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.

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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."

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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.

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