Best Practices for a Successful Plan Audit

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TELL ME ABOUT YOU

Poll Question #1:

What is your role in the audit of an employee benefit plan?

A. Sponsor
B. TPA/recordkeeper
C. Custodian/trustee
D. Auditor

OVERVIEW

- What is an audit?
- The audit process
- End of audit deliverables
- Corrections
- Working with the auditor

WHAT IS AN AUDIT?

The objective is for the auditor to express an opinion as to whether the plan's financial statements are presented fairly, in all material respects, and in conformity with generally accepted accounting principles (GAAP).

WHAT IS AN AUDIT?

Potential disconnect …

The tangible result of the audit is the auditor’s opinion on the financial statements, which present plan-level data.

The path to the auditor’s opinion weaves its way through participant-level data and plan compliance.

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WHAT IS AN AUDIT?

- Gain an understanding of the plan
- Gain an understanding of internal controls
- Plan the engagement
- Audit balances (investments, receivables, etc.)
- Audit participant data and allocations
- Audit plan obligations and benefit payments
- Consider DOL/ERISA compliance
- Report on the financial statements

THE AUDIT PROCESS

Poll Question #2: How many hours does the average audit of a defined contribution plan require?

A. 30

B. 80

C. 120

D. 200

THE AUDIT PROCESS

Who is in charge?

An effective team, with one designated leader:
- Sponsor
- TPA or recordkeeper
- Trustee/custodian
- Auditor

THE AUDIT PROCESS

Leadership of the process = audit efficiency

Audit efficiency =

- Less time on site
- Fewer delays waiting on information
- Timely completion of the audit
- Reasonable fees

THE AUDIT PROCESS

Process checklist

- Sponsors can manage the process using a checklist
- Draw from past audit experience
- Or discuss the process with the TPA and auditor to create the checklist

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THE AUDIT PROCESS

Sample process checklist items

- ❑ Complete/review census template
- ❑ Request W-3 or payroll summary from HR
- ❑ Reconcile census totals to payroll
- ❑ Transmit/approve census to TPA/recordkeeper
- ❑ Review annual testing
- ❑ Complete recommended corrective actions
- ❑ Verify testing is passed

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THE AUDIT PROCESS

Sample process checklist items

- ❑ Contact auditor to discuss timing
- ❑ Request a PBC letter from auditor
- ❑ Request reporting package
- ❑ Establish start date for fieldwork
- ❑ Compile information for auditor
- ❑ Prepare confirmation requests for auditor
- ❑ Be available during fieldwork
- ❑ Request exit meeting

THE AUDIT PROCESS

The document request letter

- aka “PBC letter” – prepared by the auditor
- Comprehensive list of information and documents needed by the auditor
- Each item should be assigned to a responsible party (sponsor, TPA, recordkeeper, trustee, custodian, etc.)
- Set deadlines for completion

THE AUDIT PROCESS

The Census: fact or fiction?

The Census is the focus of about 30 to 40 percent of audit procedures.

- What auditors focus on:
  - Date of birth
  - Date of hire
  - Wages
  - Contributions

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THE AUDIT PROCESS

- DOB – tied to a government ID
- DOH – tied to a hire authorization
- Wages – recalculated based on authorized wage rates, hours worked, bonuses, fringes, etc.
- Contributions – recalculated based on eligible wages and elected deferral percentage or dollar amount
- Total census wages – reconciled to the W-3 or summary payroll reports

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THE AUDIT PROCESS

What do we find?

- Typos in dates, usually no impact, sometimes affects eligibility or vesting
- Wages, improper inclusions, or exclusions
- Individuals who have been excluded from the census entirely

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THE AUDIT PROCESS

TAKEAWAYS:

- Coordination is key
- Get a copy of the PBC Letter
- Verify the census data

END OF AUDIT DELIVERABLES

Poll Question #3: How many documents does the auditor issue?

A. 1
B. 2
C. 3
D. Who cares? I just want to file the 5500 before October 14.

END OF AUDIT DELIVERABLES

- Auditors' report
- Financial statements
- Auditor required communications
- Management letter

AUDITORS' REPORT

- Limited Scope
  - Disclaimer of opinion
  - Only applies to investment information (no impact on procedures in other areas); allows auditor to rely on plan level investment information
  - Certification must be issued by a qualified party
    - Bank, trust company, thrift, insurance carrier regulated or supervised and examined by a federal or state agency
  - Not accepted by the SEC

AUDITORS' REPORT

- Full scope
  - Audit opinion allowed as engagement not limited under DOL regulations
  - Requires the substantive testing of investment securities
    - Valuation at plan year end
    - Purchase and sale activity during the year
    - Earnings on investments

FINANCIAL STATEMENTS

- Financial statements are the responsibility of plan management
  - Preparation
  - Review
  - Understanding of disclosures/source of information

FINANCIAL STATEMENTS

- Statement of net assets available for benefits
  - Presented at fair value
  - Two years of balances presented

- Statement of changes in net assets available for benefits
  - Presented at contract value (ASU 2015-12)
  - One year of activity (two years if filed with SEC)

FINANCIAL STATEMENTS

- Note 1 – summary of plan provisions
  - Have there been plan amendments?

- Note 2 – summary of accounting policies
  - Are they consistent with actual operation?
  - Were there new accounting standards adopted or forthcoming?

FINANCIAL STATEMENTS

- Investment footnote
  - Separately identify individual investments representing five percent or more of net assets
  - Detail investment gain/(loss) by investment type
  - Separately identify non-participant directed investments
  - ASU 2015-12

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FINANCIAL STATEMENTS

- Fair value footnote
  - Report investments by level classification (1, 2, 3)
  - Discuss valuation methodologies applied
  - Disaggregate investment types by consistency in underlying assets, risk tolerance, etc.
  - ASU 2015-12

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FINANCIAL STATEMENTS

- Guaranteed investment contracts footnote
  - Disclose significant contract provisions, including
    - Restrictions on transacting at contract value
    - Reserves against contract value for credit risk
    - Crediting interest rates
    - How often rates reset
    - Termination provisions
    - Average yields
  - Information typically obtained from the custodian or enrollment package

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FINANCIAL STATEMENTS

FASB Accounting Standard Update (ASU) No. 2015-12

- Part I, Fully Benefit-Responsive Investment Contracts
  - Clarifies that contract value is the relevant measurement attribute for fully benefit-responsive investment contracts (FBRICs).
  - Eliminates the requirement to measure and present the fair value of FBRICs
- Part III, Measurement Date Practical Expedient
  - Not applicable to most plans

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FINANCIAL STATEMENTS

- Part II, Plan Investment Disclosures
  - Eliminates the requirements to disclose:
    a) individual investments that represent five percent or more of net assets available for benefits, and
    b) Net appreciation (depreciation) in fair value by general type
  - Simplifies the level of desegregation of investments that are measured using fair value. The plan will continue to disaggregate investments that are measured using fair value by general type; however, the plan is no longer required to disaggregate investments by nature, characteristics and risks. Further, the disclosure of information about fair value valuation methodologies will continue to be provided by general type of plan assets.

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FINANCIAL STATEMENTS

- Other required footnote disclosures
  - Tax status
    - Determination letters
    - Opinion letter
  - Plan termination
    - Partial plan terminations
  - Forfeiture account activity
    - Amount utilized; balance remaining

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FINANCIAL STATEMENTS

- Other required footnote disclosures
  - Significant amendments during the plan year
    - Changes in eligibility/covered employees
    - Changes in contributions
    - Changes in distribution options
  - Distributions requested prior to but paid after year end

FINANCIAL STATEMENTS

- Other required footnote disclosures
  - Reconciliation to Form 5500
    - Net assets available for benefits
    - Increase/decrease in net assets available for benefits
    - ERISA requirement – regardless of materiality
  - Subsequent events
    - Required to report events identified as well as the date through which events were evaluated for recognition or disclosure

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FINANCIAL STATEMENTS

- Other required footnote disclosures
  - Related party or party–in-interest transactions
    - Related party
      - Affiliates
      - Trusts
      - Principal owners of plan sponsor and immediate family
      - Management of the plan sponsor and immediate family
      - Other parties with control or significant influence on operating policies

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FINANCIAL STATEMENTS

- Other required footnote disclosures
  - Related party or party–in–interest transactions
    - Party–in–interest
      - Fiduciary
      - Anyone providing services to the plan
      - Plan sponsor
      - Employee organization with members covered by the plan
      - Owners and immediate family members
      - Person or entity with ability to exercise control or significant influence of on operating policies

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FINANCIAL STATEMENTS

- Supplemental schedules
  - Schedule of assets (held at end of year)
  - Schedule of reportable transactions
  - Schedule of delinquent participant contributions

THE AUDIT PROCESS

Poll Question #4: How many pages is the disclosure checklist for a defined contribution plan (PPC version):

A. 5
B. 38
C. 67
D. 112

REQUIRED AUDITOR COMMUNICATIONS

- Matters to be communicated
  - Auditor's responsibility under standards
  - Planned scope and timing of the audit
  - Significant findings from the audit
    - Auditor's view on qualitative aspects of significant accounting practices
      - Accounting policies
      - Accounting estimates
      - Financial statement disclosures

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REQUIRED AUDITOR COMMUNICATIONS

- Significant findings from the audit (continued)
  - Significant difficulties encountered
  - Uncorrected misstatements
  - Disagreements with management
  - Other matters that are significant and relevant to those with oversight of the financial reporting process

REQUIRED AUDITOR COMMUNICATIONS

- Corrected misstatements (posted adjustments)
- Representations the auditor requests from management
- Management's consultation with other accountants
- Other significant correspondence with management

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MANAGEMENT LETTER

- An audit typically does not include tests of internal controls
- Auditors have a responsibility to
  - Gain an understanding of the internal control environment in order to effectively plan the audit
    - Interviews and questionnaires
    - Walkthroughs
  - Report identified deficiencies in internal control

MANAGEMENT LETTER

- Deficiency in internal control when the design or operation does not allow management to prevent, detect, or correct a misstatement timely
  - Design deficiencies
    - Control is missing
    - Control not properly designed
  - Operation deficiencies
    - Control not operated as designed
    - Control not performed by appropriate person

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MANAGEMENT LETTER

- Findings categorized as follows:
  - Material weakness
  - Significant deficiency
  - Control deficiency
  - Best practices

MANAGEMENT LETTER

Material Weakness

- A deficiency or combination of deficiencies in internal control such that there is a reasonable possibility that a material misstatement of the financial statements will not be prevented or detected and corrected on a timely basis.

Significant Deficiency

- A deficiency or combination of deficiencies in internal control that is less severe than a material weakness, yet important enough to merit attention.

MANAGEMENT LETTER

Control Deficiency

- A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect and correct misstatements on a timely basis.

Best Practice

- Suggestions for enhancements in internal control based on industry standards or other examples the auditor has witnessed in operation at other clients.

MANAGEMENT LETTER

- Material weaknesses and significant deficiencies are required to be communicated in writing

- Other matters may be communicated in writing or verbally

IT'S ALMOST OVER…

Poll Question #5: How much longer is this webcast?

A. 15 minutes
B. Don't bother me, I'm sleeping
C. Two shakes of a sheep's tail
D. This is so fun I don't want it to end!

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CORRECTIONS

I once heard someone say that a "qualified plan" is a contradiction in terms. Every plan has at least one qualification problem, you just may not have found it yet.

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CORRECTIONS

Compensation problems:

- Misunderstanding the definition of compensation is the greatest source of operational failures we find
- TPA understands the definition
- Trustees/management understand the definition
- Payroll clerk does not

CORRECTIONS

What can a TPA do?

- Educate the individuals who handle payroll for your clients (a value-added service)
- Review coding of wage sources – for sponsors that outsource their payroll (ADP, Paychex, etc.)
- Assist the sponsor in determining the pervasiveness of the error and formulate a corrective action

CORRECTIONS

Employer contribution problems:

- Most common error is improper inclusion/exclusion of participants
- Missing or improper true-up calculations

What can a TPA do?

- When assisting with calculations, don't assume that what you have been provided by the client is complete and/or accurate, ask questions

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CORRECTIONS

Hardship distribution problems:

- What are auditors finding?

  - Uninformed human resources personnel authorizing HD
  - Sympathy overrides what the document says
  - Lack of documentation
  - Improper amounts

- “Self certification”…

CORRECTIONS

What can a TPA do?

- Educate your clients – letter/email/seminar
- Explain how costly an improper hardship distribution is to the employer
- Assist with corrections when needed

WORKING WITH THE AUDITOR

Poll Question #6: Which auditor is your favorite to work with?

A. The partner
B. The old-school auditor
C. The staff auditor
D. None of the above

WORKING WITH THE AUDITOR

- Avoiding the love/hate relationship with the auditor can be the most challenging part of the audit

- Neither party speaks the same language

- Objectives of each party are different

- Plan sponsor can get stuck in the middle

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WORKING WITH THE AUDITOR

- Ask to be kept in the loop on all audit issues, audit status, open items, etc.
- Reasonable turnaround of requested data
- Reasonable response time to email/phone
- Patience – three parties involved with three different schedules and three different roles

WORKING WITH THE AUDITOR

How to work with the partner:

- Ask for the audit manager’s phone number

WORKING WITH THE AUDITOR

How to work with an old-school auditor:

- Include the client in discussions to avoid “he said/she said” scenarios
- Ask the auditor to explain their objective in the interest of formulating a solution
- In the absence of a paper document, explain the process and let the auditor come up with a revised procedure

WORKING WITH THE AUDITOR

How to work with the staff auditor:

The reality:

To keep audit costs down, a lot of work is assigned to auditors with less experience. Unfortunately this means they may not have the background to understand the intricacies of plan documents and DOL regulations. They also may not have the experience (or authority) to formulate alternate solutions.

WORKING WITH THE AUDITOR

How to work with the staff auditor:

What can you do?

- Try not to strangle them over the phone
- Recognize the point when you need to politely move up the chain of command
- Request a meeting with the audit manager, or have the sponsor do so

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Questions?

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