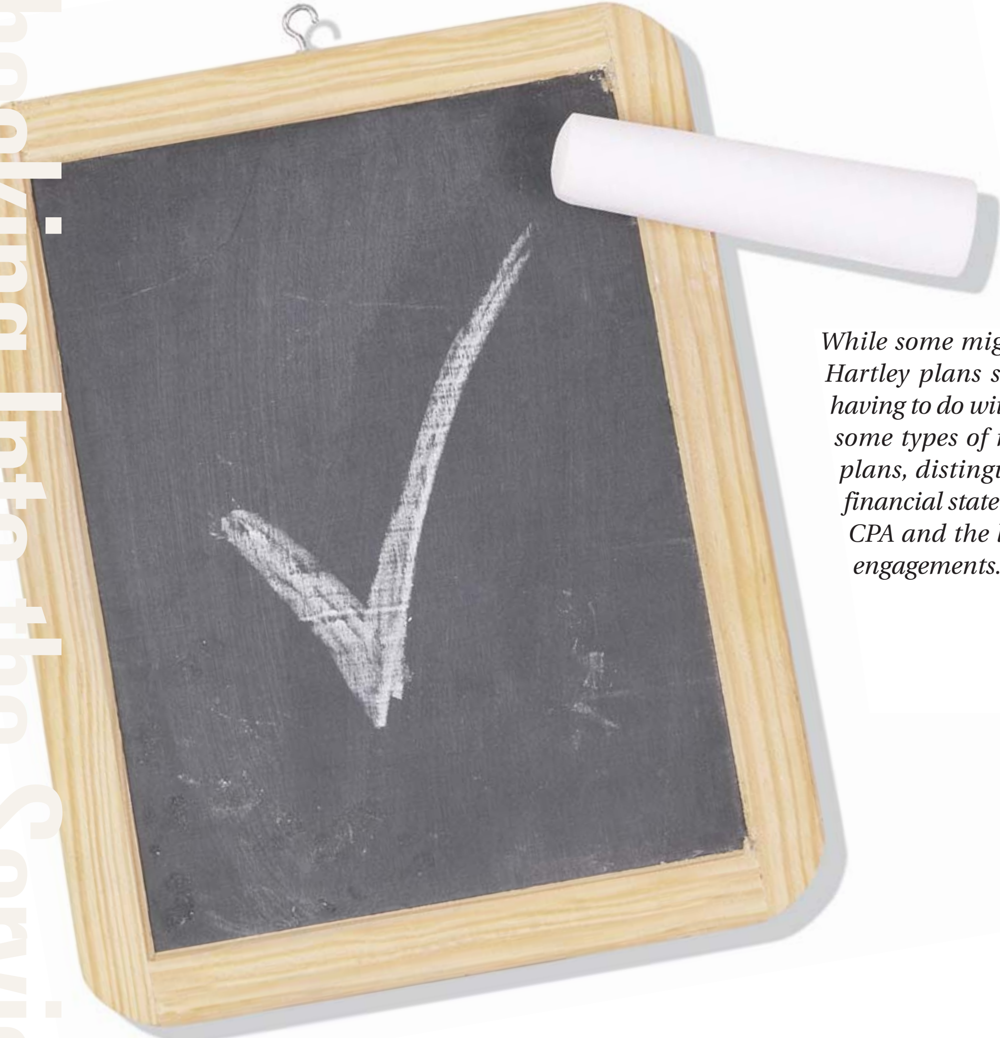

While some might say the A in CPA stands for "audit," Taft-Hartley plans sometimes have a need for CPA services not having to do with financial statements. This article will discuss some types of nonaudit engagements for employee benefit plans, distinguishing these engagements from an audit of financial statements. It will explain the responsibilities of the CPA and the limitations with respect to the other types of engagements.

Checking Into the Services of a Plan's CPA

Checking Into the Services of a Plan's CPA

by Michael A. Van Sertima and Vincent F. Panettieri

Trustees and a plan's professionals are familiar with the CPA's audit of a plan's financial statements. This article will discuss some other types of engagements beneficial to employee benefit plans, distinguishing these engagements from an audit of financial statements. It will explain the responsibilities of the CPA and the limitations with respect to the other types of engagements.

As a reference point, let's go over the audit requirements of employee benefit plans and the primary objective and inherent shortcomings of an audit. The general rule is that an audit is required for employee benefit plans with 100 or more participants at the beginning of the plan year. The objective of an audit conducted in accordance with generally accepted auditing standards is to provide reasonable assurance as to whether or not the financial statements are free of material misstatement, whether from fraud or error.

There are two important elements here worthy of elaboration. First, *reasonable assurance* implies that the auditor is not an insurer of the financial statements; the auditor does not guarantee the accuracy of the financial statements. There is a risk that the auditor will unknowingly give a clean opinion on financial statements that contain a material misstatement. In other words, even though the auditor complied with auditing standards, the financial statements could contain a material misstatement. The reason for this is that in an audit, testing of transactions and account balances are performed on a sample of transactions, rather than on entire populations. There is a chance that a sample will not indicate a problem in the population. Additionally, if the management of an entity concocts an elaborate scheme to mask a material misstatement, there is a probability that the misstatement will remain undetected, despite the audit being conducted in accordance with auditing standards.

Second, the auditor's procedures are designed to uncover material misstatements. The auditor will give a clean opinion on financial statements that are fairly stated even though the auditor is aware that they contain misstatements that are not material. This is because in the auditor's judgment, the misstatement would not affect the decision of a reasonable user of the financial statements.

Attestation vs. Nonattestation

The work of a CPA may be broadly classified into *attestation and nonattestation* engagements. In attestation engagements, the CPA reports on the reliability of information or an assertion by a third party. A typical example of an attestation engagement is an audit of financial statements. The assertion being reported on here is management's representation that the financial statements are free of material misstatements (i.e., the financial statements are fairly stated). Other examples are a review of financial statements, and reporting on the accuracy and completeness of an employer's contributions to a plan (payroll audits). In attestation engagements, the CPA must be independent. *Independence* means that the CPA must be unbiased throughout the attestation engagement. Nonattestation engagements, such as consulting (management advisory services) and preparation of tax returns, do not require the CPA to be independent.

Review of Financial Statements

A review is substantially less in scope than an audit and consists primarily of inquiries of the client and analytical procedures (e.g., variance and ratio analyses, which are also performed in an audit). Important differences between an audit and a review are:

- An audit provides a high level of assurance while a review provides a moderate level.
- Unlike an audit, in a review the CPA does not obtain an understanding of internal controls.
- The CPA does not perform tests of transactions and balances for a review.

A review of financial statements is not mentioned in the Employee Retirement Income Security Act of 1974 (ERISA). There is no requirement for a plan to have its financial statements reviewed. Of what use then is a review of financial statements? Some large plans (those with over 100 participants and which require audits) use this level of service for interim (quarterly or semiannual) financial statements (the year-end financials would still be audited). If there's a somewhat "difficult" transition from one board of trustees to another, it may be in the new board's interest to have interim reviews (in addition to the annual audit) of financial statements performed until the plan's affairs are once again on an even keel.

Since small plans (fewer than 100 participants) in general are exempt from the audit requirement, trustees should consider having a CPA perform an annual review of financial statements. This will at least give the trustees some level of assurance on the financial statements. Of course, should the trustees desire a higher level of assurance, they can opt to have an audit performed, even though it is not required. Cost/benefit of audited or reviewed financial statements should be the key consideration in the small plan situation.

Compilation

At the other end of the continuum (audit being at the other end and a review somewhere in-between) is a service that provides no assurance on financial statements. This is a compilation of financial statements. Like a review of financial statements, there is no legal requirement for the compilation of a plan's financial statements. As it is a nonattest service, the CPA is not required to be independent of the client, but lack of independence must be disclosed in the compilation report. For a compilation, all the CPA does is to put in the form of financial statements the numbers provided by the client. Management is responsible for

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The role of an accountant is expanding due to the Economic Growth and Tax Relief Reconciliation Act, which increased the nontaxable contribution limits for 401(k) investments. Many accountants provide financial planning advice on 401(k) plans for both participants and plan sponsors, as well as draft documents, test and offer compliance help. Accountants are teaming up with retirement services providers and third-party administrators or becoming representatives of a vendor's 401(k) products.

Jeff Stimpson.
Practical Accountant,
September 2004, pp. 44-46.
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the financial statements, even though the CPA prepares them. This service, like a review, may be used for interim financial statements that are presented at trustees meetings or for those plans that do not require an annual audit.

The existence of these three levels of service should be viewed in the context that a CPA is required to issue a report on financial statements whenever the CPA's name is associated with such statements. A CPA is prohibited from preparing financial statements without reporting on the responsibility he or she is assuming with respect to such statements. That is, the CPA must issue one of three reports (audit, review or compilation) whenever his or her name is associated with financials. This is to avoid misunderstandings regarding the level of assurance being provided.

Limited Scope Audit

Under Department of Labor (DOL) regulations, an employee benefit plan is permitted to direct its auditor to perform a limited scope audit. As the name suggests, the auditor does not perform a full audit. The auditor does not perform audit procedures on investment-related balances (investments held at year-end; realized and unrealized gains and losses; and interest and dividends) provided the assets are held and the transactions executed by an investment custodian (bank or insurance company) that is regulated, supervised and subject to periodic examination by a federal or state agency. The investment custodian must also certify the accuracy and completeness of the investment information submitted to the plan.

Since the auditor does not perform any audit procedures on balances that are highly material to the financial statements, the auditor would be unable to provide an opinion on the financial statements as a whole. The auditor would, therefore, issue a disclaimer of opinion. Essentially, the auditor reports that an opinion could not be expressed on the financial statements. This is the only departure from an unqualified (or clean) opinion that is accepted by DOL.

✓ *In the authors' experience, there is more widespread use of the limited scope audit in corporate-sponsored (single employer) employee benefit plans than in Taft-Hartley plans.*

Other Services

The above services, namely audit (full and limited scope), review and compilation all pertain to financial statements. There are other services, not having to do with financial statements, that are also provided by CPAs who service Taft-Hartley plans. These are:

- Agreed-upon procedures
  —Payroll "audits"
  —Administrative expense allocations
  —Claims audits
- Consulting.

Agreed-Upon Procedures

As the name suggests, an agreed-upon procedures engagement entails the performance of procedures agreed upon by the CPA and client, and in some cases, other third parties. This is a rigidly defined engagement in that the CPA does only what is agreed upon with the client—no more, no less. In other words, the CPA's responsibility is limited only to the procedures performed. In practice, the CPA helps the client formulate the procedures. Because the procedures are agreed upon by the CPA and the client, the degree of assurance provided depends on the specific procedures performed. As such, agreed-upon procedures reports are restricted in their distribution to only the client and other parties who agreed to the procedures. Since this is another type of attestation engagement, the CPA must be independent. The report issued for this type of engagement could be rather lengthy as it has to list the procedures performed and the CPA's findings. An important point to note is that the CPA does not render an opinion, but merely presents findings stemming from procedures performed. Payroll audits and administrative expense allocation studies are two engagements performed as agreed-upon procedures.

Payroll Audits

The performance, or rather the nonperformance, of payroll audits by a plan is a hot-button area for DOL. The performance of these audits is an integral part of a plan's collection policy. Payroll audits are performed as agreed-upon procedures. These are compliance engagements to test the accuracy and completeness of employers' contributions to a benefit plan. Essentially, the CPA tests the degree to which a plan's contributing employer is complying with the governing collective bargaining agreement (CBA). Possible outcomes of a payroll audit are the employer rigidly followed the CBA and therefore all contributions required to be paid were remitted to the plan on time; the employer overpaid contributions; or the employer did not pay in accordance with the CBA. The latter outcome will result in an amount owed to the plan for the contributions, interest, and in some cases, cost of the payroll audit. Noncompliance usually takes the form of the employer not remitting on time; not reporting an employee; reporting the employee well after the employee's probationary period ends; and wittingly or unwittingly using a lower, outdated contribution rate. In the construction trades, because of the mobility of employees, employers sometimes remit to the wrong jurisdiction (plan). Examples of procedures performed are:

- Compare the employer's salary or wage total (for a certain period) per the payroll register to federal or state tax filings.
- Select (a certain number of) employees from the employer's payroll records (for a certain period) and trace to the contribution remittance report.

Examples of findings are:

- The wage total per the payroll register (for a period) was $XX,XXX more than the amount per the federal tax filing.
- (The following) bargaining unit employees were omitted from the contribution remittance report.

A plan may elect to have payroll audits done in-house by an employee, rather than by an external CPA. Obviously the employee's report would not be an agreed-upon procedures report but would take some other form as determined by the plan's management.

✓ *In the authors' experience, conducting payroll audits, in addition to aiding trustees in discharging their fiduciary duty to collect employers' contributions, could result in a healthy boost to a plan's bottom line. It is not uncommon for a plan, especially one that has a newly implemented payroll audit program, to be on the receiving end of additional contributions in hundreds of thousands and even millions of dollars.*

Administrative Expense Allocation

Another hot-button area with DOL is expense-sharing arrangements among related plans and, in some cases, a union. There are two potential problems here: The first is that the arrangement is inequitable, resulting in one or more entities subsidizing the operations of the others, and the second is that reimbursements to the entity that pays the common indirect expenses are not timely (DOL prefers monthly reimbursements). Both of these situations result in the participants of a benefit plan being shortchanged, thus giving rise to prohibited transactions.

An agreed-upon procedures engagement could be used to determine the reasonableness of a shared expense arrangement among related benefit plans and a union. Since it is common for related plans and a union to operate from one location, there are advantages for the entities to enter into an agreement to share certain common indirect expenses.

✓ *In the authors' experience, some attorneys advise plans to adopt a written agreement signed by the plans' trustees. Additionally, if a CPA conducts an agreed-upon procedures engagement, the report issued should be adopted by the trustees and approved in the minutes.*

A typical expense-sharing arrangement will cover such expenses as rent, utilities, payroll and payroll-related expenses, legal fees related to collection of contributions and trustees meetings and conferences. It should be emphasized that as many expenses as possible should be treated as direct expenses, i.e., expenses that could be identified to a particular plan and paid by that plan. The written agreement to share expenses should provide for the basis to be used (e.g., square footage, time spent by employees, contributions, etc.) and the timely reimbursement to the entity that pays the shared expenses.

The CPA and client will agree on procedures such as to:

- Determine expenses are allocated using an appropriate base
- Recalculate the ratio borne by each entity
- Compare the actual shared expenses to what should have been shared based on the recalculated ratios
- Determine any under or over allocation among the plans
- Determine whether or not reimbursements were timely
- Compute an estimated periodic reimbursement for a forthcoming period.

✓ *The authors recommend that a shared expense arrangement be reviewed at least every three to five years but more frequently if there are significant changes in plan operations such as plan mergers, hiring of personnel, personnel reduction, say, due to outsourcing, etc.*

Claims Audits

In the course of auditing a plan's financial statements in accordance with auditing standards, the CPA tests a sample of benefit payments. The size and other attributes of the sample vary depending on the auditor's assessment of risk. Therefore, there's a probability that the sample may not bring to light a significant problem in the population. A plan's management may periodically desire more extensive testing to be done. Sometimes this is due to issues coming to the attention of plan management or a change in the administration of the plan. In the case of a welfare plan, an audit of claims could be undertaken as an agreed-upon procedures engagement. Such an engagement may involve generating electronic files for participant eligibility and claims paid, and then performing cross-checks with data manipulation software. Cross-checking claims paid to eligibility data will determine if claims were paid to or for ineligible individuals. Other procedures that may be performed are those designed to uncover duplicate payments and payment of benefits in excess of an annual or lifetime maximum.

✓ *With respect to pension benefits, the following are procedures that the authors have performed for clients:*

- Determine if more than 12 checks were issued to retirees for the year; investigate any such occurrence.
- List all new payees for the period; compare to new retirees approved by the trustees and/or plan administrator.
- Determine if payees' addresses have changed; investigate if there have been changes.

Consulting

Consulting engagements or management advisory services are nonattest in nature and may be used for virtually anything that has to do with plan operations. In a consulting engagement, the CPA is in effect on a fact-finding mission and will bring certain matters to the attention of plan management, provide advice and help to implement changes in operations. Some of these engagements may involve benchmarking—comparing a particular pension or welfare plan to similarly positioned plans with respect to:

- The ratio of administrative expenses to employers' contributions
- The ratio of payroll and related expenses to employers' contributions
- Investment expenses as a percentage of investments
- Administrative expense per participant
- The ratio of administrative expense to benefits paid.

Making such comparisons will pinpoint areas of operational weaknesses. The CPA's experience in the benefit plan niche can go a far way in assisting plan management to resolve operational issues in areas such as:

- Reasonableness of a plan's payroll
  - —Is total payroll comparable to similarly situated plans?
- Is the plan processing and paying benefits in a timely manner?
- Efficiency of plan operations
  - —Is there a duplication of procedures?
  - —Are certain procedures beneficial to the plan?
  - —Should the plan outsource certain operations (e.g., processing of claims)?
- Fraud
  - —Recommend and implement measures to reduce the risk of fraud.
  - —Investigate suspected fraud.
  - —Quantify fraud losses.
  - —Develop evidence to be used in fraud litigation.
- The design and improvement of internal control
  - —Analysis of existing system of internal control
  - —Identification of weaknesses
  - —Suggestions for improvement.

Continued on next page

Note that an opinion on the effectiveness of internal control is not provided in a consulting engagement. This would be done through another type of attestation engagement.

The parameters of a consulting engagement will vary widely depending on what the plan is out to accomplish. Of course, the engagement could evolve as it progresses, as findings lead to new questions. A consulting engagement is not as rigid as an agreed-upon procedures engagement. Consequently, it is advisable that some engagements be performed as consulting rather than agreed-upon procedures. In this manner, the CPA does not have to seek agreement on procedures to be performed as new developments are encountered. Another difference between the two types of engagement is that there is more flexibility in the format of a consulting report than an agreed-upon procedures report. The latter type of report must use a prescribed format and wording.

It is imperative that plan management thoroughly understands the benefits and limitations of nonaudit engagements and how they differ from an audit of financial statements. In addition to reading the engagement letter (the contract with the CPA), it would be beneficial to review a sample of the report that would be issued at the conclusion of the engagement. **B&C**

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Michael A. Van Sertima is an audit manager with Schultheis & Panettieri, LLP of New York. He specializes in performing financial statement, operational and internal control audits of employee benefit plans and labor organizations. Van Sertima earned a bachelor of science degree in accounting from the City University of New York. He is a member of the American Institute of Certified Public Accountants and the New York State Society of Certified Public Accountants. Van Sertima is an International Foundation speaker and author.

Vincent F. Panettieri is a partner with Schultheis & Panettieri, LLP of New York. He provides accounting, auditing and management advisory services to labor unions, Taft-Hartley multiemployer benefit funds, not-for-profit and for-profit organizations. He became a partner in 1997 and currently serves as the co-managing partner of the firm. Panettieri is a member of the American Institute of Certified Public Accountants, the New York State Society of Certified Public Accountants and the International Foundation of Employee Benefit Plans. He received a bachelor of science degree from Marist college.