



## Choose Your Auditor Carefully for Employee Benefit Plans

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## Executive Summary

The Department of Labor and IRS are ramping up efforts to improve compliance in corporate employee benefit plan administration. Frequent errors point to inadequate or improper administration by organizations, but also to auditors that lack the proper training and experience to conduct a technically appropriate employee benefit plan audit. Failure to make improvements can result in penalties and fines to companies and organizations — and even criminal charges in severe cases. That's why it's so important to choose an audit team with experience once your organization reaches 100 eligible participants.



## About the Author

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The American Institute of Certified Public Accountants has made a concerted effort to cooperate with the Department of Labor and the IRS to inform companies and organizations about their fiduciary responsibilities regarding employee benefit plans. In 2014, the AICPA released an advisory report for plan sponsors, administrators and trustees on the basics of why employee benefit plans need an independent audit — and how to hire a qualified, independent public accountant.

This awareness is more important than ever. The DOL has noted an unacceptable level of errors in plan audits. Exploring further, they found that many plan administrators failed to properly administer and record plan information on behalf of qualified employees. An audit should catch administrative errors, but the auditors themselves are causing mistakes.

Auditors who perform only a handful of employee benefit plan audits a year may lack enough experience or credentials to identify areas of weakness in controls or plan operations. If companies and organizations aren't aware of these weaknesses or don't remedy them, they can face serious penalties. The DOL Employee Benefits Security Administration (EBSA) may reject plan filings and assess penalties on companies and organizations of up to \$1,100 per day, without limit, for these deficient filings. Administrators and officers can even be held personally liable to restore losses incurred by the plan or other losses connected to employee payroll.

A 2015 report by the DOL found that nearly four in 10 Form 5500 filings had enough major deficiencies to merit rejection of the filing. This percentage encompasses \$653 billion and 22.5 plan participants and beneficiaries at risk. The DOL report was based on Form 5500 filings from 2011, which sounded the alarm bells regarding the integrity of employee benefit plans for participants and their beneficiaries.

*“There is a clear link between the number of employee benefit plan audits performed by a CPA and the quality of the audit work performed. CPAs who performed the fewest number of employee benefit plan audits annually had a 76% deficiency rate.” —U.S. Department of Labor*

If CPA firms simply needed to perform more plan audits to improve audit quality, the accounting industry could encourage more intensive training and membership through the AICPA Employee Benefit Plan Audit Quality Center (EBPAQC). However, the nature of employee benefit plans and third-party administration continues to evolve and increase in complexity. Public accountants who have specialized for years in audits of employee benefit plan financial statements are at a clear advantage to deliver consistent quality to their clients into the future.

Any company or organization that has 100 or more eligible participants in an employee benefit plan is required to have a financial statement audit of the plan in accordance with the Employee Retirement Income Security Act of 1974 (ERISA) and DOL requirements. An independent, qualified public accountant must perform these audits to deliver a reliable report to participants, plan management, the DOL and other interested parties. The audit helps protect the financial integrity of the employee benefit plan so that the necessary funds will be available to pay retirement and other promised benefits.

The magic number of “eligible participants” may include more than just current employees. They could include former employees with funds still held in the benefit plan as well as retired employees receiving benefits. It also includes eligible but not participating employees. That’s why it’s so important to work with a qualified plan auditor to identify and assure compliance and accurate reporting.

## Selecting a Quality Auditor

When seeking a quality, independent public accountant to perform a financial statements audit of your employee benefit plan, the AICPA outlines several guidelines to consider. First of all, auditors found to be out of compliance with professional standards had the following characteristics:

- Inadequate technical training and knowledge
- Lack of awareness regarding the unique factors of employee benefit plan audits
- Lack of established quality review and internal process controls for each audit
- Misperception that EBP audits are simply fulfilling a governmental requirement
- EBP audits encompassing a very small percentage of the firm's overall audit practice
- Missing necessary audit work
- Misinterpreting the limited scope audit exception
- Limited time to adapt to new technical guidance

As you can see, there are many telltale signs that a potential auditor may not be highly qualified. When seeking an auditor, you must know how to evaluate knowledge and experience, licensing and ability to perform tests unique to employee benefit plan audits. Such tests may include:

- Finding whether plan assets covered by the audit are fairly valued
- Unique aspects of plan obligations
- Timeliness of plan contributions
- How plan provisions affect benefit payments
- Allocations to participant accounts
- Issues that may affect the plan's tax status
- Transactions prohibited under ERISA

Less experienced auditors may be assigned to perform routine aspects of the audit, but you need to make sure that a more experienced employee benefit plan auditor will be reviewing that work as well as performing more complicated aspects of the audit.

When looking for a quality, independent auditor, you might start by asking for references and discuss the quality of work with other EBP clients. Ask the firm about recent training and continuing education specific to employee benefit plans. Another simple way to compare quality auditors with one another is to search for the firms that are members of the AICPA Employee Benefit Plan Audit Quality Center (EBPAQC). These firms have made a voluntary commitment to audit quality by adhering to higher standards in their policies, procedures and training. At a minimum, auditors for these plans must be licensed or certified as public accountants through a state authority.

*The DOL noted that firms with membership in the AICPA EBPAQC had fewer audit deficiencies. By contrast, most CPAs performing the fewest audits and showing the most deficiencies were not members. —U.S. Department of Labor*

Given all of these factors, one more distinction that must be identified is if the firm has sufficient independence to satisfy ERISA standards for third-party reporting. An independent auditor or its employees, for example, should not also maintain the financial records for the employee benefit plan. The same firm may perform tax filing, but accounting work may be deemed a conflict of interest that would affect an objective audit report. For more information on selecting a quality auditor for EBP financial statement audits, refer to the AICPA report, <http://bit.ly/1SN8w0h>

The report even provides guidelines on developing a detailed RFP to engage auditors.

## Key Areas of DOL Scrutiny

Does your employee benefit plan auditor really understand what's at stake when performing your audit? It is more than a governmental requirement. It protects the assets promised to your employees and ensures that plan administration is in full compliance with the US Department of Labor and IRS.

The DOL has spent more than 25 years assessing the quality of employee benefit plan audits and taking aggressive action to improve them. The most recent study showed that only 61% of audits fully complied with professional standards compared to a 1997 baseline study that showed 81% of plan audit compliance. The decline correlates to an increasing amount of plan assets and number of plan participants at risk. This fact increases the chances of personal liability for your organization's plan administrators and board members.

How is the DOL measuring audit deficiency? There are several areas it deems vital to compliance as defined by Generally Accepted Accounting Principles (GAAP), Generally Accepted Auditing Standards (GAAS) and the ERISA Act of 1974. ERISA was enacted by Congress to fix abuses in the nation's private pension and welfare benefit plan system. Since then, the Act has been extended to apply to all defined contribution and defined benefit plans such as Simple IRAs and 401(k)/403(b) plans.

Companies and organizations that are required to have an employee benefit plan audit of financial statements must hire a qualified, independent auditor as part of their fiduciary responsibilities. The chosen auditor should understand areas in which the DOL is finding common deficiencies. The auditor also needs the knowledge to properly test and report on each unique plan.

Let's outline a few of these areas, and the questions you should ask your potential audit team about their knowledge or level of accomplishment in these areas.

### **Level of EBP specific continuing professional education**

The DOL found that audit teams with at least 8 or more hours of continuing professional education specific to employee benefit plan audits in the previous three years had fewer audit deficiencies. CPAs with the fewest deficiencies (and who also performed the most audits) cited an average of 24 or more hours of continuing professional education in the last three years previous to the audit.

Ask your prospective employee benefit plan audit team about the level of CPEs they have achieved in the years leading up to your audit. Also ask them how many EBP audits they perform each year.



## **Compliance with Plan Documents**

Cornwell Jackson audits more than 75 employee benefit plans a year. The number one issue we identify is that daily management of the plan often does not match the original plan documents. For example, definitions of compensation in the plan documents don't match what is actually reported for employees. Auto enrollment is another area that requires careful management, since employees must be enrolled within a timely manner as soon as they are deemed eligible (unless they choose to opt out). The mere opportunity to enroll must be communicated to employees in a timely manner, too.

The DOL has noted other deficiencies in day-to-day management, including accurate recording of participant data, proper and timely payments of benefits and timely, accurate collection of employee contributions.

Quality independent auditors should be able to discuss the importance of consistency between plan documents and day-to-day management as well as internal controls — and how they test for such weaknesses.

## **Limited Scope Audits**

An increasing number of what are called “limited scope” audits appear to have contributed to a decline in audit quality since 2001. Limited scope audits allow auditors to issue “no opinion” on the plan's financial statements. However, limited scope audits do not decrease the auditor's duty to focus on all relevant audit areas. They simply allow auditors to exclude investments held and investment-related transactions and income already certified by qualifying entities (e.g. investment brokerage firms).

Almost 60% of limited-scope audits in the 2015 DOL study “contained major GAAS deficiencies in areas of the audit not related to investments, including contributions, participant data, benefit payments and internal controls.”

When considering a potential auditor for a limited-scope audit, ask about the audit team's approach to ensure that all relevant audit areas were included in the audit engagement.



## Clean Peer Review

Many of the auditors included in the DOL study were also found to show deficiencies in professional standards based on peer review. A qualified peer auditor with particular knowledge of EBP audits can identify these deficiencies. Peer review overall is designed to support high quality audit standards and best practices across all firms. However, the DOL found that many CPAs with deficient or rejected audits also did not have an acceptable peer review. Some of them did not undergo peer review at all.

Ask your potential EBP auditor about their history of peer review and whether they can attest to an acceptable peer review.

If you are concerned about your audit team's qualifications to perform a quality independent employee benefit plan audit, include these questions and considerations in your RFP process and visit the AICPA EBPAQC to learn more. There is also an EBP audit preparedness checklist available through the AICPA at <http://bit.ly/1pWHGIM>.

## **Top Employee Benefit Plan Audit Quality Improvements**

Glaring deficiencies in employee benefit plan audits across the accounting industry have prompted the U.S. Department of Labor's Employee Benefits Security Administration to put several initiatives in place to improve the quality of audits and auditors in the coming years. Is your auditor preparing for these new standards?

Firms with smaller employee benefit plan practices and correspondingly high levels of audit deficiencies may be subject to more discipline enforced through their state boards of accountancy. The DOL is also recommending amendments to the ERISA Act of 1974 to impose civil penalties more often on CPAs who fail to meet qualifications to perform the audit — or if the audit is determined to be largely deficient.

## DOL Recommendations to Improve Audit Quality

The DOL recommended eight other changes and improvements to the oversight of employee benefit plan audits. They include:

- Working with the American Institute of Certified Public Accountants Peer Review staff to improve the peer review process as it relates to employee benefit plans as well as enforcement of discipline on CPAs that don't receive an acceptable peer review.
- Amending the definition of "qualified public accountant" to include additional qualifications to ensure quality employee benefit plan audits.
- Repealing the "limited-scope" audit exemption so that all auditors are required to file a formal and unqualified opinion — standing behind the quality of the organization's financial statements.
- Adding more authority to the Secretary of Labor to establish special accounting principles and audit standards that relate to financial reporting issues of employee benefit plan audits.
- Expanding licensing requirements for CPAs that audit employee benefit plans. The AICPA is already planning to offer a certificate program to distinguish CPAs who specialize in EBP audits.
- Expanding education for plan administrators on the importance of hiring a qualified employee benefit plan auditor.
- Communicating with state boards of accountancy to ensure that only competent CPAs are performing employee benefit plan audits
- Communicating with state CPA societies to add employee benefit plan audit training opportunities, particularly in states that have a large number of CPA members performing only a handful of audits annually.

The very nature of employee benefit plan audits is changing to support higher quality audit services. Auditors performing the audit must be aware of these changes and the increased educational requirements and scrutiny. For example, the DOL is calling for more transparency in the audit report that includes listing all plan participants and their beneficiaries as well as outlining management's responsibilities for the plan. If you need a refresher on plan administration compliance, review this DOL report: [dol.gov/ebsa/publications/fiduciaryresponsibility.html](https://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html)

## **Security Enhancements and Form Changes for Benefit Plan Audits**

In addition to how information is laid out in the EBP audit report, plan administrators must be mindful of issues such as cyber security and changes to the Form 5500 that require additional information.

Administrator responsibilities regarding cyber security include:

- Written information security policies
- Periodic audits to detect cyber security threats
- Periodically tested back-up and recovery plans
- Responsibility for losses through cyber security insurance
- Training policies to reinforce security of data

Key changes to the Form 5500 include:

- New questions about unrelated business taxable income, in-service distributions and trust information
- A number of new provisions for multi-employer plans with 500 or more total participants (including retired employees or former employees that have not moved assets from the plan).

As you can see, plan administrators have a greater burden to hire a qualified auditor, given evolving training and certification of auditors and the complexity of the audit itself. It will greatly benefit any plan administrator or trustee to schedule time with a EBP auditor at Cornwell Jackson to understand these changes and pursue additional training if necessary.

