U.S. Department of Labor

Office of Inspector General—Office of Audit

EMPLOYEE BENEFITS SECURITY ADMINISTRATION

CHANGES ARE STILL NEEDED IN THE ERISA AUDIT PROCESS TO INCREASE PROTECTIONS FOR EMPLOYEE BENEFIT PLAN PARTICIPANTS

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U.S. Department of Labor
Office of Inspector General
Office of Audit

BRIEFLY…

Highlights of Report Number 09-12-002-12-121, issued to the Assistant Secretary for Employee Benefits Security.

WHY READ THE REPORT

The Employee Retirement Income Security Act of 1974 (ERISA) is the primary federal law governing private sector employee benefit plans. ERISA requires that most large employee benefit plans use an independent qualified public accountant (IQPA) to audit the plan's financial statements in accordance with Generally Accepted Auditing Standards. For plan year 2010, the most recent complete year available, about 84,000 plans filed audited financial statements with EBSA, representing 93 million participants and $5.7 trillion in assets.

The Department of Labor's (DOL) Employee Benefits Security Administration (EBSA) has the responsibility to ensure these audits meet ERISA requirements. One problem is that ERISA allows limited scope audits, which means the auditor does not need to audit plan asset information if the assets are held and certified by certain financial institutions. Since the auditor does not test asset information certified by the financial institution, the auditor disclaims an opinion on the plan's financial statements, providing no assurances to participants or beneficiaries on the reliability of the plan's financial statements.

As far back as 1984, reviews by DOL's Office of Inspector General (OIG), the U.S. Government Accountability Office (GAO), and EBSA have shown that ERISA audit requirements need changing. In fact, OIG and GAO have recommended EBSA seek repeal of limited scope audits, obtain authority over plan auditors, and improve oversight of employee benefit plan audits. To address these issues, EBSA established an Office of Chief Accountant (OCA) in 1989 to monitor and improve the quality of employee benefit plan audits and to identify and correct substandard audits.

WHY OIG CONDUCTED THE AUDIT

We conducted this audit to determine if EBSA's oversight of ERISA audits had improved audit quality and increased participant protections.

READ THE FULL REPORT

To view the report, including the scope, methodology, and full agency response, go to:

http://www.oig.dol.gov/public/reports/oa/2012/09-12-002-12-121.pdf.

September 2012

Changes Are Still Needed in the ERISA Audit Process to Increase Protections for Employee Benefit Plan Participants

WHAT OIG FOUND

Despite EBSA's significant efforts to improve oversight and audit quality, protections and assurances have decreased over time for participants and beneficiaries. EBSA's improvement efforts have included working with the AICPA to establish an audit quality center that provides guidance and education, redesigning its targeting methods to identify and correct substandard plan audits, and providing training and outreach activities for plan auditors. However, these efforts have been offset by plan administrators' increased use of limited scope audits and a significant growth in asset value of plans subjected to limited scope audits. The percentage of plans electing limited scope audits has grown from about 46 percent in 1987 to approximately 70 percent in 2010. The reported value of assets excluded from plan audits has similarly grown from about $520 billion (43 percent) in 1989 to $3.3 trillion (58 percent) in 2010.

While the use of limited scope audits is a major obstacle in providing audit protections for plan participants, EBSA could have done more within the existing law to improve audit quality. Specifically, EBSA could have: 1) used existing authority to clarify and strengthen limited scope audit regulations and formally evaluated recommendations by the ERISA Advisory Council for improving limited scope audits; 2) made better use of available enforcement tools over IQPAs, even though EBSA lacked the legal authority to prevent IQPAs from conducting substandard audits; 3) improved procedures in its reviews of IQPAs to ensure that audits met professional standards; and 4) completed a statistically valid reassessment of overall employee benefit plan audit quality since it had not completed one since 2004, and as a result cannot statistically demonstrate if audit quality has improved since that time.

WHAT OIG RECOMMENDED

We recommended the Assistant Secretary for Employee Benefits Security continue to seek repeal of the limited scope audit exemption and obtain authority over plan auditors. We also recommended that in the interim, EBSA: (1) use existing authority to clarify and strengthen limited scope audit regulations and evaluate the ERISA Council recommendations, (2) make better use of available enforcement tools over IQPAs, (3) improve procedures in audit quality reviews, and (4) perform a reassessment of audit quality.

EBSA generally agreed with our recommendations. EBSA also agreed to further examine its authority and guidance under limited scope audits, additional enforcement tools over IQPAs, and the merits of conducting another reassessment of audit quality.

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U.S. Department of Labor

Office of Inspector General
Washington, D.C. 20210

September 28, 2012

Assistant Inspector General's Report

Phyllis C. Borzi
Assistant Secretary
for Employee Benefits Security
U.S. Department of Labor
200 Constitution Avenue, NW
Washington, DC 20210

The Employee Retirement Income Security Act of 1974 (ERISA) is the primary federal law governing the investment of assets in private sector employee benefit plans. ERISA requires most large employee benefit plans to obtain annual audits of their financial statements by independent qualified public accountants (IQPA). The Department of Labor's (DOL) Employee Benefits Security Administration (EBSA) has the responsibility to ensure these audits meet ERISA requirements to help protect participant and beneficiary benefits. For plan year 2010, the most recent complete year available, about 84,000 plans filed audited financial statements with EBSA, representing 93 million participants and $5.7 trillion in assets.

In 1990, EBSA's Office of Chief Accountant (OCA) started a program to improve the quality of ERISA audits through oversight, education, and outreach. In that regard, we conducted an audit to answer the following question:

> Has EBSA's oversight of ERISA audits improved audit quality and increased participant protections?

SCOPE AND METHODOLOGY

We reviewed professional standards, applicable regulations, and EBSA policies and procedures. We also reviewed a sample of OCA examinations of IQPA audits from FYs 2008 through 2011. We interviewed officials from EBSA, the American Institute of Certified Public Accountants (AICPA), the Pension Benefit Guarantee Corporation (PBGC), and met with employee benefit plan experts as well as a member of the ERISA Advisory Council to gain an understanding of the employee benefit plan audit process, EBSA oversight, and plan audit quality standards.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. We have detailed our objective, scope, methodology, and criteria in Appendix B.

RESULTS IN BRIEF

Despite EBSA's significant efforts to improve ERISA audit quality, protections have decreased over time for plan participants and beneficiaries. EBSA's improvement efforts have included working with the AICPA to establish an audit quality center that provides guidance and education, redesigning its targeting methods to identify and correct substandard plan audits, and providing training and outreach activities for plan auditors. However, these efforts have been offset by increased limited scope audits and continuing lack of EBSA's legal authority. We also concluded that EBSA could make improvements in its audit quality reviews.

We did not determine whether audit quality has improved because EBSA has not performed a reassessment of overall employee benefit plan audit quality since 2004. Instead, we are recommending EBSA assess audit quality to measure its program effectiveness.

Limited Scope Audits

ERISA allows the use of limited scope audits, meaning plan administrators can instruct plan auditors to not audit plan asset information certified by certain financial institutions. This limits the scope of plan audits, resulting in less audit testing and prevents plan auditors from providing assurances to plan participants and beneficiaries regarding their plan's financial statements. The limited scope audit exemption presents challenges for plan administrators to report plan investments correctly at current value[1] in accordance with ERISA requirements since IQPAs do not audit the values. Without an audit, plan administrators do not always make the effort to ensure they present the plan's assets at current value as required by ERISA.

Since 1984, we have recommended EBSA seek legislative repeal of limited scope audits. EBSA has supported this recommendation and made several proposals to Congress to repeal the limited scope audit provision. Congress has not acted on any of these proposals and has not repealed the provision. EBSA has not formally sought repeal since 1997.

The lack of protections provided by limited scope audits have extended to more participants and more plan assets in recent years. The percentage of plans using limited scope audits has grown from about 46 percent in 1987 to about 70 percent in 2010. The

[1] Section 3(26) of ERISA states, "The term 'current value' means fair market value where available and otherwise the fair value as determined in good faith by a trustee or a named fiduciary (as defined in section 402(a) (2)) pursuant to the terms of the plan and in accordance with regulations of the Secretary, assuming an orderly liquidation at the time of such determination."

reported value of assets excluded from plan audits has similarly grown from about $520 billion (43 percent) in 1987 to $3.3 trillion (58 percent) in 2010, the most current information at the time we began our audit.

While the use of limited scope audits is a major obstacle in providing audit protections for participants and beneficiaries, EBSA has not taken all appropriate actions within the existing law. Specifically, EBSA has not ensured that, in limited scope audits, plan administrators present the current value for plan investments, as ERISA requires. In addition, while the ERISA Advisory Council studied limited scope audit issues and made recommendations to clarify and amend limited scope regulations, EBSA has not formally evaluated these recommendations, citing other priorities for its regulatory process.

Lack of Legal Authority Limits Monitoring and Enforcement

EBSA continues to lack the legal authority to oversee IQPAs. Without this authority, EBSA can only refer IQPAs to the AICPA and/or State Boards of Accountancy. Since 1984, we have recommended that EBSA seek a congressional change to ERISA to allow EBSA to oversee IQPAs directly. With this authority, EBSA could better prevent IQPAs that EBSA finds performing audits that do not meet professional standards from continuing to perform employee benefit plan audits. EBSA has agreed with this recommendation and made several proposals to Congress to obtain this authority. Congress has not acted on these proposals to provide EBSA the requested authority, and EBSA has not sought this additional authority since 1997.

If EBSA obtained authority to regulate and enforce ERISA standards on IQPAs, it could save significant resources directed at targeting and monitoring deficient audits. Historically, the highest risk for deficient audits was in audits performed by less experienced firms: generally those that perform less than 25 employee benefit audits per year. This group of firms historically produced more deficient audits than firms performing more plan audits per year. For FYs 2010 to 2011, EBSA spent 70 percent of its reviews on these firms; yet, these firms audited less than 25 percent of the $5.7 trillion in plan assets. Additionally, sometimes EBSA must monitor the same firms year after year. If EBSA could require these firms to obtain better training before performing plan audits and enforce sanctions if these firms did not meet professional standards, EBSA could spend less time on targeting and monitoring these inexperienced or less trained firms.

Despite EBSA's lack of legal authority, there are monitoring tools it could have been using to help improve audit quality. For example, EBSA could have published the names of IQPAs that repeatedly performed substandard work, deterring them from continuing to perform poorly.

EBSA's Review Procedures for IQPAs

EBSA's reviews did not always sufficiently document that IQPA audits met professional standards. EBSA did not specifically require reviewers to document procedures in each of the office's review guide or document why certain procedures were not performed. Further, even when the reviewers performed all procedures, the review guide did not cover all audit requirements. We found for seven percent of sampled cases, EBSA reviews did not adequately document applicable review procedures and did not document why certain procedures were not performed. We also found, EBSA's review guide did not specifically address audits in which the plan custodian certified some, but not all, plan assets in limited scope audits. As a result, EBSA accepted audit work that may have contained deficiencies that could have adversely affected participant and beneficiaries' retirement benefits.

EBSA's Reassessment of Audit Quality

EBSA has not performed a reassessment of overall employee benefit plan audit quality since 2004. In that study, as well as in one performed in 1997, EBSA conducted statistically valid reviews of employee benefit plans as a means of measuring whether overall audit quality had improved. These reviews provided EBSA management important information on the effectiveness of EBSA's oversight of IQPAs and provided data on where audit quality problems were occurring. Since EBSA has not performed such a review since 2004, it cannot statistically demonstrate if audit quality improved since that time.

RECOMMENDATIONS

We recommended the Assistant Secretary for Employee Benefits Security continue to seek repeal of the limited scope audit exemption and obtain authority over plan auditors. We also recommended that in the interim, EBSA: (1) use existing authority to clarify and strengthen limited scope audit regulations and evaluate the ERISA Council recommendations, (2) make better use of available enforcement tools over IQPAs, (3) improve procedures in audit quality reviews, and (4) perform a reassessment of audit quality.

EBSA RESPONSE

In response, EBSA generally agreed with the findings and recommendations in the report. EBSA stated that it has made consistent and comprehensive efforts to improve audit quality and those efforts have evolved over time and been adapted to take into account the size of the filing universe and the resources available. EBSA also stated it had long advocated statutory reform because several statutory provisions of ERISA limit the Secretary's ability to combat audit quality deficiencies.

Specifically, EBSA agreed with the recommendations to continue to seek repeal of the limited scope audit exemption and obtain authority over plan auditors. EBSA stated it did not have the authority by regulation to eliminate limited scope audits but would examine what authority it did have to clarify and strengthen the limited scope audit regulations. EBSA also stated it would examine related guidance for plan administrators and auditors in the areas described in the audit report and in the recommendations of the ERISA Advisory Council. EBSA also agreed to evaluate OIG's suggestion that it advise plan administrators of the potential for fiduciary breaches from selection of QPAs known to produce deficient audits and to consider the other suggestions in the report regarding enforcement tools. Finally, EBSA stated it would evaluate the merits of another statistically-based reassessment of audit quality as it developed future work plans.

The Assistant Secretary’s entire response is contained in Appendix D.

OIG Conclusion

We concur with EBSA’s proposed corrective actions but will wait until definitive actions are determined and implemented to evaluate actual corrective actions taken and to close recommendations.

RESULTS AND FINDINGS

Objective — Has EBSA’s Oversight of ERISA Audits Improved Audit Quality and Increased Participant Protections?

EBSA Needs to Take Further Actions to Mitigate The Decrease in Protections For Employee Benefit Plan Participants

Finding 1 — EBSA Needs to Take Additional Actions to Increase Protections for Employee Benefit Plan Participants

Despite EBSA’s efforts to improve ERISA audit quality, protections and assurances have decreased over time for plan participants and beneficiaries. EBSA has taken significant actions including working with the AICPA to establish an audit quality center that provides guidance and education, redesigning its targeting methods to identify and correct substandard plan audits, and providing training and outreach activities for plan auditors. However, the increased use of limited scope audits and continuing lack of legal authority that limits EBSA’s enforcement have offset these efforts to improve participant protections. We also concluded that EBSA’s audit quality review procedures were incomplete.

We did not determine whether audit quality has improved because EBSA had not conducted an overall assessment of audit quality since 2004. Instead, we are recommending EBSA assess audit quality to measure its program effectiveness.

Limited Scope Audits Continue to Provide Inadequate Protections for Plan Participants and Beneficiaries

ERISA section 103(a)(3)(c) allows the plan administrator to instruct the auditor not to perform any auditing procedures with respect to investment information prepared and certified by a bank or similar institution or by an insurance carrier who acts as trustee or custodian and is regulated, supervised, and subject to periodic examination by a State or Federal agency. The election is available, however, only if the trustee or custodian certifies both the accuracy and completeness of the information submitted.

When the plan administrator elects a limited scope audit, the IQPA has no responsibility under Generally Accepted Auditing Standards (GAAS) to test the accuracy or completeness of the investment information certified, obtain an understanding of internal control maintained by the certifying institution over investments held, or assess control risk associated with assets held and transactions executed by the institution. The legislative intent for the rule was to exempt institutions that were already regulated and examined by a Federal or State agency from duplicative audits. However, it has been shown that, since 1974, supervision and examination by Federal and State agencies have decreased significantly, the audit effort would not be duplicative of audits by federal or state oversight agencies, and that these institutions are subject to abuse and mismanagement as well.

<u>Repeal of the Limited Scope Audit Exemption</u> - Since 1984, we have recommended repeal of the limited scope audit provision because we believe that this provision no longer serves the purpose intended and increases risk of loss to plan participants and beneficiaries. This is because: (a) there is minimal audit coverage to be duplicated; (b) assets held by banks and similar institutions have been subject to abuse and mismanagement and, therefore, need to be included in plan audits; (c) limited scope audits do not include an opinion from the auditor regarding the reliability of the financial statements and are of limited use to DOL, plan participants and beneficiaries; and (d) a very significant amount of plan assets are not audited.

According to EBSA, banks and other financial institutions have also expressed concern about the burden of having numerous plan auditors performing audit work on them. However, if the limited scope audit provision was eliminated, financial institutions could use a report many currently have, *Report on Controls at a Service Organization Relevant to User Entities' Internal Control over Financial Reporting* (SOC-1 reports), that is prepared in accordance with Statement on Standards for Attestation Engagements No. 16, *Reporting on Controls at a Service Organization.* Plan auditors can and do rely on these reports in lieu of having to visit financial institutions to perform audit work thereby eliminating the need for every plan auditor to visit every financial institution to perform audit work.

EBSA has agreed that the limited scope audit exemption should be repealed and in the past, has proposed changes to ERISA. However, Congress has not acted to make these changes and EBSA has not formally proposed eliminating the limited scope audit provision since 1997.

In recent years, several emerging issues make repeal even more critical. According to industry sources, in recent difficult economic times many plans have shifted assets into more complex, hard-to-value investments, such as limited partnerships, private equity funds, real estate, and hedge funds as a means to increase investment return. In addition, technology has substantially changed the accountability and transparency for pension plan assets held by financial institutions.

These investments present challenges to plan administrators and auditors in ensuring both the existence and valuation of these assets. In 1974 when Congress passed ERISA, stock certificates were still used and held to show asset ownership. Today, qualified financial institutions use clearinghouses, subsidiaries, and other third-party organizations to hold plan assets. Qualified financial institutions have only electronic book entries to show they are holding plan assets. However, the information for these electronic entries may come directly from clearinghouses or from brokers and other non-qualified institutions.

We selected a judgmental sample of 20 plans with limited scope audits and contacted the plans and the asset custodians to determine how the custodian actually held the assets and how the custodians accounted for them. Virtually none of the custodians held securities certificates, as they would have in 1974 when Congress passed ERISA. All accounted for the investment securities by electronic entries in records. In one case, “external” parties such as a broker dealer (a non-qualified institution) provided the information for the custodian’s record entries. These “external” parties provided year-end information to the qualified financial institution that then included the asset information on its certification. These assets included on the certification by the qualified financial institution escaped scrutiny under the limited scope audit exception.

These situations make verifying asset existence more critical to participants and beneficiaries interests but, under limited scope audits, verification of existence is not part of the plan auditor’s responsibility.

Today’s environment also makes valuation more difficult. Under limited scope audits, qualified institutions need only certify that their asset lists are complete and accurate as reflected in their records. However, for financial statement purposes plan administrators must show assets at current value. This means that plan administrators must determine the current value of assets – a task some plan administrators do not spend the time and effort to complete. In our sample of 20 plans contacted, 10 trustees/custodians stated that their certifications were not at current value. One major investment company with over $160 billion in retirement assets said their certification was only “complete and accurate,” but did not represent current value. Other examples of responses included stating that such investments as private equity investments, pooled funds, and other investments not publicly traded, were not shown at current value.

Therefore, the Form 5500s for the 10 plans may not have been presented in compliance with ERISA, and could be misleading to plan participants and beneficiaries. Further, these plans' financial statements could provide incorrect basis for external users, such as the PBGC and plan actuaries.

The repeal of the limited scope audit provision is more critical today than ever. The lack of protections provided by limited scope audits have extended to more participants and more plan assets in recent years. The percentage of plans electing limited scope audits has grown from about 46 percent in 1987 to approximately 70 percent in 2010. The reported value of assets excluded from audits has similarly grown from about $520 billion (43 percent) in 1987 to $3.3 trillion (58 percent) in 2010. Due to the continuing lack of assurances provided by limited scope audits, $3.3 trillion of plan assets with limited scope audits lack assurances as to their existence and valuation. With this amount of assets lacking assurances to participants of their existence and value, EBSA needs to renew its efforts to repeal the limited scope provisions of ERISA.

<u>EBSA Should Take Available Action Now</u> - There are actions EBSA should take relative to limited scope audits to improve protections for participants and beneficiaries within its existing authority.

Holding Assets - First, EBSA has not issued sufficient guidance on what control and accountability a financial institution needs to have over plan assets to be able to certify under ERISA. The holding of plan assets in 2012 bears little resemblance to the holding of assets in 1974 when ERISA was enacted, but EBSA has not issued any specific guidance on the control and accountability a custodian or trustee must have in order to provide a certification to a plan administrator. As a result, while qualified financial institutions may be certifying plan assets, those assets may not actually be in the control or accountability of an institution qualifying under ERISA.

As noted earlier, the legislative basis for allowing limited scope audits was that the assets held by banks, similar institutions, and insurance companies regulated and supervised by and subject to periodic examinations by a State or Federal agency were already subject to sufficient audit. However, in 1974 these financial institutions generally had more direct physical control and verification of existence of the actual asset. A major change in how investment ownership and custody were handled began in the early 1970's, about when ERISA was being developed. The major changes were not implemented until later, after Congress passed ERISA. Today, electronic records are all that trustees or asset custodians maintain. In most forms of investment, actually custody of plan investments in terms of certificates, etc., if any, lies with one of several clearinghouses.

The move to an electronic environment significantly changed the environment of the limited scope audit. Asset custody and ownership recording was shifted to clearinghouses. The clearinghouses provide electronic records of ownership to their clients. Qualified financial institutions rely on the clearinghouses for custody of an asset. The clearinghouses are part of the Federal Reserve System and may even be qualifying financial institutions themselves. This is the industry practice today, replacing the early ERISA days of assets supported with paper to today's electronic records.

However, we found that qualified financial institutions are not relying only on the clearinghouses for electronic information but are relying on electronic information obtained from non-qualifying institutions. In our judgmental sample of 20 limited scope audits, we found that 5 of the qualifying institutions providing certifications obtained the information they certified from brokerage firms and other non-qualifying institutions specifically not allowed under ERISA to provide asset certifications. For example, in one case, a qualifying institution certified to over $6 million of plan assets. However, the qualifying institution stated it obtained the information it certified from the plan's investment broker. The qualifying institution had very little, if any, control or accountability over the plan asset. The plan's broker bought and sold investments and dealt directly with the clearinghouses that had actual custody of the assets. It appears the brokerage, a non-qualifying institution, had accountability for the assets and just provided necessary information to the qualified institution, which certified the assets to the plan, contrary to what Congress envisioned under the limited scope audit exemption.

EBSA has not provided sufficient guidance to deal with the current practices regarding investment ownership and accountability. Existing guidance provides definitions of qualifying institutions and those authorized to certify asset listings. However, there is no guidance on what control or accountability is necessary for a financial institution to be considered holding the asset within the intent of the limited scope audit exemption.

As a result, certifications from qualifying financial institutions used as a basis for limiting the scopes of plan audits may not meet the intent of ERISA in allowing limited scope audits. If qualifying financial institutions are basing certifications on information from non-qualifying institutions, this nullifies the safety assumed in allowing limited scope audits, and plan participants and beneficiaries are inappropriately subject to risk of loss of their retirement benefits.

Valuing Assets in Limited Scope Audits – EBSA has not provided guidance and enforcement to plan administrators with regards to the use of financial institution certifications of plan assets in limiting the scope of an audit and obtaining and supporting the current value for plan investments. In addition, while the ERISA Advisory Council studied the issue of limited scope audits and made recommendations, EBSA has not formally evaluated recommendations made by the ERISA Advisory Council regarding limited scope audits.

Plan administrators using limited scope audits are not consistently presenting plan assets at current value in their financial statements as required by ERISA. Instead, plan administrators are using asset values from asset certifications provided by qualified financial institutions even though these certifications do not always represent current value. This is occurring because plan administrators do not fully understand their responsibilities under limited scope audits and EBSA has neither provided sufficient guidance nor enforced these ERISA requirements. As a result, plan administrators are not providing plan participants, beneficiaries, and external users of plan financial statements current value information on plan assets as required by ERISA.

In a 2002 letter to the AICPA, EBSA noted, based on their own review, that plan administrators might incorrectly assume that the certification provided for annual reporting purposes by financial institution represents the current value of the plan's assets. ERISA requires plan administrators to present plan assets at current value in their annual report and financial statements. Generally Accepted Accounting Principles (GAAP) specifies plan management is responsible for making the fair value measurements and disclosures included in the financial statements. As part of fulfilling its responsibility, management needs to establish an accounting and financial reporting process for determining the fair value measurements and disclosures, select appropriate valuation methods, identify and adequately support any significant assumptions used, prepare the valuation, and ensure that the presentation and disclosure of the fair value measurements are in accordance with GAAP.

Participants and beneficiaries use this information to evaluate the financial soundness of their plan and its performance from year to year. External parties, such as plan actuaries and the PBGC, also use the information in determining plan-funding issues, in monitoring plan financial health, and in taking over plans when necessary.

In full scope audits, IQPA's ensure that plan administrators present assets at current value. It is part of their audit testing to verify that plan assets are presented at current value and their audit opinion provides assurances that this has been done. However, the limited scope audit exemption presents challenges in the current environment for plan administrators to report plan investments at current value in accordance with ERISA requirements. The qualified financial institutions are only required to certify that the investment information is complete and accurate. It is the plan administrator's responsibility to ensure the presentation of the assets at current value. Without a full audit to verify this, plan administrators do not always take the necessary action to ensure they present the plan's assets at fair value.

For our sample of 20 limited scope audits, we asked the plan administrators to provide us with documentation of how they ensured they presented plan assets at current value. Half of plan administrators could not provide such documentation or explain how they assured themselves of current value. From these same plans, 10 trustees/custodians (one-half) stated that they did not show all of the assets certified at current value. While it is not the trustees'/custodians' responsibility to present current value, plan administrators are failing to establish an accounting and financial reporting process for determining and presenting the fair value of plan assets in accordance with GAAP and ERISA.

EBSA enforcement cases have also shown the failure of plan administrators to obtain and report plan assets at fair value. As part of its enforcement project initiatives from FY 2010 to 2011, EBSA's Office of Enforcement conducted investigations into plan valuations of hard to value investments such as real estate, collectibles, hedge funds, limited partnerships, and distressed investments. During this period, EBSA closed approximately 100 investigative cases involving hard to value investments and ERISA violations. About half of these cases had limited scope audits. The types of ERISA violations identified in these cases with limited scope audits included failures to obtain appraisals or valuations where appropriate.

The 2010 ERISA Advisory Council studied limited scope audits. The Council developed concerns similar to ours and submitted the following recommendations to the Secretary of Labor for consideration on limited scope audits:

- Clarify the kinds of entities that are qualified to issue certifications under existing regulations and guidance and reiterate that only qualified entities may issue certifications.

- Amend the limited scope audit regulations to require that the certification of investment information include a disclaimer that investment values may not have been subject to independent verification of fair value by the certifier.

- Require plan administrators to include any certification issued in connection with a limited scope audit in the plan's Form 5500[2] filing or other annual report.

- Issue informal education materials targeted to plan sponsors and plan auditors that would assist them in understanding their respective obligations with respect to limited scope audits.
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EBSA, however, has not formally evaluated the feasibility of implementing the ERISA council recommendations.

The existence and valuation of plan assets is critical to plan operations and has implications for defined contribution and defined benefit plans. One concern for a defined benefit plan is that overstating asset value could place a plan at risk of unknowingly being underfunded. Alternatively, if a value is too low, it would give rise to excessive deductible plan contributions. For a defined contribution plan, a proper valuation is essential to determine a participant's benefits when they are due to be paid and accurate annual and income tax reporting. The fair market value of plan assets is also important for Form 5500 reporting and forfeiture allocation. Since plan participants are paid on a regular basis based on the current value of their account's share of the plan assets, the plan must know how much is owed to each participant at the time of distribution.

[2] The 5500 Series forms are used by employee benefit plans to satisfy annual reporting requirements under ERISA and the Internal Revenue Code.

EBSA Continues to Lack the Legal Authority to Regulate IQPAs Performing ERISA Plan Audits

EBSA continues to lack the legal authority to oversee IQPAs. Under ERISA, as enacted by Congress in 1974, when EBSA identifies substandard audit work, EBSA can only reject the annual filing by the plan administrator and refer the IQPA to the State accountancy board and/or professional bodies for disciplinary actions. EBSA cannot prevent an auditor from doing employee plan audits or sanction an IQPA for repeatedly performing substandard audits.

Since 1984, the OIG has recommended EBSA propose changes to Congress to allow EBSA to oversee IQPAs directly and prevent poor performing IQPAs from doing audits on employee benefit plans by setting standards or authorizing sanctions. EBSA has agreed with this recommendation and has proposed changes to ERISA, but Congress has not acted to make the changes and EBSA has not proposed obtaining additional authority over plan auditors since 1997. As a result, it is difficult for EBSA to be effective in ensuring audit quality.

EBSA has spent a significant share of its resources on IQPAs that produced poor quality audits. EBSA's oversight in the past has shown that IQPAs with relatively less experience in auditing employee benefit plans generally have less training and competence in employee benefit plan audits. For FYs 2010 to 2011, EBSA focused more than 70 percent of its reviews on IQPAs that audited less than 25 employee benefit plans annually even though these IQPAs audit less than 25 percent of the $5.7 trillion in plan assets. Since EBSA cannot limit or prevent an IQPA from continuing to do employee benefit plan audits, EBSA has no choice but to devote resources where the risk of deficient audits is the highest.

Other entities with similar oversight responsibilities do not lack this authority. The Joint Board for the Enrollment of Actuaries (JBEA), the Securities and Exchange Commission (SEC), the Public Company Accounting Oversight Board, and the Internal Revenue Service each have oversight responsibilities similar to EBSA, but possess much greater enforcement powers to meet these responsibilities. All have sufficient authority to correct deficient work, require remedial action when necessary, or remove deficient professionals from doing work in their respective area of responsibility. By contrast, EBSA lacks comparable enforcement and oversight powers over its audit practitioners. For example, if the SEC finds substandard audit work, it has the authority to bar, censure, or suspend auditors from doing SEC related audits. The SEC also has the power to impose civil penalties in cease-and-desist proceedings directly against the auditor. These penalties range from $5,000 to $500,000. Similarly, the JBEA can suspend or remove from enrollment actuaries who do not comply with JBEA regulations.

With the effect on its resources and the risk of deficient audits, EBSA needs to renew its efforts to obtain additional authority over plan auditors. However, even without

Congress granting additional authority, there are enforcement tools EBSA could have used, some of which other Department of Labor agencies have used. For example:

- EBSA could have published the names of IQPAs that repeatedly perform substandard work to deter them from continuing to perform poorly. OSHA uses this practice in its Severe Violator Enforcement Program (SVEP). OSHA publishes the names of companies it considers severe violators and has established criteria for how companies get on OSHA's SVEP list, how long the companies stay on the list, and how the companies get off the list.

- EBSA could have reminded plan administrators in the rejection of their annual filings that they have fiduciary duties to act solely in the interests of plan participants and beneficiaries and that if a poor performing IQPA continued to be used and losses occurred, there was a potential for fiduciary breach of consequences. EBSA issues such letters in other areas of enforcement, advising plan administrators of potential fiduciary breaches.

Considering EBSA's lack of authority and the resources it spends on deficient IQPAs, EBSA needs to leverage whatever enforcement authority it has. This includes looking into other enforcement methods used within DOL and by outside agencies.

EBSA Should Improve Procedures in Audit Quality Reviews to Ensure that IQPA Audits meet Professional Standards

EBSA needs to improve its procedures for reviewing IQPA audits to help ensure IQPA audits meet professional standards. Specifically, EBSA needs to: (1) expand review procedures to include areas of professional standards not currently examined, and (2) complete all review procedures or document why reviewers did not perform all procedures. EBSA's review checklist did not include certain points of professional standards and EBSA did not believe it was necessary to document the reason the reviewer did not perform every procedure. However, as a result, EBSA is not detecting all deficiencies in IQPA reviews.

In 1990, EBSA's Office of Chief Accountant (OCA) initiated a program to identify and correct substandard ERISA audits in an effort to improve quality through oversight, education, and outreach. In performing quality reviews of IQPA audit documentation, EBSA used the AICPA audit guide for audits of employee benefit plans. This guide constitutes generally accepted auditing standards and IQPAs performing plan audits must follow the guide or be prepared to explain any deviations from it. For its purposes, EBSA developed a detailed checklist its reviewers could use as they went through IQPA audit work.

However, EBSA could improve this guide in two areas that could affect the reliability of IQPA audit work to ensure: (1) all plan assets were held and certified by the plans' financial institutions for limited scope audits, and (2) IQPA asset valuation testing meets generally accepted auditing standards.

Specifically, EBSA's could enhance its reviews of limited scope audits to include procedures to identify whether all plan assets were held and certified by the plan's financial institution, or if some plan assets were outside of the certification. Currently, EBSA procedures only verify whether the plan's financial institution is a qualified institution, but not whether the institution holds and certifies to all plan assets. Generally accepted auditing standards require IQPAs to test the existence and valuation of assets not included in certifications under limited scope audits. As a result, EBSA's review procedures may not detect all instances where limited scope audits cover assets not included in certifications from qualified financial institutions.

For example, in one case we found a plan's investment in limited partnerships, constituting more than five percent of the total assets, was not certified by the plan's qualified financial institution, and the IQPA did not perform sufficient testing of the partnerships. EBSA rejected the plan's Form 5500 filing; however, the work that was ultimately accepted could have included more substantive testing.

We also found that EBSA procedures did not include steps to ensure that IQPAs did not rely solely on client asset statements for valuation. Auditing Interpretations Section 332 (*Auditing Derivative Instruments, Hedging Activities, and Investments in Securities*), states that simply receiving a confirmation from a third party, either in aggregate or on a security-by-security basis, does not in and of itself constitute adequate audit evidence with respect to the asset valuation or existence.

In one of our sample cases, the IQPA performed a full scope audit engagement on a multi-employer defined benefit plan and rendered an unqualified opinion. The plan had invested about $2 million in a real estate fund that represented about 9.4 percent of the plan's total investments. When the IQPA performed testing on this real estate fund, the IQPA relied on an unaudited quarterly statement from the real estate company. In the IQPA audit documentation, the IQPA referred to obtaining this quarterly statement directly from the plan's investment advisor. In fact, this quarterly real estate statement specifically indicated that the results were unaudited. EBSA noted no deficiency in the adequacy of procedures performed by the plan's IQPA.

In addition, for two of the 28 (seven percent) full-scope cases sampled, EBSA's case file did not adequately document the procedures EBSA performed. For example, an EBSA review of a plan with $86 million in total assets did not specifically document which procedures in the investment section the reviewer performed. The plan invested $59 million (69 percent of total plan assets) in a group annuity contract offered by an insurance company. EBSA however, did not reference the insurance contract procedures contained in the investment section of its guide. As a result, EBSA accepted audits in which deficiencies could exist that could, in turn, adversely affect participant and beneficiaries' retirement benefits.

EBSA Should Complete a Reassessment of Audit Quality and Establish Measureable Programs to Determine if Audit Quality Has Improved

EBSA has not completed an assessment of overall employee benefit plan audit quality since 2004. EBSA management did not release the results of the last audit quality assessment and OCA did not feel additional assessments were cost effective if the results were not released or otherwise useable in public. Since EBSA has not performed such a review since 2004, it cannot demonstrate if its oversight program has been effective in improving audit quality from a statistical standpoint.

Prior to 2004, EBSA conducted recurring statistically valid reviews of employee benefit plan audits as a means of measuring whether overall audit quality improved over several years. These reviews, in part, were the result of a 1989 OIG report that disclosed that 23 percent of IQPA employee benefit plan audits did not meet professional standards and 65 percent of IQPA audit reports did not meet ERISA requirements.

Subsequent to the issuance of the OIG's report, EBSA and the AICPA took numerous steps to improve the quality of employee benefit plan audits. Those actions included:

- Creating the Office of the Chief Accountant (OCA). One of OCA's main goals was to improve the quality of employee benefit plan audits;

- Targeting and reviewing IQPA audits and reports by OCA, which do not meet professional auditing standards;

- Referring practitioners to the AICPA's Professional Ethics Division and/or the respective State Board of Accountancy for potential disciplinary action due to deficient audit work; and

- Developing a series of "Outreach Programs" aimed at heightening awareness and providing guidance to practitioners and auditors.

Additionally, the AICPA made a concerted effort to improve the guidance and training available to auditors of employee benefit plans.

Also in response to the OIG's report, EBSA committed to reassess the level and quality of audit work IQPAs were performing with respect to audits of employee benefit plans covered under ERISA. The first of these reviews was performed in 1997 using plan audits from plan year 1992 (most recent available at the time). That review showed that 19 percent of the audits conducted by IQPAs pertaining to the 1992-filing year failed to comply professional standards and 33 percent of IQPA reports failed to comply with ERISA's requirements. EBSA stated it could not conclude from a statistical standpoint that the quality of employee benefit plan audit work had improved since the OIG's assessment in 1989.

Despite the lack of improvement in audit quality, this review provided EBSA management with important information on the effectiveness of EBSA's oversight of IQPAs, where audit quality problems were occurring, and what types of audit issues were of concern. The review also: (1) developed information to be used in implementing the Government Performance and Results Act of 1993 (GPRA), (2) established baselines for measuring future success in achieving the overall program outcome of improving the quality of employee benefit plan audits, and (3) assisted EBSA in trying to obtain the best use of its limited resources in this area. Overall, the review produced a series of recommendations that EBSA used to improve its program over the next few years.

In 2004, EBSA performed a similar study with the same objectives. While EBSA management at the time did not release the information from the study, EBSA did use the information internally to evaluate how effective its oversight was and to adjust targeting methods and make other program adjustments.

However, EBSA has not reassessed audit quality since 2004. EBSA stated that since the results of the 2004 study were not released, its usefulness was impaired and it was not considered cost effective to do another study for in-house use only. As a result, EBSA cannot demonstrate how effective its oversight has been in improving audit quality. The 1997 review EBSA performed showed that audit quality had not improved, which was a critical conclusion and showed EBSA it needed to adjust its program, which it did. Even though the 2004 study was not released, it was of further use to EBSA in modifying its targeting and oversight. Without another study, EBSA cannot demonstrate whether it is now being more effective.

Conclusion

While EBSA has taken significant actions to increase oversight and improve audit quality, protections and assurances for plan participants have decreased. This is primarily due to the increase in limited scope audits and a continuing lack of authority by EBSA over plan auditors. However, even with these limitations, EBSA could make additional changes to improve audit quality and the protections these audits provide participants and beneficiaries.

RECOMMENDATIONS

We recommend the Assistant Secretary for Employee Benefits Security:

1. Renew efforts to seek repeal of limited scope audit exemption.

2. Improve current protections under current authority by:

    a. Clarifying the requirements needed to hold and certify plan assets for limited scope audits.

   b. Providing guidance to plan administrators to identify and adequately support current value of plan assets in limited scope audits.

   c. Evaluating the recommendations from the ERISA Advisory Council on limited scope audits.

3. Renew efforts to obtain authority over plan auditors and make better use available enforcement tools.

4. Improve the quality of EBSA audit documentation reviews by adding procedures to ensure:

   a. For limited scope audits, all plan assets are either certified by a qualifying financial institution or tested by the IQPA.

   b. IQPAs do not rely on client statements for existence and valuation for full scope audits.

5. Perform a reassessment of audit quality to determine if audit quality has improved.

We appreciate the cooperation and courtesies that EBSA personnel extended to the Office of Inspector General during this audit. OIG personnel who made major contributions to this report are listed in Appendix E.

Elliot P. Lewis
Assistant Inspector General
for Audit

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Appendices

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Appendix A

Background

The Employee Retirement Income Security Act of 1974 (ERISA) is the primary federal law governing the investment of assets in private sector employee benefit plans. The ERISA requires that most large employee benefit plans obtain an annual audit of their financial statements. ERISA requires these plan administrators to engage, on behalf of plan participants, an independent qualified public accountant (IQPA) to audit the plan's financial statements in accordance with Generally Accepted Auditing Standards (GAAS). The IQPA opines on whether the plan's financial statements are presented in accordance with GAAP. ERISA requires that these financial statements be included in the annual report these plan administrators file with the Secretary of Labor.

The Employee Benefits Security Administration (EBSA) has the responsibility to ensure that these audits meet ERISA requirements to help protect participant and beneficiary benefits. For plan year 2010, the most recent complete year available, plan administrators filed about 83,624 audited financial statements on private employee benefit plans holding assets over $5.7 trillion and covering approximately 93 million participants.

For plans whose assets are held by certain financial institutions, ERISA provides an option for a limited scope audit under which the auditor need not audit investment information certified by the financial institutions. Generally, this exemption applies to assets held by banks and insurance companies. Since the auditor does not test the accuracy or completeness of the investment information certified by the financial institution, the auditor disclaims an opinion on the plan's financial statements, providing no assurances to participants or beneficiaries as to the reliability of the plan's financial statements.

As far back as 1984, reviews by the U. S. Department of Labor's Office of Inspector General (OIG), the U.S. Government Accountability Office (GAO), and EBSA have shown that employee benefit plan audit requirements need changing. OIG and GAO recommended EBSA seek repeal of limited scope audits, obtain authority over plan auditors, and improve oversight of employee benefit plan audits. To address these issues, in 1989 EBSA established an Office of Chief Accountant (OCA). One of OCA's main responsibilities was to monitor and improve the quality of employee benefit plan audits. As part of an overall enforcement and compliance assistance effort, OCA implemented a program in 1990 to identify and correct substandard audits.

The percentage of plans using limited scope audits has grown from about 46 percent in 1987 to approximately 70 percent in 2010. The reported value of assets excluded from audits has similarly grown from about $520 billion (43 percent) in 1987 to $3.3 trillion (58 percent) in 2010. Due to the continuing lack of assurances provided by limited scope audits, $3.3 trillion of plan assets with limited scope audits lack assurances as to their existence and valuation.

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Appendix B

Objective, Scope, Methodology, and Criteria

Objective

The objective of this audit was to determine if EBSA's oversight of ERISA audits improved audit quality and increased participant protections.

Scope

Our scope included all EBSA policies and procedures pertaining to audit quality review activities for January 1, 2008, through August 31, 2011. Additionally, for FY 2010 and 2011, we received enforcement case results on closed investigations for plans with hard to value investments and one or more ERISA violations. We reviewed prior EBSA and GAO studies on audit quality. We conducted fieldwork at EBSA headquarters in Washington, DC.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective.

Methodology

We reviewed professional standards, applicable regulations, and EBSA policies and procedures. We interviewed officials from EBSA, the American Institute of Certified Public Accountants (AICPA), the Pension Benefit Guarantee Corporation (PBGC), and met with employee benefit plan experts as well as a member of the ERISA Advisory Council to gain an understanding of the employee benefit plan audit process, EBSA oversight, and plan audit quality standards.

In planning and performing our audit, we considered EBSA's internal controls that were relevant to our audit objective. We confirmed our understanding of these controls through interviews, obtaining, and reviewing EBSA reviews, policies, procedures, and enforcement actions. Our consideration of internal controls relevant to our audit objective would not necessarily disclose all matters that might be significant deficiencies. Because of inherent limitations in internal controls, misstatements or noncompliance may nevertheless occur and not be detected.

To determine whether EBSA oversight over ERISA audits improved audit quality and increased participant protections, we reviewed a sample of EBSA examinations of IQPA audits from FYs 2008 through 2011. We selected and reviewed a stratified random sample of 62 out of 961 EBSA audit quality reviews of IQPA audits completed during FY 2010 and FY 2011. For these sampled case files, we reviewed IQPA audit documentation and EBSA reviews of IQPA audit documentation. These 62 sampled plans had end-of-year total asset values of $2.03 billion. Of the 62 sampled case files, 34 had limited scope audits and 28 plans had full scope audits. We contacted plan administrators for the 34 limited scope plan audits in our sample to obtain complete certification statements of plan assets and any documentation to support fair value assumptions of plan assets where applicable. We also contacted these plans trustees or asset custodians and obtained information about how the trustees/custodians held, accounted for, and valued plan assets in their certification. Since EBSA's reviews of IQPA audits were non-statistical, we did not extrapolate our sampled testing to the employee benefit plan filing universe.

To achieve the audit's objective, we relied on computer-processed data from the ERISA Filing Acceptance System II (EFAST2) Form 5500 Series plan filings, and OCA's work paper review database. We assessed the reliability of this data by (1) performing analytical tests of data elements, (2) reviewing prior OIG and GAO reports on the EFAST2 system, and (3) tracing selected data elements to plan documents. Based on these tests and assessments, we concluded the data was sufficiently reliable for us to use in meeting the audit's objective.

Criteria

We used the following criteria to accomplish our audit:

- Employee Retirement Income Security Act of 1974
- 29 CFR 2520.103-5 Transmittal and certification of information to plan administrator for annual reporting purposes
- 29 CFR 2520.103-8 - Limitation on scope of accountant's examination
- Generally Accepted Accounting Principles, as applicable.

Appendix C

Acronyms and Abbreviations

AICPA	American Institute of Certified Public Accountants
FY	Fiscal Year
DOL	Department of Labor
EBSA	Employee Benefits Security Administration
ERISA	Employee Retirement Income Security Act of 1974
GAO	Government Accountability Office
GAAP	Generally Accepted Accounting Principles
GAAS	Generally Accepted Accounting Standards
GPRA	Government and Performance Results Act
IQPA	Independent Qualified Public Accountant
OCA	EBSA's Office of Chief Accountant
OIG	Office of Inspector General
PBGC	Pension Benefit Guarantee Corporation

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Appendix D

EBSA Response to Draft Report

U.S. Department of Labor

Assistant Secretary for
Employee Benefits Security Administration
Washington, D.C. 20210

DATE: SEP 2 6 2012

MEMORANDUM FOR: ELLIOT P. LEWIS
Assistant Inspector General for Audit

FROM: PHYLLIS C. BORZI
Assistant Secretary of Labor Phyllis C. Borzi

SUBJECT: EBSA Response to OIG Performance Audit
Draft Audit Report No. 09-12-002-12-121

Thank you for the opportunity to comment on the recommendations in your above referenced Audit Report on the Employee Benefits Security Administration's (EBSA's) oversight of annual financial audits of employee benefit plans required under the Employee Retirement Income Security Act (ERISA).

EBSA is responsible for the administration and enforcement of most of the civil provisions of Title I of ERISA and assists in enforcing criminal provisions in ERISA and related statutes. EBSA oversees approximately 707,000 private retirement plans, 2.5 million health plans, and similar numbers of other welfare benefit plans, such as those providing life or disability insurance. The employee benefit plans under our jurisdiction hold more than $6 trillion in assets and cover approximately 140 million participants and beneficiaries.

Congress enacted ERISA in 1974 to remedy certain abuses in the nation's private pension and welfare benefit plan system. ERISA contains provisions that were enacted in recognition of the fact that protecting plan participants and beneficiaries required the establishment of effective mechanisms to detect and deter abusive practices. These provisions include annual reporting of financial information and activities of employee benefit plans to the U.S. Department of Labor (Department). An integral component of ERISA's annual reporting provisions is the requirement that employee benefit plans be subject to an annual audit performed by an independent qualified public accountant (IQPA). The audit requirements apply to most large funded employee benefit plans. Plans with fewer than 100 participants are exempt from this requirement if they meet certain conditions.

The Department is committed to ensuring continued confidence in the financial information reported by employee benefit plans that is relied upon by plan participants and beneficiaries, employers and other organizations sponsoring ERISA-covered plans, and the public. We have been and continue to be concerned about what appears to be failures among some plan auditors to comply with their professional standards and with ERISA's reporting and disclosure requirements. A particular concern is inadequate audits of plans holding hard to value assets. For example, the Department has had ongoing problems with audit quality in cases where plans

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buy employer stock for more than its fair value. Auditors should be reviewing these issues as part of their audit engagement, and the Department has brought enforcement actions citing auditors for having knowingly participated in fiduciary breaches. These concerns have been the focus of a series of studies by the Office of Inspector General (OIG) and EBSA's Office of the Chief Accountant (OCA).

As described in your Audit Report, EBSA has made consistent and comprehensive efforts to improve audit quality and those efforts have evolved over time and been adapted to take into account the size of the filing universe and the resources available. We have also long advocated statutory reform because several statutory provisions of ERISA limit the Secretary's ability to combat audit quality deficiencies. Specifically, section 103(a)(3)(A) of ERISA generally requires administrators of employee benefit plans to engage an IQPA to conduct an examination of the financial statements and other books and records of the plan in accordance with generally accepted auditing standards (GAAS) and to prepare an opinion as to whether the financial statements (and schedules required to be included in the annual report) are presented fairly in conformity with generally accepted accounting principles (GAAP). The IQPA's opinion must be made part of the plan's Annual Return/Report (Form 5500) as required by section 103(a)(1)(A). However, ERISA section 109 prohibits the Department from requiring that the financial statement and opinion prepared by the IQPA be submitted on a prescribed form. GAAP and GAAS standards are set by the Financial Accounting Standards Board (FASB) and the American Institute of Certified Public Accountants (AICPA), respectively. These statutory provisions provide no authority to the Secretary to set special audit standards and accounting principles for employee benefit plans.

Section 103(a)(3)(D) of ERISA defines a "qualified public accountant" as a person who is a State regulated certified public accountant or licensed public accountant, as well as a person practicing in a State that does not regulate accountants provided that the Secretary certifies such person pursuant to regulation. Since the vast majority of states regulate accountants, the Secretary has no ability to establish special competency standards for most public accountants auditing ERISA employee benefit plans. ERISA also provides no authority for EBSA to impose civil penalties directly on accountants for deficient audit work or for filing a deficient accountant's opinion as part of an employee benefit plan's annual report. When accountants fail to follow accounting procedures or fail to meet auditing standards, EBSA's statutory authority under ERISA section 104(a)(4) is to reject the plan's annual report and penalize the plan administrator under ERISA section 502(c)(2). This indirect impact on the auditor through its business relationship with the plan has proven to be an inadequate deterrent.

The statutory and regulatory requirements for auditing an ERISA-covered plan are also somewhat unique from other company and entity audits because ERISA's statutory authorization of the limited scope audit allows plan administrators to choose to have the plan audited in a manner that would not otherwise be consistent with GAAS. Specifically, ERISA section 103(a)(3)(C) provides an option for a limited-scope audit under which the auditor, generally, need not audit investment information certified by certain banks or insurance carriers. The regulations at 29 C.F.R. § 2520.103-8 implement the limited-scope audit provision.

We have the following responses to the recommendations on page 4 of your draft report:

OIG RECOMMENDATION: EBSA should continue to seek repeal of the limited scope audit exemption and obtain authority over plan auditors.

Historically, the Department has advocated for congressional consideration of statutory amendments to ERISA that would repeal the limited scope audit exemption and provide EBSA with more effective regulatory authority over ERISA plan auditors. Congress, however, has not enacted any legislation in this area. We appreciate the OIG looking at the audit quality issue again, and believe the OIG report will give the Department another opportunity to advocate for legislative change. The Department agrees with the recommendation.

OIG RECOMMENDATION: EBSA should use existing authority to clarify and strengthen limited scope audit regulations and evaluate the ERISA Advisory Council recommendations.

EBSA continually evaluates the effectiveness of its existing regulations and the appropriateness of amendments to them. This evaluation is the basis for EBSA's regulatory agenda, which is published as part of the Unified Agenda of Federal Regulatory and Deregulatory Actions pursuant to Executive Order 12866. The evaluation is informed by retirement plan trends, stakeholder input, experience gained through EBSA's enforcement and participant assistance programs, and various external factors such as legislative and technological developments. The Department's limited scope audit regulations implement an express statutory authorization in ERISA section 103(a)(3)(C). Thus, the Department would not have the authority by regulation to eliminate limited scope audits. We will, however, examine what authority we have to clarify and strengthen the limited scope audit regulations, and our related guidance for plan administrators and auditors, in the areas described in the Audit Report and in the recommendations of the ERISA Advisory Council. Any amendments to the existing regulations would require the Department to comply with the Administrative Procedure Act, which generally requires agencies to provide public notice and seek comment prior to enacting regulations, and other applicable rulemaking and regulatory impact analysis requirements.

OIG RECOMMENDATION: EBSA should make better use of available enforcement tools over IQPAs and improve procedures in audit quality reviews.

Through its civil and criminal enforcement program, EBSA plays an essential role in protecting the integrity of retirement and welfare benefits of more than 140 million people. EBSA has a comparatively small enforcement staff relative to the size of the employee benefit universe, and is always looking for ways to make better use of available enforcement tools. In that regard, OCA is currently updating the guide that its auditors use to evaluate the work performed by employee benefit plan auditors. This renewed guidance will conform the existing version of the guide with newly issued audit and accounting standards and guidance. Prior to its release, OCA leadership will conduct training to ensure that all staff have a solid understanding of the guide, its content, and the importance of consistent and thorough documentation of IQPA work. Also, as the OIG noted, EBSA has authority to enforce fiduciary standards against plan administrators who repeatedly hire poor performing IQPAs to conduct plan audits. EBSA will evaluate OIG's suggestion that it advise plan administrators of the potential for fiduciary breaches from selection of IQPAs known to produce deficient audits. EBSA will also consider the other suggestions in the report regarding enforcement tools.

OIG RECOMMENDATION: EBSA should perform a reassessment of audit quality.

While EBSA has not conducted a statistically-based study to evaluate audit quality since 2004, OCA continues to evaluate audit quality among the various strata of IQPAs. Utilizing information contained in the Form 5500, OCA has created a multi-tiered inspection program designed to evaluate audit quality based on the size of an IQPA's benefit plan practice. Since 2004, OCA has conducted more than 100 inspections of firms with large benefit plan practices and more than 2,400 reviews of audit work performed by IQPAs with smaller benefit plan practices. The agency continues to work diligently to assess audit quality within all segments of the IQPA population as a part of its multi-tiered inspection program. We intend to evaluate the merits of another statistically-based reassessment of audit quality as we develop future work plans.

We appreciate the opportunity to provide our comments on your report and hope that they will be helpful to you in developing a final document.

Appendix E

Acknowledgements

Key contributors to this report were Ralph McClane (Audit Director), Jason Jelen (Audit Manager), Chih "Steve" Chiang (Auditor-in-Charge), Lewis Leung, Richard Donna Jr., Tim Kerschen, Angela Stewart, and Steve Witherspoon (Reviewer).

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