Department of Labor

Office of Inspector General—Office of Audit

EMPLOYEE BENEFITS SECURITY ADMINISTRATION

EBSA Needs Additional Authority to Improve the Quality of Employee Benefit Plan Audits

Date: September 30, 2004
Report Number: 09-04-005-12-121

Department of Labor
Office of Inspector General
Office of Audit

BRIEFLY...

Highlights of Report Number: 09-04-005-12-121, a report to the Assistant Secretary for the Employee Benefits Security Administration. (EBSA)
September 30, 2004

WHY READ THE REPORT:

The Employee Retirement Income Security Act (ERISA) requires that most large employee benefit plans obtain an annual audit of their financial statements. This provision is an important part of ERISA's protection system for plan participants and beneficiaries. In Fiscal Year 2001, retirement plan administrators filed about 65,000 financial statements DOL's Employee Benefits Security Administration (EBSA) is responsible to ensure that these audits meet ERISA requirements, including professional auditing standards. EBSA's Office of the Chief Accountant (OCA) administers an enforcement and compliance assistance effort to identify and correct substandard audits.

WHY OIG DID THE AUDIT:

Prior reviews by the U. S. Department of Labor Office of Inspector General (OIG), the U.S. Government Accountability Office (GAO), and EBSA found that a number of plan audits had not met ERISA requirements. The overall objective of our audit was to evaluate the effectiveness of EBSA's process to identify and correct substandard audits. Our audit focused on EBSA's actions during the period October 1, 2000 through September 30, 2001.

READ THE FULL REPORT:

The full report is available at:

http://www.oig.dol.gov/public/reports/oa/2004/09-04-005-12-121.pdf

SEPTEMBER 2004

EBSA NEEDS MORE AUTHORITY TO IMPROVE THE QUALITY OF EMPLOYEE BENEFIT PLAN AUDITS

WHAT OIG FOUND

We found that EBSA ineffectively identified and corrected substandard ERISA audits. EBSA:

- Lacked sufficient authority to prevent substandard work by plan auditors.
- Did not ensure timely correction of substandard audits.
- Operated a Case Tracking System (CTS) that was inaccurate and incomplete.
- Required better methods to target deficient plan audits.

WHAT OIG RECOMMENDED

We recommended that the Assistant Secretary for Employee Benefits Security:

- propose changes to ERISA to give EBSA greater enforcement authority,
- require corrective actions related to substandard audit deficiencies (including those identified by OIG) and expand reviews to more recent audits,
- improve the accuracy of the CTS database and the completeness of the case file documentation and monitor the location of the case files within EBSA's offices, and
- develop better targeting methods.

EBSA generally agreed with our report. EBSA cited previous and ongoing efforts to improve audit quality. EBSA disagreed with our finding that it did not adequately ensure that plan auditors corrected some of the audit deficiencies we cited. With respect to EBSA's enforcement authority, EBSA recognizes deficiencies in the current law and is considering options for correcting those deficiencies.

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EXECUTIVE SUMMARY

The Employee Retirement Income Security Act (ERISA) requires that most large employee benefit plans obtain an annual audit of their financial statements. In fiscal year 2001, plan administrators filed about 65,000 financial statements[1] on private pension plans holding assets over $4 trillion and covering over 88 million participants. One of the Employee Benefits Security Administration's (EBSA) responsibilities is to ensure that these audits meet ERISA requirements, including professional standards, to help protect participant and beneficiary benefits.

To effectively improve the quality of employee benefit plan audits, EBSA needs additional enforcement authority. EBSA also needs to improve its follow-up procedures, the case management system, and targeting methods to identify substandard audits.

As far back as 1984, reviews by the U. S. Department of Labor, Office of Inspector General (OIG), the U.S. Government Accountability Office (GAO), and EBSA have shown that a significant number of these audits have not met ERISA requirements.[2] These substandard audits have not provided participants and beneficiaries the protections envisioned by the Congress. To deal with this problem, EBSA established an Office of Chief Accountant (OCA). One of OCA's main responsibilities is to ensure the quality of employee benefit plan audits. As part of an overall enforcement and compliance assistance effort, OCA implemented a program in 1990 to identify and correct substandard audits.

The overall objective of our audit was to evaluate the effectiveness of EBSA's process to identify and correct substandard audits.

Although EBSA 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. 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.

[1] The term financial statements, as used here, means a plan's required financial statements, accompanying schedules, and auditor's report.
[2] ERISA Section 103(a) requires employee benefit plan audits to comply with Generally Accepted Auditing Standards and establishes detailed requirements for the financial statements.

We found the following conditions:

1. EBSA cannot take direct action against auditors who perform substandard audits. (See pages 1 to 8 for a more detailed discussion.)

2. EBSA did not fully ensure that auditors corrected audit deficiencies it identified. We found that 9 of 16 audits we reviewed, that EBSA previously identified as substandard, had not been brought up to ERISA requirements. (See pages 8 to 15 for a more detailed discussion.)

3. EBSA did not ensure that auditors corrected recurrent deficiencies in year(s) that were more recent. We found that 20 out of 27 (74 percent) plans we reviewed had substandard audits that continued into years that were more recent. (See pages 8 to 15 for a more detailed discussion.)

4. EBSA's Case Tracking System (CTS) was not accurate, the documentation of case files was not always complete, and 3 out of 110 case files could not be located during our fieldwork. (See pages 15 to 18 for a more detailed discussion.)

5. EBSA's targeting methods were not effective. In fiscal year 2001, EBSA's targeting only identified substandard audits in about 3 percent of the cases reviewed. Historical data show that EBSA should find at least 20 percent of the cases reviewed to be substandard. (See pages 19 to 24 for a more detailed discussion.)

These conditions occurred primarily because:

1. ERISA does not grant EBSA enforcement powers over the auditors performing employee benefit plan audits.

2. EBSA did not obtain sufficient documentation to ensure that audit deficiencies were corrected.

3. EBSA did not believe it had sufficient resources to expand workpaper reviews to later years' audits.

4. EBSA did not believe that certain data fields in the Case Tracking System were critical to its day-to-day operations and did not have a system to monitor the location or contents of the case files within EBSA's offices.

5. EBSA did not place sufficient management emphasis on changing targeting methods and did not have appropriate data easily available.

RECOMMENDATIONS

We recommend the Assistant Secretary for Employee Benefits Security:

1. Propose changes to ERISA to grant EBSA greater enforcement authority over such matters as registration, suspension, debarment, and civil penalties against employee benefit plan auditors.
2. Obtain sufficient documentation to ensure audit deficiencies are corrected.
3. Expand workpaper reviews to more recent years when EBSA finds audit deficiencies.
4. Review the OIG referrals and take necessary action to correct the substandard audits.
5. Improve the accuracy of the CTS and the completeness of the case file documentation and implement a system to monitor the location of the case files within EBSA's offices.
6. Analyze available data and develop targeting methods based on common attributes of plans with substandard audits.

EBSA'S RESPONSE

EBSA generally agreed with our conclusions and recommendations, and identified planned steps to address the recommended actions. EBSA cited previous and ongoing efforts to improve audit quality. With respect to EBSA's enforcement authority, EBSA recognizes deficiencies in the current law and is considering options for correcting those deficiencies. EBSA agreed it could improve documenting corrected audit work. However, of the nine cases OIG identified as not having been brought up to ERISA requirements, EBSA believed six had been properly documented and closed after receiving additional information from the plan auditors. Also, EBSA stated the OIG's finding on the effectiveness of EBSA's targeting methodology failed to take into account annual report filings the agency rejected in FY 2001 based on desk reviews that identified inadequate financial statement disclosures.

We have included EBSA's responses within each finding in the report. EBSA's response to the draft report is attached in its entirety to this report as Appendix D.

OIG'S CONCLUSION

Based on information provided by EBSA officials in their response, the first recommendation is unresolved, and recommendations 2 through 6 are resolved but not closed. Additional action or information needed is discussed after each recommendation in the report.

U.S. Department of Labor

Office of Inspector General
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Assistant Inspector General's Report

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We have audited EBSA's process for identifying and correcting substandard employee benefit plan audits. Our overall objective was to evaluate the effectiveness of EBSA's process to identify and correct substandard audits. Thus, we addressed the following specific objectives:

1. Does EBSA have sufficient enforcement authority to ensure that employee benefit plan audits adequately protect participants and beneficiaries?

2. Does EBSA ensure that plan auditors correct substandard audits?

3. Does EBSA ensure that the deficiencies identified do not recur in other years?

4. Are EBSA's methods for identifying substandard employee benefit plan audits effective?

We conducted the audit in accordance with Government Auditing Standards for performance audits. Our audit scope, methodology, and criteria are detailed in Appendix B.

RESULTS AND RECOMMENDATIONS

Objective 1: Does EBSA have sufficient enforcement authority to ensure that employee benefit plan audits adequately protect participants and beneficiaries?

EBSA does not have sufficient enforcement authority to ensure that employee benefit plan audits adequately protect participants. As a result, EBSA cannot take timely effective actions on substandard audits and problem auditors continue to perform plan audits.

EBSA Needs Enforcement Authority Over Plan Auditors

Although EBSA has the responsibility to enforce ERISA's audit requirements, ERISA does not grant EBSA enforcement powers over the auditors performing employee benefit plan audits. In fact, EBSA has much less enforcement capabilities than other Federal agencies with similar responsibilities. As a result, EBSA cannot take direct enforcement action against the plan auditor for substandard audit work. EBSA can only take indirect enforcement action by imposing civil penalties against the plan administrator, the person who engages a plan auditor. Auditors in our sample audited 140 plans, comprising nearly $3 billion in assets that covered about 140,000 participants. Overall, substandard audits significantly increase the risk of loss of plan assets and benefits.

ERISA does not provide EBSA with sufficient authority to take effective enforcement action on substandard audits.

ERISA Section 103 requires a plan administrator to obtain an audit that complies with generally accepted auditing standards (GAAS).[3] In 2001, there were about 65,000 plans requiring audits. Moreover, although ERISA grants authority to EBSA to enforce provisions on fiduciaries, including plan administrators, a plan auditor is not a fiduciary. Hence, EBSA cannot disbar, suspend, nor take any effective action against a plan auditor for substandard work.

Instead, EBSA must work through the plan administrator in correcting substandard audits. Since the audit is a part of ERISA's reporting process, EBSA corresponds with the plan administrator to initiate an audit review. If EBSA finds deficiencies during its audit review, EBSA can reject an annual report filing and take action against the plan administrator. This includes significant fines and court actions for fiduciary violations. However, the plan administrator is generally neither knowledgeable about nor capable of correcting the deficiencies identified by EBSA. For this, the plan administrator must rely on the expertise of the plan auditor. Therefore, neither EBSA nor the Office of the Solicitor considers it productive to punish a plan administrator for the plan auditors' substandard work.

Since EBSA cannot take direct action against the plan auditor for substandard audit work, EBSA relies on other entities to administer disciplinary or remedial actions against auditors. EBSA's practice is to refer plan auditors to the American Institute of Certified Public Accountants (AICPA) if a plan auditor is a member of the AICPA. If the plan auditor is not an AICPA member, EBSA's

[3] Significant areas of employee benefit plan audits include, but are not limited to, internal control, investments, contributions, and benefit payments.

practice is to refer the plan auditor to a state board of accountancy (State board).[4]

The AICPA Process

The AICPA is a voluntary, nonprofit, professional organization of Certified Public Accountants (CPAs).[5] Although membership is voluntary, the AICPA provides an enforcement program for it members, including plan auditors. EBSA refers plan auditors who are AICPA members determined by EBSA to have performed substandard audits, to the AICPA for investigation. Upon receiving an EBSA referral for substandard audit work, the AICPA performs a comprehensive and thorough investigation. This investigation involves evaluating all of the plan audit work, not just the specific EBSA findings. In addition, the AICPA conducts one or more meetings with the plan auditor as a part of this investigation. If the AICPA identifies deficiencies relating to GAAS, it takes remedial or disciplinary actions against the plan auditor. These disciplinary actions range from required coursework to expulsion from the organization.

In addition to the length of time required for EBSA's investigation and referrals, the additional investigative procedures and due process the AICPA follows could add considerable time in resolving substandard work. First, upon receipt of the referral, the AICPA conducts its own *de novo* investigation of the auditor's work, which duplicates EBSA's investigation. Then the AICPA corresponds with the plan auditor and allows for response(s). Ultimately, the findings are presented to the AICPA Professional Ethics Committee, which then determines the remedial or disciplinary action required.

For the reasons above, this process, including the completion of the remedial or disciplinary action, can take several years. Based on a statistical sample of 20 (out of the 39) referrals EBSA made to the AICPA between 1998 and 2001, we determined that as of June 30, 2004:

- 14 of these cases against plan auditors were closed, and required an average of over 3 years for the investigation and the disciplinary or remedial actions to be completed, and

- 6 cases were still pending the completion of final disciplinary or remedial actions and had been open for an average of 4 years.

Meanwhile, many of these individual plan auditors, whose plan audit EBSA referred to the AICPA for substandard work product, continued to conduct substandard plan audits. We found that audit work in 74 percent (20 of the 27) of

[4] EBSA referred 51 CPAs to the AICPA or State Boards of Accountancy during the years 1998 through 2001. Of these referrals, 39 were made to the AICPA and 12 were made to State Boards of Accountancy.

[5] Throughout this report, we refer to CPAs as plan auditors. The terms CPA, IQPA, auditor, and plan auditor are synonymous.

plans sampled continued to be substandard in the years after the original plan year in which EBSA detected deficiencies. While some of these plans had changed auditors and therefore the substandard work was not performed by the CPA disciplined by the AICPA, in certain instances, the plan auditor was the same individual. In these cases, the considerable time required to finalize the remedial and disciplinary actions against CPAs may have an impact on the continued substandard audit work of these CPAs. Many of these plan auditors had not yet completed the remedial training that was required by the AICPA during this period. This purpose of this additional training was to enhance the auditors' competence in this audit area and thereby improve the quality of the audit work.

For instance, EBSA determined in February 1999 that an auditor performed substandard audit work on an employee benefit plan for the 1996 plan year. The substandard work included GAAS violations encompassing failure to (1) exercise due professional care, and (2) follow the requirements of governmental authorities. Although the AICPA initiated the investigation of this case promptly, this investigation took over one year to complete. Additionally, remedial actions against the auditor were not completed until April 2001, over 2 years after the referral date. However, these remedial actions did not fully resolve the issues. In December 2003, the AICPA took additional remedial action against this auditor. As of February 2004, this case still had not been fully resolved. During this time, the auditor continued to perform substandard audit work on this employee benefit plan. This same plan auditor also continued to audit other employee benefit plans.

In another example, EBSA referred an auditor to the AICPA in June 2000, for violating eight GAAS standards for plan year 1997. These violations included, (1) deficiencies in planning and supervising the audit, (2) insufficient audit procedures in the areas of investments, contributions, participant data, and plan obligations, and (3) insufficient evidence of audit test work for administrative expenses and subsequent events. The AICPA did not close this case until March 2004 after remedial action was completed. During this period, this auditor continued to conduct the audit on this plan as well as other employee benefit plans.

Moreover, even when the AICPA expels a plan auditor from the organization for egregious substandard audit work, this may have little effect on the plan auditor. The AICPA is a voluntary membership organization and does not have any licensing authority. Therefore, the plan auditor may continue to perform employee benefit plan audits even after expulsion. The AICPA does, however refer all matter that result in disciplinary action to the appropriate State Board. For example, EBSA cited one plan auditor in our sample for substandard audit work and the AICPA eventually expelled this auditor in September 2002 for the audit work he performed on plan year 1997. After expulsion, the plan auditor continued to audit this employee benefit plan and numerous other plans, which comprised a significant component of his auditing and accounting practice.

State Boards of Accountancy

EBSA and the AICPA also refer auditors who have performed substandard audits to State Boards. The State Boards grant licenses to CPAs to practice public accounting. State Boards also have the authority to investigate and revoke licenses. Each State Board follows its own rules and procedures regarding investigations and removal of CPA licenses as determined by state laws and regulations.

State Boards, however, are inconsistent and ineffective in their oversight of employee benefit plan auditors. EBSA made 51 referrals of auditors between the years 1998 and 2001. Of these, 12 were to State Boards. We performed follow-up and review on all of these referrals. We found that 42 percent of the referrals EBSA made to State Boards resulted in no enforcement, disciplinary, or remedial action. In these cases, the State Boards did not initiate an investigation or they closed the cases with no findings subsequent to the investigation.

In one case, EBSA determined that a plan auditor had not performed any audit testing and referred the plan auditor to the appropriate State Board. The State Board took no action. State Board officials told us disciplinary action in that state occurs only after two infractions of auditing standards. Since the State Board had not received a second complaint, the State Board took no action and dismissed the case.

In another case, the State Board we contacted could not find any record of a referral made by EBSA. After a search of their complaint database, the State Board told us they probably dismissed the case because EBSA did not use the approved form to make this referral.

As noted above, States have different thresholds for actions, such as two complaints of gross negligence or the use of a specific form to make a referral. EBSA's referrals are, unfortunately, subject to these various thresholds, which frequently result in no action.

<u>Other Federal Agencies</u>

Other federal agencies with similar oversight of responsibilities have much more direct enforcement authority. The Joint Board of Pension Actuaries (Joint Board), the Securities and Exchange Commission (SEC), the Public Company Accounting Oversight Board (PCAOB), and the Internal Revenue Service (IRS) all have professional oversight responsibilities. Each of these organizations has much greater enforcement authority over the practitioner in order to meet their responsibilities.

Joint Board

ERISA established the Joint Board to set up professional standards and qualifications for actuaries to conduct pension work. The Joint Board consists of representatives from the DOL and the IRS. An actuary must satisfy Joint Board standards and qualifications and obtain approval to perform actuarial services on ERISA employee benefit plans. Applicants must submit a membership form to the Joint Board and must pass a comprehensive pension actuarial exam. In addition, the Joint Board requires annual continuing professional education credits. The IRS acts as the investigative office for the Joint Board and refers any deficient actuarial work to the Joint Board. The Joint Board meets four times a year to review complaints of deficient actuarial work. The Joint Board has the power to assess non-monetary penalties against actuaries, such as letters of reprimand, and to suspend or recommend actuaries be disbarred.

The SEC

The primary mission of the SEC is to protect investors and maintain the integrity of the securities markets. One of the SEC's most important protections on behalf of investors is the requirement that public companies obtain an annual audit; a requirement similar to that of ERISA. Historically, the SEC has allowed state licensed CPAs to represent SEC registrants in audit work. However, the Securities Acts of 1933 and 1934 grant the SEC the authority to monitor and take enforcement action against auditors for substandard work. Through this authority, the SEC has implemented a stringent monitoring program to review the quality of audit workpapers and to ensure that audits are conducted in accordance with the required standards.

If the SEC finds substandard audit work, it has the authority to bar, censure, or suspend auditors. The SEC also has the power to impose civil penalties in cease-and-desist proceedings directly against the auditor. These penalties range from $5,000 to $500,000.

The PCAOB

The PCAOB, a quasi-governmental body created under the Sarbanes-Oxley Act of 2002 (Sarbanes-Oxley), began operations on April 26, 2003. Congress mandated the creation of the PCAOB in part because they believed that the AICPA's peer review process was not effective. The PCAOB provides an expansion of SEC's powers in the oversight of audit firms who practice before the SEC. The PCAOB has the power to write its own standards; to register and de-register auditors; and to conduct a continuing program of inspections to assess the degree of compliance of each registered public accounting firm with professional standards and other regulatory requirements.

The PCAOB has also established procedures for the investigation and discipline of registered public accounting firms and associated persons. When violations of professional standards are detected, the PCAOB has the authority to impose sanctions designed to deter possible recurrence and to enhance the quality and reliability of future audits. The sanctions range from monetary penalties and remedial measures, to revocation of firm registration or the barring of a person from participating in audits of public companies.

PCAOB's oversight responsibilities resemble that of EBSA, including the requirement of annual audits as a protection tool for the investing public and, in employee benefit plans, participants and beneficiaries. Further, the magnitude of PCAOB's responsibilities can be compared with that of EBSA. PCAOB oversees audits of mutual fund portfolios of $6.1 trillion in assets, investment advisers' management of $21 trillion in assets, and $6.3 trillion in assets under management by investment companies. Approximately 44 million U.S. households invest in mutual funds audited under the oversight of PCAOB. In comparison, EBSA is responsible for 7 million employee benefit plans holding over $4 trillion in assets on behalf of over 140 million employees.

<u>IRS</u>

Under Title 31, Section 330 of the United States Code, the IRS oversees enrolled agents, CPAs, and attorneys who prepare taxes and appear before the IRS in the event of an audit. While the IRS allows CPAs and attorneys to practice based on their state licenses, enrolled agents must undergo an application process and either possess extensive IRS experience or pass an examination. As a condition of renewing any of these licenses, a specific amount of education is mandated.

In addition, the IRS monitors tax preparers, including CPAs and attorneys, through the tax return examination process. If the IRS finds deficient tax preparation work, it has the authority to penalize, suspend, or disbar these practitioners from practicing before the IRS.

<u>Summary</u>

In summary, the Joint Board, SEC, PCAOB, and IRS each have oversight responsibilities similar to EBSA, but possess much greater enforcement powers to meet these responsibilities. Specifically, all these agencies monitor professional work to protect the public. All have sufficient authority to correct deficient work, to require remedial action when necessary or to remove deficient professionals from doing work in their respective area of responsibility. Having such authority has enabled each agency to better deter substandard work. By contrast, EBSA stands alone of those we reviewed, as the one federal agency without comparable enforcement and oversight powers over its audit practitioners.

If EBSA had the similar enforcement authority over plan auditors, EBSA, in our opinion, could have intervened effectively in the instances noted. Instead, plan audits are not corrected timely and therefore are not adequately protecting participant interests in plan assets and participants' benefits are unnecessarily at risk.

RECOMMENDATION:

1. We recommend the Assistant Secretary for Employee Benefits Security propose changes to ERISA to grant EBSA greater enforcement authority over such matters as registration, suspension, debarment, and civil penalties against employee benefit plan auditors.

EBSA RESPONSE TO THE FINDING:

EBSA stated that it recognized the deficiencies in the current law and was considering options for correcting those deficiencies.

OIG CONCLUSION:

This recommendation is unresolved. We will consider it resolved when EBSA determines what action to take to correct deficiencies in the law. We will follow up with the options EBSA pursues to obtain additional authority to take enforcement actions against plan auditors performing substandard work.

Objective 2: Does EBSA ensure that plan auditors correct substandard audits?

EBSA did not fully ensure that auditors corrected audit deficiencies in the year reviewed. Based on the audits we reviewed, we concluded that 9 of the16 substandard audits that EBSA identified had never corrected all the identified deficiencies.

Objective 3: Does EBSA ensure that the deficiencies identified do not recur in other years?

EBSA did not ensure auditors corrected recurrent deficiencies in year(s) that were more recent. We found that 74 percent (20 out of 27) of the plans where EBSA identified a substandard audit continued to have substandard audit(s) in one or more subsequent years.

EBSA Needs to Ensure Plan Auditors Correct Audit Deficiencies

EBSA did not fully ensure that auditors corrected audit deficiencies in the year EBSA reviewed or more recent years. This occurred because EBSA did not obtain sufficient documentation from plan auditors that:

- identified deficiencies in the year EBSA reviewed were sufficiently corrected, and
- did not believe they had sufficient resources to expand workpaper reviews to later years' audits.

As a result, participants in plans did not have adequate assurances that the plan assets existed, were properly valued or that the plan conducted its financial operations properly. These issues are discussed in the following sections.

We reviewed 16 audits that EBSA previously identified as substandard; 9 of these were never corrected by plan auditors.

Identified Deficiencies Not Corrected

EBSA did not obtain sufficient documentation to determine that auditors corrected deficiencies EBSA identified. We reviewed 16 audits that EBSA previously identified as substandard and had notified the plan auditors of the deficiencies. We concluded that in 9 of these audits, plan auditors never corrected the identified deficiencies. These audits covered almost $90 million in assets and affected about 3,000 participants.

ERISA requires plan auditors to conduct employee benefit plan audits in accordance with GAAS. To evaluate compliance with GAAS, EBSA uses the guide it prepared based on the AICPA Audit and Accounting Guide, Audits of Employee Benefit Plans. According to GAAS, if plan auditors do not follow the AICPA guidance, they need to be prepared to justify each departure from the guidance. We used both EBSA's and the AICPA guide to measure audit quality.

When EBSA finds substandard audit work, it generally does two things. First, it refers the substandard plan auditor to the AICPA or a State Board for a separate investigation and corrective actions. Second, it issues a Notice of Rejection (NOR), informing a plan administrator that the annual report filing has been rejected due to audit quality deficiencies. The plan administrator then works with EBSA and the plan auditor to correct the deficiencies. When EBSA is satisfied the deficiencies are corrected, it generally withdraws the NOR and accepts the annual report filing. Only if the plan auditor corrects audit deficiencies can the plan participants and beneficiaries get the full benefit of an audit.

To determine if auditors fully corrected audit deficiencies identified by EBSA, we first identified the universe of plan auditor referrals (referrals) EBSA made to either the AICPA or State Accountancy Boards during calendar years 1998 through 2001. During this period, EBSA referred 51 plan auditors for substandard audit work and rejected the annual filings for which the plan auditors performed these audits. We then selected a statistically valid sample of 27 of these referrals and the corresponding audits for testing. We requested access to the workpapers for these audits for the same year EBSA reviewed. However, due to the length of time that had passed since EBSA reviewed these audits, only 16 of the 27 plan auditors still had the workpapers for the year that EBSA had reviewed. Eleven of the 27 plan auditors told us they had either lost or destroyed the workpapers EBSA had reviewed. Seven of these 11 auditors have potentially violated ERISA retention requirements and we have referred them to EBSA for appropriate action.

We examined the workpapers of the remaining 16 audits using EBSA's review guide, which EBSA based on the AICPA Audit and Accounting Guide – Audits of Employee Benefit Plans. We specifically reviewed those areas EBSA had determined were substandard to find out if corrective actions had brought the audit work into compliance with GAAS.

Based on the 16 audits we reviewed, we concluded that in 9 of these audits, identified by EBSA as substandard, the plan auditors still had not complied with GAAS. For example, in one substandard audit, EBSA determined that the auditor performed almost no audit work at all. EBSA rejected the Form 5500 filing and provided a very detailed Notice of Rejection (NOR) specifically describing the audit deficiencies. In response to the NOR, the auditor revised the audit report and submitted copies of audit programs for the substandard audit areas. EBSA accepted the corrective actions and withdrew the NOR.

However, when we reviewed the same audit, we found the auditor had not actually performed significant additional audit work. We found that although the auditor had sent EBSA the audit programs that specify the audit steps the auditor should accomplish, the auditor had not performed the actual audit work indicated in these audit programs. The audit continued to be substantially substandard when measured against GAAS. Moreover, the auditor had not performed most of the audit procedures essential to protect participants, such as verifying the existence of investments or checking benefit payment computations. These two areas are critical in ensuring investments exist to fund benefits and that participant benefits are being paid properly. These were also the same areas EBSA identified as substandard several years earlier. Over 300 participants in this $2 million plan did not receive the audit protections intended by ERISA. They had no assurance that the plan assets existed, were properly valued or that the plan conducted its financial operations properly.

In another case, EBSA found the auditor had not performed sufficient work in several major audit areas, including internal controls, investments, contributions, and benefit payments. Accordingly, EBSA rejected the Form 5500 filing, and issued a NOR, which provided specific details of the deficiencies identified. In response, the auditor submitted a revised audit report on the financial statements. EBSA accepted the revised report and financial statements, withdrew the NOR, and accepted the audit as corrected.

Our review of the auditor's workpapers determined that while the auditor revised the audit report, the auditor had not corrected most of the audit deficiencies EBSA had identified. The audit was still substandard in the areas previously identified as substandard by EBSA and did not meet GAAS. The auditor did not address the audit deficiencies, and did not perform such basic tasks as (1) verifying investment existence and value, (2) verifying participant eligibility, or (3) determining the accuracy of benefit computations. These areas are critical because investments fund most benefits and participants need assurances that plans are valuing investments properly and are computing and paying their benefits properly and only to eligible recipients. Due to the audit deficiencies, over 1,000 plan participants in this $60 million plan did not receive these assurances.

Overall, as stated earlier, 9 of the 16 audits reviewed did not correct identified deficiencies to the level required by GAAS. EBSA could not ensure plan auditors corrected audit deficiencies identified by EBSA because EBSA had not allocated sufficient resources to the following tasks. EBSA did not:

- require auditors to demonstrate the corrective actions the auditors took to remedy specific deficiencies identified in the audits; and
- follow up on the corrective actions to ensure the auditors corrected the GAAS deficiencies.

As shown in the examples above, EBSA did not devote sufficient effort to following up and ensuring plan auditors corrected substandard audits. Instead, in 9 of the 16 cases we reviewed, EBSA accepted work or documents that did not provide sufficient evidence that the plan auditors had corrected the deficiencies.

In addition, as explained in the following section, EBSA did not expand its reviews to more recent years after it found an audit deficiency. As a result, these audit deficiencies were present in audits of subsequent years, affecting the overall quality of these employee benefit plan audits.

<u>Recurrent Deficiencies Not Corrected</u>

Once EBSA identified a substandard audit, EBSA did not (1) determine if the same deficiencies existed in audits performed after the year reviewed, or if they did, (2) ensure that the auditor corrected these deficiencies in the audits conducted after the EBSA review. This inaction, coupled with the lack of corrective action discussed above, exposed participants and beneficiaries to several years of financial vulnerability without the protections ERISA intended from plan audits.

> EBSA did not review more recent audits to determine if they were also substandard.

Several years can pass between the time the plan audit is performed and the time EBSA reviews the audit. This happens because of the lengthy filing[6] and processing time and the availability of EBSA's resources. In the meantime, auditors are likely to have performed several additional years' audits before EBSA conducts a review of an audit.

For example, we found that generally, 3 years passed between the ending of a plan year and an EBSA workpaper review. This means that, in most plans, an auditor would have performed two intervening audits by the time EBSA performed its workpaper review.

However, when EBSA found audit deficiencies, even when audits were substandard in nearly every audit area, it did not expand its review to these more recent years to determine if the deficiencies continued. More recent audits are likely to have the same deficiencies year after year. We were able to review more recent audits for all 27 plan audits in our sample. We reviewed all available workpapers for the years after the one EBSA reviewed through at least plan year 2001, and in some cases, 2002 when available. This consisted of one to eight audits per plan, depending on the availability of workpapers. In total, we reviewed 137 audits, including 16 audits that EBSA reviewed previously and 120 audits that plan auditors conducted after EBSA's reviews. Due to the lack of workpaper availability, we also reviewed one audit conducted before the year EBSA reviewed for informational purposes. Exhibit I to this report details the plan years we reviewed.

Overall, we found that 20 out of 27, or 74 percent, of the plans where EBSA identified a substandard audit continued to have substandard audits in one or more subsequent years. For example, in 1997 EBSA selected a welfare benefit plan for review based on an audit report and financial statements for its plan year 1993 that did not comply with professional standards. EBSA performed a review on the workpapers for plan year 1993 and found the audit work to be substandard. The auditor did not perform some of the most basic audit work required under GAAS. There was no audit program, no documentation of internal controls reviewed, and no client representation letter, despite GAAS requirements for each of these. In addition, EBSA found testing in the following audit areas to be deficient: benefit payments, party-in-interest and prohibited transactions, plan tax status, commitments and contingencies, subsequent events, investments, contributions, and participant data.

By the time EBSA reviewed the audit work in 1997 and identified these deficiencies, three plan years had elapsed and the same auditor had performed audits of each of these years. Yet, EBSA did not expand its review to include these more recent audits of plan years 1994 through 1996.
By the time of our audit in 2003, the same plan had obtained eight audits (through plan year 2001) since the EBSA review. We reviewed all eight audits

[6] The filing due date may be extended to 9 ½ months after the plan's year-end.

(plan years 1994 through 2001) and found all to be substandard in every audit area. Our conclusions were nearly identical to the original EBSA conclusions on the audit work. For all years, there was inadequate work in such critical areas as investments, benefit payments, contributions, and prohibited transactions. This welfare plan provided life insurance, disability, and supplemental health protections for 150 participants. For the 8 years we reviewed, the participants and beneficiaries were without the protections ERISA intended through a plan audit.

In another plan, EBSA found serious deficiencies with both the audit and the financial statements. EBSA issued a NOR informing the plan administrator and auditor of the deficiencies that needed to be corrected. In response, the plan administrator restated the financial statements and the auditor revised the audit report the year EBSA reviewed.

We examined the audit workpapers for the plan year after EBSA's review. We found the same audit areas to be substandard. Specifically, we determined there was little or no planning performed, no internal control assessment documentation, almost no work in the area of investments, and no audit work in the areas of contributions, benefit payment, participant data, party-in-interest and prohibited transactions, plan tax status, commitments and contingencies, and subsequent events.

This plan did not have an acceptable audit, as required by ERISA for the 3 years audited by this CPA firm after EBSA's review. This plan had about $2 million in assets and covered about 200 participants. During those 3 years, the participants had no assurances of the financial integrity of their pension plan.

In both examples, auditors had completed at least two additional years' audits by the time EBSA performed its review. EBSA was at the auditor's office and could have expanded its review to more recent years. More importantly, EBSA could have required corrective actions on all the audits at the same time.

EBSA management, however, told us it could better use staff resources on other activities, including education and compliance assistance. EBSA management also told us expanding the reviews to cover more recent audits would take time away from reviewing other plans. Rather than reduce the number of plans reviewed, while increasing the years reviewed, it was their decision to review as many plans as possible, keeping the number of years at each plan to a minimum.

We disagree that expanding the reviews would take time away from reviewing other plans. During our audit, we found that the additional time required to conduct a review of more recent years' audit workpapers was not as significant as the initial review. This would be particularly true if the expanded review was limited to areas where EBSA noted deficiencies in the initial review. We believe

EBSA could protect more plan assets and assure more participant benefits with minimal additional costs.

This is not a new concept. EBSA's 1997 study of plan audit quality specifically recommended this action. The report concluded that when EBSA identifies audit deficiencies, EBSA should review more recent work products to ensure continued compliance with professional audit standards. However, EBSA has not implemented this recommendation because it believed this process would take an inordinate amount of staff resources.

Summary

Overall, we concluded the majority of the plans in our sample did not receive an audit that complied with GAAS, as intended by ERISA. We found that plan auditors did not correct 9 of the 16 audits in which EBSA identified deficiencies. Furthermore, 20 of the 27 (74 percent) of the plans in our sample had substandard audits that continued into more recent years. Plans with substandard audits in our sample cover assets totaling over $159 million and about 20,000 participants. Many of the plan audits did not verify the existence of assets, substantiate the values of assets, or review benefit eligibility.

We have referred the plan auditors who continued to perform substandard work after EBSA's review, and 13 additional plan auditors we found during our review, to EBSA for appropriate action.

RECOMMENDATIONS:

We recommend the Assistant Secretary for Employee Benefits Security:

2. Obtain sufficient documentation to determine that audit deficiencies were corrected.

3. Expand workpaper reviews to more recent years when EBSA finds audit deficiencies.

4. Review the OIG referrals and take necessary action to correct the substandard audits.

EBSA RESPONSE TO THE FINDING:

Regarding the nine substandard audits OIG identified as not corrected, EBSA concluded that six of these cases were properly documented and closed after receiving additional information from plan auditors.

However, EBSA agreed to implement the recommendations. Specifically, EBSA agreed to:

- implement new procedures to ensure improved and more uniform documentation of corrected audit work,
- instruct staff to review the plan audits of more recent years, where applicable, and evaluate the need to examine new auditors' work, and
- review the OIG referrals and take necessary action.

OIG CONCLUSION:

Although EBSA obtained additional information from plan auditors, EBSA did not examine all workpapers for corrective actions. We examined all of the workpapers of these substandard audits using EBSA's review guide, which EBSA based on the AICPA Audit and Accounting Guide – <u>Audits of Employee Benefit Plans</u>. We specifically reviewed workpapers related to those areas EBSA had identified as substandard to determine whether corrective actions had brought the audit work into compliance with GAAS. In nine cases, we concluded the plan auditor did not make corrections and we believe that EBSA would come to the same conclusion if it reviewed the actual workpapers. Therefore, our recommendations remain unchanged.

Despite our disagreement on the specific cases, EBSA agreed to implement the recommendations and these recommendations are resolved. To close the recommendations EBSA needs to provide documentation of the new procedures and actions taken on the OIG referrals.

EBSA Needs to Improve Its Case Tracking System and Case File Documentation

> EBSA did not maintain its case file tracking system accurately and case files were missing and incomplete.

EBSA's case file information was not accurate or complete. Specifically, we found (1) certain data fields in the case tracking system were not accurate and (2) some case files were missing or incomplete. Case information problems occurred because EBSA did not believe that certain data fields in the Case Tracking System CTS) were critical to its day-to-day operations, and did not have a system to monitor the location of the case files within EBSA's offices. As a result, EBSA was not able to monitor case files adequately to be assured that plan auditors corrected substandard audits.

EBSA established the CTS in order to monitor and track the progress and status of case files, the corrections made by plan auditors, and other actions taken. During our review, the CTS was composed of an electronic database and physical case files representing approximately 2,400 employee benefit plans reviewed by EBSA annually. EBSA used the electronic database to track a case file's status and the actions taken by EBSA. EBSA ran queries using the database, such as identifying those plans that had an audit workpaper review and the results of the review. This was intended to allow management to monitor case status, corrective actions, and final case disposition.

However, the CTS was not complete and accurate. We found that the electronic database contained errors and some case files lacked documentation or could not be located.

<u>Database not accurately maintained</u>

EBSA did not update its electronic case database accurately. During our audit testing for 2001, we attempted to track the status of the 75 cases EBSA had selected for workpaper reviews through the database. We found that EBSA had not recorded the workpaper review results of 38 of these 75 cases (51 percent). However, in fact, EBSA had completed some of these workpaper reviews more than a year earlier. For example, 13 of 14 (93 percent) of the workpaper reviews EBSA completed in February 2001 were not reflected in the October 2002 CTS report.

In addition, we tried to track the status of seven plan auditors referred to the AICPA or State Boards in calendar year 2001 for substandard audit work. We found that EBSA had recorded four of these seven erroneously in the CTS database. For example, for three of these auditors the CTS database indicated that EBSA found no deficiencies in the audit work, even though EBSA had referred the auditors for significantly substandard work in each case.

<u>Case Files - Missing and Incomplete</u>

For our audit testing on all audit objectives, we attempted to locate and review 110 case files. As discussed in the following paragraphs, there were several problems in locating and reviewing these files.

First, EBSA's case file documentation was incomplete. Of the 110 case files we reviewed, we specifically tried to determine the corrective actions taken in 35 selected files. During our analysis of the 35 case files, we found 9 case files (26 percent) where EBSA's case file did not document final corrective or enforcement action taken. For example, one plan's case file showed significant violations of ERISA. However, we could not determine from the case file what actions EBSA had taken. Only through interviewing EBSA staff did we learn the action taken was EBSA transferring the case to the Office of Enforcement. EBSA did not document this action in the case file.

Second, EBSA could not readily access 8 out of 110 (7 percent) case files at the Washington, DC office. During our fieldwork, EBSA staff was eventually able to locate five of these eight files. However, it took considerable time and effort by both administrative and professional staff to track down the location of the files.

Despite the efforts of the staff, during our fieldwork, EBSA could not find:

- the complete case file of a plan on which it had performed a workpaper review. The EBSA workpaper review identified serious deficiencies in four major audit areas in addition to noncompliance with GAAS and ERISA requirements. However, since the file was lost, EBSA could not determine if it took corrective actions or the status of the case. We believe this case represented significant hours of staff time, which may be lost if the results of the review are not acted upon.

- the case file for which it had issued a "Notice of Intent to Assess Penalty." This notice informs a plan administrator that EBSA has found ERISA violations and intends to impose a penalty. Since the file was lost, EBSA could not determine what deficiencies it previously identified, what corrective actions it took, or the status of the case. Again, we believe this case represented a significant number of staff hours.

- the case file of a plan where the records indicated EBSA had reviewed the plan's financial statement. EBSA could not determine if the staff ever reviewed the plan's financial statements or what the results were, if any. The benefits of this review will be lost if the results cannot be determined.

Case tracking system problems occurred because EBSA has no standardized procedures to maintain such files. EBSA had not developed a handbook, checklist, or other written procedures to ensure that staff properly documented a case or that the CTS database is current. Further, although EBSA utilizes a logbook system for case files removed from their premises, they have not developed such a system to monitor the location of their nearly 3,000 case files within their offices.

Maintaining the case tracking system would not take significant additional resources. We believe the OCA administrative staff expended time looking for case information and some cases went uncorrected. Therefore, the CTS did not fully serve as an effective management information system. Improving controls over the case tracking system would save time and could increase enforcement effectiveness.

EBSA did not have assurances that it had taken all required corrective actions. In 3 of the 9 cases previously noted, EBSA overlooked corrective actions. For example, EBSA reviewed a profit sharing plan and determined the plan did not obtain the required audit. There was no evidence of any substantial corrective action or follow-up by EBSA in the case file and, in fact, the plan never obtained an audit or submitted an auditor's report. The case remained uncorrected 4 years after EBSA's initial review.

In another case, EBSA determined that the plan administrator did not obtain the required audit and tried to notify the plan administrator. The postal service returned EBSA's correspondence undelivered. There was no evidence in this case file that EBSA took any further action. However, we easily located the plan sponsor using the Internet. The plan administrator never obtained an audit and remained out of compliance with ERISA.

EBSA cannot depend upon its CTS database for accurate or timely information as to case files' status or applied corrective measures. To understand the status or disposition of certain of case files, EBSA must make follow-up inquiries among its staff. This is not an effective use of staff time and management cannot readily retrieve the current progress and status of the cases. An inaccurate CTS may lead to violations that remain uncorrected, thus exposing plan participants to unnecessary risks. Overall, the problems with the case tracking system hamper the agency's ability to manage its human resources efficiently to meet its goals.

RECOMMENDATION:

5. We recommend the Assistant Secretary for Employee Benefits Security improve the accuracy of the CTS database and the completeness of the case file documentation and implement a system to monitor the location of the case files within EBSA's offices.

EBSA RESPONSE TO THE FINDING:

EBSA agreed with the recommendation and will develop and implement improvements to the CTS during fiscal year 2005.

OIG CONCLUSION:

We consider the recommendation resolved. To close the recommendation, EBSA needs to provide documentation of the improvements it makes.

Objective 4: Are EBSA's methods for identifying substandard employee benefit plan audits effective?

> Properly prepared financial statements are not indicators of high quality audits.

EBSA is following its policy for targeting plans with financial statements that are not presented in accordance with standards and requirements for workpaper review. However, EBSA's targeting methods are not effective. In fiscal year 2001, EBSA's targeting identified substandard audits in only about 3 percent of the plans reviewed.

Historical data show that EBSA should find at least 20 percent of the plan audits reviewed to be substandard.

EBSA Needs to Develop More Effective Targeting Methods

EBSA has not analyzed available data as a means to develop effective targeting methods for identifying substandard plan audits. This occurred because EBSA did not place sufficient management emphasis on changing targeting methods. As a result, EBSA's targeting methods for identifying substandard audits were not effective. While historical data show approximately 20 percent or greater of plan audits are substandard, EBSA's fiscal year 2001 targeting only identified about 3 percent of the plan audits as substandard. This means EBSA could be missing a large number of substandard audits and is not effectively directing its resources towards plans that are most likely to have substandard audits. This reduces overall protections for plan participants and beneficiaries.

EBSA's Goal

In its 2002 Annual Performance Plan, EBSA stated that, relative to employee benefit plan audits, its goal was " . . . ensuring that audits of employee benefit plans comply with professional standards." To meet this goal, EBSA must enforce the ERISA audit requirements on approximately 65,000 employee benefit plans each year.

Since EBSA does not have sufficient resources to review all of these plan audits, EBSA uses various targeting techniques to identify those plan audits that are substandard.

EBSA's Targeting Methods

In order to fulfill its responsibility of enforcing ERISA audit requirements, EBSA performs computer targeting of the 65,000 plans and selects 2,000 to 3,000 plan financial statements for a "desk review"[7] for compliance with GAAP, GAAS, and ERISA. EBSA has based this targeting on such attributes as type of audit opinion, type of plan investments, and lack of required financial statements.

If the desk review determined the audit reports and the accompanying financial statements met professional standards and ERISA requirements, EBSA ended its review and accepted the filing. If however, the financial statements did not meet these requirements, EBSA then performed a review of the audit workpapers, generally at the plan auditors' office. Based on the workpaper review, EBSA concluded if there were deficiencies in the audit work. Each year EBSA performs about 75 such detailed reviews.

[7] A desk review is the review of the plan's audit report and accompanying financial statements to determine whether these documents are presented in compliance with GAAP, GAAS, and ERISA requirements.

EBSA used this targeting approach because it considered audit reports and their accompanying financial statements that did not comply with requirements as strong indicators that the related audits are also substandard. Conversely, EBSA presumed that financial statements that met standards were a reflection of a quality audit.

We reviewed 164 of 64,996 audit reports and accompanying financial statements of employee benefit plans. The purpose of our review was to determine whether EBSA's initial computer targeting process was adequate in identifying plans for a financial statement review. Although EBSA used certain attributes in its selection process, such as type of audit opinion, we selected our sample using statistical methods. We did not include in our sample those plans EBSA chose for review during 2001. Based on our review of these 164 audit reports and accompanying financial statements, we determined that only 5 percent (9 out of 164) presented significant deficiencies and should have been reviewed further by EBSA. This was comparable to EBSA's results for 2001. For this year, EBSA identified 3 percent (75 out of 2,401) of the audit reports or financial statements it reviewed that exhibited deficiencies significant enough to warrant further follow-up.

To determine if EBSA appropriately identified substandard financial statements as a means of determining whether further review is required, we selected a statistical sample of 75 of the 2,401 financial statements EBSA reviewed during 2001. We found that EBSA appropriately applied its criteria in assessing whether plans should be subjected to a workpaper review in order to identify substandard audits. Specifically, we found only one case in which we disagreed with its conclusions.

However, this targeting method of reviewing financial statements was not effective in identifying substandard audits. With EBSA's expertise, experience, and available data, targeting methods should produce results at least as reliable as that derived from a statistically random selection method. In fiscal year 2001, EBSA's targeting identified only about 3 percent of the audits reviewed as substandard. Before 2004, EBSA and OIG studies showed that random selection identified about 20 percent of plan audits to be substandard.

Based on our audit, several factors led us to conclude that appropriately prepared and presented financial statements were not reliable indicators of a properly conducted audit. First, during our review of a statistical sample of substandard audits, we analyzed the relationship between the quality of the financial statements and that of the audit work for each year reviewed. In total, we reviewed 137 sets of plan financial statements and audit workpapers for the 27 plans in our sample. (See pages 36 to 39 for a detailed discussion of the methodology.)

Our tests disclosed that over 20 percent of plan audits with financial statements that complied with standards were, in fact, significantly substandard in actual audit work. For example, we reviewed a plan whose financial statements met all standards and requirements. However, for all 6 years we reviewed, the audits of this employee benefit plan were substandard. The auditor did not meet the standards in the areas of planning the audit, assessing internal controls, testing of investments and participant data. Therefore, we concluded that compliant financial statements were not reliable indicators of audit quality.

Also, EBSA's 1997 study supported this conclusion. In this study, performed on a random statistical basis, the data showed that 19 percent of the audits were substandard but less than 5 percent of the audits had substandard reports. In fact, the majority (39 of 50) of the audits with major deficiencies had reports that met requirements. Further, 7 of the 12 plans with substandard financial statements, actually had audits that otherwise met GAAS requirements. Therefore, using substandard reports to target audits for review would have missed the majority of the substandard audits while wasting resources in expanding reviews unnecessarily.

The 1997 study further concluded that EBSA needed to revise its targeting methods. The study specifically stated:

> EBSA should revise the criteria for targeting cases to identify a greater number of plan filings with audits performed by small to medium size IQPA firms. Currently, targeting is based on factors, which do not relate to the size of the IQPA firm.

However, as discussed in the following section, EBSA has not implemented the recommendation from its 1997 study nor has it determined what changes are necessary based on current data.

<u>EBSA Did Not Implement Recommendations</u>

EBSA did not implement its own recommendations on changing targeting methods. According to EBSA management, it postponed the targeting change because data to implement more effective targeting were not available. In order to implement the recommendations of the EBSA 1997 study, EBSA needed to identify the CPA firms performing the plan audits in order to target smaller firms. However, this information was not available in the Form 5500 information EBSA received. While some of the information was on the Form 5500, it was not complete nor did EBSA capture the information in its database.

Therefore, to implement the recommendations would have required a large investment of staff time. Each plan would have had to be manually researched as to the size of its CPA firm or other targeting information. It was EBSA's management decision that this was too time-consuming and that resources could be better used on other enforcement activities.

In the interim, EBSA used targeting methods that the historical data did not support.

Studies with Statistical Random Sampling

As noted earlier, past OIG, EBSA and GAO studies using statistical random sampling have shown a high deficiency rate in plan audits. Historically, approximately 20 percent of employee benefit plan audits have been substandard. For example, an OIG audit in 1989 found that 23 percent of audits did not meet the audit standards.[8] GAO reviewed the OIG work and confirmed the validity of its work (and the deficiency rate) in 1992.[9] EBSA further confirmed this with its own review in 1997 that showed 19 percent of the audits reviewed did not meet the audit standards.[10] All of these studies used random statistical sampling, with no targeting involved.

Substandard Audit Indicators

These OIG, GAO, and EBSA studies have shown that some attributes are strong indicators of substandard audits. For example, the 1997 EBSA study stated that the size of the CPA firm performing the audit was a strong substandard audit indicator. Specifically, this study showed that plans audited by smaller firms were more likely to be substandard than those audited by larger firms. Our statistical sample of 27 plans with substandard audits showed this same trait. (See Exhibit II.) The studies conducted by OIG and GAO contain a wealth of similar information on the substandard audit indicators.

However, EBSA did not use this available data to develop targeting methods. Instead, EBSA continued to use audit report and financial statement reviews to identify substandard audit work. This produced a much lower deficiency rate. Out of the 2,401 plans EBSA reviewed in 2001, EBSA only identified 75 audits that failed its desk and/or workpaper reviews. This indicates a 3 percent deficiency rate. However, using the 20 percent historical deficiency rate, we estimate 480 of these 2,401 plans were probably substandard. We, therefore, estimate EBSA did not detect over 400 substandard audits in its review of the 2,400 plans. Since EBSA did not detect these substandard audits, the auditors were never required to make corrections and participants did not obtain the full protections of audits ERISA required.

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[8] U.S. Department of Labor, Office of Inspector General, *Changes Are Needed in the ERISA Audit Process to Increase Protections for Employee Benefit Plan Participants*, November 9, 1989.
[9] United States General Accounting Office, *Employee Benefits Improved Plan Reporting and CPA Audits Can Increase Protections Under ERISA*, April 9, 1992.
[10] U.S. Department of Labor, Pension and Welfare Benefits Administration, "*Assessment of the Quality of Employee Benefit Plan Audits*, " March 1997.

Participants and Beneficiaries Do Lose in Substandard Audits

Participants and beneficiaries in several plans we sampled did, in fact, lose benefits because of substandard audits. In at least four plans, substandard audits did not discover overvalued assets. These overvalued assets were undetected for several years and, when finally discovered, resulted in participants and beneficiaries losing 60 percent of their pension value.[11]

In these instances, the plan auditors performed substandard work and did not apply required audit procedures, including verifying plan investment existence or value. In fact, the investments were improperly stated and the principal of the company handling the assets was eventually convicted of fraud. Audits that complied with GAAS might have prevented this. Improved targeting by EBSA could better identify these plan audits before losses become significant.

RECOMMENDATION:

We recommend the Assistant Secretary for Employee Benefits Security:

6. Analyze available data and develop targeting methods based on common attributes of plans with substandard audits.

EBSA RESPONSE TO THE FINDING:

EBSA agreed with the recommendation that alternative techniques are necessary to improve targeting substandard audits. EBSA stated it will evaluate the results of a 2004 study and revise the approach for targeting plans. EBSA stated it would evaluate the results of these changes by early fiscal year 2006.

However, EBSA stated that the OIG's discussion of the results of past EBSA targeting efforts failed to take into account filings EBSA rejected in FY 2001 based on desk reviews that identified inadequate financial statement disclosures.

OIG CONCLUSION:

The only means to definitively identify a deficient audit is to perform a review of the plan auditor's workpapers. Although EBSA rejected over 500 filings in 2001, only 75 of these represented a rejection due to a substandard audit, since EBSA only reviewed 75 plan auditors' workpapers in 2001. EBSA rejected the remaining filings based on other criteria, such as a missing audit report.

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[11] In April 2002, the former principal of a registered investment adviser pleaded guilty to mail fraud. The criminal charges against this individual carry a maximum penalty of 8 years in prison and a fine of $500,000. The complaint states that the company fraudulently sold investments to pension funds and other investors, using client's funds to make interest payments to other clients. Total losses to investors exceeded $355 million. In June 2002, a Federal judge approved a settlement calling for the recovery of approximately $143 million.

Therefore, we concluded EBSA identified only 75 (or 3 percent) out of the 2,401 audits selected as substandard.

Based on EBSA's response, however, we consider this recommendation resolved. To close the recommendation, EBSA needs to provide documentation of how it incorporated the results of its 2004 study into new targeting and the evaluation of its targeting changes.

Elliot P. Lewis

Elliot P. Lewis
June 20, 2004

EXHIBIT

Exhibit I

Results of Workpaper Reviews

Sample Number 1)	Plan Year End Date Reviewed by EBSA 2)	Notice of Rejection Date 3)	Plan Year End Date Reviewed by OIG 4)	Plan Auditor 5)	Audit in Compliance with Standards? 6)	Financial Statements in Compliance with Standards? 7)
1	5/31/98	11/2/99	N/A	**Original**	N/A	N/A
			5/31/98	**New**	N	N
			5/31/99		N	N
			12/31/99		N	N
			12/31/00		N	N
			12/31/01		N	N
2	6/30/95	10/26/98	6/30/95	**Original**	N	N
			N/A	**New**	N/A	N/A
			N/A		N/A	N/A
			6/30/98		Y	Y
			6/30/99		Y	Y
			6/30/00		Y	Y
			6/30/01		Y	Y
3	4/30/97	2/2/99	N/A	**Original**	N/A	N/A
			4/30/97	**New #1**	Y	Y
			4/30/98		Y	Y
			4/30/99		Y	Y
			4/30/00	**New #2**	Y	Y
			4/30/01		Y	Y
			4/30/02		Y	Y
4	12/31/95	10/19/98	12/31/95	**Original**	Y	Y
	12/31/96	10/19/98	12/31/96		Y	Y
			12/31/97		Y	Y
			12/31/98		Y	Y
			12/31/99		Y	Y
			12/31/00		Y	Y
			12/31/01		Y	Y

Sample Number 1)	Plan Year End Date Reviewed by EBSA 2)	Notice of Rejection Date 3)	Plan Year End Date Reviewed by OIG 4)	Plan Auditor 5)	Audit in Compliance with Standards? 6)	Financial Statements in Compliance with Standards? 7)
5	12/31/95	2/13/98	12/31/95	**Original**	N	N
	12/31/96	2/13/98	12/31/96		N	Y
			12/31/97		N	Y
6	12/31/95	7/30/99	N/A	**Original**	N/A	N/A
			12/31/96		N	N
			12/31/97		N	N
			12/31/98		N	N
			12/31/99		N	Y
			12/31/00		N	Y
			12/31/01		N	Y
7	12/31/95	9/25/98	N/A	**Original**	N/A	N/A
			12/31/95	**New**	N	N
			12/31/96		N	Y
8	1/31/96	3/4/99	N/A	**Original**	N/A	N/A
			1/31/96	**New**	Y	Y
			1/31/97		Y	Y
9	12/31/95	4/2/99	N/A	**Original**	N/A	N/A
			12/31/96		N	Y
			12/31/97		N	Y
			12/31/98		N	Y
			12/31/99		N	Y
			12/31/00		N	Y
			12/31/01		N	Y
10	6/30/94	1/12/98	N/A	**Original**	N/A	N/A
			6/30/95		N	N
			6/30/96		N	N
			6/30/97		N	N
			6/30/98		N	N
			6/30/99		N	N
			6/30/00	**New**	N	N
			6/30/01		N	N
			6/30/02		N	N

The accompanying notes are an integral part of this exhibit

Legend:

N/A Audit workpapers were not available for review and examination.
Y Results of the audit indicate that compliance with standards has been met.
N Results of the audit indicate that compliance with standards has not been met.

Sample Number 1)	Plan Year End Date Reviewed by EBSA 2)	Notice of Rejection Date 3)	Plan Year End Date Reviewed by OIG 4)	Plan Auditor 5)	Audit in Compliance with Standards? 6)	Financial Statements in Compliance with Standards? 7)
11	12/31/94	1/12/98	N/A	**Original**	N/A	N/A
			N/A		N/A	N/A
			12/31/96		N	N
			N/A	**New**	N/A	N/A
			12/31/98		Y	Y
			12/31/99		Y	Y
			12/31/00		Y	Y
			12/31/01		Y	Y
12	12/31/96	4/26/00	12/31/96	**Original**	N	N
			12/31/97		N	N
			12/31/98		N	N
			12/31/99		N	N
			12/31/00	**New**	N	N
			N/A		N/A	N/A
13	12/31/97	6/19/00	12/31/97	**Original**	N	N
			12/31/98		N	N
			12/31/99		N	N
			12/31/00		N	N
			12/31/01		N	N
14			6/30/96	**Original**	N	N
	6/30/97	7/24/00	6/30/97		N	N
			6/30/98		N	N
			6/30/99		N	N
			6/30/00	**New #1**	Y	Y
			6/30/01		Y	Y
			6/30/02	**New #2**	Y	Y
15	12/31/95	10/19/98	N/A	**Original**	N/A	N/A
			12/31/96		N	N
			12/31/97		N	N
			12/31/98		N	N
			12/31/99	**New**	Y	Y
			12/31/00		Y	Y
			12/31/01		Y	Y
16	6/30/95	10/2/98	N/A	**Original**	N/A	N/A
			N/A		N/A	N/A
			6/30/97	**New #1**	N	N
			6/30/98		N	N
			12/31/98		N	Y
			12/31/99		N	Y
			12/31/00	**New #2**	Y	Y
			12/31/01		Y	Y

Sample Number 1)	Plan Year End Date Reviewed by EBSA 2)	Notice of Rejection Date 3)	Plan Year End Date Reviewed by OIG 4)	Plan Auditor 5)	Audit in Compliance with Standards? 6)	Financial Statements in Compliance with Standards? 7)
17	12/31/96	5/17/99	N/A	**Original**	N/A	N/A
			N/A		N/A	N/A
			N/A		N/A	N/A
			12/31/99		N	N
			12/31/00		N	N
			12/31/01		N	N
18	4/30/96	2/8/99	N/A	**Original**	N/A	N/A
	4/30/97	2/8/99	N/A		N/A	N/A
			4/30/98	**New**	Y	Y
			4/30/99		Y	Y
			4/30/00		Y	Y
			4/30/01		Y	Y
19	12/31/97	7/11/00	12/31/97	**Original**	N	N
	12/31/98	7/11/00	12/31/98		N	N
			12/31/99		N	N
			12/31/00		N	N
			12/31/01		N	N
20	9/30/97	6/23/00	9/30/97	**Original**	N	Y
	9/30/98	6/23/00	9/30/98		N	Y
			9/30/99		N	Y
			9/30/00		N	Y
			9/30/01		N	Y
21	5/31/95	2/13/98	N/A	**Original**	N/A	N/A
			N/A		N/A	N/A
			N/A		N/A	N/A
			5/31/98	**New**	Y	Y
			5/31/99		Y	Y
			5/31/00		Y	Y
			5/31/01		Y	Y
22	11/30/98	2/23/01	N/A	**Original**	N/A	N/A
			11/30/98	**New**	Y	Y

The accompanying notes are an integral part of this exhibit

Legend:

N/A Audit workpapers were not available for review and examination.
Y Results of the audit indicate that compliance with standards has been met.
N Results of the audit indicate that compliance with standards has not been met.

Sample Number 1)	Plan Year End Date Reviewed by EBSA 2)	Notice of Rejection Date 3)	Plan Year End Date Reviewed by OIG 4)	Plan Auditor 5)	Audit in Compliance with Standards? 6)	Financial Statements in Compliance with Standards? 7)
			11/30/99		Y	Y
			11/30/00		Y	Y
23	12/31/95	5/17/99	N/A	**Original**	N/A	N/A
	12/31/96	5/17/99	12/31/96		N	N
			12/31/97		N	N
			12/31/98		N	N
			12/31/99		N	N
			12/31/00		N	N
			12/31/01		N	N
24	12/31/95	10/30/98	N/A	**Original**	N/A	N/A
			N/A	**New**	N/A	N/A
			N/A		N/A	N/A
			12/31/97		N	Y
			12/31/98		N	Y
			12/31/99		N	Y
			12/31/00		N	Y
			12/31/01		N	Y
25	12/31/95	1/12/98	12/31/95	**Original**	N	Y
			12/31/96		N	Y
			12/31/97	**New**	N	Y
			12/31/98		N	Y
			12/31/99		N	Y
			12/31/00		N	Y
			12/31/01		N	Y
26	6/30/95	10/5/98	N/A	**Original**	N/A	N/A
			6/30/96		N	N
			6/30/97		N	N
			6/30/98		N	N
			6/30/99		N	N
			6/30/00		N	N
			6/30/01		N	N
			6/30/02		N	N
27	12/31/98	9/4/01	12/31/98	**Original**	N	N
			12/31/99	**New**	N	N
			12/31/00		N	N
			12/31/01		N	N
Total			**137**			

Notes to Exhibit I

1) Sample Number – A statistical sample of 27 plans from a universe of 51 plans whose audit EBSA had referred to a State Board or the AICPA during 1998 – 2001.

2) Plan Year End Date Reviewed by EBSA – EBSA performed an onsite review of the auditor's workpapers for the year(s) indicated. In general, we determined that EBSA reviews only one plan year during these onsite examinations. For the 27 plans selected for our sample, EBSA reviewed more than one year in only 7 instances, although the audit workpapers for 20 of these plans were completed and available for review.

3) Date of Notice of Rejection (NOR) – At the completion of the review of the plan auditor's workpapers, EBSA issued a NOR, identifying the deficiencies in the audit work.

4) Plan Year End Date Reviewed by OIG – For the statistical sample of 27 plans, we reviewed the auditor's workpapers for the years reviewed by EBSA (if these audit workpapers were available), and all available workpapers of more recent audits. In total, we reviewed 137 plan year audits for the 27 plans selected for testing.

5) Plan Auditor – We have presented the years audited by the original auditor and reviewed by EBSA. In some cases, the plan administrator obtained the services of a different auditor after EBSA's review. This is indicated on the exhibit as New auditor. If more than one different auditor was obtained in the years after EBSA's review, this is indicated as New #1 and New #2.

6) Audit in Compliance with Standards – ERISA requires the plan administrator to obtain an audit that complies with GAAS. This reflects the results of our audit.

7) Financial Statement in Compliance with Standards – ERISA requires the plan administrator to present the plan's audit report and financial statements in accordance with GAAS and GAAP. This reflects the results of our audit.

Exhibit II

Employee Benefit Plans Audited by Plan Auditors from OIG Sample [1)]

Number of Plans Audited by Auditor [2)]	Number of Participants (Range)	Total Assets (Rounded)	Size of Auditor's Firm	Number of Professional Staff
19	20,000 - 25,000	$784,300,000	2 - 10 offices	21 - 50
2	500 - 1,000	44,200,000	Single office	1 - 10
22	5,000 - 10,000	113,000,000	Single office	>50
6	500 - 1,000	11,000,000	Single office	1 - 10
3	500 - 1,000	12,700,000	Single office	1 - 10
15	10,000 - 15,000	226,000,000	Single office	1 - 10
4	5,000 - 10,000	126,000,000	Single office	1 - 10
4	500 - 1,000	24,000,000	2 - 10 offices	1 - 10
4	500 - 1,000	12,500,000	Single office	1 - 10
1	Less than 500	8,600,000	Single office	1 - 10
2	500 - 1,000	39,100,000	Single office	1 - 10
27	35,000 - 40,000	804,000,000	Single office	1 - 10
4	500 - 1,000	15,600,000	2 - 10 offices	11 - 20
8	5,000 - 10,000	165,000,000	Single office	1 - 10
3	10,000 - 15,000	298,000,000	Single office	1 - 10
4	25,000 - 30,000	9,900,000	Single office	1 - 10
12	5,000 - 10,000	85,600,000	Single office	11 - 20
140	**140,000**	**$2,779,500,000**		

1) We attempted to identify all employee benefit plans that were audited by plan auditors who EBSA referred to the AICPA or State Boards, or OIG identified during audit test work as performing substandard audit work. In general, this search was conducted using the employer identification number of the auditor. For various reasons, including an auditor moving from a sole practitioner work status to employment by a CPA firm (and using the employer identification number of the lead firm partner), we were able to identify employee benefit plans for only 17 of these auditors conducting employee benefit plan audits in 2001.

2) These 17 plan auditors were responsible for audits of employee benefit plans included in our sample, as well as other employee benefit plans not reviewed by EBSA or OIG for a total of 140 employee benefit plans.

APPENDICES

Appendix A

BACKGROUND

Past reviews of employee benefit plan audit quality have consistently disclosed serious deficiencies in ERISA audits. A 1989 OIG audit disclosed almost a quarter of employee benefit plans did not comply with one or more professional standard.[12] In addition, the OIG found that two-thirds of the plan audit reports and accompanying financial statements did not meet the ERISA reporting and disclosure requirements. Other studies of employee benefit plan audits from 1992 and 1997 performed by the GAO and EBSA confirmed that there was a consistently high noncompliance rate with audit standards.[13]

In response to these reviews, EBSA established and increased its oversight of audit activities by creating the Office of Chief Accountant (OCA). OCA, an office of 40 staff persons, implemented outreach activities and developed a help desk for practitioners and plan administrators. OCA also reviews selected plan Form 5500s, financial statements, and workpaper reviews to ensure accuracy and compliance with ERISA. OCA works with professional and regulatory organizations and refers plan auditors to the AICPA and State Boards for substandard audit work.

[12] Ibid 8.
[13] Ibid 9 and Ibid 10.

Appendix B

SCOPE, METHODOLOGY AND CRITERIA

SCOPE

Our audit covered EBSA's process for identifying substandard employee benefit plan audits and ensuring plan auditors corrected the deficiencies. Our audit focused on EBSA's actions during the period October 1, 2000 through September 30, 2001. During that timeframe, EBSA received 64,996 filings that required an audit. From this population, EBSA performed 2,401 desk reviews. EBSA subsequently performed workpaper reviews on 75 of the 2,401 plans included in their desk reviews. To determine whether plan auditors corrected substandard audits, we expanded the timeframe because of the small number of EBSA referrals. Thus, we sampled the population of 51 EBSA referrals made between January 1, 1998, and December 31, 2001. For the referrals sampled, we included corrective actions taken by either the AICPA or State Boards through June 30, 2004.

A performance audit includes obtaining an understanding of internal controls considered significant to the audit objectives and testing compliance with significant laws, regulations, and other compliance requirements. In order to plan our performance audit, we considered whether internal controls considered significant to the audit were properly designed and placed in operation.
Our work on established management controls included reviewing policies and procedures, interviewing key personnel, and reviewing selected actions to observe controls in place. We obtained an understanding of management controls over program operations that EBSA management had implemented to reasonably ensure that the program met its objectives. We also obtained an understanding of management controls that EBSA implemented to reasonably ensure that plan audits complied with ERISA.

Our testing of internal controls was focused only on the controls related to our audit objectives of assessing that EBSA's process for identifying and correcting substandard audits was effective and was not intended to form an opinion on the adequacy of internal controls overall, and we do not render such an opinion. Weaknesses noted in our testing are discussed in results of this report.

We conducted the audit in accordance with generally accepted government auditing standards issued by the Comptroller General of the United States. Our audit included reviews of policies, procedures, plan documents, and other auditing procedures we considered necessary in the circumstances.

We conducted our audit fieldwork from October 2002 through June 2004. We conducted fieldwork at EBSA's Headquarters in Washington, DC, and at CPA firm offices throughout the United States. We gave each selected CPA the option of providing copies of workpapers to the OIG office in San Francisco or having OIG staff review the workpapers at the CPA firm office. As a result, we received copies of workpapers to review in our office from 13 CPA firms, and 14 CPA firms elected to have their audit workpapers reviewed in their offices. The firms visited were located in the following states: California, New York, North Carolina, Delaware, Texas, New Jersey, Massachusetts, Minnesota, Georgia, and Pennsylvania.

METHODOLOGY

In performing our audit, we conducted interviews, researched applicable laws, reviewed EBSA's policies and procedures, and studied similar entities. In our analysis of EBSA's oversight and monitoring process, we used both statistical and judgmental sampling.

To determine whether EBSA had sufficient enforcement authority to ensure that employee benefit plan audits adequately protect participants, we compared EBSA's legislative authority as provided by ERISA to other Federal and private organizations with similar oversight responsibilities. We also conducted interviews with personnel from and researched information on the SEC, IRS, the Joint Board of Actuaries, and the PCAOB. Through these interviews and research, we identified each entity's level of legislative and regulatory authority. This authority included enforcement, registration and enrollment systems, complaint referral processes, audit monitoring practices, and corrective follow-up procedures.

To evaluate whether EBSA ensured that plan auditors corrected substandard audits, we performed several tests:

- First, we determined if plan auditors corrected the audit deficiencies identified by EBSA. We selected a statistical sample of 27 out of 51 plans whose auditor EBSA referred to a State Board or the AICPA during calendar years 1998 through 2001. We stratified the universe of 51 plans into 2 strata – 1998 and 1999 through 2001. We combined the latter years due to the small number of referrals.

  For each plan, we tried to examine the audit workpapers for the year of referral. However, auditors for 11 of the 27 plans had either destroyed or lost the workpapers for the plan year EBSA had examined. Therefore, we could only examine 16 plans' sets of workpapers for the same year that EBSA reviewed and referred to the AICPA or State Board.

- Next, we determined whether EBSA made the appropriate referral of plan auditors to either a State Board or the AICPA. We statistically selected 35 out of 75 workpaper examinations EBSA performed in 2001. We evaluated the results of these workpaper examinations to determine whether EBSA applied their referral criteria appropriately.

To determine if audit deficiencies identified by EBSA were corrected for subsequent years, we used the same statistical sample of 27 plans, as noted above. We obtained and reviewed all available audit reports with the accompanying financial statements and audit workpapers for the years after EBSA reviewed the plan through plan year 2001, and evaluated whether these documents complied with GAAP, GAAS, and ERISA.

Due to the timing of each plan's audit, some plan auditors had not completed their audit through plan year 2001. This resulted in a varying number of audits reviewed for each plan, ranging from two to eight audits for each plan, for a total sample of 137 plan year audits for the 27 plans.

To evaluate whether EBSA effectively identified substandard audits, we:

- determined whether EBSA's initial computer targeting process effectively identified plans with substandard audits. In order to do this, we statistically selected audit reports for 164 plans of the 64,996 plan filings EBSA received during fiscal year 2001 that required an audit report. We reviewed the audit reports and accompanying financial statements for compliance with GAAS and ERISA and, compared this rate to EBSA's deficiency rate based their targeted methods.
- determined if EBSA appropriately identified substandard audit reports or financial statements as a means of determining whether further review is required. We selected a statistical sample of 75 of the 2,401 audit reports EBSA reviewed during 2001. We reviewed the audit reports and accompanying financial statements for compliance with GAAS and ERISA.

We did not design specific tests for the CTS. However, issues with the CTS arose during the sampling and testing described above.

CRITERIA

The Employee Retirement Income Security Act of 1974 (ERISA) governs employee benefit plans. ERISA was designed to establish protections for plan participants and beneficiaries and includes fiduciary standards, funding levels, penalties for plan sponsors for noncompliance, and Federal insurance for certain pension plans.

EBSA administers Title I of ERISA. Title I requires plan administrators to engage an independent qualified plan auditor to annually audit the plan and file the audit report with DOL. Title I also stipulates that the examination comply with GAAS and include the testing of plan books and records considered necessary by the plan auditor. The auditor must opine on whether the financial statements and schedules are presented fairly in conformity with GAAP.

Under Title I, EBSA has the responsibility to oversee and monitor compliance with these audit requirements. EBSA's oversight and monitoring process includes:

- reviewing employee benefit plan audit reports and workpapers,
- ensuring plan auditors correct substandard ERISA audits, and
- referring auditors who perform substandard audit work to the AICPA and State Boards of Accountancy.

Appendix C

ACRONYMS AND ABBREVIATIONS

AICPA	American Institute of Certified Public Accountants
CTS	Case Tracking System
CPA	Certified Public Accountant
DOL	Department of Labor
EBSA	Employee Benefits Security Administration
ERISA	Employee Retirement Income Security Act
GAAP	Generally Accepted Accounting Principles
GAAS	Generally Accepted Auditing Standards
GAO	United States Government Accountability Office
IRS	Internal Revenue Service
IQPA	Independent Qualified Public Accountant
NOR	Notice of Rejection
OCA	Office of the Chief Accountant
OIG	Office of Inspector General
PCAOB	Public Company Accounting Oversight Board
SAS	Statements on Auditing Standards
SEC	Securities and Exchange Commission

Appendix D

RESPONSE TO DRAFT REPORT

U.S. Department of Labor

Assistant Secretary for
Employee Benefits Security Administration
Washington, D.C. 20210

September 30, 2004

MEMORANDUM FOR: ELLIOTT P. LEWIS
Assistant Inspector General
for Audit
Office of Inspector General

FROM: ANN L. COMBS
Assistant Secretary

SUBJECT: OIG Draft Report – *EBSA Needs Additional Authority to Improve the Quality of Employee Benefit Plan Audits*
Draft Report Number: 09-04-005-12-121

The Employee Benefits Security Administration has reviewed Draft Report No. 09-04-005-12-121, *EBSA Needs Additional Authority to Improve the Quality of Employee Benefit Plan Audits*. We appreciate the opportunity to provide comments on the draft report.

I. General Comments

While we agree in general with the conclusions and recommendations contained in the draft report, we believe that to tell the complete story, the report should discuss prior and ongoing EBSA actions to deal with the audit quality issue. Our efforts to improve audit quality have evolved over time and should be viewed by taking into account the size of the filing universe and the resources available. We have always recognized the need for an effective education, outreach, and compliance assistance strategy to complement our enforcement efforts. Our goal has been to prevent problems from arising and to allow us to focus our limited enforcement resources on the most significant audit quality problems. Each year, OCA's 10 staff auditors perform approximately 50-75 on site workpaper reviews and perform 2,400-3,000 desk reviews of the 70,000 Form 5500 filings that are required to contain audit reports.

In 1988, EBSA created the Office of the Chief Accountant (OCA). One of OCA's major functions is reviewing plan audit reports, submitted annually, for compliance with professional accounting principles, auditing standards, and regulatory reporting and disclosure requirements. Since that time, over 33,000 plan filings have been reviewed and we have made over 550 referrals to the AICPA's Professional Ethics Division and/or state boards of public accountancy. EBSA has worked closely with the AICPA and the Financial Accounting Standards Board (FASB) to update and improve the professional guidance available to practitioners in an effort to address substandard accounting and auditing work. This includes annual updates to the AICPA's Accounting and Audit

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Guide, *Audits of Employee Benefit Plans*; publication of a yearly Employee Benefit Plan Risk Alert; and, updated accounting principles for defined contribution pension plans and welfare benefit plans.

We have created and conducted a number of national outreach programs aimed at heightening awareness on accounting and auditing issues impacting employee benefit plans. EBSA actively participates in the AICPA's Annual Employee Benefit Plan Conference. Over 1,000 practitioners attend this annual conference. EBSA also works with State CPA Societies, the International Foundation of Employee Benefit Plans and other professional organizations in developing and participating in educational outreach conferences. We believe this is an effective approach for leveraging the agency's impact as we try to improve the professional work of the almost 10,000 CPAs that perform plan audits.

In addition, major revisions have been made to the Form 5500 Series Annual Return/Report to streamline the Form so that it is easier to complete. In July 2000, EBSA implemented the Electronic Filing Acceptance System (EFAST) to process the revised Form 5500. The processing system is designed to utilize imaging technology to process the Form 5500 filings. In conjunction with the implementation of the revised Form 5500 and the EFAST Processing System, EBSA also created a "Help Desk" designed to answer filer questions and other technical inquiries. Since its inception in March 2000, the EBSA "Help Desk" has responded to over 220,000 requests for technical assistance and other filer inquiries. EBSA has also made major revisions in its reporting enforcement and voluntary compliance programs by reducing civil penalties to further encourage delinquent filers to voluntarily comply with their annual reporting and disclosure obligations under ERISA. We believe these compliance assistance activities have had a positive impact on our target audience, including plan auditors.

EBSA recognizes the need, however, to re-focus our enforcement strategies with respect to plan audits. Rather than focusing OCA's staff resources on individual reviews of CPA firms performing only one or two plan audits each year, a substantial portion of the staff time will be devoted to examining audit quality issues in the work of CPA firms that handle large numbers of plan audits. This new enforcement approach is facilitated by the revised Form 5500, which allows us to more readily identify the plan auditor. The 2001 Form 5500 database indicates that almost 10,000 CPAs performed approximately 73,000 plan audits. Further analysis shows that only 37 CPA firms accounted for 32,300 plan audits (80% of the plan assets under audit). Conversely, there are 4,807 CPAs that audit only one plan (1.5% of plan assets under audit). Therefore, we are focused on ensuring that these 37 CPA firms have the necessary policies and procedures in place to assure their audit work complies with applicable professional standards. In this regard, our approach will be similar to that of the Public Company Accounting Oversight Board, which utilizes an inspection program of CPA firms auditing publicly traded companies. In fact, we have started to implement this approach, on a limited basis, as we review the professional work of five regionally based CPA firms. In FY 2005, we plan to conduct reviews of two national firms doing significant amounts of employee benefit plan audits. Using a rotating schedule, we will review the work of all the national level firms in future years. Additionally, reviewing the work performed by smaller CPA firms will continue to be part of our targeting strategy.

II. Specific Comments on Objectives and Recommendations

Finding 1: *Although EBSA has the responsibility to enforce ERISA's audit requirements, ERISA does not grant EBSA enforcement powers over the auditors performing employee benefit plan audits.*

Recommendation 1: *We recommend the Assistant Secretary for Employee Benefits Security propose changes to ERISA to grant EBSA greater enforcement authority over such matters as registration, suspension, debarment, and civil penalties against employee benefit plan auditors.*

EBSA recognizes the deficiencies in the current law and is considering options for correcting those deficiencies.

Finding 2: *EBSA did not fully ensure that auditors corrected audit deficiencies in the year EBSA reviewed or more recent years.*

Recommendation 2: *We recommend the Assistant Secretary for Employee Benefits Security obtain sufficient documentation to determine that audit deficiencies were corrected.*

While we agree with this recommendation, we disagree with the finding that we have not adequately ensured the correction of nine out of 16 cases. In six of the nine cases, we continue to believe that the cases were properly documented and closed after receiving additional information from plan auditors. We will put in place new procedures to ensure better and more uniform documentation of corrected audit work.

Recommendation 3: *We recommend the Assistant Secretary for Employee Benefits Security expand workpaper reviews to more recent years when EBSA finds audit deficiencies.*

With respect to the sufficiency of audits of more recent years, we agree that this can be a problem, and EBSA has altered its enforcement approach to deal with this situation by instructing staff to review the audits of more recent years. However, we note that in 17 of the 27 cases in the original OIG sample, the plan administrator hired new auditors as a result of our initial enforcement actions. Therefore, reviews could not be performed of those auditors whose work we found to be deficient. When new auditors are appointed for a plan, we will evaluate the need to examine that future work based on an assessment of the risks surrounding the integrity of plan assets and operations.

3

Recommendation 4: *We recommend the Assistant Secretary for Employee Benefits Security review the OIG referrals and take necessary action to correct the substandard audits.*

We agree with the recommendation to review the OIG referrals and take necessary actions.

Finding 3: *EBSA's case file information was not accurate or complete.*

Recommendation 5: *We recommend the Assistant Secretary for Employee Benefits Security improve the accuracy of the CTS database and the completeness of the case file documentation and implement a system to monitor the location of the case files within EBSA's offices.*

We agree with the recommendation. During FY 2005, OCA will develop and implement improvements to the CTS.

Finding 4: *EBSA's targeting methods are not effective.*

Recommendation 6: We recommend the Assistant Secretary for Employee Benefits Security analyze available data and develop targeting methods based on common attributes of plans with substandard audits.

We agree with the OIG's recommendation that alternative techniques are necessary to better target problems with substandard audit work. In FY 2003-2004, EBSA conducted a follow-up to our earlier baseline study to gather additional data to improve the planning and management of our audit program. The results of our most recent study are still be evaluated; they will be incorporated into future targeting strategies. Also in FY 2004, with the revision of the agency's approach to targeting plan audits for further review, greater emphasis was placed on the work of selected auditing firms rather than an individual filing. At the end of FY 2005 or early in FY 2006, we will evaluate the results of these new strategies.

However, we would like to take exception to one of the OIG's conclusion about the success rate of OCA's past targeting efforts. There is a misconception on page 23 of the report, where the OIG states that:

> "Out of the more than 2,400 plans EBSA reviewed in 2001, EBSA only identified 75 audits that failed its desk and/or workpaper reviews. This indicates a 3% deficiency rate. However, using the 20% historical deficiency rate, we estimate over 450 of these 2,400 plans were probably substandard. We, therefore, estimate EBSA did not detect over 300 substandard audits in its review of the 2,400 plans."

4

During FY 2001, the Division of Accounting Services rejected over 500 filings, many of which contained audit deficiencies. The OIG has failed to count filings that were rejected based on a desk review because of failures of the auditor to ensure the adequacy of disclosures in the financial statements.

In conclusion, we will be glad to further discuss this response with you.