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Internal Audit of Human Resources (HR)

People Costs and Business Risk - Finance Understanding Human Resources

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Agenda

- **Introduction**
- **HR Players, Plans and Programs**
- **Focusing in on HR Risks**
  - **HR Related Risks**
  - **Approach an Audit of HR**
  - **High Risk Areas**
- **What We Find**
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People Costs and Business Risk

People costs are significant drivers of current and future performance

- Efficiency and effectiveness of these programs is critical

Litigation exposure has increased due to

- Downsizing
- Benefit cuts
- Market driven losses in retirement programs.

Business risks are created if there are unexpected or substantial increases in costs and expenses from benefits such as health care and pensions

Finance Understanding Human Resources

Human Resource people and Internal Audit people don't always see eye to eye

- HR may react to a review as a test, rather than an improvement opportunity
- Internal Audit may not have the depth of specialized knowledge that apply to areas in HR

HR Players, Plans and Programs

What Do We Mean by HR?

Areas Covered:

- Compensation, payroll, incentives, expatriate services
- Benefits
- Employment laws (anti-discrimination laws, privacy laws, union laws, etc.), succession planning, diversity & culture, employment disputes
- Recruiting, hiring, training/learning & development, evaluating/promoting, terminating

What Do We Mean by HR?

Players Covered:

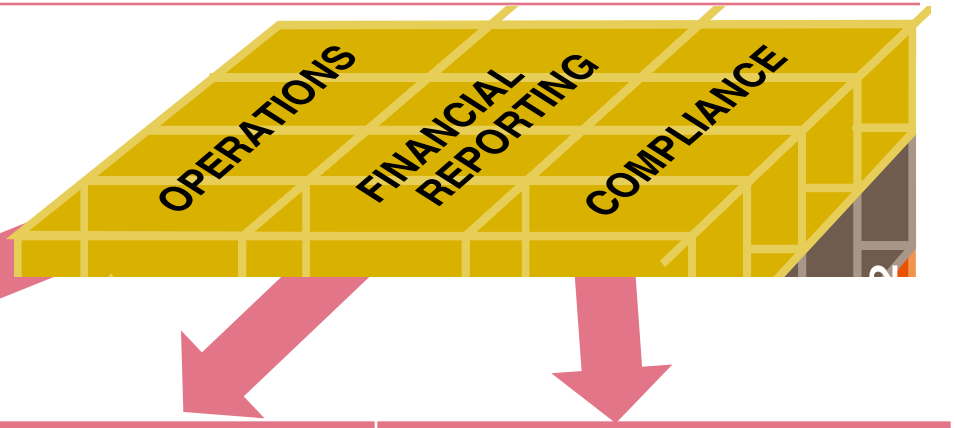
- HR department: Strategy, Operations
- Specialists - actuaries, underwriters, consultants
- Vendors
- Trustees/custodians
- Payroll
- HRIS, data warehouses (IT)
- Legal/compliance involvement
- Finance involvement
- Plan committees and fiduciaries

Things to Know when Auditing HR

- HR not as finance-oriented so documentation, controls, and governance might not be as complete as in finance
- HR, compensation and benefits specialist knowledge are more important than industry or sector specialist knowledge
- Traditional leverage models for staffing an audit don't always work - subject matter specialists are usually needed
- HR cycles/processes frequently rely on third-party vendors
- 401(k) plans and/or pension plans are also separate legal entities
  - under the employer's control
  - have trusts and extended fiduciary connections
- In each country there will be different plans, plan types, arrangements, vendors, compliance requirements, etc.

Focusing in on HR Risks

The HR COSO Cube



Operations	Financial Reporting	Compliance	
• Recruiting, Hiring, Termination • Compensation • Benefits (H&W and Retirement) • Performance Management • Learning & Development • Payroll and HRIS • HR Administration • Diversity & Culture • Outsourcing Vendor Management	• IFRS • ASC 715 • 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

Risks Related to HR

Government	Financial	People	Reputational
• Federal, State, Local • Non-US • Penalties, Tax Deductions • Government contract issues	• Wages • Heath Care, Pensions, 401(k) • Accounting Treatment • Taxes • Deferred Liabilities	• Attract and retain best talent • Individual and class action law suits • Sustainability of the organization	• Branding • Bad Press and effect on customers, employers, investors, etc.

How to Approach an Audit of HR

Five major options:

- Review all of HR
- Perform a broad assessment to determine where there are issues requiring a deeper dive
- Take a staggered approach
- Focus on problem areas or general higher risk areas
- Select strategically for riskier plans or programs

Strategic Plan Approach to an Audit of HR

Questions to assess riskier plans or programs:

- Is some preliminary assessment necessary to determine risk drivers?
  - What are the riskier plans or programs?
  - What are the risk drivers?
- How do you assess risk when multiple countries involved?
- What is focus: compliance risk, financial risk, operational risk?
- What is the timeframe and budget?
- Are any vendor changes being considered?

Areas of HR for IA

HR can be broken into the following cycles:

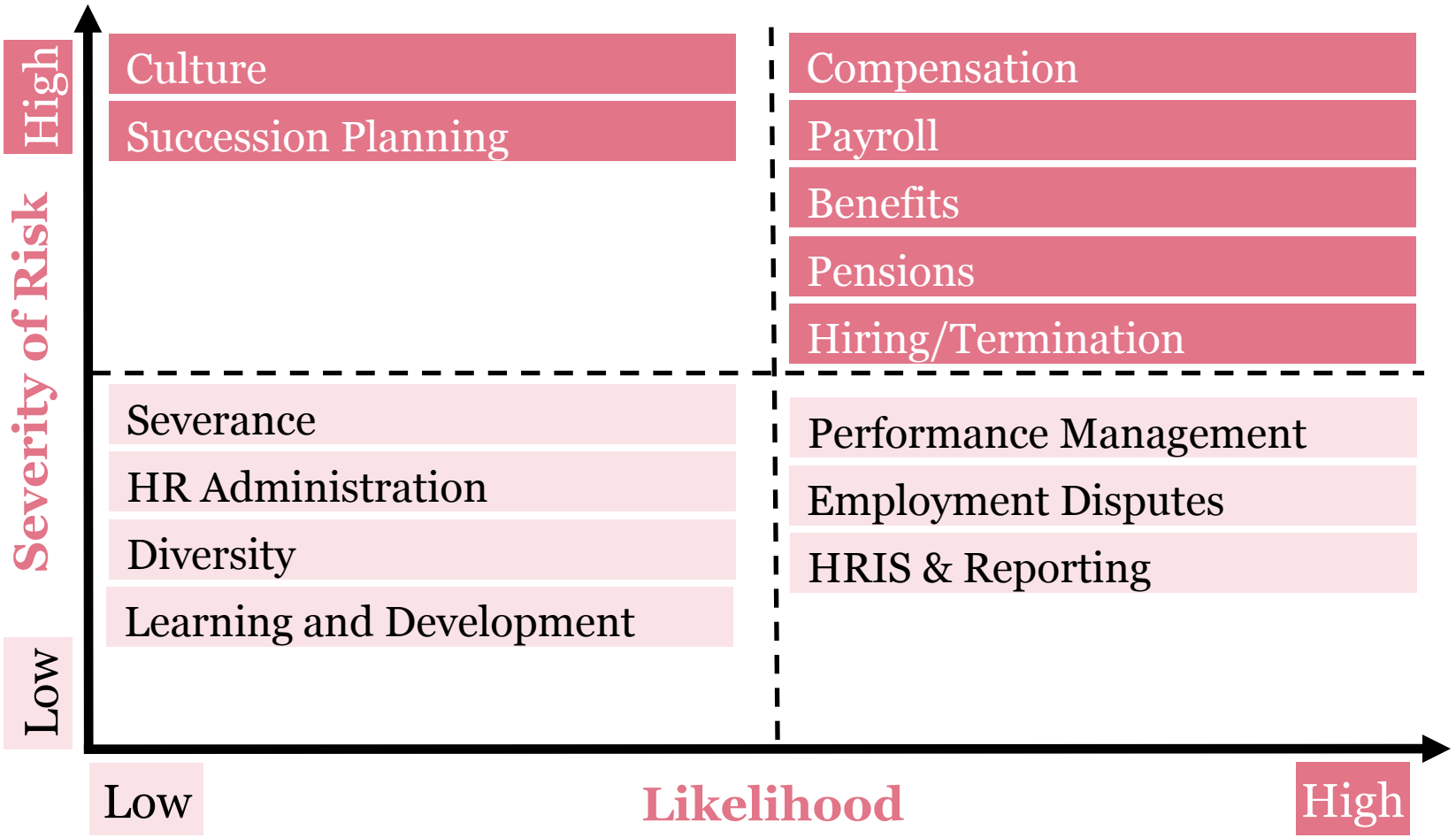
- Compensation
- Payroll
- Benefits
- Pensions
- Hiring/Termination
- Severance
- HR Administration
- Diversity
- Learning & Development
- Culture
- Succession Planning
- Performance Management
- Employment Disputes
- HRIS & Reporting
- Expatriate Services

Other Considerations:

- Vendor Oversight
- Mergers
- Acquisitions

Example of Risk Profile Matrix

From the HR Perspective



Qualified Plans Often High Risk

Pension Plans and 401(k) Plans are Top Risk Areas

- Large asset pools
- Large annual expense or cash outlays
- Trusts
- Many transactions
- Highly data intensive
- Largely outsourced
- Highly regulated
- Multi-pronged governmental enforcement

Compensation Programs Also High Risk

Includes compensation, payroll and incentives

- Large dollar expenditures
- Complex employee classifications
- Broad definition of what is included in compensation (in-kind pay, timing of pay, non-qualified pay and deferred pay)
- Equity compensation
- Employment arrangements
- Highly regulated (FICA, withholding rules, FASB rules)
- Increasing IRS enforcement

Other Top Review and Risk Areas in HR

- ***Health and welfare programs***: large dollar expenditures, largely outsourced, complex plans and programs.
  - Medical claims reviews
  - Pharmacy claims reviews
  - COBRA reviews
  - HIPAA reviews
  - FSA, HRA, etc. reviews
  - Healthcare reform readiness
- ***Employment laws***: counsel typically involved
- ***Hiring, training, etc.***: typically not easy to audit due to their structure

Special considerations

- Legal quandary with certain plan reviews where there are fiduciaries
- Reporting to stakeholders who serve in fiduciary status
- Accessing specialist knowledge in each area and each country
- Messaging and changing facts
- Health and welfare programs a high risk area: large dollar expenditures

What We Find

Taste of Issues and Reviews

- Data issues
- Service Organization Control issues under AT 801/SSAE 16 (formerly AU 324/SAS 70)
- Vendor issues
  - Complying with terms to contract
  - Billing according to contract
  - Working outside AT 801/SSAE 16 (formerly AU 324/SAS 70)
  - Lack of controls
  - Use of incorrect or inaccurate data; lack of data reconciliations
- Legal considerations

War stories

- COBRA reviews
- Multi-country foreign plan reviews
- Qualified plan reviews
- Medical plan reviews
- Employee classification and payroll reviews

Contact information

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