documentation backbone shared by the plans wrapped therein. The Financial Reporting Executive Committee (FinREC) recommends that such wrapped plans or programs be accounted for similar to a merger of two or more plans at the time the plans or programs are combined (see paragraphs 4.130–4.131 for guidance on merged plans).

4.09 Wrapper plans typically "wrap" together several welfare benefit programs into a single plan document. An unintended consequence of sponsoring a single wrapper plan for all of an employer’s benefit programs is the need to subject certain components of the wrapped plan to the DOL’s audit requirement that may not have otherwise required an audit (for example, insured activity). As such, some employers may choose to have more than one wrapper plan document for different plans, such as one for self-insured and one for insured plans.

4.10 A review of the plan agreement, summary plan description, contracts with insurance companies, employee handbooks, previously filed Form 5500s, consultation with legal counsel, and wrapper documents is needed in the determination of the plan’s reporting entity. Once the reporting entity has been established, all plan transactions, including contributions, benefit payments and expenses, whether paid through a trust or otherwise (for example, some plans may pay only a portion of the plan’s benefit payments and expenses through a trust), should be recorded in the plan’s financial statements. The nature and design of the plan directly affects its accounting and reporting and requires consideration of the following:

- **Who is covered by the plan.** A plan may cover multiple types of participants, such as active employees, terminated employees under COBRA, dependents, beneficiaries, retirees, union, and nonunion employees.

- **Types of benefits.** A plan may include benefits that are fully insured or self-insured, or a combination thereof. All benefits covered under the plan, whether paid through a trust or otherwise, are to be included in the plan’s financial statements.

- **Who contributes.** Participants may be required to contribute to the cost of their benefits, or the plan sponsor may cover some or all of the cost.

- **How are benefits funded.** Benefits may be funded from contributions made to a trust or trusts, from the general assets of the plan sponsor or a combination. Therefore, the trust may not include all the activity of the plan.
**Practice Tip**

The Internal Revenue Code (IRC) provides for certain types of tax-advantaged financial arrangements such as FSAs, health savings accounts (HSAs) and HRAs. See appendix 4B for a more detailed discussion of these types of arrangements. When an FSA, HSA, or HRA is wrapped into a health and welfare plan that requires an audit, consultation with the plan’s legal counsel may be needed to aid in the determination about whether the FSA, HSA, or HRA activity should be included in the plan’s financial statements. Considerations in that determination may include the sources of funding (for example, employer, participants, or both), who has legal title to the amounts in the accounts, how the claims are adjudicated (for example, by employer, self-adjudicated by participant, or other), or whether a carry-forward provision exists in the next plan year for unused amounts. In practice, these arrangements are commonly reported as follows:

- **FSAs and HRAs.** If they are wrapped or a component of the health and welfare benefit plan, FinREC recommends that amounts available to participants at year-end be included in the plan’s statement of net assets available for benefits, and the associated activity (for example, contributions and benefits paid) be included in the plan’s statement of changes in net assets available for benefits. Claims incurred before plan year-end that are submitted after year-end (but before the date defined by the plan) along with the amount and ultimate disposition of forfeited amounts should be disclosed.

- **HSAs.** If they are a component of the health and welfare benefit plan, FinREC recommends disclosure that the arrangement exists, but that the associated activity be excluded from the plan’s financial statements because the plan is not obligated to pay the benefits.

**Background**

**Administration of a Health and Welfare Benefit Plan**

4.1 The administration of a health and welfare benefit plan involves several parties. Those parties may include the following:

- Plan sponsor
- Plan administrator
- ERISA legal counsel
- Insurance company for fully insured benefits
- Insurance company for stop-loss insurance
- Claims processor (also referred to as claims adjudicator) for self-insured benefits
- Outside administrators (commonly used for outsourced enrollment, eligibility, and contributions for COBRA and postretirement participants)
- Actuary for calculation of the plan’s benefit obligation (such as claims incurred but not reported, postemployment, and postretirement obligations)
- Pharmacy benefit managers
• Other service providers

HIPAA Considerations

4.12 Health Insurance Portability and Accountability Act (HIPAA) establishes standards for the privacy and protection of individually identifiable electronic health information, as well as administrative simplification standards. The rules include standards to protect the privacy of individually identifiable health information.

4.13 The rules (applicable to health plans, health care clearing houses, and certain health care providers, known collectively as “covered entities”) present standards with respect to the rights of individuals who are the subjects of this information, procedures for the exercise of those rights, and the authorized and required uses and disclosures of this information. HIPAA requires that plan sponsors enter into a business associates agreement with any of their service providers that have access to any protected health information (PHI). A plan auditor is considered a business associate and would generally be required to sign a business associate agreement. HIPAA privacy laws and business associates agreement provisions require maintenance of the privacy of the PHI.

4.14 Recent legislative changes that affect HIPAA create many additional requirements, enforcement provisions and penalties for covered entities, business associates, vendors, and others.

Annual Health Care Process

4.15 The timing window on annual health care enrollment programs may appear to be limited, but significant effort goes on throughout the year. Unlike retirement plans, sponsors of health and welfare benefit plans typically go through an annual comprehensive process to evaluate the health and welfare benefits they provide. As a result, it is not uncommon for changes to be made to the benefits offered, vendors utilized, and cost sharing amounts on an annual basis. The health care process is important to understand because it will likely affect audit risk assessments and audit planning, given contract changes, new or changed systems, and new processes.

4.16 Exhibit 4-1 illustrates the process. See appendix 4A for further details on each step in the process.

Exhibit 4-1: The Health Care Process

Note A: Annual Contract Negotiation With Service Providers

Plan sponsors assess existing contracts and then engage in contract negotiations with their service providers, giving consideration to any new legislation or regulatory changes.

Note B: Employee Communication and Open Enrollment
Plan sponsors communicate the annual benefit offerings to eligible participants during the open enrollment process. Changes in benefit vendors, benefit costs, options, and eligibility criteria (if any) are communicated at this time. Participants then select their benefits and level of coverage.

**Note C: Payroll, COBRA, and Retiree Contribution Process**

Required contributions from eligible participants are input into applicable systems so the proper contributions can be withheld, collected, and remitted to appropriate vendors.

**Note D: Benefits Administration**

Benefit claims are processed either internally or externally through a third party. Edit checks are performed to evaluate the information.

**Note E: Funding or Payment of Service**

Payments of claims or premiums are made based upon preestablished funding criteria as documented in contractual agreements.

**Health and Welfare Arrangements**

4.17 The nature of a plan’s health and welfare arrangements directly affects the method of accounting for the assets, liabilities, benefit obligations, and related changes. In some arrangements, an insurance company may assume all or a portion of the financial risk, or in others, a third party may provide only administrative services, such as claims processing (see paragraphs 4.61–4.65).

4.18 Some of the more common types of health and welfare arrangements are described in more detail in appendix 4B.

**Accounting and Reporting for Health and Welfare Benefit Plans**

4.19 This chapter describes generally accepted accounting principles (GAAP) for accounting and financial reporting for defined benefit and defined contribution health and welfare benefit plans as set forth in FASB ASC 965, *Plan Accounting—Health and Welfare Benefit Plans*. Other GAAP may also apply. FASB ASC contains all authoritative U.S. GAAP. This chapter also provides guidance that has been recommended by FinREC on the accounting, reporting, or disclosure of transactions or events that are not set forth in FASB ASC and describes related auditing procedures and guidance for health and welfare benefit plans. GAAP, other than those discussed in this chapter, may also apply to health and welfare benefit plans.

4.20 This chapter does not address the preparation of financial statements on an other comprehensive basis of accounting (OCBOA) other than GAAP; however, the financial statements may be prepared on such bases as the cash basis or modified cash basis, as permitted by the DOL regulations. If the financial statements are prepared on an OCBOA
other than GAAP, disclosure of the plan’s benefit obligation information as described in paragraph 4.25 is required.

4.21 FASB ASC 715, Compensation—Retirement Benefits, provides standards of financial accounting and reporting by employers for health and welfare benefits expected to be provided to a participant and his or her beneficiaries after retirement. Although FASB ASC 715 does not apply to health and welfare benefit plans, this chapter adopts certain of its measurement concepts (see paragraphs 4.104–4.112). Terminology used in discussing postretirement benefits in this chapter is intended to follow usage and definitions provided in FASB ASC 715.

4.22 FASB ASC 712, Compensation—Nonretirement Postemployment Benefits, provides standards of financial accounting and reporting by employers for certain postemployment benefits provided to former or inactive employees after employment but before retirement. Benefits provided may include salary continuation, supplemental unemployment benefits, severance, disability-related job training and counseling, and continuation of health care and death benefits. Although FASB ASC 712 does not apply to health and welfare benefit plans, this chapter adopts certain of its measurement concepts (see paragraphs 4.96–4.103). Terminology used in discussing postemployment benefits in this chapter is intended to follow usage and definitions provided in FASB ASC 712.

Financial Statements

Defined Benefit Health and Welfare Plan

4.23 According to FASB ASC 965-205-10-1, the objective of financial reporting by defined benefit health and welfare plans is the same as that of defined benefit pension plans; both types of plans provide a determinable benefit. Accordingly, the primary objective of the financial statements of a defined benefit health and welfare plan is to provide financial information that is useful in assessing the plan’s present and future ability to pay its benefit obligations when due. To accomplish that objective, a plan’s financial statements should provide information about all of the following: (a) plan resources and the manner in which the stewardship responsibility for those resources has been discharged, (b) benefit obligations, (c) the results of transactions and events that affect the information about those resources and obligations, and (d) other factors necessary for users to understand the information provided.¹

4.24 Per FASB ASC 965-205-45-1, the financial statements of a defined benefit health and welfare plan prepared in accordance with GAAP² should be prepared on the accrual basis of accounting and include all of the following:

¹It should be recognized that (a) information in addition to that contained in a plan’s financial statements is needed in assessing the plan’s present and future ability to pay its benefit obligations when due, and (b) financial statements for several plan years, rather than for a single year, may provide more useful information in assessing the plan’s future ability to pay benefit obligations.

²Financial statements prepared on a comprehensive basis of accounting other than generally accepted accounting principles (GAAP) should disclose information regarding benefit obligations.
a. A statement of net assets available for benefits as of the end of the plan year (see paragraphs 4.29–4.69)

b. A statement of changes in net assets available for benefits for the year then ended (see paragraphs 4.70–4.79)

c. Information regarding the plan's benefit obligations as of the end of the plan year (see paragraphs 4.80–4.116)

d. Information regarding the effects, if significant, of certain factors affecting the year-to-year change in the plan's benefit obligations (see paragraphs 4.117–4.118)

4.25 Per FASB ASC 965-205-45-2, information about the benefit obligations should be presented in a separate statement, combined with other information on another financial statement, or presented in the notes to financial statements. Regardless of the format selected, the plan financial statements should present the benefit obligations information in its entirety in the same location. The information should be presented in such reasonable detail as is necessary to identify the nature and classification of the obligations.

Defined Contribution Health and Welfare Benefit Plan

4.26 In accordance with FASB ASC 965-205-10-2, the objective of financial reporting by a defined contribution health and welfare plan is to provide financial information that is useful in assessing the plan's present and future ability to pay its benefits. To accomplish that objective, a plan's financial statements should provide information about all of the following: (a) plan resources and the manner in which the stewardship responsibility for those resources has been discharged, (b) the results of transactions and events that affect the information about those resources, and (c) other factors necessary for users to understand the information provided. For example, vacation, holiday, and legal are typical plans whose benefits are limited to the balance in the participant’s account. FinREC notes that FSAs and HSAs also contain benefits that are limited to the balance in the participant’s account.
4.27 Per FASB ASC 965-205-45-3, the financial statements of a defined contribution health and welfare plan prepared in accordance with GAAP should be prepared on the accrual basis of accounting and include both of the following:

a. A statement of net assets available for benefits of the plan as of the end of the plan year (see paragraphs 4.29–4.69) 

b. A statement of changes in net assets available for benefits of the plan for the year then ended (see paragraphs 4.70–4.79).

4.28 FASB ASC 965-205-45-4 states that because a plan's obligation to provide benefits is limited to the amounts accumulated in an individual's account, information regarding benefit obligations is not applicable.

Net Assets Available for Benefits

Cash

4.29 Cash accounts are typically maintained for the payment of claims, insurance premiums, or other plan transactions. Noninterest-bearing cash balances of health and welfare benefit plans are not classified as an investment, but are typically shown as a separate line item on the financial statements.

4.30 FinREC recommends that investments in short-term, highly liquid investments, such as interest-bearing cash or overnight deposits be included as an investment rather than as a cash equivalent. The current Form 5500 also requires interest-bearing cash to be reported as an investment on Schedule H, line 4i—Schedule of Assets (Held At End of Year).

4.31 According to FASB ASC 230-10-15-4, a statement of cash flows is not required to be provided by a defined benefit pension plan that presents financial information in accordance with the provisions of FASB ASC 960. Other employee benefit plans that present financial information similar to that required by FASB ASC 960 (including the presentation of plan investments at fair value) also are not required to provide a statement of cash flows.

4.32 A definition of a cash equivalent need not be disclosed as required by FASB ASC 230-10-45-6 when a statement of cash flows is not presented.

Investments

4.33 Benefit plans may hold a wide array of investments, such as public and private common stock of domestic and foreign companies, preferred stock, domestic and foreign government bonds, corporate bonds, asset backed securities, including those issued by

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7 See footnote 2.
8 See footnote 5.
government agencies, guaranteed investment contracts, insurance contracts, real estate, and derivatives, as well as registered investment companies (for example, mutual funds), partnerships, common trusts, pooled insurance company separate accounts (PSAs), unit investment trusts, real estate investment trusts, and others. In addition, many of these investments are managed by an investment manager. However, due to the nature of a health and welfare benefit plan, certain plans may only hold cash and short-term investments, such as interest-bearing cash, money market accounts, repurchase agreements, and other short term investments.

4.34 According to FASB ASC 965-325-35-1, plan investments, whether they are in the form of equity or debt securities, real estate, or other investments (excluding insurance contracts) should be reported at their fair value at the financial statement date.9

4.35 As defined in the FASB ASC glossary, fair value of plan investments is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Although GAAP does not require disclosure of original cost of investments in the financial statements, original cost of investments is required to be disclosed on certain supplemental schedules to the Form 5500.

Practice Tip

Readers of this guide should refer to chapter 7, “Investments,” for a more in depth discussion of the investments unique to health and welfare benefit plans that are described in this chapter, as well as a discussion of investments not covered in this chapter.

4.36 Some of the more unique investment types or methods of holding investments for health and welfare benefit plans are discussed in the following sections:

   a. Common Funds
   b. Insurance Contracts
   c. Investment Contracts
   d. Master Trusts
   e. Trust Owned Life Insurance

Common Funds

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9 In accordance with FASB 965-320-25-1, the accrual basis of accounting requires that purchases of securities be recorded on a trade-date basis. However, if the settlement date is later than the financial statement date, and (a) the fair value of the securities purchased just before the financial statement date does not change significantly from the trade date to the financial statement date, and (b) the purchases do not significantly affect the composition of the plan's assets available for benefits, accounting on a settlement-date basis for such purchases is acceptable.
A common fund is a fund managed by a bank or entity with trust powers exclusively for the collective investment of assets from several trust accounts. Common trust funds are similar to open-end mutual funds but are not registered with the Securities and Exchange Commission (SEC); instead they are regulated by the Comptroller of the Currency. Health and welfare benefit plans and VEBA trusts are precluded from investing in bank-managed collective funds because all participants in a collective fund must be entities tax exempt under IRC Section 401(a) or public retirement systems. As such, common funds are used by trust departments to efficiently manage the assets of other clients (such as VEBA trusts, foundations, and endowments) through a commingled fund.

**Insurance and Investment Contracts**

The terms *insurance contract* and *investment contract* are used in this chapter as those terms are described for accounting purposes in FASB ASC 944, *Financial Services—Insurance*. See paragraphs 3.17–3.19 in this guide.

**Insurance Contracts**

According to FASB ASC 965-325-35-3, insurance contracts should be presented in the same manner as specified in the annual report filed by the plan with certain governmental agencies pursuant to ERISA; that is, either at fair value or at amounts determined by the insurance entity (contract value).

The current Form 5500 permits unallocated insurance contracts to be reported at either current value or as determined on the Schedule A to the Form 5500, *Insurance Information*, which is contract value. This is an exception to the general requirement of FASB ASC 965 that plan investments be presented at fair value. Plans not subject to ERISA should present insurance contracts as if the plans were subject to the reporting requirements of ERISA. See paragraphs 3.23–3.27 for a description of allocated and unallocated funding arrangements.

**Investment Contracts**

Investment contracts held by defined benefit health and welfare benefit plans should be reported at their fair values as stated in FASB ASC 965-325-35-2.

As noted previously in paragraph 4.03, defined contribution health and welfare benefit plans provide benefits that are limited to the amount contributed to the participant’s account, expenses, and any forfeitures allocated to the participant’s account. In such plans, plan participants have a vested interest in monitoring the financial condition and operations of the plan because they bear investment risk under these plans, and plan transactions can directly affect their benefits (for example, investment mix and risk and return).

**Fully Benefit-Responsive Investment Contracts**

According to FASB ASC 965-325-35-8, defined contribution health and welfare benefit plans should report fully benefit-responsive investment contracts (including derivative
contracts) at fair value. However, contract value is the relevant measurement attribute for that portion of the net assets available for benefits of a defined contribution health and welfare benefit plan attributable to fully benefit-responsive investment contracts. See paragraphs 2.32–2.35 for further guidance on fully benefit-responsive investment contracts.

**Master Trusts**

4.44 A master trust is a trust account made up of assets of some or all of the employee benefit plans of a company that sponsors more than one plan or a group of corporations under common control. Typically, each plan has an undivided interest in the assets of the trust, and ownership is represented by a record of proportionate dollar interest or by units of participation.

4.45 In accordance with FASB ASB 960-30-45-11, investments in master trusts are presented as a single line item in the statement of net assets available for benefits. See chapter 7 for further guidance on accounting and reporting investments held in master trusts.

**Practice Tip**

In practice, some employers have commingled the assets of multiple plans they sponsor without formally establishing a master trust agreement. Determination of the appropriate financial statement and Form 5500 reporting for such arrangements needs to be considered.

**Trust Owned Life Insurance**

4.46 Certain health and welfare plans invest in trust only life insurance (TOLI) investments administered by an insurance company. The TOLI is an investment vehicle designed to increase the tax efficiency of the plan’s investments through an arrangement that has the tax benefits of insurance and rate of returns and risk of mutual fund investments. The insurance company issues life insurance contracts on a portion of the plan participants in which the plan is the beneficiary of the contract. The insurance premiums are paid out of the investment in the TOLI to the insurance company, and the death payments are either reinvested in the TOLI or paid to the plan (at the plan’s discretion). Under the terms of these arrangements, the premiums paid to the insurance company (less certain fees) are held in a separate account by the insurance company to pay death benefits estimated to be paid during the year. At the end of each year, the insurance company calculates the actual amount that should have been charged in the previous year using the actual experience rate of the contract. This amount is compared to the amount held in the separate account, and the investment account is either increased for any amounts due the plan or deducted for any amounts due the insurance company.

4.47 Typically, the value of the TOLI investment is recorded at its cash surrender value, which may or may not be fair value. The cash surrender value of the TOLI is the value that could be received by the trust at the balance sheet date, if the contract were terminated. These contracts generally have no surrender charges and no significant withdrawal limitations.
other than it may take two to three weeks for the insurance company to cash out from the various investments.

**Presentation of Plan Investments**

4.48 In accordance with FASB ASC 965-325-45-1, information regarding a plan's investments should be presented in enough detail to identify the types of investments and should indicate whether reported fair values have been measured by quoted prices in an active market or have been determined otherwise (paragraphs 4.120–4.129 include additional disclosures related to investments).

4.49 FinREC recommends that defined benefit health and welfare benefit plans classify investments in one of two ways in the statement of net assets available for benefits. The employer may choose, but is not required, to use the classification of plan assets as reported in the employer's financial statements under “Pending Content” in FASB ASC 715-20-50-1 (see (a) that follows) or may classify such plan investments as recommended in FASB ASC 962-325-45-5 and FASB ASC 965-325-45-2 (see (b) that follows). FinREC believes that the classification as set forth in “Pending Content” in FASB ASC 715-20-50-1 is consistent with FASB ASC 820, *Fair Value Measurements and Disclosures*, and would also meet the requirements for disclosing plan investments by type under FASB ASC 960-325-45-1. The examples of classifications as described in “Pending Content” in FASB 715-20-50-1 provide a greater detail of investments by type than what is currently required under FASB ASC 962-325-45-5 and FASB ASC 965-325-45-2. If the health and welfare plan continues to classify investments in accordance with FASB ASC 965-325-45-2, then the plan needs to also comply with the fair value disclosure classifications for FASB ASC 820. The following are examples are ways to classify such investments:

   a. According to “Pending Content” in FASB ASC 715-20-50-1, an employer should disclose separately for pension plans and other postretirement benefit plans the fair value of each class of plan assets as of each date for which a statement of financial position is presented. Asset classes should be based on the nature and risks of assets in an employer’s plan(s). For additional guidance on determining appropriate classes of plan assets, see FASB ASC 820-10-50-2A. Examples of classes of assets could include, but are not limited to, cash and cash equivalents; equity securities (segregated by industry type, company size, or investment objective); debt securities issued by national, state, and local governments; corporate debt securities; asset-backed securities; structured debt; derivatives on a gross basis (segregated by type of underlying risk in the contract, for example, interest rate contracts, foreign exchange contracts, equity contracts, commodity contracts, credit contracts, and other contracts); investment funds (segregated by type of fund); and real estate. These examples are not meant to be all inclusive. An employer should consider the overall objectives in FASB ASC 715-20-50-1(d)(1) through 715-20-50-1(d)(5) in determining whether additional classes of plan assets or further disaggregation of classes should be disclosed.

   b. In accordance with FASB 962-325-45-5 and FASB ASC 965-325-45-2, the presentation of plan investments in the statement of net assets available for...
benefits detailed by general type may include government securities, short-term securities, corporate bonds, common stocks, mortgages, real estate, investments in bank common or collective trust funds, registered investment companies (for example, mutual funds), and investments in contracts with insurance companies, including separate accounts.

**Practice Tip**

Additional categories may include master trusts, deposit administration contracts, and immediate participation guarantee contracts.

### 401(h) Accounts

4.50 FASB ASC 965-205-45-6 states that certain retiree health benefits may be funded through a 401(h) account in a defined benefit pension plan, pursuant to Section 401(h) of the IRC. Refer to paragraphs 3.41–3.48 of this guide for a detailed discussion of 401(h) accounts. The 401(h) account assets and liabilities used to fund retiree health benefits, and the changes in those assets and liabilities, should be reported in the financial statements of the health and welfare benefit plan. According to FASB ASC 965-205-45-7, the 401(h) account assets and liabilities and changes in them can be shown in the health and welfare benefit plan financial statements in either of the following ways:

a. As a single line item on the face of the financial statements

b. Included in individual line items with separate disclosure in the footnotes about the 401(h) amounts included in those individual line items

4.51 In accordance with FASB ASC 965-205-45-8, if the assets and liabilities are shown as a single line item in the statement of net assets, the changes in net assets also should be shown as a single line item in the statement of changes in net assets. If the assets and liabilities are included in individual asset and liability line items in the statement of net assets, the changes in individual 401(h) amounts should be included in the changes in the individual line items in the statement of changes in net assets, with separate disclosure in the footnotes about the 401(h) amounts included in those individual line items. FASB ASC 965-205-50-2 states the notes to the financial statements should disclose the significant components of net assets and changes in net assets of the 401(h) account. FASB ASC 965-205-45-8 also states the 401(h) obligations should be reported in the health and welfare benefit plan’s statement of benefit obligations. Likewise, the health and welfare benefit plan’s statement of changes in benefit obligations should include claims paid through the 401(h) account.

4.52 In accordance with FASB ASC 965-205-50-3, if retiree health benefit obligations are funded partially through a 401(h) account of the defined benefit pension plan, the plan should also disclose the fact that the assets are available only to pay retiree health benefits. The notes to the financial statements should disclose the significant components of net assets and changes in net assets of the 401(h) account. Additionally, the notes should
include a reconciliation of amounts reported in the financial statements to the amounts reported in the Form 5500.

4.53 FASB ASC 965-205-50-4 states that because ERISA requires 401(h) accounts to be reported as assets of the pension plan, a reconciliation of the net assets reported in the financial statements to those reported in the Form 5500 is required for the health and welfare benefit plan.

**Practice Tip**

Any assets held for investment purposes in the 401(h) account should be shown on Schedule H, line 4i—Schedule of Assets (Held at End of Year) and Schedule H, line 4j—Schedule of Reportable Transactions for the pension plan (as applicable).

**Contributions and Contributions Receivable**

4.54 Contributions made to a health and welfare benefit plan can come from employer contributions, participant contributions (for example, active or inactive employees, retirees, or COBRA participants) or a combination.

4.55 According to FASB ASC glossary, contributions receivable are the amounts due, as of the date of the financial statements, to the plan from employers, participants, and other sources of funding (for example, state subsidies or federal grants), each of which should be separately identified as required by FASB ASC 965-310-45-1. Contributions receivable include amounts due pursuant to firm commitments, as well as legal or contractual requirements. Per FASB ASC 965-310-25-1, with respect to employer contributions recognized pursuant to a formal commitment, evidence of such a commitment may include any of the following: (a) a resolution by the employer's governing body approving a specified contribution; (b) a consistent pattern of making payments after the end of the plan year, pursuant to an established funding policy that attributes such subsequent payments to the preceding plan year; (c) a deduction of a contribution for federal income tax purposes for periods ending on or before the financial statement date; or (d) the employer's recognition as of the financial statement date of a contribution payable to the plan. According to FASB ASC 965-310-35-1, contributions receivable should include an allowance for estimated uncollectible amounts.

4.56 Defined benefit health and welfare benefit plans typically pay claims on a pay-as-you-go-basis. Participants may pay a portion of the claims but, typically, a significant portion of the claims are funded by the plan or the plan sponsor. Benefit obligations recorded as of

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10 The existence of an accrued liability in the employer's statement of financial position or a plan's benefit obligations exceeding its net assets available for benefit obligations does not, by itself, provide sufficient support for recognition of a contribution receivable by the plan.

11 Generally, a plan sponsor contributes to the plan as claims are due to be paid by the plan to reimburse claims paid by a third-party administrator rather than prefunding the plan.
the plan year-end include claims payable, incurred but not reported claims (IBNR), premiums due to insurance companies, postemployment benefits, accumulated eligibility credits, and postretirement benefits. Unlike a defined benefit pension plan or defined contribution pension plan, often health and welfare benefit plans have few investments because claims are funded as needed.

4.57 For defined benefit health and welfare benefit plans, FinREC recommends that a receivable from the employer be accrued equal to the liability for claims IBNR for participant claims if, as of the date of the financial statements, there is a legal or contractual requirement for the employer to fund the specific amount. This legal or contractual requirement generally does not exist for single employer plans.

Other Receivables

4.58 Health and welfare plans can have other receivables, including those associated with contractual relationships. Whether a rebate or refund is due, the employer or the plan is determined based upon the service provider agreements. See paragraph 4.59 for a discussion of rebates and refunds receivable and paragraph 4.60 for a discussion of receivables due to subsidies. Some examples of other receivables include the following:

- Investment related receivables, such as the following:
  - Interest and dividend income
  - Securities lending income
  - Due from brokers for securities sold
  - Derivative related activity (for example, receivable for variation margin and foreign currency forward contracts)
- Fee reimbursements (for example, from plan sponsor or service providers)
- Prescription drug rebate programs
- Refunds (for example, duplicate claims or favorable experience-rated insurance contract adjustments)
- Recoveries (for example, receivable from subrogation, spousal coverage, automobile insurance)
- Amounts due from plan sponsors or others relating to operational defects
- Reimbursements for nonexempt transactions
- Legal settlements
- Government subsidies

Refunds or Rebates

4.59 When a rebate or refund from service providers is contractually due to the plan, FinREC recommends that such rebates or refunds be recorded as plan assets if collection is probable, and the amount can be reasonably estimated. If the amount cannot be reasonably estimated, such amounts should be recorded when received with appropriate disclosure. If the associated benefit has been paid, rebates and refunds should be recorded as an offset to
benefit payments or premium payments, as applicable, with appropriate disclosure. In circumstances in which the employer is contractually due the rebate or refund, the plan should consider disclosing the existence of such programs.

**Subsidies**

4.60 When a plan sponsor has a health and welfare benefit plan, the benefits may qualify for certain subsidies from a government agency. The subsidy may be paid in various ways (for example, directly to the plan sponsor rather than the plan or as a deduction on the plan sponsor’s payroll tax return). Each subsidy should be evaluated separately. If the subsidy is legally due the plan, the recording of a receivable may be appropriate. The primary objective of the financial statements of a 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 when due. Therefore, an amount to be paid to the plan sponsor that does not reduce the amount of benefits that need to be covered by the plan’s assets and future employer contributions should not be reflected in the plan’s financial statements. If the plan sponsor is not required to use the amount due back to fund benefits and may use the subsidy for any valid business purpose, the amount should not be recorded as a receivable on the plan’s financial statements.

**Deposits With and Receivables From Insurance Companies and Other Service Providers**

4.61 Per FASB ASC 965-310-25-2, whether a premium paid to an insurance entity represents payment for the transfer of risk or merely represents a deposit will depend on the circumstances of the arrangement. The nature of payments made to an insurance entity should be analyzed to determine the extent to which financial risk has been transferred from the plan to the insurance entity. Insurance entities may require that a deposit be maintained that can be applied against possible future losses in excess of current premiums.

4.62 Per FASB ASC 965-310-25-3, these deposits should be reported as plan assets until such amounts are used to pay premiums. Similarly, premium stabilization reserves, which exist when premiums paid to an insurance entity exceed the total of claims paid, and other charges are held by an insurance entity and used to reduce future premium payments. Premium stabilization reserves generally should be reported as assets of the plan until such amounts are used to pay premiums. If such reserves are forfeitable when the insurance contract terminates, this possibility should be considered in recognizing this asset.

4.63 FASB ASC 965-310-50-1 requires the nature of payments made to insurance entities to be disclosed for both of the following:

   a. Deposits required to be maintained to be applied against future losses in excess of current premium
   b. Premium stabilization reserves

4.64 According to FASB ASC 965-10-05-8, certain group insurance contracts covering health and welfare benefit plans include a provision for a refund at the end of the policy year of
the excess of premiums paid over the total of paid claims, required reserves, and the fee charged by the insurance entity. Often, such experience-rating refunds (or dividends) are not determined by the insurance entity for several months after the end of the policy year. Per FASB ASC 965-310-25-3, in the case of experience-rating refunds, and in cases when the policy year does not coincide with the plan's fiscal year, the refund due as of the financial statement date should be reported as a plan asset if it is probable that a refund is due, and the amount can be reasonably estimated. FASB ASC 965-310-50-2 requires that if the amount of the refund due from an insurance entity for experience-rating cannot be reasonably estimated, that fact should be disclosed.

4.65 According to FASB ASC 965-310-40-1, service providers may require that deposits by the plan be applied against claims paid on behalf of plan participants. Such deposits should be reported as plan assets until the deposit is applied against paid claims.

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**Practice Tip**

It may be necessary to report the deposit as an investment on the Form 5500 supplemental schedule of assets (Held at End of Year) if the deposit account earns interest.

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**Operating Assets**

4.66 According to FASB ASC 965-360-35-1, plan assets used in plan operations should be reported at cost less accumulated depreciation or amortization and may consist of any of the following:

- Buildings
- Equipment
- Furniture and fixtures
- Leasehold improvements

4.67 FASB ASC 360, *Property, Plant, and Equipment*, addresses accounting for the impairment of long-lived assets for assets to be held and used and assets to be disposed of. FASB ASC 360-10-35-21 requires that long-lived assets to be held and used by the plan, such as real estate owned by the plan for plan operations, be tested for recoverability whenever events or changes in circumstances indicate that the carrying amount may not be recoverable. Long-lived assets to be abandoned or exchanged for a similar productive asset should be considered held and used until disposed of. FASB ASC 360-10-35-43 states that long-lived assets classified as held for sale should be measured at the lower of its carrying amount or fair value less cost to sell. A long-lived asset should not be depreciated while it is held for sale. See FASB ASC 360 for further accounting and disclosure requirements.

**Accrued Liabilities**

4.68 A plan may have liabilities (other than for benefits) that should be accrued, in accordance with FASB ASC 965-20-25-1. Such liabilities may include the following:
• Accrued expenses (for example, fees for third-party administrators, claims processing, investment management, trustee, recordkeeping, actuarial, and other professionals incurred during the period).
• Amounts owed for securities purchased or other investment-related payables
• Obligations to return securities lending collateral
• Derivative-related payables
• Income taxes payable by the plan
• Amounts due to the plan sponsor (for example, the reimbursement of plan expenses as permitted by the plan document)
• Amounts due to third-party administrators on behalf of the plan

4.69 The total amount of claims payable (benefit claims that have been processed and approved for payment, but not paid), premiums payable and claims IBNR are included in the “Amounts Currently Payable” section of the plan’s statement of obligations or in the footnotes. As such, these amounts should not be accrued as liabilities on the plan’s statement of net assets. Such obligations would, however, be recorded as liabilities in the plan’s Form 5500, thereby creating the need for a reconciliation of net assets and changes therein between the financial statements and the Form 5500 and included in the footnotes to the plan’s financial statements. See paragraph 4.120(l) for further discussion of reconciling items to Form 5500.

Changes in Net Assets Available for Benefits

4.70 According to FASB ASC 965-20-45-3, the statement of changes in net assets available for benefits should be presented in enough detail to identify the significant changes during the year, including, as applicable, the following:

a. Contributions from employers segregated between cash and noncash contributions. FASB ASC 965-20-30-1 requires a noncash contribution to be recorded at fair value at the date of the contribution.

b. The nature of noncash contributions described either parenthetically or in the notes to the financial statements.

c. Contributions from participants, including those collected and remitted by the plan sponsor.

d. Contributions from other identified sources (for example, state subsidies or federal grants).

e. The net appreciation or depreciation in fair value for each significant class of investments, segregated between investments whose fair values have been measured by quoted prices in an active market and those whose fair values have been otherwise determined. Net appreciation includes realized gains and losses on investments that were both purchased and sold during the period.

Practice Tip
Consistent with FASB ASC 962-205-45-7, FinREC believes that gains and losses from investments sold need not be segregated from unrealized gains and losses relating to investments held at year-end. This information may be presented in the accompanying footnotes. Ordinarily, information regarding the net appreciation or depreciation in the fair value of each significant class of investments is found in the notes to the financial statements.

\textit{f.} Investment income, excluding the net appreciation or depreciation.

Certain registered investment companies and other investment funds pay dividends or capital gain distributions that are reinvested into the plan. FinREC recommends dividends be considered investment income and shown separately from changes in fair value. FinREC recommends capital gain distributions be considered either investment income and shown separately from changes in fair value or included as part of the net change in fair value. “Participant-directed” and “self-directed” are considered investment programs and, therefore, such presentation relates to their underlying investments.

\textit{g.} Income taxes paid or payable, if applicable.

\textit{Practice Tip:} For example, unrelated business income tax expense.

\textit{h.} Payments of claims, excluding payments made by an insurance entity pursuant to contracts that are excluded from plan assets.

\textit{i.} Payments of premiums to insurance entities to purchase contracts that are excluded from plan assets.\textsuperscript{12}

\textit{j.} Operating and administrative expenses.

\textit{Practice Tip}

See DOL Advisory Opinion No. 2001-01A for guidance on reasonable expenses of administering the plan and paragraph 4.77.

\textit{k.} Other changes (such as transfers of assets to or from other plans), if significant.

\textbf{4.71} Per FASB ASC 965-20-45-4, the list of minimum disclosures is not intended to define the degree of detail or the manner of presenting the information, and subclassifications or additional classifications may be useful.

\textbf{4.72} FinREC recommends that the following items also be presented separately, if they are significant:

- Other employer contributions or other income, including fee income from securities loaned and from miscellaneous sources, such as reimbursements for lost income or operational defects

\textsuperscript{12} Refer to paragraphs 7.52–7.58 for further discussion of allocated insurance contracts.
• Other expenses, such as interest expense on debt or short sales, bank borrowings, margin accounts, and reverse repurchase agreements
• Transfers of assets to or from other plans, including transfers associated with mergers and spinoffs (see paragraphs 4.130–4.131)

Stop Loss

4.73 As defined in appendix 4B, the insurance company assumes the benefit obligation in excess of the defined limits. Consistent with the presumption of the reporting entity, FinREC recommends that capturing all activity associated with providing the health program is most meaningful to financial statement users, and that in order for financial statement users to fully understand the costs of such health programs and to appropriately reflect the true plan obligations, amounts due from stop-loss insurers should be included in the plan’s financial information.

4.74 As such, FinREC recommends that stop-loss premiums paid, whether paid by the plan or plan sponsor, be recorded as an expense of the plan. Stop-loss amounts due to the plan or trust from insurers should be recorded as an asset with a corresponding offset to benefit payments if the benefit has been paid. Appropriate disclosure should be made regarding the amount of stop-loss recoveries that have been netted against benefits paid.

4.75 Although not common place, FinREC recognizes that there may be instances when recording stop loss activity in the plan’s financial statement may not be appropriate given the numerous variations and extensions of coverage that are available in the marketplace. Amounts payable to the plan sponsor that do not reduce the amount of benefits that need to be covered by the plan’s assets and future employer contributions, may not need to be reflected in the plan’s financial statements. In such circumstances, the plan should consider disclosure of the existence of such stop-loss arrangements and the fact that the plan’s financial statements do not reflect any amounts associated with such arrangements.

4.76 Numerous factors should be considered when determining if such activity should be included in the plan’s financial statements including, but not limited to, the following:
• How the document is written (individual vs. aggregate coverage)
• How the amounts are reimbursed (for example, to the plan sponsor or through the claims processor)
• Who the named insured is (for example, the plan sponsor or plan)
• Who is entitled to receive the reimbursement (plan or plan sponsor)

Plan Expenses

4.77 Certain expenses may be paid on behalf of the plan by the plan sponsor. Health and welfare benefit plans may pay administrative and investment-related expenses if the plan document allows for such payments. Payment of improper expenses by the plan is a breach of fiduciary duties and may be considered a nonexempt transaction. For example, expenses incurred relating to the formation of the plan (such as settlor functions) would not be considered reasonable expenses for the plan. Settlor functions include decisions
relating to the formation, design, and termination of the plan. Expenses incurred related to implementing settlor decisions may be reasonable expenses of the plan. See the DOL-issued publication *Understanding Retirement Plan Fees and Expenses* and the DOL Advisory Opinion No. 2001-01A to better understand and evaluate plan fees and expenses.

4.78 In certain instances, it may be difficult to understand the nature of the plan expenses because they are often netted against income or there may be other arrangements resulting in expenses not being apparent on the service provider statements. Plan expenses may be paid from plan assets as permitted by the plan document. The policy for paying such expenses should be applied consistently from year to year. See paragraph 4.121a) for guidance on the financial statement disclosures related to expenses.

4.79 Typical allowable plan expenses may include the following:

- Investment management fees
- Trustee or custodial fees
- Claims processing fees
- Recordkeeping and compliance fees
- Professional fees (such as auditing, attorney, actuarial, and consulting fees)
- Operating expenses (such as provider access fees, preferred provider organization (PPO) network fees, pharmacy benefit manager (PBM) administration expenses, expenses for medical reviews and second opinions, HIPAA, and compliance fees)
- Reimbursement of plan sponsor direct costs, such as plan administrative salaries and other administrative expenses subject to applicable ERISA rules and regulations
- Other fees, for example, trustee meetings and expenses, office supplies, printing and mailing expenses

**Benefit Obligations**

4.80 Per FASB ASC 965-30-35-1, benefit obligations for single-employer, multiple-employer, and multiemployer defined benefit health and welfare plans should include the actuarial present value, as applicable, for all of the following:

- Claims payable, claims IBNR, and premiums due to insurance entities

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13 Plan sponsors may want to consult with legal counsel when determining whether fees are considered settlor fees.

14 Per FASB ASC 965-30-35-2, administrative expenses expected to be paid by the plan (but not those paid directly by the plan’s participating employer(s)) that are associated with providing the plan’s benefits should be reflected either by including the estimated costs in the benefits expected to be paid by the plan or by reducing the discount rate(s) used in measuring the benefit obligation. According to FASB ASC 965-30-50-7, if the latter method is used, the resulting reduction in the discount rate(s) should be disclosed.
• Accumulated eligibility credits and postemployment benefits, net of amounts currently payable

• Postretirement benefits for the following groups of participants:  
  — Retired plan participants, including their beneficiaries and covered dependents, net of amounts currently payable and claims IBNR  
  — Other plan participants fully eligible for benefits  
  — Plan participants not yet fully eligible for benefits

4.81 According to paragraphs 3–7 of FASB ASC 965-30-35, aggregating claims payable and claims IBNR is often appropriate if adequate time has passed to provide sufficient data on costs incurred, and the actuarially determined expected cost of long-term medical claims is insignificant. Benefits expected to be earned for future service by active participants (for example, vacation benefits) during the term of their employment should not be included. Benefit obligations should be reported as of the end of the plan year.  

The effect of plan amendments should be included in the computation of the expected and accumulated postretirement benefit obligations once they have been contractually agreed to, even if some provisions take effect only in future periods. For example, if a plan amendment grants a different benefit level for employees retiring after a future date, that increased or reduced benefit level should be included in current-period measurements for employees expected to retire after that date.

4.82 FASB ASC 965-30-45-1 requires that to the extent they exist, the amounts of benefit obligations in each of the three major classifications previously identified should be shown as separate line items in the financial statements or notes to financial statements. Regardless of the format selected, the plan financial statements should present the benefit obligations information in its entirety in the same location. For negotiated plans, FASB

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15 In accordance with FASB ASC 965-30-35-1(a), claims IBNR may be computed in the aggregate for active participants and retirees. Alternatively, if claims IBNR are not calculated in the aggregate for active participants and retirees, the claims for retirees are recorded in the postretirement benefit obligation.

16 See footnote 15.

17 See footnote 15.

18 According to FASB ASC 965-30-35-6, the financial status of the plan considers assets and obligations as of the same date. Because plan assets are required to be presented as of the plan's year end, the benefit obligations also should be measured and presented as of the plan's year end. That requirement does not, however, preclude the plan from using the most recent benefit obligations valuation rolled forward to the plan's year end to account for subsequent events (such as employee service and benefit payments), provided that it is reasonable to expect that the results will not be materially different from the results of an actuarial valuation as of the plan's year end. In rolling forward the benefit obligations to the plan's measurement date, the discount rates should be adjusted as appropriate to reflect current rates of return on high quality, fixed-income investments. For example, if a valuation was performed at September 30 and the plan has a calendar year-end, the benefit obligations as of September 30 should be rolled forward to December 31 by making appropriate adjustments, such as for additional employee service; the time value of money; benefits paid; and changes in the number of participants, actuarial assumptions, discount rates, per capita claims costs, and plan terms.
ASC 965-30-50-3 states that benefit obligations due during a plan’s contract period may, but need not, be disclosed.

Claims

4.83 According to FASB ASC 965-30-45-2, in an insured health and welfare benefit plan, claims payable and currently due, and claims incurred but not yet reported to the plan, will be paid by the insurance entity. Consequently, they should be excluded from the benefit obligations of the plan. Benefit obligations of a self-funded plan should present the amount of both of the following:

- Claims payable and claims currently due for active and retired participants, dependents, and beneficiaries
- IBNR claims for active participants

4.84 According to FASB ASC 965-30-45-3, IBNR claims for retired participants are included in the postretirement benefit obligation, if separately calculated in accordance with FASB ASC 965-30-35-1(a) (see also footnote 16 in this chapter).

4.85 For a self-funded plan, claims payable represents claims processed and approved for payment but not paid as of year-end. Claims IBNR includes claims that have occurred but have not been reported, including claims that are being processed but have not yet been approved.

4.86 According to FASB ASC 965-30-35-1A, for a self-funded plan, the cost of IBNR claims should be measured at the present value, as applicable, of the estimated ultimate cost to the plan of settling the claims. Estimated ultimate cost shall reflect the plan’s obligation to pay claims to or for participants, regardless of status of employment, beyond the financial statement date pursuant to the provisions of the plan or regulatory requirements.

4.87 Claims IBNR can be calculated by the plan sponsor, actuary, and claim processor or a third-party administrator. Claims IBNR is normally estimated based on historical claims data and industry trends and should be measured at the present value, as applicable, of the estimated ultimate cost to the plan of settling the claims (including those associated with terminal diseases and catastrophic accidents) beyond the measurement date pursuant to the plan’s provisions and regulatory requirements, regardless of employment status. The ultimate cost to the plan may be limited by factors, such as the maximum coverage specified in the plan document, stop-loss coverage, and Medicare.

4.88 For example, an individual contracts a terminal disease or has a catastrophic accident in December. The claim is reported subsequent to year-end. Treatment is ongoing and is expected to continue throughout the next year. The plan does not require any return to work and will fully cover all services. The actuarial present value of the obligation for all future payments to be made as of the plan year-end should be included as a benefit obligation in IBNR.

4.89 Understanding cash activity regarding claims processing is critical to determining the appropriate accounting and reporting for claims paid from these cash accounts. For
example, it is important to identify the existence and ownership of any accounts controlled by claims processors that hold cash deposits of the plan. Claims processors may require customers to provide an initial deposit or a zero balance account to provide adequate funds as claims are paid and checks clear. Any amounts on deposit should be recorded as a plan asset (see paragraph 4.62 and the practice tip in paragraph 4.65).

4.90 Determining when to record claims paid from cash accounts that are owned by the claims processor depends on the accounting policy established by plan management. If plan management has established an accounting policy to record claims as they are paid to participants or providers, then claims paid by the claims processor are typically recorded as claims when paid by the claims processor, and the plan records an accrued liability to reimburse the claims processor for any claims paid on behalf of the plan that were not reimbursed to the claims processor prior to year-end. If plan management has established an accounting policy to record claims when submitted to the plan by the claims processor for reimbursement, then claims paid by the claims processor prior to year-end that are not reimbursed by the plan as of year-end are typically recorded as claims payable (a benefit obligation) and are not recorded as claims until the plan reimburses the claims processor. Regardless of which accounting policy is established, FinREC recommends that the plan’s accounting policy with respect to recording claims should be disclosed in the financial statements and applied on a consistent basis.

**Premiums Due Under Insurance Arrangements**

4.91 Benefits to participants may be provided through insurance arrangements that transfer the risks of loss or liability to an insurance company (see paragraph 4.17). Group insurance contracts for health and welfare benefit plans are usually written for a one-year period, although the contract may provide for annual renewals. The contract generally specifies, among other things, the schedule of benefits, eligibility rules, premium rate per eligible participant, and the date that premiums are due. According to FASB ASC 965-30-25-2, the benefit obligations should include any obligation for premiums due, but not paid, under insurance arrangements.

4.92 Per FASB ASC 965-30-35-13, if the insurance contract requires payment of additional premiums, such as retrospective premiums, when the loss ratio exceeds a specified percentage, an obligation for the estimated additional premiums should be included in the benefit obligations.

4.93 Per FASB ASC 965-30-25-5, experience ratings determined by the insurance entity or by estimates (for example, in fully insured, experience-rated arrangements) may result in a premium deficit. Premium deficits should be included in the benefit obligations if both of the following criteria are met: (a) it is probable that the deficit will be applied against the amounts of future premiums or future experience-rating refunds, and (b) the amount can be reasonably estimated. According to FASB ASC 965-30-50-4, if no obligation is included for a premium deficit under insurance arrangements because either or both of the

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19 In accordance with FASB ASC 965-30-45-5(a), this determination should consider (a) the extent to which the insurance contract requires payment of such deficits, and (b) the plan's intention, if any, to transfer coverage to another insurance entity.
conditions are not met, or if an exposure to loss exists in excess of the amount accrued, disclosure of the premium deficit should be made if it is reasonably possible that a loss or an additional loss has been incurred.

**Accumulated Eligibility Credits**

4.94 In many industries (for example, the entertainment and building trades industries), the amount of hours an employee works are not uniform throughout the year. In some months, employees work overtime hours, and in other months, they may not work at all. According to FASB ASC 965-30-35-12, health and welfare benefit 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.

*Practice Tip*

These eligibility credits or hours are commonly referred to as a *bank* of hours. The bank of hours is created by crediting a participant for hours worked in prior periods in excess of the minimum hours required to receive benefits. If a plan participant does not work the sufficient number of hours in a given period to receive a benefit, the bank of hours for that employee is typically charged for the hours necessary to make up the shortage.

4.95 According to FASB ASC 965-30-35-12, at the financial statement date, accumulated eligibility credits represent an obligation of the plan arising from prior employee service for which employer contributions have been received. This benefit obligation is generally determined by applying current insurance premium rates to accumulated eligibility credits or, for a self-funded plan, by applying the average cost of benefits per eligible participant to accumulated eligibility credits. In either case, the obligation for accumulated eligibility credits should consider assumptions for mortality and expected employee turnover, or other appropriate adjustments, to reflect the obligation at the amount expected to be paid.

**Postemployment Benefits**

4.96 According to FASB ASC 965-30-25-3, plans that provide postemployment benefits should recognize a benefit obligation for current participants based on amounts expected to be paid in subsequent years, if all the following conditions are met:

- a. The participants’ rights to receive benefits are attributable to services already rendered.
- b. The participants’ benefits vest or accumulate.\(^{20}\)
- c. Payment of benefits is probable.

\(^{20}\) In accordance with FASB ASC 965-30-25-3(b), for example, the supplemental unemployment benefit is 52 weeks’ pay if a participant worked 3 years; 78 weeks’ pay if a participant worked 5 years; and 104 weeks’ pay if a participant worked 7 years. In this situation, the benefits would be considered accumulating. Benefits that increase solely as a function of wage or salary increases are not considered accumulating.
d. The amount can be reasonably estimated.

4.97 Per FASB ASC 965-30-35-9, the postemployment benefit obligation should be measured as the actuarial present value of the future benefits attributed to plan participants’ services rendered to the measurement date, reduced by the actuarial present value of future contributions expected to be received from the current plan participants. That amount represents the benefit obligation that is to be funded by contributions from the plan’s participating employer(s) and from existing plan assets. The obligation is to be measured assuming the plan continues in effect, and all assumptions about future events are met. Any anticipated forfeitures or integration with other related programs (for example, state unemployment benefits) should be considered. The benefit obligation should be discounted using rates of return on high quality, fixed-income investments currently available with cash flows that match the timing and amount of expected benefit payments and expected participant contributions.

4.98 According to FASB ASC 965-30-25-4, for postemployment benefits that do not meet conditions (a) and (b) of paragraph 4.96, the plan should recognize a benefit obligation if the event that gives rise to a liability has occurred, and the amount can be reasonably estimated. For example, if all participants receive the same medical coverage upon disability regardless of length of service (the benefits do not accumulate) and the benefits do not vest, medical benefits for disabled participants should be accrued at the date of disability and not over the participants’ working lives.

4.99 FASB ASC 965-30-35-10 states that when participant contributions are required after the event triggering postemployment benefit occurs, the postemployment benefit obligation should be measured in a manner consistent with paragraph 4.98. As a result, in those situations, the benefit obligation should represent the amount that is to be funded by contributions from the participating employer(s) and from existing plan assets.

4.100 Per FASB ASC 965-30-50-2, if an obligation for postemployment benefits is not recognized in accordance with paragraphs 4.97–4.99 only because the amount cannot be reasonably estimated, the financial statements should disclose that fact.

4.101 Many plans require that participants pay the estimated full cost of health benefits provided under COBRA. In such situations, the plan would not recognize a postemployment obligation provided the premiums cover the claims and related costs incurred. If the plan sponsor subsidizes the cost of health benefits provided under COBRA, a postemployment obligation should be recognized by the plan to the extent that all criteria required by FASB ASC 715 and FASB ASC 712, as applicable, are satisfied.

4.102 As illustrated by a similar example in FASB ASC 712-10-25-5, in the event that health benefits provided under COBRA are self-insured, FinREC recommends that the cost of those postemployment benefits be recognized when the event causing the plan to become obligated to pay COBRA benefits occurs, and a reasonable estimate can be made. COBRA benefits typically become a postemployment obligation of the plan when the participant terminates employment and enrolls in COBRA benefits. Depending on how the obligation for claims IBNR is estimated, a portion of the COBRA obligation may be
included in the obligation for claims IBNR; however, this obligation will typically not include the entire postemployment obligation for COBRA. For example, the postemployment obligation for COBRA benefits should include the employer’s portion of the claims expected to be incurred and paid for all participants on COBRA as of the plan’s year-end through the date their COBRA benefits cease. Any claims incurred after the plan’s year-end for these participants would not be included in the obligation for claims IBNR. It is important for plan sponsors to ensure claims IBNR for postemployment have been properly included in the obligations reported (that is, that it has not been double-counted or omitted entirely) and consider disclosure of where it has been recorded.

4.103 Care should be taken to not double-count these claims in the obligation for claims IBNR and postemployment obligations.

Postretirement Benefit Obligations

4.104 According to FASB ASC 965-30-35-15, health and welfare benefit plans may continue to provide benefits to participants after retirement (postretirement benefits). Those benefits may commence immediately upon termination of service, or payment may be deferred until the participant attains a specified age. If a plan provides postretirement benefits to participants, an estimated amount for those benefits, as described in the following paragraph, should be included in the benefit obligation.

Practice Tip

This may be either in the active participants plan or in a separate retiree plan.

4.105 Per FASB ASC 965-30-35-16, the postretirement benefit obligation as of the measurement date is the actuarial present value of all future benefits attributed to plan participants’ services rendered to that date, assuming the plan continues in effect, and all assumptions about future events are fulfilled. Postretirement benefits comprise benefits expected to be paid to or on behalf of any of the following, who are expected to receive benefits under the health and welfare benefit plan:

- A retiree or active participant
- A terminated participant
- A beneficiary or covered dependent

4.106 Per FASB ASC 965-30-35-17, postretirement benefits expected to be paid to or for an active participant, a beneficiary, or a covered dependent who is still earning their postretirement benefits (that is, one who is not yet fully eligible) should be measured over the participant's credited period of service up to the date when full eligibility for benefits is attained.\(^\text{21}\)

\(^\text{21}\) Per FASB ASC 965-30-35-18, for example, if a participant has worked 8 years and must work another 16 to be fully eligible for benefits after retirement, one-third of the postretirement benefits have been earned and should be included in the postretirement benefit obligation if it is probable that the employee will work the remaining 16 years.
4.107 As discussed in paragraph 4.80, claims IBNR may be computed in the aggregate for active participants and retirees. Alternatively, if claims IBNR are not calculated in the aggregate for active participants and retirees, the claims IBNR for retirees are included in the postretirement benefit obligation. It is important for plan sponsors to determine that claims IBNR for retirees have been properly reported, have not been double-counted or omitted entirely, and consider disclosure regarding where they are recorded.

4.108 According to FASB ASC 965-30-35-19, if a multiemployer health and welfare benefit plan provides postretirement benefits, the benefit obligation should include the postretirement benefit obligation. Consideration should be given to the promises currently made to employees and the history of making such payments to retirees. The fact that benefits may be reduced or even potentially eliminated would not ordinarily affect the promise made as of the end of the plan year unless the change meets the substantive plan criteria of FASB ASC 715-60, (for example, an amendment is in place or has been communicated to employees). The fact that the contributing employers of a multiemployer plan do not record a similar obligation under FASB ASC 715 does not affect the accounting for the obligations by the plan.

4.109 According to FASB ASC 965-30-35-20, the postretirement benefit obligation should be measured using the plan’s written provisions, to the extent possible, as well as the substantive plan if it differs from the written plan. In many health and welfare benefit plans, postretirement benefits are not defined as a specified amount for each year of service. FASB ASC 715-60-35 describes the measurement of the postretirement benefit obligation. For multiemployer plans that do not have date-of-hire information as required by FASB ASC 715-60-35-66, reasonable estimates thereof should be used to measure the obligation. Death or disability benefits provided outside of a pension plan, if the employee is considered to be retired, should also be included in the calculation of the postretirement benefit obligation. Benefits that are provided through an insurance contract should be excluded. 22

Practice Tip

The postretirement benefit obligation is measured as of the plan’s year-end.

4.110 According to FASB ASC 965-30-35-21, in measuring the postretirement benefit obligation, explicit assumptions should be used, each of which represents the best estimate of a particular future event. All assumptions should presume that the plan will continue in its present form unless evidence to the contrary exists. Principal actuarial assumptions used should include all of the following:

22 In accordance with FASB ASC 965-30-35-20, insured plans should be reviewed carefully to determine the extent to which postretirement benefits are insured. Currently, except for single-premium life insurance contracts, few, if any, insurance contracts unconditionally obligate an insurance entity to provide most forms of postretirement benefits.
• 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)

4.111 Per FASB ASC 965-30-35-22, the postretirement benefit obligation information should include the following classifications:
• Obligations related to retired plan participants, including their beneficiaries and covered dependents
• Obligations related to active or terminated participants who are fully eligible to receive benefits
• Obligations related to other plan participants not yet fully eligible for benefits

4.112 FASB ASC 965-30-50-1 states that separate disclosure for each classification for each significant benefit (for example, medical and death) may be appropriate.

Medicare Prescription Drug, Improvement, and Modernization Act of 2003

4.113 FASB ASC 715-60 addresses when and how an employer that provides postretirement prescription drug coverage should recognize the effects of the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the Medicare Act), but does not address the accounting for the subsidy by the health and welfare benefit plan itself. The following AICPA Technical Questions and Answers (TIS) provide guidance on accounting and disclosures for single employer and multiemployer employee benefit plans related to the Medicare Act.

• TIS section 6931.06, “Accounting and Disclosure Requirements for Multiemployer Employee Benefit Plans Related to the Medicare Prescription Drug, Improvement, and Modernization Act of 2003” (AICPA, Technical Practice Aids)

Recognition of Plan Events

4.114 According to FASB ASC 965-30-35-7, the effect of plan amendments should be included in the computation of the expected and accumulated postretirement benefit obligation
once they have been contractually agreed to, even if some provisions take effect only in future periods.

4.115 As shown in the following table, plan amendments adopted before the measurement date of the actuarial valuation should be given effect in the valuation, even if some provisions take effect only in future periods. For example, a plan amendment may provide for a change in benefits that includes a retroactive component, and it may also include provisions to increase benefits in future plan years. Plan amendments adopted after the measurement date of the valuation should be excluded.

<table>
<thead>
<tr>
<th>Effective Date</th>
<th>Amendments adopted within reporting year</th>
<th>Amendments adopted after the reporting year</th>
</tr>
</thead>
<tbody>
<tr>
<td>Effective date within the reporting year</td>
<td>Effect of amendment should be included in benefit obligations presented as of the end of the reporting year.</td>
<td>Effect of amendment should not be included in benefit obligations presented as of the end of the reporting year.</td>
</tr>
<tr>
<td>Effective date after the reporting year</td>
<td>Effect of amendment should be included in benefit obligations presented as of the end of the reporting year.</td>
<td>Effect of amendment should not be included in benefit obligations presented as of the end of the reporting year.</td>
</tr>
</tbody>
</table>

4.116 Certain events occurring after the reporting year should not be reflected in the benefit obligation presented as of the end of the reporting year. For example, if the sponsor terminated the employment of certain employees subsequent to year-end, the associated postretirement benefit obligation would not be reduced. However, disclosure of such events may be appropriate.

Changes in Benefit Obligations

4.117 According to FASB ASC 965-30-45-4, information regarding changes in the benefit obligations within a plan period should be presented to identify significant factors affecting year-to-year changes in benefit obligations. Per FASB ASC 965-30-45-5, changes in each of the three major classifications of benefit obligations should be presented in the body of the financial statements or in the notes to the financial statements; the information may be presented in either a reconciliation or narrative format. Providing such information in the following categories will generally be sufficient: (a) claims payable, claims IBNR, and premiums due to insurance entities; (b) accumulated eligibility credits and postemployment benefits, net of amounts currently payable; and (c) postretirement benefits for the following:

- Retired plan participants, including their beneficiaries and covered dependents, net of amounts currently payable and claims IBNR
- Other plan participants fully eligible for benefits
c. Plan participants not yet fully eligible for benefits

4.118 According to FASB ASC 965-30-45-6, minimum disclosure regarding changes in benefit obligations should include the significant effects of (a) plan amendments, (b) changes in the nature of the plan (mergers or spinoffs), and (c) changes in actuarial assumptions (health care cost-trend rate or interest rate). Per FASB ASC 965-30-45-7, changes in actuarial assumptions are to be considered as changes in accounting estimates and, therefore, previously reported amounts should not be restated. The significant effects of other factors may also be identified. These include, for example, benefits accumulated, the effects of the time value of money (for interest), and benefits paid. FASB ASC 965-30-45-8 states that if presented, benefits paid should not include benefit payments made by an insurance company pursuant to a contract that is excluded from plan assets. However, amounts paid by the plan to an insurance entity pursuant to such a contract (including purchases of annuities with amounts allocated from existing investments with the insurance company) should be included in benefits paid. If only the minimum disclosure is presented, presentation in a statement format will necessitate an additional unidentified other category to reconcile the initial and ultimate amounts.

Financial Statement Disclosures

4.119 According to FASB ASC 965-325-50-1 and 965-30-50-1, disclosure of a health and welfare benefit plan's accounting policies should include the following:

- A description of the methods and significant assumptions used to determine the fair value of investments and the reported value of insurance contracts.
- A description of the methods and significant actuarial assumptions used to determine the plan's benefit obligations. Any significant changes in assumptions made between financial statement dates and their effects should be described.

4.120 According to FASB ASC 965-205-50-1, the plan's financial statements should disclose other information as described in this paragraph. Certain of the disclosures relate to plans with accumulated assets rather than those with trusts that act more as conduits for benefit payments or insurance premiums. Separate disclosures may be made to the extent that the plan provides both health and other welfare benefits. The disclosures should include, if applicable, all of the following:

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23 In accordance with FASB ASC 965-30-45-7(a), actuarial experience gains or losses may be included with the effects of additional benefits accumulated rather than separately disclosed. If the effects of changes in actuarial assumptions cannot be separately determined, those effects should be included in benefits accumulated and described accordingly.

24 In accordance with FASB ASC 965-30-45-8, because of the use of different actuarial assumptions, the amount paid by the plan to an insurance company may be different from the previous measure of the actuarial present value of the related accumulated plan benefits. If that information is available, it should be presented as an actuarial experience gain or loss.

25 See FASB ASC 235, Notes to Financial Statements for further information regarding financial statement disclosures.
a. A brief, general description of the plan agreement, including, but not limited to, participants covered, vesting, and benefit provisions.  

b. A description of significant plan amendments adopted during the period, as well as significant changes in the nature of the plan (for example, a plan spin-off or merger with another plan) and changes in actuarial assumptions.

c. The funding policy and any changes made to the policy during the plan year. If the benefit obligations exceed the net assets of the plan, the method of funding this deficit, as provided for in the plan agreement or collective bargaining agreement, also should be disclosed.

   i. For a contributory plan, the disclosure should state the method of determining participants' contributions.

   ii. For each year for which a year-end statement of net assets available for benefits is presented, a description of the portion of the plan’s estimated cost of providing postretirement benefits funded by retiree contributions.

   iii. If the plan terms provide that a shortfall in attaining the intended cost sharing in the prior year(s) is to be recovered by increasing the retiree contribution in the current year, that incremental contribution should be separately disclosed.

   iv. If the plan terms provide that participant contributions in the current year are to be reduced by the amount by which participant contributions in prior year exceeded the amount needed to attain the desired cost-sharing, the resulting reduction in the current year contribution should be separately disclosed.

   v. The information about retiree contributions should be provided for each significant group of retired participants to the extent their contributions differ.

d. If significant plan administration or related costs are being borne by the employer, that fact should be disclosed.

e. The federal income tax status of the plan.

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26 In accordance with FASB ASC 965-205-50-1(a), if a plan agreement, or a description thereof, providing this information is otherwise published or made available, the description in the financial statement disclosures may be omitted, provided that a reference to the other source is made.

27 In accordance with FASB ASC 965-205-50-1(c), the plan’s estimated cost of postretirement benefits is the plan’s expected claims cost for the year. It excludes benefit costs paid by Medicare and costs, such as deductibles and copayments, paid directly to the medical provider by participants. The portion of the plan’s estimated cost that is funded by retiree contributions is determined at the beginning of the year based on the plan sponsor’s cost-sharing policy. In determining that amount, the retirees’ required contribution for the year should be reduced by any amounts intended to recover a shortfall (or increased by amounts intended to compensate for an overcharge) in attaining the desired cost-sharing in prior year(s).

28 A plan’s tax exempt status is a position that may be subject to uncertainty. In September 2009, FASB issued ASU No. 2009-06, Income Taxes (Topic 740)—Implementation Guidance on Accounting for Uncertainty in Income Taxes and Disclosure Amendments for Nonpublic Entities. ASU No. 2009-06 provides implementation guidance on accounting for uncertainty in income taxes and eliminates the disclosure requirements of paragraphs 15(a)–15(b) of FASB ASC 740-10-50 for nonpublic entities, as defined in FASB ASC 740-10-20. The implementation guidance in
Practice Tip

No determination letter program exists for health and welfare benefit plans; however, a 501(c)(9) VEBA trust must obtain a determination letter to be exempt from taxation, and that fact should be disclosed.

f. The policy regarding the purchase of contracts with insurance entities that are excluded from plan assets. Consideration should be given to disclosing the type and extent of insurance coverage, as well as the extent to which risk is transferred (for example, coverage period and claims reported or claims incurred).

g. FASB ASC 965-325-50-1 requires identification of investments that represent 5 percent or more of the net assets available for benefits as of the end of the year. Consideration should be given to disclosing provisions of insurance contracts included as plan assets that could cause an impairment of the asset value upon liquidation or other occurrence (for example, surrender charges and market value adjustments).

h. The amounts and types of securities of the employer and related parties included in plan assets and the approximate amount of future annual benefits of plan participants covered by insurance contracts issued by the employer and related parties.

i. Significant real estate or other transactions in which the plan and any of the following parties are jointly involved: the sponsor, the plan administrator, employers, or employee organizations.

j. Unusual or infrequent events or transactions occurring after the financial statement date, but before the financial statements are issued or are available to be issued (as discussed in FASB ASC 855-10-25), that might significantly affect the usefulness of the financial statements in an assessment of the plan's present and future ability to pay benefits. For example, all of the following should be disclosed:

   i. A plan amendment adopted after the latest financial statement date that significantly increases future benefits attributable to an employee's service rendered before that date

   ii. A significant change in the market value of a significant portion of the plan's assets

   iii. The emergence of a catastrophic claim

ASU No. 2009-06 also expands the FASB ASC glossary definition of a tax position. In addition, TIS section 5250.15, “Application of Certain FASB Interpretation No. 48 (codified in FASB ASC 740-10) Disclosure Requirements to Nonpublic Entities That Do Not Have Uncertain Tax Positions” (AICPA, Technical Practice Aids), clarified that the description of open tax years that remain subject to examination is a required disclosure for a nonpublic entity even if the entity has no uncertain tax positions.
If reasonably determinable, the effects of such events or transactions should be disclosed. If such effects are not reasonably determinable, the reasons why they are not quantifiable should be disclosed.

**k.** Material lease commitments, other commitments, or contingent liabilities.

**l.** A reconciliation and explanation of the differences, if any, between the information contained in the financial statements and the amounts reported on the Form 5500 in accordance with FASB ASC 965-205-50-3.

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**Practice Tip**

Note that reconciling items are generally for current obligations and would not include such items as postemployment and postretirement obligations. Common reconciling items to the Form 5500 include claims payable and amounts currently due to insurance companies, claims IBNR, and 401(h) account balances and transactions.

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**m.** 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.

**n.** For health and welfare benefit plans providing postretirement health care 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.

**o.** Any modification of the existing cost-sharing provisions that are encompassed by the substantive plan(s) and the existence and nature of any commitment to increase monetary benefits provided by the plan and their effect on the plan's financial statements.

**p.** Termination provisions of the plan and priorities for distribution of assets, if applicable.

**q.** Restrictions, if any, on plan assets (for example, legal restrictions on multiple trusts).

**r.** For a defined contribution health and welfare plan, the accounting policy for, and the amount and disposition of, forfeited nonvested accounts. Specifically, identification of whether those amounts will be used to reduce future employer contributions, employer expenses, or will be allocated to participants accounts.

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**Practice Tip**

FinREC recommends that this disclosure also be made when there is a defined contribution component included in a defined benefit health and welfare benefit plan.

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**s.** In accordance with FASB ASC 965-325-50-2, for fully benefit-responsive investment contracts, in the aggregate
i. a description of the nature of those investment contracts, how they operate, and the methodology for calculating the interest crediting rate, including the key factors that could influence future average interest crediting rates, the basis for and frequency of determining interest crediting rate resets, and any minimum interest crediting rate under the terms of the contracts. This disclosure should explain the relationship between future interest crediting rates and the amount reported on the statement of net assets available for benefits representing the adjustment for the portion of net assets attributable to fully benefit-responsive investment contracts from fair value to contract value.

ii. The average yield earned by the plan for all fully benefit-responsive investment contracts (which may differ from the interest rate credited to participants in the plan) for each period for which a statement of net assets available for benefits is presented. This average yield should be calculated by dividing the annualized earnings of all fully benefit-responsive investment contracts in the plan (irrespective of the interest rate credited to participants in the plan) by the fair value of all fully benefit-responsive investment contracts in the plan.

iii. The average yield earned by the plan for all fully benefit-responsive investment contracts with an adjustment to reflect the actual interest rate credited to participants in the plan for each period for which a statement of net assets available for benefits is presented. This average yield should be calculated by dividing the annualized earnings credited to participants in the plan for all fully benefit-responsive investment contracts in the plan (irrespective of the actual earnings of those investments) by the fair value of all fully benefit-responsive investment contracts in the plan.

iv. A description of the events that limit the ability of the plan to transact at contract value with the issuer (for example, premature termination of the contracts by the plan, plant closings, layoffs, plan termination, bankruptcy, mergers, and early retirement incentives), including a statement regarding whether the occurrence of those events that would limit the plan’s ability to transact at contract value with participants in the plan is probable or not probable. (The term probable is used in this paragraph consistent with its use in FASB ASC 450, Contingencies.)

v. A description of the events and circumstances that would allow issuers to terminate fully benefit-responsive investment contracts with the plan and settle at an amount different from contract value.

In accordance with FASB ASC 965-325-50-3, for ERISA-covered plans, if a fully benefit-responsive investment contract does not qualify for contract-value reporting in the DOL Form 5500 but is reported in the financial statements at contract value, and the contract value does not approximate fair value, the DOL’s rules and regulations require that a statement explaining the differences between amounts reported in the financial statements and DOL Form 5500 be added to the financial statements.
u. In accordance with FASB ASC 965-30-50-5, the weighted-average assumed discount rate used to measure the plan’s obligation for postemployment benefits.

v. Other disclosures elsewhere in the guide (for example, see the “Master Trusts” and “Fair Value Disclosures” sections in chapter 7).

Note: This list does not include information that, in accordance with ERISA requirements, must be disclosed in the schedules filed as part of a plan's annual report. It is important to note that any information required by ERISA be disclosed in the schedules; disclosure of the information on the face of the financial statements or in the notes to the financial statements but not in the schedules is not acceptable.

4.121 FinREC also recommends that the following disclosures be made, if significant:

a. The significant terms of expense offset arrangements with third parties, whereby expenses are netted against income, be disclosed in the notes to the financial statements. Expense offset arrangements generally consist of fees being paid to a third-party service provider (for example, recordkeeper) directly through the use of investment fee rebates made available by the plan’s separate third-party investment manager.

b. FSAs, HRAs, and HSAs (see paragraph 4.10).

c. Refunds and rebates due from service providers (see paragraph 4.59).

d. Stop-loss arrangements (see paragraphs 4.73–4.75).

e. Claims accounting policy (see paragraph 4.90).

f. Claims IBNR related to postemployment benefits (see paragraph 4.102).

Fair Value Measurements

4.122 See chapter 7 for required disclosures relating to fair value measurements in accordance with FASB ASC 820.

Derivatives and Hedging

4.123 FASB ASC 815, Derivatives and Hedging, provides accounting and reporting for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as derivatives), and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. FASB ASC 815 applies to certain contracts that meet the definition of derivative instrument, as defined in FASB ASC 815-10-15-83. See FASB ASC 815-10-15-13 for further information on certain contracts that are not subject to the requirements of FASB ASC 815.

Financial Instruments
FASB ASC 825-10-50-10 requires all entities, except for those covered by an exemption for which the disclosure is optional, to disclose within the body of the financial statements or in the accompanying notes the fair value of financial instruments for which it is practicable to estimate fair value. An entity should also disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments. Generally, financial instruments of a health and welfare plan are included in the scope of FASB ASC 825, *Financial Instruments*, and are subject to the disclosure requirements of FASB ASC 825-10-50. In addition, the disclosure requirements of FASB ASC 820 may also apply.

FASB ASC 825-10-50-1 requires disclosure of all significant concentrations of credit risk arising from all financial instruments. In accordance with FASB 825-10-50-21, the following information should be disclosed about each significant concentration:

- Information about the (shared) activity, region, or economic characteristic that identifies the concentration
- The maximum amount of loss due to credit risk that, based on the gross fair value of the financial instrument, the entity would incur if parties to the financial instruments that make up the concentration failed completely to perform according to the terms of the contracts and the collateral or other security, if any, for the amount due proved to be of no value to the entity
- The entity’s policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the entity’s access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments
- The entity’s policy of entering into master netting arrangements to mitigate the credit risk of financial instruments, information about the arrangements for which the entity is a party, and a brief description of the terms of those arrangements, including the extent to which they would reduce the entity’s maximum amount of loss due to credit risk.

According to FASB ASC 825-10-50-3, the disclosures are optional for plans that meet the following criteria:

- The plan is a nonpublic entity.
- The plan’s total assets are less than $100 million on the date of the financial statements.
- The plan has no instrument that, in whole or in part, is accounted for as a derivative instrument under FASB ASC 815, *Derivatives and Hedging*, during the reporting period.

In accordance with FASB ASC 825-10-50-11, fair value disclosed in the notes should be presented together with the related carrying amount in a form that makes it clear whether the fair value and carrying amount represent assets or liabilities and how the carrying amounts relate to what is reported in the statement of net assets available for benefits.

In June 2010, the AICPA issued Technical Questions and Answers (TIS) section 1800.05, “Applicability of Fair Value Disclosure Requirements and Measurement Principles in Financial Accounting Standard Board (FASB) Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*, to Certain Financial Instruments” (AICPA, Technical Practice Aids). This question and answer addresses whether the fair value measurement principles and disclosure requirements in FASB ASC 820, *Fair Value Measurements and Disclosures*, apply to financial instruments that are not recognized at fair value in the statement of financial positions, but for which fair value is required to be disclosed in the notes to financial statements in accordance with paragraphs 10–19 of FASB ASC 825-10-50.
Risks and Uncertainties

4.126 FASB ASC 275-10-50-1 requires plans to make disclosures in their financial statements about the risks and uncertainties existing as of the date of those financial statements in the following areas: (a) the nature of their operations, (b) the use of estimates in the preparation of financial statements, (c) certain significant estimates, and (d) current vulnerability due to certain concentrations.

4.127 In accordance with FASB ASC 275-10-50-8, certain significant estimates should be disclosed when known information available prior to issuance of the financial statements indicates that (a) it is at least reasonably possible that the estimate of the effect on the financial statements of a condition, situation, or set of circumstances that existed at the date of the financial statements will change in the near term due to one or more future confirming events, and (b) the effect of the change would be material to the financial statements. For example, the present value of accumulated plan benefits of a defined benefit health and welfare benefit plan could be subject to a material change when

a. employees covered by the plan work in an industry that experienced a significant economic downturn in the previous year, and it is reasonably possible that in the subsequent period, a significant number of employees will retire early without a monetary incentive to do so in order to avoid being laid-off with nominal benefits. This could significantly increase the present value of accumulated plan benefits.

b. employees covered by the plan are party to a collective bargaining agreement that was up for renegotiation at year-end, and it is reasonably possible that management's offer to significantly decrease benefits in lieu of granting the union's request for a significant increase will be accepted within the next year. This could significantly decrease the present value of accumulated plan benefits.

4.128 In accordance with FASB ASC 275-10-50-16, vulnerability from concentrations arises when a plan is exposed to risk of loss greater than it would have had it mitigated its risk through diversification. FASB 275-10-50-16 states that concentrations should be disclosed if, based on information known to management before the financial statements are issued or are available to be issued, (a) the concentration exists at the date of the financial statements; (b) the concentration makes the plan vulnerable to the risk of a near-term severe impact; and (c) it is at least reasonably possible that the events that could cause the severe impact will occur in the near term. For example, if the plan owns several investment properties (that is, apartment buildings) located in a geographic area that has only one significant employer, and that employer announced last year that it is considering leaving the area and it is reasonably possible that it will do so within the next year, this could significantly affect the plan's future cash flows from rents and the value of the investment properties.

Practice Tip

Many plan's participants may be concentrated in a specific industry that carries with it certain risks. Plans may also hold investments and other assets (other than financial instruments for
which concentrations are covered by FASB ASC 825 rather than FASB ASC 275, *Risks and Uncertainties*) that are concentrated in a single industry or in a single geographic area.

4.129 Because the disclosure requirements of FASB ASC 275, in many circumstances, are similar to or overlap the disclosure requirements in certain other FASB ASC topics (for example, FASB ASC 450), in accordance with FASB 275-10-50-1, the disclosures required by FASB ASC 275 may be combined in various ways, grouped together or placed in diverse parts of the financial statements, or included as part of the disclosures made pursuant to the requirements of other FASB ASC topics.

**Plan Mergers and Spinoffs**

4.130 Unique issues arise in health and welfare benefit plan mergers and spinoffs. Merger and spin-off documentation and plan documents should be reviewed to determine the effective merger date and the appropriate timing of the transfer of the benefit obligations, in addition to any applicable assets, to the successor plan. FinREC recommends that the net assets transferred into or out of the plan be recorded on the statement of changes in net assets available for benefits following the net increase or decrease for the period.

4.131 Additionally, the plan sponsor of the predecessor plan should consider the need for determining obligations for claims payable, premiums payable to insurance companies, claims IBNR, and postretirement obligations as of the merger date, with the statement of changes in benefit obligations reflecting the transfer of such amounts to the successor plan. Further spin-off considerations include determination of the amount of assets that would also be transferred to the successor plan in addition to the identified benefit obligations. Such amounts are normally described in the spin-off agreement.

**Terminating Plans**

4.132 Interpretation No. 8, "Reporting on Financial Statements Prepared on a Liquidation Basis of Accounting" of AU section 508, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, AU sec. 9508 par. .33–.38), contains applicable guidance regarding the auditor's reporting responsibilities for terminating plans. For purposes of this discussion, a terminating plan includes all plans about which a termination decision has been made regardless of whether the terminating plan will be replaced.

4.133 FASB ASC 965-40-50-1 states that when the decision has been made to terminate a plan, or a wasting trust—that is, a plan under which participants no longer accrue benefits but that will remain in existence as long as necessary to pay already accrued benefits—exists, the relevant circumstances should be disclosed in all subsequent financial statements issued by the plan.

4.134 If the decision to terminate a plan is made before the end of the plan year, the plan's year-end financial statements should be prepared on the *liquidation* basis of accounting, as described in the following text. (If the decision is made after the year-end but before the year-end financial statements have been issued, the decision is generally a *type two*
subsequent event requiring the disclosure described in AU section 560, *Subsequent Events*, [AICPA, *Professional Standards*.]

4.135 As noted in the preceding paragraph, plan terminations typically include the cessation of future benefits. Accordingly, an obligation for current claims payable, IBNR claims, and claim run out may need to be recorded. Claim run out occurs when a plan terminates but continues to cover, for example, existing participants’ claims incurred up to a certain date, typically the termination date.

4.136 In accordance with FASB ASC 965-40-25-1, plan financial statements for periods ending after the termination decision are prepared on the liquidation basis of accounting. Per FASB ASC 965-40-35-1, for terminating plan assets, changing to the liquidation basis will usually cause little or no change in values, most of which are current market values. Assets that may not be carried at market values include operating assets, insurance and certain investment contracts carried at *contract value*, or large blocks of stock or other assets that cannot be readily disposed of at their quoted market prices.

4.137 Benefit obligations should be determined on a liquidation basis, and their value may differ from the actuarial present value of benefit obligations reported for an ongoing plan. Consideration should be given upon termination to whether any or all benefits become vested for certain types of plans.

**Terminating Trusts**

4.138 Terminating trusts are more commonly encountered than terminating plans. Factors affecting the decision to terminate a trust may include moving a funded plan to an unfunded plan status or to a fully insured plan, both of which (upon termination of the existing trust) may eliminate the ongoing requirement for a plan audit. It is typically recommended that trust be legally dissolved to accomplish the desired results because even though the trust may not be utilized, if not legally dissolved, the plan may still be considered funded and, if all other audit requirements are met, may need an audit.

4.139 Consideration should be given to the timing of the trust termination and the time period covered by the financial statements. If the trust was in existence at any time during the year, and all other audit requirements are fulfilled, then the plan's financial statements would need to cover the entire year, not just the time period the trust was in operation. As further discussed in paragraph 4.02, the trust activity is not what is audited; the trust is merely one of the reasons a need for an audit exists. Therefore, special attention should be paid to ongoing plan operations for the remainder of the unfunded period in that claims can continue to be paid or perhaps insurance payments made if fully insured. Such claims or insurance premiums paid would need to be reflected in the plan’s financial statements if the trust was in place at any point during the year, in addition to plan activity during the period of time the trust was in existence.

**Tax Considerations**
4.140 A trust may be established to hold the assets of a health and welfare benefit plan; it 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 or VEBA. Although a VEBA that meets the tax requirements of the IRC may be tax-exempt, it could still be liable for unrelated business income tax, or UBIT, on its unrelated business taxable income, or UBTI. UBTI is income generated by the VEBA that is not substantially related to the purpose that is the basis of the VEBA’s tax exemption and includes all but “exempt function income,” less allowable deductions. Exempt function income includes income set aside for the payment of life, sick, accident, or other benefits, including the reasonable administration costs.\(^{32}\) VEBA that generate UBTI must file a Form 990-T with the IRS in addition to meeting its Form 990 filing requirement.

4.141 VEBA are also subject to discrimination rules under IRC Section 505. No VEBA, except plans maintained pursuant to a collectively bargained agreement, are considered tax-exempt unless the related health and welfare benefit plan meets certain discrimination requirements. Generally, plan benefits must be made available to employee classifications that do not favor highly compensated employees (HCEs) and must be provided in a manner that does not discriminate in favor of HCEs. Specific nondiscrimination rules apply for self-insured medical benefit plans, group term life insurance benefits, and dependent care assistance programs and cafeteria plans. Auditors may inquire of the plan’s administrator or other expert about whether testing for IRC compliance has been performed.

4.142 Unlike defined contribution and defined benefit pension plans, health and welfare benefit plans have no IRS determination letter program. Alternatively, the IRS may issue a tax exemption letter for the trust, if applicable. VEBA established since 1984 are required to request exempt status from the IRS using Form 1024. VEBA established before 1984 do not need an exemption letter, if they had previously formally declared exempt status through the filing of Form 990 with the IRS. If the trust has been amended since the original exemption letter, the Form 990 procedures require disclosure of the changes; no new application for an exemption is required.\(^{33}\)

4.143 The audit requirement with respect to a health and welfare benefit plan that utilizes a VEBA trust applies to the plan, not the VEBA trust (see instructions to Form 5500 for guidance). A VEBA trust’s governing instrument will generally have no language covering the plan's operations. The governing instrument is limited to the investment and management of plan assets. Disbursements are made as authorized by the plan administrator. Operational attributes of the related plan must still be audited in accordance with this chapter whether or not such attributes apply to the VEBA trust. Auditors may look to the plan’s governing instrument or “wrap document” to determine which plan attributes fall under the scope of the plan audit.

\(^{32}\) See www.irs.gov/irm/part7/ch12s05.html; Internal Revenue Code Section 512(a)(3).

\(^{33}\) It is the trust that is required to get a determination letter, not the plan itself.
4.144 Paragraph 4.05 explains that a VEBA is one of several arrangements available to hold plan assets of an employee welfare plan. Key considerations in auditing plans funded through VEBAs arise from the distinct tax regulations associated with VEBAs and, oftentimes, assets of several welfare plans are commingled into a single VEBA.

4.145 The audit and reporting issues for a VEBA that holds the assets of a single plan of a single sponsor are discussed fully in this chapter and related paragraphs of this guide. When the VEBA holds the assets of several plans of a single employer, additional audit issues are present. If the VEBA qualifies as a master trust, the master trust rules discussed in paragraph 4.15 will apply. When the underlying welfare plans have no assets other than those held by the VEBA, the required Form 5500 supplemental schedules typically associated with individual single employer plan Form 5500 filings are attached to the master trust filing and need not be included with the separate filing of each participating plan. (See the instructions to the Form 5500 for guidance on master trust filings.) If the VEBA does not qualify as a master trust, Form 5500 schedules should be prepared for each plan.
Appendix 4A—The Annual Health Care Process

4A-1 This appendix provides a more detailed description of the annual health care process illustrated in the preceding exhibit 4-1.

Health Care Reform

4A-2 In March 2010, Congress passed two pieces of legislation designed to reform the U.S. health care system. The Patient Protection and Affordable Care Act (PL 111-148) was enacted on March 23 and was quickly followed by the Health Care and Education Reconciliation Act of 2010 (PL 111-152), which amended several portions of the first act, as well as added new provisions of its own. One of the goals of the legislation is to reform the health care delivery system to improve its quality while lowering its overall cost.

4A-3 Health reform is far-reaching, and much uncertainty exists about how health reform measures will affect the way health care entities will deliver services to their patients in the future and how they will be compensated for those services.

Note A: Annual Contract Negotiation With Service Providers

4A-4 Annually, plan sponsors participate in contract negotiations with their various service providers. Among other things, these contracts identify the plan’s

- service providers,
- benefits and services offered and selected,
- fully insured vs. self-insured benefits,
- funding requirements, and
- required deposits.

4A-5 Due to the complexity associated with processing claims (see paragraph 4.20), contracts with service providers commonly specify acceptable contractual error rates. Often, the claims processor’s performance against established targets is used prospectively in negotiating contract terms versus settled retroactively. It is the plan sponsor’s responsibility to monitor the performance of their service providers against the terms of their healthcare contracts.

4A-6 Once the contracts are executed, the plan sponsor determines the contribution rates to be paid by participants depending on the level of coverage the participant has selected. See paragraphs 4A-9–4A-11 in this appendix for further discussion of the contributions process.

Note B: Employee Communication and Open Enrollment
Plan sponsors communicate the annual benefit offerings to eligible participants during annual open enrollment. Enrollment can be performed in house or can be outsourced. During enrollment, information is provided to eligible participants, which describes such things as the benefits offered, costs of the various coverage options, applicable deductibles and copays, and out-of-pocket maximums. Participants may enroll online or complete enrollment forms manually by a predetermined deadline (new hires may enroll throughout the year). Confirmations of benefit selections are sent to participants for review and approval.

The enrollment information collected during this process and census data (for example, new hires, change in status, terminations) is used by the plan sponsor for purposes of employee contribution withholding and self-billing to certain providers. It is also provided to the various applicable service providers, such as claims processors, insurance providers, and actuaries.

Note C: Payroll, COBRA, and Retiree Contributions Process

Once participants have selected their benefits and level of coverage, active employee contribution rate changes are input into the payroll system. The plan sponsor then processes payroll, withholding the proper amount of contributions based on the level of coverage selected by the participant (see paragraph 4.10). When contributions are withheld from payroll, they may be remitted to the related plan trust account or sent directly to the applicable service provider.

Practice Tip

Plan sponsors should determine that contribution rates, annual enrollment, and new enrollee data are loaded into the payroll system accurately and timely. Changes in contribution rates that are incorrectly coded into the payroll system or not entered timely will result in improper amounts being withheld from a participant’s pay. Further, if annual enrollment updates or new enrollee data are not entered timely or accurately, a participant’s enrollment may be adversely affected.

Employer contributions may be voluntary or required under the terms of a collective bargaining agreement negotiated with one or more labor organizations. Plans may require contributions from employers and participants (contributory plans) or only from employers (noncontributory plans). Contributions by active employees are typically based at a set amount dependent on the coverage selected by the employee and are funded from employee withholdings.

For ERISA purposes, participant contributions are deposited in the trust of the health and welfare benefit plan on the earliest date that they can reasonably be segregated from the employer's general assets, but in no event later than 90 days from the date on which such amounts are withheld or received by the employer.

COBRA and Retiree Participants
4A-12 Many health and welfare benefit plans are required to provide continuation of benefits upon termination of employment through the Consolidated Omnibus Budget Reconciliation Act (COBRA). COBRA contains provisions giving certain former employees, retirees (when postretirement benefits are not offered by the plan), spouses, and dependent children the right to temporary continuation of health coverage. COBRA participants must be offered benefits identical to those received immediately before qualifying for continuation coverage.

4A-13 During periods of unemployment, a plan may require contributions by participants to maintain their eligibility for benefits. Coverage for COBRA participants is usually more expensive than health coverage for active employees because the employer usually pays some or all of the premiums for active employees, whereas COBRA participants generally pay the entire premium. COBRA contributions for terminated employees who elect this coverage are usually set based on 102 percent of the cost to the plan for active employees, including both the portion paid by employees and any portion paid by the employer plus 2 percent to cover administrative costs.¹

4A-14 Retiree contributions may be fully covered by the employer, the retiree, or shared by both. For retirees and participants covered under COBRA, collection of contributions can vary. Their contributions may be paid directly to the plan sponsor, to a third-party administrator, or, for retirees, the amounts may be withheld from pension retirement checks. More commonly, COBRA and retiree contributions are made to the plan sponsor or trustee by way of a lock box. Payments made to a lock box are then deposited into the plan’s trust (for funded plans). Notification of payment amounts or payment coupons, or both, are then forwarded to the plan sponsor periodically. Payments made directly to the plan sponsor are either deposited into the trust or used directly to pay claims.

4A-15 In many cases, the collection of COBRA and retiree contributions is performed by outside administrators. However there are times when enrollment records for COBRA and retirees are maintained by the plan sponsor, who in turn collects the contributions.

Note D: Benefits Administration

Claims Processing

4A-16 Claims processors use automated systems. A key element in the claims payment process is the installation and maintenance of a plan’s key benefit provisions, participant information, providers (both network and nonnetwork), and rate structure. For example, network providers provide services to enrollees at a contractually reduced rate, whereas the participant maybe responsible for differences between the provider’s normal charge

¹ The American Recovery and Reinvestment Act of 2009 (ARRA), signed into law on February 17, 2009, provides relief to millions on the COBRA plan or ex-employees who need COBRA coverage. This “COBRA stimulus plan,” among other things, provides for a specified period of time a COBRA premium subsidy whereby the employee’s out-of-pocket cost is reduced by 65 percent without regard to employer paid amounts. See www.dol.gov/ebsa/COBRA.html for more information on COBRA Continuation Coverage Assistance under the ARRA.
and the amount allowed under the plan for services rendered by an out-of-network provider.

4A-17 Service centers or clearing houses may be utilized by claims processors to process submitted claims and queries from interested parties (participants, healthcare service providers). As participants receive services from a physician or other providers, participants or their providers generally submit claim forms (electronic or paper) to a clearinghouse that reviews the claim for accuracy and completeness, and then submits the claim to the individual claims processor. Paper claims are typically imaged and then manually keyed into electronic format by the clearing house before processing through the claims processor’s system. Electronic claims received by claims processors follow one national standard format.

4A-18 Once a claim is received into the claims processor’s system, information on the claim is validated electronically against stored data. Claims not validated are processed within the procedures set up by the claims processor in which a request for additional information may be sent back to the participant, including eligible dependents or beneficiaries, or service provider. The additional information may be requested in the form of a denial, which may be more prevalent with multiemployer plans obligated to meet Department of Labor timeliness regulations.

4A-19 Although the majority of validated electronic and paper claims are sent through an auto-claims payment process, the rest are sent through a manual process. In both processes, negotiated rates, consistency in service and diagnosis, investigation for other coverage, copays and deductibles are applied.

4A-20 In the claims payment process, electronic edit checks match submitted information with known information in the claims processor’s system. Significant edit checks may include, but are not limited to, the following:

- Member eligibility
- Covered benefit
- Required referral on file
- Excluded coverage or procedure
- Proper coding
- Timely receipt of claim
- Benefit limits
- Authorized provider
- Coordination of benefits
- Duplicate claims
- Others, depending on the claims processor

Passing or failing edit checks determines whether claims are approved, denied, or suspended for manual review. Claims adjustments, such as errors identified in quality reviews, requests for reconsideration, refunds from physicians, recoveries from subrogation and legal settlements or other audits, and credit balance recoveries could result in refunds to the plan.
Insured Activity

4A-21 The plan sponsor may pay the premiums for the insured benefits directly or may outsource the process to an outside service provider.

Note E: Funding or Payment of Service

4A-22 Payments of claims or premiums are made based upon preestablished funding criteria as documented in contractual agreements. When a claims processor is used to process benefit payments, they may require a deposit from the plan to pay benefits. The deposit is reduced as claims are paid and is subsequently replenished. If a deposit is not required, the claims processor commonly pays the claim and then seeks reimbursement for claims paid.

4A-23 Payments of claims and claims adjustments are typically grouped. Payments are prepared and sent to submitters, and either an invoice is created for issued payments or the customer bank account is charged for the payments that have cleared the bank.

4A-24 An explanation of benefits (EOB) is sent to participants detailing their claim payment (that is, details about how and why claims were or were not covered, summary of charges submitted and processed, the amount allowed, amount paid, and so forth). Reports are made available by the claims processor to plan sponsors related to claims activity of the plan (claim expense reports, claim lag study, detail payment logs, payments by benefit type, payments by month, and large claim reports) usually through an online portal.

4A-25 The plan sponsor will typically negotiate with the claims processor about when the plan will be billed for claims paid.
Appendix 4B—Examples of Health and Welfare Arrangements

Arrangements With Insurance Companies

4B-1 The nature of, and method of accounting for, the assets and benefit obligations of a health and welfare benefit plan may be determined by the arrangement with the insurance company. The insurance company may assume all or a portion of the financial risk, or it may provide only administrative services (see paragraph 4B-2 that follows).

4B-2 Some of the more common types of insurance company arrangements include the following:

- *Fully insured, pooled arrangements.* In a fully insured, pooled arrangement, specified benefits are covered by the insurance company. The insurance company pools the experience of the plan with that of other similar plans and assumes the financial risk of adverse experience. In such an arrangement, a plan generally has no obligation for benefits covered by the arrangement other than the payment of premiums due to the insurance company (see paragraph 4.74).

  — *Experience-rated arrangements.* In an experience-rated arrangement, specified benefits are paid by the insurance company that assumes the financial risk. The plan’s experience under the contract is monitored by the insurance company. To the extent that the plan’s experience under the contract is less than the premiums paid, the plan is entitled to an experience-rating refund or dividend (see paragraphs 4.64–4.65). If the plan’s experience under the contract exceeds premiums, the accumulated loss is generally borne by the insurance company but may be carried over to future periods until it has been recovered. The plan often has no obligation to continue coverage or to reimburse the carrier for any accumulated loss, although there are certain types of contracts that require additional payments by the plan.

  — *Minimum premium plan arrangements.* In a minimum premium plan arrangement, specified benefits are also paid by the insurance company. The insurance contract establishes a dollar limit, or trigger point. All claims paid by the insurance company below the trigger point are reimbursed by the plan to the insurance company. The insurance company is not reimbursed for benefits incurred that exceed the trigger point. This type of funding arrangement requires the plan to fund the full claims experience up to the trigger point. Although minimum premium plan arrangements may have characteristics of both self-funded and fully insured experience-rated arrangements, amounts paid below the trigger point in a minimum premium plan are taxable to the employer as a premium because such a plan is, in essence, a fully insured plan with a variable premium. Careful review of each arrangement will help to determine when the benefit obligations are assumed by the insurance company.
— Stop-loss insurance arrangements. In a stop-loss insurance arrangement, a plan's obligation for any plan participant's claim may be limited to a fixed dollar amount (specific stop-loss coverage), or the plan's total obligation may be limited to a maximum percentage (for example, 125 percent) of a preset expected claims level (aggregate stop-loss coverage). These arrangements are commonly used with administrative service arrangements. The insurance company assumes the benefit obligation in excess of the limit. Stop-loss insurance arrangements may have characteristics of both self-funded and fully insured arrangements. Stop-loss arrangements of this type may be described by a variety of terms; therefore, details of all insurance or administrative arrangements should be reviewed to determine if stop-loss provisions are included and to determine when benefit obligations assumed by the insurance company. The named insured under stop-loss arrangements is often the employer, and amounts received are sometimes deposited in the general assets of the employer and not reflected in the plan’s financial statements.

- Administrative services only (ASO) arrangements. In an administrative service arrangement, the plan retains the full obligation for plan benefits. The plan may engage a claims processor to make all benefit payments, who in turn, charges the plan for those payments, and collects a fee for the services provided usually on a per claim basis or per participant basis. Administrative service agreements are not insurance arrangements, and payments for these administrative services are to be reported separately from claims paid or premiums paid.

- Managed care arrangements. In a traditional indemnity plan, the patient’s choice of doctors or medical institutions is not restricted, and the plan merely provides for the payment of benefits but makes no arrangement for providing care itself. Managed care programs are an alternative to traditional indemnity plans and attempt to manage health care delivery with the goal of controlling costs. They affect the way health care is organized, financed, and delivered. In a managed care arrangement, an organization such as health maintenance organizations (HMOs), another type of doctor-hospital network, or an insurance company, acts as an intermediate between the person seeking care and the physician. Therefore, managed care arrangements commonly rely on primary care physicians, who act as a gatekeeper through whom the patient has to go to obtain other health services (for example, specialty medical care, surgery, and physical therapy). Some common types of managed care programs include the following:
  — Provider organizations (PPOs). Group hospital, physician, or ancillary health care providers combined in some type of organization that contract with employers, unions, trust funds, outside administrators, and insurance carriers to provide services on a discounted or negotiated fee-for-service basis to a defined pool of patients. Participants are not required to use a PPO provider, but are given financial incentives (for example, reduction or elimination of deductibles or copayments and increase in selected benefits) to induce them to utilize PPO providers.
— **HMOs.** HMOs can be any public or private organization providing a full range of health services to an enrolled population within a defined geographic area in return for a fixed, prepaid premium for all services provided. In an HMO arrangement, the HMO provides all or most of the services covered under the plan in return for a capitation fee (that is, a payment on a per capita basis, which is fixed without regard to the actual number or nature of services provided to each participant during a set period of time). Many sponsors self-bill the HMO provider on a monthly basis, and the HMO provider generally retains the right to audit the self-billed amounts for accuracy.

— **Self-funded HMOs.** Self-funded HMOs are similar to a self-funded indemnity plan in that the plan pays an administrative fee similar to an ASO fee, pays fees for services rendered, and specialist fees. For hospital charges, however, the sponsor generally only pays what the HMO was charged by the hospital, which is usually discounted because of the contractual arrangement between the HMO and the hospital.

— **Point of service (POS).** Participants choose at the point when care begins to receive services from a participating or nonparticipating network provider and there is usually a financial disincentive to choosing an out of network provider. POS plans are often viewed more as a product than an organization and can be offered by HMOs, PPOs, or self-insured employers.

**Other Health and Welfare Plan Arrangements**

4B-3 Health and welfare benefit plans may enter into various other arrangements. Gaining an understanding of the plan’s service providers and the elements of contractual arrangements is important. Some other arrangements commonly encountered include the following:

- **Pharmacy benefit manager.** Employers providing prescription drug benefits frequently use a pharmacy benefit manager (PBM) to help control drug costs. PBMs buy in bulk, which enables them to offer lower priced mail order prescriptions. They also negotiate the dispensing fee and discounts from the wholesale cost of drugs with local pharmacies. PBMs, in turn, refund to plans based on the actual utilization pattern of a drug for that plan. The actual capture of such refunds at the end of each calendar quarter typically takes three to six months to reach the PBMs from the manufacturers. Once the PBM gets the refund check, it has to recalculate the refund for each of its participating plans that are eligible for refunds and process payments to such plan. See paragraphs 4.58, 4.59, and 4.64 for discussion of refunds.

- **Tax-advantaged financial arrangements.** The Internal Revenue Code (IRC) provides for the following types of defined contribution arrangements.

  — **Flexible spending arrangements.** A flexible spending arrangement (FSA) (also commonly referred to as a flexible spending account) is one of a number
of tax-advantaged financial accounts that can be set up by an employer through an IRC Section 125 cafeteria plan.\(^1\) FSAs allow participants to set aside a portion of their earnings to pay for qualified expenses as defined in the cafeteria plan document (for example, medical expenses, dependent care, or other expenses). Money deducted from a participant's contribute to an FSA is not subject to payroll taxes. Participants can withdrawal funds from their FSA up to the maximum amount of reimbursement (which is the amount the participant elected to contribute for the year as defined in the IRC) to pay qualified medical expenses even if they have not yet funded the account. The employer may also contribute to the FSA if specified in the plan document. These arrangements may be utilized by paper claim submissions, or debit cards, credit cards, and stored value cards utilized by the plan subject to applicable substantiation methods. FSAs are "use-it-or-lose-it" plans whereby the amounts in the account at the end of the plan year cannot be carried forward to the next year and are forfeited back to the plan sponsor (however, some plans provide for a grace period of up to 2 ½ months after the end of the plan year whereby qualified medical expenses incurred in that period can be paid from any residual amounts in the account at the end of the previous year). Applications for refunds must be made by a date defined by the plan.

—Health savings accounts. Individuals enrolled in certain high-deductible health plans (HDHPs) can establish health savings accounts (HSAs) to receive tax-favored contributions (from either the employee or employer). The contribution made to the HSA is used on a tax-free basis to pay or reimburse qualifying health expenses. It also may be used for future expenses, used (on a taxable basis) for nonhealth purposes, or can be withdrawn at age 65 as supplemental retirement income. Funds held in the HSA can be used to pay premiums for long-term care insurance and can be used to pay for health insurance premiums while receiving unemployment benefits or continuation benefits under the COBRA. HSAs are not "use-it-or-lose-it plans," and the participant owns the account and is responsible for substantiating distributions from their HSA account.

**Practice Tip**

In Field Assistance Bulletins 2004-1, *Health Savings Accounts* and 2006-2, *Health Savings Accounts—ERISA Q&As*, the Department of Labor (DOL) addressed various questions concerning HSAs, including the issue of whether HSAs established in connection with employment-based group health plans constitute employee welfare benefit plans for purposes of Title I of ERISA.

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\(^1\) Section 125 plans (also known as cafeteria plans or flexible benefit plans) are plans under which the employee makes an irrevocable decision to forego a portion of future income in exchange for receiving future benefits not subject to income tax at reception date. Accordingly, employees are allowed to pay for certain employee benefits on a pretax, rather than an after-tax, basis. The employer deducts the cost of the employee’s future benefits from present income as a business expense.
—Health reimbursement arrangement. A health reimbursement arrangement (HRA) is similar to an HSA, however, HRAs are funded solely through employer contributions and may not be funded by the employee. No requirement exists for the arrangement to be part of an HDHP, and the funds can be held by the employer or a voluntary employees’ beneficiary association (VEBA) trust. Employees are reimbursed tax-free for qualified medical expenses up to a maximum dollar amount for a coverage period. Amounts remaining at the end of the year can generally be carried over to the next year. The employer is not permitted to refund any part of the balance to the employee, the account cannot be used for anything other than reimbursements for qualified medical expenses, and remaining amounts are not portable upon termination once the employee leaves the employer. HRAs are employer-established benefit plans and may be offered as a component of other health plans, including FSAs.

• Multiple employer welfare arrangements (MEWAs). A multiple employer welfare arrangements is a noncollectively bargained arrangement or plan that is established to provide health care or other employment benefits, or both, to benefit the employees of two or more employers that are not under common control. A MEWA can be either fully insured or self-insured. Determining whether a plan has been properly classified as a MEWA is critical to determining applicable regulatory authority, accounting, and reporting.

Practice Tip

The Employee Benefits Administration of the U.S. DOL has prepared a booklet, *Multiple Employer Welfare Arrangements under ERISA: A Guide to Federal and State Regulation*, to address many of the questions that have been raised concerning the effect of ERISA on federal and state regulation of MEWAs. This booklet may be useful in providing a better understanding of the scope and effect of ERISA coverage, but also serves to facilitate state regulatory and enforcement efforts, as well as federal-state coordination, in the MEWA area.

See www.dol.gov/ebsa/Publications/mewas.html#section1.

• Group insurance arrangements (GIAs). Group insurance arrangements are different than MEWAs. They provide welfare benefits to the employees of two or more unaffiliated employers. GIAs are commonly sponsored by a trade association and provide fully insured benefits in return for the payment of premiums into an associated-sponsor trust by the subscribing employers.
Chapter 6

[Reserved]
Chapter 7

Investments

Introduction

7.01 This chapter describes generally accepted accounting principles in the United States of America (GAAP) and provides general accounting and reporting guidance for employee benefit plan investments. Unique investment considerations relating to specific types of employee benefit plans are further detailed in chapter 2, “Defined Contribution Retirement Plans;” chapter 3, “Defined Benefit Pension Plans;” and chapter 4, “Health and Welfare Benefit Plans.” Although this chapter includes the most common types of investments held by employee benefit plans, it does not attempt to include all investments possibly held by an employee benefit plan. The following AICPA publications may be helpful in understanding certain financial instruments that may not be covered by this guide but may be found in employee benefit plans:

a. AICPA Audit and Accounting Guide Investment Companies

b. AICPA Audit Guide Derivative Instruments, Hedging Activities, and Investments in Securities

c. AICPA Practice Aid Alternative Investments—Audit Considerations, a Practice Aid for Auditors

7.02 The accounting and reporting requirements, as well as the general descriptions of the investments in this chapter, apply to both full and limited scope audits.

Background

7.03 The investments of an employee benefit plan often consist of securities with a readily determinable market value, such as common or preferred stocks, fixed income securities, or shares of registered investment companies. Other investments may include common or collective trust funds maintained by a bank or trust entity, limited partnerships, hedge funds, private equity investments, real estate, mortgages or other loans, repurchase or reverse repurchase agreements, and derivative investments, such as futures, options, or swap contracts. Some of these investments may not have a readily determinable market value. Investments may also be in the form of deposit administration or immediate participation guarantee contracts and individual or pooled separate accounts maintained by an insurance entity and life insurance.

7.04 Investment management arrangements vary by type of plan. For example, in a typical 401(k) plan, a menu of investment options is offered to participants that ordinarily include shares of registered investment companies (RICs, or mutual funds), common or collective trust funds, pooled separate accounts, or other investment funds. These plans may also offer participants the option to create an account and invest in an almost unlimited
selection of investment choices. These options are known as self-directed brokerage accounts and are discussed in paragraph 2.21 in this guide.

7.05 In the typical defined benefit plan, investment advisers are used to achieve investment objectives, such as maximizing total return, preserving capital, generating income, or a combination of these. Within the last decade, many plans have adopted more aggressive investment strategies that incorporate a variety of techniques or specialized products to achieve investment objectives. The role of advisers has become increasingly specialized as advisers are selected to invest portions of a plan's portfolio in a particular product or industry or to use a specialized strategy or technique.

7.06 As the complexity of employee benefit plan investment portfolios have increased, so has the inherent risk in such investment portfolios. This increase is, in part, reflective of the complexity in valuing securities that do not have a readily determinable market value. It is, moreover, a reflection of the changing nature of benefit plan portfolios that once were considered to follow more conservative investment policies and approaches.

7.07 Plan management is responsible for establishing an accounting and financial reporting process for determining fair value measurements. The plan management may look to the investment manager, trustee, custodian, or other outside service provider (for example, a pricing service) to assist in the mechanics of the valuation. However, plan management is responsible for obtaining sufficient information to evaluate and independently challenge the valuation.

Investment Activities and the Use of Service Organizations

7.08 Portfolio management, custodianship, trusteeship, and recordkeeping are significant activities related to benefit plan investments. The investment activities are administratively distinct from other aspects of the plan because most investment activities are outsourced to organizations other than the plan sponsor, for example, an investment manager or adviser, a trustee, a custodian, and a recordkeeping agent. The use of agents to perform such functions does not relieve the plan sponsor of the responsibility for overseeing the maintenance and reliability of accounting records, as well as the valuation methodologies used to prepare financial information that are the basis for the financial statements in accordance with GAAP.

The Investment Manager or Adviser

7.09 The investment manager or adviser generally provides investment advice, research services, and certain administrative services under a contract, commonly referred to as the investment advisory agreement.

The Custodian

7.10 Custody of the plan's investments is entrusted to a bank, insurance entity, or a member of a national securities exchange that is responsible for their receipt, delivery, and safekeeping under a contract, commonly referred to as the custodian agreement. A plan
may also enter into a subcustodial agreement to provide a custody function for other types of investments, such as foreign securities.

The Trustee (Directed and Discretionary)

7.11 Trustees generally are responsible for the safekeeping of the investments covered under the trust agreement. Sometimes, however, plans will not appoint a trustee to maintain custody of the plan's investments but, rather, will self-administer the investments and investment transactions and provide for their safekeeping with a custodian.

7.12 In a directed trust, including a participant-directed trust, the trustee acts as custodian of a plan's investments and is responsible for collecting investment income and handling trust asset transactions as directed by the party named as having discretion to make investment decisions, such as the plan administrator, the plan's investment committee, the participant, or the plan's investment adviser. A discretionary trust differs in that the trustee has discretionary authority and control over investments and is authorized by the plan or its investment committee to make investment decisions. A discretionary trust gives the trustee authority to purchase and sell investment assets within the framework of the trust instrument. Many variations of investment authority exist that may be given to the trustee, such as a combination of discretionary and directed arrangements within a trust. Furthermore, a plan may have one or more trusts as well as one or more custodial or safekeeping accounts.

Multiemployer Plan Considerations

7.13 Many multiemployer plans make use of the services of a third-party administrator who contracts to be responsible for plan administration. Although third-party administrators are not normally considered trustees under the Employee Retirement Income Security Act of 1974 (ERISA), there may be circumstances in which they perform such procedures as processing of investment transactions relating to trading and accruals of investment income, investment income collection, and periodic reconciliation procedures over account balances.

Investment Recordkeeper

7.14 The investment recordkeeper maintains information regarding the positions of investments and related activity for each plan based on information provided by the investment adviser and trustee or custodian. Usually the trustee or custodian also maintains investment records for the plan. However, in certain master trust or commingled investment arrangements, it may be necessary for the plan sponsor to engage a separate recordkeeper to maintain the investment records for each plan.

Valuation of Investments

7.15 Plan investments should generally be presented at their fair value at the reporting date, in accordance with FASB ASC 960-325-35-1, FASB ASC 962-325-35-1, and FASB ASC 965-325-35-1. (Also see chapters 2, 3, and 4 for further guidance.)
Outside valuation or pricing services are often used by trustees or custodians to value certain investments. Those pricing services may include quotations on listed securities and over-the-counter securities. Also, particularly for debt securities, pricing services may provide valuations determined by other pricing techniques. Methods generally recognized in the valuation of financial instruments include analogy to reliable quotations of similar financial instruments, pricing models, matrix pricing, or other formula-based pricing methods. Those methodologies incorporate factors for which published market data may be available. For instance, the mathematical technique known as “matrix pricing” may be used to determine fair value based on market data available with respect to the issue and similar issues without exclusive reliance on issuer-specific quoted market prices. For investments that are not priced by an outside service, a variety of methods are used to determine fair value. In these cases, plan sponsors, trustees (or custodians), other third-party administrators, or some combination thereof may have a role in determining fair value. Chapter 2 of the AICPA Audit and Accounting Guide Investment Companies provides further guidance on valuation of investments.

Fair Value Measurements

FASB ASC 820, Fair Value Measurements and Disclosures, defines fair value, sets out a framework for measuring fair value, and requires certain disclosures about fair value measurements. The following paragraphs summarize concepts in FASB ASC 820 but are not intended as a substitute for reviewing FASB ASC 820 in its entirety. Because investments are often the most significant account on the statement of net assets available for benefits, it is suggested that users of this guide refer to FASB ASC 820 for more complete information on fair value measurements and disclosures.

Meeting the requirements of FASB ASC 820 requires coordination among plan management, custodians, investment fiduciaries, and plan auditors. Plan sponsors and plan administrators will need to determine whether they have the appropriate valuation processes in place and sufficient data to determine the fair value of the plan’s investments using the framework provided and to present the disclosures about the use of fair value measurements required.

Definition of Fair Value

FASB ASC 820-1020 defines fair value as “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.”

Valuation Techniques

Paragraphs 24–35 of FASB ASC 820-10-35 describe the valuation techniques that should be used to measure fair value. Valuation techniques consistent with the market approach, income approach, or cost approach should be used to measure fair value, as follows:

- The market approach uses prices and other relevant information generated by market transactions involving identical or comparable assets or liabilities.
Valuation techniques consistent with the market approach include matrix pricing and often use market multiples derived from a set of comparables.

- The income approach uses valuation techniques to convert future amounts (for example, cash flows or earnings) to a single present amount (discounted). The measurement is based on the value indicated by current market expectations about those future amounts. Valuation techniques consistent with the income approach include present value techniques, option-pricing models, and the multiperiod excess earnings method.

- The cost approach is based on the amount that currently would be required to replace the service capacity of an asset (often referred to as *current replacement cost*). Fair value is determined based on the cost to a market participant (buyer) to acquire or construct a substitute asset of comparable utility, adjusted for obsolescence.

7.21 FASB ASC 820-10-35-24 states that valuation techniques that are appropriate in the circumstances and for which sufficient data are available should be used to measure fair value.

7.22 As explained in paragraphs 25–26 of FASB ASC 820-10-35, valuation techniques used to measure fair value should be consistently applied. However, a change in a valuation technique or its application is appropriate if the change results in a measurement that is equally or more representative of fair value in the circumstances. Such a change should be accounted for as a change in accounting estimate in accordance with the provisions of FASB ASC 250, *Accounting Changes and Error Corrections*.

The Fair Value Hierarchy

7.23 The fair value hierarchy in FASB ASC 820-10-35-37 prioritizes the inputs to valuation techniques used to measure fair value into three broad levels. The three levels are as follows:

a. Paragraphs 40–41 of FASB ASC 820-10-35 state that level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities that the reporting entity has the ability to access at the measurement date. An *active market*, as defined by the FASB ASC glossary, is “a market in which transactions for the asset or liability occur with sufficient frequency and volume to provide pricing information on an ongoing basis.” A quoted price in an active market provides the most reliable evidence of fair value and should be used to measure fair value whenever available, except as discussed in FASB ASC 820-10-35-16D. FASB ASC 820-10-35-44 provides guidance on how the quoted price should not be adjusted because of the size of the position relative to trading volume (blockage factor), but rather, would be measured within level 1 as the product of the quoted price for the individual instrument times the quantity held.
**Practice Tip**

See paragraph 7.32 for certain entities that calculate net asset value per share (NAV) (or its equivalent, for example, member units or an ownership interest in partners’ capital to which a proportionate share of net assets is attributed).

b. Paragraphs 47–51 of FASB ASC 820-10-35 explain that level 2 inputs are inputs other than quoted prices included within level 1 that are observable for the asset or liability, either directly or indirectly. If the asset or liability has a specified (contractual term), a level 2 input must be observable for substantially the full term of the asset or liability. Adjustments to level 2 inputs will vary depending on factors specific to the asset or liability. Those factors include the condition and location of the asset or liability, the extent to which the inputs relate to items that are comparable to the asset or liability, and the volume and level of activity in the markets within which the inputs are observed. An adjustment that is significant to the fair value measurement in its entirety might render the measurement a level 3 measurement, depending on the level in the fair value hierarchy within which the inputs used to determine the adjustment fall. As discussed in paragraph 48 of FASB ASC 820-10-35, level 2 inputs include the following:

i. Quoted prices for similar assets or liabilities in active markets

ii. Quoted prices for identical or similar assets or liabilities in markets that are not active

iii. Inputs other than quoted prices that are observable for the asset or liability (for example, interest rates and yield curves observable at commonly quoted intervals, volatilities, prepayment speeds, loss severities, credit risks, and default rates)

iv. Inputs that are derived principally from, or corroborated by, observable market data by correlation or other means (market-corroborated inputs)

c. As discussed in paragraphs 52–55 of FASB ASC 820-10-35, level 3 inputs are unobservable inputs for the asset or liability. Unobservable inputs should be used to measure fair value to the extent that relevant observable inputs are not available, thereby allowing for situations in which little, if any, market activity exists for the asset or liability at the measurement date. Unobservable inputs should be developed based on the best information available in the circumstances, which might include the reporting entity’s own data. In developing unobservable inputs, the reporting entity need not undertake all possible efforts to obtain information about market participant assumptions. Unobservable inputs should reflect the reporting entity’s own assumptions about the assumptions that market participants would use in pricing the asset or liability (including assumptions about risk). Assumptions about risk include the risk inherent in the inputs to the valuation technique. A measurement (for example, a mark-to-model
measurement) that does not include an adjustment for risk would not represent a fair value measurement if market participants would include one in pricing the related asset or liability. The reporting entity should not ignore information about market participant assumptions that is reasonably available without undue cost and effort. Therefore, the entity’s own data used to develop unobservable inputs should be adjusted if information is reasonably available without undue cost and effort that indicates that market participants would use different assumptions. Pending content in FASB ASC 820-1-55-22 discusses level 3 inputs for particular assets and liabilities.

7.24 As explained in FASB ASC 820-10-35-37, in some cases, the inputs used to measure fair value might fall in different levels of the fair value hierarchy. The level in the fair value hierarchy within which the fair value measurement in its entirety falls should be determined based on the lowest level input that is significant to the fair value measurement in its entirety.

Considerations When Determining Fair Value

Fair Value Determination When the Volume or Level of Activity Has Significantly Decreased

7.25 FASB ASC 820-10-35-51A–H clarifies the application of FASB ASC 820 in determining fair value when the volume and level of activity for the assets or liability has significantly decreased. Guidance is also included in identifying transactions that are not orderly. In addition, select paragraphs of FASB ASC 820-10-55-59A–I provide illustrations on the application of this guidance.

Fair Value Measurements of Investments in Certain Entities That Calculate NAV per Share (or Its Equivalent)

7.26 Paragraphs 59–62 of FASB ASC 820-10-35 provide additional guidance on the fair value measurements of investments in certain entities that calculate NAV (or its equivalent). This guidance permits, as a practical expedient, a reporting entity to estimate the fair value of an investment, that is, within the scope of the guidance, using the NAV (or its equivalent) if the NAV is calculated in a manner consistent with the measurement principles of FASB ASC 946, Financial Services—Investment Companies, as of the reporting entity’s measurement date.¹ See paragraph 7.32 for required disclosures.

Fair Value Option

¹ The AICPA issued a series of Technical Questions and Answers (TIS) to provide nonauthoritative guidance that is intended to assist reporting entities with the provisions of Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, Fair Value Measurements and Disclosures (specifically, Accounting Standards Update [ASU] No. 2009-12, Fair Value Measurements and Disclosures (Topic 820): Investments in Certain Entities That Calculated Net Asset Value per Share (or Its Equivalent), to estimate the fair value of investments in certain entities that calculate net asset value. TIS sections 2220.18–.27 (AICPA, Technical Practice Aids), apply to investments that are required to be measured and reported at fair value and are within the scope of paragraphs 4–5 of FASB ASC 820-10-15.
For assets and liabilities not currently required to be reported at fair value, FASB ASC 825, *Financial Instruments*, creates a fair value option under which an entity may irrevocably elect fair value as the initial and subsequent measure for many financial instruments and certain other items, with changes in fair value recognized in the statement of activities as those changes occur. An election is made on an instrument-by-instrument basis (with certain exceptions), generally when an instrument is initially recognized in the financial statements. Most financial assets and financial liabilities are eligible to be recognized using the fair value option, as are firm commitments for financial instruments and certain nonfinancial contracts. See FASB ASC 825 for further guidance, including presentation and disclosure requirements.

**Fair Value Measurement Disclosures**

*Recurring Measurements*

“Pending Content” in FASB ASC 820-10-50 discusses the disclosures required for assets and liabilities measured at fair value. “Pending Content” in FASB ASC 820-10-50-1 requires the reporting entity to disclose certain information that enables users of its financial statements to assess the valuation techniques and inputs used to develop those measurements. For assets and liabilities that are measured at fair value on a recurring basis in periods subsequent to initial recognition, the disclosures required by FASB ASC 820-10-50 in the tabular format, as shown in example 8 (paragraphs 60–63) of “Pending Content” in FASB ASC 820-10-55, should be made. For recurring fair value measurements using significant unobservable inputs (level 3), the reporting entity is required to disclose certain information to help users assess the effect of the measurements on earnings (or changes in net assets) for the period.

“Pending Content” in FASB ASC 820-10-50-2 requires the following disclosures to be made for each class of assets and liabilities. The reporting entity should provide sufficient information to permit reconciliation of the fair value measurement disclosures for the various classes of assets and liabilities to the line items in the net assets available for benefits.

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2 In January 2010, FASB issued ASU No. 2010-06, *Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements*. ASU No. 2010-06, among other things, changes the requirement to show purchases, sales, issuances, and settlements on a net basis to require separate disclosure for each type. The separate disclosure requirement of purchases, sales, issuances, and settlements activity are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years. Examples related to the guidance in this ASU are included in FASB ASC 820-10-55. Readers are encouraged to review the ASU in its entirety.

3 “Pending Content” in FASB ASC 820-10-50-5 provides the required disclosures for nonrecurring measurements.

4 See footnote 3.

5 For derivative assets and liabilities, the disclosures listed in paragraphs 7.29(a)–(c) should be made on a gross basis. The disclosures listed in paragraphs 7.29(d)–(e) should be made on either a gross or net basis.
a. The fair value measurement at the reporting date.

b. The level within the fair value hierarchy in which the fair value measurement in its entirety falls, segregating the fair value measurement using any of the following:
   i. Quoted prices in active markets for identical assets or liabilities (level 1)
   ii. Significant other observable inputs (level 2)
   iii. Significant unobservable inputs (level 3)

c. The amounts of significant transfers between level 1 and level 2 of the fair value hierarchy and the reasons for the transfers. Significant transfers into each level should be disclosed separately from transfers out of each level. A reporting entity should disclose and consistently follow its policy for determining when transfers between levels are recognized.

d. For fair value measurements using significant unobservable inputs (level 3), a reconciliation of the beginning and ending balances, separately presenting changes during the period attributable to any of the following:
   i. Total gains and losses for the period (realized and unrealized), separately presenting gains or losses included in earnings (or changes in net assets) and gains or losses recognized in other comprehensive income, and a description of where those gains or losses included in earnings (or changes in net assets) are reported in the statement of income (or activities) or in other comprehensive income.
   ii. Purchases, sales, issuances, and settlements.
   iii. Transfers in or out, or both, of level 3 and the reasons for those transfers. Significant transfers into level 3 should be disclosed separately from significant transfers out of level 3. A reporting entity should disclose and consistently follow its policy for determining when transfers between levels are recognized. The policy about the timing of recognizing transfers should be the same for transfers into level 3 as that for transfers out of level 3.

e. The amount of the total gains and losses.

f. For fair value measurements using significant other observable inputs (level 2) and significant unobservable inputs (level 3), a description of the valuation technique (or multiple valuation techniques) used, and the inputs used in determining the fair values of each class of assets or liabilities. If there has been a change in the valuation technique(s), the reporting entity should disclose that change and the reason for making it.
“Pending Content” in FASB ASC 820-10-50-2A states that for equity and debt securities, class should be determined on the basis of the nature and risks of the investments in a manner consistent with the guidance in FASB ASC 320-10-50-1B even if the equity securities or debt securities are not within the scope of FASB ASC 320-10-50-1B. Major security types are based on the nature and risks of the security. In determining whether disclosure for a particular security type is necessary and whether it is necessary to further separate a particular security type into greater detail, all of the following should be considered:

- The activity or business sector
- Vintage
- Geographic concentration
- Credit quality
- Economic characteristic

For all other assets and liabilities, judgment is needed to determine the appropriate classes of assets and liabilities for which disclosures about fair value measurements should be provided.

Fair value measurement disclosures for each class of assets and liabilities often will require greater disaggregation than the reporting entity’s line items in the statement of financial position. A reporting entity should determine the appropriate classes for those disclosures on the basis of the nature and risks of the assets and liabilities and their classification in the fair value hierarchy (that is, levels 1, 2, and 3). In determining the appropriate classes for fair value measurement disclosures, the reporting entity should consider the level of disaggregated information required for specific assets and liabilities under other FASB ASC topics. For example, under FASB ASC 815, Derivatives and Hedging, disclosures about derivative instruments are presented separately by type of contract, such as interest rate contracts, foreign exchange contracts, equity contracts, commodity contracts, and credit contracts. The classification of the asset or liability in the fair value hierarchy also should affect the level of disaggregation because of the different degrees of uncertainty and subjectivity involved in level 1, level 2, and level 3 measurements. For example, the number of classes may need to be greater for fair value measurements using significant unobservable inputs (that is, level 3 measurements) to achieve the disclosure objectives because level 3 measurements have a greater degree of uncertainty and subjectivity.

**Disclosures Relating to Fair Value Measurements of Investments in Certain Entities That Calculate NAV per Share (or Its Equivalent)**

“Pending Content” in FASB ASC 820-10-50-6A requires disclosures for each class of investment about the attributes of investments within the scope of paragraphs 4–5 of FASB ASC 820-10-15, such as the nature of any restrictions on the investor’s ability to redeem its investments at the measurement date, any unfunded commitments, and the investment strategies of the investees. These disclosures are required for all investments
within the scope of paragraphs 4–5 of FASB ASC 820-10-15 regardless of whether the practical expedient in FASB ASC 820-10-35-59 has been applied.

Accounting and Disclosure for Investments

Statement of Net Assets Available for Benefits

7.33 As previously noted in paragraph 7.15, plan investments generally are to be presented at their fair value at the reporting date (see paragraphs 7.52–7.67 and 2.32–2.37 for special provisions concerning the valuation of insurance and benefit responsive investment contracts). Per FASB ASC 960-325-50-3, the historical cost of plan investments presented at fair value is neither required nor proscribed.⁶ (The accounting for assets used in the administration of the plan is discussed in paragraphs 2.50–2.51; 3.56–3.57; and 4.66–4.67).

Presentation of Plan Investments

7.34 According to FASB ASC 960-325-45-1, paragraphs 2 and 5 of FASB ASC 962-325-45 and paragraphs 1–2 of FASB ASC 965-325-45-1, information regarding a plan’s investments (except for participant-directed defined contribution pension and health and welfare plans) should be presented in enough detail to identify the types of investments and should indicate whether reported fair values have been measured by quoted prices in an active market or are fair values otherwise determined. They may include government securities, short-term securities, corporate bonds, common stocks, mortgages, real estate, investments in bank common or collective trust funds, and registered investment companies (for example, mutual funds).

Practice Tip

The types of investments may also include master trusts and investments in contracts with insurance companies, including separate accounts, deposit administration (DA), and immediate participation guarantee (IPG) contracts.

7.35 In addition to the requirements in FASB ASC 960-325-45, 962-325-45, and 965-325-45, for plan investments to be detailed by general type, FASB ASC 820 requires disclosures about fair value to be made for each class of assets and liabilities. The disclosures required by FASB ASC 820 would typically satisfy the disclosures required by this paragraph.

7.36 In accordance with FASB ASC 960-325-50-2 and FASB 965-325-50-1, financial statement disclosures should include the identification of investments that represent 5 percent or more of the net assets available for benefits as of the end of the year. In accordance with FASB 962-325-45-7, in addition to the requirement to identify those investments that represent 5 percent or more of net assets available for benefit, defined contribution plans should specifically identify those investments that represent 5 percent or more of net assets available for benefits that are nonparticipant-directed. This

⁶ Historical cost is not required to be disclosed in the financial statements; however, supplemental schedules to the Form 5500 require historical cost.
disclosure is required for each period for which a statement of net assets available for benefits is presented. Listing all investments in Schedule H, line 4i—Schedule of Assets (Held at End of Year) required by ERISA does not eliminate the requirement to include this disclosure in the financial statements.)

**Statement of Changes in Net Assets Available for Benefits**

**Reporting Investments in the Statement of Changes in Net Assets Available for Benefits**

7.37 According to FASB ASC 960-30-45, 962-205-45-7, and 965-20-45-3, information regarding changes in net assets available for benefits should be presented in enough detail to identify the significant changes during the year. Chapters 2, 3, and 4 list the minimum disclosures that should be included in the statement of changes in net assets available for benefits. The following list only includes those minimum disclosures that are investment related. (Refer to paragraphs 2.56, 3.61, and 4.70 for a complete list of all minimum disclosures required.)

a. The net appreciation (depreciation) in fair value for each significant class of investments, segregated between investments whose fair values have been measured by quoted prices in an active market and those whose fair values have been otherwise determined. Realized gains and losses on investments that were both bought and sold during the year should be included. Such information may be useful in assessing the relative degree of objectivity or subjectivity in measuring the plan's investments and the relationship thereof to investment performance during the year. (Separate disclosure of realized gains and losses on investments sold during the year is neither required nor proscribed.) This information may be presented in the accompanying footnotes.

b. Investment income, exclusive of changes in fair value described in (a) preceding.

Certain registered investment companies and other investment funds pay dividends or capital gain distributions that are reinvested into the plan. FinREC recommends that the dividends be considered investment income and shown separately from changes in fair value. FinREC recommends that capital gain distributions be considered investment income and shown separately from changes in fair value or included as part of the net change in fair value.

c. Payments to insurance entities to purchase contracts that are excluded from plan assets. FASB ASC 960-205-50-1(e) requires disclosure of the plan’s dividend income related to excluded contracts and permits that income to be netted against this item.

**Registered Investment Companies (Mutual Funds)**

7.38 A registered investment company is an investment firm that is registered with the Securities and Exchange Commission and complies with certain stated legal requirements for the collective investment and reinvestment of assets contributed thereto from investors (employee benefit plans and nonemployee benefit plans). Many employee benefit plans,
particularly 401(k) plans and profit sharing plans, hold investments in open ended mutual funds.

Investments in Common or Collective Trust Funds

7.39 A *common or collective trust fund* (CCT) is a trust maintained by a bank, trust company, or similar institution, which may be a subsidiary of a larger financial services company, that is regulated, supervised, and subject to periodic examination by a state or federal agency, for the collective investment and reinvestment of assets contributed thereto from employee benefit plans maintained by more than one employer of a controlled group of corporations.

7.40 A CCT may be used to invest some or all of a plan's assets. A plan generally acquires investment units, sometimes referred to as *units of participation*, representing an undivided interest in the underlying assets of the trust. The purchase or redemption price of the units is determined periodically by the trustee based on the current market values of the underlying assets of the fund. The financial statements of many CCTs are often examined and reported on by auditors engaged by the bank. See paragraph 7.26 for accounting and reporting for investments in certain entities that calculate NAV.

7.41 It is common for plans to hold CCTs that invest in stable value assets that include traditional bank or insurance company-issued guaranteed investment contracts or synthetic investment contracts. See paragraph 2.32 for further guidance on accounting for stable value funds.

Practice Tip

Some plans may set up a separate account to invest plan assets, and the account may be reported on the trustee or custodial statements as a "fund" that may appear to be a common or collective trust or similar vehicle. However, a reading of the agreements would provide information that the account is not a "fund" with commingled assets of other benefit plans, but merely an account with investments that are owned by the plan. The investments in such accounts should be reported as individual investments owned by the plan.

Master Trust Arrangements

Practice Tip

In certain instances, typically as a result of plan mergers, transfers, or terminations, a trust that has historically reported as a master trust holds assets of a single plan. Consideration should be given regarding whether the trust continues to be reported as a master trust or whether it should be reported as a trust held on behalf of a single plan. Plan sponsors should look to the definition of a master trust according to the Department of Labor’s (DOL’s) Form 5500 instructions (as follows) and consult with legal counsel to determine if the trust can continue to be reported as a master trust.
According to the DOL's Form 5500 instructions, a master trust is a trust for which a regulated financial institution (bank, trust company, or similar financial institution that is regulated, supervised, and subject to periodic examination by a state or federal agency) serves as trustee or custodian and in which assets of more than one plan sponsored by a single employer or by a group of employers under common control are held.

A company that sponsors more than one employee benefit plan or a group of corporations under common control may place assets relating to some or all of the plans into one combined trust account, sometimes referred to as a master trust. Each plan has an interest in the assets of the trust, and ownership is represented by a record of proportionate dollar interest or by units of participation. Plan interests in master trusts may be divided interests, undivided interests, or a combination thereof. See paragraph 2.38 for further discussion. A bank ordinarily serves as the trustee for a master trust, acts as custodian, and may or may not have discretionary control over the assets.

According to FASB ASC 960-30-45-11, a plan’s investments in a master trust are presented in a single line item in the statement of net assets available for benefits. In addition FASB ASC 960-30-50-1 states that in the notes to the financial statements that the investments of a master trust be detailed by general type, such as government securities, short-term securities, corporate bonds, common stocks, mortgages, and real estate, as of the date of each statement of net assets available for benefits presented. FASB ASC 960-30-50-2 and 962-325-50-7 state that the net change in the fair value of each significant type of investment of the master trust and total investment income of the master trust by type, including interest and dividends, should also be disclosed in the notes for each period for which a statement of changes in net assets available for benefits is presented.

According to FASB ASC 960-30-50-3 and 962-325-50-8, the notes to the financial statements should also disclose a description of the basis used to allocate net assets, net investment income, gains and losses to participating plans, and the plan's percentage interest in the master trust as of the date of each statement of net assets available for benefits presented.

For master trusts, FinREC recommends that because audited financial statements are not required for the master trusts, the notes to the financial statements include the following disclosures:

a. A statement of net assets available for benefits of the master trust.

b. A statement of changes in net assets available for benefits of the master trust. To present the plan’s activity at the plan level and the master trust's activity at the master trust level, FinREC recommends that the plan’s activity, such as contributions (and related accruals) and benefit payments be recorded at the plan level, not the master trust level. Such activity should be recorded as a transfer in or out of the master trust. Plan level expenses that are plan specific (such as actuary, legal, and audit fees) and related accruals should be recorded at the plan level. Master trust investment expense (such as trustee, custodian, and investment

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management fees) and related accruals should be recorded at the master trust level.

c. Investments greater than 5 percent of master trust net assets.

Practice Tip

Investing in a master trust does not eliminate the disclosure requirements relating to the underlying investments in the master trust, as set forth in this chapter.

7.47 To present the investment risk specific to each plan, FinREC recommends that the following additional disclosures be made for plans with a specific interest (not an undivided interest) in master trust investments:

a. The plan’s percentage interest in each investment type

b. Investments greater than 5 percent in which the plan specifically invests

Practice Tip

Some plans commingle their assets in an account that does not meet the definition of a master trust in accordance with the DOL’s Form 5500 instructions. In certain situations, the account may be referred to as a master trust by the plan sponsor, but because it does not comply with the DOL’s master trust definition, it cannot be reported as a master trust. In these situations, because the account is not considered a master trust for accounting and reporting purposes, FinREC recommends the plan report its investment in the account based on an allocation of individual investments of the account.

Other Investments

7.48 Plans also invest in private investment funds meeting the definition of an investment company under the provisions of the AICPA Audit and Accounting Guide Investment Companies, such as the following:

- Hedge funds
- Private equity funds
- Real estate funds
- Venture capital funds
- Commodity funds
- Offshore fund vehicles

Separately Managed Accounts
Some plans have accounts at a trust company, insurance entity, or similar institution consisting of individual plan assets that are managed by an investment manager specifically for the plan. Often, these separately managed accounts are mistaken for pooled investment vehicles (for example, insurance entity pooled separate accounts [PSAs], mutual funds, or CCTs). A review of the underlying investment agreement with the investment manager or discussions with the service providers will typically reveal whether the investment is a pooled or separately managed vehicle. Individual assets of a separately managed account are held in the name of the plan and should be audited and reported in a manner similar to other individual investments held directly by the plan. In addition, these investments would be considered individual investments for purposes of reporting on Form 5500, Schedule H, line 4i—Schedule of Assets (Held at End of Year) and line 4j—Schedule of Reportable Transactions and for the 5 percent disclosure requirement for investments held by the plan. For these investment arrangements, they do not meet the DOL’s Form 5500 definition of a direct filing entity (DFE) and, therefore, they are not permitted to file as a DFE.

**Investments Reported as 103-12 Entities as Required by the DOL**

Many limited partnerships, hedge funds, and other pooled funds, such as group trusts, elect to file with the DOL as a 103-12 entity. A 103-12 entity is an arrangement consisting of two or more plans that are not members of a related group of employee benefit plans, that is not a master trust, investment account, CCT, or PSA, whose underlying assets include plan assets within the meaning of Title 29 U.S. Code of Federal Regulations (CFR) Part 2510.3-101. A 103-12 designation does not represent a legal form of operation but is merely a term given to an entity once it elects to file a Form 5500 with the DOL as a 103-12 entity.

Making this determination about whether a plan can follow this alternative method of reporting can be complicated and may necessitate legal or other specialized industry consultation. Generally, a 103-12 entity will operate based on its legal structure (according to its operating agreements) in the form of a financial services product, such as a trust or a limited partnership. Typically, audited financial statements are required by the entity’s operating agreement and are prepared in accordance with GAAP in a format following industry standards consistent with the entity’s operations. For example, a 103-12 entity that operates as a limited partnership would look to GAAP financial statement reporting requirements for limited partnerships.

**Contracts With Insurance Entities**

A plan may invest assets with an insurance entity pursuant to any of a number of different types of contracts. The nature of the contract will determine the related accounting and regulatory reporting requirements.7

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7 Plans funded solely with certain types of insurance contracts are not required under the Employee Retirement Income Security Act of 1974 to prepare financial statements or engage an independent auditor.
The amounts remitted to an insurance entity become the assets of the insurance entity for which it, in turn, assumes an obligation to fulfill the contract terms. This differs from a bank trust arrangement when a bank holds the assets for the plan as a fiduciary, and the assets are not included in the bank's financial statements. The extent to which the assets and transactions related to insurance arrangements are recorded in the plan's financial statements, and the extent of auditing procedures to be applied, depend on the terms of the contract with the insurance entity.

For employee benefit plans, the fundamental basis of distinction in classifying contracts for accounting purposes is

a. whether the contributions are currently used to purchase insurance or annuities for the individual participants, or

b. whether some or all of the contributions are accumulated in an unallocated fund to be used to meet benefit payments as they come due or to purchase annuities for participants at retirement or on earlier termination of service with a vested right.

Contractual arrangements under which funds are currently allocated to purchase insurance or annuities for individual participants are referred to as allocated funding arrangements, whereas other arrangements are called unallocated funding arrangements. Funds in an unallocated contract may be withdrawn or otherwise invested. Some contractual arrangements may involve both allocated and unallocated funding. Essentially, allocated contracts are excluded from, and unallocated contracts are included in, plan assets.

Allocated funding arrangements include annuity contracts. As defined in the FASB ASC glossary, an allocated contract is a contract with an insurance entity under which payments to the insurance entity are currently used to purchase immediate or deferred annuities for individual participants. As defined in the FASB ASC glossary (definition 1), an annuity contract is a contract in which an insurance entity unconditionally undertakes a legal obligation to provide specified pension benefits to specific individuals in return for a fixed consideration or premium. An annuity contract is irrevocable and involves the transfer of significant risk from the employer to the insurance entity. As such, investments in allocated contracts are not assets of the defined benefit pension plans.

An unallocated contract, as defined in the FASB ASC glossary, is a contract with an insurance entity under which related payments to the insurance entity are accumulated in an unallocated fund to be used to meet benefit payments when employees retire, either directly or through the purchase of annuities. Funds in an unallocated contract may also be withdrawn and otherwise invested. Unallocated funding ordinarily is associated with a group DA contract and an IPG. For investment purposes, unallocated funds may be

8 See paragraphs 7.63–7.66 for a discussion of insurance company separate accounts.
9 Although the term allocated account is used by insurance companies in connection with defined contribution plans when amounts are recorded in separate participant accounts, the term allocated, as it is used here, refers to situations in which the obligation to pay defined benefits under the plan is assumed by the insurance company.
10 See paragraphs 3.23–3.27 in this guide as well as FASB ASC 960-325-35-3.
11 Practice Tip: In the case of plans, payments would typically be contributions paid.
commingled in a general or pooled separate account or held in an individual separate account. These contracts generally should be included in the plan’s financial statements.

7.58 Determining whether insurance contract assets and related obligations should be reported in the plan’s financial statements requires a careful review of the contract.

DA Contracts

7.59 The term *deposit administration* is applied to a type of contract under which contributions are not currently applied to the purchase of single-payment deferred annuities for individual participants. Under a DA contract, payments to the insurance entity that are intended to provide future benefits to present employees are credited to an account. For investment purposes, the monies in the account are commingled with other assets of the insurance entity. The account is credited with interest at the rate specified in the contract; it is charged with the purchase price of annuities when participants retire and with any incidental benefits (death, disability, and withdrawal) disbursed directly from the account.

7.60 Although the insurance entity will guarantee a minimum stipulated interest rate on funds in the *active life fund* and rates at which annuities may be purchased, it does not guarantee that sufficient funds will be available to meet the cost of annuities to be purchased.

7.61 Experience-rated interest credits on funds in the undivided account are determined by the insurance entity, but they are not guaranteed. The calculation of these credits is based on internal records kept by the insurance entity for each contract and are determined by the actual investment experience of the insurance entity. These interest credits may be paid out, added to the balance of funds in the undivided account, or considered in an overall dividend calculation that also takes into account mortality, other actuarial experience, and reserves required by the insurance entity. Under DA contracts, amounts of dividend or rate credits are generally determined solely at the discretion of the insurance entity, which has no contractual obligation to pay a dividend. The contract holder has no contractual right to demand an accounting.

IPG Contracts

7.62 The IPG contract is a variation of the DA contract. In an IPG contract, the account is credited with the contributions received during the contract period plus its share of the insurance entity’s actual investment income. The IPG contract is written in two forms. Under either form the insurance entity is obligated to make lifetime benefit payments to retired employees. One form provides for the actual purchase of annuities as employees retire. An annual adjustment to the account occurs to reflect the insurance entity’s experience under the annuities. In the other form, the IPG contract may accomplish the same objective through a different technique. When an employee retires, pension payments are made directly from the account without the purchase of an annuity. However, according to a premium schedule in the contract, the balance of the account must be maintained at the amount required to provide for the remaining pension benefits for all current retirees. That portion of the account is referred to as the *retired life fund*. Thus, if necessary, the account could always be used to buy all annuities in force.
Investment Arrangements With Insurance Entities

7.63 A separate account may be used independent of, or as an adjunct to, a DA or IPG contract.

7.64 Separate accounts were developed to allow insured plans to compete with trust funds in making investments and in funding variable annuity plans. The assets of a separate account plan are assets of the insurance entity but are not commingled with the insurance entity's general assets. The purpose of a separate account is to provide flexibility in the investment of the plan's funds. A separate account may be established solely for one plan or, more commonly, may be pooled with the funds of several plans.

7.65 A separate account in which only one plan participates is generally referred to as an individual separate account or as a separate-separate account. The investments in the account must be separately identified, and the account is operated similarly to a bank trust fund, although it is included in the insurance entity's financial statements.

7.66 A separate account in which several plans participate generally is referred to as a pooled separate account, or PSA. A PSA is maintained by an insurance carrier, which is regulated, supervised, and subject to periodic examination by a state agency for the collective investment and reinvestment of assets contributed thereto from employee benefit plans maintained by more than one employer of controlled group of corporations. PSAs are similar to mutual funds except that they are issued by insurance companies and are not publicly traded like mutual funds. Each plan's share of a PSA is determined on a participation-unit or variable-unit basis. \(^\text{12}\) The plan's equity account provides a cumulative record of the number of participation units credited to the account and the number of units allocated or withdrawn from the account. The balance of participation units credited to the account, multiplied by the current participation-unit value, equals the amount of equity account assets held on behalf of the policyholder at any given time. The participation-unit value is adjusted periodically, usually each business day, to reflect investment results under the separate account. PSAs often have audited financial statements; however, for certain insurance companies, audited PSA financial statements are not available.

7.67 Many plans hold guaranteed investment contracts (GICs) in their investment portfolios. Normally issued through the general account, in its simplest form, a GIC is a contract between an insurance entity and a plan that provides for a guaranteed return on principal invested over a specified time period. Variations include contracts in which the plan is permitted to make deposits or withdrawals during certain windows during the contract life, contracts with multiple maturities (and rates), contracts in which the insurance entity guarantees a minimum rate and may credit the contract holder with additional interest, and contracts with floating rates. These contracts are unallocated and are generally to be included as plan assets at their contract value or fair values, as appropriate.

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\(^{12}\) In some separate accounts, a plan receives a guaranteed rate of return on funds held in the separate account. A plan's share would be the value of its units determined in accordance with applicable guidance for valuing investment contracts, and the funds held in the separate account should be viewed as an unallocated funding arrangement. Each investment contract in the pooled account should be evaluated individually for benefit responsiveness. However, if the separate account places any restrictions on access to funds for the payment of benefits, the underlying investment contracts would not be considered fully benefit-responsive.
Derivatives and Hedging Activities

7.68 Certain employee benefit plans invest in derivative instruments and participate in hedging activities. Derivatives are named as such because they derive their value from movements in an underlying, such as changes in the price of a security or a commodity. Examples of common derivatives in which benefit plans invest are as follows:

- **Commodity and financial futures contracts.** Commodity and financial futures contracts are traded on various exchanges and are, thus, distinguished from forward contracts, which are entered into privately by the parties. A commodity futures contract is a firm commitment to buy or sell a specified quantity of a specified grade of a specified commodity or, for financial futures contracts (including index futures contracts), a standardized amount of a deliverable grade security (or a basket for index futures) at a specified price and specified future date unless the contract is closed before the delivery date. For futures contracts, the date is a specified delivery month, and the contract is typically settled by executing an offsetting futures contract before or during the delivery month.

- **Option.** An option is a contract giving its owner the right, but not the obligation, to buy (call) or sell (put) a specified item at a fixed price (exercise or strike price) during a specified period (American option) or on a specified date (European option). Options may be exchange traded or over-the-counter.

- **Forward.** A legal contract between two parties to purchase and sell a specified quantity of a financial instrument at a price specified now, with delivery and settlement at a specified future date. Forward contracts are similar to futures contracts, except that they are not traded on an exchange. Their terms are not standardized, and they can be terminated only by agreement of both parties to the forward contract. If a forward contract is held until expiration, settlement by delivery is required. Most forwards are settled in cash. Forward contracts are entered into directly between two counterparties for future delivery or receipt at a specified price. As a result, they do not settle on a daily basis by margin settlement as do futures contracts. Although these contracts can be speculative in nature, a fund typically enters a forward contract to hedge overall portfolio currency risk.

- **Foreign exchange contract.** An agreement between two parties to exchange different currencies at a specified exchange rate at an agreed-upon future date. Although these contracts can be speculative in nature, a fund typically enters a foreign exchange contract to hedge overall portfolio currency risk or to settle foreign security transactions.

- **Swap.** An agreement between two parties to exchange economic risks and rewards on a specified principal amount (referred to as notional principal) of

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13 The FASB ASC glossary defines an underlying as “a specific interest rate, security price, commodity price, foreign exchange rate, index of prices or rates, or other variable.” An underlying may be a price or rate of an asset or liability, but is not the asset or liability itself. An underlying is a variable that, along with either a notional amount or a payment provision, determines the settlement of a derivative instrument.
underlying assets or obligations for a specified period. Many variations of swaps exist. Swaps can be linked to any number of underlying instruments and indexes, and swap terms can vary greatly. Trade date is the date of the commitment to enter into the swap. Interest begins accruing on the effective date, and cash flows are exchanged, as defined by the agreement.

**Practice Tip**

Often it is not apparent from a review of the investment statements that the plan is holding derivative investments. A discussion with the plan sponsor's management responsible for the investment transactions and the investment manager is helpful in determining whether the plan holds derivatives. Note: According to the DOL’s Form 5500 instructions, Schedule H Line 1c(15) includes other investments, such as options and index futures. Such investments would also be included on the Schedule of Assets (Held at End of Year).

7.69 FASB ASC 815 provides accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts (collectively referred to as *derivatives*), and for hedging activities. It requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value. FASB ASC 815 applies to certain contracts that meet the definition of *derivative instrument*, as defined in FASB ASC 815-10-15-83. See FASB ASC 815-10-15 for further information on certain contracts that are not subject to the requirements of FASB ASC 815.

7.70 As further discussed in FASB ASC 815-10-05-4, if certain conditions are met, an entity may elect to designate a derivative instrument in any one of the following ways:

a. A hedge of the exposure to changes in the fair value of a recognized asset or liability or an unrecognized firm commitment that are attributable to a particular risk (fair value hedge)

b. A hedge of the exposure to variability in the cash flows of a recognized asset or liability or of a forecasted transaction that is attributable to a particular risk (cash flow hedge)

c. A hedge of the foreign currency exposure of a net investment in a foreign operation, an unrecognized firm commitment (a foreign currency fair value hedge), an available-for-sale security (a foreign currency fair value hedge), or a forecasted transaction (a foreign currency cash flow hedge).

7.71 As stated by FASB ASC 815-10-35-2, the accounting for changes in the fair value (that is, gains and losses) of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, if so, on the reason for holding it. FASB ASC 815-10-50 also contains extensive disclosure requirements. This chapter includes certain information regarding accounting and reporting for derivatives but is not intended as a substitute for reading FASB ASC 815. Refer to the full text of FASB ASC 815 when testing accounting and reporting issues related to derivative instruments and hedging activities.
FASB ASC 815-10-50-1 states that an entity with derivative instruments should disclose information to enable users of the financial statements to understand all of the following:

a. How and why an entity uses derivative instruments

b. How derivative instruments and related hedged items are accounted for under FASB ASC 815

c. How derivative instruments and related hedged items affect an entity's financial position, financial performance, and cash flows

In accordance with paragraphs 1A–1B of FASB ASC 815-10-50, an entity that holds or issues derivative instruments (or nonderivative instruments that are designated and qualify as hedging instruments pursuant to FASB ASC 815-20-25-58 and 815-20-25-66) should disclose all of the following for every annual and interim reporting period for which a statement of financial position and statement of financial performance are presented:

a. Its objectives for holding or issuing those instruments

b. The context needed to understand those objectives

c. Its strategies for achieving those objectives

d. Information that would enable users of its financial statements to understand the volume of its activity in those instruments

For item (d) in the preceding paragraph, an entity should select the format and the specifics of disclosures relating to its volume of such activity that are most relevant and practicable for its individual facts and circumstances. Information about the instruments in items (a)–(c) in the preceding paragraph should be disclosed in the context of each instrument’s primary underlying risk exposure. Further, those instruments should be distinguished between those used for risk management purposes and those used for other purposes. Derivative instruments (and nonderivative instruments that are designated and qualify as hedging instruments pursuant to FASB ASC 815-20-25-58 and 815-20-25-66) used for risk management purposes include those designated as hedging instruments under Subtopic 815-21 as well as those used as economic hedges and for other purposes related to the entity’s risk exposures.

Securities Lending Arrangements

Practice Tip

Assets received as collateral that are included in investments on the statement of net assets available for benefits should also be included on the Form 5500 Schedule of Assets (Held at End of Year) and denoted as restricted securities on that schedule.

Securities custodians commonly carry out securities lending activities on behalf of their employee benefit plan clients. The borrowers of securities generally are required to
provide collateral to the lender (the plan). This collateral is typically cash, but sometimes it may be other securities or standby letters of credit, with a value slightly higher than that of the securities borrowed. If the collateral is cash, the lender typically earns a return by investing that cash at rates higher than the rate paid or rebated back to the borrower. If the collateral is other than cash, the lender typically receives a fee. FASB ASC 860, Transfers and Servicing, provides accounting and reporting guidance for transfers of financial assets, including accounting for securities lending activities. FASB ASC 860 addresses

a. whether the transaction is a sale of the loaned securities for financial reporting purposes.

b. if the transaction is not a sale, how the lender should report the loaned securities.

c. whether and how the lender should report the collateral.

d. how the lender should record income earned as a result of securities lending transactions.

7.76 If the securities lending transaction includes an agreement that entitles and obligates the plan (the transferor) to repurchase the transferred securities under which the plan maintains effective control over those securities, then the plan must account for those transactions as secured borrowings (not sales) and continue to report the securities on the statement of net assets. Typically, in a securities lending arrangement, the transferee has the right by custom or contract to sell or repledge the security loaned. In these instances, the securities loaned should be reclassified and reported by the plan (the transferor) separately from other assets not so encumbered (for example, as security pledged to creditors) pursuant to FASB ASC 860-30-25-5. Alternatively, if the transferee does not have the right by custom or contract to sell or repledge the security loaned, the plan should disclose in the notes to the financial statements the carrying amount and classification of any assets pledged as collateral, associated liabilities, and qualitative information about the relationship between those assets and associated liabilities as of the date of the latest statement of net assets presented pursuant to “Pending Content” in FASB ASC 860-30-50-1A. The plan should record the cash collateral received as an asset—and any investments made with that cash, even if made by agents or in pools with other securities lenders—along with the obligation to return the cash (considered the amount borrowed).

7.77 Generally, if the plan receives securities (instead of cash) that may be sold or repledged, the plan accounts for those securities in the same way as it would account for cash received. That is, the plan recognizes in the statement of net assets the securities received as collateral and the obligation to return that collateral. However, pursuant to “Pending Content” in FASB ASC 860-30-50-1A, the plan must also disclose the fair value as of the date of each statement of net assets presented of that collateral and of the portion of that collateral that it has sold or repledged and information about the sources and uses of that collateral. Because FASB ASC 860-30-25-5 requires that only the lender recognize securities collateral received in its statement of net assets, it is important to accurately identify the lender and borrower in securities lending transactions. One indicator that the
plan is the lender is that the collateral received by the lender generally has a value slightly higher (for example, 2 percent) than that of the securities being borrowed.

7.78 The plan should disclose its policy for requiring collateral or other security in accordance with “Pending Content” in FASB ASC 860-30-50-1A.

7.79 In accordance with FASB ASC 960-30-25-2 and FASB ASC 962-325-45-9, the interest income earned and rebate interest paid as a result of securities lending activity should be recorded on the statement of changes in net assets available for benefits.

Financial Statement Disclosures

7.80 Chapters 2, 3, and 4 contain detailed lists of financial statements disclosures, both required and recommended, to be made for defined contribution, defined benefit, and health and welfare plans, respectively. This section summarizes those required disclosures that are only for plan investments. Refer to paragraphs 2.65–2.75, 3.77–3.91, and 4.119–4.129 for a full list of disclosures.

Insurance Contracts

7.81 The policy regarding the purchase of insurance contracts that have been excluded from plan assets and the income from those contracts for the year should be disclosed. The plan's dividend income for the year that is related to excluded contracts should be disclosed and, as stated in FASB ASC 960-30-45-2, may be netted against payments to insurance entities related to such contracts as provided in FASB ASC 960-30-45-2(g).

7.82 According to FASB ASC 965-325-35-3, insurance contracts should be presented in the same manner as specified in the annual report filed by the plan with certain governmental agencies pursuant to ERISA; that is, either at fair value or at amounts determined by the insurance entity (contract value).

7.83 The current Form 5500 permits unallocated insurance contracts to be reported at either current value or as determined on the Schedule A to the Form 5500, Insurance Information, which is contract value. This is an exception to the general requirement of FASB ASC 965, Health and Welfare Benefit Plans, that plan investments be presented at fair value. In accordance with FASB ASC 965-325-35-3, plans not subject to ERISA should present insurance contracts as if the plans were subject to the reporting requirements of ERISA.

Fair Value Measurements

7.84 See paragraphs 7.28–7.32 for fair value measurement disclosures.

Financial Instruments
FASB ASC 825 requires all entities, except for those covered by an exemption for which the disclosure is optional, to disclose within the body of the financial statements or in the accompanying notes the fair value of financial instruments for which it is practicable to estimate fair value. An entity should also disclose the method(s) and significant assumptions used to estimate the fair value of financial instruments. According to FASB ASC 825-10-50-8, financial instruments of a pension plan other than (a) employers’ and plans’ obligations for pension benefits, other postretirement benefits including health care and life insurance benefits, postemployment benefits, employee stock option and stock purchase plans, and other forms of deferred compensation agreements; and (b) insurance contracts other than financial guarantees and investment contracts are included in the scope of FASB ASC 825 and are subject to its disclosure requirements. See paragraph 7.86 for additional disclosures required by FASB ASC 825 relating to concentrations of credit risk. In addition, the disclosure requirements of FASB ASC 820 may also apply.

FASB ASC 825-10-50-1 requires disclosure of all significant concentrations of credit risk arising from all financial instruments. In accordance with FASB ASC 825-10-50-21, the following information should be disclosed about each significant concentration:

- Information about the (shared) activity, region, or economic characteristic that identifies the concentration
- The maximum amount of loss due to credit risk that, based on the gross fair value of the financial instrument, the entity would incur if parties to the financial instruments that make up the concentration failed completely to perform according to the terms of the contracts and the collateral or other security, if any, for the amount due proved to be of no value to the plan
- The entity’s policy of requiring collateral or other security to support financial instruments subject to credit risk, information about the entity’s access to that collateral or other security, and the nature and a brief description of the collateral or other security supporting those financial instruments
- The entity’s policy of entering into master netting arrangements to mitigate the credit risk of financial instruments, information about the arrangements for which the plan is a party, and a brief description of the terms of those arrangements, including the extent to which they would reduce the entity’s maximum amount of loss due to credit risk.

Risks and Uncertainties

According to FASB ASC 825-10-50-3, the disclosures are optional for plans that meet all of the following criteria:

- The plan is a nonpublic entity.
- The plan’s total assets are less than $100 million on the date of the financial statements.
- The plan has no instrument that, in whole or in part, is accounted for as a derivative instrument under FASB ASC 815, Derivatives and Hedging, during the reporting period.

In accordance with FASB ASC 825-10-50-11, fair value disclosed in the notes should be presented together with the related carrying amount in a form that makes it clear whether the fair value and carrying amount represent assets or liabilities and how the carrying amounts relate to what is reported in the statement of net assets available for benefits.
In accordance with FASB ASC 275-10-50-16, vulnerability from concentrations arises when a plan is exposed to risk of loss greater than it would have had it mitigated its risk through diversification.

**Practice Tip**

Plans may hold investments and other assets (other than financial instruments for which concentrations are covered by FASB ASC 825, rather than FASB ASC 275, *Risks and Uncertainties*) that are concentrated in a single industry or in a single geographic area.

FASB ASC 275-10-50-16 states that concentrations should be disclosed if, based on information known to management before the financial statements are issued or are available to be issued, all of the following criteria are met: (a) the concentration exists at the date of the financial statements, (b) the concentration makes the plan vulnerable to the risk of a near-term severe impact, and (c) it is at least reasonably possible that the events that could cause the severe impact will occur in the near term.

For example, if the plan owns several investment properties (that is, apartment buildings) located in a geographic area that has only one significant employer and that employer announced last year that it is considering leaving the area, and it is reasonably possible that it will do so within the next year, this could significantly affect the plan's future cash flows from rents and the value of the investment properties.

**Master Trusts**

See paragraphs 7.45–7.46 for required and recommended disclosures relating to master trusts.

**Derivatives and Hedging Activities**

See paragraphs 7.72–7.74 for required disclosures relating to derivatives.

**Securities Lending**

See paragraph 7.78 for required disclosures related to securities lending activities.
Chapter 8

[Reserved]
[Reserved]
Chapter 10

[Reserved]
Chapter 11

[Reserved]
Chapter 12

[Reserved]
Chapter 13

[Reserved]
Appendix A: ERISA and Related Regulations

[Reserved]
Appendix B

[Reserved]
Appendix C

Illustrations of Financial Statements: Defined Contribution Plans

C.01 This appendix illustrates certain applications of the provisions of the Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 962, Plan Accounting—Defined Contribution Pension Plans, that apply for the annual financial statements of hypothetical defined contribution plans with participant-directed and nonparticipant-directed investments. Such illustrative plans include the XYZ Company 401(k) Plan (exhibits C-1–C-3), and the Sponsor Company Employee Stock Ownership Plan (exhibits C-4–C-6). It does not illustrate other provisions of FASB ASC 962 as well as other FASB ASC Topics that might apply in circumstances other than those assumed in this example. The formats and the wording of accompanying notes are only illustrative and are not necessarily the only possible presentations. Note that FASB ASC 820, Fair Value Measurements and Disclosures, disclosures are limited to the financial instruments contained within these specific examples. It is recommended that users consult all the illustrative financial statements within appendixes C, D, and E for FASB ASC 820 examples for differing types of financial instruments.

C.02 FASB ASC 962-325-35 states that defined contribution plans should report all investments (including derivative contracts) at fair value. However, contract value is the relevant measurement attribute for that portion of the net assets available for benefits of a defined contribution plan attributable to fully benefit-responsive investment contracts. According to paragraphs 2–3 of FASB ASC 962-205-45, the statement of net assets available for benefits of the plan should present amounts for (1) total assets, (2) total liabilities, (3) net assets reflecting all investments at fair value, and (4) net assets available for benefits. The amount representing the difference between (3) and (4) should be presented on the face of the statement of net assets available for benefits as a single amount, calculated as the sum of the amounts necessary to adjust the portion of net assets attributable to each fully benefit-responsive investment contract from fair value to contract value. The statement of changes in net assets available for benefits should be prepared on a basis that reflects income credited to participants in the plan and net appreciation or depreciation in the fair value of only those investment contracts that are not deemed to be fully benefit responsive.

C.03 In addition, FASB ASC 962-310-45-2 states that for reporting purposes, participant loans should be classified as notes receivable from participants. Participant loans should be measured at their unpaid principal balance plus any accrued but unpaid interest in accordance with FASB ASC 962-310-35-2. In addition, FASB ASC 962-310-50-1 states that the fair value disclosures for financial instruments prescribed in FASB ASC 825-10-50-10 through 825-10-50-16 are not required for participant loans. Participant loans continue, however, to be considered an investment for Form 5500 reporting purposes.
C.04 Although generally accepted accounting principles do not require comparative financial statements, the Employee Retirement Income Security Act of 1974 (ERISA) requires a comparative statement of net assets available for benefits. The illustrative financial statements are intended to comply with the requirements of ERISA.

C.05 ERISA and Department of Labor (DOL) regulations require that certain information be included in supplemental schedules, which are not required under generally accepted accounting principles, and reported on by the independent auditor. See appendix A for a further discussion of the ERISA and DOL requirements.

Other Resources

C.06 The illustrative financial statements contained in this appendix are only one example of how defined contribution retirement plan financial statements may look. The following table contains other sources of illustrations or actual defined contribution plan financial statements and disclosures that may provide additional guidance.

<table>
<thead>
<tr>
<th>Source/Comment</th>
<th>Source/Comment</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Source</strong></td>
<td><strong>Comments</strong></td>
</tr>
<tr>
<td>FASB ASC 815, Derivatives and Hedging</td>
<td>FASB ASC 815 contains implementation guidance and illustrations relating to derivatives and hedging.</td>
</tr>
<tr>
<td>FASB ASC 820, Fair Value Measurements and Disclosures</td>
<td>FASB ASC 820-10-55 contains implementation guidance and illustrations relating to fair value measurements.</td>
</tr>
<tr>
<td>AICPA Audit and Accounting Guide Investment Companies</td>
<td>The AICPA Audit and Accounting Guide Investment Companies contains illustrations with disclosures relating to unique investments, such as short sales, credit default swaps, futures, forwards, and derivatives.</td>
</tr>
<tr>
<td>Accounting Trends &amp; Techniques, Employee Benefit Plans, 3rd Edition</td>
<td>This publication is intended to provide preparers and auditors of employee benefit plan financial statements with a compilation of illustrative financial statement disclosures based on actual</td>
</tr>
</tbody>
</table>

1 Additional resources that contain actual plan financial statements include EFAST2, located at www.dol.gov and EDGAR, located at www.sec.gov.
### I. Illustrative Financial Statements and Disclosures of a Defined Contribution Plan With Participant-Directed and Nonparticipant-Directed Investment Programs

**Exhibit C-1**

**XYZ Company 401(k) Plan**

**Statements of Net Assets Available for Benefits**

<table>
<thead>
<tr>
<th></th>
<th>December 31, 20X1</th>
<th>December 31, 20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments at fair value (See notes C, D, E, and F)</td>
<td>$8,892,000</td>
<td>$7,655,000</td>
</tr>
<tr>
<td>Receivables:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employer contribution</td>
<td>14,000</td>
<td>10,000</td>
</tr>
<tr>
<td>Participant contributions</td>
<td>52,000</td>
<td>50,000</td>
</tr>
<tr>
<td>Notes receivable from participants</td>
<td>300,000</td>
<td>350,000</td>
</tr>
<tr>
<td>Total receivables</td>
<td>366,000</td>
<td>410,000</td>
</tr>
<tr>
<td>Total assets</td>
<td>9,258,000</td>
<td>8,065,000</td>
</tr>
<tr>
<td><strong>Liabilities:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts payable</td>
<td>10,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Excess contributions payable</td>
<td>15,000</td>
<td>—</td>
</tr>
<tr>
<td>Total liabilities</td>
<td>25,000</td>
<td>20,000</td>
</tr>
<tr>
<td>Net assets reflecting investments at fair value</td>
<td>9,233,000</td>
<td>8,045,000</td>
</tr>
<tr>
<td>Adjustment from fair value to contract value for fully benefit-</td>
<td>(15,000)</td>
<td>(10,000)</td>
</tr>
</tbody>
</table>

2 The requirements in Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) 2010-25, *Reporting Loans to Participants by Defined Contribution Pension Plans*, should be applied retrospectively to all prior periods presented, effective for fiscal years ending after December 15, 2010. Early adoption is permitted.
responsive investment contracts

Net assets available for benefits

\[
\begin{array}{cc}
\$9,218,000 & \$8,035,000 \\
\end{array}
\]

See accompanying notes to the financial statements.
XYZ Company 401(k) Plan
Statement of Changes in Net Assets Available for Benefits

Year Ended
December 31,
20X1

Additions:
Additions to net assets attributed to:

Investment income:
Net appreciation in fair value
of investments (see note C) $ 279,000
Interest 369,000
Dividends 165,000

813,000

Interest income on notes receivable from participants 20,000

Contributions:
Employer 599,000
Participant 800,000
Rollovers (see note G) 200,000

1,599,000

Total additions 2,432,000

Deductions:
Deductions from net assets attributed to:
Benefits paid to participants 1,244,000
Administrative expenses 5,000

Total deductions 1,249,000

Net increase 1,183,000

Net assets available for benefits:
Beginning of year 8,035,000
End of year $9,218,000

See accompanying notes to the financial statements.
XYZ Company 401(k) Plan
Notes to Financial Statements

A. Description of Plan

The following description of the XYZ Company (Company) 401(k) Plan (Plan) provides only general information. Participants should refer to the Plan agreement for a more complete description of the Plan’s provisions.

1. General. The Plan is a defined contribution plan covering all full-time employees of the Company who have one year of service and are age 21 or older. The Plan is subject to the provisions of ERISA.

2. Contributions. Each year, participants may contribute up to 12 percent of pretax annual compensation, as defined in the Plan. Participants who have attained age 50 before the end of the Plan year are eligible to make catch-up contributions. Participants may also contribute amounts representing distributions from other qualified defined benefit or defined contribution plans (rollover). Participants direct the investment of their contributions into various investment options offered by the Plan. The Plan includes an auto-enrollment provision whereby all newly eligible employees are automatically enrolled in the Plan unless they affirmatively elect not to participate in the Plan. Automatically enrolled participants have their deferral rate set at 2 percent of eligible compensation and their contributions invested in a designated balanced fund until changed by the participant. The Company contributes 25 percent of the first 6 percent of base compensation that a participant contributes to the Plan. The matching Company contribution is invested directly in XYZ Company common stock. Additional profit sharing amounts may be contributed at the option of the Company’s board of directors and are invested in a portfolio of investments as directed by the Company. Contributions are subject to certain limitations.

3. Participant accounts. Each participant’s account is credited with the participant’s contributions and Company matching contributions, as well as allocations of the Company’s profit sharing contribution and Plan earnings. Participant accounts may also be charged with an allocation of certain administrative expenses. Allocations are based on participant earnings, account balances, or specific participant transactions, as defined. The benefit to which a participant is entitled is the benefit that can be provided from the participant’s vested account.

4. Vesting. Participants are vested immediately in their contributions plus actual earnings thereon. Vesting in the Company’s contribution portion of their accounts is based on years of continuous service. A participant is 100 percent vested after three years of credited service.
5. **Notes receivable from participants.** Participants may borrow from their fund accounts a minimum of $1,000 up to a maximum equal to the lesser of $50,000 or 50 percent of their account balance. The loans are secured by the balance in the participant’s account. The loan interest rate, determined quarterly, is set at 2 percent above the prime rate. Principal and interest is paid ratably through monthly payroll deductions.

6. **Payment of benefits.** On termination of service due to death, disability, or retirement, a participant may elect to receive either a lump sum amount equal to the value of the participant’s vested interest in his or her account, or annual installments over a 10-year period. For termination of service for other reasons, a participant may receive the value of the vested interest in his or her account as a lump sum distribution.

7. **Administrative expenses.** Certain expenses of maintaining the Plan are paid by the Company. Loan administration fees are charged directly to the participant’s account and are included in administrative expenses.

8. **Forfeited accounts.** At December 31, 20X1 and 20X0, forfeited nonvested accounts totaled $7,500 and $5,000 respectively. These accounts will be used to reduce future employer contributions. Also, in 20X1, employer contributions were reduced by $5,000 from forfeited nonvested accounts.

**B. Summary of Accounting Policies**

*Basis of Accounting*

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

Investment contracts held by a defined contribution plan are required to be reported at fair value. However, contract value is the relevant measurement attribute for that portion of the net assets available for benefits of a defined contribution plan attributable to fully benefit-responsive investment contracts because contract value is the amount participants would receive if they were to initiate permitted transactions under the terms of the plan. The Statement of Net Assets Available for Benefits presents the fair value of the investment contracts as well as the adjustment of the fully benefit-responsive investment contracts from fair value to contract value. The Statement of Changes in Net Assets Available for Benefits is prepared on a contract value basis.

*Use of 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 changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

*Investment Valuation and Income Recognition*
Investments are reported at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See note E for discussion of fair value measurements.

Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date. Net appreciation includes the Plan’s gains and losses on investments bought and sold as well as held during the year.

*Notes receivable from participants*

Notes receivable from participants are measured at their unpaid principal balance plus any accrued but unpaid interest. Delinquent loans are treated as distributions based upon the terms of the plan document.

*Excess Contributions Payable*

Amounts payable to participants for contributions in excess of amounts allowed by the IRS are recorded as a liability with a corresponding reduction to contributions. The Plan distributed the excess contributions to the applicable participants prior to March 15, 20X2.

*Payment of Benefits*

Benefits are recorded when paid.

*Operating Expenses*

All expenses of maintaining the Plan are paid by the Company.

*Subsequent Events*

The Plan has evaluated subsequent events through [insert date], the date the financial statements were available to be issued.³

**C. Investments**

The following presents investments that represent 5 percent or more of the Plan’s net assets.

<table>
<thead>
<tr>
<th>December 31,</th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
</table>

³ The footnote would not be included when performing an 11-K audit.
Prosperity Investments Common Stock Fund, 226,250 and 200,000 shares, respectively $2,262,500* $2,000,000*  
XYZ Company common stock, 400,000 and 390,000 shares, respectively 470,000* 420,000*  
ABC Corporation common stock, 390,000 and 380,000 shares, respectively 490,000* 450,000*  
Prosperity Investments S&P 500 Collective Trust Fund, 140,000 and 210,000 shares, respectively 1,422,000 2,100,000  
Guaranteed investment contract with National Insurance Company, at contract value #2012A, matures 12/31/X5 (note F) 1,500,000 650,000  

*Nonparticipant-directed

During 20X1, the Plan’s investments (including gains and losses on investments bought and sold, as well as held during the year) appreciated in value by $279,000 as follows:

<table>
<thead>
<tr>
<th>Investments</th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mutual funds</td>
<td>$187,000</td>
<td></td>
</tr>
<tr>
<td>Common stocks</td>
<td>30,000</td>
<td></td>
</tr>
<tr>
<td>Collective trust</td>
<td>42,000</td>
<td></td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>30,000</td>
<td></td>
</tr>
<tr>
<td>U.S. government securities</td>
<td>(10,000)</td>
<td></td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$279,000</strong></td>
<td></td>
</tr>
</tbody>
</table>

D. Nonparticipant-Directed Investments

Information about the net assets and the significant components of the changes in net assets relating to the nonparticipant-directed investments is as follows:

<table>
<thead>
<tr>
<th>Net Assets</th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mutual funds</td>
<td>$2,262,500</td>
<td>$2,000,000</td>
</tr>
<tr>
<td>Common stocks</td>
<td>960,000</td>
<td>870,000</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>307,500</td>
<td>255,000</td>
</tr>
<tr>
<td>U.S. government securities</td>
<td>225,000</td>
<td>120,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$3,755,000</strong></td>
<td><strong>$3,245,000</strong></td>
</tr>
</tbody>
</table>
Changes in Net Assets:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Contributions</td>
<td>$599,000</td>
</tr>
<tr>
<td>Dividends</td>
<td>165,000</td>
</tr>
<tr>
<td>Net appreciation</td>
<td>60,000</td>
</tr>
<tr>
<td>Benefits paid to participants</td>
<td>(280,000)</td>
</tr>
<tr>
<td>Transfers to participant-directed investments</td>
<td>(34,000)</td>
</tr>
<tr>
<td></td>
<td><strong>$510,000</strong></td>
</tr>
</tbody>
</table>

E. Fair Value Measurements

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*, provides the framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820 are described as follows:

<table>
<thead>
<tr>
<th>Level 1</th>
<th>Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Plan has the ability to access.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level 2</td>
<td>Inputs to the valuation methodology include</td>
</tr>
<tr>
<td></td>
<td>• quoted prices for similar assets or liabilities in active markets;</td>
</tr>
<tr>
<td></td>
<td>• quoted prices for identical or similar assets or liabilities in inactive markets;</td>
</tr>
<tr>
<td></td>
<td>• inputs other than quoted prices that are observable for the asset or liability;</td>
</tr>
<tr>
<td></td>
<td>• inputs that are derived principally from or corroborated by observable market data by correlation or other means.</td>
</tr>
<tr>
<td></td>
<td>If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.</td>
</tr>
<tr>
<td>Level 3</td>
<td>Inputs to the valuation methodology are unobservable and significant to the fair value measurement.</td>
</tr>
</tbody>
</table>

The asset or liability’s fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement.
Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 20X1 and 20X0.

**Users’ Note:** Note that information contained herein for fair value disclosures is based upon information for the Illustration of Financial Statements: Defined Contribution as presented in exhibits C-1–C-3. This illustrative disclosure is not representative of all types of investment securities and does not represent the classification for every instance of such investment securities. It should not be assumed that these methodologies are the only appropriate methodologies for these types of assets. As stated in FASB ASC 820-10-35-5, “The principle (or most advantageous) market (and thus, market participants) should be considered from the perspective of the reporting entity, thereby allowing for differences between and among entities with different activities.” Plan sponsors will have to evaluate the appropriate classification for each type of investments securities based upon the plan’s portfolio and actual fair valuation techniques used.

**Common stocks, corporate bonds, and U.S. government securities:** Valued at the closing price reported on the active market on which the individual securities are traded.

**Mutual funds:** Valued at the net asset value (NAV) of shares held by the Plan at year-end.

**Collective trust fund:** Valued at the NAV of shares of a bank collective trust held by the Plan at year-end. The NAV is based on the fair value of the underlying investments held by the fund. Participant transactions (issuances and redemptions) may occur daily. Were the Plan to initiate a full redemption of the collective trust, the investment advisor reserves the right to temporarily delay withdrawal from the trust in order to ensure that securities liquidations will be carried out in an orderly business manner.

**Users’ Note:** Note that information included in the fair value level tables that follow, in addition to what is included in the description of the collective trust fund, is just one way to satisfy the disclosure requirements of ASU No. 2009-12. The table included in the illustration in ASU No. 2009-12 provides another example of how this information may be displayed.

**Guaranteed investment contract:** Valued at fair value by discounting the related cash flows based on current yields of similar instruments with comparable durations considering the creditworthiness of the issuer (see note F).

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.
The following table sets forth by level, within the fair value hierarchy, the Plan’s assets at fair value as of December 31, 20X1 and 20X0:

**Users’ Note:** The following table illustrates certain disclosure requirements of FASB ASC 820. The disclosures illustrated describe the nature and risks of securities as required by FASB ASC 820-10-50 and are included for illustrative purposes and are NOT intended to represent the ONLY way to disclose such information.

ASU No. 2010-06, *Fair Value Measurements and Disclosures* (Topic 820): *Improving Disclosures about Fair Value Measurements*, amends the disclosure requirements of FASB ASC 820, including amendments regarding the level of disaggregation for each class of assets and liabilities. The illustrative financial statements in this appendix have been amended to conform to ASU No. 2010-06, where applicable. The amendments in the level 3 fair value measurement roll forward related to the separate disclosures requirement of purchases, sales, issuances, and settlements activity are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years, and, therefore, these financial statements have not been updated for those amendments. These illustrative financial statements do not contain any transfers between fair value levels.

### Assets at Fair Value as of December 31, 20X1

<table>
<thead>
<tr>
<th></th>
<th>Level 1</th>
<th>Level 2</th>
<th>Level 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mutual funds:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Index funds</td>
<td>$2,262,500</td>
<td></td>
<td></td>
<td>$2,262,500</td>
</tr>
<tr>
<td>Balanced funds</td>
<td>1,375,000</td>
<td></td>
<td></td>
<td>1,375,000</td>
</tr>
<tr>
<td>Fixed income funds</td>
<td>800,000</td>
<td></td>
<td></td>
<td>800,000</td>
</tr>
<tr>
<td>Other funds</td>
<td>25,000</td>
<td></td>
<td></td>
<td>25,000</td>
</tr>
<tr>
<td>Total mutual funds</td>
<td>4,462,500</td>
<td></td>
<td></td>
<td>4,462,500</td>
</tr>
<tr>
<td>Common stocks:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Industrials</td>
<td>490,000</td>
<td></td>
<td></td>
<td>490,000</td>
</tr>
<tr>
<td>Telecommunications</td>
<td>470,000</td>
<td></td>
<td></td>
<td>470,000</td>
</tr>
<tr>
<td>Total common stocks</td>
<td>960,000</td>
<td></td>
<td></td>
<td>960,000</td>
</tr>
<tr>
<td>Collective trust – S&amp;P 500 fund</td>
<td></td>
<td>1,422,000</td>
<td></td>
<td>1,422,000</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>307,500</td>
<td></td>
<td></td>
<td>307,500</td>
</tr>
<tr>
<td>U.S. government securities</td>
<td>225,000</td>
<td></td>
<td></td>
<td>225,000</td>
</tr>
<tr>
<td>Guaranteed investment contract</td>
<td></td>
<td></td>
<td>$1,515,000</td>
<td>1,515,000</td>
</tr>
<tr>
<td>Total assets at fair value</td>
<td>$5,955,000</td>
<td>1,422,000</td>
<td>$1,515,000</td>
<td>$8,892,000</td>
</tr>
</tbody>
</table>

### Assets at Fair Value as of December 31, 20X0

<table>
<thead>
<tr>
<th></th>
<th>Level 1</th>
<th>Level 2</th>
<th>Level 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Mutual funds:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

172
Index funds  $2,000,000  —  —  $2,000,000  
Balanced funds  1,150,000  —  —  1,150,000  
Fixed income  400,000  —  —  400,000  
Other funds  100,000  —  —  100,000  
Total mutual funds  3,650,000  —  —  3,650,000  

Common stocks:  
- Industrials  450,000  —  —  450,000  
- Telecommunications  420,000  —  —  420,000  
Total common stocks  870,000  —  —  870,000  
Collective trust – S&P 500 fund  —  2,100,000  —  2,100,000  
Corporate bonds  255,000  —  —  255,000  
U.S. government securities  120,000  —  —  120,000  
Guaranteed investment contract  —  —  $660,000  660,000  

Total assets at fair value  $4,895,000  2,100,000  $660,000  $7,655,000  

There were no significant transfers between level 1 and level 2 investments during the year ended December 31, 20X1.

Level 3 Gains and Losses

The following table sets forth a summary of changes in the fair value of the Plan’s level 3 assets for the year ended December 31, 20X1.

<table>
<thead>
<tr>
<th>Level 3 Assets</th>
<th>Year Ended December 31, 20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Guaranteed Investment Contract</td>
<td>$660,000</td>
</tr>
</tbody>
</table>

- Balance, beginning of year  $660,000  
- Realized gains/(losses)  —  
- Unrealized gains/(losses) relating to instruments still held at the reporting date  40,000  
- Purchases and issuances  815,000  
- Sales and repayments  —  
- Transfers in and/or out of  —  

173
level 3

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance, end of year</td>
<td>$1,515,000</td>
</tr>
<tr>
<td>The amount of total gains or losses for the period attributable to the change in unrealized gains or losses relating to assets still held at the reporting date</td>
<td>$40,000</td>
</tr>
</tbody>
</table>

F. Guaranteed Investment Contract With National Insurance Company

In 20X0, the Plan entered into a benefit-responsive guaranteed investment contract with National Insurance Company (National). National maintains the contributions in a general account. The account is credited with earnings on the underlying investments and charged for participant withdrawals and administrative expenses. The guaranteed investment contract issuer is contractually obligated to repay the principal and a specified interest rate that is guaranteed to the Plan.

Because the guaranteed investment contract is fully benefit-responsive, contract value is the relevant measurement attribute for that portion of the net assets available for benefits attributable to the guaranteed investment contract. The guaranteed investment contract is presented on the face of the statement of net assets available for benefits at fair value with an adjustment to contract value in arriving at net assets available for benefits. Contract value, as reported to the Plan by National, represents contributions made under the contract, plus earnings, less participant withdrawals, and administrative expenses. Participants may ordinarily direct the withdrawal or transfer of all or a portion of their investment at contract value.

There are no reserves against contract value for credit risk of the contract issuer or otherwise. The fair value of the investment contract at December 31, 20X1 and 20X0, was $1,515,000 and $660,000, respectively. The crediting interest rate is based on a formula agreed upon with the issuer, but it may not be less than 4 percent. Such interest rates are reviewed on a quarterly basis for resetting.

Certain events limit the ability of the Plan to transact at contract value with the issuer. Such events include (1) amendments to the Plan documents (including complete or partial Plan termination or merger with another plan), (2) changes to the Plan’s prohibition on competing investment options or deletion of equity wash provisions, (3) bankruptcy of the Plan sponsor or other Plan sponsor events (for example, divestitures or spin-offs of a subsidiary) that cause a significant withdrawal from the Plan, or (4) the failure of the trust to qualify for exemption from federal income taxes or any required prohibited transaction exemption under ERISA. The Plan administrator does not believe that any events that
would limit the Plan’s ability to transact at contract value with participants are probable of occurring.

The guaranteed investment contract does not permit the insurance company to terminate the agreement prior to the scheduled maturity date.

The average yields earned by the guaranteed investment contract are as follows:

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Based on actual earnings</td>
<td>4.68%</td>
<td>4.90%</td>
</tr>
<tr>
<td>Based on interest rate credited to participants</td>
<td>3.97%</td>
<td>4.16%</td>
</tr>
</tbody>
</table>

G. Rollovers

On January 20, 20X1, XYZ Company acquired ABC Company and approved an amendment to terminate the ABC 401(k) Plan effective November 1, 20X1. All participants in the ABC 401(k) Plan became 100 percent vested upon termination and were provided the option to have their account balance rolled into the Plan. Participants were also permitted to roll balances to any other qualified plan or IRA, receive a lump sum distribution, or be paid through an annuity contract. Total assets of $XXX were rolled into the Plan as of December 31, 20X1, and are included in rollovers on the statement of changes in net assets available for benefits.

H. Related-Party Transactions

Certain Plan investments are shares of mutual funds managed by Prosperity Investments. Prosperity Investments is the trustee as defined by the Plan and, therefore, these transactions qualify as party-in-interest transactions; however, they are exempt from the prohibited transactions rules under ERISA. Fees paid by the Plan for the investment management services are netted against net appreciation in fair value of investments.

I. Plan Termination

Although it has not expressed any intent to do so, the Company has the right under the Plan to discontinue its contributions at any time and to terminate the Plan subject to the provisions of ERISA. In the event of Plan termination, participants would become 100 percent vested in their employer contributions.

J. Tax Status

The IRS has determined and informed the Company by a letter dated August 30, 20XX, that the Plan and related trust are designed in accordance with applicable sections of the Internal Revenue Code (IRC). Although the Plan has been amended since receiving the determination letter, 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 and, therefore, believe that the Plan is qualified, and the related trust is tax-exempt.

Accounting principles generally accepted in the United States of America require plan management to evaluate tax positions taken by the plan and recognize a tax liability if the organization has taken an uncertain position that more likely than not would not be sustained upon examination by the [identify applicable taxing authorities]. The Plan administrator has analyzed the tax positions taken by the plan and has concluded that as of December 31, 20X1, there are no uncertain positions taken, or expected to be taken, that would require recognition of a liability or disclosure in the financial statements. The Plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The Plan administrator believes it is no longer subject to income tax examinations for years prior to 20XX.

K. Risks and Uncertainties

The Plan invests in various investment securities. Investment securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect participants' account balances and the amounts reported in the statement of net assets available for benefits.

L. Reconciliation of Financial Statements to Form 5500

The following is a reconciliation of net assets available for benefits per the financial statements at December 31, 20X1 and 20X0, to Form 5500:

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net assets available for benefits per the financial statements</td>
<td>$9,218,000</td>
<td>$8,035,000</td>
</tr>
<tr>
<td>Amounts allocated to withdrawing participants</td>
<td>(50,000)</td>
<td>(35,000)</td>
</tr>
<tr>
<td>Net assets available for benefits per the Form 5500</td>
<td>$9,168,000</td>
<td>$8,000,000</td>
</tr>
</tbody>
</table>

The following is a reconciliation of benefits paid to participants per the financial statements for the year ended December 31, 20X1, to Form 5500:

| Benefits paid to participants per the financial statements | $1,144,000 |
| Add: Amounts allocated to withdrawing participants at December 31, 20X1 | 50,000 |
| Less: Amounts allocated to withdrawing participants at December 21, 20X0 | (35,000) |
Benefits paid to participants per Form 5500 $1,159,000

Amounts allocated to withdrawing participants are recorded on the Form 5500 for benefit claims that have been processed and approved for payment prior to year-end, but not yet paid as of that date.
II. Illustrations of Financial Statements: Employee Stock Ownership Plan

Exhibit C-4

Employee Stock Ownership Plan

Sponsor Company Stock Ownership Plan

Statements of Net Assets Available for Benefits

<table>
<thead>
<tr>
<th>December 31,</th>
<th>20X2</th>
<th>20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Allocated</td>
<td>Unallocated</td>
</tr>
<tr>
<td>Assets:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investment in Sponsor Company common stock, at fair value</td>
<td>$34,890,000</td>
<td>$57,430,000</td>
</tr>
<tr>
<td>Receivables:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employer contributions</td>
<td>—</td>
<td>8,607,000</td>
</tr>
<tr>
<td>Dividends and interest</td>
<td>570,000</td>
<td>459,000</td>
</tr>
<tr>
<td>Cash</td>
<td>156,000</td>
<td>863,000</td>
</tr>
<tr>
<td>Total assets</td>
<td>$35,616,000</td>
<td>$67,359,000</td>
</tr>
<tr>
<td>Liabilities:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Interest payable</td>
<td>—</td>
<td>1,396,000</td>
</tr>
<tr>
<td>Loan payable</td>
<td>—</td>
<td>73,970,000</td>
</tr>
</tbody>
</table>

4 The columns reflected in the example are appropriate for the presentation of a leveraged employee stock ownership plan (ESOP). For a nonleveraged ESOP, the presentation would reflect only the total column without the segregation between allocated and unallocated.

Allocated and unallocated designations distinguish between assets that belong to plan participants and those that are still available as collateral for the ESOP loan. Under the Employee Retirement Income Security Act of 1974 (ERISA), the lender has access to the securities held by the plan that represent unallocated employer contributions to service the debt and any earnings on those amounts. Earnings on temporary cash investments also are available to the lender.

An accrued employer contribution for current or future debt service is, therefore, reflected on the Statement of Net Assets Available for Benefits and the Statement of Changes in Net Assets Available for Benefits in the “unallocated” column. In contrast, an employer contribution accrued to fund distributions to terminated participants is reflected in the “allocated” column.

This distinction is not reflected in the participant account balances when reporting to the participant under ERISA. Contributions accrued for future debt service are allocated to the accounts of plan participants.
The accompanying notes are an integral part of these financial statements.
### Sponsor Company Stock Ownership Plan

#### Statement of Changes in Net Assets Available for Benefits

*December 31, 20X2*

<table>
<thead>
<tr>
<th></th>
<th>Allocated</th>
<th>Unallocated</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Investment income:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net appreciation in the fair value of investments</td>
<td>$9,205,000</td>
<td>$15,052,000</td>
<td>$24,257,000</td>
</tr>
<tr>
<td>Interest</td>
<td>31,000</td>
<td>58,000</td>
<td>89,000</td>
</tr>
<tr>
<td>Dividends</td>
<td>1,380,000</td>
<td>2,184,000</td>
<td>3,564,000</td>
</tr>
<tr>
<td>Employer contributions</td>
<td>—</td>
<td>11,524,000</td>
<td>11,524,000</td>
</tr>
<tr>
<td>Allocation of 142,000 shares of common stock of Sponsor Company, at fair value</td>
<td>4,637,000</td>
<td>—</td>
<td>4,637,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>15,253,000</td>
<td>28,818,000</td>
<td>44,071,000</td>
</tr>
<tr>
<td><strong>Interest expense</strong></td>
<td>—</td>
<td>5,683,000</td>
<td>5,683,000</td>
</tr>
<tr>
<td><strong>Distributions to participants</strong></td>
<td>4,586,000</td>
<td>—</td>
<td>4,586,000</td>
</tr>
<tr>
<td>Allocation of 142,000 shares of common stock of Sponsor Company, at fair value</td>
<td>—</td>
<td>4,637,000</td>
<td>4,637,000</td>
</tr>
<tr>
<td>Total deductions</td>
<td>4,586,000</td>
<td>10,320,000</td>
<td>14,906,000</td>
</tr>
<tr>
<td><strong>Net increase</strong></td>
<td>10,667,000</td>
<td>18,498,000</td>
<td>29,165,000</td>
</tr>
<tr>
<td><strong>Net assets (deficit) available for benefits:</strong></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Beginning of year</td>
<td>24,949,000</td>
<td>(26,505,000)</td>
<td>(1,556,000)</td>
</tr>
<tr>
<td>End of year</td>
<td>35,616,000</td>
<td>(8,007,000)</td>
<td>27,609,000</td>
</tr>
</tbody>
</table>

The accompanying notes are an integral part of these financial statements.
A. Plan Description and Basis of Presentation

The following brief description of the Sponsor Company Stock Ownership Plan (the Plan) is provided for general information purposes only. Participants should refer to the Plan agreement for complete information.

The Sponsor Company (Company) established the Sponsor Company Stock Ownership Plan effective as of January 1, 20XX. As of January 1, 20XY, the Plan was amended and operates, in relevant part, as a leveraged employee stock ownership plan (ESOP) and is designed to comply with Section 4975(e)(7) and the regulations thereunder of the Internal Revenue Code of 1986, as amended (IRC) and is subject to the applicable provisions of ERISA. The Plan is administered by an Employee Benefits Administration Committee comprising up to 3 persons appointed by the Sponsor Company's board of directors. The trust department of an independent third-party bank is the Plan's trustee.

The Plan purchased Company common stock using the proceeds of a bank borrowing (see note G) guaranteed by the Company and holds the common stock in a trust established under the Plan. The borrowing is to be repaid over a period of 10 years by fully deductible Company contributions to the trust fund. As the Plan makes each payment of principal, an appropriate percentage of stock will be allocated to eligible employees' accounts in accordance with applicable regulations under the IRC. Shares vest fully upon allocation.

The borrowing is collateralized by the unallocated shares of common stock and is guaranteed by the Company. The lender has no rights against shares of common stock once they are allocated under the ESOP. Accordingly, the financial statements of the Plan as of December 31, 20X2 and 20X1, and for the years ended December 31, 20X2, present separately the assets and liabilities and changes therein pertaining to

   a. the accounts of employees with vested rights in allocated common stock (allocated), and

   b. common stock not yet allocated to employees (unallocated).

Eligibility

Employees of the Company and its participating subsidiaries are generally eligible to participate in the Plan after one year of service providing they worked at least 1,000 hours during such Plan year. Participants who do not have at least 1,000 hours of service during such Plan year or are not employed on the last working day of a Plan year are generally not eligible for an allocation of Company contributions for such year.
Payment of Benefits

Distributions on account of death, disability, or retirement are made in a lump sum in the Plan year following the event. Distributions for other separations from service commence in the fifth Plan year following the separation from service and are made in five annual installments. Distributions are made in cash or, if a participant elects, in the form of Company common stock plus cash for any fractional share of common stock.

Under the provisions of the Plan, the Company is obligated to repurchase participant shares, which have been distributed under the terms of the Plan as long as the shares are not publicly traded or if the shares are subject to trading limitations. During 20X2, the Company repurchased from participants XXXX shares at prices determined from the independent appraisal.

Administrative Expenses

Substantially all Plan administrative expenses are paid by the Company.

Voting Rights

Each participant is entitled to exercise voting rights attributable to the shares allocated to his or her account and is notified by the Trustee prior to the time that such rights are to be exercised. The Trustee is not permitted to vote any allocated share for which instructions have not been given by a participant. The Trustee is required, however, to vote any unallocated shares on behalf of the collective best interest of Plan participants and beneficiaries.

Plan Termination

The Company reserves the right to terminate the Plan at any time, subject to Plan provisions. Upon such termination of the Plan, the interest of each participant in the trust fund will be distributed to such participant or his or her beneficiary at the time prescribed by the Plan terms and the IRC. Upon termination of the Plan, the Employee Benefits Administration Committee shall direct the Trustee to pay all liabilities and expenses of the trust fund and to sell shares of financed common stock held in the loan suspense account to the extent it determines such sale to be necessary in order to repay the loan.

Participant Accounts

The Plan is a defined contribution plan under which a separate individual account is established for each participant. Each participant's account is credited as of the last day of each Plan year with an allocation of shares of the Company's common stock released by the Trustee from the unallocated account and forfeitures of terminated participants' nonvested accounts. Only those participants who are eligible employees of the Company as of the last day of the Plan year will receive an allocation. Allocations are based on a participant's eligible compensation, relative to total eligible compensation.

Vesting
If a participant's employment with the Company ends for any reason other than retirement, permanent disability, or death, he or she will vest in the balances in his or her account based on total years of service with the Company. Participants vest 33 ⅓ percent per year of service and are 100 percent vested after 3 years of service.

Put Option

Under federal income tax regulations, the employer stock that is held by the Plan and its participants and is not readily tradable on an established market, or is subject to trading limitations, includes a put option. The put option is a right to demand that the Company buy any shares of its stock distributed to participants for which there is no market. The put price is representative of the fair market value of the stock. The Company can pay for the purchase with interest over a period of five years. The purpose of the put option is to ensure that the participant has the ability to ultimately obtain cash.

Diversification

Diversification is offered to participants close to retirement so that they may have the opportunity to move part of the value of their investment in Company common stock into investments which are more diversified. Participants who are at least age 55 with at least 10 years of participation in the Plan may elect to diversify a portion of their account. Diversification is offered to each eligible participant over a 6-year period. In each of the first 5 years, a participant may diversify up to 25 percent of the number of post-1986 shares allocated to his or her account, less any shares previously diversified. In the sixth year, the percentage changes to 50 percent. Participants who elect to diversify receive a cash distribution.

Participant Accounts and Forfeitures

Employer contributions and Plan forfeitures are allocated to each participant's account based upon the relation of the participant's compensation to total compensation for the Plan year. Forfeitures of terminated nonvested account balances allocated to remaining participants at December 31, 20X2 and 20X1, totaled $X,XXX and $X,XXX, respectively. Plan earnings are allocated to each participant's account based on the ratio of the participant's beginning of the year account balance to all participants' beginning of the year account balances.

B. Summary of Significant Accounting Policies

Basis of Accounting

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

Use of 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, liabilities, and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

*Investment Valuation and Income Recognition*

The shares of Company common stock are valued at fair value. See note F for discussion of fair value measurements.

Dividend income is accrued on the ex-dividend date.

Purchases and sales of securities are recorded on a trade-date basis. Realized gains and losses from security transactions are reported on the average cost method. Net appreciation includes the Plan’s gains and losses on investments bought and sold as well as held during the year.

*Subsequent Events*

The Plan has evaluated subsequent events through [insert date], the date the financial statements were available to be issued.

C. **Tax Status**

The IRS has determined and informed the Company by a letter dated June 30, 20XX, that the Plan is qualified, and the trust established under the Plan is tax-exempt under the appropriate 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 currently designed, and being operated, in compliance with the applicable requirements of the IRC. Therefore, they believe that the Plan was qualified, and the related trust was tax-exempt as of the financial statement date.

Accounting principles generally accepted in the United States of America require plan management to evaluate tax positions taken by the plan and recognize a tax liability if the organization has taken an uncertain position that more likely than not would not be sustained upon examination by the [identify applicable taxing authorities]. The Plan administrator has analyzed the tax positions taken by the Plan and has concluded that as of December 31, 20X1, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the financial statements. The Plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The Plan administrator believes it is no longer subject to income tax examinations for years prior to 20XX.

D. **Administration of Plan Assets**

The Plan's assets, which consist principally of sponsor Company common shares, are held by the Trustee of the Plan.

Company contributions are held and managed by the Trustee, which invests cash received, interest, and dividend income and makes distributions to participants. The
Trustee also administers the payment of interest and principal on the loan, which is reimbursed to the Trustee through contributions as determined by the Company.

Certain administrative functions are performed by officers or employees of the Company or its subsidiaries. No such officer or employee receives compensation from the Plan. Administrative expenses for the Trustee's fees are paid directly by the Company.

E. Investments

The Plan's investments, at December 31, are presented in the following table:

<table>
<thead>
<tr>
<th>Sponsor Company common stock:</th>
<th>20X2</th>
<th>20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Number of shares</td>
<td>1,069,000</td>
<td>1,759,000</td>
</tr>
<tr>
<td>Cost</td>
<td>$27,014,000</td>
<td>$74,456,000</td>
</tr>
<tr>
<td>Fair Value</td>
<td>$34,890,000</td>
<td>$57,430,000</td>
</tr>
</tbody>
</table>

F. Fair Value Measurements

Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 820, *Fair Value Measurements and Disclosures*, provides the framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The 3 levels of the fair value hierarchy under FASB ASC 820 are described as follows:

<table>
<thead>
<tr>
<th>Level 1</th>
<th>Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Plan has the ability to access.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level 2</td>
<td>Inputs to the valuation methodology include:</td>
</tr>
<tr>
<td></td>
<td>• quoted prices for similar assets or liabilities in active markets;</td>
</tr>
<tr>
<td></td>
<td>• quoted prices for identical or similar assets or liabilities in inactive markets;</td>
</tr>
<tr>
<td></td>
<td>• inputs other than quoted prices that are observable for the asset or liability;</td>
</tr>
<tr>
<td></td>
<td>• inputs that are derived principally from or corroborated by observable market data by correlation or other means.</td>
</tr>
</tbody>
</table>

If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the
The asset or liability’s fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets measured at fair value. There have been no changes in the methodologies used at December 31, 20X1 and 20X0.

**LEVEL 3 Inputs to the valuation methodology are unobservable and significant to the fair value measurement.**

The fair value of the Sponsor Company common stock held by the Plan is valued at fair value based upon an independent appraisal. This appraisal was based upon a combination of the market and income valuation techniques consistent with prior years. The appraiser took into account historical and projected cash flow and net income, return on assets, return on equity, market comparables, and fair value of Company assets and liabilities.

The preceding methods described may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the Plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following table sets forth by level, within the fair value hierarchy, the Plan’s assets at fair value as of December 31, 20X1 and 20X0:

**USERS’ NOTE:** The following table illustrates certain disclosure requirements of FASB ASC 820. The disclosures illustrated describe the nature and risks of securities as required by FASB ASC 820-10-50 and are included for illustrative purposes and are NOT intended to represent the ONLY way to disclose such information.

ASU No. 2010-06 amends the disclosure requirements of FASB ASC 820, including amendments regarding the level of disaggregation for each class of assets and liabilities. The illustrative financial statements in this appendix have been amended to conform to ASU No. 2010-06, where applicable. The amendments in the level 3 fair value...
measurement roll forward related to the separate disclosures requirement of purchases, sales, issuances, and settlements activity are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years, and, therefore, these financial statements have not been updated for those amendments. These illustrative financial statements do not contain any transfers between fair value levels and, therefore, no disclosure has been made.

### Assets at Fair Value as of December 31

<table>
<thead>
<tr>
<th></th>
<th>20X2</th>
<th></th>
<th>20X1</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Level 3</td>
<td>Total</td>
<td>Level 3</td>
<td>Total</td>
</tr>
<tr>
<td>Investment in Sponsor Company common stock</td>
<td>$92,320,000</td>
<td>$92,320,000</td>
<td>$71,583,000</td>
<td>$71,583,000</td>
</tr>
<tr>
<td>Total assets at fair value</td>
<td>$92,320,000</td>
<td>$92,320,000</td>
<td>$71,583,000</td>
<td>$71,583,000</td>
</tr>
</tbody>
</table>

### Level 3 Assets

#### Year Ended December 31, 20X2

<table>
<thead>
<tr>
<th>Investment in Sponsor Company Common Stock</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance, beginning of year</td>
</tr>
<tr>
<td>Realized gains/(losses)</td>
</tr>
<tr>
<td>Unrealized gains/(losses) relating to assets still held at the reporting date</td>
</tr>
<tr>
<td>Purchases</td>
</tr>
<tr>
<td>Sales</td>
</tr>
<tr>
<td>Balance, end of year</td>
</tr>
</tbody>
</table>

The amount of total gains or losses for the period included in changes in net assets attributable to the change in unrealized gains or losses relating to assets still held at the reporting date: $24,257,000

Gains and losses (realized and unrealized) included in changes in net assets for the period above are reported in net appreciation in fair value of investments in the Statement of Changes in Net Assets Available for Benefits.

### G. Loan Payable
In 20XX, the Plan entered into an $80,000,000 term loan agreement with a bank. The proceeds of the loan were used to purchase Company common stock. Unallocated shares are collateral for the loan. The agreement provides for the loan to be repaid over 10 years. The fair value of the note payable as of December 31, 20X2 and 20X1, was approximately $77,000,000 and $82,000,000, respectively, determined by using interest rates currently available for issuance of debt with similar terms, maturity dates, and nonperformance risk. The scheduled amortization of the loan for the next 5 years and thereafter is as follows: 20X3—$6,500,000; 20X4—$7,000,000; 20X5—$7,500,000; 20X6—$8,000,000; 20X7—$8,500,000; and thereafter—$36,470,000. The loan bears interest at the prime rate of the lender. For 20X2 and 20X1, the loan interest rate averaged 7.34 percent and 5.12 percent, respectively.

H. Employer Contributions

The Company is obligated to make contributions in cash to the Plan which, when aggregated with the Plan's dividends and interest earnings, equal the amount necessary to enable the Plan to make its regularly scheduled payments of principal and interest due on its term loan.
Appendix D

Illustrations of Financial Statements: Defined Benefit Pension Plans

D.01 These illustrative financial statements were originally derived from Financial Accounting Standards Board (FASB) Statement No. 35, Accounting and Reporting by Defined Benefit Pension Plans, which has now been codified in FASB Accounting Standards Codification (ASC) 960, Plan Accounting—Defined Benefit Pension Plans. These illustrative financial statements have since been modified to include changes necessary due to the issuance of authoritative guidance or to better represent aspects of current defined benefit pension plans. This appendix illustrates certain applications of the requirements of the FASB ASC 960 that are applicable for the annual financial statements of a hypothetical plan, the C&H Company Pension Plan. It does not illustrate other requirements of FASB ASC 960 as well as other FASB ASC topics that might be applicable in circumstances other than those assumed for the C&H Company Pension Plan. The formats and the wording of accompanying notes are illustrative and are not necessarily the only possible presentation. Further, the circumstances assumed for the C&H Company Pension Plan are designed to facilitate illustration of many of the requirements of FASB ASC 960. Therefore, the notes to the illustrative financial statements probably are more extensive than would be expected for a typical plan. In addition, the illustrative financial statements in this appendix have been amended to conform to FASB ASC 820, Fair Value Measurements and Disclosures.

Note that FASB ASC 820 disclosures are limited to the financial instruments contained within this specific example. It is recommended that users consult all the illustrative financial statements within appendixes C, D, and E for FASB ASC 820 examples for differing types of financial instruments.

D.02 Included are illustrations of the following alternatives permitted by paragraphs 1–8 of FASB ASC 960-20-45:

- An end-of-year versus beginning-of-year benefit information date
- Separate statements for presenting information regarding (a) the net assets available for benefits and the actuarial present value of accumulated plan benefits, and (b) changes in the net assets available for benefits and changes in the actuarial present value of accumulated plan benefits

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1 The illustrative financial statements and footnote disclosures included in this appendix have been updated to reflect Financial Accounting Standards Board (FASB) Accounting Standards Codification™ (ASC) references. However, in FASB’s notice to constituents, it suggests the use of plain English in financial statement footnotes to describe broad FASB ASC topic references. They suggest a reference similar to “as required by the Derivatives and Hedging topic of the FASB Accounting Standards Codification.” Entities might consider revising their financial statement references to reflect this plain English referencing, rather than the use of specific FASB ASC references. For specific information on FASB ASC, please see the preface in the guide.

2 See footnote 1.
• A separate statement that reconciles the year-to-year change in the actuarial present value of accumulated plan benefits versus presenting the effects of a change in actuarial assumptions on the face of the statement of accumulated plan benefits.

D.03 Although not illustrated, FASB ASC 960-20-45-2 permits the information regarding the actuarial present value of accumulated plan benefits and changes therein to be presented in the notes to the financial statements. Therefore, either or both of these categories of information may be presented on the face of one or more financial statements or the notes thereto. Regardless of the format selected, each category of information shall be presented in its entirety in the same location. If a statement format is selected for either category, a separate statement may be used to present that information or, provided the information is as of the same date or for the same period, that information may be presented together with information regarding the net assets available for benefits and the year-to-year changes therein.

D.04 This appendix also illustrates certain applications of the provisions of FASB ASC 960 that apply for the annual financial statements of a hypothetical defined benefit pension plan that has been amended to include a 401(h) account. This appendix does not illustrate other provisions of FASB ASC 960 as well as other FASB ASC topics that might apply in circumstances other than those assumed in the illustration. It also does not illustrate all disclosures required for a fair presentation in conformity with U.S. generally accepted accounting principles (GAAP). The formats and the wording of accompanying notes are only illustrative and are not necessarily the only possible presentations.

D.05 The notes to the financial statements are for the illustrative financial statements that use end-of-year benefit information. Necessary modifications to the notes when beginning-of-year benefit information is presented are in brackets.

D.06 GAAP does not require comparative financial statements unless the beginning-of-year benefit information is used. In this case, a prior-year statement of net assets available for benefits and changes therein must also be presented in order to report on the financial status of the plan. The Employee Retirement Income Security Act of 1974 (ERISA) requires a comparative statement of net assets available for benefits. The illustrative financial statements are intended to comply with the requirements of ERISA.

D.07 ERISA and Department of Labor (DOL) regulations require that certain information be included in supplemental schedules, which are not required under GAAP, and are reported on by the independent auditor. See appendix A for a further discussion of the ERISA and DOL requirements.

D.08 The Statement of Net Assets Available for Benefits, assuming a beginning-of-year information date, would be the same as that illustrated in exhibit D-1.

Other Resources
The illustrative financial statements contained in this appendix are only one example of how defined benefit pension plan financial statements may look. The following table contains other sources of illustrations or actual defined benefit pension plan financial statements and disclosures that may provide additional guidance.

<table>
<thead>
<tr>
<th>Source</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>FASB ASC 815, <em>Derivatives and Hedging</em></td>
<td>FASB ASC 815 contains implementation guidance and illustrations relating to derivatives and hedging.</td>
</tr>
<tr>
<td>FASB ASC 820, <em>Fair Value Measurements and Disclosures</em></td>
<td>FASB ASC 820-10-55 contains implementation guidance and illustrations relating to fair value measurements.</td>
</tr>
<tr>
<td>AICPA Audit and Accounting Guide <em>Investment Companies</em></td>
<td>The AICPA Audit and Accounting Guide <em>Investment Companies</em> contains illustrations with disclosures relating to unique investments, such as short sales, credit default swaps, futures, forwards, and derivatives.</td>
</tr>
<tr>
<td><em>Accounting Trends &amp; Techniques, Employee Benefit Plans, 3rd Edition</em></td>
<td>This publication is intended to provide preparers and auditors of employee benefit plan financial statements with a compilation of illustrative financial statement disclosures based on actual examples.</td>
</tr>
</tbody>
</table>

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3 Additional resources that contain actual plan financial statements include EFAST2 located at www.dol.gov and EDGAR, located at www.sec.gov.
### C&H Company Pension Plan
#### Statement of Net Assets Available for Benefits

<table>
<thead>
<tr>
<th>December 31,</th>
<th>20X2</th>
<th>20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments, at fair value (notes E, F, G, H, and J):</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Plan interest in C&amp;H Master Trust</td>
<td>$2,250,000</td>
<td>$1,860,000</td>
</tr>
<tr>
<td>C&amp;H Company common stock</td>
<td>690,000</td>
<td>880,000</td>
</tr>
<tr>
<td>Guaranteed investment contract with insurance company</td>
<td>1,000,000</td>
<td>890,000</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>3,500,000</td>
<td>3,670,000</td>
</tr>
<tr>
<td>U.S. government securities</td>
<td>350,000</td>
<td>270,000</td>
</tr>
<tr>
<td>Hedge fund</td>
<td>480,000</td>
<td>460,000</td>
</tr>
<tr>
<td>Real estate</td>
<td>270,000</td>
<td>240,000</td>
</tr>
<tr>
<td><strong>Total investments</strong></td>
<td>8,540,000</td>
<td>8,270,000</td>
</tr>
<tr>
<td>Net assets held in 401(h) account (note O)</td>
<td>1,072,000</td>
<td>966,000</td>
</tr>
<tr>
<td><strong>Receivables</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Employer’s contribution</td>
<td>40,000</td>
<td>35,000</td>
</tr>
<tr>
<td>Due from broker for securities sold</td>
<td>310,000</td>
<td>175,000</td>
</tr>
<tr>
<td>Accrued interest and dividends</td>
<td>77,000</td>
<td>76,000</td>
</tr>
<tr>
<td><strong>Total receivables</strong></td>
<td>427,000</td>
<td>286,000</td>
</tr>
<tr>
<td><strong>Cash—noninterest bearing</strong></td>
<td>200,000</td>
<td>90,000</td>
</tr>
<tr>
<td><strong>Total assets</strong></td>
<td>10,239,000</td>
<td>9,612,000</td>
</tr>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Due to broker for securities purchased</td>
<td>—</td>
<td>400,000</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>70,000</td>
<td>60,000</td>
</tr>
<tr>
<td>Accrued expenses</td>
<td>85,000</td>
<td>40,000</td>
</tr>
<tr>
<td>Amounts related to obligation of 401(h) account (note O)</td>
<td>1,072,000</td>
<td>966,000</td>
</tr>
</tbody>
</table>

---

4 Any assets held for investment purposes in the 401(h) account should be shown on Schedule H, line 4i—Schedule of Assets (Held at End of Year) and Schedule H, line 4j—Schedule of Reportable Transactions for the pension plan.
<table>
<thead>
<tr>
<th></th>
<th>1,227,000</th>
<th>1,466,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total liabilities</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net assets available for benefits</td>
<td>$9,012,000</td>
<td>$8,146,000</td>
</tr>
</tbody>
</table>

See accompanying notes to the financial statements.
### C&H Company Pension Plan
#### Statement of Changes in Net Assets Available for Benefits

<table>
<thead>
<tr>
<th>Year Ended December 31, 20X2</th>
</tr>
</thead>
</table>

**Investment income:**

- Net appreciation in fair value of investments (note E) $278,000
- Interest 325,000
- Dividends 5,000

**Less investment expenses** 39,000

**Plan interest in C&H Master Trust investment income (note G)** 129,000

**Total investment income** 698,000

**Employer contributions** 1,230,000

**Total additions** 1,928,000

**Benefits paid directly to participants** 740,000

**Purchases of annuity contracts (note H)** 257,000

**Total benefits paid** 997,000

**Administrative expenses** 65,000

**Total deductions** 1,062,000

**Net increase** 866,000

**Net assets available for benefits:**

- Beginning of year 8,146,000
- End of year $9,012,000

See accompanying notes to the financial statements.
Exhibit D-3

Practice Tip

Alternatively, exhibits D-3 and D-4 can be combined with exhibits D-1 and D-2. See FASB ASC 960-205-55 and exhibits D-5 and D-6 presented in the footnotes to the financial statements.

C&H Company Pension Plan
Statement of Accumulated Plan Benefits

December 31,

<table>
<thead>
<tr>
<th></th>
<th>20X2</th>
<th>20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actuarial present value of accumulated plan benefits</td>
<td></td>
<td></td>
</tr>
<tr>
<td>(note C)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Vested benefits:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Participants currently receiving payments</td>
<td>$3,040,000</td>
<td>$2,950,000</td>
</tr>
<tr>
<td>Other participants</td>
<td>8,120,000</td>
<td>6,530,000</td>
</tr>
<tr>
<td>Total vested benefits</td>
<td>11,160,000</td>
<td>9,480,000</td>
</tr>
<tr>
<td>Nonvested benefits</td>
<td>2,720,000</td>
<td>2,400,000</td>
</tr>
<tr>
<td>Total actuarial present value of accumulated plan benefits</td>
<td>$13,880,000</td>
<td>$11,880,000</td>
</tr>
</tbody>
</table>

See accompanying notes to the financial statements.
### Exhibit D-4

**C&H Company Pension Plan**  
**Statement of Changes in Accumulated Plan Benefits**

<table>
<thead>
<tr>
<th></th>
<th>Year Ended December 31, 20X2</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actuarial present value of accumulated plan benefits at beginning of year</td>
<td>$11,880,000</td>
</tr>
<tr>
<td>Increase (decrease) during the year attributable to:</td>
<td></td>
</tr>
<tr>
<td>Plan amendment (note L)</td>
<td>2,410,000</td>
</tr>
<tr>
<td>Change in actuarial assumptions (note C)</td>
<td>(1,050,500)</td>
</tr>
<tr>
<td>Benefits accumulated</td>
<td>895,000</td>
</tr>
<tr>
<td>Increase for interest due to the decrease in the discount period (note B)</td>
<td>742,500</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(997,000)</td>
</tr>
<tr>
<td>Net increase</td>
<td>2,000,000</td>
</tr>
<tr>
<td>Actuarial present value of accumulated plan benefits at end of year</td>
<td>$13,880,000</td>
</tr>
</tbody>
</table>

See accompanying notes to the financial statements.
II. Illustrations Assuming a Beginning-of-Year Benefit Information Date

Exhibit D-5

The presentation of the financial statement information and the footnotes are affected by the benefit information date selected for disclosure. The preferred approach is to use an end-of-year benefit information date. If beginning-of-year is presented, the present value of accumulated plan benefits will be as of the same date as the net assets. In this case, two statements of net assets available for benefits and two statements of changes in net assets are presented. Only a single year of the present value of accumulated plan benefits is required with a reconciliation from the prior year. The Statement of Net Assets Available for Benefits, assuming a beginning-of-year information date, would be the same as that illustrated in exhibit D-1.

C&H Company Pension Plan
Statement of Changes in Net Assets
Available for Benefits

(If a beginning-of-year benefit information date is selected)

<table>
<thead>
<tr>
<th>Year Ended December 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td>20X2</td>
</tr>
<tr>
<td>20X1</td>
</tr>
<tr>
<td>Investment income:</td>
</tr>
<tr>
<td>Net appreciation in fair value of investments (note E)</td>
</tr>
<tr>
<td>Interest</td>
</tr>
<tr>
<td>Dividends</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Less investment expenses</td>
</tr>
<tr>
<td></td>
</tr>
<tr>
<td>Plan interest in C&amp;H Master Trust investment income (note G)</td>
</tr>
<tr>
<td>Total investment income</td>
</tr>
<tr>
<td>Employer contributions</td>
</tr>
<tr>
<td>Total additions</td>
</tr>
<tr>
<td>Benefits paid directly to participants</td>
</tr>
<tr>
<td>Purchases of annuity contracts (note H)</td>
</tr>
<tr>
<td>Administrative expenses</td>
</tr>
<tr>
<td>Total deductions</td>
</tr>
<tr>
<td>Net increase</td>
</tr>
</tbody>
</table>
Net assets available for benefits:

<table>
<thead>
<tr>
<th></th>
<th>Beginning of year</th>
<th>End of year</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>8,146,000</td>
<td>$9,012,000</td>
</tr>
<tr>
<td></td>
<td>7,444,000</td>
<td>$8,146,000</td>
</tr>
</tbody>
</table>

See accompanying notes to the financial statements.
### Exhibit D-6

**C&H Company Pension Plan**  
**Statement of Accumulated Plan Benefits**

*(If a beginning-of-year benefit information date is selected)*

<table>
<thead>
<tr>
<th></th>
<th>December 31, 20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Actuarial present value of accumulated plan benefits (note C)</strong></td>
<td></td>
</tr>
<tr>
<td><strong>Vested benefits:</strong></td>
<td></td>
</tr>
<tr>
<td>Participants currently receiving payments</td>
<td>$2,950,000</td>
</tr>
<tr>
<td>Other participants</td>
<td>6,530,000</td>
</tr>
<tr>
<td><strong>Total vested benefits</strong></td>
<td>9,480,000</td>
</tr>
<tr>
<td><strong>Nonvested benefits</strong></td>
<td>2,400,000</td>
</tr>
<tr>
<td><strong>Total actuarial present value of accumulated plan benefits</strong></td>
<td>$11,880,000</td>
</tr>
</tbody>
</table>
C&H Company Pension Plan
Statement of Changes in Accumulated Plan Benefits

(If a beginning-of-year benefit information date is selected)

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Actuarial present value of accumulated plan benefits at beginning of year</td>
<td>$9,890,000</td>
</tr>
<tr>
<td>Increase (decrease) during the year attributable to:</td>
<td></td>
</tr>
<tr>
<td>Change in actuarial assumptions</td>
<td>700,000</td>
</tr>
<tr>
<td>Benefits accumulated</td>
<td>1,060,000</td>
</tr>
<tr>
<td>Increase for interest due to the decrease in the discount period</td>
<td>976,000</td>
</tr>
<tr>
<td>Benefits paid</td>
<td>(746,000)</td>
</tr>
<tr>
<td>Net increase</td>
<td>1,990,000</td>
</tr>
<tr>
<td>Actuarial present value of accumulated plan benefits at end of year</td>
<td>$11,880,000</td>
</tr>
</tbody>
</table>

See accompanying notes to the financial statements.

**Practice Tip**

As an alternative, it is acceptable to show a reconciliation of the significant changes in benefit obligations in paragraph form, which includes appropriate reference to related notes as well as including the actuarial present value of the accumulated plan benefits as of the end of the preceding year.
A. Description of Plan

The following description of the C&H Company Pension Plan (Plan) provides only general information. Participants should refer to the plan document for a more complete description of the Plan’s provisions.

1. General. The plan is a cash balance defined benefit plan providing retirement, disability, and death benefits to all eligible employees. The Plan sponsor is the C&H Company (the Company) and is subject to the provisions of the Employee Retirement Income Security Act of 1974, as amended (ERISA). The Plan includes all full-time employees of the Company. Employees are eligible to participate in the Plan the first day of the quarter after completing one year of service with the Company.

The Plan is administered by the Company’s Benefits Committee (Committee), which is a committee of the board of directors of the Company. The Committee has overall responsibility for the operation and administration of the Plan.

2. Participant’s Accounts. Under the Plan provisions, amounts are credited by the Company to the participants’ hypothetical accounts. The accounts are allocated compensation credits and investment credits at the end of every quarter. The compensation credits are allocated based on a percentage of the participants’ certified compensation as defined in the Plan document for that particular quarter. The applicable percentage ranges from x% to y% and is based on the participants’ age plus years of credited service (as defined in the Plan document) at the end of the quarter. Age and credited service are determined in whole years at the end of the quarter.

Participants’ hypothetical accounts also receive investment credits at the end of every quarter. The amount of the investment credit is tied to the average of the annual yields on 30-year treasury securities and is adjusted quarterly. As of December 31, 20X2 and 20X1, the interest rate was .X% and X.X% respectively.

Funding Policy. Each year, the Plan’s actuary determines the range of acceptable contributions. During 20X2 [and 20X1], the Company made contributions of $XXXXXXXX and $ XXXXXXXX, respectively. The Company's contributions for 20X2 [and 20X1] exceeded the minimum funding requirements of ERISA.

The notes are for the accompanying illustrative financial statements that use an end-of-year benefit information date. Modifications necessary to accompany the illustrative financial statements that use a beginning-of-year benefit information date are presented in brackets.
Additionally, the Company makes annual contributions to the 401(h) account based upon the maximum deductibility under the Internal Revenue Code.\(^6\)

Although it has not expressed any intention to do so, the Company has the right under the plan to discontinue its contributions at any time and to terminate the plan subject to the provisions set forth in ERISA.

3. **Pension Benefits.** Benefits are determined based on the participant’s Plan account balance. Plan participants are eligible for their plan benefit after terminating employment with vested rights. Participants become vested in the Plan upon completion of 5 or more years of service or attainment of the normal retirement age (65). If employees terminate before rendering 5 years of service, they forfeit the right to receive the portion of their accumulated plan benefits attributable to the Company’s contributions. Upon termination of employment, participants have the option of receiving their vested benefit in the form of a one-time lump sum payment or a monthly annuity payable for their lifetime. Participants may elect to defer payment of their benefit until a later date (if the value of the vested benefit is greater than $1000). Participants eligible for a special transition benefit from the prior final average pay formula design will have their final benefits determined at the time they elect to begin receiving payments from the plan. Any adjustment for the special transition benefit calculation is automatically determined and communicated to participants.

Employees who were active participants in the Plan on January 1, 20XX, and were at least age 45 with 5 or more years of credited service, became eligible for a special transition benefit under the Plan. This transition benefit was established to ensure that eligible participants would receive the same benefit or a larger benefit than they would have under the former arrangement.

4. **Death and Disability Benefits.** If an active employee dies at age 55 or older, a death benefit equal to the value of the employee's accumulated pension benefits is paid to the employee's beneficiary. Active employees who become totally disabled receive annual disability benefits that are equal to the normal retirement benefits they have accumulated as of the time they become disabled. Disability benefits are paid until normal retirement age, at which time disabled participants begin receiving normal retirement benefits computed as though they had been employed to normal retirement age, with their annual compensation remaining the same as at the time they became disabled.

**B. Summary of Accounting Policies**

The following are the significant accounting policies followed by the Plan:

---

\(^6\) In some plans, as a condition of participation, employees are required to contribute a certain percent of their salary to the plan. Disclosure should be made of this requirement as well as the amount of the accumulated contributions, including interest and the crediting interest rate. See paragraph 3.79 and FASB ASC 960-205-50-1(d).
1. **Basis of Accounting.** The accompanying financial statements are prepared on the accrual basis of accounting.

2. **Use of Estimates.** The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and changes therein; disclosure of contingent assets and liabilities; and the actuarial present value of accumulated plan benefits at the date of the financial statements. Actual results could differ from those estimates.

3. **Investment Valuation and Income Recognition.** Investments are reported at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See note F for a discussion of fair value measurements. Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis. Dividends are recorded on the ex-dividend date. Net appreciation includes the plan’s gains and losses on investments bought and sold as well as held during the year.

4. **Payment of Benefits.** Benefit payments to participants are recorded upon distribution.

5. **Administrative Expenses.** The Plan’s expenses are paid either by the Plan or the Company, as provided by the Plan document. Certain expenses incurred in connection with the general administration of the Plan that are paid by the Plan are recorded as deductions in the accompanying statement of changes in net assets available for benefits. In addition, certain investment related expenses reduced investment income presented in the accompanying statement of changes in net assets available for benefits.

6. **Subsequent Events.** The plan has evaluated subsequent events through [insert date], the date the financial statements were available to be issued.

**C. Actuarial Present Value of Accumulated Plan Benefits**

Accumulated plan benefits are those future periodic payments, including lump sum distributions that are attributable under the Plan’s provisions to the service employees have rendered. Accumulated plan benefits include benefits expected to be paid to (a) retired or terminated employees or their beneficiaries, (b) beneficiaries of employees who have died, and (c) present employees or their beneficiaries. Benefits under the plan are based on employees’ compensation during their last five years of credited service. The accumulated plan benefits for active employees are based on their average compensation during the five years ending on the date as of which the benefit information is presented (the valuation date). Benefits payable under all circumstances—retirement, death, disability, and termination of employment—are included, to the extent they are deemed attributable to employee service rendered to the valuation date. Benefits to be provided
via annuity contracts excluded from plan assets are excluded from accumulated plan benefits.

The actuarial present value of accumulated plan benefits is determined by an independent 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 December 31, 20X2 [20X1] and 20X1 were (a) life expectancy of participants (the RP 2000 Combined Mortality Table was used), (b) retirement age assumptions (the assumed average retirement age was 60), and (c) investment return. The 20X2 [20X1] and 20X1 valuations included assumed average rates of return of 7 percent [6.25 percent] and 6.25 percent, respectively, including a reduction of .2 percent to reflect anticipated administrative expenses associated with providing benefits. The foregoing actuarial 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 accumulated Plan benefits. The computations of the actuarial present value of accumulated plan benefits were made as of January 1, 20X2 [20X2] and 20X2. Had the valuations been performed as of December 31, there would be no material differences.

D. Plan Termination

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. Benefits attributable to employee contributions, taking into account those paid out before termination.

2. Annuity benefits that former employees or their beneficiaries have been receiving for at least three years, or that employees eligible to retire for that three-year period would have been receiving if they had retired with benefits in the normal form of annuity under the Plan. The priority amount is limited to the lowest benefit that was payable (or would have been payable) during those three years. The amount is further limited to the lowest benefit that would be payable under Plan provisions in effect at any time during the five years preceding Plan termination.

3. Other vested benefits insured by the Pension Benefit Guaranty Corporation (PBGC) (a U.S. government agency) up to the applicable limitations (discussed subsequently).

4. All other vested benefits (that is, vested benefits not insured by the PBGC).

5. All nonvested benefits.
Benefits to be provided via contracts under which National (note H) is obligated to pay the benefits would be excluded for allocation purposes.

Certain benefits under the Plan are insured by the PBGC if the Plan terminates. Generally, the PBGC guarantees most vested normal age retirement benefits, early retirement benefits, and certain disability and survivor's pensions. However, the PBGC does not guarantee all types of benefits under the Plan, and the amount of benefit protection is subject to certain limitations. Vested benefits under the Plan are guaranteed at the level in effect on the date of the Plan's termination. However, a statutory ceiling exists, which is adjusted periodically, on the amount of an individual's monthly benefit that the PBGC guarantees. For plan terminations occurring during 20X2, that ceiling is $X,XXX per month. That ceiling applies to those pensioners who elect to receive their benefits in the form of a single-life annuity and are at least 65 years old at the time of retirement or plan termination (whichever comes later). For younger annuitants or for those who elect to receive their benefits in some form more valuable than a single-life annuity, the corresponding ceilings are actuarially adjusted downward. Benefit improvements, if any, attributable to the Plan amendment effective may not be fully guaranteed even though total benefit entitlements fall below the aforementioned ceiling. The PBGC guarantees XX percent of any benefit improvements that result in benefits below the ceiling each year following the effective date of the amendment. If the amount of the benefit increase below the ceiling is also less than $XXX, $XX of the increase (rather than XX percent) becomes guaranteed by the PBGC each year following the effective date of the amendment. As a result, only the primary ceiling would be applicable after the fifth year following the effective date of the amendment.

Whether all participants receive their benefits should the Plan terminate at some future time will depend on the sufficiency, at that time, of the Plan's net assets to provide for accumulated benefit obligations and may also depend on the financial condition of the Plan sponsor and the level of benefits guaranteed by the PBGC.

### E. Investments

The following table presents the fair values of investments. Investments that represent 5 percent or more of the plan's net assets are separately identified.

<table>
<thead>
<tr>
<th>December 31,</th>
<th>20X2</th>
<th>20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td>C&amp;H Company common stock (25,000 shares)</td>
<td>$690,000</td>
<td>$880,000</td>
</tr>
<tr>
<td>U.S. government securities</td>
<td>350,000</td>
<td>270,000</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>3,500,000</td>
<td>3,670,000</td>
</tr>
<tr>
<td>Plan interest in C&amp;H Master Trust</td>
<td>2,250,000</td>
<td>1,860,000</td>
</tr>
<tr>
<td>Guaranteed investment contract with National Insurance Company #8041A, X% (note H)</td>
<td>1,000,000</td>
<td>890,000</td>
</tr>
</tbody>
</table>

---

7 See note F for discussion of fair value measurements.
During 20X2 [and 20X1], the plan's investments (including gains and losses on investments bought and sold, as well as held during the year) appreciated in value by $278,000 [and $41,000, respectively,] as follows:

<table>
<thead>
<tr>
<th>Net Appreciation (Depreciation) in Fair Value</th>
<th>Year Ended December 31,</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>20X2</td>
</tr>
<tr>
<td>C&amp;H Company common stock</td>
<td>$208,000</td>
</tr>
<tr>
<td>U.S. government securities</td>
<td>20,000</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>(40,000)</td>
</tr>
<tr>
<td>Guaranteed investment contract with insurance company</td>
<td>40,000</td>
</tr>
<tr>
<td>Hedge fund</td>
<td>105,000</td>
</tr>
<tr>
<td>Real estate</td>
<td>(50,000)</td>
</tr>
<tr>
<td>Foreign exchange contracts</td>
<td>(5000)</td>
</tr>
<tr>
<td></td>
<td>$278,000</td>
</tr>
</tbody>
</table>

F. **Fair Value Measurements**

Financial Accounting Standards Board (FASB) *Accounting Standards Codification* (ASC) 820, *Fair Value Measurements and Disclosures*, provides the framework for measuring fair value. That framework provides a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (level 1 measurements) and the lowest priority to unobservable inputs (level 3 measurements). The three levels of the fair value hierarchy under FASB ASC 820 are described as follows:

<table>
<thead>
<tr>
<th>Level 1</th>
<th>Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the plan has the ability to access.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level 2</td>
<td>Inputs to the valuation methodology include</td>
</tr>
<tr>
<td></td>
<td>• quoted prices for similar assets or liabilities in active</td>
</tr>
</tbody>
</table>
markets;
- quoted prices for identical or similar assets or liabilities in inactive markets;
- inputs other than quoted prices that are observable for the asset or liability;
- inputs that are derived principally from or corroborated by observable market data by correlation or other means.

If the asset or liability has a specified (contractual) term, the level 2 input must be observable for substantially the full term of the asset or liability.

| Level 3 | Inputs to the valuation methodology are unobservable and significant to the fair value measurement. |

The asset’s or liability’s fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

Following is a description of the valuation methodologies used for assets at fair value. There have been no changes in the methodologies used at December 31, 20X2 and 20X1.

**USERS’ NOTE:** Note that information contained herein for fair value disclosures is based upon information for the Illustration of Financial Statements: Defined Benefit Pension (appendix D—C&H Company Pension Plan) as presented in exhibits D-1-D-4. This illustrative disclosure is not representative of all types of investment securities and does not represent the classification for every instance of such investment securities. It should not be assumed that these methodologies are the only appropriate methodologies for these types of assets. As stated in FASB ASC 820-10-35-5, “The principle (or most advantageous) market (and thus, market participants) should be considered from the perspective of the reporting entity, thereby allowing for differences between and among entities with different activities.” Plan sponsors will have to evaluate the appropriate classification for each type of investment securities based upon the plan’s portfolio and actual fair valuation techniques used.

**C&H Company common stock:** Valued at the closing price reported on the New York Stock Exchange.

**Guaranteed investment contract with the National Insurance Company (National):** Valued at fair value by discounting the related cash flows based on current yields of similar instruments with comparable durations considering the credit-worthiness of the issuer (see note H). Funds under the guaranteed investment contract that have been allocated and applied to purchase annuities (that is, National is obligated to pay the related pension benefits) are excluded from the plan's assets.

**Corporate bonds:** Certain corporate bonds are valued at the closing price reported in the active market in which the bond is traded. Other corporate bonds are valued based on yields currently available on comparable securities of issuers with similar credit ratings. When quoted prices are not available for identical or similar bonds, the bond is valued under a discounted cash flows approach that maximizes observable inputs, such as
current yields of similar instruments, but includes adjustments for certain risks that may not be observable, such as credit and liquidity risks.

**U.S. government securities:** Valued at the closing price reported in the active market in which the individual security is traded.

**Hedge funds:** Valued based primarily on audited financial statements provided to the individual fund managers and the Plan. Such market value estimates involve subjective judgments, and the actual market price of the investments can only be determined by negotiation between independent third parties of a sales transaction. The hedge fund’s objective is to use leveraged, long, short, and derivative positions in both domestic and international markets with the goal of generating high returns. The Plan can redeem monthly from the fund (30 days prior to month end) with a lock up provision of one year. Valuation is based on the use of net asset value per share, without further adjustment, to estimate the fair value of investments in investment companies that do not have readily determinable fair values as defined by FASB.

**Real estate:** Valued on the basis of a discounted cash flow approach, which includes the future rental receipts, expenses, and residual values as the highest and best use of the real estate from a market participant view as rental property.

The preceding methods may produce a fair value calculation that may not be indicative of net realizable value or reflective of future fair values. Furthermore, although the plan believes its valuation methods are appropriate and consistent with other market participants, the use of different methodologies or assumptions to determine the fair value of certain financial instruments could result in a different fair value measurement at the reporting date.

The following table sets forth by level, within the fair value hierarchy, the plan’s assets at fair value as of December 31, 20X2, and 20X1. The following table does not include the plan’s interest in the C&H Master Trust because that information is presented in a separate table (see note H):

**USERS’ NOTE:** The following table illustrates certain disclosure requirements of FASB ASC 820. The disclosures illustrated describe the nature and risks of securities as required by FASB ASC 820-10-50 and are included for illustrative purposes and are NOT intended to represent the ONLY way to disclose such information.

<table>
<thead>
<tr>
<th>Assets at Fair Value as of December 31, 20X2</th>
<th>Level 1</th>
<th>Level 2</th>
<th>Level 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>C&amp;H Company common stock</td>
<td>$690,000</td>
<td>—</td>
<td>—</td>
<td>$690,000</td>
</tr>
<tr>
<td>Guaranteed investment contract with National Insurance Company</td>
<td>—</td>
<td>—</td>
<td>$1,000,000</td>
<td>1,000,000</td>
</tr>
<tr>
<td>Corporate bonds: Aaa credit rating</td>
<td>1,000,000</td>
<td>—</td>
<td>—</td>
<td>1,000,000</td>
</tr>
</tbody>
</table>
### Assets at Fair Value as of December 31, 20X1

<table>
<thead>
<tr>
<th></th>
<th>Level 1</th>
<th>Level 2</th>
<th>Level 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>C&amp;H Company common stock</td>
<td>$880,000</td>
<td>—</td>
<td>—</td>
<td>$880,000</td>
</tr>
<tr>
<td>Guaranteed investment contract with National Insurance Company</td>
<td>—</td>
<td>—</td>
<td>$890,000</td>
<td>890,000</td>
</tr>
<tr>
<td>Corporate bonds: Aaa credit rating</td>
<td>1,200,000</td>
<td>—</td>
<td>—</td>
<td>1,200,000</td>
</tr>
<tr>
<td>Aa credit rating</td>
<td>—</td>
<td>$2,250,000</td>
<td>—</td>
<td>2,250,000</td>
</tr>
<tr>
<td>A credit rating</td>
<td>—</td>
<td>—</td>
<td>220,000</td>
<td>220,000</td>
</tr>
<tr>
<td>Total corporate bonds</td>
<td>1,200,000</td>
<td>2,250,000</td>
<td>220,000</td>
<td>3,670,000</td>
</tr>
<tr>
<td>U.S. government securities</td>
<td>270,000</td>
<td>—</td>
<td>—</td>
<td>270,000</td>
</tr>
<tr>
<td>Hedge fund</td>
<td>—</td>
<td>—</td>
<td>460,000</td>
<td>460,000</td>
</tr>
<tr>
<td>Real estate</td>
<td>—</td>
<td>—</td>
<td>240,000</td>
<td>240,000</td>
</tr>
<tr>
<td><strong>Total assets, excluding plan interest in C&amp;H Master Trust, at fair value</strong></td>
<td><strong>$2,350,000</strong></td>
<td><strong>$2,250,000</strong></td>
<td><strong>$1,810,000</strong></td>
<td><strong>$6,410,000</strong></td>
</tr>
</tbody>
</table>

### Level 3 Gains and Losses

The following table sets forth a summary of changes in the fair value of the Plan’s level 3 assets for the year ended December 31, 20X2. [The use of the beginning-of-the-year benefit information would require this note to include December 31, 20X1 information.]
<table>
<thead>
<tr>
<th>Description</th>
<th>20XX</th>
<th>20YY</th>
<th>20ZZ</th>
<th>20A</th>
<th>20B</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance, beginning of year</td>
<td>$890,000</td>
<td>$220,000</td>
<td>$460,000</td>
<td>$240,000</td>
<td>$1,810,000</td>
</tr>
<tr>
<td>Realized gains/(losses)</td>
<td>—</td>
<td>100,000</td>
<td>20,000</td>
<td>25,000</td>
<td>145,000</td>
</tr>
<tr>
<td>Unrealized gains/(losses) relating to assets still held at the reporting</td>
<td>40,000</td>
<td>(30,000)</td>
<td>80,000</td>
<td>(75,000)</td>
<td>15,000</td>
</tr>
<tr>
<td>date</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Purchases, sales, issuances, and settlements (net)</td>
<td>70,000</td>
<td>210,000</td>
<td>(80,000)</td>
<td>80,000</td>
<td>280,000</td>
</tr>
<tr>
<td>Balance, end of year</td>
<td>$1,000,000</td>
<td>$500,000</td>
<td>$480,000</td>
<td>$270,000</td>
<td>$2,250,000</td>
</tr>
</tbody>
</table>

The amount of total gains or losses for the period included in changes in net assets attributable to the change in unrealized gains or losses relating to assets still held at the reporting date.

$40,000  $(30,000)  100,000  $(75,000)  $35,000

Gains and losses (realized and unrealized) included in changes in net assets for the period above are reported in net appreciation in fair value of investments in the Statement of Changes in Net Assets Available for Benefits.

**Changes in Fair Value Levels**

The availability of observable market data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

We evaluate the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total net assets available for benefits. For the year ended December 31, 20XX, there were no significant transfers in or out of levels 1, 2, or 3.

**G. Interest in C&H Master Trust**
A portion of the plan's investments are in the Master Trust, which was established for the investment of assets of the plan and several other C&H Company sponsored retirement plans. Each participating retirement plan has an undivided interest in the Master Trust. The assets of the Master Trust are held by GLC Trust Company (Trustee).

The value of the Plan's interest in the C&H Master Trust is based on the beginning of year value of the Plan's interest in the trust plus actual contributions and allocated investment income less actual distributions and allocated administrative expenses. At December 31, 20X2 and 20X1, the Plan's interest in the net assets of the Master Trust was approximately 9 percent and 11 percent, respectively. Investment income and administrative expenses relating to the Master Trust are allocated to the individual plans based upon average monthly balances invested by each plan.

The following table presents the fair value of the net assets of the Master Trust as of December 31, 20X2 and 20X1. Investments that represent 5 percent or more of the Master Trust’s net assets are separately identified.

<table>
<thead>
<tr>
<th>December 31,</th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>20X2</td>
<td>20X1</td>
</tr>
<tr>
<td>Common stocks</td>
<td></td>
<td></td>
</tr>
<tr>
<td>C&amp;H common stock</td>
<td>$1,255,000</td>
<td>$1,115,000</td>
</tr>
<tr>
<td>Other</td>
<td>9,745,000</td>
<td>6,885,000</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>11,800,000</td>
<td>6,700,000</td>
</tr>
<tr>
<td>U.S. government securities</td>
<td>867,000</td>
<td>750,000</td>
</tr>
<tr>
<td>Investments in securities lending</td>
<td>900,000</td>
<td>800,000</td>
</tr>
<tr>
<td>Total investments</td>
<td>24,567,000</td>
<td>16,250,000</td>
</tr>
<tr>
<td>Due from broker for securities sold</td>
<td>1,233,000</td>
<td>1,344,091</td>
</tr>
<tr>
<td>Liability under securities lending</td>
<td>(900,000)</td>
<td>(800,000)</td>
</tr>
<tr>
<td>Accrued income</td>
<td>150,000</td>
<td>135,000</td>
</tr>
<tr>
<td>Accrued liabilities</td>
<td>(50,000)</td>
<td>(20,000)</td>
</tr>
<tr>
<td>Total net assets</td>
<td>$25,000,000</td>
<td>$16,909,091</td>
</tr>
<tr>
<td>Plan interest in C&amp;H Master Trust</td>
<td>$2,250,000</td>
<td>$1,860,000</td>
</tr>
</tbody>
</table>

During 20X2 and [20X1], the Master Trust’s investments (including investments bought and sold, as well as held during the year) appreciated (depreciated) as follows:

\[ \text{Year Ended December 31,} \]

211
Investment income:

<table>
<thead>
<tr>
<th></th>
<th>20X2</th>
<th>[20X1]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net appreciation in fair value of investments:</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Common stocks</td>
<td>$ 300,000</td>
<td>$ 200,000</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>200,000</td>
<td>200,000</td>
</tr>
<tr>
<td>U.S. government securities</td>
<td>300,000</td>
<td>200,000</td>
</tr>
<tr>
<td>Net appreciation in fair value</td>
<td>$800,000</td>
<td>$600,000</td>
</tr>
</tbody>
</table>

The following are the changes in net assets for the Master Trust for the year ended December 31, 20X2. [The use of the beginning-of-the-year benefit information would require this note to include December 31, 20X1 information.]

Net investment income:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net appreciation in fair value of investments</td>
<td>$ 800,000</td>
</tr>
<tr>
<td>Interest</td>
<td>400,000</td>
</tr>
<tr>
<td>Dividends</td>
<td>230,000</td>
</tr>
<tr>
<td>Net investment income</td>
<td>$1,430,000</td>
</tr>
</tbody>
</table>

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Net transfers</td>
<td>$7,060,909</td>
</tr>
<tr>
<td>Administrative expenses</td>
<td>( 400,000)</td>
</tr>
<tr>
<td>Increase in net assets</td>
<td>8,090,909</td>
</tr>
</tbody>
</table>

Nets assets:

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Beginning of year</td>
<td>$16,909,091</td>
</tr>
<tr>
<td>End of year</td>
<td>$25,000,000</td>
</tr>
</tbody>
</table>

The closing prices reported in the active markets in which the securities are traded are used to value the investments in the Master Trust. The following table sets forth by level, within the fair value hierarchy, the Master Trust’s assets at fair value as of December 31, 20X2, and 20X1:
**USER’S NOTE**: The assets of the Master Trust are classified within level 1 of the fair value hierarchy due to the fact that they are valued using quoted market prices. Note that this is not representative of all master trusts. Accordingly, other master trusts may hold assets that are also classified within levels 2 and 3 of the fair value hierarchy. Presentation in the footnotes to the financial statements should be made accordingly.

***

The following table illustrates certain disclosure requirements of FASB ASC 820. The disclosures illustrated describe the nature and risks of securities as required by FASB ASC 820-10-50 and are included for illustrative purposes and are NOT intended to represent the ONLY way to disclose such information.

In addition, in January 2010, FASB issued ASU No. 2010-06. ASU No. 2010-06 amends the disclosure requirements of FASB ASC 820, including amendments regarding the level of disaggregation for each class of assets and liabilities. The illustrative financial statements in this appendix have been amended to conform to ASU No. 2010-06, where applicable. The amendments in the level 3 fair value measurement roll forward related to the separate disclosure requirement of purchases, sales, issuances, and settlements activity are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years, and, therefore, these financial statements have not been updated for those amendments. These illustrative financial statements do not contain any significant transfers between fair value levels and, therefore, a related disclosure has been included (see “changes in fair value levels” note).

<table>
<thead>
<tr>
<th>Assets at Fair Value as of December 31, 20X2</th>
<th>Level 1</th>
<th>Level 2</th>
<th>Level 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common stocks:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Energy</td>
<td>$5,500,000</td>
<td></td>
<td></td>
<td>$5,500,000</td>
</tr>
<tr>
<td>Healthcare</td>
<td>3,050,000</td>
<td></td>
<td></td>
<td>3,050,000</td>
</tr>
<tr>
<td>Information technology</td>
<td>1,050,000</td>
<td></td>
<td></td>
<td>1,050,000</td>
</tr>
<tr>
<td>Consumer goods</td>
<td>900,000</td>
<td></td>
<td></td>
<td>900,000</td>
</tr>
<tr>
<td>Utilities</td>
<td>500,000</td>
<td></td>
<td></td>
<td>500,000</td>
</tr>
<tr>
<td>Total common stocks</td>
<td>11,000,000</td>
<td></td>
<td></td>
<td>11,000,000</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>11,800,000</td>
<td></td>
<td></td>
<td>11,800,000</td>
</tr>
<tr>
<td>U.S. government securities</td>
<td>867,000</td>
<td></td>
<td></td>
<td>867,000</td>
</tr>
<tr>
<td>Securities lending:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash equivalents</td>
<td>100,000</td>
<td></td>
<td></td>
<td>100,000</td>
</tr>
<tr>
<td>Bonds and notes</td>
<td></td>
<td>800,000</td>
<td></td>
<td>800,000</td>
</tr>
<tr>
<td>Total Securities Lending</td>
<td>100,000</td>
<td>800,000</td>
<td></td>
<td>900,000</td>
</tr>
<tr>
<td>Total assets at fair value</td>
<td>$23,767,000</td>
<td>800,000</td>
<td></td>
<td>$24,567,000</td>
</tr>
</tbody>
</table>

*Assets at Fair Value as of December 31, 20X1*
<table>
<thead>
<tr>
<th></th>
<th>Level 1</th>
<th>Level 2</th>
<th>Level 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Common stocks:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Energy</td>
<td>$3,950,000</td>
<td>—</td>
<td>—</td>
<td>$3,950,000</td>
</tr>
<tr>
<td>Healthcare</td>
<td>2,200,000</td>
<td>—</td>
<td>—</td>
<td>2,200,000</td>
</tr>
<tr>
<td>Information technology</td>
<td>800,000</td>
<td>—</td>
<td>—</td>
<td>800,000</td>
</tr>
<tr>
<td>Consumer goods</td>
<td>750,000</td>
<td>—</td>
<td>—</td>
<td>750,000</td>
</tr>
<tr>
<td>Utilities</td>
<td>300,000</td>
<td>—</td>
<td>—</td>
<td>300,000</td>
</tr>
<tr>
<td>Total common stocks</td>
<td>8,000,000</td>
<td>—</td>
<td>—</td>
<td>8,000,000</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>6,700,000</td>
<td>—</td>
<td>—</td>
<td>6,700,000</td>
</tr>
<tr>
<td>U.S. government securities</td>
<td>750,000</td>
<td>—</td>
<td>—</td>
<td>750,000</td>
</tr>
<tr>
<td>Securities lending:</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash equivalents</td>
<td>80,000</td>
<td>—</td>
<td>—</td>
<td>80,000</td>
</tr>
<tr>
<td>Bonds and notes</td>
<td>—</td>
<td>720,000</td>
<td>—</td>
<td>720,000</td>
</tr>
<tr>
<td>Total Securities Lending</td>
<td>80,000</td>
<td>720,000</td>
<td>—</td>
<td>800,000</td>
</tr>
<tr>
<td>Total assets at fair value</td>
<td>$15,530,000</td>
<td>720,000</td>
<td>—</td>
<td>$16,250,000</td>
</tr>
</tbody>
</table>

**Changes in Fair Value Levels**

The availability of observable market data is monitored to assess the appropriate classification of financial instruments within the fair value hierarchy. Changes in economic conditions or model-based valuation techniques may require the transfer of financial instruments from one fair value level to another. In such instances, the transfer is reported at the beginning of the reporting period.

We evaluate the significance of transfers between levels based upon the nature of the financial instrument and size of the transfer relative to total net assets available for benefits. For the year ended December 31, 20XX, there were no significant transfers in or out of levels 1, 2, or 3.

**H. Guaranteed Investment Contract With National Insurance Company**

In 20X0, the plan entered into a guaranteed investment contract with National Insurance Company (National) under which the plan deposits a minimum of $100,000 a year. National maintains the contributions in an unallocated fund to which it adds interest at a rate of X percent. The interest rate is guaranteed through 20X3 but is subject to change for each succeeding 5-year period. When changed, the new rate applies only to funds deposited from the date of change. At the direction of the plan's administrator, a single premium to buy an annuity for a retiring employee is withdrawn by National from the unallocated fund. Purchased annuities are contracts under which National is obligated to pay benefits to named employees or their beneficiaries. The premium rates for such
annuities to be purchased in the future and maximum administration expense charges against the fund are also guaranteed by National on a 5-year basis.

The annuity contracts provide for periodic dividends at National's discretion on the basis of its experience under the contracts. Such dividends received by the plan for the year(s) ended December 31, 20X2 [and 20X1], were $25,000 [and $24,000, respectively]. In reporting changes in net assets, those dividends have been netted against amounts paid to National for the purchase of annuity contracts.

I. Derivative Instruments

In the normal course of business, the Plan’s assets and liabilities may include derivative financial instruments (futures and options). These derivatives involve, in varying degrees, elements of credit and market volatility risks in excess of more traditional investment holdings such as equity and debt instruments. The Plan may buy or sell interest rate futures contracts or enter into interest rate swap transactions to protect against changes in the market. Payments are made or received by the Plan equal to the changes in the contract value in accordance with contract terms and are recorded as appreciation or depreciation. The Plan may also purchase forward contracts or foreign currency as protection against changes in exchange rates. Such contracts are reported at fair value based on current exchange rates. Due to the inherent volatility in these financial instruments, the values of these investments may change in the near term, and these changes could differ materially from the amounts reported in the net assets of the Plan.

Credit risk represents the potential loss to the Plan due to possible nonperformance by obligors and counterparties of the terms of their contracts. Market risk represents the potential loss to the Plan due to the decrease or increase in the value of the financial instrument caused primarily by changes in interest rates or foreign exchange rates or a combination thereof.

Forward contracts and futures represent commitments to purchase or sell securities, money market instruments, or foreign currencies at a future date and at a specified price. Interest rate swaps involve the exchange of commitments to pay or receive interest (for example, an exchange of floating-rate payments for fixed-rate payments). Short sells represent commitments to purchase securities at a future date and at a specified price. Both credit and market risks exist with respect to forward contracts and interest rate swap transactions. Market risk exists with respect to futures, short sells, and options. These positions are carried at current market value, and the unrealized gains or losses are included in the net assets of the Plan. Financial futures are marked to market and settled with the broker on a daily basis. The Plan does not anticipate that losses, if any, as a result of credit or market risk, would materially affect the net asset position of the Plan. The Plan, to a limited extent, enters into transactions involving other financial instruments and commitments as an integral part of the overall management of the investment portfolio.

The following table summarizes the aggregate notional amounts and fair value of the Plan’s derivative financial instruments as of December 31, 20X2 and 20X1:
<table>
<thead>
<tr>
<th>Settlement Date</th>
<th>Notional Amount</th>
<th>Unrealized Appreciation (Depreciation)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Purchased:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australian Dollar 3/31/X2</td>
<td>$31,495</td>
<td>$(893)</td>
</tr>
<tr>
<td>Australian Dollar 3/31/X1</td>
<td>$705.046</td>
<td>$(2,714)</td>
</tr>
<tr>
<td><strong>Sold:</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Australian Dollar 3/31/X2</td>
<td>$281,757</td>
<td>$8,004</td>
</tr>
<tr>
<td>Australian Dollar 3/31/X1</td>
<td>$816,327</td>
<td>$6,186</td>
</tr>
</tbody>
</table>

The fair value of futures as of December 31, 20X2 and 20X1, is included in due from the broker for securities sold in the statement of net assets available for benefits.

J. Securities Lending

The Plan is not restricted from lending securities to other qualified financial institutions, provided such loans are callable at any time and are at all times fully collateralized by cash (including both U.S. and foreign currency), cash equivalents, or securities issued or guaranteed by the U.S. government or its agencies and the sovereign debt of foreign countries. The portfolios may bear the risk of delay in recovery of, or even of rights in, the securities loaned, should the borrower of the securities fail financially. Consequently, loans of portfolio securities will only be made to firms deemed by the subadvisers to be creditworthy. The portfolios receive compensation for lending their securities either in the form of fees or by retaining a portion of interest on the investment of any cash received as collateral.

All collateral received will be in an amount equal to at least 100 percent of the market value of the loaned securities and is intended to be maintained at that level during the period of the loan. The Plan bears the risk of loss with respect to the investment of collateral. The market value of the loaned securities is determined at the close of business of the portfolio, and any additional required collateral is delivered to the portfolio the next business day. During the loan period, the portfolio continues to retain rights of ownership, including dividends and interest of the loaned securities. Loan income generated from securities lending arrangements

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8 This example for securities lending shows that investment in securities lending are held in the Master Trust. If not held in the Master Trust, the amounts need to be shown on the face of the statement of net assets available for benefits.
was $12,345 for the year ended December 31, 20X2. The income from securities lending is included in interest income on the statement of changes in net assets of the Plan.

Fair value of securities loaned and corresponding collateral at December 31, 20X2 and 20X1, were as follows:

<table>
<thead>
<tr>
<th>Securities under lending agreement</th>
<th>20X2</th>
<th>20X1</th>
</tr>
</thead>
</table>

Collateralized by:

| Cash equivalents | $100,000 | $ 80,000 |
| Bonds and notes   | 800,000  | 720,000  |

Total collateral $900,000 $800,000

Payable for collateral on securities loaned $900,000 $800,000

K. Risks and Uncertainties

The plan invests in various investment securities. Investment securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statement of net assets available for benefits.

Plan contributions are made, and the actuarial present value of accumulated plan benefits are reported based on certain assumptions pertaining to interest rates, inflation rates, and employee demographics, all of which are subject to change. Due to uncertainties inherent in the estimations and assumptions process, it is at least reasonably possible that changes in these estimates and assumptions in the near term would be material to the financial statements.

L. Plan Amendment

Effective October 1, 20X2, the Plan was amended to implement a voluntary retirement window policy. This amendment provided the opportunity for eligible participants to elect early retirement during the window period from October 27, 20X2 to December 10, 20X2. The early retirement benefit was equal to the unrecorded accrued benefit at age 65, and participants could opt to receive this benefit in a lump sum payment commencing on January 1, 20X3. The effect of the Plan amendment was an increase in the actuarial present value of accumulated Plan benefits of $2,410,000.

M. Tax Status
The IRS has determined and informed the Company by a letter dated June 30, 20XX, 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.\(^9\)

Accounting principles generally accepted in the United States of America require plan management to evaluate tax positions taken by the Plan and recognize a tax liability if the organization has taken an uncertain position that more likely than not would not be sustained upon examination by the [identify the taxing authority]. The Plan administrator has analyzed the tax positions taken by the Plan and has concluded that as of December 31, 20X2, there are no uncertain positions taken or expected to be taken that would require recognition of a liability or disclosure in the financial statements. The Plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The Plan administrator believes it is no longer subject to income tax examinations for years prior to 20XX.

N. Related-Party Transactions

Certain plan investments are shares of C&H Company common stock. The Plan held 25,000 shares of C&H Company common stock at December 31, 20X2 and 20X1, valued at $690,000 and $880,000, respectively. During the years ended December 31, 20X2 and 20X1, purchases of shares by the Plan totaled $1,100,000 and $500,000, respectively, and sales of shares by the Plan totaled $1,498,000 and $750,000, respectively. This investment, and transactions in this investment, qualify as party-in-interest transactions, which are exempt from the prohibited transaction rules of ERISA.

O. 401(h) Account

Effective January 1, 1999, the Plan was amended to include a medical-benefit component in addition to the normal retirement benefits to fund a portion of the postretirement obligations for retirees and their beneficiaries in accordance with Section 401(h) of the IRC. A separate account has been established and maintained in the Plan for the net assets related to the medical-benefit component [401(h) account]. In accordance with IRC Section 401(h), the Plan’s investments in the 401(h) account may not be used for, or diverted to, any purpose other than providing health benefits for retirees and their beneficiaries. Any assets transferred to the 401(h) account from the defined benefit pension plan in a qualified transfer of excess pension plan assets (and any income allocable thereto) that are not used during the plan year must be transferred out of the account to the pension plan. The related obligations for health benefits are not included in this Plan’s obligations in the statement of accumulated plan benefits but are reflected as obligations in the financial statements of the health and welfare benefit plan. Plan participants do not contribute to the 401(h) account. Employer contributions or qualified

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\(^9\) FASB issued new guidance on accounting for uncertainty in income taxes for the year ended December 31, 2009. It may be necessary for the Plan to adopt this new guidance depending on the type of investments that may or may not require the Plan to provide for a provision for unrelated business taxable income (UBTI). See FASB ASC 740, Income Taxes, for further guidance.
transfers to the 401(h) account are determined annually and are at the discretion of the plan sponsor. Certain of the Plan’s net assets are restricted to fund a portion of postretirement health benefits for retirees and their beneficiaries in accordance with IRC Section 401(h).

P. Reconciliation of Financial Statements to Form 5500

The following is a reconciliation of net assets available for pension benefits per the financial statements to the Form 5500:

<table>
<thead>
<tr>
<th>Description</th>
<th>20X2</th>
<th>20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net assets available for pension benefits per the financial statements</td>
<td>$9,012,000</td>
<td>$8,146,000</td>
</tr>
<tr>
<td>Net assets held in 401(h) account included as assets in Form 5500</td>
<td>1,072,000</td>
<td>966,000</td>
</tr>
<tr>
<td>Net assets available per the Form 5500</td>
<td>$10,084,000</td>
<td>$9,112,000</td>
</tr>
</tbody>
</table>

The net assets of the 401(h) account included in Form 5500 are not available to pay pension benefits but can be used only to pay retiree health benefits.

The following is a reconciliation of the changes in net assets per the financial statements to the Form 5500:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amounts per Financial Statements</th>
<th>401(h) Account</th>
<th>Amounts per Form 5500</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net appreciation in fair value of investments</td>
<td>$233,000</td>
<td>$10,800</td>
<td>$243,800</td>
</tr>
<tr>
<td>Interest income</td>
<td>293,000</td>
<td>80,200</td>
<td>373,200</td>
</tr>
<tr>
<td>Employer contributions</td>
<td>740,000</td>
<td>40,000</td>
<td>780,000</td>
</tr>
<tr>
<td>Benefits paid to retirees</td>
<td>740,000</td>
<td>10,000</td>
<td>750,000</td>
</tr>
<tr>
<td>Administrative expenses</td>
<td>50,000</td>
<td>15,000</td>
<td>65,000</td>
</tr>
</tbody>
</table>

The fair values of the U.S. government securities and the money market fund held in the 401(h) account are based on the closing price reported in an active market.

<table>
<thead>
<tr>
<th>Assets at Fair Value as of December 31, 20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level 1</td>
</tr>
<tr>
<td>--------</td>
</tr>
</tbody>
</table>

The reconciliation of amounts reported in the Plan’s financial statements to amounts reported in Form 5500 is required by the Employee Retirement Income Security Act of 1974.
### Assets at Fair Value as of December 31, 20X0

<table>
<thead>
<tr>
<th></th>
<th>Level 1</th>
<th>Level 2</th>
<th>Level 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. government securities</td>
<td>$150,000</td>
<td></td>
<td></td>
<td>$150,000</td>
</tr>
<tr>
<td>Money market fund</td>
<td>800,000</td>
<td></td>
<td></td>
<td>$800,000</td>
</tr>
<tr>
<td>Total assets at fair value</td>
<td>$950,000</td>
<td>0</td>
<td>0</td>
<td>$950,000</td>
</tr>
</tbody>
</table>

**Q. Subsequent Event**

Effective July 1, 20X3, the ABC plan was merged into the Plan. ABC’s plan net assets available for benefits and accumulated benefit obligations transferred to the Plan amounted to approximately $1,750,000 and $2,125,000 respectively. This merger will not affect the participant’s pension benefits because the benefit provisions of the merged plan will be incorporated into the Plan.
Appendix E

Illustrations of Financial Statements: Health and Welfare Benefit Plans

E.01 The illustrative financial statement was originally derived from the AICPA Statement of Position (SOP) 92-6, Accounting and Reporting by Health and Welfare Benefit Plans, which has now been codified in the Financial Accounting Standards Board (FASB) Accounting Standard Codification (ASC) 965, Plan Accounting—Health and Welfare Benefit Plans. This illustrative financial statement has since been modified to include certain changes necessary due to the issuance of authoritative guidance or to better represent aspects of current health and welfare benefit plans. This appendix illustrates certain applications of the provisions of FASB ASC 965 to the annual financial statements of the following hypothetical health and welfare benefit plan.

Allied Industries Health Care Benefit Plan

Allied Industries Health Care Benefit Plan is a single employer plan that displays the benefit obligation information in separate financial statements, and the retirees contribute a portion of the cost for their medical coverage. The plan provides postemployment benefits and includes retiree health benefits that are funded partially through a 401(h) account in the plan sponsor’s defined benefit pension plan (exhibits E-1–E-5).

The sponsor of the plan offers multiple individual health and welfare benefit programs that have been combined into a single plan using a wrapper plan document. The plan has assets in an underlying voluntary employees’ beneficiary association (VEBA) trust. The plan pays some benefits directly from plan assets, and others are paid from the general assets of the employer. The plan also obtains insurance for certain benefits. It is assumed that the plan provides health benefits and life insurance coverage to both active and retired participants. It is also assumed that the plan provides long-term disability benefits and limited coverage during periods of unemployment.

Other Resources

E.02 The illustrative financial statement contained in this appendix is only one example of how a health and welfare benefit plan financial statement may look. The following table contains other sources of illustrations or actual health and welfare benefit plan financial statements and disclosures that may provide additional guidance.
<table>
<thead>
<tr>
<th>Source</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>FASB ASC 815, <em>Derivatives and Hedging</em></td>
<td>FASB ASC 815 contains implementation guidance and illustrations relating to derivatives and hedging.</td>
</tr>
<tr>
<td>FASB ASC 820, <em>Fair Value Measurements and Disclosures</em></td>
<td>FASB ASC 820-10-55 contains implementation guidance and illustrations relating to fair value measurements.</td>
</tr>
<tr>
<td>AICPA Audit and Accounting Guide <em>Investment Companies</em></td>
<td>The AICPA Audit and Accounting Guide <em>Investment Companies</em> contains illustrations with disclosures relating to unique investments, such as short sales, credit default swaps, futures, forwards, and derivatives.</td>
</tr>
<tr>
<td><em>Accounting Trends &amp; Techniques, Employee Benefit Plans, 3rd Edition</em></td>
<td>This publication is intended to provide preparers and auditors of employee benefit plan financial statements with a compilation of illustrative financial statement disclosures based on actual examples.</td>
</tr>
</tbody>
</table>

---

1 Additional resources that contain actual plan financial statements include EFAST2 located at www.dol.gov and EDGAR, located at www.sec.gov.
## ALLIED INDUSTRIES HEALTH CARE BENEFIT PLAN

### Allied Industries Health Care Benefit Plan

**Statements of Net Assets Available for Benefits**

**December 31, 20X1 and 20X0**

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Investments, at fair value</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Short-term investment fund</td>
<td>$5,000,000</td>
<td>$4,000,000</td>
</tr>
<tr>
<td>Net assets held in defined benefit plan-restricted for 401(h) account</td>
<td>1,072,000</td>
<td>966,000</td>
</tr>
<tr>
<td><strong>Receivables</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Participant contributions</td>
<td>125,000</td>
<td>100,000</td>
</tr>
<tr>
<td>Pharmacy rebate</td>
<td>60,000</td>
<td>50,000</td>
</tr>
<tr>
<td>Accrued interest</td>
<td>12,000</td>
<td>10,000</td>
</tr>
<tr>
<td><strong>Total receivables</strong></td>
<td>197,000</td>
<td>160,000</td>
</tr>
<tr>
<td>Premium stabilization reserve</td>
<td>350,000</td>
<td>400,000</td>
</tr>
<tr>
<td><strong>Total Assets</strong></td>
<td>6,619,000</td>
<td>5,526,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Liabilities</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Payable to claims administrators</td>
<td>250,000</td>
<td>240,000</td>
</tr>
<tr>
<td>Accrued expenses</td>
<td>25,000</td>
<td>25,000</td>
</tr>
<tr>
<td><strong>Total Liabilities</strong></td>
<td>275,000</td>
<td>265,000</td>
</tr>
<tr>
<td><strong>Net Assets Available For Benefits</strong></td>
<td>$6,344,000</td>
<td>$5,261,000</td>
</tr>
</tbody>
</table>

The accompanying notes are an integral part of the financial statements.
Exhibit E-2

Allied Industries Health Care Benefit Plan
Statement of Changes in Net Assets Available for Benefits
Year Ended December 31, 20X1

20X1

Additions:
Contributions
Employer $15,000,000
Participants 3,000,000
Total contributions 18,000,000
Interest income 150,000
Net increase in 401(h) account 106,000

Total Additions 18,256,000

Deductions
Claims paid, net 16,723,000
Premiums paid 300,000
Administrative expenses 150,000

Total Deductions 17,173,000

Net Increase During the Year 1,083,000

Net assets available for benefits
Beginning of year 5,261,000
End of year $ 6,344,000

The accompanying notes are an integral part of the financial statements.
### Allied Industries Health Care Benefit Plan
#### Statements of Benefit Obligations
December 31, 20X1 and 20X0

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Amounts currently payable</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Claims payable and claims incurred but not reported</td>
<td>$2,700,000</td>
<td>$2,500,000</td>
</tr>
<tr>
<td>Premiums due to insurers</td>
<td>50,000</td>
<td>45,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>2,750,000</td>
<td>2,545,000</td>
</tr>
</tbody>
</table>

**Postemployment benefit obligations, net of amounts currently payable**

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Death and disability benefits for inactive participants</td>
<td>350,000</td>
<td>400,000</td>
</tr>
<tr>
<td>COBRA benefits</td>
<td>50,000</td>
<td>45,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>400,000</td>
<td>445,000</td>
</tr>
</tbody>
</table>

**Postretirement benefit obligations, net of amounts currently payable**

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Current retirees</td>
<td>2,000,000</td>
<td>1,900,000</td>
</tr>
<tr>
<td>Other participants fully eligible for benefits</td>
<td>4,000,000</td>
<td>3,600,000</td>
</tr>
<tr>
<td>Participants not yet fully eligible for benefits</td>
<td>5,000,000</td>
<td>4,165,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>11,000,000</td>
<td>9,665,000</td>
</tr>
</tbody>
</table>

**TOTAL Benefit Obligations**

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Total</strong></td>
<td>$14,150,000</td>
<td>$12,655,000</td>
</tr>
</tbody>
</table>

The accompanying notes are an integral part of the financial statements.
### Allied Industries Health Care Benefit Plan

**Statement of Changes in Benefit Obligations**

**Year Ended December 31, 20X1**

<table>
<thead>
<tr>
<th>Category</th>
<th>20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Amounts currently payable</strong></td>
<td></td>
</tr>
<tr>
<td>Balance at beginning of year</td>
<td>$ 2,545,000</td>
</tr>
<tr>
<td>Claims and premiums incurred, including claims and premiums reclassified from postemployment and postretirement benefit obligations</td>
<td>17,228,000</td>
</tr>
<tr>
<td>Claims and insurance premiums paid</td>
<td>(17,023,000)</td>
</tr>
<tr>
<td>Balance at end of year</td>
<td>2,750,000</td>
</tr>
<tr>
<td><strong>Postemployment benefit obligations, net of amounts currently payable</strong></td>
<td></td>
</tr>
<tr>
<td>Balance at beginning of year</td>
<td>445,000</td>
</tr>
<tr>
<td>Claims incurred</td>
<td>40,000</td>
</tr>
<tr>
<td>Claims reclassified to amounts currently payable</td>
<td>(96,000)</td>
</tr>
<tr>
<td>Interest</td>
<td>1,000</td>
</tr>
<tr>
<td>Other actuarial gains and losses</td>
<td>10,000</td>
</tr>
<tr>
<td>Balance at end of year</td>
<td>400,000</td>
</tr>
<tr>
<td><strong>Postretirement benefit obligations, net of amounts currently payable</strong></td>
<td></td>
</tr>
<tr>
<td>Balance at beginning of year</td>
<td>9,665,000</td>
</tr>
<tr>
<td>Benefits earned</td>
<td>1,150,000</td>
</tr>
<tr>
<td>Claims and premiums reclassified to amounts currently payable</td>
<td>(650,000)</td>
</tr>
<tr>
<td>Interest</td>
<td>750,000</td>
</tr>
<tr>
<td>Plan amendment</td>
<td>(175,000)</td>
</tr>
<tr>
<td>Changes in actuarial assumptions</td>
<td>150,000</td>
</tr>
<tr>
<td>Other actuarial gains and losses</td>
<td>110,000</td>
</tr>
<tr>
<td>Balance at end of year</td>
<td>11,000,000</td>
</tr>
<tr>
<td><strong>Total Benefit Obligations At End Of Year</strong></td>
<td>$ 14,150,000</td>
</tr>
</tbody>
</table>

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

The following description of the Allied Industries (Company) Health Care Benefit Plan (Plan) provides only general information about the Plan’s provisions. Participants should refer to the plan agreement for a complete description of the Plan's provisions, copies of which may be obtained from the Plan sponsor.

General. The Plan provides health and other benefits to eligible employees of the Company (with at least 1,000 hours of service each year) and covered dependents. Retired employees are entitled to medical benefits if they have attained at least age 62 and have at least 15 years of service with the Company.

Certain Plan’s assets are held in a voluntary employees’ beneficiary association (VEBA) trust. The Plan is subject to the provisions of the Employee Retirement Security Act of 1974, as amended (ERISA).

Benefits. The Plan provides health benefits (medical, vision, dental, and prescription drugs), life insurance, short and long-term disability benefits, and accidental death and dismemberment benefits. Retired employees are entitled to similar health benefits (in excess of Medicare coverage). The Plan also provides continuation of certain benefits upon termination of employment through the Consolidated Omnibus Budget Reconciliation Act (COBRA).

Insured Benefits. The Plan offers one health maintenance organization (HMO) that participants can choose. The Plan fully insures the life insurance benefits (basic, supplemental, and dependent), accidental death and disability benefits (basic, supplemental, and spousal), and long-term disability benefits. The Company purchases annual insurance contracts for these insured benefits. Premiums for basic life insurance and basic accidental death and dismemberment insurance programs are paid to the insurance company from the general assets of the Company. Premiums for all other insured benefits are paid from the assets of the VEBA trust.

Experience-rated Contracts. Certain insurance contracts are subject to experience-rating adjustments. Experience ratings (calculated as the difference between premiums paid and the total of claims paid and fees charged by the insurance company) are determined by the insurance company in the following year and may result in a premium surplus or deficit.

Stop Loss Coverage. The Plan has entered into a stop-loss insurance arrangement in an effort to limit its exposure for self-insured benefits (individual participant claims over a specific dollar amount, as well as its aggregate exposure for all claims).
Self-insured Benefits. All other Plan benefits are self-insured. The claims for self-insured benefits (other than short-term disability) are processed by the Plan’s third-party claims processors under administrative services only (ASO) arrangements. The claims processors pay claims directly to or for participants and are then reimbursed by either the Plan’s Veba trust, the 401(h) account (see “401(h) Account” section that follows) within the Allied Industries Defined Benefit Plan or the general assets of the Company. Despite the Plan’s utilization of third-party claim’s processors, ultimate responsibility for payments to providers and participants is retained by the Plan.

The Plan utilizes a pharmacy benefit manager (PBM) to help control drug costs. The PBM pays refunds to the Plan based on the Plan’s actual utilization pattern of specific drugs. There is an inherent lag in between the periodic capture and calculation of refunds due the Plan and receipt of such refunds.

The Plan has a health reimbursement arrangement (HRA) that is funded solely through Company contributions. The HRA allows eligible participants to be reimbursed tax free for qualified medical expenses up to a maximum dollar amount for a coverage period. Amounts remaining at the end of the year can generally be carried over to the next year. The employer is not permitted to refund any part of the balance to the employee; the account cannot be used for anything other than reimbursements for qualified medical expenses; and remaining amounts are not portable upon termination once the employee leaves the employer.

401(h) Account. The Plan includes a health and welfare component, in addition to normal retirement benefits, to fund a portion of the postretirement obligations for retirees and their beneficiaries in accordance with Section 401(h) of the Internal Revenue Code (IRC). A separate account has been established and maintained in the [add title of defined benefit plan] for the net assets related to the medical benefit component (the 401(h) account). In accordance with IRC Section 401(h), the plan’s investments in the 401(h) account may not be used for, or diverted to, any purpose other than providing health benefits for retirees and their beneficiaries. The related obligations for health benefits are not included in the Allied Industries Defined Benefit Plan obligations, but are reported as obligations in the accompanying financial statements of the Plan.

Contributions. In addition to deductibles and copayments, participants contribute specified amounts based on applicable monthly premiums for their respective benefit elections. Participants pay the full cost of supplemental and dependent life insurance and supplemental accidental death and dismemberment insurance programs based on the current group rate premium cost. The Company pays the full cost of basic life insurance, basic accidental death and dismemberment insurance, and stop loss insurance. The costs of the postretirement benefit plan are shared by the Company and retirees. Retiree contribution rates are as follows:

<table>
<thead>
<tr>
<th>Participants Retiring</th>
<th>20X1 Retiree Contribution</th>
<th>20X0 Retiree Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>(1) Pre-1995</td>
<td>(1) None</td>
<td>(1) None</td>
</tr>
<tr>
<td>(2) 1995–20X1</td>
<td>(2) Retirees contribute 20% of</td>
<td>(2) Retirees contribute 20% of</td>
</tr>
</tbody>
</table>
The Company makes contributions to the Plan as needed to fund claims in excess of participants’ contributions. Any deficiency of the Plan’s net assets over benefit obligations is funded on a pay-as-you-go basis.

B. Summary of Accounting Policies

1. **Basis of Accounting and Use of Estimates.** The accompanying financial statements have been prepared using the accrual basis of accounting. The preparation of financial statements in conformity with generally accepted accounting principles (GAAP) requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, benefit obligations and changes therein, and disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

2. **Payment of Benefits.** Premiums paid by either the Company or the VEBA trust are recorded as premium payments in the accompanying statement of changes in net assets available for benefits.

   Claim payments are recorded when paid by the third-party claims processor. Amounts due to claims processors that have yet to be reimbursed by the Plan are recorded as payable to claims administrators in the accompanying statements of net assets available for benefits. Short-term disability payments are processed through the Company’s payroll system and paid from the general assets of the Company. These payments are recorded as claims paid in the accompanying statement of changes in net assets available for benefits.

3. **Experience-rated Contracts.** For experience-rated contracts, premium surpluses are recorded as a receivable from the insurance company. To the extent that premium surpluses are attributable to premiums paid by the Company, a payable to the Company is also recorded for surplus amounts attributable to Company-paid coverage.

   If the insurance company requires payment of additional premiums due to a premium deficit, an obligation for the additional premiums is included in benefit obligations. If the deficit relates to Company-paid coverage, a receivable from the Company is also recorded. Periodically, a premium deficit is due related to participant-funded coverage, but the trust is unable to pay the entire amount. In this case, the Company pays the difference to the insurance company and a receivable from the Company is recorded.

4. **Premium Stabilization Reserve.** The Plan is required to maintain a premium stabilization reserve with a certain insurance company, which can be drawn against to reduce future premium payments when premiums paid to an insurance company exceed the total of claims paid and other charges. The premium stabilization reserve has been included as an
asset of the Plan until such amounts are used to pay premiums. The reserve is nonforfeitable should the insurance contract terminate.

5. **Stop Loss.** Premiums for stop loss insurance are included in premium payments in the accompanying statement of changes in net assets available for benefits. Stop loss refunds totaling $XXX have been netted with claims paid in the accompanying statement of changes in net assets.

6. **Refunds.** Refunds dues from the Plan’s PBM are recorded when earned. Refunds due as of the financial statement date have been reported as a receivable, with the offset being netted against claims paid. Pharmacy rebates totaling $225,000 have been netted with claims paid in the accompanying statement of changes in net assets available for benefits for the year ended December 31, 20X1.

7. **Medicare Subsidy.** The Plan’s postretirement benefit obligation does not reflect an amount associated with the Medicare subsidy allowed under the Medicare Prescription Drug Improvement and Modernization Act of 2003 because the Plan is not directly entitled to the Medicare subsidy. The Company has included the effects of the Medicare subsidy in measuring its postretirement benefit obligation; therefore, the Plan’s postretirement benefit obligation differs from that of the Company.

8. **Health Reimbursement Arrangement.** Included in the accompanying statements of net assets are amounts available to reimburse participants for qualifying medical expenses as of December 31, 20X1 and 20X0, totaling $48,000 and $41,000, respectively. Claims incurred before plan year-end that were submitted after year-end (but before the date defined by the plan agreement) totaled $40,000 and $37,000 relating to 20X1 and 20X0, respectively. Forfeited amounts were used by the Company to offset Company contributions in the year forfeited.

9. **Investment Valuation and Income Recognition.** Investments are reported at fair value. Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. See note F for discussion of fair value measurements.

Purchases and sales of securities are recorded on a trade-date basis. Interest income is recorded on the accrual basis.

10. **Subsequent Events.** Management has evaluated subsequent events for the Plan through [insert date], the date the financial statements were available to be issued.

C. **Postretirement and Postemployment Benefit Obligations**

A postretirement benefit obligation has been recognized for retiree medical benefits for eligible participants and their dependents upon retirement. In addition, a postemployment benefit obligation has been recognized for health and welfare benefits for individuals currently on long-term disability or COBRA. These benefit obligations represent the actuarial present value of the cost of those estimated future benefits that are attributed by the terms of the Plan to employee service rendered to the date of the financial statements,
reduced by the actuarial present value of contributions expected to be received in the future from current retirees of the Plan. The obligations represent the amounts that are expected to be funded by contributions from the Company and from existing assets of the Plan. Postretirement benefits include future benefits expected to be paid to or for (a) currently retired or terminated employees and their beneficiaries and dependents, and (b) active employees and their beneficiaries and dependents after retirement from service with the Company.

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.

The obligation for COBRA benefits is estimated by an actuary based on the actual number of employees utilizing COBRA benefits as of the measurement date and claim payment history and includes an estimate for claims incurred by COBRA participants that have not been reported. Long-term disability obligations are estimated by an actuary based on reserve reports prepared from historical long-term disability benefits data.

For measurement purposes, a 9.5 percent weighted-average annual rate of increase in the average per capita cost of covered health care benefits was assumed for 20X2; 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 weighted-average health care cost trend rate assumption has a significant effect on the amounts reported as postretirement benefit obligations. If the assumed rates increased by 1 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.

The following were other significant assumptions used to determine the postretirement and postemployment benefit obligations as of December 31, 20X1 and 20X0.

<table>
<thead>
<tr>
<th>Assumption</th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Weighted-average discount rate</td>
<td>8.0%—20X1; 8.25%—20X0</td>
<td>Various rates ranging from 10% at age 62 to 100% at age 65</td>
</tr>
<tr>
<td>Average retirement age rates</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Mortality and disability</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

In 20X1, the plan was amended to increase the deductible under major medical coverage from $100 to $300 and to extend dental coverage to employees retiring after December
31, 20X2. 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 benefit obligations.

D. Claims Incurred but not Reported

Plan obligations at December 31 for claims incurred but not reported are estimated by the Plan's actuary in accordance with accepted actuarial principles based on claims data provided by the Plan’s third-party claims administrators. These amounts are paid by the Plan only if claims are submitted and approved for payment.

E. Certified Investments [include this note if a limited scope audit engagement]

Investments held at December 31, 20X1 and 20X0, and investment income for the year ended December 31, 20X1, including investment information related to the 401(h) account (see notes A and J), that is disclosed in the accompanying financial statements and supplemental schedules, was obtained or derived from information supplied to the plan administrator and certified as complete and accurate by the trustee of the Plan.

F. Fair Value Measurements

_Fair value_ is defined as “the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date” (that is, an exit price). The fair value hierarchy prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets and liabilities (level 1) and the lowest priority to unobservable inputs (level 3). The three levels of the fair value hierarchy are described as follows:

<table>
<thead>
<tr>
<th>Level 1</th>
<th>Inputs to the valuation methodology are unadjusted quoted prices for identical assets or liabilities in active markets that the Plan has the ability to access.</th>
</tr>
</thead>
<tbody>
<tr>
<td>Level 2</td>
<td>Inputs to the valuation methodology include</td>
</tr>
<tr>
<td></td>
<td>• quoted prices for similar assets or liabilities in active markets;</td>
</tr>
<tr>
<td></td>
<td>• quoted prices for identical or similar assets or liabilities in inactive markets;</td>
</tr>
<tr>
<td></td>
<td>• inputs other than quoted prices that are observable for the asset or liability;</td>
</tr>
<tr>
<td></td>
<td>• inputs that are derived principally from or corroborated by observable market data by correlation or other means.</td>
</tr>
<tr>
<td></td>
<td>If the asset or liability has a specified (contractual) term, the Level 2 input must be observable for substantially the full term of the asset or liability.</td>
</tr>
<tr>
<td>Level 3</td>
<td>Inputs to the valuation methodology are unobservable and significant to the fair value measurement.</td>
</tr>
</tbody>
</table>
The asset or liability’s fair value measurement level within the fair value hierarchy is based on the lowest level of any input that is significant to the fair value measurement. Valuation techniques used need to maximize the use of observable inputs and minimize the use of unobservable inputs.

**Users’ Note:** Note that information contained herein for fair value disclosures is based upon information for the Illustration of Financial Statements: Allied Industries Health Care Benefit Plan as presented in exhibits E-1–E-5. This illustrative disclosure is not representative of all types of investment securities and does not represent the classification for every instance of such investment securities. It should not be assumed that these methodologies are the only appropriate methodologies for these types of assets. As stated in FASB ASC 820-10-35-5, “The principle (or most advantageous) market (and thus, market participants) should be considered from the perspective of the reporting entity, thereby allowing for differences between and among entities with different activities.” Plan sponsors will have to evaluate the appropriate classification for each type of investments securities based upon the plan’s portfolio and actual fair valuation techniques used.

The short-term investment fund is a common trust fund that is designed to protect capital with low-risk investments and includes cash, bank notes, corporate notes, government bills, and various short-term debt instruments. There are currently no redemption restrictions on this investment. The fair value of the investment in this category has been estimated using the net asset value per share.

The following table sets forth by level, within the fair value hierarchy, the Plan’s assets at fair value as of December 31, 20X1 and 20X0:

<table>
<thead>
<tr>
<th></th>
<th>Level 1</th>
<th>Level 2</th>
<th>Level 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-term investment fund</td>
<td>$0</td>
<td>$5,000,000</td>
<td>$0</td>
<td>$5,000,000</td>
</tr>
<tr>
<td>Total assets at fair value</td>
<td>$0</td>
<td>$5,000,000</td>
<td>$0</td>
<td>$5,000,000</td>
</tr>
</tbody>
</table>

In addition, in January 2010, FASB issued Accounting Standards Update (ASU) No. 2010-06, Improving Disclosures about Fair Value Measurements. ASU No. 2010-06 amends the disclosure requirements of FASB ASC 820, including amendments regarding the level of disaggregation for each class of assets and liabilities. The illustrative financial statement in this appendix has been amended to conform to ASU No. 2010-06, where applicable. The amendments in the level 3 fair value measurement roll forward, related to the separate disclosures requirement of purchases, sales, issuances, and settlements activity are effective for fiscal years beginning after December 15, 2010, and for interim periods within those fiscal years, and, therefore, these financial statements have not been updated for those amendments. These illustrative financial statements do not contain any transfer between fair value levels and, therefore, no disclosure has been made.
<table>
<thead>
<tr>
<th></th>
<th>Level 1</th>
<th>Level 2</th>
<th>Level 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short-term investment fund</td>
<td>$0</td>
<td>$4,000,000</td>
<td>$0</td>
<td>$4,000,000</td>
</tr>
<tr>
<td>Total assets at fair value</td>
<td>$0</td>
<td>$4,000,000</td>
<td>$0</td>
<td>$4,000,000</td>
</tr>
</tbody>
</table>

G. Administrative Expenses

The Plan pays administrative expenses that consist primarily of administrative fees paid to third-party claims administrators, the trustee, and actuary. These expenses are reported on the statement of changes in net assets available for benefits as administrative expenses. All other administrative expenses, such as professional fees, are paid by the Company on behalf of the Plan.

H. Tax Status

The VEBA trust funding certain benefits of the Plan received an exemption letter from the IRS dated September 15, 199X, stating that the trust is tax-exempt under the provisions of Section 501(c)9 of the IRC. However, as a result of the Plan’s funding policy, from time to time the trust may be subject to income taxes. No federal or state income taxes have been recorded in 20X1 for unrelated business taxable income.

In addition, the Plan and the trust are required to operate in conformity with the IRC to maintain the tax-exempt status of the trust. The plan administrator believes that the Plan is being operated in compliance with the applicable requirements of the IRC and, therefore, believes that the related trust is tax-exempt.

Accounting principles generally accepted in the United States of America require plan management to evaluate tax positions taken by the Plan and recognize a tax liability (or asset) if it has taken an uncertain position that more likely than not would not be sustained upon examination by the [identify the taxing authority]. The Plan administrator has analyzed the tax positions taken by the Plan and has concluded that as of December 31, 20X1, there are no uncertain positions taken or expected to be taken that would require recognition of a liability (or asset) or disclosure in the financial statements. The Plan is subject to routine audits by taxing jurisdictions; however, there are currently no audits for any tax periods in progress. The Plan administrator believes it is no longer subject to income tax examinations for years prior to 20XX.

**Practice Tip**

Although tax-exempt health and welfare benefit plans are not generally subject to taxation, certain activities of the plan may be taxable. In general, unrelated business taxable income (UBTI) of a tax-exempt entity is subject to taxation. For health and welfare benefit plans, UBTI is most commonly generated from certain plan investment types (for example, nonleveraged investments, which may generate UBTI, include partnerships, real estate investment trusts, loans...**
or mortgages, and options to buy or sell securities, such as short sales or repurchase agreements), or on the plan’s investment income if their assets exceed certain allowable reserves.

If a plan has material unrelated business income tax expense, it should be presented separately on the statement of changes in net assets available for benefits. See paragraph 4.70(g).

I. Termination of the Plan

Although it has not expressed any intention to do so, the Company has the right under the Plan to modify the benefits provided to, and contributions required of, participants to discontinue its contributions at any time and to terminate the Plan subject to the provisions of ERISA. In the event of termination of the Plan, remaining assets will be applied in a uniform and nondiscriminatory manner toward the provision of benefits for or on account of the participants. No assets of the Plan may revert to the Company or be used for purposes other than for the exclusive benefit of the Plan’s participants.

J. 401(H) Account

A portion of the Plan’s obligations are funded through contributions to the company’s defined benefit pension plan in accordance with IRC Section 401(h). The following table presents the components of the net assets available for such obligations and the related changes in net assets available.

<table>
<thead>
<tr>
<th>Net Assets Available for Postretirement Health and Welfare Benefits in 401(h) Account</th>
</tr>
</thead>
<tbody>
<tr>
<td>December 31, 20X1</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Investments at fair value:</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. government securities</td>
<td>$ 140,000</td>
</tr>
<tr>
<td>Money market fund</td>
<td>900,000</td>
</tr>
<tr>
<td></td>
<td>1,040,000</td>
</tr>
</tbody>
</table>

| Cash | 20,000 | 10,000 |
| Employer’s contribution receivable | 20,000 | 15,000 |
| Accrued interest | 7,000 | 6,000 |

| Total assets | 1,087,000 | 981,000 |
| Accrued administrative expenses | (15,000) | (15,000) |
| Net assets available for benefits | $ 1,072,000 | $ 966,000 |

2 A receivable from the employer must meet the requirements of Financial Accounting Standards Board Accounting Standards Codification 960-310-25-2.
The fair values of the U.S. government securities and the money market fund held in the 401(h) account are based on the closing price reported in an active market.

### Assets at Fair Value as of December 31, 20X1

<table>
<thead>
<tr>
<th></th>
<th>Level 1</th>
<th>Level 2</th>
<th>Level 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. government securities</td>
<td>$140,000</td>
<td></td>
<td></td>
<td>$140,000</td>
</tr>
<tr>
<td>Money market fund</td>
<td>900,000</td>
<td></td>
<td></td>
<td>$900,000</td>
</tr>
<tr>
<td>Total assets at fair value</td>
<td>$1,040,000</td>
<td>0</td>
<td>0</td>
<td>$1,040,000</td>
</tr>
</tbody>
</table>

### Assets at Fair Value as of December 31, 20X0

<table>
<thead>
<tr>
<th></th>
<th>Level 1</th>
<th>Level 2</th>
<th>Level 3</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>U.S. government securities</td>
<td>$150,000</td>
<td></td>
<td></td>
<td>$150,000</td>
</tr>
<tr>
<td>Money market fund</td>
<td>800,000</td>
<td></td>
<td></td>
<td>$800,000</td>
</tr>
<tr>
<td>Total assets at fair value</td>
<td>$950,000</td>
<td>0</td>
<td>0</td>
<td>$950,000</td>
</tr>
</tbody>
</table>
Changes in Net Assets in 401(h) Account

For the Year Ended December 31, 20X1

Net appreciation in fair value of investments:
- U.S. government securities $10,800
- Interest 80,200
- Employer contributions 40,000
- Health and welfare benefits paid to retirees (10,000)
- Administrative expenses (15,000)
- Net increase in net assets available for benefits $106,000

K. Reconciliation of Financial Statements to Form 5500

The following is a reconciliation of net assets available for benefits per the financial statements to the Form 5500:

<table>
<thead>
<tr>
<th></th>
<th>20X1</th>
<th>20X0</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net assets available for benefits per the financial statements</td>
<td>$6,344,000</td>
<td>$5,261,000</td>
</tr>
<tr>
<td>Net assets held in defined benefit plan restricted for 401(h) account</td>
<td>(1,072,000)</td>
<td>(966,000)</td>
</tr>
<tr>
<td>Benefit obligations currently payable</td>
<td>(2,750,000)</td>
<td>(2,545,000)</td>
</tr>
<tr>
<td>Net assets available for benefits per the Form 5500</td>
<td>$2,522,000</td>
<td>$1,750,000</td>
</tr>
</tbody>
</table>

The following is a reconciliation of claims and premiums paid per the financial statements to the Form 5500:

<table>
<thead>
<tr>
<th></th>
<th>Year ended December 31, 20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Claims and premiums paid per the financial statements</td>
<td>$17,023,000</td>
</tr>
<tr>
<td>Add: Amounts currently payable at December 31, 20X1</td>
<td>2,750,000</td>
</tr>
<tr>
<td>Less: Amounts currently payable at December 31, 20X0</td>
<td>(2,545,000)</td>
</tr>
<tr>
<td>Claims and premiums paid per the Form 5500</td>
<td>$17,228,000</td>
</tr>
</tbody>
</table>
The following is a reconciliation of total additions paid per the financial statements to the Form 5500:

<table>
<thead>
<tr>
<th></th>
<th>Year ended December 31, 20X1</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total additions per the financial statements</td>
<td>$18,256,000</td>
</tr>
<tr>
<td>Less: Net increase in 401(h) account</td>
<td>(106,000)</td>
</tr>
<tr>
<td>Total additions per the Form 5500</td>
<td>$18,150,000</td>
</tr>
</tbody>
</table>

Claims that have been processed and approved for payment at year-end and claims incurred but not reported are not considered liabilities under GAAP and, therefore, are not presented as liabilities or claims paid in the accompanying financial statements, but are recorded on the Form 5500 as payable liability.

The net assets of the 401(h) account included in the financial statements are not included in the Form 5500 because the assets are held by the [insert name of pension plan].

L. Related-Party Transactions

Certain Plan assets were invested in a collective fund managed by the custodian of the Plan. This transaction qualifies as a party-in-interest transaction; however, they are exempt from the prohibited transactions rules under ERISA.

M. Risks and Uncertainties

The plan invests in various investment securities. Investment securities are exposed to various risks, such as interest rate, market, and credit risks. Due to the level of risk associated with certain investment securities, it is at least reasonably possible that changes in the values of investment securities will occur in the near term and that such changes could materially affect the amounts reported in the statement of net assets available for benefits.

The actuarial present value of benefit obligations is reported based on certain assumptions pertaining to interest rates, health care inflation rates, and employee demographics, all of which are subject to change. Due to uncertainties inherent in the estimations and assumptions process, it is at least reasonably possible that changes in these estimates and assumptions in the near term would be material to the financial statements.
Glossary

[Reserved]