Pension Plan Fix-It Handbook

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The Devil Is in the Details: The Importance of Procedures and Controls

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Your eyes may be glazing over as you read the column title, but persevere and read on.

In the July newsletter, you read that a key to avoiding common retirement plan errors is establishing operational procedures and controls. A recent Mid-Atlantic IRS liaison meeting also addressed the importance of internal controls (and see sidebar, page 8).

The topic is important because the existence and use of procedures and controls will go a long way in helping you survive a government audit. Established practices and procedures are required to utilize the IRS VCP (Voluntary Correction Program) component of the the Employee Plans Compliance Resolution System (EPCRS, see ¶1110, ¶1111 and ¶1112 of the *Handbook*).

If you have recently endured or are still enduring a Form 5500 ERISA financial audit, you have been peppered with questions regarding the procedures and controls used in your plan's operations. In fact, you may be responding to your auditor's management letter comments when you receive this newsletter.

Why Should You Bother?

Outsourcing the administration of your plan doesn't get you off the hook: Plan fiduciaries are responsible for monitoring service providers (see ¶920). The DOL's reasonable contract final interim regulations (see the September newsletter) emphasizes the importance of knowing what you pay for, but you have to know what services are offered in order to understand what you are paying.

A recent IRS questionnaire sent to 1,200 401(k) plan sponsors includes questions regarding data, plan provisions and compliance testing results. The IRS is using the information it gathers to "maximize its resources for education, outreach, guidance and enforcement efforts while minimizing the burden to compliant plan sponsors." An added benefit for plan sponsors is the ability to correct any errors that may be found while completing the questionnaire. Although the questionnaire was specific to 401(k) plans, the types of data-related questions are applicable to all plans.

You may think, "I've outsourced the administration of my plan — that's their job." Well, not exactly.

Don't be lulled into a false sense of security by thinking:

- *I receive the SAS 70, and it looks detailed to me.* There are two types of SAS 70 reviews. Which do you receive? Do you read it? The SAS 70 provides a description of the procedures and controls of the organization that you selected to service your plan, but it doesn't provide a description of the internal controls and procedures within your company.
- *I receive an administration manual, and looks pretty comprehensive.* You have written procedures and controls, but how frequently do you monitor them? Do the procedures and controls work? Do they have to be tweaked to reflect internal system or regulatory changes? Have you had turnover or downsizing?

  Administrative procedures are valuable if they are followed, efficient, reviewed periodically and updated to reflect regulatory changes. The quality/validity of the administrative process is only as good as the data that is sent to the administrator.

See *Controls*, p. 2

Controls *(continued from p. 1)*

Many ordinary devices around the home or office let you know when something is wrong by a beep or an alarm. What kind of alarm sounds when a plan operation procedure or control doesn't work?

Checks and Balances

It all boils down to knowing who does what and when they do it, and being able to prove they did it. If you have established a system of checks and balances to catch errors — for example, you have 500 plan participants and the data you give to the actuary indicates that you have 350 participants on the file — and someone actually reviews the data and discovers the errors, then congratulations, you have a data control. (See page 4 for a discussion of common plan errors.)

Let's take it a step further, you have 350 participants and you send the names of 350 participants to the actuary. How do you know you sent the correct 350 participants? Sounds pretty simple, but what happens when there is turnover, changes in vendor or changes to the internal system? Do the procedures and controls that worked before still work? Absent an internal review, does the actuary provide you with a data-discrepancy report that would catch the difference if you didn't?

Maybe you review your Form 5500 and see that there are 113 separated participants entitled to a deferred vested benefit and your benefits manager has a report that not only states that number but identifies the people! If your benefit manager moves on, can his or her replacement easily generate the report? Can the actuary?

Your Plan Environment

In assessing your plan's controls and procedures, can you answer the following questions?

- Who is responsible for what regarding plan administration?
- Are there clearly defined roles? Is there segregation of duties?
- Can you describe the process that interface hirings and terminations with the benefits programs?
- Are personnel records kept manually or are they computerized? A combination of both?
- How do you know that you have captured all service and compensation when calculating a benefit?
- How are plan controls communicated to new personnel in the event of turnover?
- What controls are in place to ensure that all benefits-related components of compensation are properly classified, captured and utilized in benefit calculations?

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These are all questions taken from the Employee Plans Team Audit (EPTA) Internal Control Questionnaire. You can expect to be asked these questions if you are subject to an IRS examination!

In conclusion, auditors — whether they are from the government or from your accounting firm — will ask general and pointed questions regarding the control environment in which your plan operates. They will assess the attitudes, awareness and actions of people charged with plan governance. Are you prepared to answer?