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EMPLOYEE BENEFITS

Limited Scope Audit Exemption Should Be Repealed

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Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss provisions in H.R. 2290 to enhance the employee benefit plan information available to plan participants, plan administrators, and others. H.R. 2290 would amend the Employee Retirement Income Security Act of 1974 (ERISA) by, among other things, eliminating the limited scope audit exemption, requiring more timely reporting of ERISA and other violations of the law to the Secretary of Labor or plan administrator, and requiring auditors of plans to participate in a peer review program that would include the examination of at least one plan audit. We support the proposed amendments, which are consistent with prior recommendations we have made.[1]

Limited Scope Diminishes Value of Audits

ERISA was enacted to protect employee benefit plan assets from mismanagement, fraud, and abuse and to ensure that plan participants receive the benefits to which they are entitled. Prior to enacting ERISA, the Congress found that pension plan participant interests were not adequately protected, in part, because the participants lacked information about their plans. To address this problem, ERISA established annual reporting and disclosure requirements for plan administrators and required that the reports be made available to participants so that they could monitor their plans. Under ERISA, the Department of Labor generally requires that an employee benefit plan having 100 or more participants obtain an annual financial statement audit by an independent public accountant.

ERISA allows plan administrators to exclude investments held by certain regulated institutions, such as banks and insurance companies, from the scope of a plan audit. Under this limited scope audit, the auditor is required to obtain financial statements from the company holding the investments and a certification from that company that the statements are accurate and are a part of the company's annual report. However, the auditor would not perform the normal procedures designed to provide certain basic assurances about the existence, ownership, and value of a plan's assets held in trust. The resulting lack of audit work can result in an auditor disclaiming an opinion on the financial statements. According to Labor, in 1994 (the most recent year for which information is available) about 34,000 employee benefit plans received limited scope audits and a disclaimer of opinion.

[1]See Audits of Employee Benefit Plans Need to Be Strengthened (GAO/T-AFMD-90-25, July 24, 1990) and Employee Benefits: Improved Plan Reporting and CPA Audits Can Increase Protection Under ERISA (GAO/AFMD-92-14, April 9, 1992).

The disclaimer can cause two problems. First, it can diminish the value of an audit by leaving a significant gap in the information intended to help participants evaluate their plan. For example, plan participants would have no basis for judging whether excluded investments are vulnerable to mismanagement, fraud, or abuse.

Second, the disclaimer language could confuse the participant. It says that the auditor does not express an opinion on the financial statements and supplemental schedules, but that the auditor does provide some assurance that the form and content of information included in statements and schedules comply with the Department of Labor rules and regulations. As a result of this potentially confusing wording, users of limited scope audit reports could be uncertain about what, if any, assurance these reports provide.

More Timely Reporting of Violations of Law

H.R. 2290 would require the plan administrator or auditor to notify the Secretary of Labor or the plan administrator within 5 business days of the date they determine that there is evidence that certain violations of law may have occurred. Specific reportable violations include theft, embezzlement, bribery, and kickbacks involving employee benefit plans and their operations. This provision is consistent with a recommendation we previously made.

Audits help to provide discipline by evaluating whether plan administrators have fulfilled their fiduciary duties and complied with laws and regulations. According to Labor, annual reports provided by plans—including audit reports—are its most valuable source of information for targeting investigations because they may contain information indicative of ERISA or other legal violations. While both plan participants and Labor have significant interest in violations of the law, there is no requirement in ERISA or Labor's implementing regulations that either party be promptly and directly informed by the auditor when fraud or serious fiduciary breaches are discovered.

We believe that the interests of plan participants and the government would be better served by plan administrators and auditors promptly reporting serious ERISA or other violations of the law directly to the Secretary of Labor or the plan administrator, if the auditor identified the violation. This would require that such violations be reported significantly sooner than under the current annual reporting process. H.R. 2290 addresses this issue by requiring the plan administrator or the auditor to

report to the Secretary of Labor or the plan administrator within 5 business days after determining that there is evidence that an irregularity in a plan may have occurred.

Peer Reviews Help Ensure Quality Audits

Peer review is the cornerstone of the accounting profession's quality assurance efforts. Requirements for these reviews currently exist, for example, for auditors of federal organizations, programs, and activities, as established by generally accepted government auditing standards, and for members of the American Institute of Certified Public Accountants who audit public companies. Under the peer review function other audit firms essentially verify that the firm reviewed has a system of quality controls that reasonably ensures that audits meet established standards.

Peer review procedures are tailored to the size and nature of a firm's audit work. However, they typically include a review of a firm's audit reports, working papers, and other necessary documents (for example, correspondence and continuing education documentation) as well as interviews with the reviewed firm's professional staff.

We previously reported that neither ERISA nor its implementing regulations require audit firms to participate in peer review programs. H.R 2290 would require all firms that audit employee benefit plans to participate in a peer review program and that the review include at least one plan audit. This would help ensure that audit firms performing plan audits adhere to auditing standards and perform quality audits.

Summary

The reporting and auditing provisions in H.R. 2290, particularly the repeal of the limited scope audit provision as well as the requirements for more timely reporting of violations of ERISA and other laws and peer reviews, would bring about important changes in the audits of employee benefit plans and in the information available to plan participants. These changes would provide participants with a better tool to monitor their plans and to help achieve the intended accountability objective of ERISA.

Mr. Chairman, this concludes my prepared statement. I would be pleased to respond to questions you or other Members of the Subcommittee may have at this time.

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