

**WRITTEN STATEMENT OF
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BEFORE THE 2019 ADVISORY COUNCIL ON EMPLOYEE WELFARE AND
PENSION BENEFIT PLANS**

**BEYOND PLAN AUDIT COMPLIANCE: IMPROVING THE FINANCIAL
STATEMENT AUDIT PROCESS**

JUNE 25, 2019

Good morning, distinguished members of the ERISA Advisory council. It is an honor and privilege to be here this morning to discuss the many issues surrounding the plan audit process, not the least of which is improving the plan administrator's knowledge before, during and after the audit so that audits are properly performed in an efficient and effective manner. A properly performed audit should inform plan management on how to enhance a plan's operations and provide valuable information to better secure plan assets.

I wish to emphasize that this written statement and the views I express today are my own and do not necessarily represent the official position of the Department of Labor.

A LITTLE HISTORY AND BACKGROUND INFORMATION

The Employee Retirement Income Security Act of 1974 (ERISA) requires in Section 103(a)(1)(A) that an annual report be filed with the Secretary in accordance with Section 104(a) and be furnished to participants in accordance with section 104(b). Generally under Section 103(3)(A) The administrator of an employee benefit plan shall engage on behalf of all plan participants an independent qualified public accountant who shall conduct such an examination of any financial statements of the plan and of other books and records of the plan as the accountant may deem necessary to enable the account to form an opinion as to whether the financial statements and schedules required to be included in the annual report are presented fairly in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Such examination shall be conducted in accordance with generally accepted auditing standards and shall involve such tests of the books and records of the plan as are considered necessary by the independent qualified public accountant. The opinion by the independent qualified public accountant shall be made a part of the annual report.

Nothing in the ERISA statute gives the Secretary of Labor the authority to define generally accepted accounting standards or generally accepted auditing standards. Instead these standards have been left to the accounting profession to develop. The Secretary does have enforcement authority to reject an annual report under Section 104 and to penalize a plan

administrator if the filing is incomplete or contains a material qualification by an accountant.

As far back as 1984, reviews by the DOL's Office of Inspector General (OIG), the General Accountability Office (GAO) and the EBSA have shown that these audits have not met professional standards. In 1988, the EBSA established the Office of the Chief Accountant (OCA) to establish a program to identify and correct substandard audits as one of its major priorities. Since its inception, EBSA has continued to take aggressive actions with respect to improving the quality of employee benefit plan audits. In addition to providing compliance assistance and enforcing the reporting and disclosure provisions of Title I of ERISA, OCA continues to be responsible for establishing and maintaining liaison with private sector professional organizations and regulatory bodies regarding accounting and auditing issues for employee benefit plans to ensure participants and beneficiaries are receiving their statutory protections. A properly performed plan audit has long been considered the first line of defense for plan participants and their beneficiaries and a deterrent of abusive practices.

In September 2004 the DOL's OIG concluded that the EBSA needs additional authority to improve the quality of employee plan audits. The OIG found that, "Although the OCA has reviewed a significant number of employee benefit plan audits and has made efforts to correct substandard audits including rejecting annual report filings and making referrals to professional organizations, the process for identifying and correcting substandard employee benefit plan audits has not been effective as a significant number of substandard audits remain uncorrected and plan auditors performing substandard work generally continue to audit employee benefit plans without being required to improve the quality of the audits."

EBSA's OCA performed four baseline assessments of plan audit. The last assessment was dated May 2015. It was based on 81,162 filed 2011 audit reports performed by 7,330 practice units.

The report findings included:

- Overall, EBSA's review found that 61% of the audits fully complied with professional auditing standards or had only minor deficiencies under professional standards. However, 39% of the audits (nearly 4 out of 10) contained major deficiencies with respect to one or more relevant generally accepted auditing standard requirements putting \$653 billion and 22.5 million plan participants and beneficiaries at risk. These figures reflect increases in the amount of plan assets and number of plan participants at risk compared with prior EBSA studies. "
- CPA firms that perform just a few audits annually failed 76% of the time. In contrast, firms reforming more than a few audits had a 12% deficiency rate
- The accounting professions peer review and practice monitoring efforts have not resulted in improved audit quality or improved identification of deficient audit

engagements. In 4 of the 6 audit strata, a substantial number of CPA firms received an acceptable peer review report, yet had deficiencies in the audit work that EBSA reviewed

- CPA firms that were members of the AICPA audit quality center had fewer errors
- As the level of employee benefit plan specific training increased, the percentage of deficient audit work decreased
- Of the 400 plan audit reports reviewed, 67 or 17% of the audit reports failed to comply with one or more of ERISA's reporting and disclosure requirements
- The practice monitoring peer review process established by the AICPA and administered by state CPA societies does not appear to be an effective tool. CPAs who performed deficient work often received acceptable peer review reports.
- Plan administrators hired unlicensed practitioners to perform their plan audits

The report made a number of regulatory and legislative recommendations including:

- Amend the ERISA definition of “qualified public accountant” to include additional qualification requirements to help ensure the quality of plan audits. The Secretary would be authorized to issue regulations.
- Amend ERISA to repeal the limited scope audit exemption. This exemption prevents auditors from rendering an opinion on a plan's financial statement.
- Amend ERISA to give the Secretary of Labor authority to establish accounting principles and audit standards that would protect the integrity of employee benefit plans and the benefit security of participants and beneficiaries.

CONTINUING OUTREACH AND GUIDANCE TO PLAN ADMINISTRATORS

Following the May 2015 assessment, the EBSA made announcements expressing concerns about the quality of plant auditors and audits. As a part of its continuing outreach program, the Department started sending letters to plan administrators that provided tips for selecting plan auditors. A brochure was created and distributed to the plan community, *SELECTING AN AUDITOR FOR YOUR EMPLOYEE BENEFIT PLAN*. The brochure stressed that hiring an independent qualified public accountant is one of the plan administrators most important fiduciary responsibilities as well as monitoring their work and report. It provides example questions that should be asked about the auditor's work. Because benefit plan audits are unique and different from other financial statement audits, it is important to consider a firm's qualifications and experience.

CONTINUING OUTREACH TO THE ACCOUNTING PROFESSION

What became apparent in the last audit quality assessment was that plan administrators did not understand what occurred in a financial audit and how it could assist them in performing their fiduciary duties. Although much audit work is done in a financial audit of a plan, the audit report itself lacks transparency, it generally recites canned language about being performed in accordance with generally accepted auditing standards, whether or not the financial statements are free from material misstatements and whether the supplemental schedules are fairly stated in relation to the financial statements as a whole. In limited scope audits (most reports received at the DOL), no opinion is expressed on the financial statements at all, given the permitted restrictions uniquely contained in ERISA Section 103(a)(3)(C).

What also became apparent during our work was that the audit work and auditors report was not valued but obtained merely to comply with a regulatory requirement. Very often the low bidder received this work because the administrators had difficulty differentiating one auditor from another. Price was the big deciding factor in deciding to hire a plan auditor. This has led to the “commoditization” of plan audits.

The DOL wrote to the AICPA Auditing Standards Board (ASB) in the hopes that they would take a fresh look at the audit report to enhance audit report transparency and to report on compliance activities assessed during an audit. The goal was to improve plan administrators’ understandings of the audit and to get administrators a report they would better value in achieving their fiduciary duties. For example, the ASB should encourage the use of new paragraphs to emphasize key audit matters and to report on compliance with the plan’s provisions.

The ASB has voted to issue a new Statement on Auditing Standards (SAS) however, they are still deliberating amendments. It is expected the new SAS will be issued in August 2019 effective for audit reports issued on financial statements for period ending on or after December 15, 2020. Early adoption is not permitted.

This advisory council should obtain the new SAS and focus on the sections dealing with responses to the auditor’ risk assessments and communications with plan management and those charged with governance. It would be extremely valuable for auditor to also provide negative assurance to communicate when no reportable findings were noted during the audit.

EDUCATING THE PLAN ADMINISTRATORS

A very impressive array of resource materials and training programs exists for plan administrators of employee benefit plans. For example, the Department of Labor has a dearth of materials on their web site, has conducted numerous annual educational programs aimed at plan officials throughout the country and has participated in outreach events with many stakeholders. Unfortunately, the plan administrator, unlike many plan service providers do not have to have any specific entry level tests or educational requirements or ongoing recertifications or continuing educational requirements. Consequently, they are a hard group to reach.

The AICPA over the years has prepared numerous practice aids and plan advisories to assist members of its Employee Benefit Plan Audit Quality Center. For example, in 2014 they issued a non-authoritative document entitled, **EXAMPLES OF INTERNAL CONTROL COMMUNICATIONS FOR EMPLOYEE BENEFIT PLANS**. This tool was created to help auditors in making required communications to plan management. Under auditing standards, auditors must consider timely reporting significant internal control deficiencies or material weaknesses they uncover in their audit.

IMPROVING THE ANNUAL REPORTING PROCESS AND COMMUNICATIONS BETWEEN PLAN AUDITORS AND PLAN MANAGEMENT

- The Department should have more authority to better regulate and enforce the annual reporting process. The penalty provisions under Section 502 C (2) should be amended to allow the imposition of civil monetary penalties on any person who contributes to untimely incomplete or an inaccurate annual report.
- The Department needs the authority to define who is an “independent qualified public accountant”. This broad authority could lead to better qualification standards for auditors including requirements for peer reviews and training.
- The Department should consider requiring a plan administrator to annually disclose whether any serious internal control deficiencies were reported to them by plan auditors that remain uncorrected after 60 days.
- The Department should update its brochure on selecting an auditor for your employee benefit plan to include monitoring the work of an auditor. It would be timely to update this guidance after the new SAS is issued. Providing example questions about how the auditor fulfilled their responsibilities to assess risk, evaluate internal controls and then designed audit procedures, and whether the audit work is well evidenced to support their opinion.
- The Department should require plan administrators to receive basic and ongoing fiduciary training as a condition to administering a plan and signing an annual report.

Thank you for inviting me to testify here today on what I consider to be a very important topic. I am now glad to answer any questions you may have.

