

The Importance of Internal Control in Financial Reporting and Safeguarding Plan Assets

The AICPA Employee Benefit Audit Quality Center is a firm-based, volunteer membership center created with the goal of promoting quality employee benefit plan audits. Center members demonstrate their commitment to ERISA audit quality by joining and agreeing to adhere to the Center's membership requirements. EBPAQC member firms receive valuable ERISA audit and firm best practice tools and resources that are not available from any other source.

Visit the center website at aicpa.org/EBPAQC to see a list of EBPAQC member firms and find other valuable tools prepared for plan sponsors and other stakeholders. For more information, contact the EBPAQC at ebpaqc@aicpa.org.

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Table of Contents

Introduction	ii
Why Internal Control Is Important to Your Plan	1
What Is Internal Control?	2
How to Establish Cost-Effective Internal Control	3
Monitoring Your Controls is Critical	7
Plan Auditor Communications of Internal Control Deficiencies	9
How Your Plan Auditor can Help You Improve the Effectiveness of Your Plan’s System of Internal Control	11
Additional Resources	13
Examples of Selected Controls for Employee Benefit Plans	14

Introduction

The AICPA Employee Benefit Plan Audit Quality Center has prepared this advisory to assist you as a plan sponsor, administrator, or trustee in understanding how internal control over financial reporting is critical to your plan.

This advisory discusses:

- ▶ Why internal control is important to your plan
- ▶ The basics of internal control
- ▶ How to establish cost-effective controls
- ▶ Monitoring your controls
- ▶ Plan auditor communications of internal control deficiencies
- ▶ How your plan auditor can help you improve the effectiveness of your plan's internal control
- ▶ Where to obtain additional information about internal controls

In addition, this advisory contains helpful examples of controls for you to consider establishing for your plan.

This advisory should be used for reference purposes only.

Why Internal Control Is Important to Your Plan

As a plan sponsor, administrator, or trustee, you are considered a fiduciary under ERISA — As such, you are subject to certain fiduciary responsibilities, and with these responsibilities comes potential liability: Fiduciaries who do not follow the basic standards of conduct may be personally liable to restore any losses to the plan, or to restore any profits made as a result of their improper use of the plan's assets.

Under ERISA, your responsibilities include plan administration functions such as maintaining the financial books and records of the plan, and filing a complete and accurate annual return/report for your plan. Because errors and fraud can and do occur, it is important that you establish safeguards for your plan to ensure you can adequately meet your fiduciary responsibilities. One way this can be accomplished is by implementing effective internal control over financial reporting.

Because errors and fraud can and do occur, it is important that you establish safeguards for your plan to ensure you can adequately meet your fiduciary responsibilities.

Effective internal control reduces the risk of asset loss, and helps ensure that plan information is complete and accurate, financial statements are reliable, and the plan's operations are conducted in accordance with the provisions of applicable laws and regulations. When internal control is effective, you have reasonable assurance that your plan is achieving its financial reporting objectives. When it is not effective, you have little or no such assurance.

An effective system of internal control protects your plan in two ways:

- ▶ **By minimizing opportunities for unintentional errors or intentional fraud that may harm the plan.** *Preventive controls*, which are designed to discourage errors or fraud, help accomplish this objective.
- ▶ **By discovering small errors before they become big problems.** *Detective controls* are designed to identify an error or fraud after it has occurred.

What Is Internal Control?

Internal control is a process — effected by plan management and other personnel, and those charged with governance, and designed to provide reasonable assurance regarding the achievement of objectives in the reliability of financial reporting.

Your plan's policies, procedures, organizational design and physical security all are part of the internal control process. The following are some general characteristics of satisfactory plan internal control over financial reporting:

- ▶ Policies and procedures that provide for appropriate segregation of duties to reduce the likelihood that deliberate fraud can occur
- ▶ Personnel qualified to perform their assigned responsibilities
- ▶ Sound practices to be followed by personnel in performing their duties and functions
- ▶ A system that ensures proper authorization and recordation procedures for financial transactions

The Committee of Sponsoring Organizations of the Treadway Commission's (COSO) *Internal Control — Integrated Framework* provides detailed information about internal controls. COSO has been recognized by executives, board members, regulators, standard setters and professional organizations as an appropriate and comprehensive framework for internal control, and can be a valuable resource to you in setting up your plan's internal control.

How to Establish Cost-Effective Internal Control

Internal control will vary depending on the plan's size, type and complexity; whether the plan uses outside service organizations to process transactions and manage plan investments; and the size and qualifications of the department responsible for financial reporting.

Internal control should be based on a systematic and risk-oriented approach, to ensure that there are adequate individual controls in areas with high risk, and that they are not excessive in areas with low risk. Before making the decision to adopt a control, analyze the costs of establishing and maintaining it, and consider:

- ▶ The potential benefits the control will provide
- ▶ The possible consequences of not implementing it

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Determine your plan's internal control objectives — COSO recognizes that external financial reporting objectives are primarily driven by regulations and standards set by authoritative bodies. The first step in establishing a system of internal control over financial reporting at your plan is to determine the objective of the system, or what you want it to achieve: reliable financial statements that are prepared in accordance with accounting principles generally accepted in the United States of America or in accordance with a special purpose framework.

Individual controls should be designed to meet your system's objectives —

Plan administrators should consider the assertions included in the U.S. Generally Accepted Auditing Standards (GAAS) when designing controls to address financial statement assertions inherent in the various components of the plan's financial statements, such as plan investments, contributions, benefits, participant data, plan obligations, participant loans and administrative expenses. Assertions can be classified according to the following broad categories:

- ▶ **Occurrence or existence** — Do assets and liabilities actually exist at a given date? Did recorded transactions occur during the current year or did they take place in an earlier or later year? For example, all assets in the investment account must physically exist and be available to pay benefits or plan expenses.
- ▶ **Rights and obligations** — Do assets and liabilities reported in the financial statements represent the rights and obligations of your plan as of the date of the statement of net assets available for benefits? For example, an investment should not be reported as an asset unless it is owned by the plan. Liabilities should be reported only if they represent actual obligations of your plan, not obligations of an insurance company or another entity.
- ▶ **Completeness** — Are all transactions and accounts that should be presented in the financial statements actually included? For example, all administrative expenses incurred during a given year must be recorded, and all amounts owed to brokers for securities purchased must be included in liabilities.
- ▶ **Accuracy or valuation and allocation** — Are assets and liabilities valued appropriately? Are assets, accrued liabilities, and accumulated benefit obligations included in the financial statements at appropriate amounts, and any resulting valuation or allocation adjustments recorded appropriately? For example, investments must be reported at fair value, and any related investment income appropriately allocated.

- ▶ **Cut-off** — Are all transactions and events recorded in the proper period? For example, all employer contributions for the year have been properly recorded, even if received in the subsequent year.
- ▶ **Classification and understandability** — Are transactions and events recorded in the proper accounts? Is the financial information appropriately presented and described, and is information in disclosures expressed clearly? For example, costs must be properly classified as either expenses or assets, and information about prohibited transactions that have occurred at your plan must be disclosed in the notes to your plan's financial statements.

Control objectives should be established for each of your plan's financial statement assertions. Control objectives related to the plan's financial statement assertions should cover each of the following areas:

- ▶ **Plan investments** — An example control objective for the "valuation" assertion related to investments would be that the control helps ensure that investments are measured at fair value.
- ▶ **Contributions received and related receivables** — An example control objective for the "existence or occurrence" assertion for contributions received would be that the control helps ensure that contributions by employers and participants meet authorized or required amounts.
- ▶ **Benefit payments** — An example control objective for the "completeness" assertion related to benefit payments would be that cash disbursement records are reconciled to ensure that all benefit payments are recorded.
- ▶ **Participant data and plan obligations** — An example control objective for the "rights and obligations" assertion for plan obligations would be that the control helps ensure that the actuarial valuation of benefit obligations reflects the understanding and agreement of the plan committee or responsible officials.

- **Administrative expenses** — An example control objective for the “accuracy” assertion related to administrative expenses would be that the control helps ensure that expenditures for administrative expenses are not mistakenly recorded as benefit payments.

Establish, document and communicate your internal control — Using the control objectives you’ve identified, decide what controls are best suited for your plan. By learning what processes and procedures are used at your plan, you can identify the related risks, and determine controls to mitigate or eliminate those risks. It’s a good idea to document the processes, so you can make a good assessment of where controls are needed. While ultimate responsibility for establishing internal control remains with management, you may wish to consult your plan auditor for help in determining what controls are necessary to ensure complete and accurate financial reporting by your plan. The “Examples of Selected Controls for Employee Benefit Plans” section of this advisory provides detailed examples of control objectives and related controls that you may wish to consider for your employee benefit plan.

Many plans use service organizations — such as bank trust departments, data-processing service bureaus, insurance companies or other benefits administrators — to perform various recordkeeping and reporting functions that affect financial reporting. Even in situations where you have hired a service organization to perform accounting and reporting functions, it is very likely that certain controls will be necessary at the plan level. Depending on the nature of the services performed by the service organization and the quality of the controls it has in place, additional controls may be necessary at your plan. These controls are referred to as “user controls.” Examples of user controls that you might consider putting into place at your plan when significant operations are performed by a service organization also are included in the “Examples of Selected Controls for Employee Benefit Plans” section of this advisory.

Once controls are established, it is important that they be documented and communicated to staff members who are expected to follow the policies and procedures. Staff training is a key element in ensuring the effectiveness of the plan’s internal control.

Monitoring Your Controls is Critical

Internal controls may change or fail to be performed, or the processes and procedures for which controls were created may change, rendering them less effective or ineffective. Because internal control is effective only when properly designed and operating as intended, you need to monitor the quality of your internal control's performance over time. Effective monitoring helps ensure your system of internal control continues to provide the protections you envisioned.

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Monitoring should be designed to identify and correct weaknesses in internal control before they can result in a significant misstatement in your plan's financial statements. You should periodically review the design and operation of your plan's controls, and make changes where they are not providing the desired results.

Your monitoring activities should address the following issues:

- ▶ Are controls in place and operating? Establishing policies and procedures will have no effect, if they are not implemented properly.
- ▶ Is the system working as designed? Regardless of how good your formal system is, there is no guarantee that the policies and procedures actually will be followed. Employees may circumvent important procedures in the interest of getting their work done more quickly or easily, or simply may not be aware that the policies and procedures exist.

- ▶ Are exceptions and problems identified and resolved promptly? Monitoring is effective only to the extent that results are reported to the appropriate people and corrective action is taken, if necessary.
- ▶ Are the controls periodically reviewed? Staff turnover, plan mergers and other changes necessitate that controls be frequently reviewed to ensure they continue to be effective.

In situations where you have outsourced certain plan accounting and reporting functions to service organizations, it is important that those service organizations maintain adequate controls over the transactions processed on behalf of your plan. You should be aware that the hiring of a service organization to perform any or all of your financial reporting responsibilities is a fiduciary function. As part of your fiduciary responsibilities, you are required to periodically monitor the service organization to ensure it is properly performing the agreed-upon services. The AICPA Employee Benefit Plan Audit Quality Center has prepared a Plan Advisory, *Effective Monitoring of Outsourced Plan Recordkeeping and Reporting Functions*, which provides information to assist plan sponsors, administrators and trustees in monitoring service organizations.

Plan Auditor Communications of Internal Control Deficiencies

Your plan auditor is required to communicate to you — and others in your organization charged with governance — certain deficiencies or weaknesses in internal controls over your plan's financial reporting.

All plan auditors are required to follow GAAS, which requires that "significant deficiencies" and "material weaknesses" (as defined) identified during the annual independent audit be communicated to you *in writing*. Those communications must be made every year in which the significant deficiency or material weakness exists, even if it's already been communicated to you in the past, and must include an explanation of the potential effects of the significant deficiencies and material weaknesses identified.

These communications will help improve your awareness of the importance of internal control over financial reporting, and will enable you to assess the costs and benefits of implementing adequate controls, weigh the risks of each significant deficiency or material weakness, and determine if and how to address them.

Following are examples of circumstances that may be deficiencies, significant deficiencies or material weaknesses:

- ▶ The plan does not adequately segregate accounting duties among personnel, increasing the risk that fraud could occur and go undetected.
- ▶ The plan lacks internal expertise in the areas of financial accounting, reporting and internal control, increasing the risks that a material misstatement of financial information could occur and will not be detected.
- ▶ The plan does not effectively monitor the activities of third-party administrators or custodians, increasing the risk that errors in information provided by the service organization will go undetected.

- ▶ The plan audit identifies material misstatements in accounting records, which were not identified by the plan's internal control, indicating that the plan's controls are not functioning effectively.

Essentially, the nature and severity of the deficiency will dictate whether it is a deficiency, significant deficiency or a material weakness.

Essentially, the nature and severity of the deficiency will dictate whether it is a deficiency, significant deficiency or a material weakness. For example, in a situation where there is no one at the plan with the ability to prepare the plan financial statements, it likely would be considered at least a significant deficiency. And if the person responsible for financial reporting at your plan lacks the ability even to understand the financial statements prepared by the plan auditor, it likely would be considered a material weakness. You may wish to be proactive and contact your plan auditor to inquire about the communication requirement and whether your plan should expect to receive a letter communicating what internal control deficiencies the plan auditor has identified, and any recommendations to improve the plan's internal control. This will allow you additional time to evaluate the cost/benefit implications of improving your internal control in conjunction with your fiduciary duty to the plan.

How Your Plan Auditor Can Help You Improve the Effectiveness of Your Plan's System of Internal Control

Remember, although you are responsible for establishing the system of internal control at your plan, your plan auditor can be a good resource to help guide you through the process.

Your plan auditor may provide advice, research materials and recommendations to assist you in making decisions about how to improve your plan's internal controls. Your plan auditor also can help with the financial statement preparation. You should be aware, however, that Department of Labor and AICPA auditor independence rules¹ restrict what non-audit (nonattest) services auditors can and cannot perform for a plan for which they perform the annual financial statement audit (for example, Department of Labor rules prohibit the plan auditor from maintaining financial records for the plan).

Plans hire their financial statement auditors to perform non-audit services for different reasons, including the following:

- ▶ Plan personnel lack the skills or the resources to prepare financial statements without assistance. *[This weakness signals a control deficiency that might need to be reported to you as discussed in the section "Plan Auditor Communications of Internal Control Deficiencies," above. Such a deficiency, however, exists only if the plan does not have effective controls to prevent, detect and correct misstatements in the financial statements, not because the plan auditor performs services to assist the plan.]*
- ▶ Purely as a matter of convenience. [If the plan has proper controls in place, no control deficiency exists.]

¹ DOL Interpretive Bulletin 75-9 (29 CFR 2509.75-9) relating to guidelines on independence of accountant retained by Employee Benefit Plan and AICPA Professional Code of Conduct Interpretation 101-3, Performance of Nonattest Service.

Your plan auditor can assist plan management with controls provided he or she complies with his or her professional independence standards. One component of these independence standards is plan management accepts responsibility for designing, implementing and maintaining internal control, along with overseeing the auditor's services sufficiently so that plan management can evaluate the adequacy of the services and accept responsibility for the services. What your plan auditor does as part of the audit engagement is not relevant to whether your controls are deficient. The relevant factors are the controls that the plan designs and implements to prevent, detect and correct material misstatements in the plan's financial statements under audit.

The critical issue is that the plan's internal control policies and procedures must be in place, performed by duly authorized plan personnel, or their designee who is capable of performing the control activities. Furthermore, plan management must accept responsibility for designing, implementing and maintaining internal control. For example, the plan can use its plan auditor to assist in identifying adjusting entries and drafting the financial statements and related disclosures. But to have effective controls to prevent, detect and correct misstatements in the financial statements, the plan must designate an employee to oversee the service who understands the benefit plan industry, understands how accounting entries affect the plan's financial statements, is capable of making management decisions related to the monthly and year-end closing activities, and approves and accepts full responsibility for the plan auditor's work product.

In such a case where you simply do not have a person on staff with the requisite knowledge and it does not make sense to hire such a person, you may wish to consider hiring a CPA firm other than your plan auditor to assist you with the process.

Additional Resources

The **COSO website** provides detailed information to help you better understand internal control and its importance in ensuring complete and accurate financial reporting by your plan. Visit the COSO website at [coso.org](https://www.coso.org).

The AICPA Audit and Accounting Guide, Employee Benefit Plans (the Guide), describes considerations plan auditors make relative to your internal controls in their plan audits. The Guide is available at [CPA2Biz.com](https://www.cpa2biz.com).

The AICPA EBPAQC Plan Advisory, Effective Monitoring of Outsourced Plan Recordkeeping and Reporting Functions, may serve as a useful tool in monitoring internal controls at your service organizations. That document is available on the Center website at aicpa.com/EBPAQC.

Using a SOC1SM Report in Audits of Employee Benefit Plans may serve as a useful tool in monitoring internal controls at your service organizations. This publication is available at [CPA2Biz.com](https://www.cpa2biz.com).

The **EBPAQC website** includes information that may help you better understand the plan auditor's internal control communications, and how they may affect your plan. That information can be found under the "Resources" tab at aicpa.com/EBPAQC.

Examples of Selected Controls for Employee Benefit Plans²

Following is a useful tool that provides examples of control objectives and selected controls to help achieve those objectives. The controls included are related to specific control objectives that may be relevant to an audit of a plan’s financial statements; accordingly, control activities concerning the effectiveness, economy and efficiency of certain management decision-making processes are not included. The examples are not intended to be all-inclusive or to suggest the specific objectives and controls that should necessarily be adopted by employee benefit plans. Some of the illustrated control objectives may not be relevant to particular plans because of the type of plan or the absence of certain types of transactions. The controls included are related to specific control objectives that may be relevant to a plan’s financial statements.

INVESTMENTS

Specific Objectives	Examples of Selected Controls
Investment transactions are recorded at the appropriate amounts and in the appropriate periods on a timely basis.	<ul style="list-style-type: none">▶ Reports submitted by trustees, insurance companies, asset custodians, or investment managers are reviewed.▶ Detailed subsidiary records are reconciled to trust reports on a regular basis.▶ Control totals from participant’s records are compared with control totals from trust reports on a regular basis.▶ Purchases and sales (as a result of contributions and distributions) of mutual funds are reviewed to determine that the net asset value (NAV) agrees to published quotations.▶ Purchases and sales of investments are reviewed to determine that the appropriate fair value was utilized.

²Source: American Institute of CPAs *Audit and Accounting Guide Employee Benefit Plans* (Appendix B).

INVESTMENTS

Specific Objectives

Examples of Selected Controls

Investment income and expenses are recorded at the appropriate amount and in the appropriate period on a timely basis.

- ▶ Commissions and management fees are reviewed for appropriateness and adherence to the agreement or contract.
- ▶ Interest, dividends, and other sources of income, including securities lending fees, are reviewed for receipt and accuracy by reference to reliable sources.
- ▶ If income is allocated to more than one plan or participant accounts, allocation methods of income between plans and participants are documented and reviewed.

Investments (other than insurance contracts with insurance companies and fully benefit-responsive investment contracts held by defined contribution [DC] and health and welfare plans) are measured at fair value.

- ▶ Quotation sources and appraisal reports are compared with recorded values.
- ▶ Pooled separate accounts (PSAs) and common collective trusts (CCTs) are compared with NAVs calculated by the issuer.
- ▶ Financial statements of PSAs and CCTs are obtained, and unit information contained in the financial statements is compared for reasonableness with the unit values reported to the plan.
- ▶ Valuation methods are documented in the trust agreement or plan investment committee minutes.
- ▶ Assumptions and modeling used for estimates, including independent appraisals, are appropriately reviewed and monitored.

INVESTMENTS

Specific Objectives	Examples of Selected Controls
	<ul style="list-style-type: none"> ▶ Fair value estimates for valuation of investments using unobservable inputs are approved by plan investment committee or those charged with governance. ▶ Review of restrictions imposed on investments and consideration of any adjustments to NAV per share (or its equivalent) to estimate the fair value of the investment.
Premiums and interest relating to insurance contracts are recorded at the appropriate amount and in the appropriate period on a timely basis.	<ul style="list-style-type: none"> ▶ Premium statements are compared with insurance contracts. ▶ Interest calculation is tested.
Investment transactions are initiated in accordance with the established investment policies.	<ul style="list-style-type: none"> ▶ Investment criteria or objectives are documented in the plan instrument or plan committee minutes. ▶ Authority to execute transactions is specified in the plan instrument or plan investment committee minutes. ▶ Investment transactions are reviewed by a plan investment committee for adherence to investment guidelines.
Investment assets are protected from loss or misappropriation.	<ul style="list-style-type: none"> ▶ Responsibility for investment decisions and transactions is segregated from the custodian's functions. ▶ Financial stability of financial institutions holding investments is reviewed. ▶ Written-off investments are reviewed for possible appreciation.

INVESTMENTS

Specific Objectives	Examples of Selected Controls
	<ul style="list-style-type: none">▶ Documents are controlled in a limited-access, fireproof area.▶ Securities held by custodians are confirmed.▶ Secure access to computerized investment records is limited to those with a logical need for such access.
Obligations under insurance companies' insurance contracts can be met.	<ul style="list-style-type: none">▶ Financial statements of insurance companies are reviewed.
For deposits with insurance companies, terms of insurance contracts are authorized.	<ul style="list-style-type: none">▶ Terms are specified in the plan instrument.▶ Modifications of contracts are approved by the plan investment committee.

CONTRIBUTIONS RECEIVED AND RELATED RECEIVABLES AND PARTICIPANT LOANS

Specific Objectives	Examples of Selected Controls
Amounts of contributions by employers and participants meet authorized or required amounts.	<ul style="list-style-type: none">▶ Contribution requirements or limitations are described in the plan instrument or collective bargaining agreement.▶ Contributions are determined using approved eligibility lists.▶ Actuary is used to make periodic valuations and reports.
Contributions are recorded at the appropriate amount and in the appropriate period on a timely basis.	<ul style="list-style-type: none">▶ Inputs to contribution calculations are compared with compensation defined in the plan instrument.

CONTRIBUTIONS RECEIVED AND RELATED RECEIVABLES AND PARTICIPANT LOANS

Specific Objectives

Examples of Selected Controls

- ▶ Sponsor or employer payroll records are compared with contribution calculations. In the case of multiemployer plans, some form of periodic payroll audit is performed.
- ▶ Initial controls are established over contribution records for both employer and participant contributions (for example, salary reduction amounts, after tax and rollovers).
- ▶ Clerical accuracy of contribution forms is checked.
- ▶ Subsidiary contribution records are reconciled to the trustee or asset custodian or insurance company or other third-party administrator reports.
- ▶ Contribution forms are reconciled to cash receipts ledger and bank deposits.
- ▶ Control totals for participant and employer contributions are maintained.
- ▶ Contribution receipts are issued to participants containing notices requesting reviews of discrepancies.
- ▶ Deferral change reports received from third-party service providers are timely processed in the payroll system, and changes are reviewed for accuracy.
- ▶ Plan sponsor has procedures in place to monitor that participant contributions are remitted to the trust within guidelines prescribed by Department of Labor (DOL) regulations.

CONTRIBUTIONS RECEIVED AND RELATED RECEIVABLES AND PARTICIPANT LOANS

Specific Objectives	Examples of Selected Controls
Notes receivable from plan participants and related interest income are properly reported.	<ul style="list-style-type: none">▶ Loans are made only with proper authorization based on guidelines established in the plan instrument in conformance with the Employee Retirement Income Security Act of 1974 and tax requirements.▶ Entries to detailed loan records are reconciled with cash disbursements and receipts records.▶ Interest income is calculated periodically in accordance with rates established in the plan instrument and properly accrued.▶ Detailed records maintained by the third-party administrator are reconciled with the trustee's or asset custodian's reports.▶ Records are reviewed periodically for past-due amounts.
Access to cash receipts, cash receipts records, and contribution records is suitably controlled to prevent or detect within a timely period the interception of unrecorded cash receipts or the abstraction of recorded cash receipts.	<ul style="list-style-type: none">▶ Cash is independently controlled upon receipt.▶ Procedures are in place to monitor that cash receipts are deposited intact daily.▶ To prevent theft, checks are restrictively endorsed upon receipt.▶ Procedures are in place for the segregation of duties between the responsibility for receiving contributions and for the processing of contributions.▶ Bank accounts are reconciled monthly.▶ Past-due contributions are investigated on a timely basis.▶ Secure access to computerized contribution records is limited to those with a logical need for such access.

BENEFIT PAYMENTS, CLAIMS AND DISTRIBUTIONS

Specific Objectives

Payments are recorded at the appropriate amount and in the appropriate period on a timely basis.

Examples of Selected Controls

- ▶ Calculations supporting payments are checked for clerical accuracy.
- ▶ Benefits and claims payable outstanding for a long period are investigated.
- ▶ Initial controls are established over the distribution process.
- ▶ Amounts are compared with plan or insurance company records.
- ▶ Control totals for monthly pension benefits are maintained.
- ▶ Denied claims are monitored once participants or beneficiaries are notified of their right to have denied claims reviewed.
- ▶ Initial controls are established over the maximum contributions allowed under tax regulations and corrective distributions made as required by tax regulations.
- ▶ Initial controls are established over hardship withdrawals, and documentation is maintained that supports the withdrawal request, authorization, amount and adherence to related tax regulations.
- ▶ If required by the plan agreement, participants making hardship withdrawals do not make any contributions to any plan during the six months following the withdrawal.
- ▶ Initial controls are established over forfeitures, and utilization or allocation of forfeitures is made in accordance with the plan instrument.

BENEFIT PAYMENTS, CLAIMS AND DISTRIBUTIONS

Specific Objectives

Examples of Selected Controls

Payments are determined and authorized in accordance with the plan instrument.

- ▶ Changes in participant eligibility are approved by the plan committee.
- ▶ Eligibility lists are approved.
- ▶ Signed application forms or other authorized procedures (that is, endorsed checks) are used.
- ▶ Applications that provide for review of eligibility, benefit amounts or plan compliance require approval.

Participant's benefit and cash disbursement records are controlled to prevent or detect on a timely basis unauthorized or duplicate payments.

- ▶ Responsibilities for benefit approval, recording of benefits, and maintenance of participant files are adequately segregated.
- ▶ Blank forms are prenumbered and effectively controlled.
- ▶ Periodic correspondence with retired beneficiaries is maintained, and correspondence or payments are returnable to plan committee if undeliverable.
- ▶ Check endorsements are compared with signature in applicable participant records.
- ▶ Supporting documents are effectively canceled on payment.
- ▶ Secure access to computerized benefit payment records is limited to those with a logical need for such access.

PARTICIPANT DATA

Specific Objectives

Examples of Selected Controls

Participant data are properly recorded on a timely basis.

- ▶ Participant forms (for example, enrollment, transfers and investment allocation) are controlled and maintained for future reference.
- ▶ Participants are encouraged to review transactions initiated electronically or directly with the third-party administrator.
- ▶ The number of plan participants is reconciled using enrollment forms.
- ▶ Subsidiary records are maintained for participants who are active, retired, or terminated with vested benefits.
- ▶ Plan records maintained by the sponsor are reconciled with information maintained by third-party service providers.
- ▶ Participant data are updated and reconciled to employer's personnel and payroll records (or participating employers in a multiemployer plan).
- ▶ Account balances and benefit data are furnished to participants per DOL guidelines and upon written request.

Participant eligibility is determined in accordance with authorization.

- ▶ Eligibility is defined in the plan instrument.
- ▶ Enrollment applications or third-party enrollment reports are reviewed by the plan committee or a responsible official.

Employees are notified of their eligibility.

- ▶ Procedures for identifying and contacting eligible employees are established.

PARTICIPANT DATA

Specific Objectives

Examples of Selected Controls

Access to participants' data is controlled to prevent unauthorized changes or additions.

- ▶ Employee participation refusals are retained for future reference.
- ▶ Maintenance of participant data is segregated from responsibility for benefit approval or processing.
- ▶ In the case of multiemployer plans, participant data on a sample basis are updated and reconciled to the contributing employer's personnel and payroll records during the course of a payroll audit.
- ▶ All participant-initiated enrollments, transfers, changes in investment allocations, and other change requests must be authorized by the participant. The ability to perform these activities electronically or directly with a third-party administrator is restricted to authorized participants through the use of specific identification and a personnel identification number. Invalid attempts to access and perform functions are reviewed and investigated.
- ▶ Confirmations are provided to participants for participant-initiated account activity.

Actuarial valuation of accumulated benefits or benefit obligations reflect the understanding and agreement of the plan committee or responsible officials.

- ▶ Plan committee or responsible officials discuss with the actuary the actuarial methods and significant assumptions that are the basis for actuarial calculations.

PARTICIPANT DATA

Specific Objectives	Examples of Selected Controls
Accumulated benefit or benefit obligation amounts and other actuarially determined information are determined periodically and recorded in the plan's records at the appropriate amounts.	<ul style="list-style-type: none">▶ Valuation report prepared by an enrolled actuary is reviewed.▶ Participant data in the actuary's valuation report are reconciled with the participants' subsidiary records.▶ Incurred but not reported claims are compared with historical claims lag reports on a periodic basis.

ADMINISTRATIVE EXPENSES

Specific Objectives	Examples of Selected Controls
Administrative expenses are recorded at the appropriate amount and in the appropriate period on a timely basis.	<ul style="list-style-type: none">▶ Expenses are compared with contracts and disbursements.▶ If expenses are allocated to more than one plan, investment, or fund, allocation methods and calculations are reviewed.
Types of administrative services to be offered are authorized.	<ul style="list-style-type: none">▶ Administrative services are described in the plan instrument.▶ Expenses are approved by a responsible official.▶ Revenue sharing agreements and related amounts are periodically reviewed to assure timely, proper disposition of allowable expense payments.
Access to accounts payable and cash disbursements records is controlled to prevent or detect on a timely basis unauthorized or duplicate payments.	<ul style="list-style-type: none">▶ Responsibilities for expense approval and processing are adequately segregated.▶ Supporting documents are effectively canceled on payment.

REPORTING

Specific Objectives	Examples of Selected Controls
Records are maintained in sufficient detail to provide for proper and timely reconciliation.	<ul style="list-style-type: none">▶ For defined benefit plans, subsidiary ledgers are reconciled with the trustee's or asset custodian's reports on a periodic and timely basis.▶ For DC plans, the total of all participant account balances is reconciled to the net assets in the trustee, insurance company, or asset custodian's reports on a periodic and timely basis.
Financial statements, actuarial information, disclosures, and supplemental schedules as prepared are complete, accurate, and in conformity with management's authorization.	<ul style="list-style-type: none">▶ Procedures are established to identify required disclosure items (for example, party in interest transactions, transactions in excess of 5% of plan assets, and restrictions on redemption of investments).▶ Accumulating information for disclosure in accordance with the rules and regulations of appropriate authorities.▶ Review of all financial reports and filings.▶ Written representations on financial matters are obtained from actuaries, trustees, asset custodians, insurance companies and others.▶ Plan committee reviews presentation of, and disclosures in, financial reports.▶ Procedures are established to identify required supplemental schedules and determine that they are presented in accordance with the rules and regulations of appropriate authorities.
Journal entries made are authorized.	<ul style="list-style-type: none">▶ Journal entries are adequately approved by a responsible official.

REPORTING

Specific Objectives	Examples of Selected Controls
Accounting policies, including selections from among alternative principles, are adopted as authorized.	▶ Responsibility is assigned for approval of accounting policies.
Direct and indirect access to the plan's records are controlled to protect against physical hazards and prevent or detect on a timely basis unauthorized entries.	▶ Critical forms are prenumbered and controlled before and after issuance. ▶ Record files are maintained in a controlled area with a suitable retention program. ▶ Information pertinent to plan activities is identified and prepared for analysis.

GENERAL COMPUTER CONTROLS (IN-HOUSE SYSTEM OR SERVICE ORGANIZATION)

Specific Objectives	Examples of Selected Controls
Changes to application system programs are authorized, tested, reviewed and approved prior to implementation in the production environment, and system modifications are properly documented.	▶ Segregation of duties among end users, programmers, quality assurance, library management, and production operations and support personnel is maintained throughout the program change management and development process. ▶ Separate computer environments for application development and maintenance, quality assurance testing, and production processing are maintained. Programmers and quality assurance personnel are restricted from directly modifying production source and executable code.

GENERAL COMPUTER CONTROLS (IN-HOUSE SYSTEM OR SERVICE ORGANIZATION)

Specific Objectives

Examples of Selected Controls

- ▶ Program code is moved to the production processing environment by library management personnel after approval by quality assurance and management personnel.

Development, implementation and maintenance of information systems follow a defined systems development life cycle methodology that contains management's philosophy, guidelines and direction in developing, acquiring and maintaining application systems.

- ▶ A system development life cycle methodology exists and is followed.

Physical access to the computer facility containing hardware, peripherals, communications equipment, backup media, and sensitive output and forms is restricted to authorized personnel.

- ▶ Formal procedures for granting and terminating access to company facilities, including computer centers, exist and are followed.
- ▶ Physical access to blank check stocks, printers and signature fonts is restricted to authorized personnel. Check logs are used to confirm checks printed and numbers used.

Logical access security is administered and maintained according to management's intentions and authorization.

- ▶ Access to the system is granted to individuals by security administration personnel based on written request for such authorization.
- ▶ Access rights to terminated or transferred employees are removed or modified timely by the security administration personnel based upon written request from authorized management.

GENERAL COMPUTER CONTROLS (IN-HOUSE SYSTEM OR SERVICE ORGANIZATION)

Specific Objectives

Examples of Selected Controls

Access to computer resources, such as application programs, data files, sensitive utilities and system commands, is limited to authorized individuals.

- ▶ Access to the system is granted to each user via a unique user identification number and password.
- ▶ Access to systems is limited based upon job responsibilities.
- ▶ The ability to modify application-executable programs and production data files is limited to authorized individuals.

Remote access to dial-up system is established for authorized individuals, plan administrators and participants.

- ▶ The voice response system and Internet and intranet access is limited to authorized participants through the use of specific identification and a personnel identification number. Invalid attempts to access and perform functions are rejected and transferred to an assigned representative.

Critical processing activities can be continued or restored to an acceptable level without prolonged delay or loss of service in the event of disruption.

- ▶ Master files and transaction files are stored off-site to allow re-creation of the master file.
- ▶ Contingency plans have been developed for alternative processing.
- ▶ Disaster recovery plans have been developed and tested for adequacy.

EXAMPLES OF USER CONTROLS WHEN A SERVICE ORGANIZATION IS UTILIZED

Specific Objectives

Examples of Selected Controls

Investments

Controls should provide reasonable assurance that the appropriate asset purchases or redemptions are made as a result of contributions, disbursements or other changes.

- ▶ Quarterly and annual plan reports are provided to participants. Reports should be reviewed by the participant for accuracy of dividends and capital gains processing. Plan administrators should have procedures in place to timely follow up on all reconciling items.

Contributions Received and Related Receivables and Participant Loans

Controls should provide reasonable assurance that contributions are adequately safeguarded upon receipt and processed in a timely manner by authorized individuals.

- ▶ Confirmation notices and quarterly statements are provided to plan administrators and participants. These individuals have procedures in place for reviewing these documents on a timely basis for accuracy and completeness. Plan administrators should have procedures in place to timely follow up on all reconciling items.
- ▶ Plan administrators should have policies and procedures in place that provide reasonable assurance that the confidentiality of their password is maintained, and access to the recordkeeping software is limited to authorized personnel.

EXAMPLES OF USER CONTROLS WHEN A SERVICE ORGANIZATION IS UTILIZED

Specific Objectives

Examples of Selected Controls

Controls should provide reasonable assurance that contribution remittances are applied to the appropriate plan and participant accounts and processed accurately and completely by money type (that is, contributions vs. loan repayments) according to the investment options selected by the participant.

- ▶ Confirmation notices (that is, turnaround documents) and quarterly statements are provided to plan administrators and participants. These individuals should have procedures in place for reviewing these documents on a timely basis for accuracy and completeness.
- ▶ Plan administrators should have policies and procedures in place that provide reasonable assurance that their input into the recordkeeping system is accurate and complete. Plan administrators should have procedures in place to timely follow up on all reconciling items.

Benefit Payments, Claims and Distributions

Controls should provide reasonable assurance that disbursements and related transactions (for example, benefits, claims, participant loans, hardship withdrawals and forfeitures) are authorized and valid.

- ▶ The plan administrator should have procedures in place that provide reasonable assurance that any disbursement requests are authorized and in compliance with the plan provisions.

EXAMPLES OF USER CONTROLS WHEN A SERVICE ORGANIZATION IS UTILIZED

Specific Objectives

Examples of Selected Controls

Controls should provide reasonable assurance that disbursements and related transactions are recorded and processed accurately, completely and on a timely basis.

- ▶ The plan administrator should have procedures in place to provide reasonable assurance that the information communicated to the recordkeeper regarding participant loans, hardship withdrawals, and forfeitures is complete and accurate, that amounts forfeited or disbursed are properly calculated in accordance with the plan instrument, and unused forfeitures are disposed of timely and in accordance with the plan instrument.
- ▶ Confirmations and quarterly statements are provided to participants and plan administrators. Participants and plan administrators should have procedures in place for reviewing confirmations and quarterly statements on a timely basis for accuracy and completeness. Plan administrators should have procedures in place to timely follow up on all reconciling items.

Participant Data

Controls should provide reasonable assurance that all additions and modifications to plan information are authorized and recorded and processed completely, accurately and on a timely basis.

- ▶ Confirmation notices are provided to participants to confirm accuracy of additions and modifications of data. Plan administrators should have procedures in place to timely follow up on all discrepancies.
- ▶ Confirmations are reviewed by the participant.

EXAMPLES OF USER CONTROLS WHEN A SERVICE ORGANIZATION IS UTILIZED

Specific Objectives

Examples of Selected Controls

Controls should provide reasonable assurance that participant data is recorded and processed accurately, completely, and on a timely basis and that modifications to participant data are valid and authorized.

- ▶ Confirmation notices are generated and provided to participants to review the completeness and accuracy of information entered into the recordkeeping system. Plan administrators should have procedures in place to timely follow up on all discrepancies.
- ▶ Participants have procedures in place for regularly reviewing the completeness and accuracy of information included on the confirmation notices and communicating any discrepancies to the plan administrator or recordkeeper on a timely basis.
- ▶ Plan administrators should have control policies and procedures in place that provide reasonable assurance that employees are eligible, authorized and valid participants before submitting employee application forms to the recordkeeper or enrolling employees through online access.

Controls should provide reasonable assurance that participant-initiated transfers, changes in investment allocations and other changes are authorized and valid.

- ▶ Confirmations and quarterly statements are provided to participants and plan administrators. Participants and plan administrators should have procedures in place for reviewing confirmations and quarterly statements on a timely basis for accuracy and completeness. Plan administrators should have procedures in place to timely follow up on all reconciling items.

EXAMPLES OF USER CONTROLS WHEN A SERVICE ORGANIZATION IS UTILIZED

Specific Objectives

Examples of Selected Controls

Controls should provide reasonable assurance that participant-initiated transfers, changes in investment allocations, and other changes are processed accurately, completely and on a timely basis.

- ▶ Confirmations and quarterly statements are provided to participants and plan administrators. Participants and plan administrators should have procedures in place for reviewing confirmations and quarterly statements on a timely basis for accuracy and completeness. Plan administrators should have procedures in place to timely follow up on all reconciling items.

Reporting

Controls should provide reasonable assurance that the annual plan reports are complete, accurate and generated on a timely basis.

- ▶ Quarterly statements and annual plan reports are provided to plan administrators. Plan administrators should have procedures in place for reviewing these documents on a timely basis for accuracy and completeness and notifying the recordkeeper of errors or discrepancies in a timely manner.

Controls should provide reasonable assurance that accurate plan data is available to provide accurate results when annual testing is performed.

- ▶ Plan administrators should have procedures in place that provide reasonable assurance that plan data (census and compensation) are communicated accurately and on a timely basis to the recordkeeper.

Controls should provide reasonable assurance that access to computer resources, such as application programs, data files, sensitive utilities and system commands, is limited to authorized individuals.

- ▶ Plan administrators should have policies and procedures in place that provide reasonable assurance that the confidentiality of their password is maintained, and access to the software is limited to authorized personnel.

EXAMPLES OF USER CONTROLS WHEN A SERVICE ORGANIZATION IS UTILIZED

Specific Objectives

Controls should provide reasonable assurance that remote access to recordkeeping systems is established for authorized individuals and customers.

Examples of Selected Controls

- ▶ Policies and procedures should be designed and implemented at user organizations to provide reasonable assurance that access to the recordkeeping system's hardware, software, voice response system and password is granted only to authorized individuals.

EXAMPLES OF CONTROLS RELATED TO HEALTH AND WELFARE CLAIMS

Specific Objectives

Claims are recorded at the appropriate amount and in the appropriate period.

Examples of Selected Controls

- ▶ Periodic vendor history claim reports (biweekly or weekly) are reconciled to reimbursement paid to the third-party service provider.
- ▶ Subsequent third-party service provider claim history reports are reviewed and compared with recorded claims obligation.
- ▶ Periodic targeted claims audits are performed to determine proper adjudication of individual claims.
- ▶ Subsequent third-party service provider history reports are reviewed for vendor rebates, reimbursements and refunds to provide proper monitoring and reporting.
- ▶ Review third-party service provider reports for stop-loss reporting.

EXAMPLES OF CONTROLS RELATED TO HEALTH AND WELFARE CLAIMS

Specific Objectives	Examples of Selected Controls
	<ul style="list-style-type: none"> ▶ Logs are maintained and tracked for recovery follow-up opportunities: <ul style="list-style-type: none"> • Overpayments (may receive an initial request with follow-ups based on a dollar threshold): <ul style="list-style-type: none"> - Claim adjustments - Retroactive eligibility termination • Third-party liability (may require periodic follow-up, and plan administrator may ultimately settle for lesser amounts): <ul style="list-style-type: none"> - Subrogation - Workers' compensation
Claims are determined and authorized in accordance with the plan instrument.	<ul style="list-style-type: none"> ▶ Changes in participant eligibility are reviewed (change history reports provided by third-party service provider). ▶ Eligibility lists are approved for employees, retirees and dependents. ▶ Review plan setup with third-party service provider, including rates and allowable claims and comparison of benefit formulas with the plan document. ▶ Eligibility reconciliation process is reviewed (including review of retroactive terminations).
Claims payments are valid.	<ul style="list-style-type: none"> ▶ Plan installation is reviewed with the third-party service provider to determine that key benefit provisions, participant information, providers and rate structure set-up are accurate.

EXAMPLES OF CONTROLS RELATED TO HEALTH AND WELFARE CLAIMS

Specific Objectives	Examples of Selected Controls
	<ul style="list-style-type: none"> ▶ Authorized individuals communicate changes to significant provisions to applicable third parties on a timely basis (for example, participant copays and deductibles). ▶ Contract rates and provider information are reviewed to determine that they are updated completely, accurately and timely.
Claim payments are recorded and processed accurately, completely and on a timely basis.	<ul style="list-style-type: none"> ▶ For both electronic and manually adjudicated claims, a third-party service provider type 2 SOC 1 (service organization control 1) report is obtained and reviewed to determine if it covers key controls over processes, such as: <ul style="list-style-type: none"> • Eligibility. Patient eligibility on the date of service • Provider. Proper provider identified for payment and network affiliation • Covered Expense. This includes timeliness of claim submission, signs of unbundling or upcoding on itemized bills, medical necessity and eligibility of expense under plan, consistency of diagnosis and procedure with age and sex of patient, consistency of services rendered with diagnosis and provider's license, opportunity for coverage availability through workers' compensation and third-party liability or other group coverage

EXAMPLES OF CONTROLS RELATED TO HEALTH AND WELFARE CLAIMS

Specific Objectives

Examples of Selected Controls

- **Benefit Calculations.** This includes accuracy of procedure codes; units of service and amount billed entered into claims processing system correctly; proper application of provider discount for network affiliations; reasonable and customary allowances applied to non-network claims; application of cost-containment penalties for failure to obtain precertification or second surgical opinion; application of deductibles (individual or family); adjustment for appropriate coinsurance level and application of maximums for type of benefit
- ▶ Controls over electronic data interchanges are maintained to provide complete and accurate data transmission between the plan sponsor, claims processor, providers and other vendors.
- ▶ Applications that provide for review of eligibility, benefit amounts, or plan compliance require approval.
- ▶ Access to computerized benefit payment records is limited to those with logical need for such access.
- ▶ Type 2 SOC 1 reports are reviewed for controls over edit checks of claim processing and reconciliation and appropriate follow-up occurs.
- ▶ Quality control reviews are performed to determine that eligibility, covered services, coordination of benefits and bundling are proper.

EXAMPLES OF CONTROLS RELATED TO HEALTH AND WELFARE CLAIMS

Specific Objectives	Examples of Selected Controls
	<ul style="list-style-type: none">▶ Access to records is controlled to prevent unauthorized transactions.▶ Reconciliations are performed on a periodic and timely basis to prevent and detect unauthorized or duplicate payments.
<i>Administrative Expenses</i>	
Administrative expenses are recorded at the appropriate amount, in appropriate period, and on a timely basis and are properly reported in the financial statements.	<ul style="list-style-type: none">▶ Administrative expenses reported by the third-party service provider are reviewed to determine if the expenses are in accordance with the service provider agreement.
Plan expenses are in accordance with plan document and authorized by plan sponsor.	<ul style="list-style-type: none">▶ Administrative services are described in plan instrument.▶ Expenses are approved by authorized individual.▶ Responsibilities for expense approval and processing are adequately segregated.



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