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## Changes Bring Clarity to EBP Disclosures

An [article recently published in the December PICPA Journal](#) by our Quality Control Director JulieAnn C. Verrekia, CPA.

### Changes Bring Clarity to EBP Disclosures

by JulieAnn C. Verrekia, CPA | Dec 01, 2015

Eye strain comes from struggling to see what is unclear, and it often results in headaches. To ease the pain we turn to

glasses for clarity. When it comes to employee benefit plans, accountants and auditors also desire clarity – and fewer headaches. They might finally have some focus with new guidance issued by the Financial Accounting Standards Board (FASB) that brings relief from cloudy disclosures in the financial statements of employee benefit plans covered by Title I of the Employee Retirement Income Security Act.

The new Accounting Standards Updates (ASUs) are FASB ASU No. 2015-07, *Fair Value Measurement (Topic 820): Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, and FASB ASU No. 2015-12, *Plan Accounting: Defined Benefit Pension Plans (Topic 960), Defined Contribution Pension Plans (Topic 962), Health and Welfare Benefit Plans (Topic 965): (Part I) Fully Benefit-Responsive Investment Contracts, (Part II) Plan Investment Disclosures, (Part III) Measurement Date Practical Expedient*. Before we delve into the specifics of the new guidance, first some background.

## Fog and Haze

When the U.S. Congress passed the Employee Retirement Income Security Act of 1974 (ERISA), it codified the standards for employers that offer employee benefit plans (EBPs) to their employees. ERISA provides for federal government oversight of the operating and reporting practices for EBPs.

Title I of ERISA requires EBPs that meet the definition of a large plan (1) to prepare and file a Form 5500, Annual Return/Report of Employee Benefit Plans, to prepare financial statements, and to engage an independent qualified public accountant (2) to audit those financial statements. For many years, generally accepted accounting principles in the United States (U.S. GAAP) for employee benefit plans were mainly rooted in Statement of Financial Accounting Standards No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*, which was issued in 1980. In 1990, the AICPA recognized the

need for additional guidance relating to accounting and auditing for employee benefit plans. *The Audit and Accounting Guide: Employee Benefit Plans* (the guide) served as a source of accounting principles in category “b” of the U.S. GAAP hierarchy. The AICPA also issued several statements of position (SOPs) to address unique accounting and reporting issues in employee benefit plans and to recognize the need to provide specific guidance regarding EBPs. In 2009, the FASB released its Accounting Standards Codification (ASC), a major restructuring of accounting and reporting standards designed to simplify U.S. GAAP by organizing it into separate topics. The FASB ASC contains three topics related to employee benefit plans:

- FASB ASC 960, *Plan Accounting – Defined Benefit Pension Plans*
- FASB ASC 962, *Plan Accounting – Defined Contribution Pension Plans*
- FASB ASC 965, *Plan Accounting – Health and Welfare Benefit Plans*

The issuance of the ASCs cast a spotlight on the need for clarification of certain guidance for EBPs. Because the FASB ASCs grew out of a collection of FASB and AICPA guidance, there were inconsistencies among the three different ASC sections for EBPs. For instance, the guidance in ASC 960 and ASC 962 contained differing requirements regarding the presentation of plan investments in the Statement of Net Assets Available for Benefits, which is the EBP version of a balance sheet. It was also about this time that the FASB issued comprehensive guidance on fair value measurement – FASB ASC 820, *Fair Value Measurement*.

ASC 820 and the plan accounting sections of the FASB ASC required disaggregation, or the organization of similar investment information, in multiple ways. Plan sponsors and EBP accountants and auditors had been saying that disclosing similar investment information in multiple ways was costly and

made the financial statements more cumbersome for users.

### Finding Clarity

The AICPA EBP Expert Panel and the Employee Benefit Plan Audit Quality Center advocated for change and improvement for EBP guidance. In 2013, a white paper was prepared that contained a list of specific issues for the FASB to consider. The recommendations included the following items:

- Address inconsistencies among the plan accounting sections of the FASB ASU.
- Consider simplifying fair value disclosure guidance.
- Streamline disclosure requirements between the plan accounting sections of the FASB ASC (960, 962, and 965) and FASB ASC 820.
- Examine specific issues concerning defined benefit plans, employee stock ownership plans, and health and welfare plans.

The FASB agreed to take these recommendations under advisement as part of its Simplification Project, an initiative to simplify and improve accounting standards through a series of short-term projects. Projects included in the initiative are intended to improve or maintain the usefulness of the information in financial statements while reducing cost and complexity in financial reporting. The project was titled Issue No. 15-C, *Employee Benefit Plan Simplifications by the Emerging Issues Task Force of the FASB*. In March 2015, exposure drafts were prepared. The FASB worked swiftly to solicit comments and move the exposure drafts through its approval process so it could issue final guidance in time for the Form 5500 filing deadlines.

The first was ASU No. 2015-07, *Disclosures for Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*. It was issued in May 2015. Although not specifically pertaining to EBPs, this ASU has a definite

impact on the financial statements of EBPs. FASB ASC 820 had permitted a reporting entity, as a practical expedient, to estimate the fair value of certain investments that calculate net asset value (NAV) per share to use the NAV of the investment. Previously, investments valued using the practical expedient were categorized within the fair value hierarchy on the basis of whether the investment is redeemable with the investee at NAV on the measurement date, never redeemable with the investee at NAV, or redeemable with the investee at NAV at a future date. The guidance called for categorization in either Level 2 or Level 3 of the fair value hierarchy based on the ability to redeem the investment at the measurement date. In contrast, other fair value measurements are categorized in the fair value hierarchy on the basis of the inputs used in valuation techniques to measure fair value. The practical expedient was the only fair value measurement that had different criteria for classification within the fair value hierarchy. Examples of investments that are commonly held by EBPs that are valued using the NAV per share practical expedient include common and collective trusts, pooled separate accounts, real estate investment trusts, and certain limited partnerships.

The amendments in the new ASU remove the requirement to categorize within the fair value hierarchy of investments for which fair values are measured at NAV per share using the practical expedient. Although the investment is not categorized within the fair value hierarchy, the amount measured using the practical expedient should be disclosed to permit reconciliation of the fair value of investments included in the fair value hierarchy to the line items presented in the Statement of Net Assets Available for Benefits (for EBPs). Removing those investments from the fair value hierarchy not only eliminates the diversity in practice resulting from the way in which investments measured using the practical expedient are classified, but also ensures that all investments categorized in the fair value hierarchy are

classified using a consistent approach. Investments that calculate NAV per share (or its equivalent), but for which the practical expedient is not applied, will continue to be included in the fair value hierarchy.

The amendments in the ASU also remove the requirement to make certain disclosures for all investments that are eligible to be measured at fair value using the practical expedient. Rather, those disclosures are limited to investments for which the entity has elected to measure the fair value using that practical expedient. Investments for which fair value is measured at NAV (or its equivalent) as a practical expedient should continue to disclose information regarding the nature and risks of the investments and whether the investments, if sold, are probable of being sold at amounts different from NAV. The amendments in ASU No. 2015-07 are effective for fiscal years beginning after Dec. 15, 2015, for public business entities. For all other entities, the ASU is effective for fiscal years beginning after Dec. 15, 2016. Retrospective application is required for all periods presented in the financial statements. Earlier application is permitted.

In July 2015, the FASB issued the three-part ASU No. 2015-12. Part I of ASU No. 2015-12 contains amendments to the requirement to report fully benefit-responsive investment contracts (FBRICS) at fair value in determining the net assets of an EBP. Formerly, ASC 962 had required FBRICs to be measured at contract value, with an adjustment on the face of the financial statements to reconcile fair value to contract value. Plan sponsors and EBP accountants and auditors often expressed that fair value was not meaningful information, as contract value is the amount that EBP participants would receive if they would withdraw from the plan (with a few exceptions). Also, investment contracts are reported at contract value for Form 5500 reporting purposes. Under the amendments in Part I of ASU No. 2015-12, FBRICs are to be

measured, presented, and disclosed only at contract value. The amendments apply to defined contribution pension plans and defined contribution health and welfare plans, FASB ASC 962 and FASB ASC 965, respectively. Such plans will continue to disclose information regarding the nature and risks of FBRICs.

Part II of ASU No. 2015-12 contains amendments to simplify and make more effective plan investment disclosure requirements of FASB ASC 820 and FASB ASC 960, 962, and 965. Previously, EBPs were required to disclose individual investments that represented 5 percent or more of net assets available for benefits and the net appreciation or depreciation of investments by general type, as defined. The amendments in Part II of ASU No. 2015-12 eliminate those requirements for both participant-directed investments and nonparticipant-directed investments. Total net appreciation or depreciation is still required to be disclosed.

In addition, EBPs were previously required to present investments by general type. FASB ASC 820 requires the presentation of assets to be disaggregated based on the nature, characteristics, and risk. This often caused investments to be presented in multiple ways. For example, mutual funds represent a general type of investment. Mutual funds would then be broken down further into index, balanced, international, and so on for purposes of ASC 820 disclosures. The amendments in Part II of ASU No. 2015-12 require that investments (both participant-directed and nonparticipant-directed) of EBPs be grouped only by general type, eliminating the need to disaggregate the investments in multiple ways. In addition, if an investment is measured using the NAV per share (or its equivalent) practical expedient and that investment is in a fund that files a Form 5500, as a direct filing entity, disclosure of that investment's strategy is no longer required.

Part III of ASU No. 2015-12 provides a practical expedient that allows EBPs to measure investments and investment-related

accounts as of a month-end date that is nearest to the EBP's fiscal year-end when that does not coincide with a month-end. This is referred to as the alternative measurement date. This practical expedient, if elected, is required to be applied consistently from year to year. If an EBP applies the practical expedient and a material contribution, distribution, or a significant event occurs between the alternative measurement date and the EBP's year-end, the EBP should disclose the related amounts. The EBP is also required to disclose the accounting policy election and the date used to measure investments and investment-related accounts. For instance, if an EBP's fiscal year-end is June 28, the plan may elect the alternative measurement date of June 30, the nearest month-end.

The amendments in Parts I, II, and III of ASU No. 2015-12 are effective for fiscal years beginning after Dec. 15, 2015.

Earlier adoption is permitted. The amendments in Parts I and II should be applied retrospectively for all financial statement periods presented. The amendments in Part III should be applied prospectively.

The new guidance is timely as the scrutiny of the financial statements of EBPs, specifically the audits of those financial statements, is increasing. In May 2015, the Department of Labor (DOL) issued a report on the quality of EBP audits.

This report represented the culmination of about four years of work performed by the DOL. In 2011, the Office of the Chief Accountant of the Employee Benefits Security Administration (EBSA) commenced an assessment of the quality of audit work performed by independent qualified public accountants on the financial statements of EBPs covered under ERISA. Similar assessments had been performed by the EBSA in 1997 and 2004, and the results were not favorable. The EBSA selected a statistical sample of 400 EBP audits performed by 232 CPA firms from the 2011 Form 5500 filing database. In May 2014,

the results of EBSA's assessment were released in a comprehensive report, *Assessing the Quality of Employee Benefit Plan Audits* (3). Among its many findings, the EBSA reported that 17 percent of the audit reports reviewed failed to comply with one or more of ERISA's reporting and disclosure requirements. Accordingly, there is an increasing amount of pressure on EBP sponsors to exercise due diligence in selecting an auditor. In its publication, *Selecting an Auditor for Your Employee Benefit Plan*, the DOL states:

The more training and experience that an auditor has with employee benefit plan audits, the more familiar the auditor will be with benefit plan practices and operations, as well as the special auditing standards and rules that apply to such plans.

This emphasizes the importance of the specialized knowledge that pertains to the accounting and reporting requirements of EBP financial statements.

## Conclusion

While the new guidance may not address everything on the wish list of plan sponsors, EBP accountants and auditors, the AICPA, and the DOL, it does represent a significant step forward toward simplifying and enhancing the quality of EBP financial statements. Interested parties are encouraged to consult the entire text of the new ASUs available at [www.fasb.org](http://www.fasb.org) for more complete information (4).

*1 Plans with 100 or more participants as of the beginning of the plan year must complete Form 5500 following the requirements for a large plan. Plans with fewer than 100 participants should follow the requirements for a small plan. Department of Labor regulations permit plans that have between 80 and 120 participants (inclusive) at the beginning of the plan year to complete Form 5500 in the same category (large plan or small plan) as filed the previous year.*

2 Pursuant to ERISA Section 103(a)(3)(A).

3 The complete report is available at [www.dol.gov/ebsa/pdf/2014AuditReport.pdf](http://www.dol.gov/ebsa/pdf/2014AuditReport.pdf).

4 <http://www.fasb.org/jsp/FASB/Page/SectionPage&cid=1176156316498>



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## Who We Are

Torrillo & Associates, LLC specializes in employee benefit plan audits including 401k audits, 403b audits, pension plan audits, and other retirement plan audits. We are licensed in 10 states including Pennsylvania, New Jersey, Delaware, New

York and Florida. We are also able to practice in additional states that have passed firm mobility.

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