Sent: Wednesday, October 5, 2016 3:05 PM
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Subject: ASC Topics 960, 962 and 965

To: Lisa Muehlbauer, Assistant Project Manager
Cc: Justin Gwizdala, Postgraduate Technical Assistant

I wish to bring to the attention of someone at the FASB what I see as a flaw in the GAAP that specifically relates to employee benefit plans (EBPs). The perceived flaw is composed of some unwarranted inconsistencies with generally applicable provisions of other sections, principally (but not limited to) ASC Topics 605 and 606. I have attached my analysis and believe these matters should be considered for future technical corrections to the EBP sections (*i.e.*, ASC Topics 960, 962 and 965) that we see as flawed.

Thank you,

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Gross *vs*. net presentation by EPBs of employer-funded administrative expense and investment fees

The latest version (as of January 1, 2016) of AICPA's Audit and Accounting Guide, *Employee Benefit Plans* (the Guide) contains only auditing guidance, no accounting guidance.[1] Instead, the accounting guidance has been replaced by FASB's ASB Topics 960, 962 and 965,[2] applicable, respectively, to defined benefit plans, defined contribution plans and health and welfare plans.

We believe the FASB standards designated for EBPs are flawed by not requiring gross presentation of certain revenues and expenses consistent with other generally applicable FASB standards. Most significantly, the FASB EBP standards provide no guidance on the presentation of employer funded expenses except that (similarly to those presented in earlier editions of the Guide) sample financial statements presented in the exhibits to ASC 960, 962 and 965 refer to employer paid expenses only in a nonquantified illustrative disclosure that reads "Certain expenses incurred maintaining the Plan are paid directly by the Company and are excluded from these financial statements." This illustrative disclosure clearly indicates that omission of employer funded amounts from reported administrative expenses (and contributions) is acceptable under these standards, as is the omission of any quantitative disclosure of the extent of such employer support.

Each EPB FASB standard [ASC 960-30-45-2h, 962-205-45-7h and 965-20-45-3j] requires disclosure of administrative expenses (also apparently on the face of the financial statements and not defined), and makes no distinction about such expenses paid by the employer *vs*. by the plan. The current FASB standards do not suggest even disclosure of the unrecorded employer funded portion of such expenses despite their undeniable character as related party transactions [ASC 850-10-50-1]. Also, whether employer payments of administrative expenses of the plan are discretionary or mandatory under the plan document, there is no discernable substantive difference in terms of benefit to participants whether such payments are made either directly to an outside service provider or to the plan as reimbursement of such expense. If the latter is a contribution, we maintain so is the former.

Regarding employer contributions, ASC 960-30-45-2c, 962-205-45-7c and 965-20-45-3a have historically required plans to disclose "noncash" employer contributions (which term, although it may be viewed as accommodating direct payments by employers to the third parties, is not defined, but they typically consist of but are not limited to employer securities). Since these standards specify that only the nature of any noncash contributions may be disclosed optionally in a note, it is to be presumed that the amount thereof (if material, of course) must be shown on the face of the financial statements.

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1 Earlier, superseded editions of the Guide effectively asserted (or implied) that certain costs associated with administering a plan paid directly by the employer/sponsor, are primarily employer expenses, rather than plan expenses (although they may be reimbursed out of plan assets to the extent allowable under DOL rules and regulations). It appears likely that this view may be attributable to an implied conclusion that since the employer engages the administrative service provider, it (rather than the plan) is the primary obligor in the transaction. However, the determination of a primary obligor is only one of eight possible indicators of gross reporting, none of which is singularly dispositive.

Examples of expenses deemed unreasonable and, therefore, unallowable under DOL regulations to be paid out of plan assets include those incurred in connection with the formation, design or termination of the plan. (See DOL publication, *Understanding Retirement Plan Fees and Expenses*, and DOL Advisory Opinion No. 2001-01A for details.)

Although not carried forward to, and articulated in, the now governing FASB EPB standards, the notion that the expenses belong to the employer appears to be the underlying basis for the clearly apparent, but also unarticulated, conclusion in the standards that employer funded administrative expenses may be omitted from a plan's financial statements. However, we take issue with this basic premise (*i.e.*, that such expenses belong to the employer), and we hold, instead, that, in substance, the costs of administering the plan (to the extent allowable by the DOL) are, in fact, obligations and expenses of the plan that should be included in the plan's financial statements.

2 These standards were amended by ASU 2015-12, effective for fiscal years beginning after December 15, 2015, but the amendments do not affect this analysis. The provisions of ASU 2015-12 are to be applied retrospectively, and early application is permitted.

Moreover, fees charged to plans by investment managers or similar service providers for buying, selling or holding investment securities, or accounting for and reporting investment activities may be accounted for differently, but the alternatives are not discussed in the EBP standards. Transaction fees associate with buying investment securities are generally accounted for as part of their cost, and those associated with selling are deducted from sales proceeds for computing gains and losses, Accordingly, such fees are typically deducted from investment return and netted against the investment income reported in a plan's financial statements, while other, nontransactional fees may not be. However, the GAAP that is designated as specifically applicable to EBPs [ASC 960, 962 and 965] does not suggest that netting of such fees is either permissible or prohibited and also does not require or suggest an accounting policy disclosure as a choice between acceptable alternatives in that regard [ASC 235-10-50-3].

It is our opinion that omission of employer support in the form of direct payment of administrative expense (when material, of course) from the plan's operating statement, and netting of investment fees against investment income, understate both the cost of administering the plan and the extent of support received from the employer/sponsor (and we believe each is likely to be significant to many users of the plan's financial statements). Therefore, if material (see discussion of materiality in penultimate paragraph, below), failure to report these items gross, as both contributions revenue or investment income and administrative expense, is in our opinion, potentially misleading and inconsistent with the basic principle we follow of reporting in accordance with substance over form and with nonspecific, but nonetheless applicable, GAAP, as discussed elsewhere herein.

Our conclusion is based on the view that plan administrative expenses (without regard to whether the employer/sponsor's absorption of such expenses is discretionary or mandatory under the plan document) are incurred solely to enable the plan to further its purpose, *i.e*., providing benefits to participants, and accordingly, the primary obligation to incur them is, in fact, the plan's, not the employer's. Therefore, by not requiring a gross presentation of such employer/sponsor-borne costs in the plan's operating statement, it is our belief that (like the predecessor editions of Guide from which they were derived) the FASB standards fail to recognize the economic substance of an employer/sponsor's unilateral absorption of such costs as both expenses of the plan and additional employer contributions and the employer/sponsor's role by expending such funds as one of an agent of the plan.

We believe the principal operative GAAP [ASC 605-45-45-3 through -18[3]] for determining, generally, whether gross *vs*. net presentation of revenue items (and related expenses) is that which guides the determination who is acting as a principal *vs*. who is acting as an agent with regard to certain transactions. Therefore, we believe the GAAP that is designated as specifically applicable to EBPs [ASC 960, 962 and 965] should direct users to consider this more general guidance in determining if some or all of the investment fees and any employer/sponsor funded administrative expenses should be grossed up and included in both revenues and expense.

Current GAAP [ASC 605-45-45-22 and -23] also provides that reimbursements received for out-of-pocket expenses incurred "shall be characterized as revenue in the income statement" with the costs recognized as costs or expenses. Although these administrative costs are typically paid directly by the employer/sponsor on behalf of, rather than reimbursed to, the plan and its participant beneficiaries. Consequently, they are technically not "reimbursements," per se; nevertheless, we believe they are, in substance, the same. Therefore, this suggests a requirement, albeit nonspecific to EBPs, to present the employer/sponsor-borne costs gross as employer contributions revenue and the offsetting debit necessarily as expense.

According to GAAP, a "contribution" is an "unconditional transfer of cash or other assets to an entity or a settlement or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other

3 To be superseded effective in future years (pursuant to ASU 2016-09, with early adoption permitted) by the new revenue recognition standard and replaced without with the principal *vs*. agent considerations in ASC 606-10-55-36 through -40.

than as an owner." A "nonreciprocal transfer" is defined in GAAP as a "transaction in which an entity incurs a liability or transfers an asset to another entity (or receives an asset or cancellation of a liability) without directly receiving (or giving) value in exchange" [ASC Master Glossary]. It is possible that some might argue that the payment of expenses of an EBP by the employer does not qualify as a nonreciprocal transfer (or a contribution) because such payments are part of employee compensation for services, we believe, however, that any benefits received by the employer are too indirect to treat them as exchange transactions and defeat the position that they are, in fact, contributions (consistent with how they are characterized in the Guide). Although stated in GAAP only with respect to contributions received by not-for-profit organizations, they are recognized as revenues in the period received "and as assets, decreases of liabilities, or expenses" [ASC 958-605-25-2], there is no reason not to apply the same principle to EBPs. Accordingly, we believe that, if material, they require recognition as contributions under GAAP [ASC 958-605-25-2].

In addition, although also stated in GAAP [ASC 958-605-25-2] only with respect to contributions received by not-for-profit organizations, "a contribution made and a corresponding contribution received generally are recognized by both the donor and the donee at the same time, that is, upon occurrence of the underlying event — the nonreciprocal transfer of an economic benefit," once again, we believe the same principle should be applied for EBPs (*i.e*., that there should be symmetry between the financial reporting of employers and plans such that reported pension expense of the employer generally should mirror the employer contributions reported by the plan), as well. However, GAAP {ASC 715] is silent on the treatment of such expenses when incurred by employers.

However, since it is not clearly stated that the relevant GAAP provisions cited above are applicable to EPBs (and our judgment that they should be applied is based merely on our substance-over-form assessment), unless we believe there is a management intent to mislead users, we can only recommend, but cannot compel, gross-up treatment in the financial statements. But we ordinarily should encourage our clients to record these employer/sponsor payments on the books of the plan timely, as they are made; if they do not do so, to simplify the process, we can propose them alternatively as financial statement reclassification entries rather than adjusting journal entries that need be booked by the plan.

To assess the materiality of uncorrected misstatements, auditing standards [AU-C 450.11 or for 11-K filers, AS 2810.17] require auditors to consider, among other things, the size and nature of the misstatements encountered in relation to particular classes of transactions, account balances (or financial statement line items) or disclosures, as well as the financial statements as a whole. Therefore, in addition to the traditional measures of materiality that we commonly use, this requires us to assess the materiality of unrecorded administrative expense quantitatively in relation to the would-be total (gross) value of the reported expense, considering the qualitative user sensitivity concerns generally applicable to related party transactions. Accordingly, we ordinarily should use a special, lower than normal, materiality threshold for assessing misstatements of administrative expenses in EBPs.

Although not mentioned in the current edition of the Guide's lists of risks associated with plan expenses, we believe auditors should be alert of the possible significant risks of material understatement (*i.e*., the completeness assertion) or overstatement (*i.e*., the existence or occurrence assertion, which is a fraud risk) that is often encountered with regard to employer/sponsor funded administrative expense (whether recorded or only disclosed in a note) and assure themselves that auditing procedures sufficient to address those risks are applied at the employer level (whether auditing the employer's financial statements or not) to a "reciprocal" population" (*i.e*., a population where unrecorded or otherwise missing plan balances or transactions are likely to reside), using a materiality threshold appropriate to the objective, as discussed in the preceding paragraph, to identify material understatements (or overstatements). Such procedures performed at the employer level would typically consist of tests of cash disbursements, recorded accounts payable and a search for unrecorded liabilities.