

Pension Plan Fix-It Handbook

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Upgrade Employee Benefit Plan Auditing, Says ERISA Advisory Council

By Mary B. Andersen, CEBS, ERPA

Mary B. Andersen is president and founder of ERISAdiagnostics Inc., an employee benefits consulting firm that provides services related to Forms 5500, plan documents, summary plan descriptions and compliance/operational reviews. Andersen has more than 25 years of benefits consulting and administration experience. She is a CEBS fellow and member of the charter class. She has also achieved the enrolled retirement plan agent (ERPA) designation. Andersen is the contributing editor of the Pension Plan Fix-It Handbook.

This past spring, the ERISA Advisory Council issued a report on employee plan auditing and financial reporting models. The council studied whether the requirements of ERISA Sections 103 and 104 provide the protections to plan participants and beneficiaries as originally intended. The council narrowed its focus to three issues: audit and auditor quality, limited-scope audits and Section 403(b) plan audits. The primary findings of the council include:

- some auditors require more training despite available information;
- limited-scope audits may be misunderstood;
- 403(b) plans should have been granted more time to comply with the 2009 Form 5500 requirements; and
- the Department of Labor (DOL) should continue educational outreach efforts.

Based on testimony and its own research, the council submitted a number of recommendations to the secretary of Labor for consideration, including:

- require plan administrators to identify on the Form 5500 whether the auditor is a member of the American Institute of Certified Public Accountants (AICPA) Employee Benefit Plan Audit Quality Center (EBPAQC);
- clarify the limited-scope audit provision regarding which entities are qualified to issue certifications and include the certification as part of the Form 5500 filing;
- waive the audit requirement for 403(b) plans that have assets invested entirely in individual custodial

contracts or individual annuity contracts and instead impose the audit requirement only on group annuity contracts; and

- promote quality in employee benefit plan audits and auditors.

Background

ERISA Section 103(a)(3)(A) requires plan administrators engage an independent qualified public accountant (IQPA) “on behalf of plan participants.” The IQPA is required to examine the plan’s financial statements and opine on whether the statements were prepared in accordance with generally accepted accounting standards (GAAS). Also, ERISA Section 103(a)(3)(C) provides for a limited-scope option in certain circumstances.

The current financial product environment today is not the same as it was in the 1970s when ERISA was enacted. That makes the council’s findings and recommendations that much more worth examining.

Audit and Auditor Quality

The council heard testimony that indicated that there is a “failure by auditors to understand or follow established practices and requirements.” Citing a 2004 DOL study which found that 30 percent of audits sampled were defective, the report indicates that smaller firms that don’t perform many audits are more likely to conduct the examination poorly. The reasons cited were:

- inadequate training and technical knowledge;
- lack of awareness of the nature of employee benefit plans;

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Auditing (continued from p. 1)

- lack of quality control on audit processes; and
- a failure to understand the limited-scope audit requirement.

Noting the AICPA's EBPAQC, the council indicated that lack of guidance did not appear to be an issue. Instead, the ERISA Advisory Council report says that lack of auditor training and audit firm resources are the leading causes of poor audits.

The report noted further that the AICPA is a voluntary membership organization and not all licensed auditors are members. In addition, the DOL has no authority to discipline or sanction auditors. However, the DOL can sanction the plan administrator.

The council recommended that:

- plan administrators identify on the Form 5500 whether the auditor is a member of EBPAQC;
- the DOL establish a safe harbor for initial plan auditor selection;
- the DOL establish a taskforce to work with the AICPA and other stakeholders on audit matters; and
- the DOL study quality and its promotion.

Limited-scope Audits

ERISA Section 103(a)(3)(C) provides the plan administrator with the opportunity to exclude statements prepared by a bank or similar institution or insurance carrier regulated and supervised by state or federal agency. Technically, the plan administrator elects the limited-scope audit. The auditor then is permitted to rely on statements such institutions prepare if the statements are certified as complete and accurate. The report contains a chart which contrasts the key differences between the limited-scope audit versus a full-scope audit. (See box, page 6.)

Concerns were raised that limited-scope audits are frequently misunderstood particularly with regard to: (1) what is covered by a limited-scope audit; (2) what entities can provide certifications; and (3) the importance and impact of a limited-scope audit regarding asset valuation. However, the council did not recommend repeal of the limited-scope audit. The council noted that there was no specific material evidence of participant harm by use of a limited-scope audit. The council expressed concern regarding the cost of a full-scope audit and the impact on participants.

The council recommended:

The quality of limited-scope audits and the required certifications should be reinforced and strengthened.

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Comparison of Major Aspects of Full-scope and Limited-scope Audits

Audit Aspects	Full-scope Audit	Limited-scope Audit
Provides auditor's opinion on plan's financial statements?	Yes (unqualified, qualified or adverse opinion).	No (disclaimer of opinion).
Auditor audits plan investments?	Yes. Auditor tests for existence, valuation, completeness, ownership and proper disclosures.	No. Plan sponsor instructs auditor not to test investments (including the value of the investments and any income thereon) that are covered by the certification (including hard-to-value assets).
Requires addressing hard-to-value asset issues for financial reporting?	Plan sponsor must assert proper values in the plan's financial statements. Auditor needs to address hard-to-value asset issues.	Plan sponsor must assert proper values in the plan's financial statements. Auditor is instructed not to audit hard-to-value assets if they are properly covered by the certification.
Audit scope includes testing of participant records, contributions, benefit payments, internal controls over financial reporting, and overall presentation of financial statements?	Yes.	Yes, except the auditor does not evaluate internal controls for certified investments and generally cannot evaluate whether the plan's financial statements overall are presented in accordance with GAAP due to the significance of the certified investments reported but not audited.
Fraud evaluation?	Auditor obtains reasonable, but not absolute, assurance that the financial statements are not materially misstated due to fraud. Not all fraud may be detected in an audit. A well-concealed or insignificant fraud may avoid detection.	Same as full-scope audit except the auditor does not test certified investments for possible fraud; thus any fraud with respect to certified investments would likely avoid detection by the plan's auditor.
Audit identifies any internal control, compliance or operational issues?	Yes. Significant matters detected by the auditor are reported to those charged with plan governance.	Same as full-scope audit except that matters related to certified investments are not tested by the auditor.

Auditing (continued from p. 2)

Witnesses' testimony revealed concern regarding what entities were providing the certifications and suggested that some entities should not be providing them. The DOL cautioned that it is up to the plan administrator to determine whether a limited-scope audit is appropriate; if there is a question as to who is providing the certification, then perhaps a limited-scope audit is not warranted.

The council recommended:

The DOL should clarify the type of entity qualified to issue certifications under existing regulations and emphasize that only qualified entities actually issue certifications.

The investment landscape has changed considerably since ERISA's enactment, with plans including hard-to-value assets and alternative asset classes as part of their portfolios. Witnesses acknowledged that challenges with hard-to-value assets exists whether there is a limited- or full-scope audit.

The council recommended:

The certification should be attached to the Form 5500. The council believes that attaching the certification to the Form 5500 would reinforce the importance of the certification to plan sponsors and participants.

403(b) Plans

The report acknowledges the challenges 403(b) sponsors face and recommends that only group annuity contracts be subject to the audit. Both the AICPA and DOL acknowledge that there are problems with 403(b) plan audits; the DOL has provided guidance (for example, in Field Assistance Bulletin (FAB) 2009-02 and FAB 2010-01). The council recommends that 403(b) plans be given more time to comply with the audit and reporting requirement. In response to a question, a closing note was added indicating that the council focused on the difficulties encountered by plan sponsors rather than the question which related to whether participants had adequate

protections under the law — something that might be explored in the future.

Future Actions

What should plan sponsors do as a result of the study? Prudent actions include:

- 1) Review the DOL's booklet "Selecting an Auditor for Your Employee Benefit Plan."
- 2) Visit the AICPA's EBPAQC website that contains a plan sponsor resource center with a sizeable amount of information including a checklist for preparing an RFP and selecting an auditor, as well as a 24-page booklet discussing valuing plan assets.
- 3) As always, document the steps you take in selecting and monitoring your plan providers.

Finding out More

There is a wealth of information to review on these topics.

- To view the ERISA Advisory Council's report on Employee Plan Auditing and Financial Reporting Models, go to <http://www.dol.gov/ebsa/publications/2010ACreport2.html>.
- To view the DOL's "Selecting an Auditor for Your Employee Benefit Plan" booklet, visit <http://www.dol.gov/ebsa/publications/selectinganauditor.html>.
- To visit the plan sponsor resource center on the AICPA EBPAQC website (<http://www.aicpa.org/InterestAreas/EmployeeBenefitPlanAuditQuality/Pages/EBPAQhomepage.aspx>), visit <http://tinyurl.com/3j8lmfp>.
- To view FAB 2009-2 (Annual Reporting Requirements for 403(b) Plans), visit <http://www.dol.gov/ebsa/regs/fab2009-2.html>.
- To view FAB 2010-01 (Annual Reporting and ERISA Coverage for 403(b) Plans), visit <http://www.dol.gov/ebsa/regs/fab2010-1.html>. 📄



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