

TVHRA

EFFECTIVE INTERNAL CONTROLS FOR EMPLOYEE BENEFIT PLANS





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Why Internal Controls Matter?



- **By minimizing opportunities for unintentional errors or intentional fraud (*Preventative Controls*)**
- **By discovering small errors before they become big problems (*Detective Controls*)**

Where Are The Risks?



1) Fraudulent Financial Reporting

- **Non-Readily marketable investments**
- **Ineffective monitoring by management**
- **Deficient internal control components**
- **Poor investment results**
- **Financial stability of the plan sponsor is threatened**
- **Plan has invested in employer securities**

Where Are The Risks?



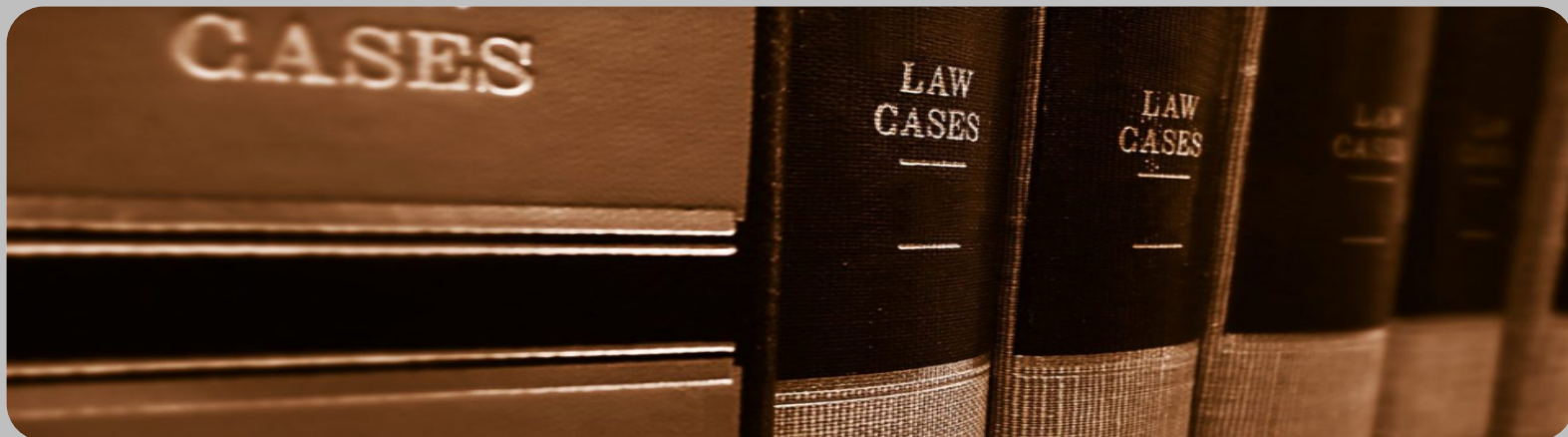
2) Misappropriation of Assets

- Lack of qualified outside service providers
- Inadequate internal controls over assets
- Personal financial pressures
- Known or anticipated future layoffs
- Recent or expected changes in benefits

DOL Criminal Enforcement Cases Examples



- ✦ **The Employee Benefits Security Administration (EBSA) Restored \$1.6 Billion to Employee Benefit Plans and its Participants during FY 2018.**



DOL Criminal Enforcement Cases Examples



- ✦ **Joint Enforcement News Releases per EBSA during 2018:**
 - *Kansas business owner assessed \$4.3 Million for diverted contributions and fraudulent loans.*
 - *Florida fund manager steals \$87k from plan by keeping employee contributions and not remitting payroll taxes that were withheld*
 - *California trustee steals \$234k by removing assets from participant accounts*

Components of Internal Control



- 1. Policies and procedures that create a proper segregation of duties**
- 2. Personnel qualified to perform their assigned responsibilities**
- 3. Sound practices to be followed by personnel in performing their duties**
- 4. System in place that ensures proper authorization and recording procedures**

Establishing a Cost Effective Control Environment



High Risk Areas

- ✦ **Participant data input and change administration**
- ✦ **Processing payroll and contributions**
- ✦ **Participant distributions**
- ✦ **Segregation of duties**

Monitoring Internal Controls



- ✦ **Are the controls in place and operating?**
- ✦ **Is the system working as designed?**
- ✦ **Are the controls and reports periodically reviewed?**
- ✦ **Are identified exceptions and problems resolved?**
- ✦ **Are you monitoring service organizations?**

SOC 1 Report

(System and Organization Controls Report)



- ◆ **Read the report!**
- ◆ **Two service providers with qualified reports**
- ◆ **Type 2 reports assess operating effectiveness**
- ◆ **Review report for exceptions and carve-outs**
- ◆ **Understand the complementary user entity controls**
 - **The service provider is expecting you to handle the user entity controls**

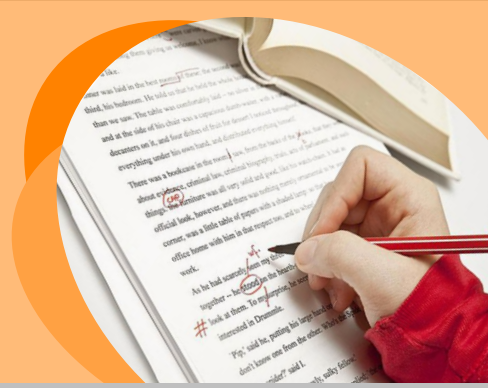
Internal Controls and Your Regulators *(example)*



“If a plan is selected for audit by the IRS, the EP agent conducting the retirement-plan examination will begin by evaluating the effectiveness of the plan's internal controls to determine whether to perform a focused audit—that is, just look at three to five issues or expand the scope of the examination. In other words, based on the strength of the plan's internal controls, the agent will decide to examine more or less of the return than originally planned.”

- Monika Templeman
former IRS Director of Employee Plans Examinations

Internal Controls and Your Auditor



- ✓ **Our audit of the financial statements will include obtaining an understanding of internal control sufficient to plan the audit and to determine the nature, timing and extent of audit procedures to be performed.**
- ✓ **An audit is not designed to provide assurance on internal control or to identify significant deficiencies or material weaknesses.**
- ✓ **Our review and understanding of the Plan's internal control is not undertaken for the purpose of expressing an opinion on the effectiveness of internal control.**






Understanding the Severity of Internal Control Deficiencies



- ✦ **Control deficiency**
- ✦ **Significant deficiency**
- ✦ **Material weakness**

Cybersecurity



-  **Records management usually contracted out to third party providers**
-  **Review cyber-security policies of third-party service providers, including encryption**
-  **Conduct periodic tests to detect threats**
-  **Perform periodic testing of backup and recovery plans**
-  **Establish internal training practices to reinforce data security and incident response plans**

How Can Your Auditor Help?



Participant Data Testing:

- ✓ Procedures exist to promptly identify and notify eligible participants for enrollment
- ✓ Retain enrollment applications including signed refusals
- ✓ Management should regularly review changes made to the payroll master file
- ✓ Determination of employee compensation under the plan

How Can Your Auditor Help?



Payroll Processing and Contributions Testing:

- ✓ Ensure adequate segregation of duties exist
- ✓ Current payrolls are compared with previous payrolls and variances are investigated
- ✓ Access to the payroll system is appropriately restricted

How Can Your Auditor Help?



Participant Distributions Testing:

- ✓ Signed or e-signed distribution forms are used
- ✓ Withdrawal forms, including requests for hardship withdrawals from 401(k) arrangements, are reviewed by a responsible official.

How Can Your Auditor Help?



Participant Loans Testing:

- ✓ **Loan requests are in compliance with plan document**
 - **Loan term (generally limited to 5 years)**
 - **Number of outstanding loans per participant**

- ✓ **Loan repayments properly being made through payroll process**

How Can Your Auditor Help?



Income Allocations to Participant Accounts (testing)

Risk Assessment by Auditor

Auditor Selection Criteria



- **Member of AICPA Employee Benefit Plan Audit Quality Center (EBPAQC)**
- **Annual specialized training in EBP auditing**
- **EBP audits reviewed annually by independent expert(s)**
- **Extensive experience in auditing EBP plans**

Department of Labor Hot Topics (DOL Alerts)



- **Timeliness of contributions and loan payments**
- **Reasonable and transparency of fees**
- **Fiduciary responsibilities**
- **Compliance with plan documents**

IRS Top Ten Failures Found In Voluntary Correction Program



- 1. Failure to amend plan for tax law changes**
- 2. Failure to follow the plan's definition of compensation for determining contributions**
- 3. Failure to include eligible employees or exclude ineligible employees from the plan**
- 4. Plan loans that do not comply with the Internal Revenue Code (IRC)**
- 5. Impermissible in-service withdrawals**

IRS Top Ten Failures Found In Voluntary Correction Program



- 6. Failure to satisfy IRC minimum distribution rules**
- 7. Employer eligibility failure**
- 8. Failed ADP/ ACP nondiscrimination tests not corrected in timely manner**
- 9. Failure to properly provide the minimum top-heavy benefit or contribution to non-key employees**
- 10. Failure to satisfy IRC 415 contribution limits**

US Department of Labor



10 Warning Signs that 401(k) Contributions are Being Misused...

- 1.** Your 401(k) individual account statement is consistently late or comes at irregular intervals
- 2.** Your account balance does not appear to be accurate
- 3.** Your employer failed to transmit your contribution to the plan on a timely basis
- 4.** A significant drop in your account balance that cannot be explained by normal market changes
- 5.** 401(k) statement that shows your contribution from your paycheck was not made

US Department of Labor



10 Warning Signs that 401(k) Contributions are Being Misused...

- 6.** Investments listed on your statement are not what you authorized
- 7.** Former employees are having trouble getting their benefits paid on time or in the correct amounts
- 8.** Unusual transactions (such as a loan to the company, a corporate officer, or a plan trustee)
- 9.** Frequent and unexplained changes in investment managers or consultants
- 10.** Your employer has recently experienced financial difficulty

Resources & Links



- ◆ [AICPA Employee Benefit Plan Audit Quality Center – The Importance of Internal Control in Financial Reporting and Safeguarding Plan Assets](#)
- ◆ [AICPA EBPAQC Plan Advisory, Effective Monitoring of Outsourced Plan Recordkeeping and Reporting Functions](#)
- ◆ [IRS – Retirement Plan Operation and Maintenance](#)



**For more information
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