# Single-Employer and Cost-Sharing Multiple-Employer Plans: Issues Associated with Testing Census Data in an Audit of Financial Statements



## Introduction and Purpose

The AICPA State and Local Government Expert Panel (SLGEP) has been engaged in numerous discussions regarding the auditing issues facing both governmental employers (employers) that participate in single-employer and cost-sharing multiple-employer defined benefit pension plans (single-employer and cost-sharing plans), as well as plans themselves.

The purpose of this whitepaper is to address the role of census data in single-employer and cost-sharing plan financial statements and the plan auditor's responsibility for such census data. Single-employer and cost-sharing plans are covered together in this whitepaper because they have similar reporting and disclosure requirements. This whitepaper addresses the responsibility of the cost-sharing plan to obtain all necessary information and the plan auditors to obtain sufficient appropriate evidence regarding the completeness and accuracy of all census data underlying certain financial statement elements of the plan.

A separate whitepaper titled, *Governmental Employer Participation in Cost-Sharing Multiple-Employer Plans: Issues Related to Information for Employer Reporting*, has been prepared by the AICPA SLGEP and addresses issues related to how employers participating in cost-sharing plans obtain all necessary information to properly recognize and disclose pension amounts in their financial statements and how their auditors obtain sufficient appropriate evidence to support their opinions on the employer financial statements.

## AICPA SLGEP Guidance

Currently, there is no specific guidance as to single-employer or cost-sharing plan auditors' responsibility over census data in the AICPA Audit and Accounting Guide, *State and Local Governments* (SLG Guide). In light of the new GASB pension standards, the AICPA SLGEP has developed the following guidance that will be incorporated into a future edition of the SLG Guide.

**Census Data: Single-Employer and Cost-Sharing Plans**

Certain financial statement assertions of single-employer plans (that is, total pension liability) and cost-sharing plans (that is, total pension liability, contribution revenues, and contribution receivables) are dependent on the completeness and accuracy of census data. The auditor's consideration of the relevant financial statement assertions dependent on census data begins with understanding the processes and controls used by management of the plan to support the completeness and accuracy of the census data that is ultimately provided to the actuary. This would include the processes and controls over significant elements of census data received from participating employers on active employees as well as the census data controlled by the plan which typically include inactives and retirees. Significant elements of census data may include: date of birth; date of hire or years of service; marital status; eligible compensation; class of employee; gender; date of termination or retirement; spouse date of birth; and employment status (active, inactive, retired). The following discussion is provided to assist auditors as they consider management processes and controls surrounding census data.

**Plan Management's Responsibility for Completeness and Accuracy of Census Data**

Management of single-employer and cost-sharing plans is responsible for the preparation and fair presentation of the financial statements in accordance with the applicable financial reporting framework, including completeness and accuracy of census data. Management is also responsible for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to error or fraud.

Effective management processes over census data separately identify the applicable risk of error related to the significant elements of census data for the various individual plan participants because the risks may differ depending on whether a participant is active, inactive, or retired. Accordingly, management of the plan would likely have different controls to address the applicable risks for active, inactive, and retired employees. For example, eligible compensation is more likely to be a significant element of census data for active employees because of the risk of error for reporting compensation directly impacts the calculation of the total pension liability. Conversely, eligible compensation would not be a significant element of census data for inactive employees or retirees as they are no longer earning wages. Therefore, management would likely have more robust processes and controls related to active employees for this element.

Effective plan management processes for the census data of active employees of a plan include procedures to verify the underlying payroll records of the participating employers to determine that the information provided is accurate and complete. The frequency and extent of such verification may be determined by the plan based on the assessed level of risk of error for each of the participating employers.

**Internal Control Considerations by Single-Employer and Cost-Sharing Plan Auditor When Effective Management Process Lacking**

The absence of effective management processes and controls by the plan to sufficiently address the appropriate risks and verify the underlying payroll records of participating employer census data in a single-employer or cost-sharing plan is a deficiency in internal control over financial reporting. The plan auditor should follow the guidance contained in AU-C 265, *Communicating Internal Control Related Matters Identified in an Audit,* when evaluating the implications of control deficiencies and whether they should be communicated to those charged with governance.

**Cost-Sharing Plan Auditor's Responsibility for Testing Completeness and Accuracy of Census Data**

To provide a basis for designing and performing audit procedures over the total pension liability, contribution revenue, and contributions receivable including census data, the auditor should identify and assess the risks of material misstatement of these elements. For this purpose, the auditor should:

1. Obtain an understanding of the processes and controls used by the plan's management to support the completeness and accuracy of census data provided to the actuary.

2. Consider the likelihood of misstatement and whether the potential misstatement is of such a magnitude that it could result in a material misstatement of the total pension liability, contribution revenue, or contributions receivable.

The nature, timing, and extent of substantive procedures to be performed by the auditor over the census data and the underlying payroll records of employers will depend on the assessed risk of material misstatement of the relevant elements and whether management has effective processes to determine the completeness and accuracy of census data provided to the actuary. In any event, in order to obtain sufficient appropriate audit evidence, it is necessary to select a representative group of contributing employers each year on a rotating basis for testing underlying payroll records of employees who are potentially eligible for participation in a cost-sharing plan. Ordinarily, it is more efficient for the auditor to take a control based approach to testing census data and the underlying payroll records of the employers when management has effective processes and controls over the census data.

When planning substantive testwork, the auditor of the cost-sharing plan uses judgment in determining which employers, if any, represent individually important employers to be directly tested at the employer's site annually and separated from the remaining population that is to be tested on a rotating basis. For example, an auditor may decide that any employer that constitutes more than 20 percent of the covered payroll will be considered individually important. Based on the composition of many plans, there may not be any individually important employers or they will likely be limited to one or two.

Once individually important employers have been identified, a risk-based approach may be used to determine which of the remaining employers to select for testing.

The auditor may find the following qualitative factors helpful when selecting employers to test:

- The size of the employer in relation to a plan;
- Past errors or control deficiencies of an employer;
- Length of time since procedures under this section were last performed at an employer;

- Whether there have been significant changes in the workforce of an employer;
- Results of internal analysis (analytical procedures) of employer information;
- New or terminating employer; and
- Whether the financial statements of participating employers are audited and have received unmodified opinions.

The frequency of procedures to be performed by the plan auditor at each employer will depend on the number of employers participating in the plan, the relative size of each employer, and the individual risk assessments. However, note that there often may be circumstances for which employers are not tested as part of such a cycle because they are relatively small and considered to be inconsequential to the plan, both individually and when aggregated with other small employers not subject to testing.

The level and extent of testing depends on whether the plan has effective controls over census data reported by employers to the plan, including a plan management process for verifying the underlying payroll records of the participating employers to determine that the information provided is accurate and complete. Auditor judgment will be needed to determine the approach used to select the employers for the purpose of testing underlying payroll records.

For example, the auditor may develop an approach such that employers representing at least five percent of the participating employees are directly tested at the employer's site at least once every five years. The number of participating employers that individually meet the five percent criteria will vary by plan and in some cases be limited to just a few. The auditor's approach for directly testing the remaining population of participating employers at their sites, which for some plans could number in the thousands, could be such that the remaining participating employers are tested on an approximate 10-year cycle.

Under such a risk-based approach, if the plan auditor cannot or does not perform site visits to directly test census data at each employer selected for testing, such census data could be tested by the employer's auditor as part of an examination engagement in accordance with AT section 101, *Attest Engagements* (AICPA, *Professional Standards*). The plan auditor could then use such examination engagements as substantive evidence in lieu of directly performing the procedures, assuming such engagements are designed to encompass the completeness and accuracy of the census data and the selection of employers subject to the examination engagements, are determined by the plan auditor.

When examination engagements on census data are performed by employer auditors, the plan auditor would still have to determine if there is sufficient reliable evidence over the completeness and accuracy of the census data underlying the plan's financial statement amounts.

As for the census data related to inactive employees and retirees, the plan auditor can directly test records maintained by the plan to obtain sufficient appropriate evidence that the census data reported for inactive employees and retirees to the actuary is correct.

**Exhibit 1: Illustration of Above-Described Cost-Sharing Plan Auditor's Risk-Based Approach**

> Consider a plan with 3,000 participating employers for which the auditor has determined that plan management has effective processes and controls to determine the completeness and accuracy of census data. Based on the number and relative size of the participating employers, as well as a low assessed risk of material misstatement, the auditor determines that one employer constitutes more than 20 percent of covered payroll and is individually important. Accordingly, this employer will be tested on an annual basis. Six employers are at least five percent of covered payroll and will be tested to approximate a five year cycle. The auditor then determines there are 400 very small employers that will never be tested because they represent less than two percent in the aggregate of the total covered payroll. The remaining employers (that is, 2,593) that represent less than five percent of covered payroll will be tested to approximate a ten year cycle.

**Single-Employer Plan Auditor's Responsibility for Testing Completeness and Accuracy of Census Data**

To provide a basis for designing and performing audit procedures over the total pension liability, including census data, the auditor should identify and assess the risks of material misstatement of the total pension liability. For this purpose, the auditor should:

1. Obtain an understanding of the processes and controls used by the plan's management to support the completeness and accuracy of census data provided to the actuary and controls that have been established relative to the census data. For single-employer plans, there often is a close coordination with employer management and overlapping processes and controls between the plan and employer that should be evaluated in determining the effectiveness of the "collective" plan controls over census data.

2. Consider the likelihood of misstatement and whether the potential misstatement is of such a magnitude that could result in a material misstatement of the total pension liability.

Given the relative simplicity of a single-employer plan, the risk-based approach to testing census data of employers participating in cost-sharing plans does not apply to single-employer plans. As these plans only contemplate one employer, the auditor of the plan would work with the plan and related employer to obtain access to the underlying records of the active, inactive, and retired participants and test the underlying data of selected participants each year to obtain sufficient appropriate evidence that the census data reported to the actuary is correct.