

PLAN ADVISORY

# The Importance of Internal Controls in Financial Reporting and Safeguarding Plan Assets



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## 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:*

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- Why internal control is important to your plan
  - The basics of internal control
  - How to establish cost-effective controls
  - Monitoring your controls
  - Auditor communications of internal control deficiencies
  - How your 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 at 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 responsibilities, and with these fiduciary responsibilities come potential liability: Fiduciaries that 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 at 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.

Effective controls reduce the risk of asset loss, and help ensure that plan information is complete and accurate, financial statements are reliable, and laws and regulations are complied with. 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.

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.

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# 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 barriers 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 comprehensive framework for internal control, and can be a valuable resource to you in setting up your plan's internal control.

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# How to Establish Cost-Effective Controls

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

Controls should be based on a systematic and risk-oriented approach, to ensure that there are adequate controls in areas with high risk, and that controls 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

**DETERMINE YOUR PLAN'S CONTROL OBJECTIVES** — The first step in establishing controls over financial reporting at your plan is to determine the objectives of the controls, or what you want them to achieve: reliable financial statements that are prepared in accordance with generally accepted accounting principles. Controls should be designed to address financial statement assertions inherent in the various components of the plan's financial statements, such as plan investments, contributions, benefits, participant data and plan obligations, participant loans and administrative expenses. Assertions can be classified according to the following broad categories.<sup>1</sup>

- **Existence or occurrence.** 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.
- **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.

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<sup>1</sup> These assertions are consistent with the COSO framework. You also may want to consider the assertions included in AICPA Statement on Auditing Standards (SAS) No. 106, *Audit Evidence*.

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- **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 plan 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 other entity.
  - **Valuation or allocation.** Are assets and liabilities valued properly? Are costs allocated reasonably among time periods? For example, investments must be reported at fair value, and administrative expenses for the current year should not be reported next year, even if that is when they are paid.
  - **Presentation and disclosure.** Are transactions recorded in the proper accounts? Is each particular component of the financial statements accurately classified, described, and disclosed? 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 "presentation and disclosure" assertion related to administrative expenses would be that the control helps ensure that expenditures for administrative expenses are not mistakenly recorded as benefit payments.

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## **ESTABLISH, DOCUMENT AND COMMUNICATE YOUR INTERNAL CONTROLS —**

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 controls remains with you, you may wish to consult your 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 third-party service providers — 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 third-party service provider 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 third-party service provider 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 only effective when properly designed and operating as intended, you need to monitor the quality of your internal control's



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performance over time. Effective monitoring helps ensure that your internal controls continue to provide the protections you envisioned.

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 internal controls in place and operating? Establishing policies and procedures will have no effect if they are not implemented.
- 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 third-party service providers, it is important that those service providers maintain adequate internal controls over the transactions processed on behalf of your plan. You should be aware that the hiring of a service provider 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 provider 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 their third-party service providers.



## 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.

SAS No. 112 (SAS is an acronym for AICPA Statement on Auditing Standards), which all plan auditors are required to follow, requires that “significant deficiencies” and “material weaknesses” (as defined in the standard) 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.

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 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 provider 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 internal controls are not functioning effectively

Essentially, the nature and severity of the deficiency will dictate whether it is a 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

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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 auditor, it likely would be considered a material weakness. You may wish to be proactive and contact your auditor to inquire about the communication requirement and whether your plan should expect to receive a SAS No. 112 letter, what control deficiencies the 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 Auditor Can Help You Improve the Effectiveness of Your Plan's Internal Control

Remember, although you are responsible for establishing internal controls at your plan, your 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 auditor also can help with the financial statement preparation. You should be aware, however, that Department of Labor and AICPA auditor independence rules<sup>2</sup> 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 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 might signal a potential control deficiency that would need to be reported to you as discussed in the section "Auditor Communications of Internal Control Deficiencies," above. However, such a deficiency only exists if the plan does not*

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<sup>2</sup> 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.

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*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.]*

It is important to keep in mind that your auditor, under his or her professional standards, *cannot* be a part of your plan's internal control. What your plan auditor does or does not do for the plan — either as part of the audit or a separate non-audit (nonattest) services engagement — is not directly 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 and be performed by duly authorized plan personnel who are capable of performing the control activities. For example, the plan can use its auditor to assist in identifying adjusting entries and drafting the financial statements and footnote 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. If the designated employee does not review the year-end adjustments and drafts of the plan's financial statements in sufficient detail to prevent, detect and correct a material misstatement, a control deficiency in internal control over financial reporting exists.

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 auditor to assist you with the process, because a CPA firm other than your auditor *can* be a part of your plan's internal control.

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## **Additional Resources:**

***The COSO Web Site*** provides detailed information to help you better understand internal controls and their importance in ensuring complete and accurate financial reporting by your plan. Especially useful is the four-volume report entitled *Internal Control Over Financial Reporting — Guidance for Smaller Public Companies*. While it is directed at public companies, the guidance is useful for other entities, including plans. It includes a high-level summary, an overview of internal control over financial reporting, evaluation tools and working tools. Visit the COSO Web Site at <http://www.coso.org/>.

***The AICPA Audit and Accounting Guide, Employee Benefit Plans (the Guide)***, describes considerations auditors make relative to your internal controls in their plan audits. The Guide is available on the AICPA's Web site at <http://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 third-party service providers. That document is available on the Center Web Site at <http://ebpaqc.aicpa.org>.

***SAS No. 70 Reports and Employee Benefit Plans*** may serve as a useful tool in monitoring internal controls at your third-party service providers. This publication is available on the AICPA's Web Site at <http://www.cpa2biz.com>.

***The EBPAQC Web Site*** includes information that may help you better understand SAS No. 112 and how it may affect your plan. That information can be found under the "Resources" tab at <http://ebpaqc.aicpa.org>.

# Examples of Selected Controls for Employee Benefit Plans

[Source: American Institute of Certified Public Accountants *Audit and Accounting Guide Employee Benefit Plans* (Appendix B)]

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 a plan’s financial statements. It also includes examples of user controls that might be implemented when significant plan operations are performed by a service organization. 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.

EXAMPLES OF SELECTED CONTROLS FOR EMPLOYEE BENEFIT PLANS	
<b>Investments</b>	
<p><b>SPECIFIC OBJECTIVES</b></p> <p>Investment transactions are recorded at the appropriate amounts and in the appropriate periods on a timely basis.</p>	<p><b>EXAMPLES OF SELECTED CONTROLS</b></p> <ul style="list-style-type: none"> <li>■ Reports submitted by trustees/asset custodians or investment managers are reviewed.</li> <hr/> <li>■ Detailed subsidiary records are reconciled to trust reports on a regular basis.</li> <hr/> <li>■ Control totals from participant’s records are compared to control totals from trust reports on a regular basis. Report of trustee’s/asset custodian’s independent auditor is reviewed.</li> <hr/> <li>■ Purchases and Sales (as a result of contributions, distributions, etc.) of mutual funds are reviewed to determine that the net asset value agrees to published quotations.</li> <hr/> <li>■ Purchases and Sales are reviewed to determine that the appropriate fair value was utilized.</li> <hr/> <li>■ Commissions and management fees are reviewed for appropriateness and adherence to the contract.</li> </ul>
<p>Investment income and expenses are recorded at the appropriate amount and in the appropriate period on a timely basis.</p>	

## EXAMPLES OF SELECTED CONTROLS FOR EMPLOYEE BENEFIT PLANS

	<ul style="list-style-type: none"> <li>■ Interest, dividends, and other sources of income, including securities lending fees, are reviewed for receipt and for accuracy by reference to reliable sources.</li> </ul>
<p>Investments (other than insurance contracts with insurance companies) are measured at fair value.</p>	<ul style="list-style-type: none"> <li>■ If income is allocated to more than one plan or participant accounts, allocation methods and calculations are reviewed.</li> <li>■ Quotation sources and appraisal reports are compared with recorded values.</li> <li>■ Pooled separate accounts and common collective trusts are compared to net asset values calculated by the issuer.</li> <li>■ Financial statements of pooled separate accounts and common collective trusts are obtained and unit information contained in the financial statements is compared for reasonableness to the unit values reported to the plan.</li> <li>■ Valuation methods are documented in the trust agreement or plan committee minutes.</li> <li>■ Basis for “good faith” estimates including independent appraisals, if any, is documented.</li> <li>■ “Good faith” estimates are approved by plan committee.</li> </ul>
<p>Premiums and interest relating to insurance contracts are recorded at the appropriate amount and in the appropriate period on a timely basis.</p>	<ul style="list-style-type: none"> <li>■ Premium statements are compared with insurance contracts.</li> <li>■ Interest amount calculation is tested.</li> <li>■ List of current participants is reviewed.</li> </ul>
<p>Investment criteria and objectives are authorized and executed in accordance with formal authorizations.</p>	<ul style="list-style-type: none"> <li>■ Investment criteria or objectives are documented in the plan instrument or plan committee minutes.</li> <li>■ Authority to execute transactions is specified in the plan instrument or plan committee minutes.</li> </ul>

## EXAMPLES OF SELECTED CONTROLS FOR EMPLOYEE BENEFIT PLANS

Investment assets are protected from loss or misappropriation.

- Investment transactions are reviewed by a plan committee for adherence to investment guidelines.
- Responsibility for investment decisions and transactions is segregated from custodian's functions.
- Financial stability of financial institutions holding investments is reviewed.
- Securities that are physically held (e.g., by a custodian or depository) are periodically counted or otherwise verified.
- Written-off investments are reviewed for possible appreciation.
- Documents are controlled in a limited-access, fireproof area.
- Securities held by independent custodians are confirmed.
- Access to computerized investment records is limited to those with a logical need for such access.
- The custodial function is separate from the responsibility for investment decisions, transactions and recordkeeping.

Obligations under insurance companies' insurance contracts can be met.

- Financial statements of insurance companies are reviewed.
- Rating bureau reports are reviewed.

For deposits with insurance companies, terms of insurance contracts are authorized.

- Terms are specified in the plan instrument.
- Modifications of contracts are approved by the plan committee.

## Contributions Received and Related Receivables and Participant Loans

### SPECIFIC OBJECTIVES

Amounts of contributions by employers and participants meet authorized or required amounts.

### EXAMPLES OF SELECTED CONTROLS

- Contribution requirements or limitations are described in the plan instrument or collective bargaining agreement.



## EXAMPLES OF SELECTED CONTROLS FOR EMPLOYEE BENEFIT PLANS

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

- Contributions are determined using approved eligibility lists.

- Actuary is used to make periodic valuations and reports.

- Sponsor or employer payroll records are compared with contribution calculations. In the case of multi-employer plans, some form of periodic payroll audit is performed.

- Initial controls are established over contribution records for both employer and participant contributions (e.g., salary reduction amounts, after tax and rollovers).

- Clerical accuracy of contribution forms is checked.

- Subsidiary contribution records are reconciled to the trustee/asset custodian or 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.

- Participant contributions are remitted to the trust within guidelines prescribed by Department of Labor regulation.

Loans receivable from plan participants and related interest income are properly reported.

- Loans are made only with proper authorization based on guidelines established in the plan instrument in conformance with ERISA and tax requirements.

- Entries to detailed loan records are reconciled with cash disbursements and receipts records.

- Interest income is periodically calculated in accordance with rates established in the plan instrument and properly accrued.

## EXAMPLES OF SELECTED CONTROLS FOR EMPLOYEE BENEFIT PLANS

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.

- Detailed records maintained by third-party administrator are reconciled with trustee's/asset custodian's reports.
- Records are periodically reviewed for past-due amounts.
- Cash is independently controlled upon receipt.
- Cash receipts are deposited intact daily.
- Checks are restrictively endorsed upon receipt.
- Responsibility for receiving and processing contributions is adequately segregated.
- Bank accounts are reconciled monthly.
- Past-due contributions are investigated on a timely basis.
- 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 applications.
- Amounts are compared with plan or insurance company records.
- Control totals for monthly pension benefits are maintained.
- Participants or beneficiaries are notified of their right to have denied claims reviewed.
- Initial controls are established over the maximum contributions allowed under tax

## EXAMPLES OF SELECTED CONTROLS FOR EMPLOYEE BENEFIT PLANS

	<p>regulations and corrective distributions made as required by tax regulations.</p> <ul style="list-style-type: none"> <li>■ Initial controls are established over hardship withdrawals and documentation is maintained that supports the withdrawal request, authorization, amount and adherence to related tax regulations.</li> <li>■ If required by the plan agreement, participants making hardship withdrawals do not make any contributions to any plan during the 12 months following the withdrawal.</li> <li>■ Initial controls are established over forfeitures and utilization/allocation of forfeitures is made in accordance with the plan agreement.</li> </ul>
<p>Payments are determined and authorized in accordance with the plan instrument.</p>	<ul style="list-style-type: none"> <li>■ Changes in participant eligibility are approved by the plan committee.</li> <li>■ Eligibility lists are approved.</li> <li>■ Signed application forms or other authorized procedures (i.e., endorsed checks) are used.</li> <li>■ Applications that provide for review of eligibility, benefit amounts, or plan compliance require approval.</li> </ul>
<p>Participant's benefit and cash disbursement records are controlled to prevent or detect on a timely basis unauthorized or duplicate payments.</p>	<ul style="list-style-type: none"> <li>■ Responsibilities for benefit approval, recording of benefits, and maintenance of participant files are adequately segregated.</li> <li>■ Blank forms are pre-numbered and effectively controlled.</li> <li>■ Periodic correspondence with retired beneficiaries is maintained, and correspondence or payments are returnable to plan committee if undeliverable.</li> <li>■ Check endorsements are compared with signature in applicable participant records.</li> <li>■ Supporting documents are effectively canceled on payment.</li> </ul>

## EXAMPLES OF SELECTED CONTROLS FOR EMPLOYEE BENEFIT PLANS

- Access to computerized benefit payment records is limited to those with a logical need for such access.

### Participant Data (and Plan Obligations)

#### SPECIFIC OBJECTIVES

Participant data are properly recorded on a timely basis.

#### EXAMPLES OF SELECTED CONTROLS

- Participant forms (e.g., enrollment, transfers, investment allocation, etc.) are controlled and are 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 employers' personnel and payroll records (or participating employers in a multi-employer plan).
- Account balances and benefit data are furnished to participants on written request.
- Plan committee or responsible officials discuss with the actuary the actuarial methods and significant assumptions that are the basis for actuarial calculations.
- 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 to historical claims lag reports on a periodic basis.

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

Accumulated benefit or benefit obligation amounts and other actuarially determined information are periodically determined and recorded in the plan's records at the appropriate amounts.

## EXAMPLES OF SELECTED CONTROLS FOR EMPLOYEE BENEFIT PLANS

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.

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 multi-employer 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 by submitting a manually signed request form. 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.
- Written confirmations are sent to participants for participant-initiated account activity.

### Administrative Expenses

#### SPECIFIC OBJECTIVES

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

#### EXAMPLES OF SELECTED CONTROLS

- Expenses are compared to contracts and to disbursements.
- If expenses are allocated to more than one plan, investment or fund, allocation methods and calculations are reviewed.

## EXAMPLES OF SELECTED CONTROLS FOR EMPLOYEE BENEFIT PLANS

Types of administrative services to be offered are authorized.

- Administrative services are described in the plan instrument.
- Expenses are approved by a responsible official.

Access to accounts payable and cash disbursements records is controlled to prevent or detect on a timely basis unauthorized or duplicate payments.

- Responsibilities for expense approval and processing are adequately segregated.
- Supporting documents are effectively canceled on payment.

### Reporting

#### SPECIFIC OBJECTIVES

Records are maintained in sufficient detail to provide for proper and timely reconciliation.

#### EXAMPLES OF SELECTED CONTROLS

- For defined benefit plans, subsidiary ledgers are reconciled with the trustee's/asset custodian's reports on a periodic and timely basis.
- For defined contribution plans, the total of all participant account balances is reconciled to the net assets in the trustee's/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.

- Procedures are established to identify required disclosure items, for example, party in interest transactions and transactions in excess of 5 percent of plan assets.
- 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

## EXAMPLES OF SELECTED CONTROLS FOR EMPLOYEE BENEFIT PLANS

	accordance with the rules and regulations of appropriate authorities.
Journal entries made are authorized.	<ul style="list-style-type: none"> <li>Journal entries are adequately approved by a responsible official.</li> </ul>
Accounting policies, including selections from among alternative principles, are adopted as authorized.	<ul style="list-style-type: none"> <li>Responsibility is assigned for approval of accounting policies.</li> </ul>
Direct and indirect access to the plan's records is controlled to protect against physical hazards and to prevent or detect on a timely basis unauthorized entries.	<ul style="list-style-type: none"> <li>Critical forms are pre-numbered and controlled before and after issuance.</li> <li>Record files are maintained in a controlled area with a suitable retention program.</li> <li>Information pertinent to plan activities is identified and prepared for analysis.</li> </ul>

### General Computer Controls (In-house system or service organization)

#### SPECIFIC OBJECTIVES

Changes to application system programs are authorized, tested, reviewed and approved prior to implementation in the production environment, and system modifications are properly documented.

#### EXAMPLES OF SELECTED CONTROLS

- Segregation of duties between 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.
- Program code is moved to the production processing environment by library management personnel after approval by quality assurance and management personnel.
- A system development life-cycle methodology exists and is followed.

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.

## EXAMPLES OF SELECTED CONTROLS FOR EMPLOYEE BENEFIT PLANS

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 center, 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 in a timely manner by the security administration personnel based upon written request from authorized management.

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 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/intranet access is limited to authorized participants via 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 recreation 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

### Investments

#### SPECIFIC OBJECTIVES

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

#### EXAMPLES OF SELECTED CONTROLS

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

### Contributions Received and Related Receivables and Participant Loans

#### SPECIFIC OBJECTIVES

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

#### EXAMPLES OF SELECTED CONTROLS

- Confirmation notices (i.e., turnaround documents) and quarterly statements are mailed 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 for timely follow-up on all reconciling items.
- Plan administrators should have in place policies and procedures that provide reasonable assurance that the confidentiality of their password is maintained and access to the recordkeeping software is limited to authorized personnel.

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 (i.e., contributions vs. loan repayments) according to the investment options selected by the participant.

- Confirmation notices (i.e., turnaround documents) and quarterly statements are mailed 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 in place policies and procedures that provide reasonable assurance that their input into the recordkeeping system is accurate and complete. Plan administrators should have procedures in place for timely follow-up on all reconciling items.

## EXAMPLES OF USER CONTROLS WHEN A SERVICE ORGANIZATION IS UTILIZED

### Benefit Payments, Claims and Distributions

#### SPECIFIC OBJECTIVES

Controls should provide reasonable assurance that disbursements and related transactions (e.g., redemptions, forfeitures) are authorized and valid.

#### EXAMPLES OF SELECTED CONTROLS

- The plan administrator should have in place procedures that provide reasonable assurance that disbursement requests are authorized and in compliance with the plan provisions.
- The plan administrator informs the recordkeeper in writing if any disbursement amounts are to be forfeited. The plan administrator should have in place procedures that provide reasonable assurance the information communicated to the recordkeeper is complete and accurate.

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

- The plan administrator informs the recordkeeper in writing if any disbursement amounts are to be forfeited. The plan administrator should have in place procedures that provide reasonable assurance the information communicated to the recordkeeper is complete and accurate.
- Confirmations and quarterly statements are sent to participants and plan administrators. Participants and plan administrators should have in place procedures for reviewing confirmations and quarterly statements on a timely basis for accuracy and completeness. Plan administrators should have procedures in place for timely follow-up on all reconciling items.

### Participant Data (and Plan Obligations)

#### SPECIFIC OBJECTIVES

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

#### EXAMPLES OF SELECTED CONTROLS

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

## EXAMPLES OF USER CONTROLS WHEN A SERVICE ORGANIZATION IS UTILIZED

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 mailed to participants to review the completeness and accuracy of information entered into the recordkeeping system. Plan administrators should have procedures in place for 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 in place control policies and procedures 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 sent 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 for timely follow-up on all reconciling items.

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 sent 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 for timely follow-up on all reconciling items.

## EXAMPLES OF USER CONTROLS WHEN A SERVICE ORGANIZATION IS UTILIZED

### Reporting

#### SPECIFIC OBJECTIVES

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

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

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.

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

#### EXAMPLES OF SELECTED CONTROLS

- Quarterly statements and annual plan reports are sent to plan administrators. Plan administrators should have procedures in place for reviewing these documents on a timely basis for accuracy and completeness.
- Plan administrators should have in place procedures that provide reasonable assurance that plan data (census and compensation) are communicated accurately and on a timely basis to the recordkeeper.
- Plan administrators should have in place policies and procedures that provide reasonable assurance that the confidentiality of their password is maintained and access to the software is limited to authorized personnel.
- 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.

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