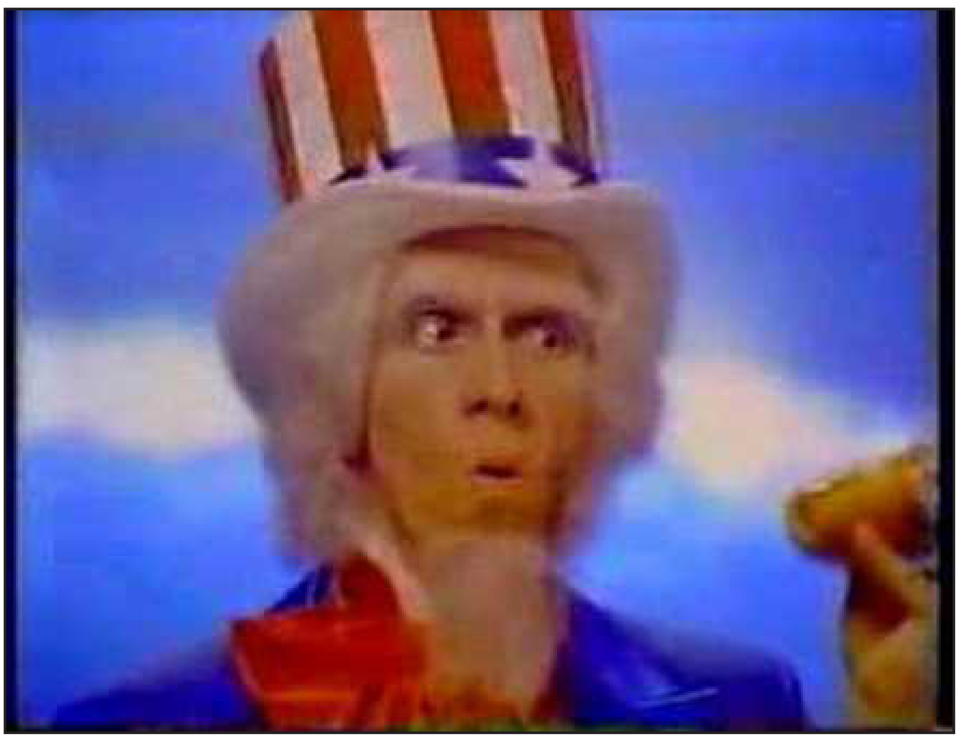
The Value Of A Good ERISA Auditing Firm

By Ary Rosenbaum, Esq.

As a child and later as an adult, I always remembered the commercial regarding Hebrew National hot dogs. Hebrew National hotdogs explained that they exceeded the Federal Government's guidelines regarding hotdog production and that they couldn't use non-meat fillers because they were Kosher and had to answer to a higher authority. In the world of retirement plans, larger retirement plans have to answer a higher authority through the independent audit requirement. The purpose of this article is let you know about the plan audit requirement and what to look for in hiring an independent auditor for your retirement plan.



Retirement plans with more than 100 participants have a requirement to get an independent audit as an attachment for their Form 5500 filing. There is an exception called the 80/120 rule which allows plans with between 80 and 120 participants, as of the 1st day of the plan year, to file the Form 5500 in the same category ("large plan" or "small plan") as indicated on the prior year's Form 5500 filing.

What counts as a participant for the audit requirement? The participant count must include (1) actively participating employees, (2) retired, deceased, or separated employees who still have assets in the plan and (3) all eligible employees who have yet to enroll or have elected not to enter the plan.

What is the purpose of a retirement plan audit? A retirement plan audit will help protect the assets and the financial integrity of a plan sponsor's retirement plan and ensure that the necessary funds will be available to pay retirement benefits to participants. The higher the quality of a plan's financial statement audit, the more reliable the information used to manage and administer the plan is. A quality audit also will help carry out a plan sponsor and plan trustee's fiduciary responsibility to file a complete and accurate Form 5500 for the plan each year. The failure to obtain an independent filing is the same consequence of making no Form 5500, so there will be harsh consequences for failing to obtain one. Recent Department of Labor (DOL) studies of audit quality have identified significant deficiencies in plan audits. Accordingly, the DOL has increased and revised its enforcement strategies with respect to audit deficiencies. The penalties for such audit failures can be substantial. The DOL can assess penalties on plan sponsors of up to $1,100 a day (capped at $50,000) per annual report filing where the required auditor's report is missing or deficient and there is no statute of limitations for a Form 5500 that is considered not being filed because of no audit attached. Since the use of a retirement plan audit is vital, the selection of an experienced and reliable auditor is very important.

As far as picking an auditing firm, it's rather simple. Federal law requires that an auditor engaged for a retirement plan audit be licensed or certified as a public accountant by a State regulatory authority. So hiring your local tax preparer, which is not a CPA firm, is not allowed.

Don't pick an auditor on price, but pick an auditor based on experience. Find out how many audits they do a year and see how many auditors work on them. From experience, any auditing firm that has their auditors average more than 12-15 audits is more of a mill and less of an actual auditing firm. A few years back, the DOL did force a CPA out of the business when it was discovered that three auditors produced 80 audits, a number far too great for the audits to be accurate.

The audit ensures that the plan is operating correctly and is in good financial condition. Paying thousands for an audit report that is suspect is the same as paying thousands of dollars for a worthless piece of paper. Beware of referrals from third party administration (TPA) firms unless the TPA makes more than just one firm as a referral and you have indicated that the auditing firm in question handles plans from different TPA providers.

While some companies would want an audit from a Big 4 firm, it's not necessary. There are many accounting firms that do just as good a job, if not better than the Big 4 firms, at a better price. I recently came across one plan where a Big 4 firm charged $54,000 for a limited scope audit, which is about $40,000-45,000 too high. There are so many high quality medium and small size CPA firms with auditing practices that you don't need the panache of getting a Big 4 firm audit.

The question for the last couple of years for me is independence. Auditors of retirement plans need to be independent and should not have any financial interests in the plan or the plan sponsor or the other plan providers that would affect their ability to render an objective, unbiased opinion about the plan.

A TPA in New York had to fold its operation into a sister TPA because the people running it had a pecuniary interest in the auditing firm that they referred their audit required clients to. I have also come across an auditing firm that is also the financial advisor of plans that it audits. While many plan sponsor probably don't care about a nefarious situation, they will if the Department of Labor ever came around and declared that the plan sponsor's independent audit requirement was not met, so their previous Form 5500 were considered invalid. After being socked with hundreds of thousands of dollars in penalties, they would care.

A good audit ensures the financial condition of the plan and serves as a check and balance on the other plan providers. The requirements to get an audit should never be taken lightly. While the purpose of an audit is to gauge the financial integrity of the plan, a good audit will review plan terms, plan investments, distribution of benefits, participant loans, potential prohibited transaction, discrimination testing, and timeliness of contributions among other major issues for review. A good audit firm will be through in their review and may identify mistakes made by the TPA, financial advisor, or ERISA attorney. A mediocre audit firm will make short shrift of the audit process and let mistakes pass. I recall one plan sponsor that had participants fail to make quarterly payments on a loan. What the TPA and the audit firm should have treated as a defaulted loan, deemed distribution, and a taxable event that was ignored. It was discovered by the Internal Revenue Service on their audit and the plan sponsor was penalized an amount that the TPA and audit firm eventually ended up eating.

It should be noted that one way a plan sponsor can curb the expense of plan audits without sacrificing quality is the use of a limited scope audit. While most plan audits are full scope audit, a limited scope audit is when the audit firm does not perform the audit of investments (valuation and existence) and plan-level investment activity. This limited scope exception is only allowed when a trust company serves as the plan's trustee and the trust company certifies its own asset statements. So while the use of a corporate trustee does not reduce the plan sponsor's liability, it can reduce the cost of an audit since a limited scope audit is less expensive than a full scope.

An audit is about the financial integrity of the plan, its is to verify that the assets are there where the plan sponsors says they are and to identify controls in place to safeguard those assets. Audits do not guarantee that the plan's administration is perfect and it certainly does not determine whether plan expenses are reasonable or not. There may be audit firms that determine whether fees are reasonable or not or may work in tandem with an ERISA attorney to root out day to day issues, but these services would be an addition to the ordinary audit. An audit is about the financial integrity of the plan; it is no form of any fiduciary warranty against plan defects.

The only mistake in picking an audit firm is rather simple. Basing the decision to hire an audit firm on price without reviewing their capabilities in performing retirement plan audits is a mistake that may cost thousands of dollars in penalties later down the line. Picking a CPA firm with a well experienced audit practice can only help the plan sponsor carry out their fiduciary responsibility, as well as minimizing liability because of the thoroughness of its work in identifying plan errors. A plan sponsor should never compromise on hiring a quality audit firm.

THE ROSENBAUM LAW FIRM P.C.

The Rosenbaum Law Firm P.C.
734 Franklin Avenue, Suite 302
Garden City, New York 11530
(516) 594-1557

http://www.therosenbaumlawfirm.com
Follow us on Twitter @rosenbaumlaw