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Payroll Auditing

A Guide for Multiemployer Plans

Second Edition

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Chapter 1

Introduction

If you are associated with a multiemployer benefit plan and are responsible for and/or perform payroll audits, this book is for you. Other than the previous edition of this book, little guidance is available concerning payroll audits for multiemployer plans. The purpose of this book is to provide you with an overview of the payroll audit procedures and methodologies for these plans, as well as to present what we consider "best practices." When appropriate, we offer practical tips for trustees, payroll auditors and payroll audit managers as well as stories illustrating points made.

To help you quickly locate the information you are seeking, the book has been divided into four sections.

- Section I provides an overview of payroll audits including the key participants in payroll audit programs and the reasons for conducting payroll audits.
- For those seeking a better understanding of payroll audit programs and processes, Section II offers chapters on the steps in the audit process from scheduling an audit to preparing the final audit report. Plan trustees, administrators and payroll auditors are advised how to enhance payroll audit quality and efficiency.
- Section III focuses on the rare, but challenging occasions when an employer fails to submit remittances due or is not cooperating with the payroll auditor. In addition to offering suggestions for dealing with these dilemmas, there are recommendations how to avoid the problems in the first place.
- Those who are responsible for the management of payroll auditors or programs will discover Section IV was written especially for you. This final section discusses internal versus external audit programs, choosing the right audit firm and finally, how to hire, train and retain individual payroll auditors.

Payroll Audit Objectives

The term *payroll audit,* as used in this book, is an examination of the records of an employer who is contributing to a multiemployer plan to determine whether the employer has made the contributions required by a collective bargaining agreement (CBA). Employers submit remittance reports to their plans detailing the hours worked or wages paid to employees covered by the CBA. The payroll auditor's job is to identify underpayments (as well as overpayments) to the plan resulting from intentional and unintentional reporting errors by employers. An underpayment is referred to as a *deficiency.*

The foremost objective of most payroll audit programs is to make money for the plan. A truly successful payroll audit program collects more in deficiencies and delinquencies than the cost of the program. It is important to note this may not be possible when there has been an aggressive payroll audit program for many years. In these cases, the more important objective may be to ensure employers comply with the collective bargaining agreement and contribute on behalf of employees as promised.

Payroll Auditing Versus Compliance Auditing

Many multiemployer benefit plans refer to the audits of contributing employers as *compliance audits* rather than *payroll audits.* There are two reasons often cited for using compliance audit versus payroll audit. Payroll audit implies an auditor is restricted to an employer's payroll records. To be thorough, however, an auditor also reviews the employer's cash receipts, disbursement records and general ledger. Additionally, the auditor may examine the employer's financial statements and income tax returns. A plan's trust agreement (or other document) gives the auditor access to the records needed for a thorough examination.

A second reason to use compliance audit instead of payroll audit is that employers seem to be less offended by the former. A payroll audit has a connotation similar to that of an Internal Revenue Service (IRS) audit. Compliance, on the other hand, suggests adherence to plan rules. Is this just smoke and mirrors? Perhaps. In the future, the term compliance audit may replace the term payroll audit. However, until this happens, payroll audit will be used throughout this book.

Reasons for Conducting Payroll Audits

Fiduciary Responsibility

Plan trustees have a fiduciary responsibility to make sure payroll audits are performed. Why are these audits a fiduciary duty? A key reason is that the Employee Retirement Security Act of 1974 (ERISA) requires plan management—a plan's board of trustees—to pursue the collection of delinquent employer contributions. In *Central States v. Pension Fund v. Central Transport, Inc.,* 472 U.S. 559 (1985), the court rejected the argument that the union, the U.S. Department of Labor or the beneficiaries are responsible for collecting delinquencies.

If trustees do not fulfill this duty to collect in a prudent manner, they can be personally liable. Prudent trustees insist their plans have a detailed written collection policy that they as well as administrative staff follow. This policy includes procedures for auditing employer contributions. Without payroll audits, it is extremely difficult to make sure employers are complying with the CBA and contributing on behalf of employees as promised. Suggestions for what should be included in a plan collection policy are in Chapter 16. A sample policy is provided as Appendix N.

Financial Statement Support

Another reason for conducting a payroll audit concerns a multiemployer plan's audited financial statements, which are another responsibility of plan trustees. Multiemployer benefit plan trustees hire an external certified public accountant (CPA) to audit their plan's financial statements on an annual basis. Plans with more than 100 participants are required to have an annual audit.

When auditing plan financial statements, a CPA must follow certain requirements established by the accounting profession. A primary requirement is that this audit be in accordance with generally accepted auditing standards (GAAS). A CPA who deviates from GAAS when conducting an audit may be subject to civil and criminal liability. The auditor also risks a loss of license and/or other sanctions by the American Institute of Certified Public Accountants (AICPA).

GAAS requires CPAs gather sufficient evidence to support the audit opinion on a plan's financial statements. To do this, the CPA must verify the completeness of plan income—including employer contributions. AICPA has published an audit guide titled *Audits of Employee Benefit Plans* that interprets GAAS. In audits of multiemployer plans, this guide states the auditor should compare employer contribution reports with information shown in participant payroll records.

It might seem the easiest way to verify employer contributions would be to ask each employer to provide a written statement that all contributions due to the plan during the year were made. There are two major problems with this approach. One is that employers are unlikely to provide such verification in writing. Secondly, even if an employer submits written confirmation, the document verifies only what the employer paid—It does not reveal what should have been paid.

The only way to ensure contributing employers have paid the full amount owed is for a payroll auditor to review the payroll records of every employer. The external auditor determines

Tips for Trustees

Some individuals argue payroll audits are a waste of time and money. We have heard many of the arguments. Chapter 2 is devoted to the excuses given and our counter arguments as to why payroll audits are necessary.

whether the plan has an adequate payroll audit program that periodically tests employer compliance with the CBA. To render an unqualified opinion on the financial statements of a plan, the CPA must be satisfied a payroll auditor is checking the records of contributing employers in a manner that fulfills the assertion of completeness in the auditing standards. The AICPA guide does not use the term *payroll audit,* but the requirement is clear. There are several alternatives to payroll audits, but each of these options has complications and risks.

What happens if an auditor cannot gather the necessary plan participant data? In such a situation, the auditor is not able to give an unqualified opinion on the plan's financial statements. Because the scope of the auditor's work was insufficient, a qualified opinion or disclaimer of opinion is given instead.

Failing to get an unqualified opinion can be disastrous for a plan. If a multiemployer plan has more than 100 participants, the U.S. Department of Labor (DOL) and the Internal Revenue Service (IRS) require the independent auditor report and plan financial statements accompany federal Form 5500. The DOL will not accept a qualified auditor's report that results from the failure to have a payroll audit program. The rejected filing is considered a *nonfiling,* which can lead to penalties of up to $1,100 per day against plan administrators.[1]

More reasons

Other reasons for a payroll audit program include:

1. **Keep employers honest.** Ideally, employers contribute to employee benefit plans because they are genuinely concerned about the welfare of their workers. For many employers, this is true. There are others, however, that make benefit contributions only because they fear they will be caught and penalized if they do not make the required payments. A payroll audit program puts the less-than-honorable employer on notice that plan trustees are serious about collecting contributions. If Employer X is audited and penalized, Employer Y down the street may pay what is owed to avoid the same penalties. Payroll auditing works much like preventive medicine.
2. **Reduce suspicion.** Conducting a payroll audit addresses suspicions that an employer is not fulfilling the terms of a CBA. Plan participants may complain when they receive their annual statements that the number of hours they worked or their wages seem amiss. Local union officials may grumble that an employer is not reporting all employees covered by the CBA. A principal purpose of the payroll audit is to find these underreported and unreported employees. Be aware, however, that a payroll audit may not always be successful if an employer hides or disguises payments—for example, by paying employees with cash.

A Payroll Auditor's Story

"On one payroll audit I found substantial deficiencies. As I explained this to the employer, his reply was, 'If you think I'm bad, you ought to see how some of my competitors cheat.' I asked him to provide the names of the 'cheating' competitors. He did. When we performed payroll audits on the competitors, we found large deficiencies for each of them."

—*Larry Beebe*

3. **Give no employer a competitive advantage.** Management trustees representing contributing employers are often just as aggressive as labor trustees in insisting payroll audits be performed. Why? No employer wants to have a competitive dis-

advantage. An employer who does not pay required fringe benefits has an economic advantage over employers that pay all their required benefit contributions.

4. **Help new employers.** New employers often do not report correctly because they do not fully understand the reporting process. Many plans have a policy that requires the audit of new employers after six or nine months of reporting. As part of the audit process, the new employer can be educated how to report properly.
5. **Determine liability upon termination.** Employers sometimes stop their contributions before a CBA expires. A payroll audit on terminating employers ensures *remittances* (payments) are sent to the plan through the agreement termination date.
6. **Document for collection.** When an employer experiences financial difficulty, payment of employee benefit contributions often slows or stops. If an employer fails to cooperate with the ensuing collection enforcement action, the plan may have to refer the matter to legal counsel. A payroll audit supports the legal action taken by the plan attorney to enforce payment.

PAYROLL AUDIT BLOG

Since the first edition of this book was published in 2008, we have sponsored a blog on payroll auditing (www.payrollauditing.com) with an editorial board of CPAs who do payroll audits and attorneys who specialize in collections for multiemployer plans. The purpose of the blog is to improve the art of payroll auditing. Blogs on payroll auditing are welcome from anyone. Blogs you submit that are posted will be credited to you. The blogs we have posted since 2008 have enabled us to add a great amount of new material to this second edition.

Endnotes

1. ERISA Section 502(c)(2).