Legal Alert: Keeping a watchful eye on retirement plan auditors

By Frank Palmieri, Esq.
April 9, 2010

Most HR/benefits professionals are familiar with the concept of training the trainers. The Department of Labor recently introduced an initiative that practitioners refer to as auditing the auditors.

Gunning for errors

Under this program, DOL is issuing letters to accounting firms who perform audits for qualified retirement plans, requesting copies of work papers and management letters, typically referred to as the SAS 112 Letter, which stands for Statement of Financial Account Standards No. 112, Employer's Accounting for Postemployment Benefits.

Understanding the audit process and the DOL initiative is imperative to employers in making business decisions regarding qualified retirement plans.

Employers who maintain qualified retirement plans with more than 100 participants as of the beginning of any plan year are required to attach an accountant's opinion to the annual Form 5500 filing. The audit is not a comprehensive compliance review of a retirement plan.

Rather, it primarily is a financial audit to detect any financial improprieties. Although most auditing firms generally test eligibility, contributions, vesting, distribution and loans as a part of an audit, such actions are performed on a sampling basis.

Accordingly, many accounting firms don't identify administrative errors, such as use of the incorrect definitions of compensation for contributions or testing, even when they exist in qualified retirement plans. For an additional fee, most accounting firms and/or employee benefit consultants will also perform a more comprehensive compliance audit.

The purpose of these projects is to specifically detect errors in the administration of qualified retirement plans and to correct errors voluntarily or under the Voluntary Compliance Program as established under the Employee Plan Compliance Resolution System Program, as most recently announced in Revenue Procedure 2008-50, or the DOL Voluntary Fiduciary Program.

Audit results

The primary products from a retirement plan audit are the audited financial statements, accountant's opinion and footnotes. In addition to the audit report, accounting firms also issue a letter to management under SAS 112.

This letter will highlight issues identified on audit. Auditors will categorize comments as control deficiencies, significant deficiencies or a material weakness, which is the most severe operational deficiency. For example, an accounting firm may note that it observed employees being improperly excluded from participation in a plan. This would be a significant deficiency.

On the other hand, an accounting firm may believe that the human resources, finance and legal departments should better communicate changes in plan design. This would simply be a recommendation to improve procedures in the future.

Under the DOL initiative, accounting firms are being subpoenaed to provide copies of all management letters to the DOL where any significant deficiencies or material weaknesses may have occurred.

Therefore, what may have been intended as confidential communications between an accounting firm and an employer will now be turned over the DOL. The DOL is undertaking this initiative based upon its investigative authority under Section 504(a)(i) of ERISA. If an accounting firm refuses to turn over records, the DOL will issue a subpoena to obtain such records.

The important issue for employers is to carefully review the draft letters to management and to negotiate the classification of any deficiency. By explaining the reason certain errors have occurred, and how they have already been corrected, an accounting firm may be willing to downgrade an error from a significant deficiency to a control deficiency.

Paying attention

More importantly, if employers understand that management letters will be disclosed to the DOL, employers will be encouraged to consider the IRS and DOL programs to correct administrative errors.

In general, under the voluntary compliance program, insignificant errors may be fixed at any point in time. Significant errors may be corrected by the end of the second plan year following the year in which the error occurs. Thus, an error made in January 2009 can be corrected by Dec. 31, 2011, for a calendar year plan without any IRS filing.

Significant errors that are more than two years old may be corrected under the voluntary compliance program by filing an application with the IRS and paying the applicable user fee. User fees have dropped significantly from the original amnesty programs introduced by the IRS.

For small employers with between 51 and 100 participants, administrative errors may be fixed for a fee of $2,500. Larger employers with over 10,000 participants may pay a fee of $25,000 to fix errors.

As the audit season begins for the 2009 plan years, employers should carefully consider footnote disclosures in financial statements and management letters received from accounting firms. If necessary, voluntary compliance program applications may be filed with the IRS. For fiduciary breaches, employers may also consider the voluntary fiduciary program as sponsored by the DOL.

Bottom line: Failure to act when errors have already been communicated to the DOL is like playing cards with an open hand. No bluffing will work and all bets are off.

Accounting terms explained

Here is a summary of accounting terms under the Statement of Financial Accounting Standards No. 112, Employer's Accounting for Postemployment Benefits.

Control deficiency: When the design or operation of a control does not allow management or employees, in the normal course of performing their functions, to prevent or detect misstatements on a timely basis.

Significant deficiency: A deficiency, or a combination of deficiencies, in internal control over financial reporting that is less severe than a material weakness yet important enough to merit attention by those responsible for oversight of the plan's financial reporting.

Material weakness: A deficiency, or combination of deficiencies, in internal control over financial reporting such that there is a reasonable possibility that a material misstatement of the plan's financial statements will not be prevented or detected on a timely basis.

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