

Internal Audit Concerns for HR

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Agenda

Increased focus on HR in Internal Audits

- Trends in HR

How to determine your HR Risk Areas

Examples of Specific HR Risks

- Hiring/Termination
- Compensation
- Payroll
- Benefits
- Outsourcing

Increased Importance of Internal Audit

Recession Driven Incentives, Pressures and Opportunities
+
Ever Increasing Legal & Regulatory Requirements
+
New Professional Standards and Frameworks
+
Market and Management Expectations
=
INCREASED INTERNAL AUDIT RISK

Risks Related to HR

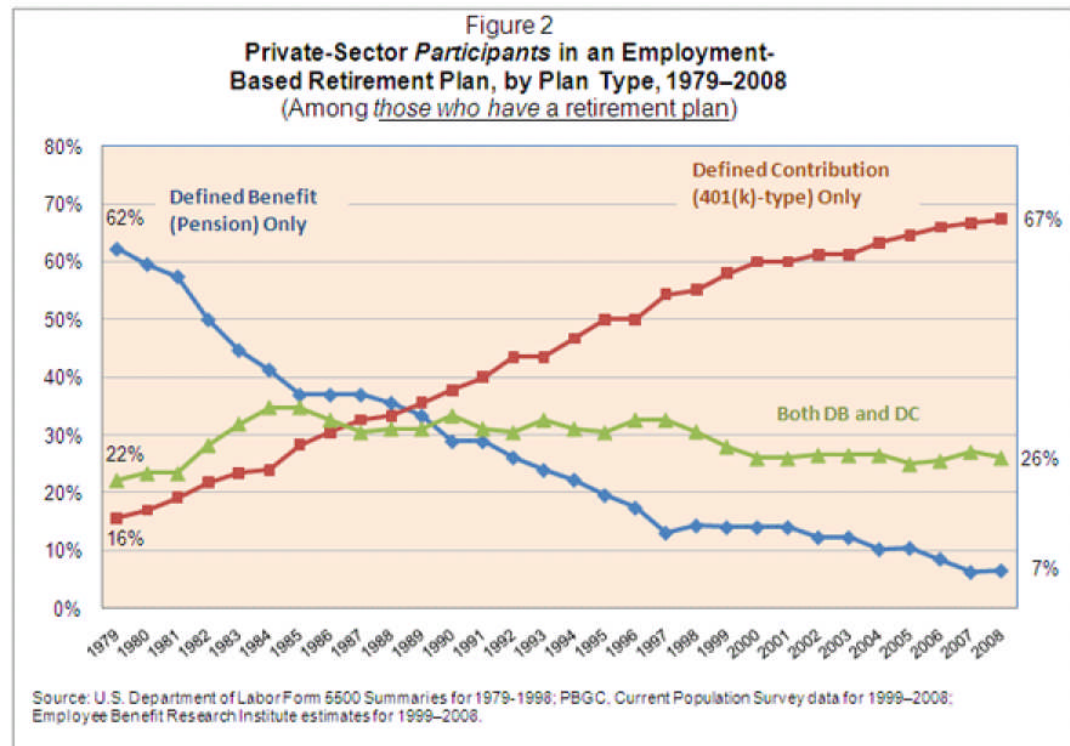
Government	Financial	People	Reputational
<ul style="list-style-type: none"> • Federal, State, Local • Non-US • Penalties, Tax Deductions • Government contract issues 	<ul style="list-style-type: none"> • Increase costs for compensation/benefits • Accounting Discrepancies • Taxes/Penalties • Individual and class action lawsuits 	<ul style="list-style-type: none"> • Attract and retain best talent • Sustainability of the organization 	<ul style="list-style-type: none"> • Public image/negative press • Effect on customers, employees, investors, etc.

We, as SMEs, have assisted IA with:

- Developing risk profiles
- Selecting which areas to examine and how to examine
- Conducting the Examinations
- Evaluating the results

Trends in Retirement Plans

- Gradual shift of risk from employers to employees
- Decrease in defined benefit plans / increase in defined contribution plans
- More mobile workforce
- Increased self-service HR model
- Increase in costs to retire
- Tighter reporting and funding rules



Trends in Retirement Plans

Among those companies offering retirement plans:

- 63% said they are very likely to perform funding and accounting projections (DB)
- 55% intend to review their fund operations, including expenses and revenue sharing (DC)
- 35% are very likely to review their 401(k) plan governance structure or hire a third party monitor to review their investment options (DC)
- 30% plan to perform an asset liability study (DB)
- 29% are very likely to assess the risks that their plans are running based on current strategies (DB,DC)

From survey of 190 mid to large-size US companies.

Health Reform at a Glance

New rules for employer-sponsored benefit plans

The health reform laws require companies to...

Begin:

- Providing coverage to children up to age 26
- Covering children regardless of pre-existing conditions
- Considering participation in pre-65 retiree reinsurance program
- Reporting value of worker health benefits on W-2
- Considering offering new community living assistance services and supports benefit (CLASS)
- Providing uniform statement of benefits to employees
- Providing 1099 for certain corporate service providers
- Notifying workers about the state insurance exchanges that will start in 2014
- If available, considering whether to join state health insurance exchanges (small employers)
- Covering all full-time workers or pay the "free-rider" penalty
- Getting subsidies for providing coverage to their workers (small employers only)
- Considering offering 30% wellness incentives to workers
- If available, considering whether to join state health insurance exchanges (large employers)

2010

2011

2012

2013

2014

2017-2018

Stop:

- First plan year after Sept. 23, 2010
- Setting lifetime limits on benefits
 - Implementing annual benefit limits that do not meet HHS standards
 - Allowing OTC drugs as qualified medical expenses
 - Allowing FSA contributions of more than \$2,500
 - Deducting federal subsidies for retiree drug coverage
 - Setting out-of-pocket limits that are greater than health savings account plan limits
 - Making workers wait more than 90 days to enroll
 - Setting annual plan limits
 - Excluding benefits for pre-existing conditions
 - Offering "high-cost" benefit plans or face 40% excise tax

Key Employer Considerations Under Health Reform

Free Rider Penalties

FT employees who are not eligible for health benefits?
Employees paying > 9.5% of their income for coverage?
Definition of "full time" other than 30 hours or greater?
Significant seasonal or transient workforce?
Waiting periods for benefits > 90 days?
Relative merits of "pay or play"?

Benefit Mandates

Any plans with...
Lifetime benefit maximums?
Annual benefit limits?
High out-of-pocket limits?
Pre-existing condition exclusions?
Exceptionally high costs?

Retiree Medical

Accounting impact examined?
Alternative Rx arrangements to RDS?
Temporary reinsurance program?
Exposure to Medicare Advantage programs?
Potential exit strategy?

New Benefits Opportunities

Significant portion of your workers who are lower paid and potentially eligible for subsidies under the exchanges?
Wellness incentives?
Long term care plan for employees?

Executive Pay and Benefit Programs

Any health benefits for executives that are not offered to rank and file employees?
Any unusual compensation structures that may be classified as "unearned income" and subject to Medicare surtaxes?

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Examples of Specific HR Risks

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- Compensation
- Payroll
- Benefits
- Outsourcing

Areas of HR for IA

- HR can be broken into the following cycles:
 - Hiring/Termination
 - Payroll
 - Compensation
 - Benefits
 - Pensions
 - Expatriate Services
 - Performance Management
 - Learning & Development
 - HR Administration
 - HRIS & Reporting
 - Severance
 - Diversity & Culture
 - Succession Planning
 - Employment Disputes

The HR COSO Cube



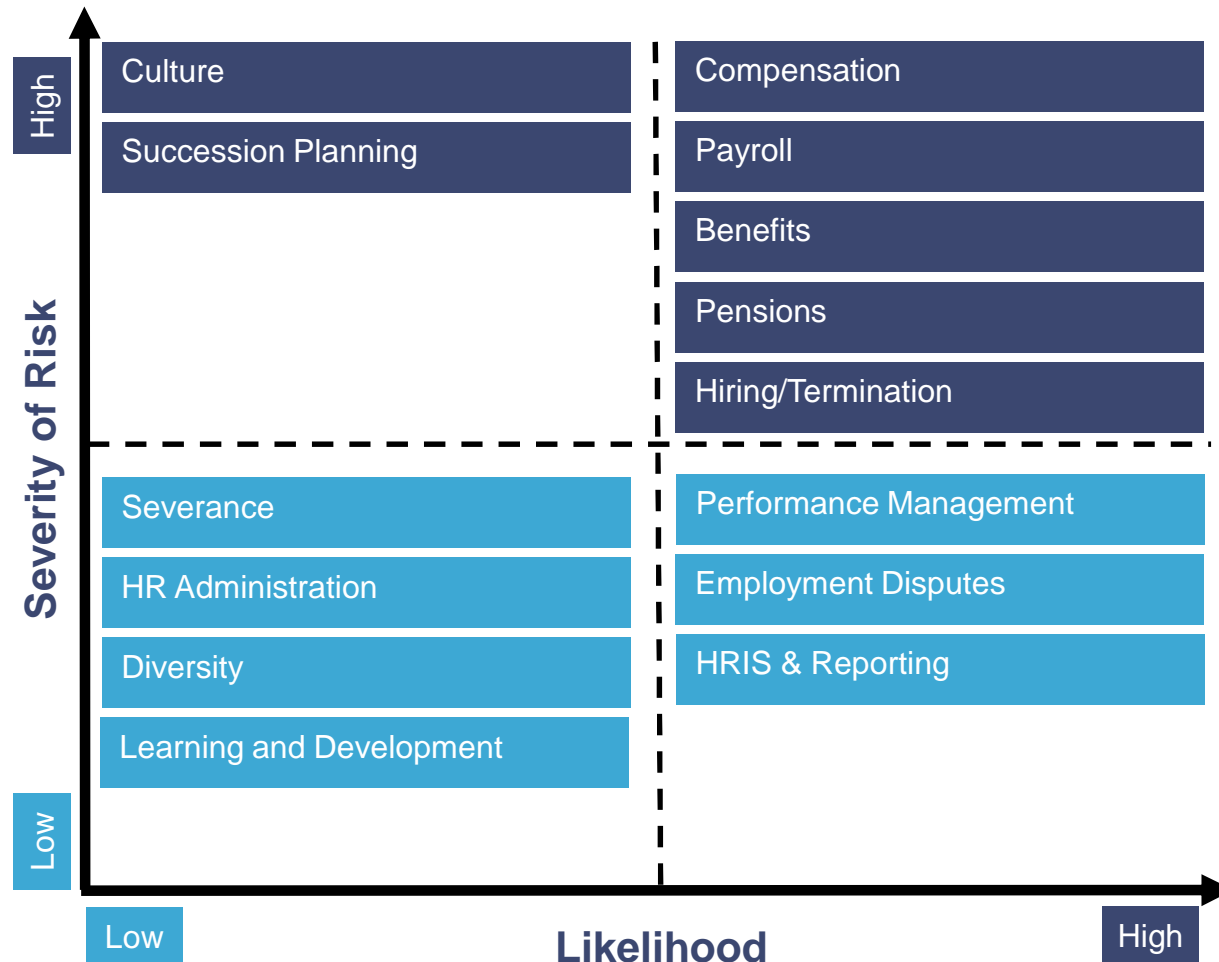
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- IFRS
- FAS 87
- FAS 88
- FAS 106
- FAS 112
- FAS 123R
- FAS 132
- Compensation
- Taxes
- Deferred Liabilities

- ADA
- ADEA
- COBRA
- ERISA
- FLSA
- FMLA
- HIPAA
- IRCA
- IRC
- Health Care Reform

- OSHA
- SEC
- Title VII
- USERRA
- WARN
- Affirmative Action
- State Laws
- Non-U.S. Laws

Example of Risk Profile Matrix from HR Perspective



HR can be broken into the following cycles:

- Hiring/Termination
- Payroll
- Compensation
- Benefits
- Pensions
- Performance Management
- Learning & Development
- HR Administration
- HRIS & Reporting
- Severance
- Diversity
- Succession Planning
- Employment Disputes
- Culture

Other Considerations:

- Vendor Oversight
- Mergers
- Acquisitions

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How to determine your HR Risk Areas

Examples of Specific HR Risks

- ***Hiring/Termination***
- ***Compensation***
- ***Payroll***
- ***Benefits***
- ***Outsourcing***

Risks Related to Hiring/Terminations

Government	Financial	People	Reputational
<ul style="list-style-type: none"> • Federal law (e.g., Title VII, Age Discrimination in Employment Act, Equal Pay Act) • State law • Local law 	<ul style="list-style-type: none"> • Direct and indirect costs of bad hires • Individual and class action law suits 	<ul style="list-style-type: none"> • Attract and retain best talent • Sustainability of the organization 	<ul style="list-style-type: none"> • Bad Press and effect on customers, employees, investors, etc.

Areas to Examine:

1. Determination of employment needs

- Business plans
- Job descriptions
- Educational requirements/certifications
- Coordination of HR and business units

2. Interview Process

- Guidelines, written recommendations
- Background checks
- Offer process
- Employment contracts

3. On Boarding Process

- Entry of information
- Equipment needs
- Work flow
- I-9s
- Tax reporting
- Payroll interface
- Benefit enrollment

4. Terminations

- Documentation
- Business needs
- Succession planning
- Severance pay
- Coordination of HR and business units

5. Former employees

- Last day work
- Return of property, IDs
- Cobra
- Rehires

6. Related issues

- Legal involvement
- Hiring of temps
- Diversity
- Documentation

Case Study: Examples of Hiring/Termination

What can go wrong?	Examples
Illegal/Discriminatory Hiring Practices	<ul style="list-style-type: none"> • HR does not have process for updating changes in law • Special independent contractor review • Employees who interview candidates may ask unlawful questions • Records not properly maintained
Hiring not in line with business needs or requirements	<ul style="list-style-type: none"> • New hires do not have proper approval levels • Compensation does not follow company policy • Background checks not performed • Required certifications not verified
Processing on Initial Hire Information	<ul style="list-style-type: none"> • I-9 forms not properly submitted • Employee not properly enrolled in benefit plans • Employee not paid correctly • Employee's first days at work unproductive

Case Study: Example of Hiring/Termination (continued)

What can go wrong?	Examples
Employee files a wrongful termination suit	<ul style="list-style-type: none"> • Lack of documentation of employment performance • HR not part of process when a performance issue arises • HR not part of termination process
Appropriate personnel not notified when the employee separates	<ul style="list-style-type: none"> • Former employee allowed to access records and property • Business does not develop transition plan • Payroll continues to pay employee
No defined severance plans	<ul style="list-style-type: none"> • Similar employees can be treated inconsistently • Company severance pay not offset by governmental required severance pay (non-US concern) • Accounting treatment for severance plans

Risks Related to Payroll

Government	Financial	People	Reputational
<ul style="list-style-type: none"> • Tax Withholding • FICA/FUTA 	<ul style="list-style-type: none"> • Over and underpayments to employees • Fraud • Administration cost 	<ul style="list-style-type: none"> • Employee moral • Employee cash flow 	<ul style="list-style-type: none"> • Negative press

Areas to Examine:

1. System Integrity
 - Pay checks correctly calculated
 - Configuration/set up
 - Vendor Interfaces
2. Security
 - Unauthorized access
 - Unauthorized changes
 - Access to own records
 - Review of who has access
3. Taxes
 - Tax table update
 - FICA/FUTA
 - Earnings and deduction codes
 - Reporting
 - Transmission of taxes
4. Salary Changes
 - Authorization
 - Off-cycle changes
 - Salary increases within expectations
 - Retro pay adjustments
5. Transfer of funds
 - Direct deposit
 - Check printing
 - Off-cycle payments
 - Funding
 - Payroll reconciliation
6. Related issues
 - Garnishments
 - STD/LTD
 - ESSP
 - Stock options
 - Time entry

Case Study: Payroll

What can go wrong?	Examples
Processes require manual entry and adjustments	<ul style="list-style-type: none"> • Retro-active adjustments for salary increases incorrectly performed • Termination status not updated
Systems not properly updated to reflect changes	<ul style="list-style-type: none"> • State tax requirements not correctly updated • Earnings codes not properly or uniformly categorized (taxable, pensionable, etc) • Patches to payroll system not fully vetted • Change in payroll system do not reflect company's actual practices
Increases in pay not properly reviewed	<ul style="list-style-type: none"> • No system verification if pay differs from prior amounts • Employees can edit own payroll records • Raises not timely implemented
Off cycle paychecks do not have proper controls	<ul style="list-style-type: none"> • Payroll withholdings (401(k), garnishments, etc) not properly processed • Checks issued without the proper authorization • Timely transmission of taxes

Risk Related to Compensation, including stock options

Government	Financial	People	Reputational
<ul style="list-style-type: none"> • Disclosures • Prohibited Transactions • Penalties and sanctions 	<ul style="list-style-type: none"> • Actual cash expense • Balance sheet implications 	<ul style="list-style-type: none"> • Attract and retain best talent 	<ul style="list-style-type: none"> • Bad Press

Areas to Examine:

1. Design

- Business needs
- Total Spend
- Budgets
- Market competitiveness
- Approval process
- Short term vs. long term incentives
- Equity versus cash

2. Administration

- Merit Increases
- Bonuses
- Commission plans
- Equitable pay

3. Compensation Committee

- Independence
- Expertise
- Use of outside advisors
- Authority
- Risk evaluation

4. Non-qualified plans

- Eligibility
- Distributions
- 409A
- Plan documentation

5. Stock Options

- Grant price
- Backdating
- Vesting
- Tax withholding
- 83(b) election
- FAS 123

6. Related issues

- 16(b) compliance
- Disclosure
- Hedging against company
- Holding stock of company
- Fringe benefits

Case Study: Compensation, including Stock Options

What can go wrong?	Examples
Compensation practices are not aligned with business needs	<ul style="list-style-type: none"> • Incentive plans overly focused on short term stock performance • Bonuses paid for metrics that do not meet business objectives • Overly complex incentive plans
Compensation changes do not have proper oversight	<ul style="list-style-type: none"> • Bonuses and merit increases are discretionary and discriminatory • Pools are not monitored to budgets or Board/Compensation Committee guidelines
Nonqualified deferred compensation program not operated in compliance	<ul style="list-style-type: none"> • Employees who are not “top hat” are allowed to participate • Breakpoint between qualified and non-qualified plans • 409A tax implications • FICA
Stock options not properly administered	<ul style="list-style-type: none"> • Lack of controls to make sure options are not backdated • Lack of coordination between payroll and administrator • State tax not properly withheld • Non-US requirements not met

Risks Related to Benefits

Government	Financial	People	Reputational
<ul style="list-style-type: none"> • IRS, ERISA, DOL • Prohibited Transactions • Plan disqualification • Limited state and Local 	<ul style="list-style-type: none"> • Actual cash expense • Balance sheet implications 	<ul style="list-style-type: none"> • Attract and retain best talent • Enable retirement • Healthy workforce 	<ul style="list-style-type: none"> • Bad Press

Areas to Examine:

- Design
 - Business needs
 - Total spend
 - Market competitiveness
 - Approval process
- Administration
 - Day to day processing
 - Vendor oversight
 - Transmission of data
 - Large payments
 - ERISA/Code compliance
- Governance
 - Roles/Accountability
 - Risk Management
 - Performance measures
 - Fiduciary duty
 - Work flow
- Governmental Filings
 - Form 5500s
 - Plan documentation
 - SPDS, notices
- Financial
 - Funding
 - Actuarial assumptions
 - Data completeness
 - Approval process
 - Reporting
- Related issues
 - Outside legal advisors
 - Acquisitions and divestitures

Examples of Breadth and Depth of Roles in HR

ERISA Fiduciary Roles

(Plan Participant Interests)

Investment Committee

- Investment Strategy
- Asset Allocation
- Hiring Investment Mgrs.
- Hiring Trustees
- Overseeing investment performance
- Monitoring plan ownership of company stock
- Ensuring minimum funding of defined benefit plans
- Selection of 401(k) investment options
- Investment expenses

Administration Committee

- Ensuring proper plan operation / administration
- Overseeing administrative expenses paid from plan assets
- Procedures for claims payment and appeals
- Vendor / administrator selection and monitoring
- Compliance with plan documents and applicable laws

Plan Sponsor Roles

(Shareholder Interests)

- Pension Expense Assumptions
- Funding decisions (beyond minimum funding requirement)
- Appointment of plan financial statement auditors
- Internal controls pursuant to Sarbanes Oxley § 404
- Plan design
- Adoption of new plans
- Amendment / termination of existing plans
- Changes in recordkeepers

Case Study: Benefits

What can go wrong?	Examples
Inaccurate reporting of benefits expense	<ul style="list-style-type: none">• Miscalculation of expense causes restatement of financials• Improperly excluded populations• Management does not own assumptions• No inventory of plans
Systems not properly capturing service	<ul style="list-style-type: none">• Exclusion of eligible employees• Incorrect calculation of benefit amounts• Incorrect forfeitures for terminated participants
Overpayments from the Plans	<ul style="list-style-type: none">• Deceased participants continue to be paid or covered• Incorrect calculation based on plan terms• Incorrect coverage for dependants• Claims paid for services not covered by the plan

Case Study: Benefits (continued)

What can go wrong?	Examples
Delinquent filing and disclosure	<ul style="list-style-type: none"> • Form 5500 not filed • Audits not performed • Participant notices not distributed timely (eligibility, HIPAA, COBRA, retirement) • Tax reporting to participants
401(k) plan investments are not monitored	<ul style="list-style-type: none"> • Lack of investment policy statement • Overwhelming number of investment options • Fees not properly disclosed • Diversified asset mix not present • Investment performance not regularly monitored
Employees elections are not captured or processed timely	<ul style="list-style-type: none"> • Deferral changes are not processed • IRS limits are exceeded • Not enrolled in proper medical plans
Employee contributions are not deposited into the trust timely	<ul style="list-style-type: none"> • Multiple payrolls delay transmission • Change in payroll frequency not reflected in payroll contributions • Not focusing on legal requirements • Excise tax pyramids until correction occurs

Risks Related to Outsourcing

Government	Financial	People	Reputational
<ul style="list-style-type: none"> • Fiduciary Duties • Privacy requirements 	<ul style="list-style-type: none"> • Cost of outsourcer • Performance metrics • Viability of outsourcer 	<ul style="list-style-type: none"> • Interaction with employees • Identity theft 	<ul style="list-style-type: none"> • Errors of vendor

Areas to Examine:

1. Selection of Outsourcer

- Business need
- RFP process
- Selection criteria
- Reasonableness of fees
- Conflicts of interest
- Documentation

2. Contractual Reviews

- Actual agreement
- Scope of agreement
- Service Level
- Limitations of liability
- Length/termination
- Change orders
- Implementation fees
- Transition to successor suppliers

3. Monitoring of Performance

- Service level agreements
- Administration manual
- On-site audits
- Invoices
- Service Team
- 3rd party outsourcing
- Data protection
- Customer satisfaction surveys

4. Outsourcer's Limitations

- System customization
- SAS Type 2
- Retained expertise
- Delegation of authority
- Retention of liability

Case Study: Outsourcing

What can go wrong?	Examples
Vendor's performance is not monitored	<ul style="list-style-type: none"> • Vendor's system is not flexible for specifics of company plans • Vendor not performing required tasks • Vendor not meeting performance standards
Vendor's fees are not reasonable	<ul style="list-style-type: none"> • Vendor not paid enough – so engagement not properly staffed • Fees are not formalized in executed contracts • Vendor selected without considering employer's fiduciary responsibilities
Vendor not satisfying legal requirements	<ul style="list-style-type: none"> • Outsourcers actively try to limit responsibility • Contributions to 401(k) plans are not timely transferred • State taxes not properly withheld
Company not retain in-house expertise	<ul style="list-style-type: none"> • Company tries to outsource legal responsibilities • Company not able to use proper judgment when resolving issues

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