

## Employee Benefit Plans — Financial Statement Audits

The AICPA® EBPAQC is a firm-based, volunteer membership center created with the goal of promoting quality employee benefit plan audits. Center members demonstrate their commitment to ERISA audit quality by joining and agreeing to adhere to the Center's membership requirements. EBPAQC member firms receive valuable ERISA audit and firm best practice tools and resources that are not available from any other source.

Visit the center website at [aicpa.org/EBPAQC](http://aicpa.org/EBPAQC) to see a list of EBPAQC member firms and find other valuable tools prepared for plan sponsors and other stakeholders. For more information, contact the EBPAQC at [ebpaqc@aicpa.org](mailto:ebpaqc@aicpa.org).

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# Introduction

The AICPA® Employee Benefit Plan Audit Quality Center (EBPAQC) has prepared this advisory to provide you, the plan sponsor, administrator or trustee with an understanding of and insights into the independent audit of the financial statements of an employee benefit plan. While this document addresses audits of financial statements that are prepared for purposes of filing with the U.S. Department of Labor (DOL) on Form 5500, *Annual Return/Report of Employee Benefit Plan* (Form 5500), much of the information may be useful in understanding the processes involved in the audits of plans that file a Form 11-K with the U.S. Securities and Exchange Commission (SEC).

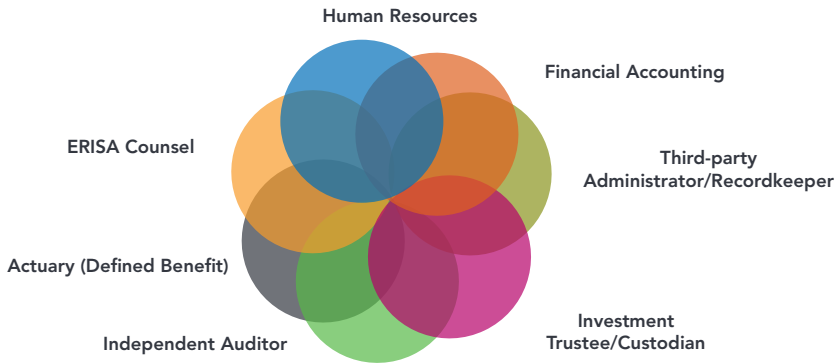
A financial statement audit is conducted by an independent certified public accountant. The independent auditor's overarching goal is to obtain reasonable — but not absolute — assurance that the financial statements prepared by plan management are fairly presented. To communicate that assurance, the independent auditor provides an opinion about whether the plan's financial statements are presented fairly, in all material respects, in accordance with U.S. generally accepted accounting principles as promulgated by the Financial Accounting Standards Board (FASB) (GAAP) or a special purpose framework that is acceptable to the DOL, such as the modified cash basis of accounting.

This advisory describes the roles and responsibilities of individuals involved in the plan's financial reporting and audit process, and the purpose, objectives and benefits of a financial statement audit. The term plan management as used throughout this document refers to the party or parties that created the plan and/or have ultimate responsibility for the plan's maintenance, compliance, and oversight and may include the plan sponsor, plan administrator, plan committees or others charged with governance. This advisory also discusses audit scope, general audit matters common to all audits, the audit process, the auditor's report, and what you can do to assist in the audit process.

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# Plan Financial Reporting and Audit Process and Management's Responsibilities

The primary objective of a plan's financial statements is to provide information that is useful in assessing the plan's present and future ability to pay benefits.

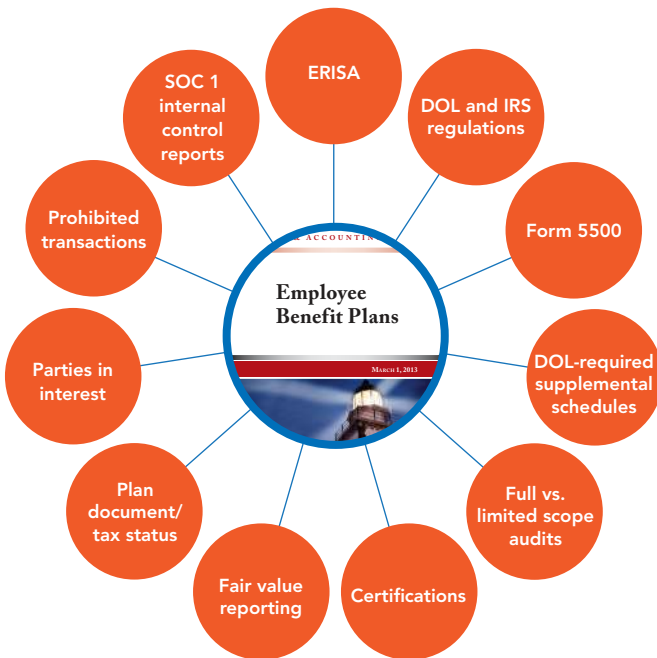


The financial reporting process may involve many parties, including the plan sponsor's financial accounting and human resources departments, a third-party administrator, investment trustees and custodians, an actuary, ERISA legal counsel and the independent auditor. Plan management may hire service organizations to perform record keeping and reporting functions, but the ultimate responsibility for accurate financial reporting rests with plan management.

One of the most important duties of plan management is to hire the independent auditor. In some cases the plan sponsor may have an audit committee, employee benefits committee or administrative committee that oversees the financial reporting process, including internal control over financial reporting and the appointment, compensation and oversight of the independent auditor.

The plan financial reporting and audit environment is unique in many respects, including the nature of plan operations; the various laws and DOL and Internal Revenue Service (IRS) regulations with which plans must comply; and special reporting and audit requirements. These matters, which affect every plan, add to the complexity of an employee benefit plan audit. Other matters that may complicate the plan reporting and audit process may include changes to the plan document; plan mergers, freezes or terminations; and changes in service organizations.

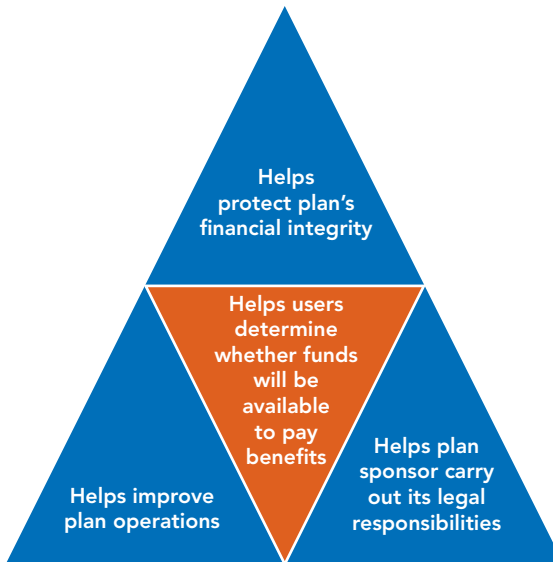
### Unique Aspects of the EBP Reporting and Audit Environment



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# Purpose, Objectives and Benefits of the Independent Audit

The Employee Retirement Security Act of 1974 (ERISA) generally requires employee benefit plans with 100 or more participants to have an independent financial statement audit as part of the plan sponsor's obligation to file a Form 5500.



Financial statement audits provide an independent, third-party opinion to participants, plan management, the DOL and other interested parties that the plan's financial statements provide reliable information to assess the plan's present and future ability to pay benefits. A financial statement audit helps protect the financial integrity of the employee benefit plan, which helps users determine whether the necessary funds will be available to pay retirement, health and other promised benefits to participants. The audit may also help plan management improve and streamline plan operations by evaluating the

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strength of the plan's internal control over financial reporting and identifying control weaknesses or plan operational errors. And the audit helps the plan sponsor carry out its legal responsibility to file a complete and accurate Form 5500 for the plan with the DOL.

The overall objectives of the plan auditor under professional standards are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error and to report on the financial statements in accordance with his or her findings. In addition, the DOL requires the independent auditor to offer an opinion on whether the DOL-required supplemental schedules attached to the Form 5500 are presented fairly in all material respects, in relation to the financial statements as a whole.

To accomplish these objectives, the auditor plans and performs the audit to obtain reasonable assurance (see a discussion of reasonable assurance below) that material misstatements, whether caused by error or fraud, are detected. The auditor assesses the reliability, fairness and appropriateness of the plan's financial information as reported by plan management. The auditor tests evidence supporting the amounts and disclosures in the plan's financial statements and DOL-required supplemental schedules; assesses the accounting principles used and significant accounting estimates made by management; and evaluates the overall financial statement presentation to form an opinion on whether the financial statements as a whole are free of material misstatement.

### **The Auditor's Responsibility for ERISA, DOL and IRS Compliance and Fraud Detection**

The independent financial statement audit is an important part of the safeguards established by Congress in ERISA to protect plan participants. As noted above, the auditor is responsible for obtaining reasonable assurance that the financial statements as a whole are free from material misstatement, whether caused by fraud or error. Absolute assurance is not attainable and even a properly planned and performed audit may not detect a material misstatement. A material misstatement due to fraud may not be detected for a number of reasons. For example, the act may involve conduct designed to



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conceal it, such as collusion, forgery, deliberate failure to record transactions, management override of controls or intentional misrepresentations made to the auditor.

In conducting a plan audit, the auditor has a responsibility to perform procedures with respect to the provisions of ERISA and DOL and IRS regulations that have a direct effect on the determination of material amounts and disclosures in the financial statements. For employee benefit plans, this would include party in interest transactions that may be prohibited by ERISA. When the auditor becomes aware of information concerning a possible prohibited party in interest transaction or other noncompliance with laws and regulations, the auditor obtains an understanding of the nature of the transaction, the circumstances in which it occurred and sufficient other information to evaluate the effect on the financial statements. As part the auditor's consideration of the plan's compliance with laws and regulations, the auditor is required to make certain inquiries and review correspondence with the DOL and IRS. The auditor also considers the effect of the transaction on the financial statements.

Most laws and regulations relate more to the plan's design and operations than to its financial reporting process and, as such, any potential financial statement effect is indirect. With respect to laws and regulations that do not have a direct effect on the determination of the amounts and disclosures in the financial statements but where noncompliance with such laws and regulations may have a material effect on the financial statements (such as those necessary for the plan to avoid material penalties or lose its tax exempt status), the auditor's responsibility is limited to performing specified audit procedures that may identify noncompliance with those laws and regulations that may have a material effect on the financial statements.

Determining whether an act constitutes noncompliance ultimately is a matter for legal determination, such as by a court of law, and the auditor ordinarily does not have a sufficient basis for determining possible violations of such laws and regulations.

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# General Audit Considerations

The following are some general audit considerations for all employee benefit plan financial statement audits.

## **Generally Accepted Auditing Standards**

The independent auditor must follow generally accepted auditing standards (GAAS). These standards provide a measure of audit quality and the objectives to be achieved in an audit. They address auditor technical training and proficiency; independence; due professional care; planning and supervision; obtaining a sufficient understanding of the entity and its environment to assess the risk of material misstatement; obtaining sufficient appropriate audit evidence; and the required components of an auditor's report.

## **Adequate Technical Training and Proficiency**

An auditor is required to have adequate technical training and proficiency to perform the audit; therefore, the auditor only accepts an audit when he or she will be able to meet the responsibilities and requirements related to the engagement. Factors to be considered include expertise in the benefit plan area, ability to meet the engagement's time requirements and deadlines and ability to meet ERISA audit requirements.

## **Professional Skepticism**

Professional skepticism is fundamental to an independent auditor's objectivity and includes a questioning mind and an objective assessment of audit evidence. It requires an emphasis on the importance of maintaining the proper state of mind during the audit. The auditor uses his or her knowledge, skill, and ability to perform — in good faith and with integrity — the gathering and objective evaluation of audit evidence.

## **Auditor Independence**

The auditor's independence from the plan and plan management is essential for a successful audit because it enables him or her to approach the audit with the necessary professional skepticism. Independent auditors must adhere to rules of auditor independence established by the AICPA and DOL and

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for plans that file a Form 11-K, the SEC and the Public Company Accounting Oversight Board (PCAOB). These rules address financial interests and relationships with the plan sponsor; maintaining plan records; and providing non-audit and other services. For example, the DOL will not consider an auditor to be independent with respect to a plan if the audit firm or any of its employees maintain the financial records for the employee benefit plan.

*Financial statement audits are guided by two important factors: reasonable assurance and materiality.*

**Reasonable Assurance and Materiality**

Financial statement audits are guided by two important factors: reasonable assurance and materiality. These two factors affect the way the independent auditor examines, on a test basis, transactions that occurred and controls that functioned during the year. The extent or scope of the testing also is driven by the auditor’s risk assessment (see the “Risk Assessment” section on page 16). Because it is not practical for an independent auditor to examine every transaction, control and event — it would preclude timely financial reporting and be prohibitively expensive and resource intensive — there is no guarantee that all material misstatements, whether caused by error or fraud, will be detected. Reasonable assurance is obtained by reducing audit risk to an appropriately low level through applying due professional care, including obtaining sufficient appropriate audit evidence. The concept of materiality is applied in planning and performing the audit, in evaluating the effect of any identified misstatements and in forming the opinion included in the auditor’s report. The determination of materiality is a matter of professional judgment and is based on a combination of both quantitative and qualitative factors. Inherent in reaching judgments about materiality is the auditor’s perception of the needs of users of the financial statements.

**Professional Judgment**

Auditors use their professional judgment to determine how much evidence is sufficient and what kind of evidence should be collected in order to form an opinion on the financial statements. Auditor judgment also is

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required in interpreting the results of audit testing and evaluating audit evidence. Auditors also exercise professional judgment in evaluating the reasonableness of accounting estimates based on information that could reasonably be expected to be available prior to the completion of the audit. As a result, with regard to the plan's accounting estimates, the auditor often has to rely on evidence that is persuasive rather than convincing. More judgment is needed when auditing accounting estimates, such as valuations of hard-to-value investments or benefit obligation amounts in financial statements, the measurements of which are inherently uncertain and depend on the outcome of future events.

### **Auditor Communications**

Professional standards require auditors to communicate certain matters to plan management and "those charged with governance," which is defined as the person(s) with responsibility for overseeing the strategic direction of the plan and obligations related to the accountability of the plan. The appropriate individual or group may vary depending on the matter to be communicated. The communications are made throughout the audit: during the planning stage, during fieldwork and many times after the auditor's report is issued. Some communications will be formalized in writing, while others may be verbal communications. The communications will address various issues such as the nature and parameters of the engagement; plan internal control matters; and audit findings and recommendations for improvement. Further discussion of these auditor communications can be found in the AICPA EBPAQC's plan advisory, *Understanding Auditor Communications* (see more information about this publication in the "Additional Resources" section on page 31).

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## Full Scope vs. Limited Scope

Typically, financial statement auditors are engaged to audit and report on the reporting entity's financial statements, including all assets; liabilities and obligations; and financial activities. These audits are performed without any client-imposed scope limitation or other restriction. ERISA is unique in that, when certain criteria are met, it permits plan management to instruct the auditor to limit the scope of testing of investment information included in the financial statements. This limited scope election must be supported by a certification from a qualified entity as to both the accuracy and completeness of the plan's investment information. Such audits are referred to as "limited scope" audits. Plan management is responsible for determining that the conditions of the limited scope audit exemption have been met.

*Plan management is responsible for determining that the conditions of the limited scope audit exemption have been met.*

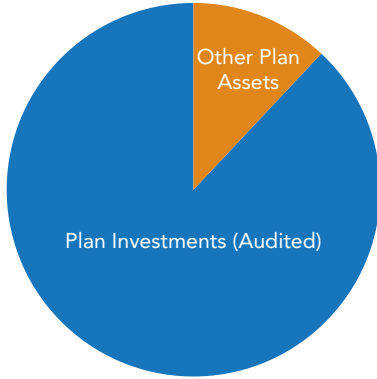
In a limited scope audit, the auditor does not audit the certified investment information (investments typically are the most significant plan assets). He or she still tests participant data, including the allocation of investment income to individual participant accounts, and tests contributions, benefit payments and other information that was not certified. Even though the auditor performs procedures on everything except the investment information in a limited scope audit, he or she will disclaim an opinion — which means the auditor cannot express an opinion — on the financial statements because of the significance of the information that was not audited.

Limited scope audits and the resulting disclaimers of opinion are not acceptable to the SEC for purposes of employee benefit plans that file Form 11-K with the SEC.

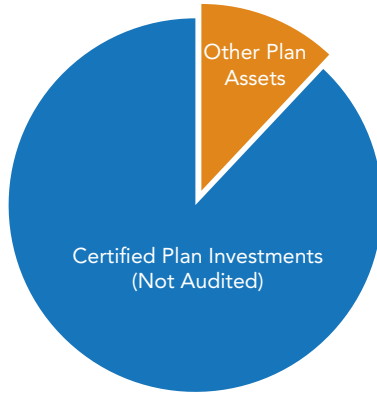
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## Full vs. Limited Scope Audits

Full Scope Audit

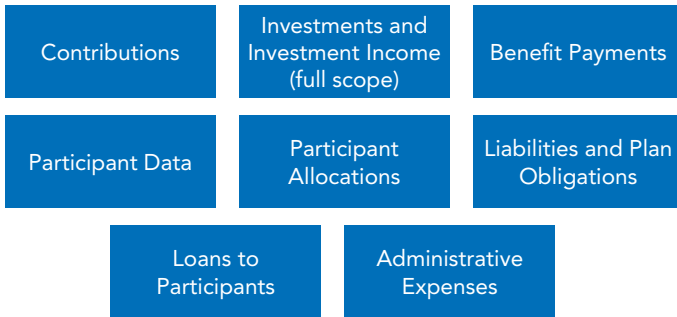


Limited Scope Audits



# Audit Areas

The financial statement audit for employee benefit plans typically cover employee and employer contributions; benefit payments; plan investments and investment income (full scope audits); participant data; participant allocations; liabilities and plan obligations; loans to participants; and administrative expenses. In addition, the auditor considers other matters that may affect the financial statements, as discussed below.



**Contributions** — The auditor tests contributions from the employee and employer to determine whether the amounts received by or due to the plan are properly determined and recorded and disclosed in the financial statements, and whether any appropriate allowances have been made for uncollectable amounts.

**Benefits and Benefit Payments** — Benefits are tested to determine whether the payments are in accordance with plan provisions and related documents, whether payments are made to or on behalf of the persons entitled to them and only to such persons, and whether transactions are properly recorded in the proper account, amount and period.

**Liabilities and Plan Obligations** — The auditor performs tests to determine whether all plan liabilities are reported in the financial statements. In a defined benefit plan, the auditor will test plan obligations to determine that they are

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properly estimated and reported in the financial statements. Testing plan obligations typically will include using the work of an actuary.

**Participant Data and Allocations** — The auditor applies procedures to relevant participant data, such as demographic data (e.g., sex, marital status, birth date and period of service); payroll data relevant to determining contributions and benefit payments (e.g., wage rate, hours worked, earnings and contributions to the plan); participant elections (e.g., investment elections and elected deferral rates); and benefit data (e.g., benefit levels and options selected) to determine whether all covered employees have been properly included and whether accurate participant data were supplied to plan management and the plan actuary, if applicable. This work often is done in conjunction with other audit areas such as contributions or benefits testing. The auditor also tests whether investment income has been properly allocated to individual participant accounts.

**Investments and Investment Income** — In a full scope audit, the auditor applies procedures to determine whether investments are properly recorded, owned by the plan, properly valued as of the financial statement date (generally at fair value), properly presented in the financial statements and the appropriate related disclosures are made, and that investment transactions are made in accordance with the plan's established investment policies. The auditor also tests whether the income from the plan's investments has been properly recorded. As noted above, in a limited scope audit, the auditor does not audit the certified investment information (investments typically are the most significant plan assets); however, he or she still tests the allocation of investment income to individual participant accounts and evaluates whether investments are properly presented in the financial statements and the appropriate related disclosures are made.

**Loans to Participants** — Loans to participants and the related interest are tested to determine whether the amounts due the plan have been properly identified, valued, recorded and disclosed in the financial statements.



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**Administrative Expenses** — Expenses may be tested to determine if they are in accordance with agreements, are properly classified and are recorded in appropriate amounts in the proper period.

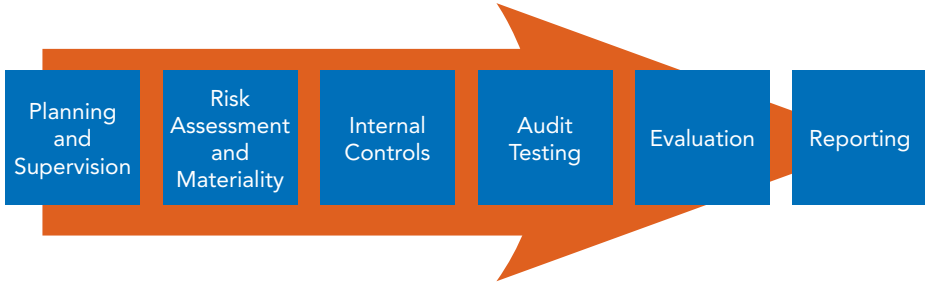
### **Other Auditing Considerations**

**Parties in Interest and Prohibited Transactions** — Professional standards require that the auditor be aware of the possible existence of party in interest and material related party transactions that could affect the financial statements or for which DOL reporting regulations require disclosure and be aware of the possibility that noncompliance with laws and/or regulations (including party in interest transactions that may be prohibited by ERISA) may have occurred. They also require that the auditor perform procedures to identify instances of noncompliance with those laws and regulations related to party in interest and prohibited transactions that may have a material effect on the financial statements.

*The auditor is required to inspect correspondence, if any, with the DOL and IRS.*

**Plan Tax Status** — The auditor also must be aware of the possibility that violations of tax laws and regulations may have occurred. The auditor is expected to inquire of management and other appropriate parties and obtain representations from management concerning whether the plan is in compliance with the laws and regulations that affect the plan's qualified status. The auditor also is required to inspect correspondence, if any, with the IRS. In addition, if specific information comes to the auditor's attention that provides evidence concerning the existence of possible violations affecting the financial statements, he or she should apply auditing procedures specifically directed to ascertaining whether a violation has occurred.

# The Audit Process



## Planning and Supervision

Professional standards require that the auditor adequately plan the work and supervise any assistants. Audit planning includes developing an overall audit strategy for the expected conduct, organization and staffing of the audit; establishing a written understanding with the client regarding the services to be performed, including the scope of the audit and the auditor's responsibilities regarding any supplemental schedules accompanying the basic financial statements; and obtaining an understanding of the plan's internal controls. The nature, timing and extent of planning will vary according to the type of employee benefit plan, the size and complexity of the plan's operations, the auditor's experience with the plan, and his or her understanding of the plan and its environment, including its internal control.

Matters that affect the scope of the audit include whether the audit will be a full scope or a limited scope; the type of trust and/or custodial arrangement and nature of investment options; involvement of service organizations and other key service providers; and whether the audit is an initial audit, merged plan or final audit. The auditor also should consider whether specialized skills are needed in performing the audit, such as an investment valuation specialist or actuary.

## Risk Assessment

Audit risk is the risk that the auditor expresses an unmodified opinion when the plan's financial statements are materially misstated. The auditor considers audit risk in relation to the overall financial statement level and the assertion

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level (existence or occurrence, completeness, valuation or allocation, rights and obligations, presentation and disclosure, and cutoff) for classes of transactions, account balances, and disclosures, and performs procedures to assess the risks of material misstatement at both levels.

In designing the plan audit, the auditor will consider whether certain areas might require special scrutiny. A few areas presenting particular risks of material misstatement when auditing employee benefit plans are (a) the fair value of investments with no readily ascertainable market, (b) new types of investments, (c) accuracy of benefit amounts and (d) whether contributions are accurately calculated.

The results of the risk assessment completed during the planning stages of an audit provide the basis for determining the scope of the audit and nature, timing, and extent of the audit tests that will be performed. Audit planning is a continuous process, however, and the audit scope might be adjusted during the course of the audit based on audit results or consideration of other factors.

### **Internal Control**

The auditor must obtain an understanding of the plan and its environment, including its internal control relevant to the audit, which will provide a basis for designing and implementing the audit plan.

An important part of the auditor's planning is to look at the internal control over the financial reporting process — including those at service organizations that perform accounting, participant, and/or investment record keeping functions — that are in place and then evaluate their effectiveness in order to assess the risks of material misstatement. In examining internal controls over financial reporting, auditors will seek to determine whether the plan has established effective procedures to reduce the chances of errors or fraud.

If controls are in place and are effective, the auditor may be able to reduce the amount of detailed testing later in the audit.

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**SOC 1 Reports** — An effective approach to help plan management understand and monitor the quality and effectiveness of service organizations, such as outsourced plan administrators and the investment trustee or custodian, is to request a report on the controls at the service organization, called a service organization control (SOC) 1 Report (SOC 1 Reports were formerly known as SAS 70 reports). SOC 1 Reports can be extremely important to you in fulfilling your fiduciary duty to monitor controls at service organizations. Obtaining a SOC 1 report also is important for the plan auditors to use in understanding and assessing controls at the service organization that are relevant to the plan financial statements. Further discussion of the importance of SOC 1 reports can be found in the *AICPA EBPAQC’s plan advisory, Effective Monitoring of Outsourced Plan Record Keeping and Reporting Functions* (see more information about this publication in the “Additional Resources” section on page 31).

### **Audit Testing**

In developing an audit strategy, the auditor considers whether to rely on the relevant controls at the plan and the plan’s service organizations for various areas of the audit based on an assessment of factors such as cost/benefit considerations, the size of the plan and prior year results of control testing. If test results indicate the plan’s controls are effective, the auditor may reduce the level of “substantive tests” he or she performs as a basis for the audit opinion.

Substantive audit procedures provide evidence about particular financial statement assertions by management and whether actual account balances are fairly stated. Based on the auditor’s assessment of risk and the quality of the plan’s internal controls, the auditor then performs substantive testing procedures on selected account balances and transactions. If internal controls are strong, this will reduce but not entirely eliminate the amount of substantive testing the auditor needs to perform.

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There are two types of substantive audit procedures:

- **Substantive Analytical Procedures** — In these tests, the auditor gathers evidence about relationships among various accounting and non-accounting data such as industry and economic information. When relationships are significantly different from the auditor's expectations, the auditor will seek to understand the reason and undertake additional investigation until satisfied that items were properly recorded. Examples of variations in relationships among data can include specific unusual transactions or events, accounting changes, business changes or misstatements. For example, comparing average recurring defined benefit plan benefit payments per participant to the prior year ratio. If the amount changes substantially from one year to the next, the auditor would investigate the apparent anomaly until satisfied that he or she understood the reasons for the change.
- **Substantive Tests of Details of Account Balances, Classes of Transactions and Disclosures** — The details supporting financial statement accounts are tested to obtain assurance that material misstatements do not exist. Substantive procedures may be performed on a sample basis over an existing group of similar transactions. Sampling approaches can either be statistical or non-statistical. A simple example of this type of audit procedure would be to re-compute benefits for selected participants based on the plan-related documents, option elected and pertinent service or salary history to support the recorded benefits paid to participants. Independent auditors also can select targeted samples to match specific risk criteria, as well as use the results of sample testing, in some instances, to conclude on the population as a whole.

It is important to note that if the auditor decides on an approach that relies on internal control, he or she tests the controls for purposes of determining the nature, timing and extent of substantive testing to be performed. The auditor is precluded from relying exclusively on the plan's internal controls as a basis for concluding that the financial statements are free from material misstatement. Even in audits of plans with excellent controls, auditors can reduce substantive testing, but cannot eliminate substantive testing entirely.

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In designing the audit strategy, judgments are made in the selection of the auditing procedures to be performed, considering three factors:

- **Nature** — The auditor can choose from a variety of audit procedures. These procedures include *inspection, observation, inquiry, confirmation, recalculation, analytical procedures and re-performance* and may be used throughout all stages of the audit process. For example, the confirmation of investments with the custodian is an effective procedure to establish the physical existence of the asset reported on the plan's statement of net assets available for benefits, but it is not an effective test of the fair value of those investments. An effective test of the fair value of an investment such as a mutual fund might be to compare the reported value with quoted prices in active markets for identical assets (for example, prices derived from NYSE, NASDAQ and the Chicago Board of Trade).

*The auditor can choose from  
a variety of audit procedures*

- **Timing** — The auditor tests asset balances "as of" the statement of net assets available for benefits date. However, sometimes information provided to the auditors to support balances is as of a date other than the statement of net assets date. For example, the plan may receive a copy of financial statements to support the value of its investment in a limited partnership as of a date prior to the statement of net assets available for benefits date. In that case, the auditor will consider the reliability of the financial statements for valuing that investment "as of" that interim date and then perform some procedures related to activity between that date and year-end to draw a conclusion about the investment balance at year-end.
- **Extent** — The auditor determines the extent of testing he or she will perform. The necessary extent of a substantive audit procedure will often depend on the materiality of the account, disclosure or transactions; the assessed risk of material misstatement; and the necessary degree of assurance from the procedure.

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The nature, timing and extent of auditing procedures are driven by judgments based upon the results of the auditor's risk assessment and planning processes, discussed above. The scope of the audit (i.e., full scope or limited scope) also affects the audit procedures performed. As mentioned earlier, if plan management elects to engage the auditor to perform a limited scope engagement, that would affect the procedures performed in the investments area.

## **Evaluation**

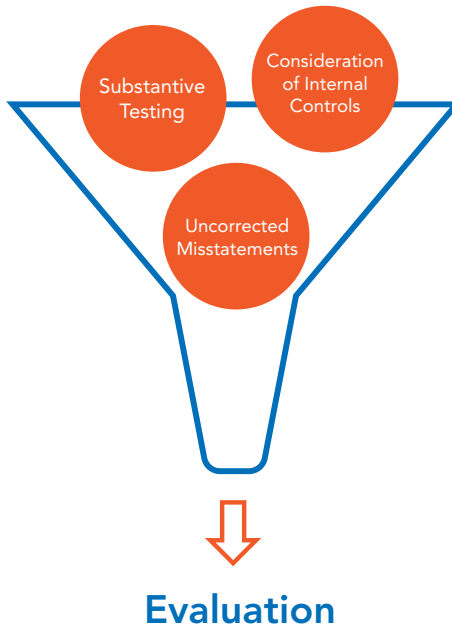
The auditor evaluates the audit evidence obtained and considers what type of audit opinion to issue. Professional standards define certain requirements and provide broad guidelines about the evaluation of audit evidence. However, the auditor also is required to exercise professional judgment to determine the nature and amount of evidence required to support the audit opinion. As the audit progresses, the audit team completes its tests and evaluates the results. A portion of this evaluation is qualitative in nature, in which the auditor considers whether the test results confirm or contradict plan management's assertion that the financial statements are prepared in accordance with GAAP or a special purpose framework.

Depending on the test results, the engagement team may need to adjust its audit plan, modify its tests, or perform additional procedures in response to this updated information as warranted. When the auditor discovers misstatements in the accounting records or financial statements, he or she informs plan management, who then decides whether and how to make any adjustments. Plan management bears the ultimate responsibility for the financial statements and may determine that some misstatements are immaterial in their judgment and do not warrant a change to the financial statements.

The audit team summarizes any uncorrected misstatements and performs an independent evaluation as to whether the uncorrected misstatements — both individually and in the aggregate — result in financial statements that are materially misstated. The auditor cannot express an unmodified opinion on the plan's financial statements unless he or she is satisfied that there are no material misstatements.

In the case of a limited scope audit where plan management has limited the scope of testing on investment information, the auditor still will evaluate the results of testing the non-investment activity of the plan, such as participant eligibility, employee and employer contributions; benefit payments; and plan administrative expenses.

## Evaluation





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# Auditor's Report

At the conclusion of the audit, the auditor issues the written audit report, which contains the following elements:

- A title that includes the word *independent*
- An appropriate addressee
- An introductory paragraph that identifies the entity whose financial statements have been audited, states that the financial statements have been audited, identifies the title of each of the statements and specifies the date or period covered by the audit
- A section that describes management's responsibility for the preparation and fair presentation of the financial statements
- A section that describes the responsibility of the auditor
- A statement that audit was conducted in accordance with GAAS
- An explanation about how the auditor is required to plan and perform the audit
- A description of an audit
- A statement about whether the auditor believes the audit evidence obtained is sufficient and appropriate to provide a basis for his or her opinion
- A section that contains the auditor's opinion

If the auditor concludes that the financial statements, as a whole, "present fairly, in all material respects," the financial status of the plan and the changes in its financial status (for defined benefit plans, including defined

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benefit health and welfare benefit plans) or the net assets available for benefits and changes in net assets available for benefits (for defined contribution plans) in accordance with the appropriate financial reporting framework (for example, GAAP or modified cash basis of accounting), the auditor issues what is known as an “unmodified opinion.” It is important to recognize that, even though the audit is planned and performed at the individual account level, auditors express an opinion on the financial statements as a whole. For full scope audits, the auditor’s report also will include a report on whether the supplemental schedules “are fairly stated in all material respects in relation to the basic financial statements as a whole.”

Depending on the results of the engagement, the unmodified opinion may include an emphasis-of-matter or other-matter paragraph in the auditor’s report (see Table 1).

### **Limited Scope Reports**

As noted above, plan management may instruct the auditor to perform a limited scope audit. In that case, the auditor’s report will include a disclaimer of opinion on the financial statements that states that because of the significance of the information the auditor did not audit, the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, the auditor does not express an opinion on the financial statements. In addition, the auditor’s report includes an other-matter paragraph (see table 1 on right) that disclaims an opinion on the supplemental schedules and a report on the form and content of the supplemental schedules in compliance with DOL rules and regulations.

Table 1: Types of Financial Statement Audit Opinions

Unmodified Opinions	Description
Unmodified Opinion	<p>An unmodified opinion states that the financial statements present fairly, in all material respects, the financial status of the plan and the changes in its financial status or the net assets available for benefits and changes in net assets available for benefits in accordance with an applicable financial reporting framework. For plans, the appropriate frameworks are U.S. GAAP or the modified cash basis of accounting.</p>
	<p>An “emphasis-of-matter” or “other-matter” paragraph does not affect the independent auditor’s unmodified opinion on the financial statements.</p>

Unmodified Opinions	Description
Emphasis-of-Matter or Other-Matter Paragraph Added (continue to page 27)	The auditor includes an emphasis-of-matter paragraph in the auditor's report when he or she finds it necessary to draw users' attention to a matter appropriately presented or disclosed in the financial statements that is of such importance that it is fundamental to users' understanding of the financial statements. For example, a plan may have material amounts of alternative or hard-to-value investments whose valuations are subjective in nature that may warrant an emphasis-of-matter paragraph.

Unmodified Opinions	Description
Emphasis-of-Matter or Other-Matter Paragraph Added (continued from page 26)	An other-matter paragraph is included in the auditor's report when the auditor considers it necessary to communicate a matter other than those that are presented or disclosed in the financial statements that he or she believes is relevant to users' understanding of the audit, the auditor's responsibilities or the auditor's report. For example, where the auditor concludes that the supplemental schedules do not include all required information or the information is inaccurate or inconsistent with the financial statements and the omission or inconsistency is not considered a material misstatement, the auditor may add an other-matter paragraph.

Modified Opinions	Description
Qualified opinion	A qualified opinion states that, except for the effects or possible effects of certain matters, the financial statements are presented fairly, in all material respects, in accordance with an applicable financial reporting framework.
Adverse opinion	An adverse opinion states that the financial statements are not presented fairly in accordance with the applicable financial reporting framework.
Disclaimer of opinion	A disclaimer of opinion states that the auditor has not been able to obtain sufficient appropriate audit evidence to provide a basis for an audit opinion. Accordingly, the auditor does not express an opinion on the financial statements. As noted above, a disclaimer of opinion is issued in the case of a limited scope audit.

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## Your Role in the Audit Process

Plan audits are unique and can be quite complex. Preparation and assistance on your part can lead to a significant reduction in the time the auditor spends. Here are some steps you can take that will help you meet your fiduciary responsibilities and contribute to an efficient audit.

- Assign an individual who is responsible for the plan's financial statements. Plan management is responsible for the plan's financial statements, including 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, and identifying and ensuring that the plan complies with the laws and regulations applicable to its activities. You might look to someone from the sponsor's financial reporting department to be responsible for the preparation of the financial statements. AICPA independence rules permit auditors to assist with financial statement preparation if certain safeguards are met. However, auditors of plans that file a Form 11-K with the SEC are precluded from preparing the financial statements.
- Assign an individual who is responsible for coordinating the audit and obtaining the necessary input and cooperation of all parties involved, including the financial reporting, human resources and benefits, payroll and treasury departments as well as trustees, custodians, record keepers, actuaries and other external parties.
- Establish and maintain good internal control policies and procedures. The AICPA EBPAQC Center plan advisory, *The Importance of Internal Controls in Financial Reporting and Safeguarding Plan Assets* provides valuable information to assist you in this area (see "Additional Resources" section on page 31 for more information).

- Make sure the plan's records are complete and up to date, and that all records are readily and easily accessible. The audit will require more time if the records are incomplete or inadequate or if controls do not exist or are ineffective.
- The plan document and IRS opinion or determination letter should be up to date. The plan should be able to demonstrate that the plan has met all of the IRS qualification requirements.
- The plan should establish and maintain a written investment policy.
- Review the reports prepared by the plan's service organizations, investment reports and certifications for consistency, completeness and reasonableness, and inquire about any information you don't understand. Obtaining answers to questions you have about those reports in advance will help you answer inquiries you may receive from your auditors. Consider whether adjustments to the information provided by your service organizations may be necessary to prepare the plan's financial statements.
- Prepare schedules and collect documentation requested by your auditors in advance. Providing schedules of the underlying activity or items supporting account balances, such as investments or plan expenses, and a trial balance that supports the financial statement amounts, can help the auditor reduce the amount of time he or she spends on the audit.
- Obtain and read SOC 1 reports from service organizations to determine if the controls relevant to the plan, including those at the plan sponsor (user entity controls), are adequate to ensure complete and accurate financial reporting. It also is important that you document the controls for which the plan is responsible and monitor compliance with those controls throughout the year.
- Arrange for the auditor to have direct access to other service organizations used by the plan to obtain information or answer questions arising during the audit.



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## Additional Resources

### **EBPAQC Plan Sponsor Resource Center**

The EBPAQC has compiled helpful tools and resources for plan sponsors, administrators and trustees, which can be found on the EBPAQC website at [aicpa.org/ebpaqc](http://aicpa.org/ebpaqc).

### **EBPAQC Plan Advisories**

The following EBPAQC plan advisories can be found on the EBPAQC website at [aicpa.org/ebpaqc](http://aicpa.org/ebpaqc).

#### **Understanding Auditor Communications.**

This advisory addresses auditor's communications with those charged with governance, engagement letters, management representation letters, communications about internal control matters identified in an audit, management letters and verbal communications, how auditor communications can help and where to obtain additional information about auditor communications.

**Effective Monitoring of Outsourced Plan Record Keeping and Reporting Functions.** This advisory is a comprehensive document that contains information about your fiduciary responsibility for monitoring service organizations and useful tips for selecting and monitoring service organizations. It also addresses the quality of plan accounting information, monitoring service organization controls over plan accounting information and special considerations for different types of plans.

**The Importance of Internal Controls in Financial Reporting and Safeguarding Plan Assets.** This advisory assists plan administrators in understanding their responsibilities for establishing, maintaining and monitoring internal controls at their plans.

**Valuing and Reporting Plan Investments.** This advisory assists plan sponsors in understanding their responsibilities for valuing and reporting their plan investments. It is a comprehensive document that contains information about your responsibility for reporting plan investments, how plan investments are reported, investment valuation and related disclosures, your responsibility for

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valuing investments and establishing internal controls, special considerations for alternative investments, investment information you should request from the plan trustee or custodian, how your independent auditor can assist you and where to obtain additional information.

## **DOL Resources**

### **[U.S. Department of Labor Employee Benefits Security Administration Fiduciary Education Campaign Website.](#)**

Fiduciary Education Campaign includes nationwide educational seminars and webcasts to help plan sponsors understand rules and meet their responsibilities to workers and retirees. The campaign also includes educational materials on topics such as understanding fees and selecting an auditor. [dol.gov/ebsa/](https://dol.gov/ebsa/)

### **[Meeting Your Fiduciary Responsibilities.](#)**

ERISA sets standards of conduct for those who manage an employee benefit plan and its assets (called fiduciaries). This publication provides an overview of the basic fiduciary responsibilities applicable to retirement plans under the law. [dol.gov/ebsa/publications/](https://dol.gov/ebsa/publications/)

### **[Selecting an Auditor For Your Employee Benefit Plan.](#)**

Federal law requires employee benefit plans with 100 or more participants to have an audit as part of their obligation to file the Form 5500. This booklet will assist plan administrators in selecting an auditor and reviewing the audit work and report. [dol.gov/ebsa/publications/](https://dol.gov/ebsa/publications/)

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