Plan Audits

Audit 101: A Guide to Employee Benefit Plan Audits—Per the Department of Labor—Auditor Communications

Plan auditors communicate in both written and oral formats to clients at different times throughout the year. We will discuss these communications in this and a later column in order to assist plan sponsors, plan administrators, trustees, audit committees, employee benefit plan committees, administrative committees, and investment committees to better understand the communications they may receive from their plan auditors. In this column we will focus on the compliance-related communications that auditors must obtain or provide to perform and complete the audit of a plan's financial statements, which include the engagement letter, management representation letter, and communication with those charged with governance. In a later column we will discuss communications about internal control matters identified in an audit.

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Engagement Letter

The independent qualified public accountant (IQPA) will issue a written engagement letter to the client to establish and document an understanding regarding the services to be performed. The engagement letter should include the objectives of the audit, the scope of the audit, management's responsibilities, and the auditor's responsibilities. In addition, auditors are required to communicate the planned scope and timing of the audit to the person or persons responsible for overseeing the strategic direction and obligations related to the accountability of the plan. That "person" could be the investment committee, plan administrator, benefits committee, board of directors, an individual charged with governance, or possibly the audit committee. Through sufficient discussion with the client, the auditor will determine who best fits this description.

The client should thoroughly review the engagement letter and sign it as evidence of their understanding with the auditor. Among other things, the engagement letter will include:

- The objective and scope of the engagement;
- A statement that due to the inherent limitations of an audit, there is a risk that a material misstatement may not be detected;
- Identification of the applicable financial reporting framework;
- Reference to the expected form and content of reports to be issued; and
- A statement that circumstances may occur in which a report may differ from its expected form and content.

The engagement letter will also include a list of matters regarding the various responsibilities of plan management and the auditor. Plan management is responsible for items such as:

- Understanding the objective of the audit;
- The plan's financial statements and the selection and application of the accounting policies;
- Establishing and maintaining effective internal control over financial reporting;

- Designing and implementing programs and controls to prevent and detect fraud;
- Identifying and ensuring that the plan complies with the laws and regulations applicable to its activities;
- Making all financial records and related information available to the auditor; and
- Adjusting the financial statements to correct material misstatements.

The auditor is responsible for the following:

- Conducting the audit in accordance with generally accepted auditing standards (GAAS);
- Obtaining reasonable rather than absolute assurance about whether the financial statements are free of material misstatement, whether caused by error or fraud;
- Obtaining an understanding of the plan and its environment, including its internal controls, sufficient to assess the risks of material misstatement of the financial statements and to design the nature, timing, and extent of further audit procedures; and
- The expression of an opinion on the plan's financial statements.

Management Representation Letter

At the end of an engagement, the auditor is to obtain written representations from plan management and when appropriate, those charged with governance, who have appropriate responsibilities for the financial statements and knowledge of the related plan matters. This letter will include specific representations regarding management's responsibilities for the preparation and fair presentation of the financial statements, management's responsibility to produce the information needed to complete the audit, and representations covering the completeness of transactions. The importance of that requirement is emphasized by the fact that the inability to obtain those written representations is a scope limitation that prevents the auditor from expressing an unmodified opinion. When those representations are either (1) not provided by management, or (2) the auditor cannot rely on the representations due to the auditor concluding that sufficient doubt exists about management's integrity, then the auditor is required to disclaim an opinion or withdraw from the engagement.

There are many representations that are obtained in this communication from management, including the following:

- Management's belief that the financial statements are fairly presented in conformity with GAAP;
- Management's belief that the effects of any uncorrected financial statement misstatements, both individually and in the aggregate, are immaterial to the financial statements taken as a whole;
- Management's acknowledgment of its responsibility for the design and implementation of programs and controls to prevent and detect fraud;
- Whether current versions of the plan and/or trust documents have been filed with the appropriate agency;
- Whether the plan has complied with the fidelity bonding requirements of ERISA;
- Information concerning transactions with parties in interest;
- Whether the plan has complied with the DOL's regulation for remitting employee contributions (and as applicable participant loan repayments) to the plan on a timely basis;
- Whether there were reportable transactions that were not disclosed in the supplemental schedules;
- Whether there is a present intention to terminate the plan;
- That management provided to the auditor all applicable financial records, plan amendments, trust agreements, insurance contracts, and actuarial reports prepared for the plan;
- Management's identification of all material accounting estimates and their reasonableness;
- The fair value of investments that do not have a readily determinable market price and thus were valued "in good faith" by the plan's board of trustees, administrative or investment committee, or specialist engaged by the plan;
- Unasserted claims or assessments that the plan's lawyer has advised are probable of assertion and must be disclosed in accordance with applicable accounting standards or if a lawyer was not consulted during the period;
- That no events occurred that would be reportable to the PBGC, if the plan is a defined benefit retirement plan;
- Compliance of the form and content of the information included in the financial statements and schedules with the DOL reporting and disclosure rules;
- Information concerning any subsequent events that may have occurred between the plan year end and the auditors' report date; and

- In the case of a DOL limited-scope audit, management's representation that it instructed the auditor not to perform any auditing procedures with respect to information on investments prepared, and certified to, by the trustee, other than to compare the information with the related information in the financial statements and supplemental schedules.

Auditor's Communication with Those Charged with Governance

Auditors are required to make certain communications (either written or orally) to "those charged with governance"—that is, the person(s) with responsibility for overseeing the strategic direction of the plan and obligations related to the accountability of the plan, both prior to and after the audit. The appropriate individual or group may vary depending on the matter to be communicated. For a single-employer plan, persons charged with governance may include the audit committee of the plan sponsor or the appropriate group overseeing the financial reporting process of the plan, such as the employee benefit committee, administrative committee, plan administrator or other responsible party. For a multiemployer plan, those charged with governance ordinarily will be the joint board of trustees.

There are the following broad categories of matters to be communicated to those charged with governance:

During the Planning Phase of the Audit

The auditor communicates that he/she is responsible for forming and expressing an opinion about whether the financial statements are presented fairly in accordance with generally accepted auditing principles and that the audit of the financial statements does not relieve management or those charged with governance of their fiduciary responsibilities. In addition, the auditor will discuss the scope of the audit and provide an overview of key aspects of scope and timing without compromising audit effectiveness. For example, the auditor would describe the use of the concept of materiality in planning and performing the audit, but not specific testing thresholds or amounts.

Following the Audit

The auditor communicates significant findings or issues from the audit. These include items such as:

- The auditor's views about qualitative aspects of the plan's significant accounting practices, including accounting policies, estimates, and financial statement disclosures;
- The process management used to develop accounting estimates, including fair value estimates, and the basis for the auditor's conclusions as to the reasonableness of those estimates;
- Significant difficulties encountered during the audit. This might include significant delays in receiving required information, unnecessarily brief time to complete the audit, extensive and unexpected effort required to obtain audit evidence, unavailability of evidence, and restrictions imposed on the auditors by management;
- Disagreements with management about matters that could individually or in the aggregate be significant to the financial statements or auditor's report, regardless of whether the disagreements were satisfactorily resolved;
- Misstatements brought to the attention of management as a result of auditing procedures; and
- If management consulted with other accountants with regard to accounting or auditing matters related to the plan.

Significant Issues Discussed, or Subject to Correspondence With, Management

These will be discussed in greater detail in a later column, but relate to findings or issues that are significant and relevant to those charged with governance and the plan and may include issues such as the application of accounting principles and auditing standards, business conditions, plans or strategies that may affect the risks of material misstatement of the plan's financial statements.

There are instances where the auditor finds a misstatement that is below a calculated materiality level and plan management decided not to adjust its figures. The auditor aggregates the total of these financial statement misstatements during the engagement and concludes that any uncorrected misstatements are not material, both individually and in the aggregate, to the financial statements taken as a whole. A summary of these misstatements is provided as part of the communications with those charged with governance.

Conclusion

The types of communication we have discussed are items that the auditor or sponsor must complete in order to perform and issue a report on the plan's financial statements. As discussed, the engagement letter is obtained at the beginning of the audit process and is used to communicate planning matters, including the auditor's responsibilities under generally accepted auditing standards and the planned scope and timing of the audit. The representation letter is obtained at the end of the audit process and includes a list of specific representations that management is making to the plan auditor as it relates to the plan and plan-related matters. The purpose of the governance communication is to ensure plan fiduciaries who are not directly involved in the audit process receive formal communication about plan matters and whether there are any matters that occur during the audit that would be relevant to the persons charged with governance in overseeing the financial reporting process. ■