Monitoring Outside Service Providers, Part II:
Resource Provider Considerations

Richard F. Fischer, CPA
Louis Plung & Company, LLP

richard.fischer@louisplung.com
412-281-8771
Internal Control Responsibilities

• To design appropriate controls - Need to consider degree of interaction between the Plan sponsor and the outside service organization(s).
  – Who initiates, executes, and records.
  – Depends on the nature of the Plan and the structure of the service organization.

• Example – DB plan with investment transactions initiated by third party based on board investment polices - versus - DC plan with participant directed transactions.
Monitoring Outside Service Providers

- Resource – AICPA Employee Benefit Audit Quality Center – *Plan Advisory on Effective Monitoring of Outsourced Plan Recordkeeping and Reporting Functions*
Outside Service Providers - Common Practice Problems - Overreliance

1. Lack of appropriate due diligence in hiring.
2. Lack of understanding of the services.
   - Who performs pricing services, recordkeeping, custodial services, investment advisory services, etc?
   - Who will prepare 5500?
   - Who will perform the discrimination testing?
   - How will participant complaints be monitored?
3. Failure to monitor.
4. Failure to consider user controls.
Overreliance on Outside Service Providers - Examples

• 2/15/2011 WSJ “Currency Charges Weren’t Monitored”
• OTHER
Fiduciary Responsibilities

DOL Publication
“Meeting Your Fiduciary Responsibilities”
http://www.dol.gov/ebso/publications/fiduciaryresponsibility.html

• Sponsors of employee benefit plans are considered fiduciaries under ERISA.
• Sponsors are therefore subject to potential personal liability for their fiduciary responsibilities.
Hiring a service provider to perform any plan administrative functions is a fiduciary function.

- Hiring process
  - Look at a number of providers.
  - Assess whether the fees are reasonable for the services provided.
  - Consider the financial condition of the organization and their experience with plans of a similar nature and size.
Fiduciary Responsibility
Hiring a Service Provider

DOL publication

• Hiring Process (continued)
  • Review information about the quality to the organization and qualifications of professionals handling the account.
  • Ask about recent litigation or enforcement actions.
  • Inquire about the organization’s business practices.
Fiduciary Responsibility
Hiring a Service Provider

**DOL publication**

- Hiring Process (continued)
  - Determine how the assets will be invested or investment directions will be handled.
  - Determine whether the plan has fiduciary liability insurance.
- The hiring process should be documented and the decision reviewed routinely.
Other Service Provider Hiring Considerations

• Does the service provider have a report over its internal controls (SAS 70 Report)? If not,
  – Consider the ramifications on the service provider’s commitment to quality.
  – Monitoring may be more difficult.
  – Audit costs may increase.
  – May need to perform site visit.
  – Might have to implement more extensive mitigating controls at the user entity.
Monitoring Outside Service Providers

1. Work with the outside service provider to make sure that you have an understanding as to exactly what services they will be providing and the structure of the organization (i.e. what key services are outsourced).
Monitoring Outside Service Providers

2. Determine exactly what reports you will receive and when you will receive them. Examples:
   - Forfeitures
   - Distributions
   - Expenses
   - Contributions by deposit date and allocation date
   - Asset listing and Schedule of Assets Held
   - Loan activity
   - Trade date/Settlement date reconciliations
   - Reconciliation between record keeper and custodian.
Monitoring Outside Service Providers

3. Review the reports for accuracy, reconcile with internal records, where applicable.
4. Verify that the fees charged are in agreement with the contract.
5. Review compliance testing.
6. Review error reports and participant complaint log.
Monitoring Outside Service Providers

7. Consider an on-site meeting with the service provider.
8. Discuss any changes to the Plan or the Plan’s operations.
9. Discuss impact of regulatory changes on the Plan and the Plan’s operations.
10. Review service auditor reports, where available.
Monitoring Outside Service Providers

- Service auditor reports can be used to gain an understanding of the controls over significant transaction classes that are generally physically or operationally separate from the organization audited.
- Can also obtain this information from the user manuals, system overviews, technical manuals, contracts, etc.
Monitoring Outside Service Providers

- Plan management is responsible for the design and operating effectiveness of the Plan’s internal control system and for the accuracy of the Plan’s financial statements.
- Controls at a service organization are relevant to the Plan’s internal controls as they impact the information used in the financial statements.
Monitoring Outside Service Providers

• Service organizations may assume liability for the performance of certain functions. However,
  – Plan cannot outsource its responsibilities.
  – Plan management is responsible for monitoring.
  – Plan management is also responsible for the relevant user controls.
Monitoring - Conclusion

• Third-party service organizations are typically a pervasive part of an employee benefit plan internal controls.

• Hiring a service organization is a fiduciary responsibility. Due diligence is key. Don’t forget to document the process.

• It’s important to understand the scope of the services to be provided by the service organization and the involvement of multiple sub-organizations.
Monitoring - Conclusion

- Other monitoring activities include on-site visits, reviewing reports provided by the service organization, evaluating the participant complaint logs, reviewing error reports, ensuring that fees charged are reasonable and in accordance with the contract.

- Document procedures performed to demonstrate compliance with your fiduciary responsibilities.
Questions?

Richard F. Fischer, CPA

Louis Plung & Company, LLP
Four Gateway Center, 9th Floor
Pittsburgh, PA 15222
richard.fischer@louisplung.com
412-281-8771