

2010 ERISA Advisory Council Employee Benefit Plan Auditing and Financial Reporting Models

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Description

The 2010 ERISA Advisory Council (“Council”) will study whether the audit requirement and financial reporting model contained in ERISA §§ 103 and 104 provide the protections to plan participants and beneficiaries that Congress originally intended when it enacted ERISA in 1974. At that time, the most common retirement plans were defined benefit pension plans. Defined contribution plans have increasingly become the preponderant model for today’s workforce. Defined benefit plans provide for a payment of specified benefits at retirement to be funded from the total assets of the plan. In contrast, a participant’s retirement benefits from a defined contribution plan are based on amounts allocated to the participant’s individual accounts.

Plans in 1974 did not operate in the computerized, automated environment and varied structures that exist today. They rarely invested in sophisticated, alternative investments or other complex financial products that are commonplace in the current markets. The types and structures of institutions holding plan assets have also become more complex over the years. Finally, both Generally Accepted Auditing Standards (“GAAS”) and Generally Accepted Accounting Principles (“GAAP”), as they apply to employee benefit plans, have changed since 1974. Such changes warrant a review of ERISA’s auditing requirements and financial reporting model.

ERISA §§ 103(a)(1)(A) and 104(a)(1) require the administrator of an employee benefit plan subject to Part 1 of Title I of ERISA to file an annual report with the Secretary of Labor. Under 29 C.F.R. § 2520.103-1, the annual report is generally required to include a Form 5500, Annual Return/Report of Employee Benefit Plan (hereafter, “Form 5500”) and any statements and schedules required to be attached to the Form 5500.

ERISA § 103(a)(3)(A) requires a plan administrator to engage, on behalf of all plan participants, an independent qualified public accountant (“IQPA”) to conduct an examination of the plan’s financial statements. That examination is to be conducted in accordance with GAAS. The IQPA is to form an opinion on whether the financial statements are presented in accordance with GAAP. Under the authority of ERISA §§ 103(a)(3)(A) and 104(a)(2)(A), the Department of Labor has generally waived the audit requirement for qualifying plans that have fewer than 100 participants at the beginning of the plan year. *See* 29 C.F.R. § 2520.104-46. ERISA § 109 prohibits the Department of Labor (“DOL”) from requiring that the financial statement and opinion prepared by the IQPA be submitted on a prescribed form. The opinion prepared by the IQPA is to be made a part of the annual report.

In addition, for qualifying plans, ERISA § 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 requirements.

ERISA § 103(b) requires the annual report to include certain financial statements of the plan. Generally, much of the plan's financial information is included with the Form 5500. In addition, plans generally must file audited financial statements with the Form 5500. Qualifying plans with fewer than 100 participants are also generally exempt from the requirement to attach audited financial statements to the Form 5500. Under ERISA § 103(c)(5), the Secretary of Labor may require the administrator to include as part of the annual report such financial and actuarial information as the Secretary may find necessary or appropriate.

Title III of ERISA, at ERISA § 3004, requires the Secretary of Treasury and the Secretary of Labor to consult each other when they are required to carry out provisions related to the same subject matter. I.R.C. § 6058 requires administrators of I.R.C. § 401(a) qualified plans to file an annual return stating such information as the Secretary of Treasury may by regulations prescribe with respect to the qualification, financial condition, and operations of the plan. The Form 5500 is the appropriate form for filing such return. *See* Treas. Reg. § 301.6058-1(a)(1). I.R.C. § 6652(e) imposes a penalty equal to \$25 per day, up to \$15,000, for a failure to file an annual report under I.R.C. § 6058 on the date and in the manner prescribed therefor, unless it is shown that such failure is due to reasonable cause. I.R.C. § 6058(f) cross-references ERISA § 3004.

The Secretary of Labor may, under ERISA § 505 but subject to Title III and § 109 of ERISA, prescribe such regulations as the Secretary finds necessary or appropriate to carry out the provisions of Title I of ERISA. ERISA § 505 expressly provides that such regulations may define accounting, technical and trade terms used in such provisions; may prescribe forms (subject to ERISA § 109); may provide for the keeping of books and records; and may provide for the inspection of such books and records (subject to ERISA § 504(a) and (b)).

If the Department of Labor finds that the annual report is incomplete or if there is a material qualification by the IQPA in the audit opinion, then it may reject the annual report pursuant to ERISA § 104(a)(4). As relevant here, under ERISA § 104(a)(5), if the plan administrator fails to file a satisfactory report within 45 days after such rejection, the Secretary may, if she deems it in the best interest of participants, (1) retain an IQPA on behalf of the participants to perform the audit, (2) bring a civil action for such legal or equitable relief as may be appropriate to enforce the provisions of Part 1 of Title I of ERISA, or (3) take any other action authorized by Title I of ERISA. The plan is liable to the Secretary for the expenses of such audit, and the Secretary may bring an action to recover such expenses.

ERISA § 502(a)(5) generally authorizes the Secretary to bring an action to enjoin a violation of Title I of ERISA or obtain other appropriate equitable relief to redress such violation or enforce any provision of Title I of ERISA. Under ERISA §§ 502(a)(6) and 502(c)(2), the Secretary may assess a penalty against a plan administrator for a failure to file a timely annual report. A rejected report is treated as not being filed unless a satisfactory report is filed within 45 days of the notice of rejection. The amount assessed may be up to \$1,000 per day, as adjusted by the

Federal Civil Penalties Inflation Adjustment Act of 1990, as amended. See 29 C.F.R. § 2560.502c-2(b)(1). Presently the adjusted amount is \$1,100 per day. ERISA § 502(a)(2) authorizes the Secretary of Labor to bring a civil action for appropriate relief under ERISA § 409. The U.S. Supreme Court has held that the civil enforcement provisions enumerated in ERISA § 502(a) constitute the sole civil enforcement provisions available under ERISA. *Massachusetts Mut. Life Ins. Co. v. Russell*, 473 U.S. 134, 146 (1985).

Objective And Scope

The objective of this study is to identify what actions, if any, the Secretary of Labor may take with respect to ERISA's audit requirement and financial reporting model to improve the Department of Labor's oversight of employee benefit plan audits in order to enhance retirement security in the United States. The Council intends to study how auditors work with plans to comply with ERISA § 103, the advantages and disadvantages of the audit requirement, the current financial reporting model under § 103 of ERISA, whether that model can and should be modified, and to what extent, if any, it should be modified. The Council's study will include a review of the applicability of limited-scope audits. The Council's recommendations will focus on the types of guidance or regulations that the Secretary should consider with respect to ERISA's audit requirement and financial reporting model. Depending upon its findings, the Council may recommend, among other things, that the Secretary seek enhanced statutory authority to prescribe a new reporting model (*i.e.*, accounting standards or GAAP), prescribe revised or new audit and auditor standards for employee benefit plans, or both.

Questions for Potential Witnesses

Do the current audit requirement and financial reporting model under ERISA § 103 and the regulations thereunder adequately protect plan participants and beneficiaries? Should there be a different GAAP for pension plans, such as a DOL-defined reporting model or a regulatory reporting model?

What guidance has been issued and remains viable on the reporting model(s) and audit requirements of employee benefit plans?

To what extent does the Secretary of Labor have the authority to modify the reporting model(s) or auditing requirements?

Should the Department of Labor develop a regulatory financial reporting model that is more consistent than GAAP, as promulgated by FASB, with the purposes of ERISA? Should any such model require an audit of the plan as a whole or should the DOL promulgate specific areas of the plan or its operations that auditors should review to better protect participants and beneficiaries and enhance retirement security? What, if any, additional information should be audited by and reported on by the IQPA, such as fees? Would the cost of such additional auditing be worth the benefits?

Should the Secretary of Labor require auditors to audit the Form 5500 and its required schedules? Is the Form 5500 a better reporting model for plans?

What is the scope of the authority of the Secretary of Labor under ERISA § 103(c)(5) to require administrators to furnish financial information as part of the annual report?

To what extent should the Secretary of Labor interpret the phrase “generally accepted accounting principles” under ERISA § 103(b)(3)(A) to include one or more Other Comprehensive Bases of Accounting (in addition to including GAAP, as promulgated by FASB)? Does the Secretary of Labor have the authority to interpret this phrase in ERISA to mean something other than GAAP as promulgated by FASB? What other regulatory reporting models would be appropriate (or inappropriate) for each plan type (defined benefit, defined contribution, including ESOPs, and health and welfare)? Are there any special needs for multi-employer plans?

Should the IQPA be engaged by a plan administrator to review or audit the plan’s compliance with laws and regulations, or any plan operations or governance?

Does the relief provided to 403(b) administrators by the Department of Labor under Field Assistance Bulletins 2009-02 and 2010-01 adequately protect the interest of plan participants and beneficiaries in a manner that Congress intended when it imposed the audit requirement? What protections do disclaimed opinions furnished in response to such relief provide to participants and beneficiaries?

What are the values of, and purposes served by, an audit of a defined contribution plan at the plan level, rather than at the level of individual accounts? Should an audit be performed at both levels?

Under the current Attestation Standards under the Statements of Standards of Attestation Engagements, AT Section 201, are there procedures that could be performed and reports that auditors could issue that would, as compared to audits at the plan level, better serve plans, their participants, and their beneficiaries?

Should the limited-scope audit exception be modified or repealed? To what extent does the exception remain useful in today’s complex environment of available investments and structures of certifying entities? What would be the advantages and disadvantages to modifying or repealing limited-scope audits?

Does the current disclaimer of opinion provided by IQPAs under the limited scope exception provide any useful assurance regarding the financial condition of the plan to participants and beneficiaries?

Should the limited-scope audit have been modified, updated, or repealed when piecemeal opinions were no longer permitted under GAAS? For limited-scope audits, should the DOL allow for opinions that would be similar in nature to a piecemeal opinion?

To what extent are custodians/trustees complying with the limited-scope audit regulatory requirements for certification? To what extent are entities certifying assets that they are not

holding? Are auditors able to ascertain adequately that certifications are proper and comply with the regulation?

Should the criteria of what types of investments that can be certified or what types of entities can certify be updated for today's complex environments? Should hard-to-value assets be certified or subject to full scope audit procedures?

What are the concerns, if any, about the quality of plan audits and plan auditors?

Do the current GAAS auditing standards protect plan participants and beneficiaries?

Should an employee benefit plan audit be conducted in accordance with a different (non-GAAS) auditing standard? To what extent should the Secretary of Labor interpret the phrase "generally accepted accounting standards" under ERISA § 103(b)(3)(A) to mean something other than GAAS as promulgated by the accounting profession? Does the Secretary of Labor have the authority to interpret this phrase in ERISA to mean something other than GAAS as promulgated by the accounting profession?

Is the enforcement regime for deficient annual reports adequate? What penalties apply for inappropriate audits and what is the enforcement mechanism? Should plan administrators be the persons penalized for the failure of the auditor to comply with GAAS? Should there be changes to the role and authority of the Department of Labor enforcement mechanisms and penalty structures as it relates to plan auditors?

To what extent are auditors complying with GAAS? What is the potential harm to the plan or its participants and beneficiaries if an auditor fails to comply with GAAS? Would the use of a more appropriate financial reporting model or regulatory reporting model increase compliance with GAAS? To what extent may and should the Department of Labor modify the auditor standards for purposes of ERISA § 103?

What should be the role of the Department of Labor with respect to education about ERISA's audit requirement and financial reporting model? Which stakeholders would be the target of any such education?