STATEMENT OF
PATRICIA A. DALTON
DEPUTY INSPECTOR GENERAL
U.S. DEPARTMENT OF LABOR
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COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT
U.S. HOUSE OF REPRESENTATIVES

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Good morning, Mr. Chairman and Members of the Subcommittee. Thank you for inviting the Office of Inspector General (OIG) to discuss our oversight of the Department of Labor's (DOL) employee benefit plan activities, and specifically those issues raised by proposals to repeal the limited scope audit provision in the Employee Retirement Income Security Act (ERISA) and change the reporting requirements for plan auditors. I am here in my capacity as the Deputy Inspector General to present the views of the OIG, which may not necessarily concur with the views of the Department.

It is essential that employee benefit plans be afforded sufficient protections to ensure that participant assets are adequately protected and are available when individuals retire. The universe of benefit plan assets now exceeds $3.5 trillion. These assets are not under the supervision and control of one administrator, one agency, or one financial institution; nor do these plans rely solely on traditional investments such as mutual funds, stocks, and bonds. Since the passage of ERISA in 1975, these plans have become more diversified and complex, and have greatly expanded their choice of investment vehicles. Without additional safeguards, the potential for problems increases.

The OIG has a long-standing interest in this area. One of the goals in our five year strategic plan is Ato help workers and retirees by safeguarding workplace employment, unemployment and disability benefits and enhanc[e] the DOL's effectiveness in administering related programs.@ The OIG carries out this goal through its oversight of the activities of DOL's Pension and Welfare Benefits Administration (PWBA), by its review of proposed legislation and regulations, and by its criminal enforcement activities pursuant to our special labor racketeering authority.

Unless the government, pension plan administrators, and plan participants have accurate and sufficient information, it is difficult to know whether plan assets are properly protected. To ensure this protection, I am here today to testify in support of the repeal of the limited scope audit provision and the direct reporting of serious violations to DOL.

The Limited Scope Exemption

In 1989, the OIG reviewed ERISA's annual plan audit process. We concluded that significant changes were needed to increase protections for employee pension plan participants. Among other changes, we recommended the repeal of ERISA Section 103(a)(3)(C), which allows plan administrators to elect, under certain conditions, to have plan assets excluded from audits conducted by independent auditors. PWBA concurred with our recommendation and, since 1989, we have continued to highlight this issue as a ASignificant Concern@ in many of our Semiannual Reports to Congress.

ERISA generally requires every plan with more than 100 participants to obtain an audit of the plan's financial statements each year. The audit report must be sent to DOL and made available to the plan's participants. ERISA Section 103(a)(3)(C) permits the plan's administrator to exclude from this audit any of the plan assets held in Aa bank or similar institution or insurance carrier regulated by a State or Federal agency.@ This exclusion was placed in ERISA under the presumption that assets held in these institutions have already been audited and are therefore Asafe.@

However, this presumption may not always be true. Problems have existed and may continue to exist in banks and financial institutions. The savings and loan crisis made all Americans painfully aware of what can go wrong in financial institutions. We have seen reports about banks which have misvalued, misdirected, or made inappropriate investments of plan assets. Despite Federal and State regulations and oversight, transactions can and do go astray in financial institutions.

Accordingly, the limited scope exemption has two negative ramifications: first, the plan auditor does not examine all the assets of ownership, valuation and existence; and second, because this exclusion of audit coverage is generally significant, the plan auditor declines to give or Adisclaims@ an opinion on the plan's financial statements. The wording generally used is A. . . because of the significance of the information that we did not audit, we are unable to, and do not, express an opinion on the plan's financial statements. . . .@

Beyond excluding assets in banks and financial institutions, the limited scope audit provision exacerbates audit quality problems. Generally Accepted Audit Standards require that, even in limited scope audits, the auditor perform some testing in the areas that are not excluded from the audit scope. However, in our 1989 audit we found that, in some plan audits, no testing was done since a disclaimer of audit opinion was going to be issued anyway. The approach taken seemed to be one of why do additional work when no assurances are going to be provided.

In 1992, the General Accounting Office (GAO) examined many of the same issues covered in our 1989 audit and issued a report that fully supported our findings and recommendations. The GAO specifically agreed that Congress should repeal the limited scope audit provision to better protect plan participants. The GAO stated that a limited scope audit Adiminishes the value of the audit and may confuse statement users. Also, there is no reason to believe that these [plan] assets are not vulnerable.@

More recently, in 1996, PWBA performed a followup study and issued another report confirming the findings of both our 1989 audit and GAO's 1992 report. PWBA's report reiterated the need to eliminate the limited scope audit provision and concluded that the failure to understand the limited scope audit exception was a common factor affecting audit quality. Their review found instances where auditors performed almost no audit work. In these cases PWBA also concluded that the users

of the plans financial statements had virtually no assurances with respect to the financial operation of the plan.

Mr. Chairman, the limited scope exemption results in a significant exclusion of audit assurances. At the present time, approximately $1 trillion in employee benefit assets are excluded from plan audits. Eliminating the limited scope exemption will not guarantee that all covered plan assets will be 100% protected. However, OIG, PWBA, and GAO have all agreed that it will permit more effective scrutiny and oversight of these funds and decrease the potential for fraud and mismanagement.

Since our recommendation in 1989, PWBA has made a conscientious effort to have ERISA Section 103(a)(3)(C) repealed. However, this has not occurred, and I will now address some of the arguments made in opposition to this change.

Increased Burden Associated with Full Scope Audits

Some employee benefit plan specialists have contended that requiring full scope audits will cause an undue reporting burden on small businesses. Other interested parties have also expressed concerns that if Congress repeals ERISA's limited scope audit provision and plans are subjected to full scope audits, the process will become burdensome.

We have carefully considered these concerns. ERISA does not require plans with less than 100 participants to obtain an audit. According to PWBA's 1997 Private Pension Plan Bulletin, there were 702,097 private pension plans in America. Of these, 641,410 (91 percent) had less than 100 participants. Repealing the limited scope audit provision will not affect 91 percent of the pension plans. In particular, repeal will not affect small business pension plans, but will affect only the larger plans.

However, increased audit coverage for 9 percent of the pension plans will increase coverage of 88 percent of the nation's pension plan assets and improve protections for 90 percent of the nation's pension plan participants, retirees and beneficiaries. We believe full scope audits for these large plans are well worth the additional burden.

Impact of Full Scope Audits on Banks and Financial Institutions

A major concern of banks and financial institutions is the intrusion of additional auditors into their business operations. We believe this concern has some justification. Fortunately, America's business community and the American Institute of Certified Public Accountants (AICPA) have already developed and implemented the solution to this problem. The AICPA has issued a pronouncement, Statement on Auditing Standards (SAS) 70, which allows two groups of auditors, auditing financially interrelated companies, to rely on each other's work without duplication. This pronouncement, which was effective in March 1993, sets forth the professional requirements an auditor must meet and the reporting standards an auditor must follow when relying on another auditor's work. Most important, SAS 70 will allow an employee pension plan auditor to accomplish a full scope audit and issue a full

opinion while relying, when possible, on the audit work already accomplished by the financial institution's auditors. In general, the plan auditors should not need to intrude into the financial institution. The plan auditor and the financial institution auditor simply need to talk and share their work.

We recognize that this will require greater coordination and communication between plan and financial institution auditors and that SAS 70 does require plan auditors to take certain steps to ensure that financial institution's auditor's work can be relied upon. However, SAS 70, when adhered to, will allow full exchange of audit work and reduce auditors' intrusion into banks and financial institutions.

Increased Costs from Full Scope Audits

The cost of a full scope audit as compared to a limited scope audit is not and should not be an issue in protecting the American workers' employee benefit plan assets. Each of the 61,000 large employee pension plans are already paying for annual plan audits. Participant contributions to the plans fund these audits; yet, these audits do not provide adequate assurance of the correct valuation, actual existence or proper ownership of the plan's assets, or potentially uncover false statements contained in the plan's representations.

Assuming the plan's auditors are able to rely on the work of the financial institution's auditors, a significant increase in audit costs would not be expected. Several years ago, the AICPA estimated that if a plan, currently audited on a limited scope basis, were audited on a full scope basis, the overall increase in costs would be 10 to 30 percent. The assurances given in a full scope audit make it worth the price, particularly when compared to getting no opinion in a limited scope audit.

Reporting Serious Violations to DOL

In connection with its 1989 audit and recommendation to repeal the limited scope audit, the OIG has also recommended that independent public accountants (IPAs) and plan administrators be required to report potential serious ERISA violations directly to DOL. Currently, IPAs are required to report potential violations only to plan administrators, who have no direct reporting requirement themselves to the Department. As you might imagine, IPAs often have little incentive to report possible violations for fear of losing future plan audit work.

Requiring IPAs to report potential violations to DOL would alleviate this problem and would involve accountants in the kind of active role they are supposed to play in the safeguarding of pension assets by providing a first line of defense to plan participants. I would point out that the Securities and Exchange Commission (SEC) recently adopted rules, pursuant to statutory instructions, that require auditors to report a client's uncorrected illegal acts to the client's board of directors and then to the SEC if the board does not do so itself. The same requirements should apply to IPAs for benefit plans.

Conclusion

The OIG is committed to effective oversight of PWBA as well as the detection and prevention of fraud in employee benefit plans. Full scope audits of benefit plan assets will neither duplicate oversight work, increase costs dramatically, create an undue burden on small business, nor create additional bureaucracy. The OIG fully supports the repeal of the limited scope exemption.

Mr. Chairman, this concludes my prepared statement, I would be pleased to answer any questions that you or the other Subcommittee Members may have.