Statement of
Stephen R. Sutten

Before the U.S. Department of Labor Advisory Council
On Employee Welfare and Pension Benefit Plans

Employee Benefit Plan Auditing and Financial Reporting Models

August 31, 2010

I am Stephen R. Sutten and I am pleased to appear before the U.S. Department of Labor Advisory Council on Employee Welfare and Pension Benefit Plans. Recently retired, I have over 30 years of experience with employee benefit, trust and estate, and executive compensation work. I have served as a Tax and ERISA specialist providing employee benefit technical support services at a "big 4" and a regional accounting firm to the audit, tax and employee benefit consulting functions. I have also served as a technical advisor in the field of executive compensation and benefits to service providers on Tax and ERISA issues. In the early years of my career, I administered estates, trusts, custodian accounts, and conservatorships at two national trust companies, providing technical support with the law department to the personal trust and employee benefit administrative functions. I have also managed an employee benefit department in a trust company at a community bank. I have provided employee benefit technical support, as an officer based in the trust company to the institutional marketing, qualified plan recordkeeping (both daily and periodic functions), and trust administration units of a large mutual fund company.

I commend this Advisory Council for holding this hearing to identify what appropriate actions the Secretary of Labor may take in order to enhance plan participant protection, with respect to the Accountant's Report requirements presently included in section 103 of the Employee Retirement Income Security Act of 1974 (ERISA). My comments will focus primarily on providing observations and suggestions relating to the present level of participant protection that is offered by the Plan Administrator today in directing the Qualified Independent Certified Public Accountant to perform a "limited scope audit," authorized by section 103 of ERISA. My comments will be provided in light of the new technology, investment vehicles and structure of financial corporations providing trust, investment and recordkeeping services to qualified retirement plans and funded welfare arrangements which have evolved, since the enactment of ERISA, to favor the establishment and sponsorship of "portable" qualified defined contribution retirement plans.

I. Some Preliminary Observations:

Signed into law by President Gerald Ford on Labor Day, September 2, 1974, the Employee Retirement Income Security Act (P.L. 93-406) has been in place for over 35 years. Many of the Labor Regulations interpreting Sections 103 and 104 of ERISA, addressing the Annual Report and Accountant's Report requirements, were originally considered and issued in the 1970s. In the retirement and welfare universe at that time, most qualified retirement plans were either designed as "traditional" employer funded defined benefit plans, profit sharing plans, or welfare plans that were primarily limited to providing medical and life benefits through the use of "fully-insured" catastrophic coverage indemnification contracts with insurance companies.

Since that time, we have seen the creation and development of an array of qualified retirement plan and welfare plan designs. We have also seen a number of high-impact innovations in the structure of investment vehicles and in the delivery of benefits, utilizing the advances in technology and the changes in the American workplace that have taken place since the enactment of ERISA. Some examples of the plan designs and technological innovations that have occurred since the passage of ERISA include:

1. §401(k) Plans enabling employees to elect a level of participation and directing investment, pursuant to ERISA section 404, among a menu of funds,
2. ESOPs and "New Comparability" Defined Contribution and Defined Benefit Plans, such as the "Age Weighted" and "Cash Balance" Designs,
3. Self-insured welfare benefit programs funded through Voluntary Employee Beneficiary Associations ("VEBAs") and utilizing employer and VEBA owned "stop-loss" insurance coverage,
4. Plan financial statements generated through plan "participation-based" omnibus accounting systems maintained by non-bank service providers,
5. "Daily" and "real time" modified cash basis accounting, as opposed to traditional accrual accounting,
6. "Bundled" retirement plan services offered through large financial groups and contractual financial alliances, and
7. Plan administration in the e-environment, focusing on the use of the Internet, particularly involving in 401(k) individual account plans, participant election of deferral amounts, direction of participant investment, establishment of participant loans, and deposit and withdrawal of benefits.

All of these developments have revolutionized the design, administration, and delivery of employee benefits. However, in the midst of all of this, there has been little change, outside of the issuance of "small plan" audit rules, in the reporting and disclosure rules within ERISA Sections 103 and 104 that were enacted during an earlier time, designed to accommodate a different employee benefit universe, and exist in a different administrative and services setting. This fact alone has presented a formidable challenge to today's accounting profession.

The governmental regulatory agencies continue to look primarily to the accounting profession to serve as the nation's gatekeeper for its retirement and funded welfare plan "lock boxes". In a May 17, 2002, letter to Richard M. Steinberg, Chair of the Employee Benefit Panel-Department of Labor Liaison Task Force at the AICPA, John J. Canary Chief, Division of Coverage, Reporting and Disclosure, Office of Regulations and Interpretations of the Department of Labor, writes, on the subject of "limited-scope" certification:

> Accountants engaged on behalf of participants to conduct employee benefit plan audits play an important role in bringing questions, issues, and irregularities discovered during the course of their audit engagement to the attention of the plan administrator. In this regard, we believe accountants should, as part of their audit engagement, review certifications and notify plan administrators of potential problems with a certification when, as in cases such as those presented in your letter, there may be a question as to whether the furnished certification provides an appropriate basis on which the administrator may limit the scope of the plan's audit or provides a basis for reporting the current value of plan assets on a plan's annual report. Providing plan administrators with this important compliance assistance information ultimately will enhance the security of retirement, health and other plan assets for participants and beneficiaries.

Within the plan's audit files the qualified independent certified public accountant, in preparing the Accountant's Report, often holds a good amount of the information reflecting the plan's design features, as well as its administrative and investment policies. Whether the Accountant's Report reflects an accurate and competent assessment of the financial statement's compliance with generally accepted accounting principles, or results in an flawed opinion that fails to recognize the various systemic problems of a plan gone bad, is dependent on the accountant's ability to receive and understand accurate information addressing the plan's design, the identity and performance of the investment vehicles funding its benefits, and an accurate record of the plan's financial transactions. Receipt of accurate and complete information, accountants are finding, is becoming substantially more problematic. Specifically, being able to determine the precise business structure of certain "new-age" investment groups and the investment vehicles for providing benefits within them, determining whether the administration of the plan is in accordance with its procedures and policies with respect to the investment of plan assets, or even being able to receive accurate investment transactional information from the relevant service providers has been more problematic of late.

II. Background of the "Limited Scope" Audit Exemption.

The limited scope audit exemption is included in section 103 of ERISA and is interpreted by 29 CFR 2520.103-8. Under ERISA section 103 and the Labor Regulations, the ERISA audit rules permit a plan administrator of a covered employee benefit plan to instruct the qualified independent auditor not to perform any auditing procedures with respect to investment information *prepared and certified* by a bank, trust company, insurance company or similar institution (such as a federal savings bank (FSB)) which acts as trustee or custodian of plan investments. The limited scope exemption applies only to the investment information certified by the trustee or custodian, and does <u>not</u> extend to participant data, contributions, benefit payments, or other information whether or not it is certified by the trustee or custodian. The regulations stipulate that the bank or similar institution or insurance carrier must be "<u>regulated and supervised and subject to periodic examination by a State or Federal Agency</u>". As pointed out by the AICPA in their recent testimony to this Council, the limited scope exemption applies only to the investment information prepared and certified by the trustee or custodian. In other words, the limited scope audit may be directed to be performed by the auditor by a plan administrator with respect to certified investment information that is received on a plan specific basis and which is prepared on accounting systems that are maintained by the trustee or custodian bank or insurance company and, as such, are subject to federal or state banking or state insurance regulation.

Originally, the "limited scope audit" exception was lobbied for by the bankers and insurance companies largely because the controls in place for the investment of plan assets within their internal accounting systems were already subject to close periodic examination and regulation by the Office of the Comptroller of the Currency (for federally chartered banks) and state banking and insurance commissioners. The Report of the U.S. Senate Committee on Labor and Public Welfare that was issued on April 18, 1973 and accompanied Senate Bill No. 4 of the 93rd Congress, 1st Session (known as The Retirement Income Security Act of 1973), includes early language supporting the philosophy for the proposal to establish the "limited scope audit":

> The Committee regards the following changes in the reporting and disclosure provisions as most significant.
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> * * * * * * *
>
> Second, the annual report must include the opinion of an independent auditor based upon the results of a required annual audit. Such information will allow better assessment of the plan's financial soundness by administrators and participants alike **(the exemption for the books**

of institutions providing investment, insurance, and related functions and subject to periodic examination by a government agency will prevent duplicative audit examinations of these institutions). In light of this change, the provision requiring the Secretary to obtain certification of the report by an independent accountant prior to making an investigation of plan books and records has been eliminated as superfluous. (emphasis added)

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Therefore, it would appear that a primary reason included in the Senate Committee Report for the enactment of a limited scope audit provision (which was later adopted by the Conference Committee and became a part of ERISA) was based on the fact that the auditor would have no responsibility to obtain an understanding of or test the controls in place for the investment of plan assets on the internal trust and accounting systems maintained by banks and insurance companies and subject to periodic governmental regulatory control testing. The systems within the banking or insurance organization that hold and account for the investment activity and generate the trust transaction reporting would be subject to thorough periodic examinations by those federal and state agencies and there would be, accordingly, no need for the qualified independent auditor to question or test the underlying controls of those systems.

The Office of the Comptroller of the Currency ("OCC"), an agency of the Department of the Treasury, regulates federally-chartered banks and trust companies. Many of the state laws enacted to regulate state-chartered banks and trust companies have adopted the OCC rules. The OCC regulations require trust departments of national banks and trust companies to perform an internal audit of the trust department. Specifically, 12 CFR 9.9 mandates the following:

> 9.9 Audit of fiduciary activities.
>
> (a) Annual audit. At least once during each calendar year, a national bank shall arrange for a suitable audit (by internal or external auditors) of all significant fiduciary activities, under the direction of its fiduciary audit committee, unless the bank adopts a continuous audit system in accordance with paragraph (b) of this section. The bank shall note the results of the audit (including significant actions taken as a result of the audit) in the minutes of the board of directors.
>
> (b) Continuous audit. In lieu of performing annual audits under paragraph (a) of this section, a national bank may adopt a continuous audit system under which the bank arranges for a discrete audit (by internal or external auditors) of each significant fiduciary activity (i.e., on an activity-by-activity basis), under the

> direction of its fiduciary audit committee, at an interval commensurate with the nature and risk of that activity. Thus, certain fiduciary activities may receive audits at intervals greater or less than one year, as appropriate. A bank that adopts a continuous audit system shall note the results of all discrete audits performed since the last audit report (including significant actions taken as a result of the audits) in the minutes of the board of directors at least once during each calendar year.

In carrying out their regulatory mandate, the OCC periodically reviews the required audit as part of their own examination of the trust department. Over the years, the OCC has generally maintained the regulatory authority to look at and test any particular aspect in connection with their examination of the banks systems. Examples of controls over investments to be tested would include; custody, valuation, purchases and sales, interest, dividend and other income, realized gains/losses and unrealized gains/losses. In carrying out their regulatory mandate, they do not rely solely on either an internal audit or external audit. And, as the audit is regarded as an internal audit by the OCC, usually neither the internal nor external audit will include any opinion. Over the years, we have seen some instances where banks have retained external auditors to assist the internal auditors in special projects; usually in larger banks. We have also occasionally seen some trust companies outsource certain pieces of the required 12 CFR 9.9 audit to an external accounting firm.

In the Department of Labor Advisory Opinion letter of May 17, 2002 issued to Mr. Richard M. Steinberg, referenced above, the Department of Labor also noted:

> Consistent with the obligation of employee benefit plan administrators to file complete and accurate annual reports, it is the responsibility of the administrator to determine whether the conditions for limiting the scope of an accountant's examination, as set forth in ERISA and the Department's regulations, have been satisfied. If there is a question as to whether a party providing a certification as an authorized representative of a financial institution holding plan assets is in fact authorized to represent the financial entity for this purpose, as may be the case where there is not an explicit statement of authority included as part of the certification, the plan administrator must take steps to resolve this question before authorizing limited scope reporting.

So, in the view of the Department of Labor, if the qualified independent certified public accountant performing the audit of a qualified plan has any reason to doubt the validity of the certification that is provided, it has a duty to pursue any issues regarding the validity of the certification before performing a limited scope audit.

III. Discussion.

My comments will center on several pertinent areas of growing concern with respect to the limited scope audit provision, centering on emerging investment vehicles that have been designed and implemented by large financial groups providing investment, administrative, and documentation services to the plan sponsors and plan administrators of these plans. Specifically, my comments will address emerging developments in the financial industry that have undermined the original purpose of the “limited scope audit” rules, and which could potentially result in undermining the protection that ERISA was originally intended to afford participants and beneficiaries of the qualified plan through the performance of a limited scope audit by a qualified independent certified public accountant. My specific areas of development for discussion will include:

- The Effect of the Consolidation of Employee Benefit Service Providers as Units within Large Financial Groups

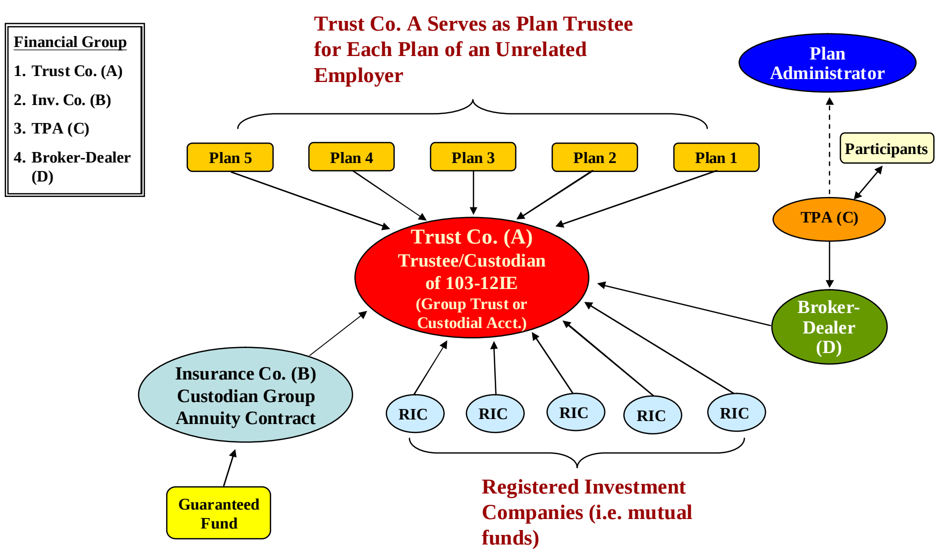
- Issues directly relating to “Omnibus” Accounting, including the Limited-Scope Audit

A. Consolidation In the Structure of Financial Groups.

Over the years, the accounting profession, in carrying out its mandate under ERISA, has been privy to changes in the structure and organization of the financial groups providing delivery of qualified plan services to plan sponsors and plan administrators. This restructuring has taken place in order to take advantage of the incredible breakthroughs in technology and the changing workplace, both which have contributed to the popularity of defined contribution plans. These changes in the structure for doing business have also been designed to accommodate the increasingly competitive business of documenting, investing and administering qualified defined contribution plans by providing cost-efficient delivery of bundled qualified plan services. These changes in structure, however, have presented challenges to the accountants who audit employee benefit plans. Over the years, we have seen large financial groups, often traditionally based in the insurance and mutual fund industries that have acquired or established trust companies, third party administrators, and broker dealers to augment their insurance and investment company practices. The result has been structures encouraging the “bundling” of plan documentation, investment and administration services, each often handled within designated subsidiaries held by the financial group. This structure has also contributed to the development and popularity of “omnibus accounting”, particularly with respect to 401(k) plan investment and administration.

Shown below is a financial group structure that provides for an investment vehicle, in the form of a custodian account that could qualify for special direct filing entity ("DFE") treatment under Labor Regulations section 25250.103-12 as a "103-12 Investment Entity", designed to maximize the contributions of insurance, mutual fund, and commingled fund investment by bringing all of the financial investment resources of the group into one account. The trust company, third party retirement plan administrator and broker-dealer are all subsidiaries of the Financial Group.

Large Financial Group Model



By maintaining such a structure designed to provide seamless delivery of bundled plans services primarily to plan administrators and sponsors of defined contribution plans, these organizations also are most likely to provide plan financial statements to the auditor prepared through the "omnibus accounting" methodology discussed below.

B. Omnibus Accounting:

This practice, developed in the late 1990s primarily in financial groups such as those discussed above, has proved problematic for the direction of a limited scope audit. In addition to a "controlled group" approach, in some instances, banks and insurance companies have established outside alliances with non-bank TPAs, broker dealers, and trust companies to fill these roles. This has become a particularly popular practice in the administration of 401(k) Plans. These plans often adopt "modified cash/daily" recordkeeping and valuation, and provide the participants with a large menu of funds among which to choose investment for the assets held in their individual accounts.

The Format:

In this model, preparation of the plan financial statements often no longer resides on systems maintained by a bank or insurance company and subject to periodic federal or state examination and regulation. Instead, a participant allocation system residing in a non-bank third party administrator is utilized, along with an omnibus investment account also residing in a non-bank subsidiary, to prepare a plan's annual trust accounting. In general, these systems accomplish this task by matching the participant information received from the employers of all plans participating in a particular investment fund with the investment transaction data within the omnibus account that tracks transactions for all plans participating in that investment.

Under this new procedure, the investment history for all participants in all plans whose investment activity is tracked within the omnibus account is sorted, by use of the participant recordkeeping system at the TPA, and allocated to each respective participant account. This data is then made plan specific, based on information indicating in which respective plan the participants reside. The "financial statement" for the plan which is sent to the respective employers, instead of having its source in the "trust based" asset transaction journal generated for the respective plan from the bank or insurance company systems, is instead based on the plan participants' representative share of the investment activity for all plans participating in the omnibus account, as determined by the participant recordkeeping system residing in the non-bank third party administrator. The source of the information in an omnibus account arrangement is the participant information provided by the respective employers to the TPA, and the investment transaction generated by the omnibus account for all plans participating in that investment.

Because of this methodology, the plan's financial statement itself often appears in an abbreviated format, showing only beginning and end of the year summaries of dividends, interest, purchases and sales for each investment fund within the plan, as well as year end fair market values of each fund. While a bank or insurance company residing within the financial group or alliance will usually certify as to of "accuracy and completeness" of these statements, the bank or insurance company did not prepare them; instead, they are usually compiled by the TPA, on its participant recordkeeping system. Occasionally, auditors still see certifications executed by "non-bank agents" who are responsible for the participant recordkeeping systems within the third party administrator; however, following the issuance of the Department of Labor

Advisory Opinion noted above, it is clear that any certification other than one signed and attested by an authorized bank or insurance company officer will not be adequate.

<u>The</u> <u>Problems:</u>

There appear to be a number of problems with this approach. First, in a modern day omnibus account setting, the systems for the omnibus account and participant allocation summaries are usually maintained by and residing in a subsidiary of the financial group or member of an alliance that is not a bank, trust company, insurance company or similar organization which serves as trustee or custodian and is subject to federal or state regulation, supervision, and periodic examination of that system that prepares the plan financial statements.

As noted above, under Labor Regulations Section 2520.103-8, the examination and report of an independent qualified public accountant need not extend to any statement or information *<u>prepared</u> and certified* by a bank or similar institution or insurance carrier. The preparation of these plan financial statements are often not on bank or insurance company systems that are subject to state or federal government regulatory examination, so it would appear that there is no basis for the plan administrator to direct the independent qualified public accountant to perform a “limited scope” report for the plan. In addition, it would seem that the bank, trust company, insurance company or similar institution may not certify financial statements that have not been prepared on its own systems.

The Labor Regulations Section 2520.103-8 was drafted at a time when most employee benefit plan benefits were funded through plans which held plan assets either in trusts or custodian accounts within either national or state chartered banks or trust companies, or insurance companies. The investment transactions of these plan assets were tracked on systems that directly reported investment history to “trust specific” accounting systems, both systems being maintained within the bank, trust or insurance company, and the interrelationship of these systems were subject to control testing by state or federal agencies. As indicated above, since the procedures and controls on these systems were always subject to state or federal regulation, Congress saw no need for the auditor to re-test these systems when a properly certified plan was the subject of an Accountant’s Report. Where such regulatory oversight is not present, it would appear that ERISA would require the auditor to embark on control testing of that system, within the protocol of a full-scope audit.

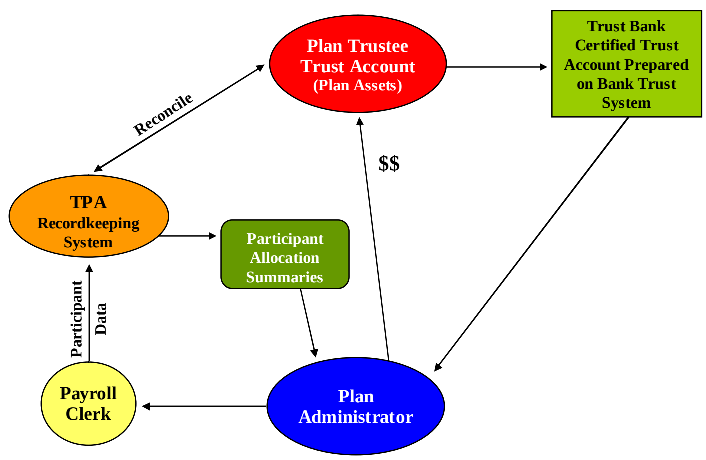
A second problem involves the format of the financial statements. A notable difference between traditional and omnibus accounting is that with the accounting systems in place at the time of the passage of ERISA, the product generated by the system was a trust transaction journal, depicting all of the asset activity within the plan or trust during the plan year. In contrast, the purpose of omnibus accounting is to allocate the investment experience in all plans within the omnibus asset account among all of the participants in all plans participating within the omnibus account. Instead of directly depositing plan contributions into a plan trust or custodian account at the bank or insurance company, they are often sent from the employer directly into the omnibus account. The investment data compiled in the omnibus account is directly sent and processed by a non-bank TPA participant accounting system and is then made "plan specific," based on the participant data received by the employers. The resulting "plan financial statement" is sent on to the employer and the auditors. Therefore, not only the accuracy of the information sent by the respective employer must be scrutinized in this type of arrangement, but also the reconcilement of the check deposited to the omnibus account with the participant data received by the TPA.

In such a case, the auditor usually receives no daily transaction journal for the plan. Often the financial statements that are provided are in the form of beginning and end of the year summaries. The underlying data for the preparation of the summaries is often based on participant allocation summaries generated by the participant allocation system of the TPA depicting allocation of investment history to each participant rather than a trust based transaction journal data which would normally be generated by the bank or insurance company systems. And the information that appears in the participant allocation summaries is only as good as the information received by the TPA from the various employers or payroll providers. Over the years, accountants have found sporadic problems in the accuracy of information concerning a plan's share of the investment history of the omnibus account.

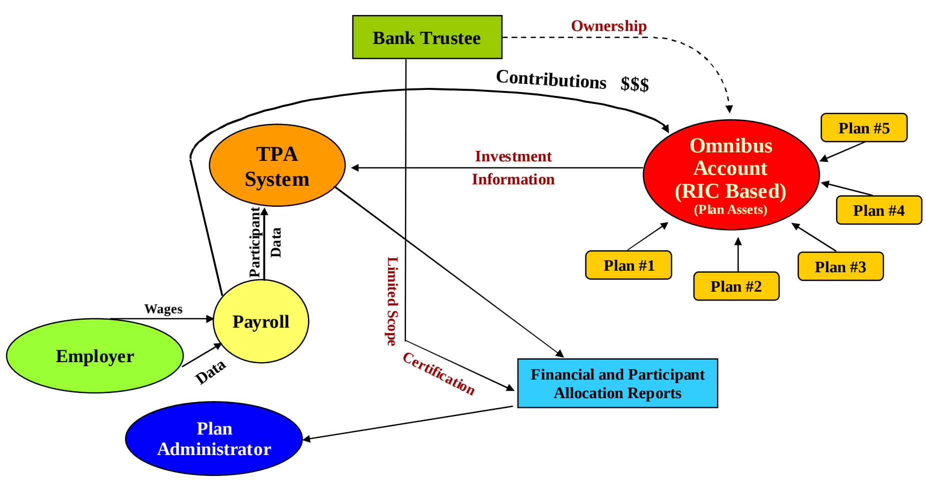
Finally, there is concern with the extent of outsourcing for services rendered to both the omnibus account and the recordkeeping systems and the extent of the control testing between the two. We have seen instances where some of the control testing and transactional work has been outsourced to third party providers; particularly with respect to valuing plan assets in the non-bank omnibus account. Whether these providers have suitable controls and procedures in place for their systems, or whether they can demonstrate that successful control testing has been performed is also a source of concern. Also of concern is the apparent lack of control testing directed at the interaction between the non-bank omnibus account and the recordkeeping system held in the TPA.

The charts below compare and contrast designs that we have seen depicting operational flowcharts for a "traditional trust-based accounting" system and a "non-bank omnibus accounting" system. For the financial groups, the evolution of omnibus accounting appears to capture "state of the art" advances in technology to minimize production costs and provide plan participants with maximum access for directing investments, requesting participant loans, changing deferral contribution amounts, and requesting distributions. For the accounting profession, it has provided special challenges in assessing the presence of satisfactory controls and concluding that these systems are performing adequately.

Traditional Trust Based Accounting Design



Non-Bank Omnibus Accounting Design



IV. Recommendations to the ERISA Advisory Council:

This study by the 2010 ERISA Advisory Council is intended to determine whether the audit requirement and financial reporting model included in ERISA section 103 and 104 provide the protections to plan participants and beneficiaries that Congress originally intended when it enacted ERISA in 1974.

The limited scope audit provisions were originally enacted by Congress primarily to take into account the regulatory and examination presence of the respective government agencies, with respect to bank and insurance company systems, which was a required condition of doing business in the 1970s. Congress decided that permitting a limited scope audit exception would save unnecessary cost and that no participant would be harmed by the failure of the qualified independent certified public accountant to perform a full scope audit on a system subject to governmental examination.

Since that time, many things have changed in the design and administration of employee benefit plans. As a result, financial groups have restructured the way in which they have delivered qualified plan administrative and investment services, in order to take advantage of technological breakthroughs and continue to do business on a cost effective basis.

Over the years the employee benefit industry has moved from an emphasis on annuity based employer provided benefits with the funding held in a qualified trust apart from the creditors of the plan sponsor, to an emphasis on participant and employer provided benefits through participant enabled individual accounts, the assets for which are held in a qualified trust apart from the creditors of the plan sponsor. In large part, leaps of technology and drastic changes in the composition of the workplace and in the structure of doing business has moved this process along. The greater mobility of the workforce and greater portability of employee benefit plans is illustrated in the liberalization of the plan vesting requirements; this event alone may have done much to encourage much of the shift away from the popularity of employer sponsored defined benefit plans.

So the challenge we have today is to balance the use of these new technology-smart cost efficient qualified plan investment and administration models with the original mandate of ERISA to protect the best interests of participants and beneficiaries in providing accurate and complete financial statements for the qualified independent certified public accountant to consider in its plan audit. With the above in mind, the following recommendations are offered to the Advisory Council with respect to the limited scope audit requirement:

1. To the extent that the plan administrator of an employee benefit plan can demonstrate that the financial statements provided to the qualified

independent certified public accountant are prepared by a bank, trust company, insurance company, or similar organization that maintains both a trust accounting system and an asset investment system subject to federal or state banking or insurance regulation as intended under the limited scope audit rules, the plan administrator may direct the auditor to perform a limited scope audit, providing that the bank, trust company, insurance company or similar organization provides an acceptable certification by one of its enabling officers.

2. To the extent that a qualified plan has its financial statements prepared through the use of a system maintained by an organization that is not a bank, trust company, insurance company or similar organization, then the systems that are producing this information should be subject to control testing. It is suggested that this testing be in the form of a periodic audit by a qualified independent certified public accountant, which assessing the policies and procedures placed in operation and tests of operational effectiveness of the systems over investment holdings and transactions, being utilized to prepare the financial statements for the plan, along the lines dictated by SAS 70. Controls over investments to be tested would include; custody, valuation, purchases and sales, interest, dividend and other income, realized gains/losses and unrealized gains/losses. If any of these transactions and activities are performed by an outsourced party, the systems of the outsourced party should also be tested. If such a SAS 70 type report has been successfully completed, then a limited scope audit may be directed by the plan administrator for the purposes of the completion of an Accountant's Report for the plan.

Thank you again for the opportunity to submit these comments.

[From the Congressional Record-Senate, April 12, 1973]

INTRODUCTION OF BILLS AND JOINT RESOLUTIONS

The following bills and joint resolutions were introduced, read the first time and, by unanimous consent, the second time, and referred as indicated:

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By Mr. JAVITS (by request):

S. 1557.

A bill to amend the Welfare and Pension Plans Disclosure Act. Referred to the Committee on Labor and Public Welfare.

INTRODUCTORY STATEMENT BY MR. JAVITS
EMPLOYEE BENEFITS PROTECTION ACT

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II. REPORTING AND DISCLOSURE

The underlying theory of the Welfare and Pension Plans Disclosure Act to date has been that reporting of generalized information concerning plan operations to plan participants and beneficiaries and to the public in general would, by subjecting the dealings of persons controlling employee benefit plans to the light of public scrutiny, insure that the plan would be operated according to instructions and in the best interests of the participants and beneficiaries. The Secretary's role in this scheme was minimal. Disclosure has been seen as a device to impart to participants and beneficiaries sufficient information to enable them to know whether the plan was financially sound and being administered as intended. It was expected that the knowledge thus disseminated would enable participants to police their plans.

But experience has shown that the limited data available under the present Act is insufficient even though the burden of enforcement has been partly assumed by the Secretary. The Amendments therefore are designed to increase the data required in the reports, both in scope and in detail. Experience has also demonstrated a need for a more particularized form of reporting, so that the individual participant knows exactly where he stands with respect to his plan-what benefits he is entitled to and what steps he must follow to secure his benefits.

Moreover, the addition of fiduciary responsibility provisions has increased the need for both generalized and particularized data. On one hand, participants will be able to ascertain whether the plan's fiduciaries are observing the rules set out in the fiduciary responsibility section only if they have access to sufficient data about plan transactions. On the other hand, the prophylactic effect of the fiduciary responsibility section will operate efficiently only if fiduciaries are aware that the details of their dealings will be open to inspection, and that individual participants and beneficiaries will be armed with enough information to enforce their own rights as well as the obligations owed by the fiduciary to the plan in general. The existing exemption from coverage under the Welfare and Pension Plans Disclosure Act for plans of tax-exempt private organizations has been removed. Substantial numbers of persons are now participants in plans established by these organizations and they are entitled to the same assurances and protection as participants in other private plans.

To provide the flexibility necessary to avoid hardship and duplicative reporting, as well as unnecessary paperwork for both plan administrators and the Secretary, the Act includes exemption and variation authority which the Secretary may apply on a class basis.

There are four significant changes designed to impart more information about the plan and its operations in general.

First, administrators will no longer be required to include the trust agreement or other instrument governing the plan in the plan description. However, the description must be written in layman's language so that participants and beneficiaries will be able to understand their plan's schedule of benefits and requirements concerning eligibility for benefits, nonforfeitability, and procedures for claims and remedies.

Second, the annual report must include the opinion of an independent accountant based upon the results of an annual audit. Such information will allow better assessment of the plan's financial soundness by administrations and participants alike (the exemption for the books of institutions providing investment, insurance and related functions and subject to periodic examination by a government agency will prevent duplicative audit examinations of these institutions).

Third, plans other than those which are unfunded must include in their reports information pertaining to leases, party in interest transactions and investment assets other than securities in addition to information about securities investments and loans.

Finally, actuarial information is now required so that participants and beneficiaries can judge the progress of the plan's funding scheme and its overall financial soundness. Amendments to provide particularized information to individual participants and beneficiaries are found in section 8. In addition to the plan administrator's obligation to make available copies of the plan description and latest annual report, the Secretary may require the administrator to furnish reasonable notification in layman's language to all participants of their rights under the Act, and to furnish to any participant or beneficiary so requesting in writing a fair summary of the annual report and a statement of what benefits (including nonforfeitable benefits, if any) have accrued in his favor or both. This will enable a participant to find out where he stands with respect to the plan at any given time. Administrators must make good faith efforts to supply to a participant
(or his survivor), upon his termination of service under a plan, a notice explaining exactly what procedures must be followed to secure benefits due.

Further, the administrator must furnish to participants and beneficiaries upon request complete copies of the plan description, annual report, or bargaining agreement, trust agreement, contract or other instrument under which the plan is established and operated. He may make a reasonable charge to cover the cost of such copies. If a plan is subject to a Federal vesting requirement and is exempted from providing preretirement vesting for benefits earned during a year of financial hardship, participants must be informed of the lack of vesting in that year.

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Appendix II- Legislative History of ERISA

Calendar No. 119 93D CONGRESS SEINATE RPR

1st Session I No. 93-127

RETIREMENT INCOME SECURITY FOR EMPLOYEES ACT OF 1976
April 18, 1973.-Ordered to be printed

Mr. Williams, from the Committee on Labor and Public Welfare, submitted the following
REPORT [To accompany S. 4]

The Committee on Labor and Public Welfare, to which was referred the bill (S. 4) to strengthen and improve the protections and interests of participants and beneficiaries of employee pension and welfare benefit plans, having considered the same, reports favorably thereon
with an amendment and recommends that the-bill as amended do pass.

I. Synopsis

The provisions of S. 4 are addressed to the issue of whether American working men and women shall receive private pension plan benefits which they have been led to believe would be theirs upon retirement from working lives. It responds by mandating protective measures, and prescribing minimum standards for promised benefits. The purpose of S. 4 is to prescribe legislative remedies for the various deficiencies existing in the private pension plan systems which have been determined by the Senate Subcommittee's comprehensive study of such plans. This legislation would authorize the establishment within the Department of Labor of an Office of Pension and Welfare Plan Administration which would implement specified and required standards of vesting, funding, reinsurance, disclosure and fiduciary standards, and a voluntary program of portability of vested pension credits. That office would also be charged with enforcement of the provisions of the Act.

The Act imposes minimum vesting requirements in pension plans, whereby employees, after eight years of service, will be entitled to a vested nonforfeitable right to 30% of their accrued pension benefits, and, thereafter, each year will acquire an additional 10% to such right until, at the end of 15 years' service, they will be entitled to 100% vested benefits. Where plans are determined by the Secretary of Labor to contain vesting formulas which provide a degree of vesting protection as equitable as the vesting schedule in the bill, compliance with the statutory vesting schedule may be waived by the Secretary. Pension plan participants would be vested in the accrued pension benefits attributable to service with their employer performed both before and after the effective date of the Act. Under specified circumstances, where the vesting requirements would increase costs or contributions to an extent that "substantial economic injury" would result to the employer and to the participants' interests, the Secretary may defer compliance with the vesting provisions for a period not to exceed five years.

The Act establishes minimum funding requirements for pension plans to assure that all unfunded pension liabilities of the plan will be funded over a 30-year period. However, the Secretary of Labor is authorized to permit variances from such funding requirements to plans which qualify under appropriate conditions.

It establishes a voluntary program for portability of pension credits through a central fund, whereby employees of participating employers may transfer vested credits from one employer to another upon change of employment.

A plan termination insurance program is established to guarantee that vested pension credits of employees will be paid upon termination of a pension plan when there are not sufficient assets to pay the workers' vested benefits. It insures benefits already earned and vested under the terms of the pension plan, prior to the date of enactment. The bill prescribes new and stringent rules of conduct required for trustees and fiduciaries administering employee benefit funds, and prohibits conflicts of interest and various specific practices to prevent actual or potential misuse of such funds.

It requires additional and comprehensive disclosure of vital data in reports to be filed with the Federal Government, and understandable explanations to workers of their rights and obligations under their pension plans.

The bill makes it unlawful for any person to discharge, suspend, expel, fine, discipline or discriminate against participants in order to interfere with their rights under the plan or the Act or for the purpose of preventing the attainment of their rights under the plan or the Act.
It is made a criminal offense to use fraud, force or violence, or threats thereof, in this connection.

Finally, it establishes federal jurisdiction and adequate remedies to both the Government and individual worker for judicial and administrative enforcement of the bill's provisions, including recovery of pension benefits due.

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TITLE V.-DISCLOSURE AND FIDUCIARY STANDARDS

Title V amends the Welfare and Pension Plans Disclosure Act in two significant ways. First, by additions to and changes in the reporting requirements designed to disclose more significant information about plans and the transactions engaged in by those controlling plan operations and to provide specific data to participants and beneficiaries concerning the rights and benefits they are entitled to under the plans and the circumstances which may result in their not being entitled to benefits. Second, by the addition of a new section setting forth responsibilities and proscriptions applicable to persons occupying a fiduciary relationship to employee benefit plans, including a "prudent man" standard for evaluating the conduct of all fiduciaries, and by barring from responsible fiduciary provisions in such plans for a period of five years all persons convicted of certain listed criminal offenses.

REPORTING AND DISCLOSURE

The underlying theory of the Welfare and Pension Plans Disclosure Act to date has been that reporting of generalized information concerning plan operations to plan participants and beneficiaries and to the public in general would, by subjecting the dealings of persons controlling employee benefit plans to the light of public scrutiny, insure that the plan would be operated according to instructions and in the best interests of participants and beneficiaries. The Secretary's role in this scheme was minimal. Disclosure has been seen as a device to impart to employees sufficient information and data to enable them to know whether the plan was financially sound and being administered as intended. It was expected that the information disclosed would enable employees to police their plans. But experience has shown that the limited data available under the present Act is insufficient. Changes are therefore required to increase the information and data required in the reports both in scope and detail. Experience has also demonstrated a need for a more particularized form of reporting so that the individual participant knows exactly where he stands with respect to the plan-what benefits he may be entitled to, what circumstances may preclude him from obtaining benefits, what procedures he must follow to obtain benefits, and who are the persons to whom the management and investment of his plan funds have been entrusted. At the same time, the safeguarding effect of the fiduciary responsibility section will operate efficiently only if fiduciaries are aware that the details of their dealings will be open to inspection, and that individual participants and beneficiaries will be armed with enough information to enforce their own rights as well as the obligations owed by the fiduciary to the plan in general.

The Committee regards the following changes in the reporting and disclosure provisions as most significant.

First, the general exemption in Section 4(b) (3) of the Act for plans of certain non-profit organizations such as hospitals, universities, foundations, etc. has been revised to exempt only plans of religious organizations. There is no substantial reason why employees covered by plans of non-profit organizations should be entitled to less protection or less disclosure than employees covered by plans of profitmaking organizations.

Second, the annual report must include the opinion of an independent auditor based upon the results of a required annual audit. Such information will allow better assessment of the plan's financial soundness by administrators and participants alike (the exemption for the books of institutions providing investment, insurance, and related functions and subject to periodic examination by a government agency will prevent duplicative audit examinations of these institutions). In light of this change, the provision requiring the Secretary to obtain certification of the report by an independent accountant prior to making an investigation of plan books and records has been eliminated as superfluous.

Third, funded plans must include in their reports particularized information pertaining to leases, party-in-interest transactions, and investments in assets other than securities, in addition to information about securities, investments, and loans. With respect to transactions other than those involving parties-in-interest, particularized information is to be provided, in general, if the transaction exceeded three percent of fund value. Also, actuarial information is now required so that participants and beneficiaries and the Secretary can evaluate the funding of the plan.

Amendments to provide detailed information to individual participants are found in Section 8 of the Welfare and Pension Plans Disclosure Act. In addition to the current obligation to make available copies of the plan description and latest annual report, the administrator will be required to furnish or -make available, whichever is most practicable, to every participant upon enrollment in the plan a summary of the plan's important provisions, an explanation of the benefits, and the circumstances which may disqualify a participant from securing benefits, as well as the availability of the underlying plan documents, such as bargaining agreements, trust agreements. The participant may obtain from the administrator a copy of any or all underlying documents relating to the plan upon the payment of a reasonable charge (as determined by the Secretary).

Finally, in view of the significantly expanded functions, given to the Secretary under the Retirement Income Security for Employees Act and the Welfare and Pension Plans Disclosure Act, the membership of the Advisory Council to the Secretary found in Section 14 is amended to create new permanent categories of membership, including investment counselors, actuarial consultants, and accountants, and the composition of the Advisory Council is increased to 21 members to take account of these functions.

Appendix III- Legislative History of ERISA

[From the Congressional Record-House, Aug. 12, 1974]

CONFERENCE REPORT ON H.R. 2, PENSION REFORM

Mr. Perkins submitted the following. conference report and statement of the bill (H.R. 2) to provide pension reform:

93D CONGRESS HOUSE OF REPRESENTATIVES REPORT 2d Session I No. 93-1280

EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974

AUGUST 12, 1974.-Ordered to be printed

Mr. PERKINS, from the committee of conference, submitted the following
CONFERENCE REPORT
[To accompany H.R. 2]

The committee of conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 2) to provide for pension reform, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendment of the Senate and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the Senate amendment insert the following:

SHORT TITLE AND TABLE OF CONTENTS

Section 1. This Act may be cited as the "Employee Retirement Income Security Act of 1974".

* * * * * * *

ANNUAL REPORTS

SEC. 103. (a) (1) (A) An annual report shall be published with respect to every employee benefit plan to which this part applies. Such report shall be filed with the Secretary in accordance with section 104 (a), and shall be made available and furnished to participants in accordance with section 104 (b).

(B) The annual report shall include the information described in subsections (b) and (c) and where applicable subsections (d) and (e) and shall also include-

(i) a financial statement and opinion, as required by paragraph (3) of this subsection, and
(ii) an actuarial statement and opinion, as required by paragraph (4) of this subsection.

(2) If some or all of the information necessary to enable the administrator to comply with the requirements of this title is maintained by-

(A) an insurance carrier or other organization which provides some or all of the benefits under the plan, or holds assets of the plan in a separate account,
(B) a bank or similar institution which holds some or all of the assets of the plan in a common or collective trust or a separate trust, or custodial account, or
(C) a plan sponsor as defined in section 3 (16) (B), such carrier, organization, bank, institution, or plan sponsor shall transmit and certify the accuracy of such information to the administrator within 120 days after the end of the plan year (or such other date as may be prescribed under regulations of the Secretary).

(3) (A) Except as provided in subparagraph (C), the administrator of an employee benefit plan shall engage, on behalf of all plan participants, an independent qualified public accountant, who shall conduct such an exaination of any financial statements of the plan, and of other books and records of the plan, as the accountant may deem necessary to enable the accountant to form an opinion as to whether the financial statements and schedules required to be included in the annual report by subsection (b) of this section are presented fairly in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year. Such examination shall be conducted in accordance with generally accepted auditing standards, and shall involve such tests of the books and records of the plan as are considered necessary by the independent qualified public accountant. The independent qualified public accountant shall also offer his opinion as to whether the separate schedules specified in subsection (b) (3) of this section and the summary material required under section 104(b) (3) present fairly, and in all material

respects the information contained therein when considered in conjunction with the financial statements taken as a whole. The opinion by the independent qualified public accountant shall be made a part of the annual report. In a case where a plan is not required to file an annual report, the requirements of this paragraph shall not apply. In a case where by reason of section 104(a) (2) a plan is required only to file a simplified annual report, the Secretary may waive the requirements of this paragraph.

(B) In offering his opinion under this section the accountant may rely on the correctness of any actuarial matter certified to by an enrolled actuary, if he so states his reliance.

(C) The opinion required by subparagraph (A) need not be expressed as to any statements required by subsection (b) (3) (G) prepared by a bank or similar institution or insurance carrier regulated and supervised and subject to periodic examination by a State or Federal agency if such statements are certified by the bank, similar institution, or insurance carrier as accurate and are made a part of the annual report.

(D) For purposes of this title, the term "qualified public accountant" means-

(i) a person who is a certified public accountant, certified by a regulatory authority of a State;

(ii) a person who is a licensed public accountant, licensed by a regulatory authority of a State; or

(iii) a person certified by the Secretary as a qualified public accountant in accordance with regulations published by him for a person who practices in States where there is no certification or licensing procedure for accountants.

* * * * * * *

SUMMARY OF DIFFERENCES BETWEEN THE SENATE VERSION AND THE HOUSE VERSION
OF H.R. 2 TO PROVIDE FOR PENSION REFORM

Prepared for the use of The House and Senate Conferees On H.R. 2

Part II - TERMINATION INSURANCE REPORTING AND DISCLOSURE

JUNE 5, 1974

* * * * * * *

8. Annual Report-Independent Accountant and Financial Audit

House bill.

(1) Plan administrators are to engage, on behalf of plan participants, an independent qualified public accountant to examine plan financial statements and form an opinion as to whether the financial statements fairly conform with generally accepted accounting principles.

(2) The accountant is to conduct his examination in accordance with generally accepted auditing standards.

(3) He is to report whether certain supplementary financial data present information fairly in all material respects.

(4) the accountant's opinion is to be made part of the annual report.

(5) The accountant's opinion is not required" for statements prepared by a bank or similar institution or insurance carrier if the statements are certified by the bank, etc., and are made part of the annual report.

(6) The bill defines qualified public accountant as including:
- (a) certified public accountants,
- (b) licensed public accountants,
- (c) other persons who meet standards of education and experience prescribed by the Secretary of Labor in regulations,
- (d) in addition, the Secretary may prescribe by regulation higher standards for qualification.

Senate amendment.

(1) Plan administrators are to have the plan audited annually.

(2) The audit is to be in accord with regulations issued by the Secretary of Labor and in accordance with generally accepted standards of auditing.

(3) No comparable provision.

(4) The auditor's opinion is to form a part of the annual report.

(5) An audit is not to be required of the records of a bank, insurance company, or other institution providing insurance, investment, or related functions for the plan if the records are subject to periodic examinations by Federal or State agencies.

(6) No comparable provision.

Staff comment.

The conferees may wish to adopt the House provisions with the following changes:

(a) To the extent a plan is not required to make an annual report, an annual audit would not be required. Thus, if the annual report requirement was waived, the audit would not be required.

(b) With respect to plans that report on simplified forms, the Secretary of Labor may waive the requirement of an annual audit.

(c) (i) An audit would not be required of a bank, insurance company, or other institution providing insurance, investment, or other related functions for the plan if the records are subject to periodic examination by State or Federal agencies, to the extent the transactions in question are certified by the financial institution.

(ii) Where a bank, etc., performs functions for the plan and certifies records or transactions to the plan, this certification must occur within 120 days after the end of the plan year.

(d) With respect to reporting on forms, see Item 23, below.

(e) The provisions of the House bill which define qualified public accountant would be followed, except that, with respect to point (6) (c) of the House bill,
Secretary of Labor would be authorized to prescribe standards only for persons who practice in States where there is no certification or licensing procedure for

accountants.

Appendix V

Written Response to Advisory Council Questions:

1. If a plan's financial statements are misstated (example: assets not properly stated at "fair value"), what is the risk that such misstatements would not be identified in a limited scope audit? Would such misstatements be identified and corrected in a full-scope audit?

In the case of a limited scope, it would probably be very likely that any misstatements would not be identified by the auditor in a properly conducted limited scope audit. In a limited scope audit, the data included in any financial statements prepared by the bank, trust company, insurance company or similar organization that are properly certified as accurate and complete and prepared on a system subject to governmental agency supervision will be normally be accepted at “face value” by the auditor. The auditor, upon receipt of proper certification will have no responsibility to inquire into the books and records that were used to compile the financial statement. Also, it should be noted that in the limited scope exemption applies only to the investment information certified by the trustee or custodian, and does not extend to participant data, contributions, benefit payments, or other information whether or not it is certified by the trustee or custodian. There is a better possibility that any misstatements would be identified and corrected in a full scope audit, depending on the nature and extent of the misstatements.

2. Have any participants ever been harmed by a Plan having a limited-scope audit? Are there any examples or scenarios where this could happen, but would not happen if there had been a full-scope audit?

In a properly conducted limited scope audit, the financial statements generated by the bank, trust company, insurance company or similar organization are prepared on their systems subject to government agency supervision and examination, and properly certified as complete and accurate. In such an instance, any resulting harm to participants would be minimized, unless there was a failure to properly assess the controls attendant to the bank systems through either the required internal audit or by the government agency responsible for the examination.

That being said, we have seen instances where the auditor has received limited scope certification by a bank or trust company that relates to financial statements that have been prepared, at least in part, by systems residing at non-bank subsidiaries. This creates a potential for harm. In one occurrence, two participants in a qualified 401(k) plan elected to defer an amount equal to the maximum permissible limit during a calendar year. The plan’s assets, certified by a bank, resided and were accounted for in a non-bank omnibus system and the plan’s financial statement was prepared with the use of a participant account allocation system. While the tax treatment was handled correctly for each participant on their respective Form W-2, the participant allocation summary at the non-bank TPA did not include credit for the deposit of these deferrals into the omnibus account. Thus, there appeared to have been a system breakdown in reconciling the participant deferral data forwarded to the TPA from the employer with the financial data that was received from the omnibus account. Whether this was the result of a systemic failure of the non-bank systems was unclear.

A related issue involves the timing and accuracy of the fair valuation and the financial transactional data that are furnished regarding certain alternative investments that are held in non-bank accounts, such as individual brokerage accounts. Financial information for these alternative investments are often included in the bank limited scope certification. Self-directed brokerage accounts in 401(k) plans have become much more common. The timing and accuracy of the fair valuation of the assets held in these accounts are normally under performed by and are under the control of the non-bank brokerage agent and not the certifying bank trustee.

Other types of investments that we have seen, on occasion, that are held on non-bank systems but included in the certification are investment funds specifically designed for employee benefit plan investment such as stable value and employer stock funds, but valued either by third party systems or held in a non-bank account.

3. To what extent does the exception remain useful in today's complex environment of available investments and structures of certifying entities? Are there assets being included in limited-scope certifications at values that do not reflect "fair value" under ERISA? Are we certain these values are getting properly adjusted for Plan and participant reporting?

The exception appears to remain useful when the financial statements are prepared on trust account and asset investment account systems that are maintained within a bank, trust company, insurance company or similar institution under governmental regulation and examination, and the financial statements are properly certified by the bank, trust company, insurance company or similar organization as being accurate and complete. However, we have seen instances where alternative assets are certified based on best available information and not fair value. In addition, there is often a lag in getting updates of values (i.e. the bank may certify a value on its 12/31 financial statement based on a 9/30 value of the alternative investment).

Another issue is that the banks often have little control over these investments “held” by the issuers of certain alternative investments. An illustration of this occurs when alternative investments are being included in the limited scope certifications that have been listed as “commingled funds” and have not qualified as direct filing entities. While this is more of a Form 5500 issue, it has been difficult, in situations such as this, for the accountant to obtain underlying asset information such as timely fair value, particularly when the valuation services have been delegated to third party providers such as in the case of some hedge funds.

4. 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?

Attention should be given to the structure of the investment vehicles that are being used today to fund benefits in a qualified plan setting, particularly in situations described above where there are commingled funds that do not pursue direct filing entity treatment. Whether hard to value assets should be certified would depend on the extent of the governmental regulation and/or examination and control testing and oversight of the accounting systems, particularly with respect to the systems being used to assess fair value for these derivative investments. Perhaps this will require the Department of Labor working with the OCC and insurance commissioners in assessing the acceptability of the present policies and procedures for testing controls for valuation of hard to value assets on these systems, and if appropriate, working with agencies in revising protocol.

5. 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 regulations?

Often, trust company subsidiaries of large financial groups are “certifying” financial statements that are not held and being accounted for on their systems subject to governmental regulation and examination. Instead, they are being prepared with the use of an omnibus asset investment and participant allocation systems residing in non-bank subsidiaries and not subject to federal or state regulatory examination. It is difficult for auditors to ascertain whether the certification meets the original requirements of the limited scope audit exception unless they have a great deal of experience in auditing employee benefit plans, the types of investments currently being offered and the structure of the accounting methodology being utilized.

In addition, self-directed brokerage accounts in 401(k) plans have become much more common. Assets held in these accounts are normally held under the control of the non-bank brokerage agent and not the trustee, but are often included in the certification issued by the bank. Other types of investments that we have seen held on non-bank systems but included in the certification are funds specifically designed for employee benefit plan investment such as stable value and employer stock funds.

6. Even with a proper limited-scope certification, is a GAAS audit of a plan under the limited-scope exception enough? Should there be additional procedures required either at the Plan level or at the certifying entity?

If the plan meets the limited scope audit requirements, a GAAS audit of the plan financial statements submitted to the auditor should be enough. That being said, whether the participant allocation system, apart from the trust accounting system, has been control tested is another matter. Today's emphasis is on the individual participant account plan, such as the 401(k) plan, which is now the retirement plan of choice in the workplace. Accordingly, it may make more sense to require each TPA, even in a situation where the financial reporting and certification requirements of a limited scope audit have been met, to obtain a SAS 70 type examination that has been completed taking into account the controls for the participant allocation system.

7. What is the potential liability, if any, of a certifying entity if its certification is inaccurate as a result of an intentional act (or failure to act), gross negligence, or negligence?

The potential liability for inaccurate certification may be difficult to determine. In such a case, it is possible that the financial statements may not be accurately reporting the financial transactional history of the plan with accurate and timely fair value. As a result, the participants and beneficiaries may not have access to completely reliable plan financial information in accordance with ERISA.

8. What assets, if any, cannot be certified for any reason? What assets, if any, would not be certified as a matter of standard business practices?

We have seen instances in which commingled funds investing in derivative investments, which have not elected to qualify as 103-12 Investment Entities, have demonstrated difficulty in reporting underlying investments and fair market value for the derivatives. Although this involves more of a Form 5500 reporting issue, it deserves some consideration. In addition, certain derivative investments that reside offshore and are not subject to the jurisdiction of the US court system as required by ERISA may pose some potential problems when held in these commingled funds.

9. Should the limited-scope audit be repealed? If not, why? What are the positives? If not repealed, should it be modified? How? What suggestions would you have?

To the extent that the plan administrator of an employee benefit plan can demonstrate that the financial statements provided to the qualified independent certified public accountant are prepared by a bank, trust company, insurance company, or similar organization and that the plan assets resides on both a trust accounting system and an asset investment system maintained by the bank or insurance company and subject to federal or state banking or insurance regulation as intended under the limited scope audit rules, the plan administrator should be able to direct the auditor to perform a limited scope audit, providing that the bank, trust company, insurance company or similar organization provides an acceptable certification by one of its authorized officers.

If a qualified defined contribution plan has its financial statements prepared all or in part by non-bank systems such as through the use of an omnibus asset investment account and a participant recordkeeping system, or outsources various functions such as valuation of assets that reside on systems not maintained by the bank, then the systems that are producing this information should be subject to outside control testing. It is suggested that this testing be in the form of a periodic audit by a qualified independent certified public accountant, assessing the policies and procedures placed in operation and tests of operational effectiveness of the systems over investment holdings and transactions being utilized to prepare the financial statements for the plan, along the lines dictated by SAS 70. Controls over investments to be tested would include; custody, valuation, purchases and sales, interest, dividend and other income, realized gains/losses and unrealized gains/losses. If any of these transactions and activities has been performed by an outsourced party, they should be tested at the outsourced party. If such report has been shown to be successfully completed, then the limited scope audit may be directed by the plan administrator for the purposes of the Accountant's Report for the plan. It is suggested that the reports on control testing for non-bank systems be submitted to and reviewed by the Department of Labor.