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It's Time to Repeal the Limited Scope Audit

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Employers are subject to audits of their ERISA compliance. But how useful have they been? A report by the U.S. Department of Labor's Office of Inspector General to the Assistant Secretary for Employee Benefits Security Administration attempts to answer this question: "Has EBSA's Oversight of ERISA Audits Improved Audit Quality and Increased Participant Protections?"

Apparently not enough, according to the report, which DOL's OIG issued in September 2012. While acknowledging EBSA's lack of legal authority and its significant efforts to improve audit quality, the report recommends that EBSA seek to repeal limited scope audits.

In these, auditors do not confirm the value of investments; instead, they leave to the retirement plan administrator or investment manager the correct reporting of value when preparing financial statements.

The report also recommended that EBSA gain authority over retirement plan auditors.

Until limited scope audits are repealed, the OIG recommends that EBSA:

- clarify and strengthen existing regulations;
- evaluate the ERISA Advisory Council recommendations (see column in August 2011 newsletter);
- make better use of enforcement tools;
- improve audit quality review procedures; and
- reassess the quality of audits being done.

Background

ERISA Section 103(a)(3)(C) lets the plan administrator exclude from review by its independent auditor statements prepared by a bank or similar institution or insurance carrier that is regulated and supervised by a state or federal agency. This provision allows the auditor to rely on statements prepared by such institutions if the statements are certified as "complete and accurate."

Plan administrators held paper stock certificates when ERISA was passed in 1974, enabling plan sponsors and auditors to verify the existence of an asset as well as its value. Today, many financial institutions do not hold assets but rather maintain book entries with clearinghouses, subsidiaries or others actually holding the assets. Ironically, the organizations that hold the assets provide input for the institution's book entries. The Independent Qualified Public Accountant does not have to verify the existence of the assets under a limited scope audit, so they escape scrutiny. Knowing the correct value is critical when performing actuarial valuations as well as for valuing participant accounts.

The report states that "the percentage of plans using limited scope audits has grown from about 46 percent in 1987 to about 70 percent in 2010. The reported value of assets excluded from plan audits has similarly grown from about $520 billion (43 percent) in 1987 to $3.3 trillion (58 percent) in 2010…"

OIG, as it has since 1984, recommends repeal of the limited scope audit. EBSA has tried to do this, with its last attempt coming in 1997; EBSA agreed with the latest OIG recommendation to continue to seek repeal.

The report's findings and recommendations

Limited scope audits provide inadequate protection for plan participants and beneficiaries.

Verifying the existence and value of plan assets should be a critical component of an audit. However, in a limited scope audit, not all assets are audited. In

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Andersen (continued from p. 1)

addition, it is the plan administrator's responsibility to prepare financial statements at current value.[1] Both the OIG report and EBSA's investigations reveal that there is much room for improvement in these areas.

As noted above, the institutions providing the statements likely are not holding the assets. The organization actually holding the assets provides the asset listings to the financial institution. Under a limited scope audit, the institutions must certify that the statements are complete and accurate as reflected in their records, but it is up to the plan administrator to present the correct value on the financial statements.

Also under a limited scope audit, the IQPA does not have to test the accuracy and completeness of the statements, obtain an understanding of internal controls or assess risk controls related to the assets. Nor does the limited scope audit include an auditor's opinion regarding the reliability of the financial statements, which leads to a significant amount of assets not being audited.

To complicate matters, retirement plans have begun to shift into hard-to-value assets such as limited partnerships, private equity funds, real estate and hedge funds, presenting challenges to both the plan administrator and the IQPA in ensuring existence and valuation of the asset. The statements the financial institutions provide certify that they are complete and accurate as to holdings but not as to value. It bears repeating that it is the plan administrator's responsibility to show the assets at current value.

Of the 20 plans contacted during the OIG audit, 10 trustees/custodians said that their certifications were not at current value. Some responses noted that private equity investments, pooled funds and non-publicly traded investments were not shown at current value. EBSA's own investigations into hard-to-value plan assets found that half of the cases used the limited scope audit, which allowed for failure to obtain appraisals or valuations, when appropriate.

A major premise of the exclusion of certain statements from the plan audit is federal and state supervision of the various financial institutions that issue the statements. The report indicates that such supervision has decreased significantly since 1974. Noting that these institutions are subject to abuse and mismanagement, the OIG said it believes no independent audit effort would duplicate state or federal oversight activities.

[1]ERISA Section 3(26) says, "The term 'current value' means fair market value where available and otherwise the fair value as determined in good faith by a trustee or named fiduciary (as defined in section 402(a)(2)) pursuant to the terms of the plan and in accordance with regulations of the Secretary, assuming an orderly liquidation at the time of such determination."

To address concerns raised by the various financial institutions about numerous auditors reviewing them, OIG notes that auditors can, and do, rely on reports (for example, Report on Controls at a Service Organization Relevant to User Entities' Internal Controls over Financial Reporting (SOC-1 reports)) instead of onsite audit work at the financial institution.

Bottom line, OIG seems to believe that the limited scope audit is of little use to DOL, plan participants or beneficiaries.

EBSA continues to lack the legal authority to regulate IQPAs performing ERISA plan audits.

Currently, EBSA can only deal with substandard audit work by rejecting the Form 5500 filing and referring the IQPA to the appropriate disciplinary organizations. EBSA cannot prevent an auditor from auditing a plan, even if that auditor repeatedly performs substandard audits. EBSA has made proposals to Congress to change this situation; however, without result. It last did so in 1997.

EBSA has focused its efforts where the risk of deficient audits is the greatest; that is, IQPAs with limited experience, training and competence in conducting employee benefit audits. More than 70 percent of EBSA's reviews have been on IQPAs that audited fewer than 25 employee benefit plans per year, even though the work of these IQPAs amounts to less than a quarter of the total $5.7 trillion in U.S. plan assets.

The report notes that other organizations such as the IRS, the Securities and Exchange Commission, and the Joint Board for the Enrollment of Actuaries have much greater enforcement power than EBSA when it comes to auditor oversight. For example, the SEC has the authority to bar auditors from performing SEC-related audits as well as to impose civil penalties. However, despite this lack of authority, the OIG believes that EBSA could have published the names of IQPAs that repeatedly perform substandard work, while emphasizing the plan administrator's fiduciary responsibility to select and monitor a qualified service provider.

EBSA should improve procedures in reviewing audit quality to ensure that IQPA meets professional standards.

The Office of the Chief Accountant at EBSA initiated an outreach, education and oversight effort to identify and correct deficient audits. In addition, EBSA developed a detailed review checklist based on the American Institute of Certified Public Accountants' employee benefit audit guide.

The OIG recommends expansion of EBSA's checklist to determine whether assets certified by the financial in-

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Andersen (continued from p. 2)

stitution are actually held by that institution. Currently, EBSA only verifies that the financial institution is a qualified institution, not whether it holds and certifies all plan assets.

The report also recommends that EBSA improve its own IQPA review procedures by including areas not currently examined as well as requiring that reviewers complete all procedures or document why they were not performed.

EBSA should complete a reassessment of audit quality and establish measurable programs to determine if audit quality has improved.

OIG recognizes that EBSA and AICPA have taken numerous steps to improve audit quality.

But the report notes that EBSA has not completed an assessment of employee benefit plan audit quality since 2004; as a result, it says, EBSA cannot demonstrate if its oversight program has been effective in improving audit quality.

What does this mean to plan sponsors?

It is critical that a plan sponsor understand its responsibility in preparing financial statements for audit. The "to do's" that appeared at the end of the August 2011 column are worth repeating:

1) Review DOL's booklet, "Selecting an Auditor for Your Employee Benefit Plan."
2) Visit AICPA's Employee Benefit Plan Audit Quality Center website, which contains a plan sponsor resource center with a sizable amount of information, including a checklist for preparing a request for proposals from auditors and another for selecting one, as well as a 24-page booklet on valuing plan assets.
3) As always, document the steps you take in selecting and monitoring your plan providers.

Finding out More

To review the OIG report on EBSA audit oversight, go to this link: http://www.oig.dol.gov/public/reports/oa/2012/09-12-002-12-121.pdf.

To see "Selecting an Auditor for your Employee Benefit Plan" from DOL, go to this link: http://www.dol.gov/ebsa/publications/selectinganauditor.html.

To visit AICPA's plan sponsor resource center, go to this link: http://www.aicpa.org/INTERESTAREAS/EMPLOYEEBENEFITPLANAUDITQUALITY/RESOURCES/PLANSPONSORRESOURCECENTER/Pages/default.aspx.

For more information about selecting an auditor and filing annual Form 5500 reports to DOL, see ¶830 in the *Handbook*.