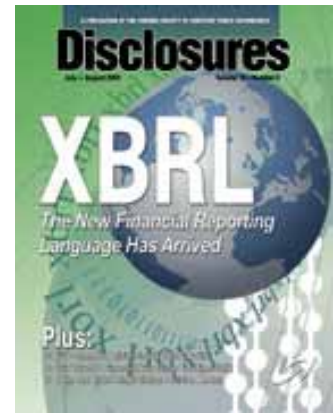


FIVE COMMON DEFICIENCIES IN ERISA AUDITS

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After the formation of the American Institute of CPAs (AICPA) Employee Benefit Plan Audit Quality Center in March 2004, the AICPA Peer Review Board released its AICPA 2003/2004 Peer Review Board Oversight Task Force Report and Comments. This report noted many common recurring deficiencies found in employee benefit plan audits, also known as Employee Retirement Income Security Act of 1974 (ERISA) audits, five of which are illustrated in this article.



Participant Contributions

Auditors often fail to test the timeliness of participant contributions. This subject remains an enforcement initiative for the U.S. Employee Benefits Security Administration (EBSA).

The relevant audit program from Practitioners Publishing Company (PPC) Audits of Employee Benefit Plans defines the audit objective as: “Employee contributions represent all contributions made by employees and are properly determined and presented in accordance with generally accepted accounting principles, plan provisions, and, if applicable, ERISA requirements.” This objective is all encompassing, covering all five financial statement assertions: existence, valuation, completeness, presentation and disclosure, and rights and obligations.

Absent a banner year in the stock market, contributions are typically the largest addition to net assets reported in financial statements. To comply with U.S. Department of Labor (DOL) regulations, an auditor should determine that the employer remitted employee contributions withheld to the plan or trustee in a timely manner.

Regulation 29 CFR 2510.3-102(b) states that employers are required to remit the employee contributions to the plan as soon as they can be reasonably segregated from the employer’s general assets, but no later than “the 15th business day of the month following the month in which the participant contributions are withheld or received by the employer.” Auditors must educate their clients that the latter is not a grace period.

If the employer has proven they can remit contributions to the plan within two to three days, any exceptions to that precedent should be analyzed. If the employer’s payroll is weekly, this means auditors must assess the timeliness of at least 52 remittances during the year to ensure completeness, preferably from review of a client-prepared schedule of remittances.

Acceptable reasons for a delay from the norm might include a natural disaster, such as Hurricane Isabel disrupting business in September 2003. Another valid reason could be if the plan changed its trustee or custodian, and there was a blackout period during the conversion so neither vendor could accept contributions. A third valid reason might be delays in processing during a payroll or accounting system conversion (as soon as administratively feasible).

In contrast, the DOL probably wouldn’t view the payroll administrator’s vacation a valid reason for a later remittance, thus it is important for sponsors to have someone else trained to perform the task as a backup.

If any contributions are deemed delinquent, they could be corrected either applying for the EBSA’s Voluntary Fiduciary Correction Program (VFCP) as updated in April 2006 (avoiding a reportable transaction and the related excise taxes as long as they notify the participants of the correction), or by paying the late contributions, computing and reimbursing the plan for lost earnings and paying the 15 percent excise tax using Form 5330. If the employer chooses the latter, the delinquent contribution constitutes a prohibited

transaction that must be reported on the Form 5500 (per clarified instructions for Schedule H, line 4a) and in a supplemental schedule until the year after they are corrected.

If the transaction is discovered during the annual audit, this means it would be disclosed a minimum of two years. A good practice for the human resources personnel, who often administer benefit plans of the sponsor, would be to enlist the help of accounting personnel to monitor the balance in the 401(k) withholdings account, which should always be zeroed out quickly.

Benefit Payments

Auditors often fail to test the approval of benefit payments. The relevant PPC audit program defines the audit objectives as: "Benefit payments represent payments to all (and only) those entitled to receive them ...All benefit payments are properly determined, recorded, and presented in accordance with plan provisions and generally accepted accounting principles."

These objectives also cover all five financial statement assertions. Knowledge of the features of each plan is necessary to accomplish these objectives, given that benefit payments are usually the largest deduction from net assets reported in the financial statements. Procedures should include examination of approvals and supporting documents (such as an approved benefit election form for a retiring participant, a withdrawal request or employment termination notice, a death certificate, a cancelled check, etc.).

Special consideration should be given if participants may submit withdrawal requests electronically, as there is no written record maintained. The auditor could confirm the disbursement with the participant or agree the disbursement to a transaction report from the electronic system.

Another potential deficiency is to place inappropriate reliance on the Statements on Accounting Standards (SAS) 70 report (type II, or "Report on Controls Placed in Operation and Tests of Operating Effectiveness"). The benefit of a SAS 70 report in this case is to gain an understanding of the trustee's or administrator's controls over benefit payments, not to eliminate the need for any testing.

Investments

Auditors often fail to understand the testing requirements on a limited scope audit. The relevant PPC audit program defines the limited scope audit objectives as: "Investments and investment transactions comply with the plan provisions, investment policy, and ERISA requirements;" and "there is adequate financial statement disclosure of liens, pledges, or other security interests in investments. The disclosures required by GAAP have been made."

These objectives cover two financial statement assertions: presentation and disclosure, and rights and obligations. If a proper certification is obtained from a bank or similar financial institution or insurance company, the auditor effectively disclaims an opinion on the existence, valuation and completeness assertions. However, limited scope does not endorse a complete lack of audit procedures.

For instance, the allocation of investment income to individual accounts is not certified by the trustee or custodian. If it must be tested by the auditor, however, the auditor may reduce (not eliminate) substantive procedures by using a type II SAS 70 report, if it is available. This report often includes tests of participant data, such as the allocation of income and forfeitures, and can be useful provided that the report and reported test results are related to the existence, valuation or completeness assertions noted above.

Participant Data

Auditors often perform inadequate testing of participant data. The relevant PPC audit program defines an audit objective as: “Accurate data for all eligible employees is included in participant records that are maintained as required by ERISA and are used by the plan administrator or actuary to determine financial statement amounts...”

This objective covers two financial statement assertions: valuation and completeness. The source of participant data is typically the employee census the third-party administrator uses to perform compliance testing, e.g. the ADP/ACP test. This census ideally includes dates of birth, hire and/or termination and compensation and deferral amounts.

Because there is no universal definition of eligible compensation, auditors should be familiar with each plan’s definition and test the payroll and personnel records to ensure the plan is being operated as intended. This should include tracing pay rates to authorizations and/or hours worked to production records to ensure compensation is accurate.

Participant Loans

Auditors often perform inadequate testing of investments, including participant loans. If a plan allows participant loans, at a minimum, regardless of scope, an auditor should test a sample to determine that loans were made according to the plan’s loan policy, and that loans were properly segregated as an investment in the participants’ accounts.

Although participant loan repayments aren’t subject to the DOL’s participant contribution regulation above, delinquent remittance of participant loan repayments is considered a prohibited transaction, and similar relief is available through the VCFP as applies to participant contributions.

Conclusion

Remarkably enough, a common deficiency in all of these areas was either no audit work performed or no audit documentation. Firms choosing to perform employee benefit plan audits will need to budget more time to comply with the raised expectations of the EBSA, and the challenge will be to educate plan sponsors on the benefits of a sufficient, though more expensive, annual audit.

Resources

- AICPA Employee Benefit Plan Audit Quality Center
- AICPA Audit and Accounting Guide, *Employee Benefit Plans*
- AICPA Audit Risk Alert, *Employee Benefit Plans Industry Developments — 2006*
- Practitioners Publishing Company (PPC) *Audits of Employee Benefit Plans*
- U.S. Employee Benefits Security Administration



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Disclosures
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