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Benefits in Brief

News and Insights for HR Executives, CFOs and Professional Administrators Summer 2018

Employee Benefit Plan Audits
What Are Management's Responsibilities?

The Department of Labor (DOL) generally requires employee benefit plans with more than 100 participants to have a financial statement audit conducted annually as part of their obligation to file Form 5500. The goal of such an audit—which must be conducted by an independent CPA firm—is to provide reasonable assurance that the plan's financial statements are presented fairly in accordance with U.S. GAAP.

Along with the independent CPA, this audit involves a wide range of individuals. They typically include the accounting and human resources departments, a third-party administrator and actuary, legal counsel, and an investment trustee or custodian.

It's important to remember, however, that the final responsibility for accurate and timely financial reporting lies with the plan sponsor and plan management—not the service providers engaged by the plan. This makes it critical that management be actively involved in the financial reporting and auditing processes.

What's Covered in an Audit?

A financial statement audit typically covers the following areas:

- Employee and employer contributions
- Benefits payments
- Plan investments and investment income
- Participant data and allocations
- Liabilities and plan obligations
- Participant loans
- Administrative expenses

You can help the plan audit process go more smoothly by ensuring that a high-level person in the finance department reviews the financial statements for accuracy ahead of time. If the HR or payroll manager isn't financially literate or doesn't understand GAAP, he or she shouldn't be responsible for providing the auditor with accurate data.

Typically, the biggest reporting challenge in a plan audit is reconciling contributions and making sure that auditors are provided with a complete and accurate listing of contributions. Prior to the audit, you should reconcile contributions reported by the plan (on Form 5500 Schedule H) to your payroll records.

For calendar year plans, contributions should equal the amount of deferrals reported on the year's W-2 forms, plus any related matching or profit-sharing amounts allocated. Also identify which payroll periods have contributions that should be recorded as plan receivables.

Ensuring Audit Efficiency

Here are eight more things you can do to help ensure a more efficient audit and, in the process, fulfill your fiduciary duties:

1. Assign responsibility for preparing the plan's financial statements to a single individual. Usually, this is someone who works in your financial reporting department. Your auditor may be able to help with this, assuming certain safeguards are in place, unless your plan files a Form 11-K with the Securities and Exchange Commission (SEC).

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Small Plan Compliance

The Importance of Conducting an Annual Review

As our lead article in this issue notes, the Department of Labor (DOL) generally requires large employee benefit plans to have a yearly audit conducted. While the main purpose of the audit is to provide reasonable assurance that the plan's financial statements are presented fairly in accordance with U.S. GAAP, the auditors also evaluate compliance with certain ERISA rules and documented plan provisions.

This often presents a double-edged sword for small plans: While sponsors don't have to bear the time and expense of conducting an audit, not performing an audit can result in compliance problems going unnoticed. And this can lead to financial penalties and, in a worst-case scenario, plan disqualification.

If you sponsor an employee benefit plan with 100 or fewer participants, you should carefully monitor compliance with ERISA rules—even though you're not required to conduct a formal plan audit. This will not only help ensure that you're meeting your fiduciary duties, but it could also uncover easy-to-correct plan errors that could lead to problems if undetected.

Performing a Plan Review

The best way to monitor a small plan for compliance is to perform an annual plan review. In this review, you'll examine plan documents and participant data to determine whether your plan is operating properly.

A plan review typically examines the following areas:

- Investment policies
- Internal controls
- Transaction processes and reconciliation
- Form 5500
- Payments and withdrawals
- Board minutes
- Plan forfeitures

In addition, a plan review also performs various tests to make sure that the plan:

- Handled participants' deferrals and investments appropriately
- Calculated matching contributions correctly
- Met eligibility requirements
- Didn't discriminate in favor of highly compensated employees

Common Small Plan Errors

Most small plan compliance problems occur in the areas of plan design and plan operations. Common mistakes include improperly matched deferrals, incorrect eligibility information, and failure to follow plan documents and other requirements. Other high-risk areas where compliance errors often occur include the following:

• **Calculation of vesting**—This is especially prevalent if the plan has changed vesting schedules or merged other plans where some participants may have vested balances that are grandfathered.

• **Hardship withdrawals**—If your plan allows hardship withdrawals, be sure to document the need. Also encourage participants to take advantage of other available options first, such as plan loans. And don't forget to suspend participant contributions for six months after the hardship.

• **Participant loans**—Set up a system for making sure that loan repayments are being remitted and applied to participant loan balances in accordance with the plan document. If your plan only allows one outstanding loan at a time, make sure participants aren't taking out multiple loans.

• **Definition of compensation**—Make sure contributions are being calculated on the correct compensation as defined by the plan document and that amounts agree to participant requests. If a participant changes his or her contribution amount and it isn't updated and the wrong amount is then withheld, it is your responsibility to restore the amounts that should have been contributed.

Specialized Expertise Required

It's smart to retain an outside party, such as a CPA firm, to perform your small plan review. Conducting such a review requires specialized expertise in plan compliance that internal staff members usually don't possess.

Our firm can perform a small plan annual review. Give us a call to schedule an appointment.

Management's Role in Plan Audits

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2. Assign responsibility for coordinating the audit to a single individual. This person should also be responsible for obtaining necessary cooperation and input from all parties involved in the audit, such as those listed previously.

3. Establish and maintain strong policies in regard to internal controls. *The Importance of Internal Controls in Financial Reporting and Safeguarding Plan Assets*, a Plan Advisory published by the AICPA Employee Benefit Plan Audit Quality Center, is a helpful resource for understanding your responsibilities for establishing, maintaining, and monitoring internal controls.

4. Ensure that all plan records are complete, up to date, and easily accessible. The same goes for the plan document and IRS opinion or determination letters. Incomplete or inadequate records make the audit process more difficult and time consuming.

5. Review outside reports carefully. Investment reports, certifications, and reports prepared by the plan's service organizations should be reviewed for reasonableness, consistency, and completeness. If there's any information in these reports that you don't understand, ask about it. Also consider whether you need to make any adjustments to the information to prepare plan financial statements.

6. Prepare requested schedules, and collect documentation ahead of time. Providing schedules of underlying activity or items supporting account balances (e.g., investments or plan expenses) in advance can reduce how much time the auditor must spend conducting the audit.

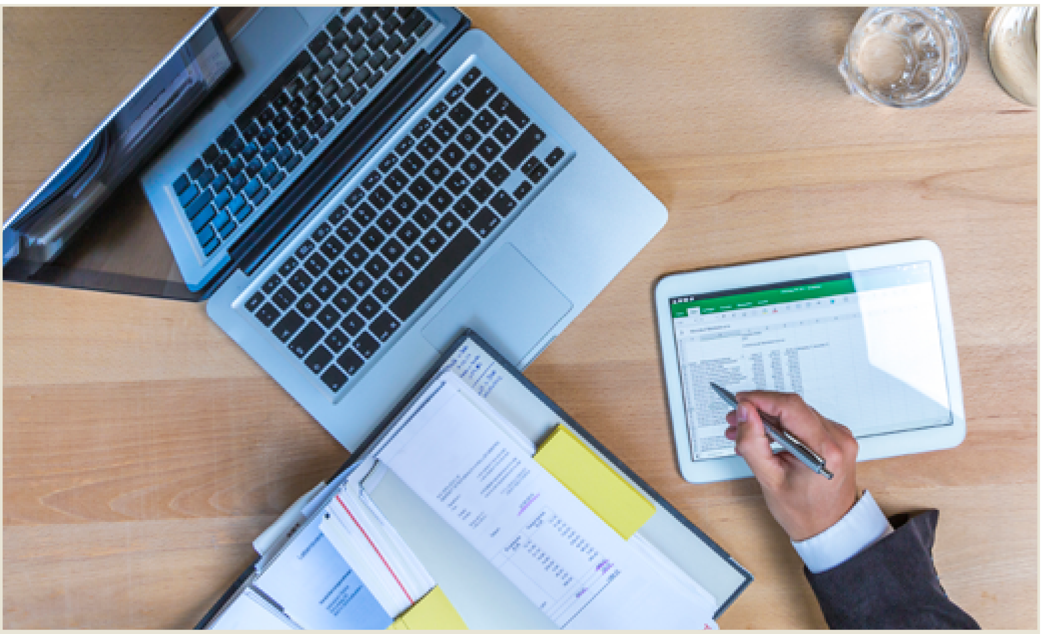
7. Read SOC 1 reports from outside service organizations. You want to find out whether the controls relevant to the plan are adequate to ensure complete and accurate financial reporting. Also review the "User Controls" contained in the SOC 1 reports. Document which controls the plan is responsible for, and monitor compliance with these controls.

8. Provide the auditor with direct access to your outside service organizations. This way, the auditor can ask them questions directly as they arise during the audit or obtain information directly from them, which will streamline and speed up the process.

Performing Thorough Due Diligence

Employee benefit plan audits can be complex. As a plan sponsor, you are responsible for hiring a CPA firm that is capable of performing an independent audit. Therefore, you should perform thorough due diligence in your search for a qualified independent auditor to perform your plan audit.

We can perform a financial statement audit for your employee benefit plan. Please contact us if you have more questions.



Full- vs. Limited-Scope Audits

In most situations, employee benefit plan auditors are engaged to report on the plan's financial statements. These typically include all assets, liabilities, obligations, and financial activities. Such an audit is referred to as a full-scope audit.

But in some situations, you can instruct the auditor to limit the scope of testing of certified investment information—or in other words, to perform a limited-scope audit. Here, the auditor does not audit the certified investment information. Instead, the auditor tests participant data, contributions, benefit payments, and other non-certified information.

In a limited-scope audit, the auditor disclaims an opinion on the financial statements due to the significance of the data that wasn't audited. In other words, the auditor doesn't express an opinion on the financial statements.

The election of a limited-scope audit must be supported by a certification from a qualified entity regarding the investment information's accuracy and completeness. Also, if your plan files Form 11-K with the SEC, you cannot perform a limited-scope audit or receive a disclaimer of opinion from the auditor.

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Sponsors Increasingly Worried About Plan Litigation

A growing number of employee benefit plan sponsors are concerned about being sued by plan participants. In a survey conducted by Cerulli Associates, more than half of the 401(k) plan sponsors who responded said they are worried about the potential for this kind of litigation.

And it's not just large plan sponsors who are worried: One out of four sponsors of small plans said that they're "very concerned" about potential litigation.

A recent issue of *Employee Benefit Adviser* noted that the number of lawsuits filed against plan sponsors has "exponentially increased" over the past two years. Most of the lawsuits facing sponsors have been related to high plan fees, a lack of investment options, poor investment options, and breach of fiduciary duty.

Specifically, many participants suing plan sponsors are charging that plans only offer high-priced retail mutual funds on the plan menu. The *Employee Benefit Adviser* article called retail mutual funds a "flashing neon light" on the radar screen of plan participants bringing lawsuits against sponsors.

In other cases, participants have claimed that investments in target-date funds were too expensive or risky or didn't perform well. In addition, some lawsuits have claimed that sponsors used proprietary funds when less-expensive or higher-performing funds were available.

Many experts believe that investment fees and expenses will continue to be a source of litigation against plan sponsors for the foreseeable future. This includes the selection of the share class that's most appropriate for the plan.

To reduce the risk of plan litigation, you should have processes in place to monitor and benchmark investment performance and cost. While this can be done internally, it's often best outsourced due to the specialized knowledge required. Many investment managers and third-party administrators can provide benchmarking as part of their package of services.

Please contact us if you have questions about how you can guard against plan litigation.