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WRITTEN STATEMENT OF

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**BEFORE THE 2019 ADVISORY COUNCIL ON
EMPLOYEE WELFARE AND PENSION BENEFIT PLANS**

**BEYOND PLAN AUDIT COMPLIANCE:
IMPROVING THE FINANCIAL STATEMENT AUDIT PROCESS**

AUGUST 27, 2019

I welcome the opportunity to address the U.S. Department of Labor's Advisory Council on Employee Welfare and Pension Benefit Plans (the ERISA Advisory Council). I especially appreciate that the ERISA Advisory Council seeks my input on how, under Section 103 of ERISA, we in this industry collectively can enhance the safety of Employee Benefit Plan assets, the effectiveness of the plan in satisfying its purpose, the efficiency of the plan's operations, and the plan's compliance with ERISA, the Internal Revenue Code (the Code), and other applicable laws.

My Background

I have spent some 30+ years as initially an auditor for JP Morgan and then as a lawyer with an ERISA Title I/Title II expertise at various international, large, or boutique law firms. My representation has always been of plan sponsors headquartered across the nation. A strength I offer those plan sponsors is understanding their business and demographics such that I can help them adopt and maintain the most robust, ERISA- and Tax-compliant and competitive Employee Benefit Plans for their employees, with plan assets safeguarded. I counsel both the ERISA fiduciaries of the plans and those Human Resource (HR) professionals who tend to the plans in day-to-day handling.

I am an ERISA/Tax partner at the law firm FisherBroyles, LLP. The firm has 240 attorneys in offices nationwide and is engaging in strategic expansion. Our attorneys hail from the sophisticated practices of BigLaw, leveraging talent and technology of a cloud-based law firm partnership. I currently chair the Employee Benefits Practice Group of my firm, and I also lead its Cannabis, Hemp, & CBD Practice Group, as that industry too is in need of understanding ERISA/Tax rules as those rules apply to their employee benefit plans.

I regularly author ERISA/Tax pieces often for various publications¹ that have large followings of in-house counsel and HR subscription readers. I also speak frequently before and train auditors² and financial advisors³ throughout the United States about Department of Labor (the Department) and Internal Revenue Service (IRS) compliance issues for which *their* plan sponsor clients blame *them* and, thus, how to avoid such issues.

Recommendations

Financial statements are the responsibility of a plan's management (we see this caveat in many audit reports), with the auditors asked to express an opinion on such financial statements. Oftentimes, what plan management does not recognize is that the numbers proffered in those financial statements might not fully take into account the exposure from serious (and potentially costly) ERISA/Tax compliance issues that have not been fully vetted. Part of today's request urged invited guests like me to comment on how to enhance the safety Employee Benefit Plan assets. The invitation recognizes that

¹ See [Lexology](#), [NAPA-NET](#), [Law360](#), and [AllThingsERISA](#), for examples.

² AICPA, Employee Benefit Plans Conference 2019, New Orleans, LA, May 2019; Massachusetts Society of CPAs, Inc., Annual Training, Norwood, MA, January 2020 (pending), for examples.

³ NAPA 401(k) Summit, Nashville, TN, April 2018, for example.

financial statement audits for Form 5500 purposes may require more than what Section 103 of ERISA contemplates.

While I do not have absolute solutions, I nonetheless have recommendations for the ERISA Advisory Council. I re-phrase the salient issue as this with respect to understanding the financials that plan management must provide to the auditors:

How do those of us in this Employee Benefit Plan industry help the plan sponsors -- those who know the least -- learn a little bit more about running their employee benefit plans, such that they can protect the assets of those plans?

For the record, my own ERISA/Tax legal practice aligns with this mission: I help plan sponsors with fiduciary duties, plan compliance, oversight, and risk assessment with respect to controls related to plan operation (which controls or lack thereof may impact what appears on financial statements); I assist those plan sponsors in navigating the nuanced rules that ERISA and the Internal Revenue Code impose on their plans.

The Department has the authority to insist upon, to press for, sophisticated training for anyone who deals with Employee Benefit Plans.⁴ The Department can compel the education necessary to sponsor a 401(k) plan, in the case of an employer. It can compel the education necessary for any party who may sell, third party administer, record keep, audit, or advise a retirement plan, in the case of 401(k) service providers.

I leave to the Department how it wends itself through ERISA Section 103, ERISA Section 502(c)(2), and the targeted and limited review and [investigative authority](#) it has over service providers

⁴ While I believe education is necessary for *all* Employee Benefit Plans, today's written statement will focus primarily on retirement plans (and I will refer just to 401(k) plans), though I believe the education is relevant for financial statement audits for all retirement plans and, as well, all health and welfare plans. Of concern, the type of ERISA bombs I reference within have indeed occurred with health and welfare plan assets too.

(including plan lawyers) to Employee Benefit Plans. Nevertheless, the Department's power to compel enhanced education of specific parties to understand ERISA and the Internal Revenue Code – as it relates to the specific operation of a 401(k) plan – positively exists. My recommendations, when implemented, should not drive up costs for sponsoring a 401(k) plan.⁵ There is room to absorb any such cost in the basis points currently derived from plan assets and with which financial advisors (FAs), third party administrators (TPAs), and record keepers (RKs) are typically compensated.

Further, in the end, I believe that collectively and holistically, the plan sponsors who are in need of guidance will welcome the collaborative approach to the recommended education.

Plan Sponsors Require Assistance

From my perspective, plan sponsors crave. . . insist on. . . and just plain need guidance. They have limited understanding of [who's who](#) with respect to their 401(k) plan and what each service provider really contributes to the relationship. These are the queries I hear repeatedly from my clients:

what's the role of the financial advisor;

what does "bundling" mean;

who is taking on fiduciary duty;

who is not taking on fiduciary responsibility;

why does it appear that the FA, TPA, and/or RK is really "calling the shots";

if they call the shots, why can't I rely on them;

can we trust the design of our retirement plan to these service providers;

why get a financial audit statement; aren't the other service providers doing their jobs;

our auditors have audited for several years in a row; how did they neglect to spot these issues;

how could they miss embezzlement that occurred over two years;

how did the FA and TPA – with whom I speak regularly – overlook these issues too?

⁵ An incremental minor cost, if any and notwithstanding, is outweighed by the benefits and protections afforded to plan participants and their money, which goes to the integrity of the financial statements.

What Auditors Overlook

Recall, I was once an auditor. I too have been viewed as “unwelcome.” Nonetheless, even when a plan sponsor has carefully selected a qualified auditor and received an unqualified opinion to attach to its 401(k) Form 5500, auditors miss significant “ERISA bombs” described directly below, and so too do the plan sponsor’s many other service providers. The “significance” of an ERISA 103 enquiry means that which goes to the very safety of 401(k) assets, for the protection of plan participants and their beneficiaries – which is part of the reason you are evaluating my testimony, input, and experience with those who adopt these 401(k) plans. What is unsettling is that, along with the annual fees paid to the auditor and the annual basis points that FAs, TPAs, and RKs derive from 401(k) assets, the plan sponsor had to expend *even more fees* for outside ERISA counsel to address and rectify these issues here below:⁶

1. A TPA calculates the match amount for 100 participants (\$50 dollars per participant, just for this example).
 - The plan sponsor wires \$5,000 to fund the match amount (100 participants x \$50).
 - When the TPA (who serves also as RK) allocates to each participant, each such participant receives \$45, with the TPA/RK skimming \$5 from each participant.
 - This happens for 14 months of payroll.

2. A plan participant (the plan sponsor’s Payroll Clerk) takes repeated loans from the 401(k), repaying each one off, then borrowing again. However, when the Payroll Clerk repays each of the six loans, he does so with money from the company bank account and not from his personal wages.
 - At termination, the Payroll Clerk requests and gets a full distribution of his 401(k) plan account, which is made up of some \$90,000 of company money (close to half the account balance).

⁶ I have altered these facts a bit to protect the ERISA fiduciaries involved. However, the plan sponsors have appropriately addressed these matters. That is, the respective plan sponsor has reported to the Department, the IRS, and/or outside detectives and police and has advised plan participants. Moreover, the respective plan sponsor has fully corrected, such that the respective plan remained tax-qualified, participants have been made whole, and the plan sponsor’s internal procedures improved.

3. A 401(k) plan has 2000+ participants. One of the investments the FA puts onto the investment platform at plan adoption has a 7-year penalty for any new money coming into that account (that is, any new money into this account that is withdrawn prior to 7 years of seasoning has a gradually decreasing penalty assessed to the participant account).
 - This specific 7-year penalty option remains in the 401(k) plan for 15 years.
 - The demographics of this company are such that employees stay fewer than 7 years, and money is distributed from this investment option (thus, with the penalty assessed).
4. A plan sponsor maintains a 401(k) plan for Service Contract Act (SCA) and non-SCA employees. The SCA fringe, required by law to be fully vested, is instead put into the plan as a match (improperly requiring one year of service for eligibility) and impermissibly subject to a vesting schedule.
5. A company terminates its executives from employment on a Friday. The next Monday, the company hires those executives as independent contractors.
 - Nonetheless, the executives seek and receive a distribution of their entire 401(k) account balances, when in fact these executives have not experienced a true “separation from service” under Internal Revenue Code rules.
6. Rather than pay the corrective contributions for weaknesses that an auditor identifies (and to allow the auditor to finish its work), the plan sponsor files each Form 5500 for several years without a financial statement audit attached.
 - The plan sponsor pays the approximate \$50,000 annual penalty for failure to attach the audit report for each of those years (as what would appear to be a “cost of doing business” and as a way not to have to pay for the cost of corrections required under ERISA or the Internal Revenue Code).
7. A behemoth in the retirement industry, a certain service provider’s 401(k) adoption agreement provides that a well-known manufacturer with foreign nationals may exclude non-resident aliens *but only if* they have no US-sourced income.
 - That large provider’s “[Summary of Plan Features](#)” (not a required document under ERISA) directs HR to exclude *all* non-resident aliens, on which HR relies and follows in operation.
 - However, this manufacturer had many non-resident aliens *with* US-sourced income. Because of the auto enroll (and match) components, this manufacturer was exposed to some \$1.5 million in corrective contributions, because of the faulty documents provided to it.

- This large provider sold this same internally-inconsistent set of plan documents to many large manufacturers, exposing each of them similarly.

There are many other issues (inadequate fidelity bond coverage or none at all; and the standard ones: loan repayments, compensation definition, late employee deferrals, non-traditional assets) that I have not described in detail, but with which I have wrangled on behalf of client.

I favor and see the value in an independent audit. What is eye-popping is that a few of the above 401(k) plans were small plans for Form 5500 purposes, which plans did not warrant a financial statement audit. In each of those instances where an audit *had* been done, however, the plan sponsor was incredulous: “*Why didn’t the auditor catch that?*”

The point I make with the above ERISA bombs is that an auditor is needed for a 401(k) to determine if internal controls are such that the financial statements are free of material misstatement. Although the financial statements are the responsibility of the plan sponsor and its management, the plan sponsor and management cannot even begin to speak to accuracy of the financial statements if the above types of ERISA/Tax compliance issues are neither detected nor properly resolved. This is where plan sponsors need assistance.

The Quandary re: Financial Statement Audit

Auditors are damned from the beginning. If they do not unearth problems such as those overlooked above, then the view is “what good are they?” If they do discover 401(k) problems that need addressing (that could mean corrections, time, money, applications to the Department or IRS), they are abhorred.

While I see real value in auditors, their work, and what they produce, plan sponsors might not. The audits are often inconvenient, interrupting summer vacation plans. The plan sponsors may view the

auditors as no more than a pesky nuisance. . . indulged only because of a regulatory requirement under ERISA Section 103. Thus, with the requirement being annual (and, in their minds, perhaps costly), the plan sponsor procures the least expensive audit.⁷ The 401(k) plan sponsor wonders openly how the auditors and their financial statement audit even begins to help with what is really relevant, from their perspective: fiduciary management oversight and day-to-day operations so that the plan sponsor can comply with ERISA and the Internal Revenue Code.

Thus, how do we assist plan sponsors in recognizing the value of financial statement audits? How do we assist the auditors in allowing them to execute on their jobs even better, without adding ERISA consulting to their list of field duties?

Outreach and Education

Have the Department Partner with Trade Groups

There is a need for the Department to speak as one with respect to the need for fiduciary⁸ education with respect to 401(k) plans. Both the Department and the IRS⁹ can do this before trade groups who represent the retirement plan service industry and/or who service retirement plans, for example: the Society for Human Resource Management (SHRM); the American Society of Pension Professionals and Actuaries (ASPPA); the American Retirement Association (ARA); the National Association of Plan Advisors (NAPA); the National Tax-deferred Savings Association (NTSA); the ASPPA College of Pension Actuaries (ACOPA); the Plan Sponsor Council of America (PSCA); the

⁷ In fact, some auditors concede that they slash the price of 401(k) financial in hopes of capturing the larger (more appreciated by the company, yet more expensive) corporate financial audit work.

⁸ While the Department's rules (Section 406 of ERISA, *et seq.*) refer to a "fiduciary," parallel provisions in Section 4975, *et seq.* of the Internal Revenue Code refer to a "disqualified person," but this written statement refers solely to a fiduciary for ease.

⁹ Hopefully, this outreach can be a joint effort with the IRS re: tax qualification and fiduciaries' obligation to ensure continued qualification of the 401(k) plan.

Spark Institute.¹⁰ Some service providers or HR professionals believe they have all the education they need for coaching their plan sponsors, but -- in my experience -- some service providers or HR need fine-tuning.

Of course, outside service providers to 401(k) plans hope to understandably sidestep the “fiduciary” role (leaving it squarely on the plan sponsor), yet often times, those outside providers -- by their conduct -- really assume fiduciary control over the plans that they are selling or for whom they are administering/recordkeeping. Even if they are not affirmatively or through their actions assuming a fiduciary role, plan sponsors are nonetheless relying heavily on the direction and guidance these outside service providers provide (i.e., plan sponsors “rubber stamp” their FA/TPA/RK recommendations). Recall the verbal testimony of Stephen L. Dobrow, of Primark, who testified before the ERISA Advisory Council this past June, that financial advisors like to “quarterback” the 401(k) plan and process.¹¹ Indeed, often the FAs are the ones who pick the “special teams” that are the TPA and the RK who will service the plan sponsor client.

Have the Department Strongly Encourage 401(k) Compliance Reviews as Part of Basis Point Compensation Already Paid to Members of Trade Groups

Plan sponsors find adopting and running a 401(k) plan is expensive, given audit costs (when required), training, costs of administering, basis points paid outside service providers, and fees that the plan sponsor directly pays from its own coffers. Assuredly, the Department possesses sway that service providers must provide compliance reviews to their plan sponsor clients without an increase in fees. Under Section 408(b)(2),¹² ERISA exempts those arrangements for 401(k) plans with outside providers

¹⁰ There are likely other trade groups, but these immediately come to mind.

¹¹ In the Matter of: Meeting of ERISA Advisory Council, June 25, 2019, page 152, line 22.

¹² The parallel provision under the Internal Revenue Code is Section 4975(d)(2).

if the arrangement is “reasonable.” It is entirely appropriate and within the Department’s power to communicate that a “reasonable” arrangement by an FA, TPA, or RK¹³ is only that which includes an annual compliance review of the 401(k) plan that the team has put into place for a plan sponsor client, with the compensation for that work garnered through existing basis point arrangements. This seems drastic and disruptive, but necessary, in light of the safety of 401(k) assets and of the need for sound plan administration.

Have Those Trade Group Members Conduct Annual Compliance Reviews

Plan sponsors do not need mere *general* guidance with respect to ERISA and the Internal Revenue Code. Instead, they need *specific* guidance on how *their own* plan affects *that* plan sponsor’s daily operations. Recall, the 401(k) plans sold to these plan sponsors were mostly shaped and driven in design by the service providers themselves. Those who quarterback the 401(k) process are well-suited to provide this type of compliance review that would help plan sponsors in their fiduciary management and oversight.

As part of that compliance review, these service providers must discuss what the *specific* design choices in operation mean to the *specific* plan sponsor. This type of discussion will help the plan sponsor client understand the details of the specific plan that they have collectively sold to the plan sponsor: how, for example, to deal operationally with the auto enrollment feature the FA recommended;¹⁴ permissibly exclude a certain class of employees; work with the SCA fringe allocation;

¹³ The various service providers can determine, by whoever takes on the task for the compliance review, how to re-allocate basis points that they, as a group, already earn from the 401(k) plan.

¹⁴ While auto enrollment increases participation and might help with discrimination testing, it also allows the FA (and/or TPA and/or RK) to be compensated from even more assets under management, which translates into an increase in compensation to the FA, TPA, and RK. It is this type of “assets under management” compensation that can be allocated to absorb the cost of annual compliance review.

calculate compensation when there are bonuses and overtime (and the proper employee deferrals and matches related thereto); assess hardship requests; comment on involuntary cash-out efforts; predict how embezzlement¹⁵ might occur with this specific plan and plan sponsor, given its unique environment (that is, different from any other plan sponsor).¹⁶

Section 502(c)(2) of ERISA could be liberally interpreted to mean that the Department may sanction any service provider who fails to provide (or fails to team up with another service provider to produce) a client a plan-specific compliance review for each plan operating each year.¹⁷ Service providers should note that it is this compliance review, after all, that will allow the service providers to assist the plan sponsor with fiduciary management/plan operations and support the integrity of the financials the plan sponsor will provide to the auditors. The service providers should work with the plan sponsor to identify which issues have been identified/vetted/corrected (which the plan sponsor could communicate to the outside auditor at the first opening meeting), such that the auditors can craft a quicker (and perhaps less expensive) financial statement audit plan.

I recommend this compliance review for any plan, no matter what size and no matter if an annual financial statement audit is needed. In this way, anyone who ever sells, administers, or record keeps for a 401(k) plan has an obligation to assist its plan sponsor client with its oversight over fiduciary management/plan operations and the dollar amounts that make their way into the financial statements.

¹⁵ See, for example, this material I authored re: [embezzlement](#). The interest and concern for protection with respect to embezzlement is overwhelming.

¹⁶ These are just examples. Perhaps ERISA Counsel can assist the Department on the types of items that a compliance review must consider.

¹⁷ The Department should also remind service providers that it has investigative authority over these service providers to ensure that there is no countenancing of abuse with respect to 401(k) plans.

Outreach at Annual Joint ERISA Practitioner Meeting

Each year since the start of my legal practice in 1993, there has been a Joint TE/GE (tax-exempt/government entity) Council for Employee Plans Meeting held (either in Baltimore, MD, or Washington, DC). The Joint Meeting draws hundreds of ERISA professionals (which regularly includes me) and even the press from across the country to absorb updated commentary on rules, procedures, policies, and trends from key Department and IRS officials. Both the Department and the IRS would have attentive, standing-room only attendees (ranging from outside counsel, fiduciary consultants, auditors, TPAs, and RKs) whose ears would perk up and who would communicate the importance of enhanced fiduciary education to their clients. The message must be that those in attendance at the Joint ERISA Practitioner Meeting must do their part to educate their clients of the value of regular compliance review over their 401(k) plans, such that those clients can support the integrity of the numbers reported on the financial statements (which are provided to outside auditors).

Outreach to and Education for Auditors

The outreach to auditors from the Department should be helpful in trying to rehabilitate the auditor image, as it relates to the Form 5500 financial statement. As part of that rehabilitation, the Department should require anyone who will receive compensation from preparing a financial statement – to include anyone who touches a 401(k) plan, for partners, seniors, managers, and juniors alike – to get very specific ERISA and Tax training on Employee Benefit Plans (and their operation) in particular. Perhaps the Department can require that 10 hours of annual continuing professional education (to include fraud/embezzlement/cyber security issue training) be devoted to ERISA/Tax, as those laws apply to 401(k) plans? Further, the Department must underscore the importance of an auditor meeting face-to-face with plan sponsor to spearhead a brainstorming session that presses the plan sponsors (to

the point of discomfort) to articulate the hypotheticals on how someone could commit fraud or embezzlement with respect to the 401(k) plan.

With the Department's new closed Multiple Employer Plan (MEP) [rules](#), enhanced auditor education is critical re: how the associated 401(k) plan and the newly-defined "employer" need to be properly audited and how MEP plan assets protected. My experience with the Cannabis Industry leads me to [believe](#) that the Department's encouragement of access to (1) health care through the [association health plan rules](#) and (2) 401(k) benefits through the expanded closed MEP rules may mean that the 300,000 employees¹⁸ now working at Cannabis Companies will urge their employers to tap into these once unavailable Employee Benefit perks through these set-ups. I predict that the Cannabis Industry's participation in Employee Benefit Plans (which was [appropriate](#) under the Internal Revenue Code, even before the Department's association health plan and association retirement plan rules) will mean millions, if not billions, of dollars flowing through those plans. Again, it is important that any education that the Department promotes should go to protecting the association health or retirement plan assets that the new and expanded rules allow.

Further, the Department should encourage auditors to educate its plan sponsor clients that the goal of protecting plan assets must take a holistic approach, starting with the plan sponsor and its service providers, with the auditor rounding out the team. If the Department accepts the recommendation for a compliance review, the auditors can approach their first planning meeting for the financial statement audit of each new plan year knowing that there has been a compliance review since the auditor's last visit (or within the last year, as the case may be).

¹⁸ <https://www.nytimes.com/2019/04/25/business/economy/jobs-in-cannabis-weed-marijuana.html?smid=nytcore-ios-share>

Outreach to and Education for Plan Sponsor

The Department could require that anyone signing a Form 5500 confirm that either the signer has CEBS¹⁹-like training (by acknowledgement on the filing) or that the plan sponsor has received an annual compliance review from one of its current service providers (whom the plan sponsor must identify by individual name and company in the Form 5500). Assuming certain of the above Outreach and Education recommendations are accepted, the Department should again remind the plan sponsor (through the Department's already-helpful website or outreach letters) of fiduciary obligations with respect to a 401(k) plan, with *particular emphasis on personal liability*. However, the Department can mitigate the concern over the personal liability aspect if it steers the plan sponsor to its outside auditor and outside service providers, because of the annual compliance review.

Further, it would be helpful for the Department to offer checklist guidance to plan sponsors on what questions to ask of each of its service providers before hiring (and or retaining) them:

are you licensed (what does that licensing entail);

what assurances does your license give me;

what self-policing do you perform on your operations;

how many plan had compliance issues under your watch;

how are our assets protected with you;

how do I ask for a SOC-1, SOC-2, or SOC-3 statements;

and how do I evaluate what those statements indicate?²⁰

¹⁹ Certified Employee Benefits Specialist. I do not recommend any certain training over another. I merely point out that CEBS-like training should mean that a plan sponsor has enough requisite education to run a plan. If a plan is large enough, then presumably a plan sponsor could pay for the cost of CEBS training for the one signing the Form 5500. If the plan is small, then it is incumbent on the plan sponsor to find a team (with the right quarterback) that can provide the compliance review as part of its services.

²⁰ These are obviously just sample questions that could find their way into a more comprehensive plan sponsor checklist.

Summary

I conclude with unwavering support for a financial statement audit. However, to burden the auditor with all the responsibility and expectations that a plan sponsor has related to overall ERISA and Internal Revenue Code compliance and fiduciary rules is asking too much. Notwithstanding, without assurance of ERISA/Tax compliance, the plan sponsor cannot really confirm the veracity of the financial statements it produces to the auditor.

An endorsed and coordinated emphasis on Outreach and Continued Education, along with required compliance reviews by the very service providers who sell a 401(k) plan to the plan sponsor, provides some recommended solutions to how the Department, under Section 103 of ERISA, can safeguard Employee Benefit Plan assets, the effectiveness of the plan in satisfying its purpose, the efficiency of the plan's operations, and the plan's compliance with ERISA and the Internal Revenue Code.

Disclaimer

This written statement (and the accompanying testimony before the ERISA Advisory Council) expresses my own views as an ERISA/Tax practitioner who counsels plan sponsors and ERISA fiduciaries. The statements herein and from my testimony do not necessarily represent the views and opinion of my law firm.

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