Sponsors of 401(k), annuity, health and welfare benefit, pension and other types of employee benefit plans should have a quality audit. The Employee Benefits Security Administration is "auditing the auditors" to be sure they are following the AICPA Employee Benefit Plan Audit Guide and performing quality audits. The inspection process works and strives to make employee benefit plan auditors in the United States better and more accountable for the benefit of participants and beneficiaries.

Why Financial Statement Audit Quality Matters!

by Kathleen M. Jackson

What's the first thing you should think about when looking at an audited financial statement for an employee benefit plan? If you answered audit quality, you are correct.

I recently spoke on this topic with Ian Dingwall, chief accountant of the Employee Benefits Security Administration (EBSA) at the International Foundation's Benefit Plan Professionals Institute in San Diego, California. Dingwall is EBSA's primary advisor on accounting and auditing issues with the agency under the Employee Retirement Income Security Act (ERISA) of 1974, the Pension Protection Act of 2006 and the Federal Employee Retirement Security Act.

EBSA has instituted an enforcement initiative to monitor the quality of ERISA audits among independent auditors. In simpler terms, EBSA has an Inspection Program to audit the auditors of employee benefit plans. EBSA does inspections for accounting firms that perform at least 200 audits and mini-inspections for accounting firms that perform 100-199 audits.

For an inspection, EBSA comes on site to review work paper files concentrating on three key audit areas: investments, benefit payments and contributions. For a mini-inspection, work paper files in those areas are sent to EBSA to conduct its review.

Augmented work paper reviews are done for firms performing fewer than 100 audits of employee benefit plans. This process entails sending a letter to the plan administrator requesting that the auditor provide, within ten to 15 days, all audit documentation for selected significant audit areas. The scope of EBSA's review may be expanded, if deemed necessary.

A Top-Down and Bottom-Up Review

Why is EBSA auditing the auditor? Contrary to some beliefs, it is not to annoy auditors throughout the country or to increase the sales of office supplies. The primary objectives are to evaluate the quality of audit work on employee benefit plans, to ensure all relevant areas have been adequately audited and to identify best practices. The EBSA Inspection Program is similar to that of the Public Company Accounting Oversight Board inspections with regard to monitoring the work of an auditor.

The Inspection Program is both a top-down and a bottom-up review of an accounting firm to see how it operates its employee benefit practice.

From a top-down perspective, EBSA wants to know, for example:

- Who is running the firm's employee benefit plan practice?
- What is the staff training and development process?
- How is the audit staff supervised?
- What are the practices regarding firm independence?
- What is the tone at the top and how is it monitored?
- What is the internal quality control review process?

From the bottom up, EBSA is looking at the details found in audit work papers to determine if the audit was performed in accordance with generally accepted accounting standards.

A general questionnaire, sent to the firm to complete prior to the start of the inspection, enables EBSA to assess the overall firm structure and control environment. This questionnaire asks about firm structure, management, training and development, supervision and independence. Initially, there is a process that EBSA and the auditing firm perform to select representative engagements. Whether an inspection or mini-inspection is performed, the procedures are quite similar. The accounting firm can expect a review of audit work papers, a discussion on preliminary findings and an exit conference.

If the results are unacceptable, EBSA may reject the plan's Form 5500 filing and may make a referral to American Institute of Certified Public Accountants (AICPA)/state societies depending on the magnitude of the findings. However, upon completion of the inspection, the accounting firm will not receive a written report from EBSA.

EBSA has seen a trend among firms that are members of the AICPA Employee Benefit Plan Audit Quality Center (EBPAQC): They have fared much better than firms that have not yet joined. EBPAQC was created in 2004 to help employee benefit plan sponsors and administrators connect with auditors committed to quality. EBPAQC provides resources for audit firms to raise awareness about the importance of performing a quality audit. Members are committed to providing quality audit services by voluntarily adhering to membership requirements. Those requirements include quality control processes, training and self-monitoring. A plan trustee can find out if the plan's auditor is a member by visiting the EBPAQC membership area at www.aicpa.org/ebpaqc.

EBPAQC currently has more than 2,000 members. It not only offers guidance to accounting firms that specialize in employee benefit plan audits, but also provides resources to plan sponsors, human resource professionals and trustees. Technical resources are available to educate interested parties about audit quality, including access to audit best practices, guidelines and tools. Members also have the benefit of an interactive forum to assist firms with audit issues they may be facing.

Per Dingwall's presentation, EBSA has noted that the scope of its program is over 80,000 annual audits. EBSA has found that 20% are unacceptable—and these are the results for firms with over 100 plan audits. Although audits may have been deemed acceptable, EBSA may have suggested improvements in audit work paper documentation.

Audit deficiencies are commonly found in the following areas:

- Participant data testing
- Benefit payments
- Investments
- Party-in-interest transactions
- Contributions receivable
- Inadequate planning and supervision.

As surprising as it may sound, in some of its inspections EBSA has found that auditors performed no work in some significant audit areas, that the auditor failed to adequately plan the audit engagement, that there was inadequate work paper documentation, or that certain firms generally lack an understanding of the nuances of employee benefit plan audits.

As an auditor who has successfully completed this EBSA program, I believe that EBSA is concerned with particular attention to details in the audit documentation to ensure that the utmost care and attention was taken when performing the audit and, as such, follows the guidance in the *Employee Benefit Plans Audit and Accounting Guide (EBP Audit Guide)*, issued by AICPA.

When conducting its reviews, EBSA thoroughly follows the Statement of Accounting Standard (SAS) No. 103, Audit Documentation (SAS 103). The main focus of SAS 103 is to be more specific with audit documentation than the auditing standard it superseded. SAS 103 requires the auditor to consider the needs of an experienced auditor having no previous connection with the audit to understand the procedures performed, evidence obtained and specific conclusions reached. To quote an EBSA auditor, "Document what you did, what you saw, and what you did with what you saw."

I shared this quote with those who attended the audit quality session at the Benefit Plan Professionals Institute. It is important for an auditor to take a second look to make sure that a prudent person, knowing nothing about the benefit plan being audited, would be able to read the work papers, understand what was done and come to the same conclusions. If it's not documented in the work papers, then it's assumed to not have been done. With audit documentation, everything in the audit work papers should serve to support the auditor's opinion.

AICPA has issued the *EBP Audit Guide* as a road map to assist the auditor in rendering an opinion. The guide suggests that the auditor should document the basis of selection, the audit evidence obtained, the nature and extent of exceptions, any actions taken to address those exceptions and, lastly, the conclusions reached within the work papers.

Making audit work papers clear and understandable can lead only to a qual-

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ity audit. Consider also linking work papers back to the audit program and risk assessment summary for further clarity. A final consideration is that the clearer the documentation is in the work papers, the smoother the quality control review process should be.

EBSA is committed to educating and assisting the millions of Americans covered by employee benefit plans audited by many accounting firms. EBSA has undertaken this initiative to educate certified public accounting firms, large and small, about the need for attention to details when preparing audits of employee benefit plans. Several state CPA societies are sponsoring conferences specifically to educate accountant and plan sponsors and trustees on audits of employee benefit plans. Further, the Foundation's 56th Annual Employee Benefits Conference being held November14-17 in Honolulu, Hawaii and the AICPA offer several sessions on employee benefit plan auditing.

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On June 29, 2010, the ERISA Advisory Council met to study whether the financial reporting model and audit requirements contained in ERISA Sections 103 and 104 continue to provide the protections to plan participants and beneficiaries that Congress originally intended when it enacted ERISA in 1974. The purpose of this study is to identify what actions, if any, the Secretary of Labor may need to take with respect to ERISA's audit requirement and financial reporting model and to improve Department of Labor (DOL) oversight of employee benefit plan audits to enhance an employee's retirement security. As a comment to the council, AICPA recommended that all ERISA auditors be required to participate in a peer review (practice monitoring) program, and for DOL to continue to refer deficient audits to the AICPA Ethics Division and state Boards of Accountancy. AICPA is opposed to DOL having a new enforcement role and authority over ERISA plan auditors. AICPA also recommended that DOL not establish a new reporting model that would be different from generally accepted accounting principles (GAAP) for ERISA plans.

Two Types of Audits

An auditor can perform two types of audits: *limited-scope* or *full-scope*. Some trustees have chosen to receive a limited-scope audit to reduce audit costs. ERISA allows the plan administrator to instruct an auditor not to perform auditing procedures on investment information prepared and certified by a bank or similar institution or by an insurance carrier that is regulated, supervised and subject to periodic examination by a state or federal agency that acts as a custodian or trustee. This action is available only if a trustee or custodian certifies to both the accuracy and the completeness of the plan asset information needed for the Form 5500.

The certification that is received and relied upon for a limited-scope audit applies only to investments. This is often misinterpreted. All other areas of plan activity, including eligibility, contributions, distributions and expenses, must be subjected to full-scope audit procedures.

A limited-scope audit certification is not a "blank check" for the auditor. The custodian's certification does not take the responsibility from the auditors completely. The auditor should still review the investment activity to be sure no material differences exist. Also, although the auditor is not auditing investments, he or she still needs to verify that investment footnote disclosures are in accordance with GAAP.

As for the plan, the limited-scope exemption generally results in reduced audit procedures and, as a result, lower audit fees. It does not exempt the plan from the audit requirement; it simply reduces the auditor's responsibilities as it pertains to investments. The custodian bank certifies that the statement or year-end reporting is complete and accurate.

And as always, plan trustees have a fiduciary duty to ensure that the plan's financial statements—not just the custodian investment statements—have been audited in accordance with GAAP and that the opinion supports the financial statements.

Back in 1974, when ERISA was developed, the limited-scope audit option perhaps made more sense. Employee benefit plans were just beginning and held investments in traditional assets, such as common stocks, mutual funds, corporate obligations and U.S. government or government agency obligations. Now, 36 years later, plans continue to invest in traditional assets but are enhancing their holdings significantly in alternative investments such as common collective trusts, hedge funds, venture capital, pooled separate accounts, limited partnerships, private equity, infrastructure and real estate investments.

Furthermore, in 2006 the Financial Accounting Standards Board (FASB) issued FASB 157, Fair Value Measurements and Disclosures (renamed FASB Accounting Standards Codification 820 in 2010) that requires increased financial statement disclosure relating to various levels of financial instruments.

Another issue is that most trustee limited-scope certifications do not cover these alternative investments because they are not held by the trustee; they often are included on the investment report by the primary custodian only as a courtesy to the plan. Sometimes, the valuation date of alternative investments is a quarter or more behind the reporting date as a result of the lag in investment reporting due to the nature of these investments.

A full-scope audit requires a long list of audit procedures for investments. Today, on the Statement of Net Assets Available for Benefits, the largest dollar amount is usually under investments. Both plan trustees and participants should want additional assurances in the form of audit procedures performed on the largest dollar value in the Statement of Net Assets Available for Benefits.

Plan sponsors should want the reported market value to be evaluated by an independent party and to have additional comfort that all required disclosures are done properly. Investment income (the amount earned during the year) should be tested appropriately also as this is often a sizable component of the Statement of Changes in Net Assets Available for Benefits. In today's world, it is becoming more essential to keep a closer eye on investments held by the plan through the use of a knowledgeable and qualified auditor.

Another significant issue is that employee benefit plan audits are no longer considered low-risk. The auditor should be more focused and take a more disciplined approach when planning and performing the audit than in years gone by.

EBPAQC has been a tremendous help to auditors in understanding what is being audited and offering guidance to enhance the auditor's knowledge of employee benefit plans. This knowledge should be shared with the plan sponsor and trustee who ultimately sign the Form 5500 and are the responsible fiduciary. It is ultimately a trustee decision whether to have the auditor perform a limited-scope or full-scope audit.

DOL issued a document a few years ago that assists plan sponsors and trustees in selecting a quality auditor for their employee benefit plan. Trustees whose employee benefit plan is searching for a new auditor should be sure to read this document, available at www.dol.gov/ebsa/publications/selectinganauditor.html. The document may surprise trustees and make them think twice about the need to be working with a high-quality accounting firm that specializes in employee benefit plan audits.

A quality audit will help protect plan assets and finances and ensure that the funds are available to provide for benefits, whether it is health, retirement or other promised benefits to the plan participants. A quality audit will help a trustee meet his or her fiduciary responsibility to file a complete and accurate Form 5500. An incomplete or inaccurate return may result in penalties assessed or a filing rejected.

Plan fiduciaries should take various steps to improve the quality of their employee benefit plan audits, aside from waiting for EBSA to step in and audit the auditor. Auditors must fully understand the many facets of the plan. They need to understand the governance and internal control structure as well as the roles of the administrator and the board of trustees.

Trustees should have an exit conference with the auditor at the completion of the audit to discuss any material weaknesses or significant deficiencies that were identified. Plan sponsors and trustees should discuss these items in detail with the auditor to be sure they understand the methodologies and steps that need to be taken to make any necessary improvements. Discuss any issues that arose during the audit as a preplanning meeting for next year's audit. Usually the exit conference will be held shortly after release of the financial statements and the auditor can get a head start on next year's audit.

It is important that the board of trustees meets with its auditor to discuss the plan's financial statements and the management recommendation letters (SAS 115) and audit communication letters (SAS 114). A quality auditor will generally be willing and eager to assist trustees, who are the responsible party that sign the plan's Form 5500 Annual Report. **B&C**

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