This paper begins with the proposition that we agree that establishing and maintaining a pension plan governance system is essential for sound management of the plan and delivery of pension benefits to plan participants. Pension plans, which hold trillions of dollars in assets, are a vital part of our economy. They offer financial protection for employees at retirement and, along with health care, is the most significant benefit offered by employers to their employees. The pension plan governance audit is an integral part of the pension plan governance system.

In the United States the pension plan sponsor is the corporate employer or other organization which sponsors the plan. In most cases the sponsor is the corporate employer, or if the plan is a multi-employer pension plan or public plan, the plan sponsor is a Board of Trustees. Under the Employee Retirement Income Security Act of 1974 (“ERISA”), the plan sponsor is a fiduciary. ERISA sets forth four basic standards of conduct for plan sponsor fiduciaries. A fiduciary must:\1:

1) discharge his duties solely in the interest of and for the exclusive purpose of providing benefits to participants and beneficiaries and paying reasonable expenses for plan administration;

2) discharge his duties with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in like capacity and familiar with such matters would use;

\1 ERISA § 404 (a)(1)
3) diversify plan investments to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and

4) act in accordance with plan documents.

As you can see, the ERISA standard of conduct for plan sponsor fiduciaries places a considerable burden on the fiduciary since all of the responsibility for management of the pension plan rests with the plan sponsor. In the United States the plan sponsor wears two hats, one as an ERISA fiduciary responsible for the management of the pension plan and the other as an official responsible for the management of the corporation. This dual role, as pension plan manager and corporate manager, is inherent with conflicts of interest and often causes confusion as to the appropriate course of action. A “best practice” pension plan governance system can facilitate the decision-making process for plan sponsor fiduciaries and ensure that appropriate procedures are in place for the investment of plan assets and the operation of the plan and that the interests of plan participants are protected.

Under the statutory structure in the United States, oversight of pension plan management is split between three government agencies, the Internal Revenue Service (“IRS”), the Department of Labor (“DOL”) and the Pension Benefit Guaranty Corporation.\(^2\) The IRS and DOL have authority to impose significant penalties against employer plan sponsors for failure to properly manage the plan. The pension plan governance audit is intended to assess how well the pension plan governance system works. Is it effective and efficient? Are legal requirements being satisfied? To make that determination, key elements of the system are reviewed; organizational structure, service provider

\(^2\) Title III of ERISA; Reorganization Plan No. 4 of 1978, 3 C.F.R. 275 (1978)
procurement and responsibilities, investment policy and asset allocation and the plan’s compliance with statutory and regulatory requirements.

A pension plan governance audit generally will consist of a review of some or all of the following areas, depending on the needs of the plan sponsor:

**Organizational Structure:**

- Nature and functions of the pension committee or Board of Trustees
- Internal audit issues
- Lines of authority/staff and consultant duties
- Relationship of plan assets and operations to company legal matters
- Governance documents
- Organizational and statutory framework
- Pension committee or Board composition, terms, qualifications
- Pension committee or Board duties and relationship to staff
- Allocation and delegation of fiduciary responsibilities
- Corporate or Board – charters, bylaws, composition, rules
- Roles of committee members or trustees relative to corporate or fund officials and external service providers
- Internal controls – separation of functions and internal audit
- Identification of conflicts of interest
- Compliance with statutory fiduciary duties and ethics policies
- Review of fiduciary liability insurance and recommendations for improvement and enhanced coverage

**Service Provider Procurement and Responsibilities:**

- Review of Fiduciary status, scope of work and conflicts of interest
- Review of actual performance vs. contract
- Reasonableness, consistency and disclosure of asset management and consultant fees
- Review of Brokerage and Trading Issues including procedures for evaluating trade execution, directed brokerage, commission recapture and soft dollar practices
- Review of selection and retention process
Investment Policy:

- Suitability in terms of committee or Board’s objectives and risk tolerance
- Suitability in terms of financial and actuarial conditions
- Adequacy and sufficiency of investment manager guidelines
- Review of Due Diligence Procedures for selecting external managers, monitoring external and internal accounts and compliance with guidelines

Asset Allocation:

- Review of methodologies and re-balancing process
- Review of inputs/assumptions for risk/return analysis and relationship to liabilities

Plan Operation:

- Review plan documents
- Review participant documentation and data
- Review procedures for the day to day administration of the plan
- Review compliance with tax, and reporting and disclosure requirements

The first step in conducting a pension plan governance audit is to identify the objectives of the audit and set up a work plan to ensure that the audit meets those objectives. Each company and organization is different and it is important to recognize how those differences will affect the audit process. A list such as the list above can be used to identify which areas of review the plan sponsor is interested in pursuing. A timetable should be constructed that is detailed as to each step of the process but that also allows for some flexibility as it is not uncommon, with so many other parties involved in the audit process, to experience some unexpected delay. The timetable or in the case of an outside independent audit, the service
A provider contract or retainer can be used to document this phase of the audit process.

The next step involves gathering all of the documents and data that will be reviewed. A checklist or spreadsheet can be used to track receipt of requested documents and data. The documents are then reviewed and any follow-up questions or request for additional documents are made at this time. Interviews may be conducted with appropriate “in-house” personnel such as committee members, human resources/benefit and payroll managers as well as the plan’s service providers. Internal controls are tested by reviewing a sample group of participant documentation.

The review process must be fully documented. Areas of compliance and non-compliance are noted and discussed with the fiduciary. Recommendations for correction of any areas of noncompliance may also be documented and discussed with the fiduciary. Finally, a report of findings and recommendations for correction, either oral or written, is provided to the fiduciary. In the United States, the plan sponsor fiduciary may correct nearly all mistakes in the management of the plan that are identified by the audit by using one of the government’s voluntary correction programs and thereby avoid the imposition of monetary sanctions in the event the pension plan is audited by the IRS or the DOL.

A pension plan audit may be conducted by an outside independent party or “in-house” personnel if such personnel has the experience to do so and can remain impartial. However, it should not be done by an existing service provider or consultant since there are likely to be conflicts of interest. The plan sponsor fiduciary should also consider whether it is important to have a confidential report of the audit’s findings that is protected under attorney-client privilege. An
important consideration for U.S. plans is that the cost of the pension plan governance review may be paid from plan assets as such review is considered part of the administration cost of the plan.

The importance of maintaining high standards for governance of pension plans must be emphasized by those with responsibility for the management of the plans. Once a pension plan governance system has been established it is critical to test its effectiveness by conducting a pension plan governance audit.