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Mitigating the Risk of Plan Auditor Selection

BY TRAVIS P. JACK

In the current regulatory environment of escalating maximum annual penalties associated with the late or deficient submission of the Form 5500; continued significant deficiency rates in plan audits; targeted, enhanced enforcement by the Department of Labor (DOL); and changes stemming from the Association of International Certified Professional Accountants' (AICPA) Enhancing Audit Quality initiative; it is imperative that Plan Administrators and those charged with governance perform the appropriate due diligence when engaging a CPA firm to provide audit services to the plan. Information derived from the latest DOL audit quality study along with both the DOL and AICPA's publications on selecting a plan auditor can be used to sidestep some of the common issues associated with making an informed decision regarding selecting a plan auditor.

Travis P. Jack, CPA, QKA is the Managing Member of Metz & Associates PLLC. Mr. Jack oversees the employee benefit plan practice at Metz & Associates and has served three terms on the executive committee of the AICPA employee benefit plan audit quality center (EBPAQC). He also served on the AICPA EBP conference planning committee for the last five years and maintains credentialed membership with the American Society of Pension Professionals and Actuaries.

There are over 80,000 qualified plans covered under the Employee Retirement Income Security Act of 1974 (ERISA) that require an audit by an Independent Qualified Public Accountant (IQPA). [An Analysis of Benefit Plan Auditors—Prepared by Summit Consulting LLC, published September 2018, <https://www.dol.gov/sites/dolgov/files/OASP/legacy/files/Benefit-Plan-Auditor-Analysis.pdf>] In general, most employee benefit plans with over 100 participants are required to have an audit performed by an IQPA, which is the regulatory term utilized for the Certified Public Accountant (CPA) who performs the plan audit. These audits accompany the submission of the Form 5500 annual report. The plan administrator is tasked with engaging an IQPA to perform this audit engagement.

The original intent of including an annual audit requirement in ERISA was to provide an additional level of assurance and protection to plan participants by having an external independent party help verify the accuracy of annually reported financial information and activities of employee benefit plans. According to the Department of Labor (DOL) Publication *Selecting an Employee Benefit Plan Auditor*, “hiring an Independent Qualified Public Accountant is one of the Plan Administrator’s most important fiduciary responsibilities.” Lack of due diligence when selecting an IQPA can generate significant possible issues, especially in the context of the current regulatory trends.

Regulatory Landscape

The agencies governing the regulation of IQPAs that perform employee benefit plan audits include the various state boards of accountancy, the Association of International Certified Professional Accountants (AICPA), and the Financial Accounting Standards Board (FASB). Specific to employee benefit plan audits, there is an additional element of oversight by the Employee Benefits Security Administration (EBSA), an agency of the DOL. EBSA has regulatory oversight authority granted under the Title I Provisions of ERISA. In 1988, EBSA established the Office of the Chief Accountant (OCA), which was tasked with the primary responsibility of ensuring that the reporting and disclosure requirements of Title I were being adhered to in a compliant fashion, including that the plan audits accompanying the filings of the annual reports were and are being conducted in accordance with professional standards set by the AICPA and FASB.

The DOL has accomplished this oversight through a combination of efforts including selecting and reviewing individual auditor workpapers sampled from Form 5500 submissions and larger statistical studies performed at regular intervals. Additionally, the DOL is involved in regular outreach and educational initiatives aimed at plan auditors. The DOL works closely with key stakeholders such as the AICPA EBP audit quality center, State CPA Societies, and State Boards of Accountancy. Collaborative efforts include participating in various Employee Benefit Plan Conferences and Webinars hosted by the AICPA and various state CPA societies. Firms that perform work that is deemed to be deficient as part of a DOL workpaper review are referred to the AICPA Professional Ethics Division and respective State Board of Accountancy.

The latest comprehensive statistical study by the DOL of Form 5500 submissions made in 2011 was published in May 2015. The demographic data related to the firms that completed the associated plan audits in the study was compiled and correlated to the associated deficiency rates of those firms. This data was then utilized to provide a broader correlation between demographic data categories and overall deficiency rates in the CPA firm population. The audit quality study cited the following results:

- Audit quality was trending downward (historical results are shown in Exhibit 1).
- The overall level of quality of the audit engagements was well below expectations with an overall 39 percent deficiency rate.

A significant concentration of the root causes cited in the DOL audit quality study as a driver of deficient audit work stemmed from insufficient or no work in audit areas that were unique to employee benefit plans, such as testing of benefit payments, participant data, and party-in-interest/prohibited transactions.

Exhibit 1			
Department of Labor Historical Audit Quality Study Results			
Year	1997	2004	2011
Deficiency Percentage	19%	33%	39%

The Potential Risk

The risk that a deficient audit creates for plan administrators is that the DOL can reject a filing with an associated deficient audit and the plan administrator may be assessed penalties up to \$2,194 per day for

the 2019 filing period. The penalty assessment starts from the original filing due date of the Form 5500, without regard for any extension filed. The DOL typically will provide a period of time to remediate issues of the deficient audit work depending on the severity. However, in many instances the plan sponsor will be responsible for the additional costs to obtain a second audit that meets professional standards to be included in the resubmission process. The cost of a second audit (often needed in a short time frame) in addition to the penalties assessed for a late filing can make the cost of a deficient audit very significant to the plan sponsor or plan administrator.

Leveraging the Qualitative Data in the Audit Quality Study to Drive Better Due Diligence When Selecting a Plan Auditor

The opportunity created by the study was that the DOL had quantified the deficiency rates by key qualitative demographic categories of the CPA firms. This information can then be used by plan fiduciaries to vet prospective plan auditors. Some of the main firm demographic criteria that was associated with lower deficiency rates were:

- The number of plan audits completed by a firm
 - Six strata were scoped by volume of plan audits performed annually. The strata ranged from one to two plan audits performed annually to over 750.
 - Deficiency rates for the strata of firms sampled that performed only one or two plan audits was 75.8 percent.
 - Deficiency rates in the two largest strata 100–749 and 750 and above in annual plan audit volume was 12 percent.
- Membership in the AICPA Employee Benefit Plan Audit Quality Center correlated with deficiency rates nearly three times lower than firms that were not members.
- A specialty in plan audit and associated EBP specific professional education and training drove higher quality results.

This information gives plan sponsors and those tasked with selecting a plan auditor key data points about what drives quality to help better select plan auditors.

Some of the key inquiries to include in the request for proposal are:

- What are the number of employee benefit plan audits completed by the firm?
 - If there are multiple offices you may also want to inquire as to the number of EBP-specific engagements completed by that office and the signing partner assigned to your engagement.
 - Additionally, the number of the specific type of plan should be requested. This is especially true when selecting an auditor for an ESOP, 403(b), defined benefit, or health and welfare plan, as they have unique rules and nuances that typically require additional expertise and attention in the plan audit process.
- Is the firm an active AICPA Employee Benefit Plan Audit Quality Center Member?
- Bios and employee benefit plan experience of the full engagement team including the number of employee-benefit-plan-specific continuing education credits taken by individual members of the audit engagement team.
- Request a copy of the firm's Peer Review Report which will either be a Pass, Pass with deficiencies, or Fail rating.
- Request a list of other plan sponsors that the firm works with and contact information for the respective plan administrators.

Trust but Verify

You are able to review and verify some of the key data requested of CPA firms.

- Membership in the AICPA Employee Benefit Plan Audit Quality Center can be checked at <https://www.aicpa.org/interestareas/employeebenefitplanauditquality/membership/find-a-member-firm.html>
- Licensing of both the signing partner and firm can be verified at
 - <https://cpaverify.org/>
 - <https://nasba.org/stateboards/>
- Listings of CPE taken are typically required as part of the CPA licensure renewal process and could be requested as part of the due diligence process.

Process Related Inquiries

In addition to ascertaining the key quality drivers to ensure that you are receiving a quality audit

process, it would be beneficial to design inquiries that delve into how the firm works with their clients, including overall processes regarding client interaction and responsiveness, and how the firm protects the sensitive plan participant data that is utilized to complete the audit process.

- What percentage of EBP jobs are completed prior to needing an extension?
- When do you send out your engagement letters and start your audit process?
- What is your process for gathering and storing plan and plan participant data?
- Please provide a narrative describing your audit process, including when the process begins and the anticipated completion timeframe.
- Please provide a sample request for information you will be expected to provide throughout the plan audit process.

For a comprehensive listing of other possible request for proposal inquiries see the AICPA publication *The Importance of Hiring a Quality Auditor* available at <https://www.aicpa.org/content/dam/aicpa/interestareas/employeebenefitplanauditquality/resources/planadvisories/downloadabledocuments/ebpqc-importance-of-hiring-plan-advisory.pdf>.

Current Industry Trends

Since the release of the audit quality study in May of 2015, the employee benefit plan landscape has seen some major changes. The AICPA also launched the Enhancing Audit Quality Initiative in 2014 to support continued quality improvements in audit and attestation services. Key AICPA initiatives included updates to enforcement, peer review, and standards and ethics enhancements. The most recent 2018 annual results and current focus areas of the AICPA Enhancing Audit quality Initiatives can be found at <https://www.aicpa.org/content/dam/aicpa/eaq/eaq-highlights-report-2018-infographic.pdf>.

The AICPA Enhancing Audit Quality initiatives, in particular the Peer Review Enhanced Oversight, in conjunction with EBSA's targeted enforcement efforts towards plan auditors based on the qualitative data derived from the 2015 audit quality study, have been very impactful on the population of firms that perform plan audits.

These factors have converged to make major demographic shifts in the population of CPA firms that provide plan audit services. Since the evaluation of the 2011

filings, the population of CPA firms providing plan audit services have dropped from 7,330 in 2011 to 5,750 in 2016, according to the Analysis of Benefit Plan Auditor Prepared by Summit Consulting for the Department of Labor, available at <https://www.dol.gov/sites/dolgov/files/OASP/legacy/files/Benefit-Plan-Auditor-Analysis.pdf>.

Conclusion

To ensure you obtain the intended protections of an independent plan audit as envisioned in the requirements of ERISA, it is important to make the

appropriate inquiries that derive the necessary qualitative data to make an informed decision regarding your plan auditor. It also is important to document the data gathered and the decisionmaking process regarding the plan auditor selection process to demonstrate prudent fiduciary processes regarding the important decision. In addition to satisfying the annual compliance requirement, an experienced plan auditor can give insight into best practices regarding plan operations and internal control environments. ■