Benefits in Brief

News and Insights for HR Executives, CFOs and Professional Administrators Fall 2020

Focus on: Plan Operations

A Deep Dive into Employee Benefit Plan Audits

Depending on the size of your employee benefit plan, you may be required to have an audit of your financial statements performed each year. The goal of this audit is to obtain reasonable, but not absolute, assurance from an independent third party that the plan's financial statements are presented accurately.

An audit helps protect the financial integrity of an employee benefit plan, which in turn helps participants determine whether funds will be available to pay retirement, health, and other promised benefits. It can also help management improve and streamline plan operations by evaluating the strength of internal controls and identifying any control weaknesses or operational errors.

Auditor Independence is Crucial

Employee benefit plan audits must be conducted by an independent CPA, preferably one with experience auditing ERISA retirement plans. Plans with more than 100 participants are required to complete and submit an audit using Schedule H along with their annual Form 5500 filing. (See sidebar on page 3 for an explanation of a key exception.) The deadline for audit completion is the same as the Form 5500 filing deadline, which is due seven months after the last day of the plan year (or July 31 for calendar year-end plans). The deadline may be extended for another 2½ months (or until October 15 for calendar-year plans).

A plan's financial statements are intended to provide information to help assess the plan's present and future ability to pay benefits to participants. The financial reporting and audit environment for employee benefit plans is unique in many ways, adding complexity to a plan audit.

Following are some of the unique aspects of the employee benefit plan reporting and audit environment.

- Numerous federal laws, including ERISA, along with additional DOL and IRS regulations
- Special reporting and audit requirements
- SOC 1 internal control reports
- DOL-required supplemental schedules
- Fair value reporting
- Prohibited transactions
- Parties in interest

The Auditor's Objective

The main objective of the independent plan auditor is to obtain reasonable assurance that the plan's financial statements as a whole are free from material misstatement, whether due to fraud or operational error. The auditor will then issue a formal report on the statements in accordance with his or her findings and the scope of the audit (full or limited scope).

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Internal Controls

What are Your Responsibilities as a Plan Sponsor?

As the sponsor of a qualified retirement plan, you're subject to certain fiduciary responsibilities. These include administration functions like maintaining the plan's financial records and filing an annual report for the plan.

It's critical to set up safeguards that help ensure you're meeting these fiduciary responsibilities because errors and fraud can and do occur in these and other areas. One way to do this is to establish effective internal controls in financial reporting and in safeguarding plan assets. These controls reduce the risk of asset loss while helping ensure that financial statements are reliable and plan information is accurate and complete.

Preventive controls minimize opportunities for both unintentional errors and intentional fraud. Meanwhile, detection controls can help you identify errors and fraud after they've occurred, but hopefully before they cause major harm to your plan.

Your Main Responsibilities

There are a number of responsibilities you face as a plan sponsor when it comes to establishing and fulfilling internal controls. Here are a few of the main plan sponsor internal control responsibilities:

• **Remitting employee deferral contributions in a timely manner.** Each pay period, deferral contributions withheld from employees' paychecks must be remitted "as soon as amounts can be reasonably segregated from the company's general assets, but no later than the 15th business day of the month following the pay date."

To consistently meet this responsibility, you should determine the number of business days it takes to process the remittance and stick with this each pay period. Consistency is critical here.

• **Reconcile deferral contributions remitted with W-2 forms.** Total remitted contributions should equal total deferrals on the W-2 summary (Form W-3) at the end of the year. If there are discrepancies, these should be investigated and reconciled, while any late or missed contributions should be reported to the plan and remitted as soon as possible (along with lost earnings).

• **Calculate eligible compensation correctly.** Your plan document and adoption agreement will define eligible compensation that your payroll department should use. Educate these employees about the importance of adhering to this definition. Make sure they understand how bonuses, commissions, severance, and other types of non-standard wages should be treated.

• **Deduct accurate deferral amounts from employees' pay.** As the plan sponsor, you're responsible for making sure that employees' deferral elections are properly withheld from their pay. Election forms or feedback information from the plan's recordkeeper should go to one employee who's responsible for updating payroll data, with a second employee reviewing election changes for accuracy.

• **Compile census data in an accurate and timely manner.** This data—which includes employees' birth, hire, and termination dates; gross compensation; hours worked; and contributions by employees and employers—is used to complete annual nondiscrimination testing. It must be compiled and remitted to the plan recordkeeper by mid-February each year.

• **Monitor third-party service providers.** Carefully review SOC 1 internal control reports and activity reports from your plan's recordkeeper, custodian, and third-party administrator (TPA). Also, make sure fees paid to third-party service providers are reasonable for the services provided and that providers are meeting the terms of their contracts.

• **Monitor plan investment options.** Plan fund performance should be monitored against key benchmarks and performance criteria. In addition, the diversity of fund options and appropriateness of share classes relative to the size of the plan should also be reviewed. You might consider hiring an independent advisor for help here if there's not a "prudent expert" on your plan's investment committee.

• **Monitor plan due dates and notice requirements.** Make sure all tax forms related to the plan (e.g., Form 5500, Form 8955-SSA) are filed accurately and on time and that an independent audit is completed if required. Make sure all required participant notices are distributed in a timely manner.

Document Fiduciary Activities

Finally, be sure to carefully document all your fiduciary activities. For example, you should keep thorough minutes of all governance meetings and records of any significant decisions the plan committee makes. Also prepare and file any monitoring or compliance reports providing evidence that you've carried out your fiduciary duties.

Taking the time now to clarify your internal control responsibilities can save you both time and money in the long run.

The Plan Sponsor's Role in an Audit

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Additionally, the auditor will report on whether the form and content of supplemental schedules required by the DOL and attached to Form 5500 are presented in compliance with the DOL's rules and regulations for reporting and disclosure under ERISA.

To do so, he or she will assess the reliability, fairness, and appropriateness of the financial information reported by plan management by:

- Testing evidence supporting the amounts and disclosures in the financial statements and supplemental schedules
- Assessing the accounting principles used and significant accounting estimates made by management
- Evaluating the overall financial statement presentation to form an opinion as to whether the statements are free of material misstatement

Using his or her knowledge of the plan's nature and control environment, the auditor will examine a number of aspects of the plan, including the following:

- Participant data and allocations
- Employee and employer contributions
- Plan distributions and participant loans
- Plan expenses, investments, and income
- Plan asset valuations
- The timeliness of plan contributions
- Liabilities and plan obligations
- Administrative expenses

Ensuring Audit Efficiency

One of the best ways to ensure audit efficiency is to review your plan's financial statements for accuracy before the auditor starts work.

Ideally, a high-level finance department employee should perform this review instead of the HR or payroll manager—especially if this manager isn't familiar with or doesn't understand GAAP. In particular, the employee should reconcile contributions reported by the plan to the payroll records to ensure the auditor receives a complete and accurate listing of contributions.

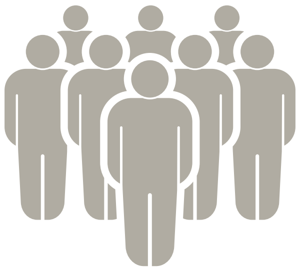
Here are a few more things you can do to help ensure a smooth and efficient audit process:

1. **Assign responsibility for financial statement preparation to a single employee.** This is usually an employee in the financial reporting department. A single employee (not necessarily the same one) should also be responsible for coordinating the audit and obtaining necessary input from all parties involved (e.g., accounting and human resources, third-party administrator, actuary, legal counsel, and investment trustee or custodian).
2. **Make sure all plan records are complete, current, and easily accessible.** The same goes for the plan document and IRS opinion or determination letters. Incomplete and outdated records will complicate and delay the audit process.
3. **Collect documentation and prepare requested schedules ahead of time.** By providing schedules of underlying activity and items supporting account balances (such as investments and plan expenses) in advance, you can limit the duration of the audit.
4. **Read your outside service providers' SOC 1 reports.** Look closely at the user controls contained in the reports. Document which controls the plan is responsible for, and carefully monitor compliance with these controls.
5. **Carefully review all outside reports.** These include investment reports and certifications as well as SOC 1 reports. Make sure these reports are consistent, complete, and reasonable. Don't hesitate to ask about anything you don't understand.

It's Your Responsibility

Remember that the ultimate responsibility for timely and accurate financial reporting lies with the plan sponsor and plan management, not with the independent auditor. Therefore, it's critical for management to be actively involved in the financial reporting and auditing process.

We can perform a financial statement audit for your employee benefit plan. Please contact us to discuss an engagement.



What is the 80-120 Rule?

There's an important exception to the requirement that employee benefit plans with more than 100 participants have an audit performed each year. This exception is often referred to as the 80-120 Rule.

According to this rule, if your plan has between 80 and 120 participants on the first day of the plan year, you can file Form 5500 in the same plan size category that you did on your most recent filing. So, if you filed as a small plan last year and meet these criteria, you can file as a small plan again this year and avoid the annual audit requirement.

CARES Act: Definition of "Qualified Individual" Expanded

In the last issue of *Benefits in Brief,* we explained how the Coronavirus Aid, Relief, and Economic Security (CARES) Act affects pensions and qualified retirement plans. One of the main retirement plan-related provisions is the addition of special coronavirus-related retirement plan distributions.

Plan participants who qualify for these distributions are exempted from the 10 percent penalty that normally applies to early withdrawals of up to $100,000 that are made this year. In Notice 2020-50, the IRS amended the definition of a qualified individual for special coronavirus-related distributions.

The new definition adds to the list of designated events that can cause adverse financial consequences that would allow a participant to qualify. The following are the new designated events:

- A reduction in pay due to COVID-19 that leads to adverse financial consequences
- A job offer rescission due to COVID-19
- A delayed start date for a new job due to COVID-19

The original legislation included the following designated events leading to adverse financial consequences:

- Being quarantined, furloughed, laid off, or unable to work due to childcare issues related to COVID-19
- Having work hours reduced due to COVID-19
- Owning a business that has been forced to close or reduce hours due to COVID-19

Plan participants may also qualify for special coronavirus-related distributions if a spouse or member of their household experiences one of these designated events leading to adverse financial consequences. A household member is defined as someone who shares the participant's principal residence.

Unless they have knowledge otherwise, plan administrators can rely on a participant's certification that he or she qualifies for a special coronavirus-related distribution. The Notice includes a sample certification. You have until the end of the plan year beginning on or after January 1, 2022 to adopt a retroactive amendment to reflect these changes.