

Examples of Internal Control Communications for Employee Benefit Plans

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Contents

INTRODUCTION.....	3
EXAMPLE COMMENTS	3
Oversight of the Financial Reporting Process	3
Investments.....	4
Selecting, Monitoring, and Valuing Plan Investments	4
Securities Lending	5
Participant Loans	5
Bank Reconciliations	6
Participant Accounts	6
Monitoring	7
Contributions	7
Employee Contributions	7
Employer Contributions	10
Eligibility	10
Distributions	11
Benefit Payments	11
Vesting Matters.....	11
Third Party Service Providers	12
Monitoring and Review	12
Payroll/Personnel Records and Census Data	14
Maintaining Records.....	14
Demographic Data.....	15
Census Data.....	15
Other	15
Plan Fees	15
Parties-in-Interest	16

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INTRODUCTION

This non-authoritative document was prepared to assist Center members in preparing internal control communications to their employee benefit plan clients. It contains example comments that may be useful in preparing required communications of internal control related matters identified in your audits, management letters, and other internal control communications.

The examples contained herein have been taken from actual communications prepared by practitioners that have been edited to protect confidentiality. The company names used in the examples are fictitious. Any resemblance or similarities to real companies are entirely coincidental and beyond the intent of the Center.

These examples are for illustrative purposes only and should be modified for the individual circumstances of each engagement. For example, AU-C 265, *Communicating Internal Control Related Matters Identified in an Audit*, includes two new requirements:

- The auditor should communicate to management at an appropriate level of responsibility, on a timely basis in writing or orally, other deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention.
- The auditor should include in the written communication of significant deficiencies and material weaknesses an explanation of their potential effects.

As a result of the second new requirement above, the auditor may need to revise certain of these illustrative comments to add an explanation of the potential effects if the auditor determines the circumstances indicate that the deficiency is a significant deficiency or material weakness.

Although professional standards do not require the auditor to make recommendations for improving internal control, they do not preclude such recommendations. As such, many firms provide recommendations as a value-added service.

EXAMPLE COMMENTS

Oversight of the Financial Reporting Process

Establish internal control over financial statement preparation and review

Plan management is responsible for establishing and maintaining internal control and for the fair presentation of the net assets available for benefits, changes in net assets available for benefits, supplementary information, and disclosures in the financial statements, in conformity with U.S. generally accepted accounting principles (GAAP). The Plan does not have a system of internal control that would provide management with reasonable assurance that the Plan financial statements and related disclosures are complete and presented in accordance with GAAP. As such, management requested us to compile the trial balance from plan records and prepare a draft of the financial statements, including the related note disclosures.

Financial statement knowledge

During our audit, we noted that the client (e.g., the assistant controller or human resource supervisor) prepares the financial statements using the year-end trial balance provided by the recordkeeper. However, the trial balance prepared by the record keeper is not prepared on the accrual basis and it was necessary for the auditor to propose adjusting journal entries to record the contributions receivable and expenses payable at year-end. In addition, it was necessary for the auditor to propose a number of revisions to the notes to the financial statements (e.g. disclosure of effect of significant plan amendments, etc.) to enable the disclosures to be in accordance with generally accepted accounting principles. The client personnel do not appear to have the necessary knowledge and skill to prepare employee benefit plan financial statements in accordance with generally accepted accounting principles.

We recommend that the company utilize individuals from the corporate finance department with the requisite knowledge and skill in employee benefit plan generally accepted accounting principles to prepare the financial statements. In addition, we recommend that a current disclosure checklist from the AICPA be used to ensure propriety and completeness of the financial statement notes.

Financial statement knowledge (2)

During our audit, we noted that the Plan employs competent individuals who understand the Plan's operations and its challenges. Personnel record the day-to-day transactions of the Plan in a consistent manner, but they are not as proficient in applying and implementing complex accounting guidance. As a result, it was necessary for us to propose a number of adjusting journal entries and prepare the Plan's financial statements in accordance with accounting principles generally accepted in the United States of America, including the appropriate note disclosures. It appears that the Plan does not currently require personnel to have the industry-specific training, knowledge and level of skill needed to prepare its financial statements. The potential effect of this control deficiency is that a misstatement or omission in the financial statements would not be prevented, detected or corrected on a timely basis. We recommend that Plan management evaluate the situation. Management should consider the current capabilities of employees and the amount of additional expense the Plan would incur as a result of training or hiring individuals with the necessary skills or knowledge to produce financial statements including note disclosures.

Investments

Selecting, Monitoring, and Valuing Plan Investments

Plan management controls related to hard-to-value investments

During our audit we noted that the plan invests in alternative investments, but the plan sponsor and plan management do not have controls in place related to those alternative investments. Plan management is responsible for implementing effective internal control over financial reporting (i.e., a process and internal controls over that process to ensure that the plan's alternative investments are reported in the financial statements at amounts in accordance with professional standards and the plan's stated accounting policies). The process and controls include having a sufficient understanding of the nature of the underlying investments, the portfolio strategy of the alternative investments, and the method and significant assumptions used by the fund manager to value the underlying investments. In addition to the potential negative effect on participant account balances, this lack of internal control may make it more difficult for the plan sponsor and plan management to ensure that plan information is complete and accurate, financial statements are reliable, and laws and regulations are complied with.

We have enclosed the Plan Advisories entitled, *The Importance of Internal Controls in Financial*

Reporting and Safeguarding Plan Assets, and Valuing and Reporting Plan Investments developed by the AICPA Employee Benefit Audit Quality Center. These Plan Advisories can assist you in fulfilling your responsibilities for establishing and monitoring internal control over and valuing your plan's alternative investments.

Knowledge of investment arrangements

During our audit, we noted that the client personnel [possibly name personnel, e.g., the assistant controller or human resource supervisor], who prepares the financial statements, is not knowledgeable regarding the various investment arrangements entered into on behalf of the plan and the financial statement implications of those arrangements. The treasury department has significant knowledge regarding the types of investment arrangements but is not involved in the accounting and reporting functions for the plan. As a result, the plan financial statements prepared did not contain the proper accounting for plan investments and required disclosures under generally accepted accounting principles. For example, it was necessary for the auditor to propose adjustments to the statement of net assets and revisions to the note disclosures relating to the plan's security lending arrangement with the trustee.

It is recommended that either (1) the client personnel increase his or her knowledge of the investment arrangements by working with the treasury department or (2) the treasurer become more involved in the financial statement preparation process.

Securities Lending

Financial statement presentation of securities lending transactions

During our audit procedures, we noted that there was ineffective design and operation of the financial closing and reporting process, resulting in the misapplication of the accounting and disclosure requirements related to securities lending transactions, as governed by Financial Accounting Standards Board (FASB) Accounting Standards Codification™ (ASC) 860, *Transfers and Servicing*.

We recommend that the plan sponsor review all security lending transactions to ensure that they are properly presented in the Plan's financial statements and accompanying notes in accordance with FASB ASC 860.

Participant Loans

Loan repayments when payroll deductions are inadequate

It was noted that during 20X0 several loans nearly defaulted as there were not enough funds from the participant's paycheck to cover the loan deduction. As such, no payment was made on the loan. When there are not enough funds to cover the loan deduction, the participant is supposed to write a check to Trustee and present it to the Company to be remitted to the Trustee. This policy should be communicated to the employees. Additionally, the Company should utilize and schedule regular review of the "Alert" function of the Trustee website to determine if there are loan payments missed by the participants.

Loan repayment set-up

Certain loans selected for testing were not properly set up for repayments. The errors were noticed in April 20X0 by ABC Bank who notified the XYZ Group (Plan Sponsor). We recommend that the Plan Sponsor request and review a listing of issued loans on a quarterly basis and agree this information to the payroll system to ensure that loan repayments are being processed.

Loan interest rates

During our audit procedures, we noted that the interest rates on all loans issued during the third quarter of 20X0 were incorrect. The interest rate used for these loans was a quarter of a percent higher than the correct percentage rate. Our testing originally noted two loans that were improperly calculated; however, upon further investigation it was determined that all loans issued during the third quarter of 20X0 were affected by this error, which resulted in higher loan payments for all participants. The incorrect rates were calculated by ABC Bank, the custodian for both plans. ABC Bank is currently in the process of determining how the loan interest rates will be corrected. We recommend the plan sponsor develop and execute policies and procedures to ensure the proper calculation participant loan interest rates.

Internal controls over loan repayments

During our walkthrough of loan repayments, we noted that there are inadequate controls regarding loan repayments when a participant has a break in service. Neither the plan sponsor nor ABC TPA is monitoring the loans to determine if a deemed distribution may have occurred. It is the responsibility of the plan sponsor to determine when a loan is in default. We recommend that plan management, on a test basis, review loan repayments for participants who have breaks in service to ascertain whether the outstanding balances should be accounted for as deemed distributions.

Remittance of loan payments

During our audit of contribution and loan remittances from payroll to the trust, we noted that loan amounts were withheld from payroll for various employees throughout the year; however, the monies were not remitted to the trust at the beginning of the plan year and the missed amounts were not remitted until June 20X0. Also, during this testing, we noted that the 3/10/X0 pay date was not by the Plan Sponsor to the trust twice during the plan year. We recommend management implement policies and procedures to review all participant contribution and loan remittances compared to payroll to ensure that the participant accounts are in agreement with contributions and loans per payroll. Total remittances for loans and contributions per payroll should be traced to the amounts remitted to the trust on a periodic basis. We also recommend management consult with their TPA to correct the pay date that was remitted twice during the Plan year.

Bank Reconciliations

Missing records

While performing procedures related to the ABC Supplemental Unemployment Benefit Plan, it was noted that the client could not locate the December 20X0 bank statement and reconciliation for the Plan Checking Account. While no issues were noted in previous years or in other months related to these bank reconciliations, we recommend that the Company implement procedures to retain such records.

Preparation of bank reconciliations

We noted during our audit that the bank statements are delivered to management but no bank reconciliations have been prepared. This account is in the name of the Retirement Plan for the Employees of ABC, Inc. Bank reconciliations are an important internal control procedure to ensure that all assets are accounted for and that any errors are detected and corrected on a timely basis, and the failure to perform reconciliations may result in undetected errors, stale uncashed benefit checks, or unusual or fraudulent activities. For example, there were two distribution checks from a prior year that were not cashed. Plan management was unaware that these checks had not been cashed.

We recommend that a formal reconciliation of this account be performed on a monthly basis. Reconciling this account will help track the outstanding checks within this Plan and identify any errors or other unusual activity.

Participant Accounts

Monitoring

Monitoring of inactive accounts

We noted that inactive accounts are not being monitored by management or ABC TPA for unusual activity or excessive fees that may be posted to these accounts. To the extent that inactive accounts have not exceeded \$5,000, consideration should be given to cashing out the accounts pursuant to the terms of the plan document. We recommend that management, on a periodic basis, review the accounts of inactive participants or those who have been separated from service to ascertain whether the changes and charges to those accounts appear to be reasonable.

Monitoring of accounts of participants 70 ½ years of age and older

We noted that there is no monitoring of accounts for participants who are 70 1/2 years of age or older by management or ABC TPA, the trustee of the Plan. We recommend that management, on a periodic basis, review the accounts of those participants who are 70 ½ or older to ascertain whether mandatory distributions are required to be paid from the accounts.

Duplicate accounts

During our testing for loans, we identified one participant who had two accounts with two different social security numbers. One of the accounts appeared to be inactive.

We recommended that the inactive account for this person be deleted so that no activity can be posted. We also recommend plan management, on a test basis, run diagnostic tests to identify duplicate social security numbers and duplicate participant names. Plan management should take corrective actions to investigate, resolve and remove participant records that have duplicate names and social security numbers.

Contributions

Employee Contributions

Timely remittance of employee contributions

- During our audit, we noted that remittances of the employee deferrals to the Plan were deposited at sporadic time spans after pay dates. Some of the remittances were even deposited after the 15th business day after the end of the month of deferral. Failure to remit participant contributions to the Plan in a timely manner results in prohibited transactions which must be separately reported to the DOL and may result in lost earnings for the Plan and penalties to the Plan Sponsor. We recommend correcting the current process to assure self-correction of these late remittances and submitting the deferrals as soon as administratively possible.
- During our audit, it was noted that sufficient controls are not in place to ensure participant contributions are remitted to the trust in a timely manner. Department of Labor (DOL) Regulation 2510.3-102 requires that participant contributions be remitted to the Plan on the earliest date on which they can be reasonably segregated from the company's general assets, but in no event later than the 15th business day following the end of the month in which amounts are contributed by employees or withheld from their wages. Failure to remit participant contributions to the Plan in a timely manner results in prohibited transactions which must be separately reported to the DOL

and may result in lost earnings for the Plan and penalties to the Plan Sponsor. We recommend that the Plan Sponsor review the procedures involved in remittance of participant contributions to the Plan and institute the necessary controls to ensure participant contributions are remitted timely. A written remittance policy should be created and followed. We also recommend the Plan self-correct all untimely remittances.

Proper remittance of employee contributions

During our testing of employee contributions, we noted participants whose employee contribution amount per payroll was different than the amount deposited in his or her participant account. The employees inadvertently did not have deferrals withheld for one pay period. Management did make the participants whole by remitting the deferral amount and the related earnings thereon for the employees to the trust; however, the amount was never run through payroll. We recommend management implement policies and procedures to review all participant contribution remittances to ensure that the participant accounts are in agreement with contributions per payroll. Total remittances per payroll should be traced to the trust deposits on a periodic basis.

Policy regarding 401(k) deductions on manual payroll checks

It was noted that during 20X0 certain participants received a manual payroll check for an insignificant amount, and 401(k) deductions were not withheld from the checks. The Company should revise its policy for drafting manual checks and include procedures which require the check writer to review deductions the employee currently is having withheld prior to writing the check.

Policy regarding inclusion of bonus 401(k) deductions on manual payroll checks

The Plan document permits a separate election to defer on each bonus that is paid. The Company should require bonus recipients to document clearly whether the recipient wants 401(k) deferrals to apply to bonuses or not.

Proper recognition of contributions

Through our audit testing of contributions, it was noted that a January 20X1 contribution in the amount of \$x,xxx,xxx had been paid to the Plan. Per discussion with XYZ personnel and our review of the draft financial statements, we noted that this contribution had been considered to be a 20X1 Plan year contribution and thus was not recorded as a receivable in the December 31, 20X0 financial statements. Upon receiving the Schedule B from Actuary, we noted that the contribution was indeed attributed to the 20X0 Plan year and brought this to the attention of XYZ's Controller's Department. Further discussions were held between XYZ and Actuary, resulting in the contribution being recorded as a receivable for the 20X0 Plan year. Failure to adequately document conclusions regarding contributions may result in a material misstatement or omission in the Plan's financial statements and/or Form 5500 that would not be prevented, detected or corrected on a timely basis. We recommend that XYZ and Actuary adequately document conclusions regarding contributions including the year of attribution on a plan year funding and tax deductibility basis.

Timely reconciliation of contributions

During our audit, we noted that the contributions per the payroll reports and the census did not agree with the total contributions per the administration report. We also noted that employer contributions recorded by the Company did not agree with the employer contributions per the plan trust statements and amounts remitted by the Plan Sponsor. Failure to reconcile these reports and statements may result in a material misstatement or omission in the Plan's financial statements and/or Form 5500 that would not be prevented, detected or corrected on a timely basis. We recommend that these amounts be reconciled on a periodic basis and that differences be investigated by management.

Timing and calculation of employee and employer contributions

During audit procedures performed on employee and employer contributions, we noted instances where the employee/employer contributions did not begin on the proper date. For example, in one case the employee elected to start participating on October 1, 20X0 and contributions were not withheld until the first pay in November. We also noted several instances where the employee/employer contributions were not calculated properly based on the employee contribution election and eligible wages. It is the Plan Sponsor's responsibility to ensure compliance with the plan document and participant instructions in the administration of the Plan.

Definition of eligible compensation for employee contribution calculations

It was noted during our audit procedures that there was inconsistency in the application of the terms in the Plan document relating to the definition of eligible compensation for the purposes of calculating the employee's contribution and the employer's contribution. Participants in our sample made and received contributions based on compensation including fringe benefits, although fringe benefits are not included in the definition of compensation in the Plan document. We noted this error existed on all participants receiving fringe benefits at that location. The plan sponsor is correcting this error. We recommend that the plan sponsor uniformly train all personnel who work with the plan and review the setup of the payroll system to ensure all locations are operating in the same manner and are consistent with the Plan document.

Exclusion of incentive bonus

Certain participants in our sample had an incentive bonus improperly excluded from eligible compensation and thus did not have the opportunity to defer on the bonus. Per discussion with the XYZ payroll department, it was noted that these bonuses are included in the calculation of the company match. Per the Plan document eligible compensation is defined as all W-2 wages. We recommend that the Plan Sponsor review the payroll system to ensure that the operation is consistent with the Plan document.

Timeliness of participant 401(k) deferrals

During our audit procedures, we noted that 401(k) deferrals were not withheld from several participants' paychecks during the year due to the timing of the paycheck, setup of pay types in the payroll software, or because the check was a manual check. The plan sponsor will correct these errors in the next monthly remittance. We recommend that the plan sponsor develop and execute policies and procedures to ensure the proper calculation of employee deferrals and that these calculations be reviewed by a knowledgeable individual at the plan sponsor because the calculations are performed by a third-party payroll service provider.

Hardship distribution rules not followed

It was also noted during audit procedures that the rules for hardship distributions were not applied appropriately as required by the Plan document. Certain participants in our contribution sample were required to stop making contributions for the next six months after receiving a hardship distribution, but then were allowed to continue making contributions when the Plan switched recordkeepers. Upon further investigation, it was determined that a control feature at the recordkeeper had not been put in place to stop the deferral contributions where a hardship distribution had been taken. This is not allowable because the Plan document states a participant must cease making contributions for six months after a hardship distribution is made. We recommend that the plan sponsor review the policies and procedures surrounding the hardship distribution process to ensure all appropriate controls are in place and are operating in accordance with the Plan document.

Set-up of withholding percentages

During our audit, we tested participant deferrals by comparing the participants' election forms to the amount of withholding used in the payroll system. It was noted that all of the participants selected for testing that had elected a percentage of compensation for their withholding were incorrectly set up within the payroll system. Therefore, withholdings taken from payroll were not correct according to the participants' election. It is our understanding that in the initial set up of the participants' election in the payroll system, the Employer converted the elected percentage to a dollar amount based on each employee's estimated year to date compensation. This is ultimately causing errors each payroll when the compensation amount is different from the estimated amount. Thus, employees are either having too much or too little withheld from what they had elected. We recommend that management review all employee elections and determine a way in which a deferral percentage, if elected, can be entered into the payroll system to properly calculate the withholdings as the employees had intended. We also recommend management discuss this matter with their legal counsel to determine proper corrective action, if any.

Employer Contributions

Caps on employer matching contributions

During our testing of contributions, we noted that certain employees' year-to-date match amounts were not correct as the match should have been capped at 4% of compensation and should have been matched at 75% up to 4% of compensation based on years of service. Instead, the employees were matched at 50% up to 4% and were not capped at the 4% of compensation. We recommend that management correct this as soon as practicable. We further recommend that management perform a review of employer contributions to ensure all other participants received the proper contribution. We also recommend that Plan management implement policies and procedures to ensure the Employer matching contribution calculations are accurate before amounts are remitted to the Plan.

Year-end adjustments for discretionary employer matching contributions

The provisions of the Plan provide for an Employer matching contribution to be made at the discretion of the Plan sponsor. The current provisions of the Plan state that the matching contribution will be made on the basis of eligible compensation and deferrals over the period of the Plan year and that an employee must have worked 1,000 hours during the plan year and be employed on the last day of the plan year to receive an allocation of the matching contribution. It is our understanding, however, that the contribution is currently being calculated and remitted for each pay period with no year-end "true-up" adjustment. We recommend that you consider amending the Plan to permit payroll-period basis contribution calculations or calculate and remit a true-up contribution at year end in order to be in compliance with Plan provisions.

Calculation of employer matching contributions

During our audit procedures, we noted that the plan sponsor, ABC Company, incorrectly calculated the employer match for certain participants, causing those participants to receive an excess match for the plan year. Upon further investigation, it was determined that the entire XYZ division was impacted by this error. The plan sponsor intends to correct these errors. We recommend the plan sponsor develop and execute policies and procedures to ensure the proper calculation of employer matching contributions and that these calculations be reviewed by someone other than the individual performing the calculation.

Eligibility

Participant eligibility

During our testing of participant eligibility, we noted that certain employees who were eligible to defer into the Plan and did elect to defer into the Plan during 20X0; however, the participants' entry dates upon meeting eligibility requirements were calculated incorrectly and they were not allowed to defer until 20X1. We recommend that Plan management discuss this with the participants and correct this by remitting the proper amount, plus lost earnings, to the participants' accounts, and also perform a review to ensure all other participants' entry dates are accurate.

Distributions

Benefit Payments

Calculation of benefit payments

During our 20X0 audit we noted that several participants did not receive the correct amount of benefit payment, based on the Plan's vesting schedule. We recommend the Plan self-correct these payments and establish controls over benefit payment calculations to ensure that correct amounts are paid.

Termination of benefit payments

Currently, there is no formal method followed to ensure that benefit payments to retirees or beneficiaries cease upon their death. We recommend the Plan implement controls to enable detection of instances where benefit payments may be made to deceased participants.

Calculation of distributions and forfeitures

During our audit procedures, we noted several participants in our sample who were paid a distribution based on the account valuation prior to all earnings and contributions being credited to the participant's account. In addition, certain other participants had errors in the calculation of their forfeited balances. The plan sponsor will correct the first error by distributing the remaining balances in the participants' accounts. We recommend that the plan sponsor review all distribution requests for accuracy and periodically spot-check reports received from the third-party recordkeeper for any distribution errors.

Vesting Matters

Calculation of vested balances

During our audit we noted instances where participants had an error in the calculation of their vested balance. For example, one participant should have been paid out at 60% but was incorrectly paid out at 80%, resulting in an overpayment of \$720. We recommend that the plan sponsor review all distribution requests for accuracy and periodically spot-check reports received from the third-party recordkeeper for any distribution errors.

Vesting percentages used

We noted from our eligibility testing that participants had vested amounts in the amount of 25%. From reviewing the Plan document, vesting percents should be either 0% or 100%. From conversations with the Plan Administrator it was determined that the incorrect vesting schedule was uploaded in 2007. We recommend that a) the vesting schedule be corrected, b) all participants who received a distribution in 2007 be reviewed in order to determine if the correct distribution occurred and c) attempt to recover from the participants overpayments, if any, which resulted from the incorrect

vesting percentages. We also recommend that Plan management recalculate, on a periodic basis and immediately before distributions are made to withdrawing participants, the vesting percentages to determine the accuracy of those percentages.

Override of vesting percentages

During our testing of benefit payments, we identified discrepancies with four participants and their vesting percentages. When we re-performed the vesting calculations we arrived at a different vesting percentage. We were informed that Plan management has the ability to override the vesting percentage, which is transmitted to ABC TPA. There appears to be a lack of documentation as to who has access to change the percentages and why this vesting modifier has been changed. ABC TPA utilizes the percentages that have been downloaded and does not perform a recalculation of, or check for changes in, the vesting percentage from period to period. We recommend that Plan management immediately correct the software applications so that overrides to vesting cannot be entered without proper authorizations and approvals. We also recommend that Plan management recalculate, on a periodic basis and immediately before distributions are made to withdrawing participants, the vesting percentages to determine the accuracy of those percentages.

Third Party Service Providers

Monitoring and Review

Monitoring compliance with the service agreements

We noted that the latest fee schedules are not obtained from service providers, although the agreements are reviewed and updated on a periodic basis. We also noted that there may be an over-reliance on the integrity of the service provider to act within the terms of the agreement, with little, if any, review by management. We recommend that a person who is independent of the negotiations of the service agreements perform periodic checks on the service providers' compliance with the service agreements, that fees charged are within the guidelines of the agreements, the fees are properly attributable to the Plan's operation, and that fees if assessed to the Plan are properly charged and allocated.

Timely and accurate recordkeeper and custodian reports

During our audit procedures, we noted that the Plan's recordkeeper and custodian, ABC Bank, did not provide timely or accurate reports to the Plan Sponsor, XYZ Group. This situation resulted in the Plan Sponsor not being able to perform timely reviews of Plan information. XYZ Group is responsible for the prudent oversight and review of all services provided by third parties to the Plans. We recommend that the Plan Sponsor perform various periodic reviews and reconciliations of information provided by your third-party service providers including (a) reconciling total Plan assets per the participant detail (the sum of the individual participant account balances) provided by the Plan's recordkeeper to total plan assets reported by the Plan trustee, (b) reconcile total contributions made to the Plan per the respective payroll registers to total contributions received by the Plan per the trustee, and (c) agree individual demographic data included in new employee personnel files to the corresponding information included in the participant detail provided by the Plan's recordkeeper.

We have enclosed a Plan Advisory entitled, *Effective Monitoring of Outsourced Plan Recordkeeping and Reporting Functions*, developed by the AICPA Employee Benefit Plan Audit Quality Center. This Plan Advisory can assist you in fulfilling your responsibilities for monitoring third-party service providers as described above.

Review and approval of information provided to TPAs

During audit procedures performed and discussions with key personnel, it came to our attention the information submitted to the third party administrator is not adequately reviewed and approved by an appropriate level of management and may be submitted by the preparer of the information. It is our recommendation the information be reviewed and approved by an appropriate level of management independent of the preparation. The Plan should maintain proper documentation of this review and approval.

SOC 1SM report considerations/management review of SOC 1 reports

- Third party service organizations perform a significant amount of the processing of plan transactions. Generally a plan sponsor must review the procedures at these service organizations on a consistent basis as well as review reports produced and assumptions made.

We understand resources are limited given the Company's current operating status and are aware multiple levels of accounting personnel are not local. We recommend instituting a policy requiring annual review of the SOC 1 report for the service organization and documentation of the acceptability of the SOC 1 report with regard to the annual assessment by Plan management that controls at the Plan sponsor and service providers are operating in a way to ensure timely and accurate processing of Plan data and also address any noted exceptions and how those exceptions may affect the Plan. Usually prepared annually, a SOC 1 report is useful in assessing the reliability of the service organization's controls over the processing and security of plan and participant data and activity. We also recommend ongoing timely review of reports provided by service organizations. These controls at the plan sponsor level serve to assure proper and complete transmission of data to third parties, proper processing of data and complete receipt of data from third parties and timely reconciliation of data, as necessary.

- During our audits, we noted that the Plan sponsor did not review, in detail, the SOC 1 report of the service organizations. Since a significant amount of the processing of Plan transactions is performed by service organizations, it is imperative that Plan management review the procedures at these service organizations on a consistent basis and document such review in detail as part of due diligence in operating the Plan.

We recommend documenting that the description of the controls listed within the SOC 1 report covers all significant transactions, processes or computer applications that affect the Plan's financial statements. In addition, if the SOC 1 report identifies noncompliance of the service organization's controls, consideration should be made as to the effects of the findings on the Plan's operations. In the instance of noncompliance, complementary controls at the Plan should be documented and enhanced as necessary. Listing the exceptions and the response of the service organizations' management alone is not sufficient. Plan management must document its own conclusions.

Another item that the plan sponsor should document, in detail, is user controls. The SOC 1 70 reports identify controls for which Plan personnel are responsible and these are typically referred to as "Client Control Considerations." Client controls are complementary to the controls of the service organization and are necessary for the service organizations' controls to be achieved.

Monitoring and implementing user controls

During our internal controls walkthrough, we noted that the user controls documented in the SOC 1 reports from the Plan's service organizations (e.g., ABC TPA) are not being monitored or implemented on a timely basis.

We recommend that management review the SOC 1 reports, document the user controls and evidence how they are operating as they relate to this Plan. If controls are not in place, management should implement the appropriate controls.

Payroll/Personnel Records and Census Data

Maintaining Records

Documentation contained in personnel files

During our testing of participant data, we noted that there were instances where employee personnel files did not contain adequate support for the employees' dates of hire and/or did not contain the employee's date of birth. We recommend that documentation be obtained and maintained in employee files to support plan operations.

Inconsistencies in demographic data

During our audit, we noted discrepancies between information recorded on the payroll report and personnel files relating to employee data such as date of birth and hire date. Since information recorded on the payroll report is used as a source for updating employee data to be used by the third party administrator and to determine the eligibility of an employee, failure to keep accurate employee data might result in eligibility status of employees being incorrectly determined. Also, it was noted that incorrect employee data was provided to XYZ Company, which uses the census data to perform the liability calculation. We recommend that in the future, any new or updated employee data being entered into the system be reviewed to make sure it agrees with supporting documents in the personnel files. The accuracy of employee data should also be reviewed before it is sent to the actuary.

Missing personnel files

We noted during the audit of ABC Pension Plan that several employee personnel files could not be located. We recommend the Company enhance its existing processes to maintain and retain employee personnel files for each employee. The files should be retained in a secure location and filed centrally, if necessary. Additionally, we suggest that throughout the year management conduct audits of the employee personnel files to ensure they can be located and are filed in the proper location.

Locating financial records

While auditing the ABC Supplemental Unemployment Benefit Plan, we noted that there was some difficulty encountered by management in finding some records. These records related specifically to payments made near the beginning of the year. We recommend the Company ensure that proper procedures are in place to prevent data from becoming "lost" or "misplaced" and that increased care be taken when filing information at or near period ends to ensure that records do not erroneously get stored under the wrong period and to ensure that records are maintained and retained at the appropriate locations in accordance with the Company's intended retention policies.

Retention of employer match calculations

During our testing of contributions, we noted several instances where the employer match recalculations did not agree with the amount of match noted per payroll. The employer match calculations per participant were not retained by management, thus we could not reconcile these differences. We recommend that management retain the employer match calculations per participant to verify the accuracy of the matching contributions. We also recommend you discuss this matter with your legal counsel to determine proper corrective action if any.

Demographic Data

Discrepancies that affect the calculation of benefits

Through the course of our audit testing of the benefit plans covering the XYZ Group employees, we noted certain demographic and payroll data discrepancies. These errors are similar to those noted in prior years' audits and include incorrect plan entry dates for new employees, failure to meet the one year service requirement prior to receiving company match, errors in calculating company match, incorrect handling of a hardship distribution and improper exclusion of commissions from wages eligible for deferral. These issues will not be on-going as all Divisions have been sold. We will provide additional detailed information to XYZ Human Resources Department for those items that require corrective action so that they may be relayed to the appropriate parties.

Census Data

Inclusion of census data changes/correct information in actuarial data

During our audit, we found several census data changes requested by the Company were not properly reflected by the Plan Actuary in the census data. Also, for both the ABC Pension Plan and the XYZ Employees Retirement Plan, several deferred vested participants were included in the census data when they should have been removed due to, for example, having previously taken a buy-out. We suggest that the Company review all changes requested of the actuary as soon as they are processed in order to ensure the actuary has properly made the change. We also recommend that the Company collaborate with the Plan Actuary and review the census data files for all pension plans in their entirety to ensure that all components agree to Company information. Once this complete review is performed, we recommend that the Company develop a procedure to periodically check samples or portions of the census data files that the actuary utilizes on a recurring basis.

Removal of deceased participants

During our procedures to verify if participants and beneficiaries of ABC Pension Plan age 90+ were still living, we noted that two beneficiaries who were deceased prior to January 1, 2006 had been properly included in the census data. We suggest that the Company expand its procedures to check that deceased beneficiaries are properly excluded from the census data, particularly with regard to joint and survivor forms of payment. Additionally, the Company should review participants who are at higher risk for being deceased by using an age threshold (e.g., 90 years of age or older) to ensure they have not passed away. The Company can utilize the website <http://ssdi.rootsweb.com> to assist in this task.

Other

Plan Fees

Fee Disclosure

ERISA section §408(b)(2) fee disclosure regulations became effective July 1, 2012. Plan management should have received the written required disclosures for the Plan's existing contracts with its covered service providers. Plan management is responsible for determining whether it received the required disclosures and for evaluating the disclosed information to determine if the contract arrangements are reasonable. If Plan management fails to comply with the requirements under §408(b)(2), the Plan may be considered to be involved in a prohibited transaction and may be subject to penalties including excise tax penalties, reimbursement to the Plan for excessive fees and potential plan disqualification. We recommend that Plan management develop written procedures or policies to

more thoroughly document these considerations, such as in the Plan management meeting minutes, that will support the conclusion that the Plan's covered service provider contracts and related fees are reasonable.

Documentation and analysis of plan fees and expenses

Understanding and monitoring Plan fees and expenses is important in providing for the services necessary for the Plan's operation. During our audit, supporting documentation and analysis was not readily available for all expenses. We recommend that you monitor the Plan's fees and expenses throughout the year to determine whether they are reasonable and in agreement with service contracts, and document this process appropriately.

Parties-in-Interest

Documentation of parties in interest

During our audit of the Plan's records, it came to our attention that the level of documentation regarding parties in interest normally expected with respect to a retirement plan is not present. Although nothing came to our attention causing us to believe that errors may have occurred, sufficient procedural controls do not seem to be in place. For example, we did not find an up to date listing of parties in interest, as those terms are defined by the law. This makes it difficult to monitor transactions with those parties to ensure that no prohibited transactions occur. We recommend that the Plan sponsor adopt a written set of policies and procedures designed to mitigate the Plan's risk with regard to identifying parties in interest.