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DOL Unhappy With Plan Audit Quality

DOL's review of 400 Form 5500 plan audits found 39% had major deficiencies in one or more generally accepted auditing standards. As a result, DOL has a list of recommendations — including the repeal of the limited scope audit exemption, additional qualifications for auditors, and the ability to levy penalties on auditors rather than plans. Administrators may wish to consider the DOL's findings in selecting and working with their auditors to ensure required plan audits bring value to their plans.

Background

Most ERISA plans are required to file annual reports about their financial information and activities with the DOL using Form 5500 and its various schedules. For most plans covering more than 100 participants, an audit report prepared by an independent qualified public accountant applying generally accepted auditing standards is a key element of the annual report. Plan administrators can instruct their auditors to avoid auditing investment information prepared and certified by banks and similar institutions — the so-called "limited scope audit exemption" included in ERISA since its 1974 enactment.

Previous DOL studies of audit quality identified audit shortfalls. During the period from December 2013 through September 2014, DOL's Office of the Chief Accountant of the Employee Benefits Security Administration selected and reviewed a sample of 400 Form 5500 plan audits from a pool of 81,162 filings for the 2011 plan year to determine whether quality had improved since the last study.

Highlights of DOL's Report

In Assessing the Quality of Employee Benefit Plan Audits DOL found 39% of the studied audits had major deficiencies in one or more generally accepted auditing standards. As they had anticipated, there was a direct correlation between errors and the number of plans audited. Firms that do few audits each year tend to lack the experience to properly complete all required elements of a quality audit. DOL found that the CPAs conducting these audits often failed to consider unique audit areas such as contributions, benefit payments, participant data and prohibited transactions.

CPA firms auditing fewer than 25 plans a year performed 35% of the 81,162 audits. This pool of 6,806 firms (nearly 95% of the total firms), thus served an average of four plans each, with the majority handling just one or two audits per year. Audit deficiencies were found in 75.8% of audits done by the firms with the least experience and in just 12.0% of audits by firms that perform 750 or more audits each year.

DOL said the result of the unacceptable audits was “putting $653 billion dollars and 22.5 million plan participants and beneficiaries at risk.” Their report correlated an increasing deficiency rate shown by this and prior studies with an increasing number of plans using the limited scope audit exemption. The deficiency rate in their 1988 study found defects in 23% compared to the 39% finding in the current study. The limited scope audit exemption was used by 48% of plans in 2001 and by 2013, 83% of plans. In a statement, the American Institute of Certified Public Accountants (AICPA) responded that they will work with the DOL to enhance quality, but noted that the quality issues identified in the study did not “pose a risk to the viability of any plan.”

> **Comment.** For example, the instances in which the audit work was not manually signed would be unlikely to put plan participant benefits at risk.

DOL Recommendations

DOL made 11 recommendations to address the report's findings involving enforcement, legislation and regulations, and outreach. Among the recommendations:

Enforcement. DOL plans to focus their own resources on firms with smaller employee plan audit practices that undertake audits of plans with large amounts of plan assets. They also intend to work with the National Association of State Boards of Accountancy (NASBA) and the AICPA to improve investigations and sanctions for CPAs performing poor work. A recommended amendment to ERISA would authorize the DOL to assess all or a portion of the current annual reporting civil penalty of up to $1,100 per day against the CPA if an annual report is rejected because of his or her poor work.

Regulatory/Legislative. In addition to repealing the limited-scope audit exemption, DOL recommends changing the qualification requirements for CPAs and authorizing the DOL to establish standards to address financial reporting issues that are either unique to, or have substantial impact on, employee benefit plans.

Outreach. DOL plans to work with NASBA to provide targeted training and licensing for CPAs who perform plan audits. DOL would also work with trade associations to help educate plan administrators about the importance of hiring competent CPAs and send targeted correspondence to plan administrators identified by the EFAST2 database as using CPAs who perform few plan audits, to deliver a similar message.

Benefits of a High Quality Audit

Operating a retirement or other benefit plan is complex. There are many opportunities for mistakes because there are many hands required to make the plan operate efficiently. Payroll must deduct and deliver the correct amount of participant contributions and must provide accurate compensation information for plan operations. Recordkeepers and investment brokers must invest plan funds as directed by participants or plan fiduciaries, as applicable, and must credit amounts to the correct accounts. Other service providers become involved with plan communications, actuarial valuations, compliance activities, and ultimately, distribution transaction processing.

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Documented processes, self-audits, and targeted compliance audits help ensure smooth operations. But the official ERISA audit by an independent accountant aims to make sure these gears are interrelating as planned and that the plan suffers no undetected fraud. Compliance exercises benefit the plan sponsor, other plan fiduciaries, and plan participants by avoiding errors and costly corrections, avoiding fines and penalties, and avoiding costly litigation.

Audit Resources

Resources are available from the DOL and AICPA for identifying and engaging a suitable plan auditor. DOL's Selecting An Auditor For Your Employee Benefit Plan outlines considerations to keep in mind when hiring an independent qualified public accountant to perform the plan's audit. In The Importance of Hiring a Quality Auditor to Perform Your Employee Benefit Plan Audit, the AICPA Employee Benefit Plan Audit Quality Center (EBPAQC) provides reasons for obtaining a quality audit, steps for identifying the best candidate for your plan, and suggested contract provisions for the assignment. AICPA provides more tools at their Plan Sponsor Resource Center.

More efforts are underway for addressing audit quality in general. AICPA's 6-Point Plan to Improve Audits focuses on additional education, standards and ethics, tools and training, peer review, ongoing monitoring of firm quality using technology, and enforcement.

In Closing

To obtain the greatest value for the dollars spent on the plan's audit, ensuring that the audit firm has a robust audit practice is a first step. DOL plans to target more of their reviews at smaller audit practices, so working with a firm that performs at least 100 annual audits may reduce the plan's likelihood of agency review.

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