EBSA's recent report on major audit deficiencies from a survey of benefit plan filings identified internal controls as the area of biggest concern.

Tackling Internal Controls for Quality Plan Audits

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In *Assessing the Quality of Employee Benefit Plan Audits*, the Employee Benefits Security Administration (EBSA) reported last May that a survey of Form 5500 Annual Return/Report plan filings from 2011 found 39% of audits (four out of ten) contained major deficiencies under professional standards.

The Employee Retirement Income Security Act (ERISA) generally requires employer-sponsored plans with more than 100 participants to submit a Form 5500, with audited financial statements, to EBSA by the last day of the seventh month after the plan year ends (with limited extensions available). The Office of the Chief Accountant of EBSA, a branch of the Department of Labor (DOL), surveyed 400 plan filings from a group of approximately 80,000 audits performed in 2011 by more than 7,000 different public accounting firms.

Key Audit Deficiencies

EBSA identified 16 specific audit deficiencies relevant to both full- and limited-scope audits.

The EBSA survey included filings from defined contribution (DC), defined benefit (DB) and welfare plans but overwhelmingly consisted of limited-scope audits for single employer DC plans. An independent certified public accountant (CPA) hired to perform a limited-scope audit cannot give an unqualified opinion on the plan's financial statements. The independent CPA's opinion generally is a disclaimer of opinion because the CPA is not required to perform sufficient work to form an overall opinion on the financial statements. DOL will accept a disclaimer of opinion for a limited-scope audit.

Limited-scope audits generally do not include auditing procedures related to investment information, such as investment pricing, income and related expenses, prepared and certified by a qualified trustee or custodian. In a full-scope audit, all of these components in the plan are subject to audit testing.

The top five deficiency areas identified in EBSA's report included:

1. Internal controls
2. Contributions received
3. Benefit payments
4. Participant data
5. Planning and supervision.

Of these five areas, internal controls had the highest audit deficiency rating with 18.3% of all plans sampled. It is clear that the report likely will result in EBSA's renewed interest in confirming compliant plan practices. Establishing effective internal controls also has been a top focus area for several years for the Internal Revenue Service (IRS) Employee Plans Team Audit Program.

Internal Controls

In the EBSA report, the chief accountant noted inadequate documentation of the internal control environment as the most frequent unacceptable major finding. Often, internal corporate officers involved with plan administration do not recognize the importance of documenting plan policies and procedures and updating them in a timely fashion.

For example, there generally are specific internal plan policies for hardship withdrawals. These address the frequency and amounts of distributions, the subaccounts available for hardship withdrawals, the process for requesting a hardship withdrawal, the applicable "hardship" standard (i.e., the regulatory safe harbor or a plan-specific hardship definition) and substantiating documentation requirements. During an audit, the CPA generally tries to ascertain whether the plan sponsor is adhering to the plan's processes and procedures—for example, whether hardship withdrawals are being made in accordance with plan provisions. The internal controls for specific plan features like hardship withdrawals are interconnected and, as reflected in the EBSA report, significantly affect how well other plan functions run.

Additional specific issues with internal controls noted in the report included:

- The failure to assess and document *control risk*—the risk that a material misstatement could occur but not be detected or prevented on a timely basis by the plan's internal control system
- No evidence of review and reliance on a Service Organization Control (SOC)-1 report
- Inadequate fraud brainstorming
- Lack of documentation of risk assessment procedures
- Failure to review internal controls of service provider(s).

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takeaways

- EBSA identified 16 specific audit deficiencies found in both full- and limited-scope audits of employee benefit plans.
- With deficiencies in internal controls found in 18.3% of plans sampled, this is an area of concern for both EBSA and the IRS Employee Plans Team Audit Program.
- The most frequent unacceptable finding was failure to document plan policies and procedures and keep them up to date.
- The EBSA report reaffirms the importance of a thorough internal review of plan operations annually.
- CPAs who performed the most plan audits had a much lower deficiency rate than those who audited fewer than 25 plans a year.

The SOC-1 report, although not required, provides assurance of a third-party administrator's internal controls over financial reporting. It is especially important because CPAs can use a Type 2 SOC-1 report to gain an understanding of the internal controls that the employer and third-party administrator established for the plan.

Every plan's set of internal controls should include procedures for (1) updating written plan terms with timely plan amendments that reflect changes in the law and in discretionary plan terms and (2) confirming that plan operations are consistent with written plan terms.

The EBSA report generally concerns the latter of these two and reaffirms the need to perform a thorough internal review of plan operations at either year-end or some other consistent point during the year. The plan vendor's plan administration manual is a useful tool for this, as it normally contains very detailed information about the minute processes that relate to electing and depositing employee and employer contributions, vesting, withdrawal rights and distributions (among other plan items). CPAs can use the plan vendor's plan administration manual as well as discussions with plan management to get an understanding of the internal control environment and control risk.

IRS offers many resources to assist administrators with creating internal plan controls. The IRS Retirement Plan Operation and Maintenance site contains several helpful examples that should be a part of every plan administration scheme. These include confirming that:

- In operation, the plan calculates contributions based on the *compensation* definition reflected in the plan document
- Deferral elections match the actual contribution amounts deposited into the plan
- Contribution limits (e.g., plan-level contribution limits, Code Section 402(g) elective deferral limits, Code Section 415 annual additions limits) are not exceeded
- Years-of-service calculations are accurate for eligibility and vesting purposes
- Written spousal consent requirements are adhered to
- Participants receive timely distributions at termination (if required by the plan) and especially at the beginning date required by Code Section 401(a)(9).

Although these internal controls primarily relate to qualified retirement plans, many essential controls cross all plan types and apply equally to retirement plans and welfare plans. Some broader internal controls include confirming that:

- All plan design options chosen during the year are reflected in year-end plan amendments
- Any legally required changes to plan operations (or the plan document) are reflected in year-end plan amendments
- Eligible employees receive plan disclosures within the time frames required by regulations
- Participant plan documentation requests receive adequate attention and timely responses
- Plan benefit claims receive timely responses within the required time frames.

Auditor Selection

The EBSA report showed that CPAs auditing fewer than 25 plans each year had a 76% deficiency rate. However, CPAs who performed the most plan audits had a 12% deficiency rate. CPAs who were members of the American Institute of Certified Public Accountants (AICPA) and Employee Benefit Plan Audit Quality Control Center also had fewer audit deficiencies. Notwithstanding the many reasons for choosing firms with small benefit plan audit practices (e.g., cost, responsiveness, etc.), quality should be a primary factor when selecting a plan auditor.

ERISA requires prudence in the selection of plan service providers, and this responsibility generally falls on the plan sponsor as plan administrator unless the plan document designates another entity as administrator. Selected auditors should have significant training and experience with plan audits, but other factors may include the size and location of the firm, the number of audits conducted for similar plans and references.

The relationship also should be free of conflicts of interest between the auditor, plan and plan sponsor. Regardless of whether there is an existing relationship or a request for proposal (RFP) process, the audit relationship should be memorialized in a written engagement letter that clearly identifies the audit scope.

During the audit process, the auditor may discover deficiencies that should be addressed immediately (preferably with the assistance of a capable employee benefits attorney). For this reason, it is important to select auditors particularly adept at identifying potential compliance issues and using a collaborative process for resolving them.

Strong internal controls are paramount throughout the audit process, including memoranda describing self-correction methods used for any plan operational errors that occurred during the year that the auditor may discover. Those internal controls, as the EBSA report shows, directly impact the quality of the plan audit.

Additional Resources

- *Assessing the Quality of Employee Benefit Plan Audits.* DOL EBSA Office of the Chief Accountant, May 2015, available at www.dol.gov/ebsa/pdf/2014AuditReport.pdf.
- Employee Plans Team Audit (EPTA) Program—Internal Control Questionnaire, Plan Failures—Internal Control Impact, Internal Controls Considerations/Improvements. IRS, November 2014, available at www.irs.gov/pub/irs-tege/ic_questionnaire_plan_failures.pdf.
- *The Importance of Hiring a Quality Auditor to Perform Your Employee Benefit Audit.* AICPA Employee Benefit Plan Audit Quality Center Plan Advisory, November 2014, available at www.aicpa.org/interestareas/employeebenefitplanauditquality/resources/planadvisories/pages/theimportanceofhiringaqualityauditortoperformyouremployeebenefitplanaudit.aspx.
- *Internal Controls Are Essential in Retirement Plans.* IRS, May 2015, available at www.irs.gov/Retirement-Plans/Internal-Controls-are-Essential-in-Retirement-Plans.
- *Retirement Plan Operation and Maintenance.* IRS, May 2015, available at www.irs.gov/Retirement-Plans/Retirement-Plan-Operation-and-Maintenance.
- *Selecting an Auditor for Your Employee Benefit Plan.* DOL EBSA, available at www.dol.gov/ebsa/publications/selectinganauditor.html.

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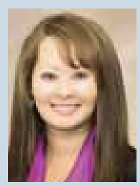

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