Examples of risks of material misstatement - health and welfare plans

Note: This practice aid is intended to help auditors identify risks of material misstatement (RMM) in accordance with AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*. This publication is an *other auditing publication* as defined in AU-C section 200, *Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standards* (AICPA, Professional Standards). Other auditing publications have no authoritative status; however, they may help you, as an auditor, understand and apply certain auditing standards.

In applying the auditing guidance included in an other auditing publication, the auditor should, exercising professional judgment, assess the relevance and appropriateness of such guidance to the circumstances of the audit. The auditing guidance in this document has been reviewed by the AICPA Audit and Attest Standards staff and published by the AICPA and is presumed to be appropriate. This document has not been approved, disapproved, or otherwise acted on by any senior technical committee of the AICPA.

Instructions

AU-C section 315, *Understanding the Entity and Its Environment and Assessing the Risks of Material Misstatement*, requires that the auditor identify and assess the risks of material misstatement (RMM) at the financial statement level and relevant assertion level for classes of transactions, individual account balances, and disclosures to provide a basis for performing further audit procedures.

To aid auditors in meeting this requirement, this document includes examples of RMM in a health and welfare plan financial statement audit which are excerpted from chapters 3, 7, 8 and 9 of the AICPA Audit and Accounting Guide, *Employee Benefit Plans* (the EBP Guide). **These examples do not include all RMM that could apply or be relevant when auditing a health and welfare plan.**

Refer to chapter 3 of the EBP Guide for guidance on performing the audit risk assessment, and chapters 7, 8 and 9 for relevant assertions defined by audit area and example audit procedures to consider in addressing identified risks.

RMM at the financial statement level

The following are potential pervasive risks for employee benefit plan audits at the financial statement level:

- Lack of oversight and monitoring of plan operations and service providers
- Lack of financial reporting expertise
- Lack of communication about plan events between the preparer of the financial statements and others in the plan sponsor organization, such as treasury, finance, and human resources
- Lack of segregation of duties and safeguarding assets

- Changes in service providers
- Changes in human resource information system or payroll system
- Changes in plan personnel
- Lack of Employee Retirement Income Security Act of 1974 (ERISA) counsel involvement
- Decision to terminate or curtail the plan
- Plan amendments
- Sale of plan sponsor
- Financial difficulty of the plan sponsor or contributing employers
- Susceptibility of plan assets to theft or fraud (even if specific RMM due to fraud are not identified, paragraph .32 of AU-C section 240 states that a possibility exists that management override of controls could occur. For example, even where a service organization reports are used as a plan's general ledger, management may be able to direct the service organization to record adjustments and nonstandard, journal entries outside of the normal accounting process or routine plan operations.
- Plan transfers (plan mergers, spin-offs, or other transfers)

RMM at the relevant assertion level for classes of transactions, individual account balances, and disclosures

Cash balances

- Certain cash accounts, such as cash clearing accounts, suspense accounts, or cash disbursement accounts, may be omitted from the financial statements because these accounts may or may not be included in the trust statements. Cash accounts owned and controlled by claims processors may be improperly recorded as cash of the plan. When cash balances are properly included, cash transactions or balances in bank statements may not reconcile to the plan's financial statements, or ending cash balances from the prior year may not agree to beginning cash balances in the current year.
- Plans may have significant amounts of cash held by the trustee or custodian outside of the plan due to uncashed checks. This cash may not be properly accounted for in the plan's financial statements.

Investments and related income

- Insurance contracts are not properly recorded in the same manner as specified in the annual report filed by the plan with certain governmental agencies pursuant to ERISA; that is either at fair value or at amounts determined by the insurance entity (contract value) as of the reporting date due to the use of inappropriate valuation methodologies, mathematical errors in the application of the methodology, or inaccurate inputs.
- Fully benefit-responsive investment contracts are not properly recorded at contract value as of the reporting date.
- TOLI investment assets are not properly accounted for or disclosed in accordance with the applicable financial reporting framework.
- Investment details and presentation for assets held in 401(h) accounts are not properly accounted for or disclosed in accordance with the applicable financial reporting framework.
- Investment manager or subcustodian reports do not reconcile to trustee (custodian) reports.

- Investment transactions are not recorded by the trustee (custodian) or are not recorded on a timely basis.
- Investment purchase and sale transactions are not properly authorized prior to initiation or are not in accordance with the plan provisions or investment policies.
- Investments recorded in the financial statements do not exist or are not owned by the plan.
- Gains and losses on sales of investments are calculated incorrectly.
- Investment income is recorded at an incorrect amount.
- Investments are not properly recorded at fair value as of the reporting date due to the use of inappropriate valuation methodologies, mathematical errors in the application of the methodology, or inaccurate inputs.
- Investment details (such as type of investment, name of issuer, CUSIP, investment identification, number of shares, maturity date, or interest rate) are incorrectly entered into the investment management system upon purchase.

Contributions and contributions receivable

- Employees are not appropriately included or excluded based upon the plan's provisions (for example, a three-month waiting period to participate or nonpayment of premiums).
- Employer or employee contributions are not properly calculated, authorized, or recorded in the proper period.
- Employee deductions from payroll are inaccurate (incorrect rate used) and not in accordance with the participant's benefit elections.
- Contribution amounts per plan sponsor records do not reconcile to the trust statements and actuarial valuation, if applicable.
- Contributions receivable are not recorded or are recorded in the incorrect period.
- Employer contributions are delinquent or uncollectable. (This is a common issue for multiemployer plans.)
- Amounts related to specific legal or contractual requirements of the employer to fund the plan have not been properly recorded.
- Contributions from COBRA participants and retirees are not properly calculated or recorded in the proper period.

Other receivables

- Interest and dividends receivable are not properly accrued.
- Income resulting from securities lending is not properly accrued.
- Amounts due from brokers for securities sold, or derivative-related activity, if applicable are not properly recorded.
- Reimbursements from the plan sponsor or service providers for fees, operational defects, or lost income are not properly recorded.
- Stop loss reimbursements, refunds, rebates, or subsidized amounts due the plan are not properly accrued.
- Receivables due for legal settlements are not properly recorded.

Deposits with, and receivables from, insurance companies and other service providers

- Deposits required to be maintained are not recorded.

- Premium stabilization reserves are not properly recorded.
- Interest-bearing deposits are not included as an investment in the Form 5500, Schedule H, line 4i—Schedule of Assets (Held at End of Year).

Operating assets

- Detailed property records are not periodically reconciled to the recorded amounts.
- Assets are improperly expensed and not in accordance with capitalization policies.
- Depreciation is not calculated properly or not properly recorded in the financial statements.
- Assets used both in operations and for investment purposes are accounted for improperly.
- Improper accounting recognition of an impaired asset.

Accrued liabilities

- Liabilities, such as due to brokers for securities purchased or investment management fees, if applicable, are not appropriately accrued.
- Unpaid administrative expenses (for example, fees for third-party administrators, claims processing, trustees, auditors, actuaries, or ERISA counsel) are not appropriately accrued in the proper period.
- Current claims payable and IBNR claims are incorrectly recorded as liabilities in the statement of net assets available for benefits rather than as obligations in the statement of accumulated benefit obligations.
- Amounts due the plan sponsor or third-party administrators (for example, claims processors) for amounts paid on behalf of the plan have not been appropriately recorded.

Claim payments

- Plan provisions are improperly applied either when installed or maintained in the claims processor's system.
- Claim payments are not properly authorized or are not in accordance with the provisions of the plan document.
- Claim payments are not recorded timely.
- Claim payment details are incorrectly submitted or entered in the claims clearinghouse or claims processing system.
- Payments made to claims processors for claims paid to participants are not tracked, are improperly recorded, and are not in accordance with the plan document or negotiated rates.
- Check registers do not reconcile to claims data files for the same period.
- Claim payments are made to or on behalf of individuals that are ineligible to receive benefits.
- Demographic information reported in the human resources system and payroll system is incomplete or incorrect.
- Claims paid in a minimum premium plan (see paragraph B-2 in appendix B of this chapter) are improperly recorded as claims versus premiums paid.
- Fictitious or duplicate claim payments are recorded.
- Claim payments are calculated incorrectly.
- Fees associated with administrative services only (ASO) arrangements are reported with claims paid.

Insurance premiums

- Insurance premiums are not properly recorded (for example, when paid from the general assets of the plan sponsor) or classified.

- Insurance premiums paid in minimum premium plans are improperly recorded as claims paid.
- Insurance premiums are not calculated in accordance with the agreement with the insurance entity (for example, in arrangements when the plan sponsor bills the insurance entity or for experience-rated contracts).
- Allocation of insurance premiums between plans is not apportioned correctly.
- Insurance premiums are not properly authorized prior to recording and payment.

Plan expenses

- Plan expenses do not represent allowable expenses per the plan document or regulatory provisions.
- Plan expenses are paid to fictitious vendors.
- Plan expenses are not properly accrued or classified.
- Plan expenses, including ASO fees, are not calculated in accordance with service provider agreements.
- Fees associated with ASO arrangements are reported in total with claims paid.
- Allocation of expenses between plans or between the plan sponsor is not apportioned correctly.
- Plan expenses are not properly authorized prior to recording and payment.
- Plan expenses are not properly recorded by the trustee or custodian.

Claims payable, claims IBNR, and premiums due to insurance entities

- Plan sponsor does not have the appropriate experience to calculate claims IBNR.
- Reported but not paid claims are double counted in the estimate of claims IBNR.
- Historical claims paid used in the calculation of claims IBNR do not reconcile to actual historical claims payment records.
- Claims IBNR are double counted when claims IBNR for retirees are included in the postretirement benefit obligation.
- Insurance premiums are not accurately determined.
- Obligations associated with claims and premiums are incorrectly recorded as liabilities in the statement of net assets instead of as obligations on the statement of benefit obligations.

Obligations for accumulated eligibility credits and postemployment benefits

- The plan sponsor or actuary does not have the appropriate qualifications or related experience to perform the valuation.
- Participant groups are inappropriately excluded or included from the census data.
- Benefits paid per the valuation do not agree with benefits paid per the trustee or plan sponsor. Participant data used in the valuation does not reconcile to the plan sponsor's payroll and personnel records.
- The plan sponsor or plan's actuary maintains incomplete or incorrect census data or uses inappropriate factors or assumptions, causing inaccurate computations and errors in the preparation of the disclosures of benefit obligations.
- The obligation is calculated as of an incorrect valuation date.
- Assumptions used in calculating the obligation are not based on the plan's provisions or plan experience or are inappropriate or unreasonable.

- Identified operational errors are not appropriately factored into the calculation of the obligation.
- Plan amendments have not been properly included or excluded, depending on the valuation date.
- Postemployment obligations are not properly recorded when the expected participant contributions are not sufficient to cover the amount of expected benefit payments.

Postretirement benefits

- The actuary does not have the appropriate qualifications or related experience to perform the valuation.
- Participant groups are inappropriately excluded or included from the census data.
- If the plan sponsor maintains multiple H&W plans, participants may not be reflected in the appropriate plan's census data and postretirement benefit obligation.
- Participant data used by the actuary does not reconcile to the plan sponsor's payroll and personnel records.
- The plan's actuary maintains incomplete or incorrect census data or uses inappropriate factors or assumptions, causing inaccurate computations and errors in the preparation of the disclosures of benefit obligations.
- The actuary calculates the postretirement benefits as of an incorrect valuation date.
- Retiree contributions are not properly reflected in the postretirement benefit obligation.
- Postretirement benefit obligation assumptions are not based on the plan provisions or plan experience or are inappropriate (for example, discount rate, average retirement age, and mortality table utilized) or unreasonable.
- Identified operational errors are not appropriately factored into the calculation of the postretirement benefit obligation.
- Plan amendments have not been properly included or excluded, depending on the valuation date.

Terminating plans or frozen H&W plans

- Plan terminations are not appropriately disclosed.
- The financial statements have not appropriately applied the liquidation basis of accounting, when applicable. For GAAP purposes, this means that the financial statements are prepared on a going concern basis when liquidation is imminent, or prepared using the liquidation basis of accounting when liquidation is not imminent, as defined by FASB ASC 205-30.
- Benefit payments are not made only to, or on behalf of, persons entitled to them.
- New entrants have been admitted to the plan after the effective date of the plan freeze.
- Claim payments have continued beyond the effective date of the plan freeze.

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