

PLAN ADVISORY

# Effective Monitoring of Outsourced Plan Recordkeeping and Reporting Functions





Employee Benefit Plan

Audit Quality Center



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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 the importance and benefits of establishing an effective monitoring program over third-party service providers (also referred to as third-party administrators or TPAs) that perform recordkeeping and reporting functions for your employee benefit plan. While this advisory specifically addresses TPAs that perform recordkeeping and reporting services, plan sponsors, administrators, and trustees should consider how information in the “Selecting and Monitoring Third-Party Service Providers” section of this advisory may be useful in monitoring TPAs that perform non-financial functions for the plan.

*This advisory discusses:*

- selecting and monitoring TPAs,
- the quality of plan accounting information,
- monitoring TPA controls over plan accounting information, and
- special considerations for different plan types (defined benefit, defined contribution, and health and welfare plans).

In addition, this advisory includes suggestions for conducting on-site reviews of TPAs and provides examples of controls that help ensure complete and accurate plan accounting information and reporting.

As a generic model, this advisory should be used for reference purposes only. The United States Department of Labor (DOL) publication *Meeting Your Fiduciary Responsibilities* provides an overview of the basic fiduciary responsibilities applicable to retirement plans under the Employee Retirement Income Security Act (ERISA). The DOL publication is available on DOL’s Web site at <http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html>.



# Selecting and Monitoring Third-Party Service Providers

**MEETING YOUR FIDUCIARY RESPONSIBILITY** — As noted in the DOL publication *Meeting Your Fiduciary Responsibilities*, sponsors of employee benefit plans are considered fiduciaries under ERISA. As such, they are subject to certain responsibilities, and with these fiduciary responsibilities comes 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 through improper use of the plan's assets, resulting from their actions.

Your fiduciary responsibilities include plan administration functions such as maintaining the financial books and records of the plan, filing the plan's annual Form 5500 Return/Report and, in many cases, obtaining a plan financial statement audit. (Federal law generally requires employee benefit plans with 100 or more participants to have an audit as part of their obligation to file an annual return/report.) Plan sponsors and trustees typically use TPAs — such as bank trust departments, data processing service bureaus, insurance companies, or other benefits administrators — in some capacity to assist in plan administration: they may outsource investment processing, recordkeeping and/or benefit payments, or claims processing as a way to reduce costs and/or increase efficiencies in administering employee benefit plans.

You should be aware that the hiring of a service provider to perform any or all of the duties noted above is a fiduciary function. In addition, as part of your fiduciary responsibilities, you are required to periodically monitor the TPA to ensure it is properly performing the agreed-upon services. In its publication *Meeting Your Fiduciary Responsibilities*, the DOL points out that one way fiduciaries can demonstrate they have carried out their responsibilities properly is to document the processes used.

**HOW THE USE OF A TPA AFFECTS YOUR FIDUCIARY DUTY** — When a plan sponsor hires one or more TPAs to handle plan administration functions, the agreement typically establishes that the service provider(s) assumes liability for its performance of those functions. For example, if an employer appoints as an investment manager a bank, insurance company, or registered investment advisor, the employer is responsible for the selection of the manager, but is not liable for the investment decisions of that manager. However, as noted above, the employer is required to periodically monitor the TPA to ensure that the TPA is handling the plan's investments prudently.

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Prudence focuses on the process for making fiduciary decisions and, therefore, it is wise to document decisions and the basis for those decisions, including an employer's selection and monitoring processes.

## The TPA Selection Process

**SELECTING YOUR TPA** — According to the DOL publication *Meeting Your Fiduciary Responsibilities a fiduciary should consider the following when selecting a TPA:*

- Information about the firm itself: financial condition and experience with retirement plans of similar size and complexity;
- The quality of the firm's services: the identity, experience, and qualifications of professionals who will be handling the plan's account; any recent litigation or enforcement action taken against the firm; and the firm's experience or performance record;
- A description of business practices: how plan assets will be invested if the firm will manage plan investments or how participant investment directions will be handled; the proposed fee structure; and whether the firm has fiduciary liability insurance.

*The DOL provides the following tips as a starting point for plan sponsors hiring TPAs:*

- Look at a number of providers, giving each potential provider the same information, and considering whether the fees are reasonable for the services provided,
- Document the hiring process,
- Ensure the service provider is clear about the extent of its fiduciary responsibilities,
- Obtain a fidelity bond for individuals handling plan funds or other plan property, and
- Monitor the plan's TPAs.

Other important points to consider when hiring a TPA are the ability to access data maintained by the TPA on both a daily and annual basis, and whether the TPA agrees to obtain a quality SAS No. 70 report (see the "Monitoring TPA Controls Over Plan Reporting" section on page 12 for further discussion of this issue). And finally, you should ensure that a TPA hired to prepare the plan financial statements will provide you with the support you need to understand those financial statements.

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**REVIEWING AND EVALUATING THE SERVICE AGREEMENT** — It is important to ensure that the TPA service agreement is complete and provides adequate protections for the plan. The service agreement should include predetermined communication and follow-up procedures between the TPA and the plan sponsor in the event of operational issues or other problems identified by the TPA. Certain financial and control measures also should be included in the third-party service provider contract. You should perform a periodic review of follow-up procedures as well as financial and control measures in the contract to ensure they are in place and functioning properly. This can easily be achieved by requesting that the service provider’s periodic reporting cover financial and control measures such as accuracy and timeliness of recording participant transactions, and other measures identified in the contract.

## **The TPA Monitoring Process**

**PERIODIC MONITORING OF YOUR TPA** — As noted above, the plan sponsor or administrator is required to periodically monitor its TPAs to ensure they are properly performing the agreed-upon services. If you use more than one TPA to handle the various plan administration functions, you are responsible for monitoring the activities of each TPA. *When monitoring your TPAs, you should:*

- Read any reports they provide,
- Review the TPAs’ performance,
- Ask about policies and practices,
- Check actual fees charged, and
- Follow up on participant complaints.

In addition, *Meeting Your Fiduciary Responsibilities* states that an employer should establish and follow a formal review process at reasonable intervals to decide if it wants to continue using the current TPAs or look for replacements.

## CONDUCTING AN ON-SITE VISIT AT YOUR TPA

On-site visits by you, the plan sponsor, at the TPA are an effective way to review its operations and controls. Such visits may be performed by an individual or a team from Corporate Finance or Human Resources. If this is not practical, phone calls and e-mail contact may be an acceptable alternative. You may decide that spot-checks of certain transactions are necessary to determine the quality and accuracy of the service provider's work. This may be especially true when no Type II SAS No. 70 report is available from the TPA.

You should prepare an agenda that addresses all pertinent issues and areas. While on-site, you should tour the facility to get a feel for the operation and atmosphere of the TPA, meet with the employees who perform the work on the account, and walk through some of the more critical processes. The meeting or phone call itself should include not only the customer service representative, but the account supervisors and manager, too. *Discussion items to consider include:*

### Monthly/Annual Reports Received from the TPA.

*Reports you should be receiving from the TPA include:*

- Contributions by amount and date received and date allocated to individual investment options
- Annual participant statement detail (beginning balance, activity detail, and ending balance with ending participant balances total tied out to the year end assets)
- Detail of forfeitures
- Distributions by participant by date
- Asset listing and statement of changes
- Schedule of Assets Held for Investment detail
- List of expenses paid by date with payee
- Trade date versus settlement date reconciliations
- Loan activity/defaulted loans
- Participants with no current address on file
- Party-in-interest/prohibited transactions

Consider the quality of the reports received from the TPA, and discuss any related issues. *Items to consider include:*

- Were reports received in a timely manner?
- Were reports accurate, or did they require amendments?
- Were the reports complete, or were some of them missing information?
- Did the reports contain the information needed to monitor the plan's activity, or is there additional information that would be useful?

### New Federal Regulations.

You should inquire about any new federal regulations that may affect the plan, and how the TPA is implementing them. The TPA should supply a report on the status of any new regulations, including the effective date of the regulation; what changes are

necessary to the third-party service provider's systems and reports in order to comply with those regulations; and the third-party service provider's action plan to implement the changes.

### Plan Audit and Form 5500 Preparation.

You should request that the TPA provide a timeline for the 5500 preparation, along with the previous year's timeline. This would be a good time to discuss any problems that arose during the prior year plan audit and Form 5500 preparation, such as any process improvements, and any areas the TPA is aware of that may cause problems in the current year. You also should discuss the audit package that will be sent to the plan auditors, and notify the third-party service provider if there is a change in plan auditors.

## CONDUCTING AN ON-SITE VISIT AT YOUR TPA, CONT'D

### **Non-Discrimination Testing.**

You should request that the TPA provide a timeline for non-discrimination testing. At the meeting, you should inquire whether preliminary testing has been done, and if any issues have been noted as a result. You also should inquire whether the information you provide to the TPA is timely, complete and accurate, and whether the information-transmission process needs to be improved.

### **Participant Complaints.**

Logs should be maintained at both the TPA and plan sponsor, with details of participant complaints specific to your plan. Procedures for monitoring and resolving complaints should be reviewed, and you should confirm that all complaints have been or are in the process of being resolved. You also should address any complaints the TPA has received during the year, and ascertain that these complaints are being adequately resolved.

### **Employee Training/Turnover.**

The TPA should provide you with an outline of its employee training program and note any changes in the program in the past year. The TPA also should supply a report that details its employee turnover ratio, and the turnover of the staff specifically assigned to the plan's account.

### **Internal Controls/SAS No. 70.**

During the meeting, you should discuss the TPA's internal control process and inquire about any changes implemented during the year. You should obtain a copy of the TPA's latest SAS No. 70 report, if applicable, and discuss the findings in the report.

### **Error Report and Related**

**Corrections.** You should ask to see the TPA's error report specific to your plan, which details all errors noted during the period and how they were resolved. This report should include details about the type and date of error, the correction date, and any monetary impact. You should review and discuss this report, and inquire how the TPA, if warranted, changed an existing procedure to prevent a similar error from occurring again.

### **Review Reconciliations.**

You should ask to review the most current account reconciliations with the TPA, and look to see that the reconciliations are being performed timely and whether reconciling items are being corrected timely. In conjunction with this review, you should ensure that amounts deposited were allocated. You also should discuss the nature of any old reconciling items and the reasons they have not been corrected.

### **Other Requests.**

You should prepare a list of reports and information you would like to receive but are not currently available. This list should be discussed with the TPA during the meeting.

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**BENEFITS OF AN EFFECTIVE MONITORING PROGRAM** — An effective monitoring program helps ensure you are meeting your fiduciary responsibilities. It also will help the plan sponsor gauge the quality of services performed by the TPA and provide valuable information regarding the TPA's controls and their effectiveness. It also can be helpful in identifying potential cost savings, areas for improved efficiencies, and opportunities to improve participant satisfaction. And, as discussed below, it can result in cost savings in connection with the annual plan audit.

**CORRESPONDING WITH YOUR TPA** — You should regularly correspond with your TPAs. Depending on the size and complexity of the plan(s) involved, it may be appropriate to contact the service provider as often as quarterly, but no less frequently than annually. Face-to-face meetings can take place either at your place of business or the TPA's. See sidebar on pages 7 and 8 for suggestions for conducting an on-site visit at your TPA, including discussion topics.

**PERFORMING AN ANNUAL REASSESSMENT OF THE EFFECTIVENESS OF THE THIRD-PARTY SERVICE PROVIDER RELATIONSHIP** — Evaluate the reasonableness of fees charged for the services, the quality of the services provided, the quality of the TPA's operations and the availability of a quality SAS No. 70 report.

**MONITORING PARTICIPANT COMMUNICATIONS AND THE PARTICIPANT COMPLAINT PROCESS** — Participants should have a formalized process to submit questions or file complaints, and should receive periodic statements of their account balances and/or confirmations of their transactions. This will help ensure that any errors in participant accounts are identified on a timely basis. You should maintain a complaint log, and ensure that all questions/complaints are followed up on and resolved in a timely manner.



## Quality of Plan Accounting Information

The plan sponsor may hire a TPA to provide plan accounting services, including preparing participant account balance information, investment reports, and tax reports; preparing monthly or periodic accounting reports used in preparing the plan's financial statements; and preparing the plan's Form 5500. It is important to note that the plan administrator (which may be the plan sponsor) remains primarily responsible for filing complete and accurate plan financial statements and Form 5500 information with the DOL. Inaccurate or incomplete filings can result in the Form 5500 being rejected by the DOL with significant penalties assessed on the plan administrator. Therefore, it is important that you ensure that you are receiving reliable and accurate information from the TPA.

**UNDERSTANDING THE ACCOUNTING INFORMATION** — As a plan sponsor you are responsible for the plan's financial reporting; therefore, you need to be familiar with the accounting basis (modified cash or accrual method using generally accepted accounting principles (GAAP)) used by the TPA. If the plan issues financial statements on the accrual basis, you should consider whether adjustments to the information provided by your TPA may be necessary to prepare the plan's financial statements consistent with GAAP. For example, the TPA may net items of income and expense that are required to be reported separately; exclude certain plan assets and liabilities; or inconsistently or incorrectly group expenses. You may want to consult with the plan's audit firm on the appropriate accounting and reporting requirements. In addition, you should check to ensure that the TPA reports include adequate information to meet other DOL reporting requirements.

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**READING THE TPA REPORTS** — A periodic review of the plan reports prepared by the TPA for consistency, completeness, and reasonableness can be an effective step in ensuring the accuracy of the accounting information provided by the TPA. A key component of this review is the consistency of the information in the reports pertaining to the plan and its operations. *Specifically, you should:*

- Compare the information in the report with that in prior-period reports. If significant differences exist, investigate the reasons for those differences.
- Consider whether the report reflects all relevant information about the plan and its transactions. Also ensure that the report provides you with adequate information to carry out your fiduciary duties as plan sponsor.
- Review the report in relation to what you know about the plan's structure, participants, and operations, to determine if information and amounts reported make sense and are reasonable.

**CHECKING ACCOUNT RECONCILIATIONS** — Another valuable step is a review of account reconciliations performed, and a comparison of specific amounts in the reports with the client data used in the reconciliations (e.g., the amount of contributions made by the plan sponsor and/or plan participants). You also should check to ensure that reconciling items are specifically identified, and that they clear in a timely manner.

**REVIEWING FOR OVERALL REASONABLENESS** — Analytical review procedures performed on account balances and activity is an effective way to determine that the information being reported is reasonable. *For example:*

- Compare the plan's total return on investments to published sources for the total return of the underlying investments.
- Compare expected participant head count (prior year head count adjusted for expected changes during the year) to actual participation levels in the plan at year-end.
- Review distribution listings for unusual items (for example, payments to people who have not terminated or have been difficult to locate in the past, or lump-sum payments from a defined benefit pension plan that seem high).



## Monitoring TPA Controls Over Plan Accounting Information

**STRONG CONTROLS ARE ESSENTIAL** — Strong controls at the TPA are essential for ensuring that plan information is complete and accurate; they are vital to the plan's financial reporting process. Another key step in effectively monitoring the TPA is to understand the quality and effectiveness of the processes, procedures and controls used to produce the plan's accounting information. (These controls will vary, depending on the services you hire the TPA to provide.) *Processes, procedures and controls you may wish to review include:*

- Participant enrollments, cash receipts, distributions of plan assets, exchanges of plan assets among investment options, and changes to non-financial account information are processed completely, accurately, and in a timely manner, according to instructions from plan sponsors and participants.
- Dividends are timely, and accurately recorded.
- Transactions for each investment option are applied with the correct market prices; ending investment balances are applied with the correct market prices; and the resulting net appreciation/depreciation is reflected in participant accounts.
- Plan assets are safeguarded from loss or misappropriation.
- Participant access to data via voice or Internet is properly authorized and secured.
- Participant transaction confirmations, account statements, and plan level periodic reports are accurate, complete, timely, and made available to participants and/or plan sponsors without intervention by TPA employees responsible for processing those transactions.
- Annual plan-level financial statements are complete, accurate, and mailed on a timely basis to the plan sponsor.

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- Year-end compliance tests are complete and accurate.
  - Changes to existing systems software and implementation of new systems software are tested, approved, and documented prior to promoting to production.
  - Access to TPA physical facilities and software programs and data is limited to authorized individuals and that environmental controls exist to protect them.
  - New plans, mergers, and transfers are established in accordance with the plan document, and participant, financial, and demographic data are accurately recorded.

AICPA's Audit and Accounting Guide, *Employee Benefit Plans — 2006*: turn to Appendix B for suggestions and advice regarding the use of service organization reports (SAS No. 70 reports) and examples of controls for employee benefit plans in the areas of investments; contributions received and related receivables; participant loans; benefit payment claims and distributions; participant data and plan obligations; administrative expenses; reporting; and general computer controls when a TPA is utilized.

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**HOW A SAS NO. 70 REPORT CAN HELP** — An effective approach to help you, the plan sponsor, understand and monitor the quality and effectiveness of the TPA's processes and controls is to request a report on the controls at the TPA, commonly referred to as SAS No. 70 reports (SAS is an acronym for AICPA Statement of Auditing Standards). Recent concern over the quality of accounting information, increased reliance on outsourcing and increased use of technology in plan administration services has resulted in greater demand for SAS No. 70 reports. A SAS No. 70 report includes a detailed description of the TPA's controls and an independent assessment of whether the controls are suitably designed and placed in operation. As discussed below, a Type II SAS No. 70 report will tell you if the TPA's controls are operating effectively.

SAS No. 70 reports can be extremely important to you in fulfilling your fiduciary duty to monitor your TPA; as such, you should obtain and read a copy each year. After reviewing the SAS No. 70 report, you may wish to document your assessment of the TPA's controls and any responses to testing errors. Such documentation provides support for the fiduciary due diligence you perform in that area.

TPAs are not required to furnish SAS No. 70 reports. Because these reports are so important to you and the plan auditor (see the "Not having a SAS No. 70 report may have a significant negative impact on you as plan sponsor" and "Consider the potential for cost savings" sections, below), it is in your best interest to make certain when you hire or retain the TPA that the TPA agrees to obtain a quality SAS No. 70 report. In addition, you may wish to meet with your plan auditors to assist you in determining what controls are important to the financial reporting process.

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## **NOT HAVING A SAS NO. 70 REPORT MAY HAVE A SIGNIFICANT NEGATIVE IMPACT ON YOU AS PLAN SPONSOR**

— If no SAS No. 70 report is available from the TPA then it will be more difficult for you — as well as the independent auditor — to ascertain that the controls at the service organization are suitably designed and operating effectively. In that case, you and the auditor likely would need to perform other procedures to assess the TPA's control environment. These procedures may include reading the user manuals or other systems documentation about the services provided; reading the reports of the internal auditors or regulatory authorities on the service organization's controls; and making inquiries of personnel at the TPA. It may be necessary for you and the auditor to perform a site visit at the TPA at additional expense to you. You also should be aware that if no SAS No. 70 report is available, and the auditor is unable to perform procedures at the service organization to satisfy his or her objectives, then the auditor must disclaim an opinion or issue a qualified opinion on the plan's financial statements. If either of those types of reports is issued, it will be rejected by the DOL, and you may be subjected to monetary penalties.

## **CONSIDER THE POTENTIAL FOR COST SAVINGS**

— Another benefit to using a TPA that obtains a SAS No. 70 report is the potential cost savings on audit fees. Quality SAS No. 70 reports may save plan auditors a significant amount of time, which ultimately will result in substantially lower audit fees. You should be aware, however, that not all SAS No. 70 reports will permit an auditor to reduce the amount of work performed with regard to controls at the service organization. In most cases, independent auditors will not be able to rely on a SAS No. 70 report that is issued by a party other than a certified public accountant (CPA) or a CPA firm. In addition, the auditor may not be able to rely on a report that lacks sufficient detail; does not include information about transactions, control objectives or individual controls relative to the plan; or does not coincide with the plan's reporting period.

**UNDERSTAND THE DIFFERENT TYPES OF SAS NO. 70 REPORTS** — There are two types of SAS No. 70 reports. It is important that you understand whether a Type I or a Type II SAS No. 70 report was issued, and what it means.

## COMPARISON OF TYPE I AND TYPE II SAS 70 REPORTS

### Type I report

#### TPA'S AUDITOR EXPRESSES AN OPINION ON:

- (1) whether the TPA's description of its controls presents fairly, in all material respects, the relevant aspects of the TPA's controls that had been placed in operation as of a specific date, and
- (2) whether the controls were suitably designed to achieve specified control objectives.

**Note:** It does *not* include an opinion about the effectiveness of the TPA's controls.

### Type II report

#### TPA'S AUDITOR EXPRESSES AN OPINION ON:

- (1) whether the TPA's description of its controls presents fairly, in all material respects, the relevant aspects of the TPA's controls that had been placed in operation as of a specific date,
- (2) whether the controls were suitably designed to achieve specified control objectives, and
- (3) whether the TPA's controls that were tested were operating with sufficient effectiveness to provide reasonable, but not absolute, assurance that the control objectives were achieved during the period specified.

**Note:** Because this report addresses the effectiveness of the TPA's controls, it is the most useful for both audit and quality monitoring purposes.

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## **FAMILIARIZE YOURSELF WITH THE CONTENTS OF A SAS NO. 70 REPORT —**

The SAS No. 70 report will include a detailed description of: the TPA's policies and procedures relevant to the plan's internal controls; the control objectives; what the TPA's auditor reviewed and tested; the time period covered by the procedures; and whether there are any instances of noncompliance. *Key elements you might see in a SAS No. 70 report include:*

- Overview of the TPA organization, organizational structure and control environment, including commitment to governance, business ethics, and compliance management,
- Description of the TPA's plan services computing environment and processing systems,
- Description of general controls, including business systems, computer operations, information security management and IT control environment, and
- Description of business process for key areas, including contribution and loan repayments, withdrawals and loans, contribution allocation changes, dividend processing, pricing, investment return, plan financial reporting, and compliance testing.

## **NOTE THE DOCUMENTED CONTROLS AND SCOPE OF TESTING PERFORMED —**

The description of controls at the TPA is an integral part of the SAS No. 70 report, and will help you determine if the controls are adequate to ensure complete and accurate financial reporting. Of particular concern is the scope of the work described in the report. This section should be carefully reviewed to ensure that it covers all significant transactions, processes, or computer applications that affect the plan's financial statements.

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**LOOK FOR ANY CARVE-OUTS** — In some instances, the service provider may use another service organization to process certain transactions or perform certain functions. In those cases, the service auditor will “carve out” those areas from its engagement. For example, a service organization may adopt the carve-out method for a computer processing subservice organization that it uses, but still maintain responsibility for restricting logical access to the system to properly authorized individuals. The AICPA Audit Guide, *Service Organizations: Applying SAS No. 70, as Amended*, provides the following example of language that might be included in a SAS No. 70 report to indicate that the report does not cover a carved-out function:

Example Trust Organization uses a computer processing service organization for all of its computerized application processing. The accompanying description includes only those controls and related control objectives of Example Trust Organization, and does not include controls and related control objectives of the computer processing service organization. Our examination did not extend to controls of the computer processing service organization.

Depending on the significance of the carved-out areas, you may need to obtain a SAS No. 70 report from the other service organization.

**CONSIDER THE PERIOD COVERED BY THE SAS NO. 70 REPORT** — The TPA’s description of controls included in the SAS No. 70 report is as of a specified date for Type I and Type II reports. (In a Type II report, the service auditor’s tests of the effectiveness of the controls will cover a period of time.) Both of these timing considerations will be stated in the SAS No. 70 auditor’s report. It is not unusual for the description of controls to be as of a date other than the plan’s year-end, or for the report to cover a different reporting period than the plan’s fiscal year. You should consider these timing issues when evaluating the usefulness of a SAS No. 70 report for your monitoring activities. If the period not covered by the report is significant, you should consider reviewing documentation and correspondence issued by the TPA regarding changes to application systems and control activities. In addition, you should make inquiries of TPA personnel about changes to the application system or related control activities outside the reporting period, changes in the reliability of the processing of financial information, and whether the service auditor could apply agreed-upon procedures to supplement the SAS No. 70 report.

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**EVALUATE ANY NONCOMPLIANCE IDENTIFIED** — It is important that you understand what controls should be in place, and whether they are operating effectively. When the service organization’s SAS No. 70 report identifies instances of noncompliance with the service organization’s controls, you should consider the effects of the findings on plan operations. When evaluating the significance of noncompliance, you should make sure to fully understand the situation noted by the service auditor and its impact on the organization’s controls. If there are areas where controls are inadequate, you should determine what complementary controls at the plan are required. Such controls are referred to in SAS No. 70 reports as “user organization controls.”

**USER ORGANIZATION CONTROLS AND CONTROL ACTIVITIES** — If effective controls are not in place at the plan, the TPA’s controls may not compensate for such weaknesses. Many SAS No. 70 reports include a list of control activities for which the plan (user organization) is responsible. This is an example of what you may see in the SAS No. 70 report regarding user organization controls and control activities:

XYZ Service Provider’s own controls rely on certain controls established with their institutional employee benefit plan clients. When assessing control risk, plan sponsors and their auditors should consider the information in this report as well as the controls in their organization. This section highlights the controls that each plan should have implemented. For plan sponsors and their auditors to rely on the controls described herein for maximum effect, each plan sponsor must determine whether the controls are in place and operating effectively. The following list of control activities, as well as plan sponsor responsibilities to the plan and/or participants, involves communication between each plan sponsor and XYZ Service Provider. This list is not meant to be a complete listing of the control activities that provide a basis for the assertions underlying the plan’s financial statements.

Turn the page for a detailed list of 13 user organization controls.

## USER ORGANIZATION CONTROLS

- (1) The plan sponsor is responsible for establishing controls to determine employee eligibility to participate in the plan, and to allow those eligible the opportunity to participate.
- (2) Each plan sponsor is responsible for establishing controls to ensure employee payroll information sent to XYZ Service Organization for contributions (employer and employee) and loan repayments is accurate, complete, and received by XYZ Service Organization on a timely basis.
- (3) Each plan sponsor should establish controls to ensure that participant information and requests submitted by the plan sponsor are accurate, complete, properly authorized, and in accordance with the plan requirements and provisions. Participant forms include, but are not limited to, enrollments, loans, exchanges, contribution allocation changes, distributions, and demographic changes, which are submitted manually and/or electronically.
- (4) The plan sponsor is responsible for establishing control activities for determining when a participant loan is in default.
- (5) The plan sponsor is responsible for establishing control activities relating to the timely review of plan reports — including annual plan financial statements, distribution reports, conversion reports, participant records, and statements provided by XYZ Service Organization — and notifying XYZ Service Organization of any discrepancies in a timely manner.
- (6) To the extent that a plan sponsor has access to XYZ Service Organization terminals and systems, the plan sponsor is responsible for establishing and maintaining adequate controls over physical and logical access at the plan sponsor locations.
- (7) To the extent that a plan sponsor has direct access to XYZ Service Organization applications, the plan sponsor is responsible for establishing controls to ensure timely notification to XYZ Service Organization of personnel changes affecting user access.
- (8) To the extent that a plan sponsor has online access to XYZ Service Organization, the plan sponsor is responsible for establishing controls to properly administer user identifications and passwords, and to monitor user activity.
- (9) The plan sponsor is responsible for implementing procedures to ensure that XYZ Service Organization receives notification of all transactions.
- (10) The plan sponsor is responsible for notifying XYZ Service Organization, in a timely manner, of changes in individuals authorized to instruct XYZ Service Organization on the plan sponsor's behalf.
- (11) Plan sponsors are responsible for establishing controls to communicate plan amendments and changes that affect plan recordkeeping in a timely manner.
- (12) The plan sponsor is responsible for notifying XYZ Service Organization when and how to allocate forfeitures.
- (13) For plans that use the Form 5500 Preparation Service, the plan sponsor is responsible for providing accurate and timely information to XYZ Service Organization for the preparation of Form 5500. The plan sponsor is responsible for filing Form 5500 with the IRS by the specified due date.

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AICPA's Audit and Accounting Guide, *Employee Benefit Plans — 2006*: turn to Appendix B for examples of selected user organization controls for employee benefit plans in the areas of investments; contributions received and related receivables; participant loans; benefit payment claims and distributions; participant data and plan obligations; administrative expenses; reporting; and general computer controls.



# Special Considerations for Different Plan Types

## Defined Benefit Pension Plans

Defined benefit pension plans often invest in a full array of marketable and non-marketable securities. Typically, a trustee and/or custodian hold investments and execute investment transactions on behalf of the plan, and prepare the year-end statements used as the basis for the financial statements.

The investment balances and activity in the underlying reports provided by the trustee/custodian are used as a basis for preparing the financial statements and investment disclosures; thus, you may wish to review that information to determine its accuracy. *The review should consider:*

- Whether the investments are properly classified (for example, investments in bank collective trust funds or limited partnerships classified as registered investment companies).
- For securities lending arrangements, the presentation of investments and related collateral for securities lending agreements is shown gross as required by FASB Statement No. 140, *Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities – a replacement of FASB Statement No. 125*. These amounts often are presented net in the trustee/custodian statements.
- Whether derivative investments are recorded on the trustee/custodian statement. Such investments sometimes are recorded off-line or reported at zero on the schedule of investments provided by the trustee/custodian, requiring additional detail in order to compile financial statement information.

You also should consider the importance of gaining an understanding of the accounting and reporting by the trustee/custodian for non-marketable investments to ensure they are reported in accordance with generally accepted accounting principles. Fair value adjustments should be made to the trustee/custodian statements as part of the financial statement compilation process performed by the plan sponsor at year end.

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## Defined Contribution Pension Plans

Many 401(k) plans outsource the administration of the plan to a third-party administrator under a full-service agreement. In these circumstances, participant transactions are initiated directly with the third-party recordkeeper, which interfaces directly with the third-party payroll processor for recording contributions. The recordkeeper prepares year-end financial reports, including the DOL's Form 5500.

TPAs market such arrangements to plan sponsors as a way to offer 401(k) benefits with minimal involvement from the plan sponsor. As noted above, the plan sponsor still has a fiduciary responsibility to periodically monitor the activities of the service provider. The suggestions in this document can help plan management ensure that proper monitoring of the service provider is performed.

## Health and Welfare Benefit Pension Plans

For various reasons — such as convenience, expertise, and confidentiality — health and welfare benefit plan sponsors often engage one or more third parties to process claims (e.g., health, dental, and disability benefits). In such cases, plan sponsors do not maintain independent records of the claims paid. Claims payments generally are the most significant element of health and welfare plan financial statements, and often are significant to plan-sponsor operations as well.

As noted above, you have a fiduciary responsibility to periodically monitor the activities of the third-party administrator. *In addition to reading the SAS No. 70 report, if available, examples of effective monitoring controls include:*

- Review of periodic (e.g., monthly or weekly) claim information at a reasonably detailed level of disaggregation (number of claims, type of service, number of employees receiving benefits, dollar amount of claim, deductible applied, and reasonable and customary allowances applied) that allows the sponsor to conclude that claims paid are for covered services and amounts paid are consistent with plan provisions.
- Review of census information from the claims processor in sufficient detail to conclude that only eligible plan participants are receiving benefits.

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- Performance of analytical procedures using disaggregated information (e.g., comparisons of average claim per participant to the expected number of claimants taking into account plan amendments, individual large claims, stop loss insurance coverage or the health care cost trend rate increase). The claims processor often prepares quarterly reports, which include head count and claim information that can be used to assist in analytics.

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For more information about the AICPA Employee Benefit Plan Audit Quality Center and employee benefit plan audits, visit the Center's Web site at <http://www.aicpa.org/ebpaqc>

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### **Additional Resources:**

***SAS No. 70 Reports and Employee Benefit Plans*** may serve as a useful tool as you carry out your fiduciary responsibilities in monitoring the activities of TPAs. This publication is available on the AICPA's Web site at <https://www.cpa2biz.com/CS2000/Products/CPA2BIZ/Publications/SAS+70+Reports+and+Employee+Benefit+Plans.htm>. You also may wish to ask your plan auditor for assistance in understanding the SAS No. 70 report.

***AICPA's Employee Benefit Plans – 2006 Audit and Accounting Guide***: turn to Appendix B to obtain examples of selected user-organization controls at your TPA and for your employee benefit plants. The Guide is available on the AICPA's Web site at <https://www.cpa2biz.com/CS2000/Products/CPA2BIZ/Publications/Employee+Benefit+Plans+2006+Audit+and+Accounting+Guide.htm>.

***Meeting Your Fiduciary Responsibilities***, a United States Department of Labor (DOL) publication, provides an overview of the basic fiduciary responsibilities applicable to retirement plans under the Employee Retirement Income Security Act (ERISA). The publication is available on DOL's Web site at <http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html>.



