# Department of Labor Study of Employee Benefit Plan Audit Quality
# Questions and Answers

**Q1: What are the audit requirements for ERISA plans, such as employee benefit plans?**

**A:** The Employee Retirement Income Security Act (ERISA) contains a requirement for annual audits of plan financial statements by an independent qualified public accountant. Generally, plans with 100 or more participants are subject to the audit requirement. The Department of Labor's (DOL) regulation establishes conditions for small employee benefit plans to be exempt from the general requirement that plans be audited each year. Generally, the plan's audited financial statements accompany the Form 5500 filed by the plan administrator. The DOL may reject a filing that has a deficient financial statement audit or that does not properly reconcile information contained in the financial statements with information contained in the Form 5500.

**Q2: How does a financial statement audit help protect plan participants and beneficiaries?**

**A:** A financial statement audit helps protect the financial integrity of the employee benefit plan, which helps users determine whether the necessary funds will be available to pay retirement, health and other promised benefits to participants. The audit may also help plan management improve and streamline plan operations by evaluating the strength of the plan's internal control over financial reporting and identifying control weaknesses or plan operational errors. And the audit helps the plan sponsor carry out its legal responsibility to file a complete and accurate Form 5500 for the plan with the DOL.

**Q3: What is a limited-scope audit – and why is it allowed?**

**A:** Typically, financial statement auditors are engaged to audit and report on a reporting entity's financial statements, including all assets, liabilities and obligations, as well as financial activities. These audits are performed without any client-imposed scope limitation or other restriction. ERISA is unique in that, when certain criteria are met, it permits plan management to instruct the auditor to limit the scope of testing of investment information included in the financial statements.

This limited-scope election must be supported by a certification from a qualified entity as to both the accuracy and completeness of the plan's investment information. Such audits are referred to as "limited scope" audits. Plan management is responsible for determining that the conditions of the limited-scope audit exemption have been met.

In a limited-scope audit, the auditor does not audit the certified investment information (investments typically are the most significant plan assets). He or she still tests participant data, including the allocation of investment income to individual participant accounts, and tests contributions, benefit payments and other information that was not certified. Even though the auditor performs procedures on everything except the investment information in a limited-scope audit, he or she will disclaim an opinion – which means the auditor cannot express an opinion – on the financial statements because of the significance of the information that was not audited.

**Q4: What difference would a full-scope audit requirement make?**

**A:** In a full-scope audit the auditor tests the plan's investments – the biggest asset of the plan – for proper valuation and, in most cases, the auditor would be able to express an opinion on the plan's financial statements and thus provide assurance to plan participants that the financial statements are fairly presented.

The AICPA is on record, since 1978, as stating that the scope of the audit should not be restricted in any way. Its longstanding view is that plan participants cannot be provided the full assurance contemplated by ERISA if the independent accountant's audit is restricted.

In 2012, the Labor Department's Office of the Inspector General (OIG) found that the Employee Benefits Security Administration's (EBSA) significant efforts to improve oversight and audit quality "have been offset by plan administrators' increased use of limited scope audits and a significant growth in asset value of plans subjected to limited scope audits." According to the report, "The lack of protections provided by limited scope audits have extended to more participants and more plan assets in recent years. The percentage of plans using limited scope audits has grown from about 46 percent in 1987 to over 83 percent in 2013.

**Q5: What authority does the Department of Labor have in overseeing or regulating employee benefit plan auditors?**

**A:** The DOL, through the Employee Benefits Security Administration, has primary responsibility for promulgating rules for plan reporting and disclosure and determining the duties imposed on fiduciaries. The DOL has existing authority to reject a plan audit (as part of a Form 5500 filing), and can fine a plan sponsor for failing to file in a timely manner or for failing to take corrective action after a filing is rejected. Additionally, the DOL has the authority to hire a new auditor on behalf of the plan and charge the plan sponsor. The Department also may make ethics referrals to state CPA licensing agencies and the AICPA Professional Ethics Division.

**Q6: The DOL's study identified a high percentage of audit deficiencies among the firms that were included in the study population. What's your reaction to the findings?**

**A:** Poor audit quality is never acceptable. We recognize that there is work to be done to improve the quality of employee benefit plan audits, and we are committed to addressing issues identified in the study. The accounting profession's overarching goal has been – and continues to be – helping individuals and firms perform the highest quality employee benefit plan audits possible. We will work with the AICPA, auditors, plan sponsors, state CPA licensing boards and the Department of Labor to accomplish that.

**Q7: What specifically is the accounting profession doing to address audit quality issues?**

**A:** The accounting profession has already begun addressing quality issues identified by the DOL. Actions to date include:

- The AICPA is reviewing all audits with quality issues that have been referred to it by the DOL (with outcomes resulting in disciplinary action then shared with the appropriate state board of accountancy);
- The AICPA's introduction and implementation of the Enhancing Audit Quality (EAQ) initiative, covering near and longer term reforms to auditing and quality control standards/guidance, the Code of Conduct, peer review, and potential transformation of peer review into a near real-time practice monitoring program;
- The AICPA's recently issued *Six-Point Plan to Improve Audits*, which provides a roadmap for the profession's continued journey to audit excellence. The plan concentrates on financial statement audits for private companies, employee benefit plans and governmental entities in the United States; and
- Guidance, tools and learning opportunities available through the AICPA and its Employee Benefit Plan Audit Quality Center.

In addition, the profession is making the following recommendations:

- Urging the DOL to seek congressional repeal of the exemption allowing limited-scope audits, which have been identified by the Department as a factor in audit quality; and
- Encouraging the DOL to initiate a comprehensive education program for plan sponsors to help them understand the importance of hiring a quality auditor.

**Q8: The report suggests that ERISA audit quality has gotten worse over time, despite the accounting profession's best efforts. Should regulation of employee benefit plan auditors continue to reside within the profession?**

**A:** Yes. A combination of accounting profession actions and recommendations coupled with DOL oversight is more than up to the task. It is important to recognize that the AICPA has a long-standing relationship with the Department of Labor on audit quality initiatives. This involves DOL's ongoing audit inspections and referrals to AICPA for investigation and remediation or discipline. It also involves DOL's involvement in guidance and training to help practitioners understand employee benefit plans and their audits. In recent years, the AICPA has noticed trends that it has addressed with members at various conferences, through the profession's peer review program and through guidance.

We have also stepped up our oversight of individuals and firms that perform employee benefit plan audits via the profession's peer review program. Further, the most significant quality issues referred to the AICPA's Professional Ethics Division by DOL are in the process of being reviewed and resolved. Members found to be deficient in their performance or in noncompliance with standards or regulatory requirements are subject to corrective or disciplinary action and could be suspended or expelled. State CPA licensing bodies are notified of all disciplinary actions and have the ability to suspend or revoke CPA licenses.

In addition, the profession is on a path to transform the traditional system of peer review through the Enhancing Audit Quality initiative. A part of this initiative, Practice Monitoring of the Future, offers a provocative concept of what practice monitoring could become. This vision marks the beginning of a process that will allow practitioners to implement improvements to their performance in real-time, potentially even before engagements are completed. Taken together, the steps will make a significant difference in the future audits of employee benefit plans.

**Q9: What is it about employee benefit plan audits that makes them so challenging?**

**A:** The employee benefit plan financial reporting and audit environment is unique in many respects, including the nature of plan operations; the various laws and DOL and Internal Revenue Service regulations with which plans must comply; and special reporting and audit requirements. These matters, which affect every plan, add to the complexity of an employee benefit plan audit. Other matters that may complicate the plan reporting and audit process may include changes to the plan document; plan mergers; freezes or terminations; and changes in service organizations. In addition, plan sponsors often hire their company auditor to audit the company's employee benefit plan, even though the auditor may not have the necessary experience and skills to perform a benefit plan audit.

**Q10: Why doesn't the profession take more meaningful action against those auditors whose work has been called into question by the Department of Labor?**

**A:** It does – and it will continue to do so. The AICPA's Professional Ethics Division investigates all problem audits referred to it by the DOL. Members found to be deficient in their performance or in noncompliance with standards or regulatory requirements are subject to corrective action and could face disciplinary action, including suspension or expulsion from the Institute. All disciplinary action is then transmitted to a state board of accountancy, which is responsible for CPA licensing. In addition, the results of ethics investigations are shared with the profession's peer review program and the firm's peer reviewer to ensure that they are aware of the problems encountered by the firm on those audits so procedures can be modified accordingly.

It's worth noting that the AICPA is collaborating with the National Association of State Boards of Accountancy on a project to expedite ethics enforcement by allowing the AICPA's Professional Ethics Division and the DOL to share their respective investigative files with state boards of accountancy.

**Q11: Is there a role for plan sponsors in the effort to improve audit quality?**

**A:** Absolutely. A plan's hiring of an auditor is considered a fiduciary function. As such, plan administrators should make the selection of an auditor a top priority and exercise due care during every phase of the auditor selection process. Because an incomplete, inadequate or untimely audit report may result in the rejection of a filing and penalties, a plan's selection of an experienced and reliable auditor is very important.

The AICPA's Employee Benefit Plan Audit Quality Center recently issued a plan advisory for plan administrators to use in hiring a quality auditor. The plan advisory notes that, "Hiring a firm that lacks knowledge of the specialized nature of the industry and skills necessary to perform plan audits conflicts with the stated goal of ERISA to protect plan participants."

For its part, the DOL has developed an online resource for plan sponsors to use in selecting an auditor. The AICPA is urging the DOL to go further by embarking on an education campaign for all plan sponsors that would underscore their responsibility to make the hiring of an experienced and reliable auditor a high priority.

**Q12: What role does a state board of accountancy play?**

**A:** The investigation of potential disciplinary matters involving practitioners who are members of the AICPA is an important responsibility. But it is only part of the profession's enforcement mechanism. Only a state board of accountancy can make a determination as to whether a CPA should be licensed, or restrict a CPA's ability to practice in certain areas, such as audits of employee benefit plans.

AICPA Professional Ethics Division investigations may result in the issuance of a "required corrective action" letter directing the auditor to address the quality issue or – depending on the severity of the matter – admonishment, suspension or expulsion from AICPA membership. When investigations result in admonishment, suspension or expulsion, the results are published and cases are referred to one or several state boards of accountancy. A state board may then investigate the matter to ensure that the practitioner is remediated or, if necessary, disciplined.

The profession stands ready to work with state boards of accountancy in the timely consideration of all ethics matters brought to their attention.

**Q13: Has the AICPA taken action against firms whose employee benefit plan auditing has been called into question by the Department of Labor? I recall hearing that the Peer Review Board has already disciplined some firms.**

**A:** The AICPA's Professional Ethics Division is reviewing the 132 audits that have been referred to us by the DOL (as of May 26). However, the Peer Review Board is not expected to take any study-related action until after the Ethics Division completes its work.

The peer review activity to which you are referring was a separate AICPA initiative to ascertain peer review compliance. Two years ago, the DOL provided a list of approximately 4,900 firms that performed employee benefit plan audits in 2011. The Institute found that 21 percent of those firms had failed to comply with peer review requirements. As a result, the Peer Review Board took action against those firms which resulted in a number of recalls of peer review reports and notifications to the state boards. But the action predates, and is unrelated to, the DOL study.

In fact, the discovery that so many firms were not complying with peer review requirements was a factor in the Institute's decision to launch the Enhancing Audit Quality (EAQ) initiative.

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