PENSION SECURITY: DEPARTMENT OF LABOR [DOL] ENFORCEMENT OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT [ERISA] AND THE LIMITED SCOPE AUDIT EXEMPTION

HEARING

BEFORE THE

SUBCOMMITTEE ON HUMAN RESOURCES

OF THE

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT

HOUSE OF REPRESENTATIVES

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PENSION SECURITY: DEPARTMENT OF LABOR [DOL] ENFORCEMENT OF THE EMPLOYEE RETIREMENT INCOME SECURITY ACT [ERISA] AND THE LIMITED SCOPE AUDIT EXEMPTION

THURSDAY, FEBRUARY 12, 1998

HOUSE OF REPRESENTATIVES,
SUBCOMMITTEE ON HUMAN RESOURCES,
COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT,
Washington, DC.

The subcommittee met, pursuant to notice, at 9:30 a.m., in room 2203, Rayburn House Office Building, Hon. Christopher Shays (chairman of the subcommittee), presiding.

Present: Representatives Shays, Pappas, Towns and Kucinich.

Also present: Representative Payne.

Staff present: Lawrence J. Halloran, staff director and counsel; Samantha Sherman, professional staff member; Nghiem Pham, acting clerk; and Cherri Branson, minority counsel.

Mr. SHAYS. I'll call this hearing to order and thank everyone for being here.

Trust, but verify. That succinct maxim of national security policy is also a fundamental tenet of our pension security policy. The Employee Income Retirement Security Act [ERISA] entrusts the management of funds to plan administrators and trustees, but verifies the integrity of pension assets and transactions through annual audits and Department of Labor [DOL] enforcement.

However, since 1989, the Department, its Inspector General, and the General Accounting Office [GAO] have pointed to a widening blind spot in the pension security system: the limited scope audit exemption. Based on the presumption that pension funds held by banks and other regulated entities were already adequately protected, the exemption put those assets beyond the direct view of plan auditors.

There lies the danger. In 1974, the presumption underlying the exemption may have been valid, but much has changed since then. The collapse of the savings and loan industry forcefully rebutted many prevailing presumptions about the implicit security of regulated financial institutions.

Sound accounting standards no longer acknowledge the validity or utility of "piecemeal" or limited audit opinions. As a result, ERISA's limited scope audit exemption works to put not just exempt assets, but all of a plan's assets, outside the protection afforded by an unqualified opinion on the fairness, accuracy and integrity of pension assets, procedures and transactions.

Administrations of both parties have urged repeal of the limited scope audit exemption, to standardize pension enforcement and enhance pension protections. But that effort, so far, appears to have been captive to ERISA's success. Banks, insurance companies and fund managers call the repeal proposal "a solution in search of a problem." The lack of notorious or devastating pension failures, they argue, proves no additional safeguards are needed. They believe the cost and administrative burden of full scope ERISA audits cannot be justified by tangible benefits.

So today we ask the Department of Labor, the IG and the GAO to describe the risks to effective enforcement of pension security posed by use of the limited scope exemption which now shields from full view $939 billion in pension assets held for more than 29 million beneficiaries.

And we ask those who use the exemption to justify their confidence that the current bifurcated audit system provides the vigilant, preventive safeguards those pension beneficiaries expect and deserve.

This oversight subcommittee cannot adopt legislation to repeal the limited scope audit exemption. But we can, through hearings like this, help the Department and the Congress take steps to improve pension security and enforcement. That is our charge, and we welcome the testimony of all our witnesses in that effort.

We haven't given the gentleman from New Jersey much time to sit down and relax, but we have commenced this hearing, and I would first like to welcome the Honorable Donald Payne, who is the ranking member of the Education and Workforce Subcommittee on Employer/Employee Relations. This is an investigative committee for waste, fraud and abuse. We look at programs, we swear our witnesses in, and we evaluate the programs. The legislative effort, if it were to proceed, would proceed through Mr. Payne's committee, and, therefore, we are particularly grateful that he's here and would welcome any statement he'd like to make and welcome his participation.

Mr. PAYNE. Thank you very much. I appreciate the opportunity to sit in for a while. This is a crazy day. It seems they try to do everything on Thursday. The Secretary of State is right next door, as a matter of fact.

But, as the ranking Democrat on the House Education and Workforce Subcommittee on Employer/Employee Relations, I am pleased to be an original co-sponsor, and I'd like to commend my colleague, Representative Chris Shays, for his outstanding leadership on this issue, which would impact on the retirement security of millions of Americans, and I'd like to just commend him for much of the progressive legislation that has come out, especially from his side, during the past decade has been Chris Shay's responsibility, and so I really feel pleased to be working with him in this regard.

Repealing the limited scope audit exemption will give plan participants and beneficiaries, and Federal law enforcement officials, more assurance that the financial statements of the ERISA plans are secure, by exposing them to the sunlight of an audit. There is no obligation to say anything whatsoever as to the fair presentation of a plan's financial activity because of the information that was not audited, not which was audited, but information which was not audited.

Therefore, there is absolutely no assurance regarding the plan's financial statements. Currently, a loophole limited scope audit provides no protections for billions of dollars in people's retirement savings, because about half of the 65,000 plans that have annual financial statement audits use limited scope audits. More than $950 billion in plan assets, out of about a $2 trillion pot, are not subject to audits. This practice creates an unacceptable loophole for plan auditors over the income that millions will be depending upon when they retire.

Requiring independent auditors to conduct full scope audits, would both make the auditors more responsible and provide an element of assurance to plan participants. This bill would go a long way toward ensuring that the plan's financial statements are fairly represented, and the main thing, protecting millions of people's livelihood. Millions of Americans are depending on us to protect their retirement security, and it is up to us not to let them down.

Thank you, Mr. Chairman.

Mr. SHAYS. Thank you, Mr. Payne. Thank you for your very kind words as well.

We have two panels and three witnesses on each panel, I believe. Our first panel includes Olena Berg, Assistant Secretary of Labor, Pension and Welfare Benefits Administration, U.S. Department of Labor; Patricia Dalton, Deputy Inspector General, U.S. Department of Labor; and David L. Clark, Director, Audit Oversight and Liaison, Accounting and Information Management Division, U.S. General Accounting Office.

We have a wonderful panel. I need to swear you in. Will you please rise?

[Witnesses sworn.]

Mr. SHAYS. We'll start with you.

STATEMENTS OF OLENA BERG, ASSISTANT SECRETARY OF LABOR, PENSION AND WELFARE BENEFITS ADMINISTRATION, U.S. DEPARTMENT OF LABOR, ACCOMPANIED BY ALAN LEBOWITZ; PATRICIA A. DALTON, DEPUTY INSPECTOR GENERAL, U.S. DEPARTMENT OF LABOR; AND DAVID L. CLARK, DIRECTOR, AUDIT OVERSIGHT AND LIAISON, ACCOUNTING AND INFORMATION MANAGEMENT DIVISION, U.S. GENERAL ACCOUNTING OFFICE

Ms. BERG. Well, thank you, Mr. Chairman, and I appreciate you and the subcommittee inviting me this morning to testify on H.R. 2290, the "Security Enforcement Compliance and Retirement Under ERISA Act," the SECURE bill. Mr. Chairman, I applaud you and Congressman Payne for sponsoring SECURE and for the bipartisan support that you've brought to this important initiative.

Stronger audits, rapid reporting of crimes, new standards of accountability for the profession that helps to protect our pensions, and civil penalty improvements, are the hallmarks of this proposal.

As you've already pointed out, administrations of both parties have called for most of the changes contained in this bill for over a decade, and as you'll be hearing, the Department of Labor's Inspector General and the General Accounting Office have both identified the problem early on and have advocated these reforms as a high priority. Now it's time for the Congress to act.

I want to begin my testimony this morning by asking you a question. How many of you would invest your money in a business where auditors are prevented from reviewing all of the company's assets and operations and, as a result, decline to issue any opinion about the fair presentation of the company's financial statements?

Mr. SHAYS. Are we under oath?

Ms. BERG. And yet, under ERISA nearly 40 million plan participants are in plans that have this type of audit.

ERISA requires that larger pension plans, those with over 100 participants, receive an annual financial audit, but the law, as we've been talking about, permits plan administrators to elect the so-called "limited scope audit" if any of the plan's assets are held in a regulated financial institution, such as a bank or insurance company.

Now, it's clear that Congress wanted plans to be audited, but also wanted to keep audit costs as low as possible, and Congress did not want plan auditors to duplicate the work of the financial institution's auditors. Well, this approach may have worked while ERISA was being drafted, but there have been subsequent changes to auditing conventions, and those changes have turned the limited scope audit into an enormous loophole. Let me explain.

In a full scope audit, the accountant offers his or her opinion about the financial statements taken as a whole. I've provided you with examples of the typical kind of language, because, for me, this is the easiest way to point out the problem. These are the actual language from a company with both a full audit and the limited scope audit. The typical language of the full scope audit reads in part as follows: "In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets available for benefits to the plan in conformity with generally accepted accounting principles." If this statement is qualified in any way at all, that is a big red flag.

If a limited scope audit is performed, however, the auditor renders no opinion whatsoever. The opinion is disclaimed even for the assets that aren't held by the regulated financial institutions. Again, let me refer you to the language in a typical disclaimed opinion: "Because of the significance of the information that we did not audit we are unable to, and do not, express an opinion on the accompanying financial statements and supplemental schedules taken as a whole."

So, in short, the Department, the plan sponsor, and the plan participants have no auditor's opinion to provide them assurance that the plan assets are secure.

As Congressman Payne already noted, of the 70,000 plans that are required to have an annual financial audit, about half of them are receiving these limited scope audits, involving $950 billion in plan assets, plan assets that are not now subject to a meaningful audit.

As far as I'm aware, the use of a limited scope audit is not permitted by any other Federal statute.

In the written statement I presented for you, I described a number of cases which I believe clearly demonstrate the value of a full scope audit over a limited scope audit. I described three cases in which the plan's auditor performed a full scope audit, which disclosed serious problems. This disclosure on the audit reports led us to open investigations, and in two of those cases our enforcement actions resulted in substantial recoveries of almost $13 million for the participants.

In the third case, the auditor's report caused the plan sponsor to take corrective action before we even got there, which I would submit to you is an even better result.

I also described two other cases where the plan's auditors performed limited scope audits. In those cases, the auditors' reports failed to note serious problems that we later discovered in our investigations. Here we recovered approximately $22 million for the plan participants.

Now, we do recognize that eliminating the limited scope audit will increase the costs of auditing ERISA plans, and while it's impossible to say exactly what those costs will be, based on information provided to us by the profession, by the AICPA, we believe that any cost increase will be on average less than $4 per participant per year. I think if you ask most plan participants if they'd be willing to pay a few extra dollars a year to know that their plan has had a meaningful audit they would say certainly.

Mr. Chairman, in our view, H.R. 2290 is a thoughtful and a balanced proposal. It will result in improved audits conducted by well-qualified accountants.

Again, I commend you and Congressman Payne for sponsoring this important improvement to the security of American workers' hard-earned retirement benefits.

I'd be happy to respond to any questions you may have.

Thank you.

[The prepared statement of Ms. Berg follows:]

STATEMENT OF OLENA BERG
ASSISTANT SECRETARY OF LABOR
PENSION AND WELFARE BENEFITS ADMINISTRATION
BEFORE THE HOUSE GOVERNMENT REFORM AND OVERSIGHT SUBCOMMITTEE ON HUMAN RESOURCES AND INTERGOVERNMENTAL RELATIONS

February 12, 1998

INTRODUCTION

Mr. Chairman and Members of the Subcommittee, thank you for inviting me to testify on H. R. 2290, the "Security Enforcement Compliance in Retirement Under ERISA Act" (SECURE). Mr. Chairman, I applaud you and Congressman Payne for sponsoring SECURE, and for the bipartisan support you have brought to this important initiative. While H. R. 2290 would make relatively minor changes to ERISA, it would make a significant improvement in the security of the benefits of millions of ERISA plan participants and their families.

Stronger audits, rapid reporting of crimes, new standards of accountability for the profession that helps to protect our pensions, and civil penalty improvements, are the hallmarks of this proposal. As the Assistant Secretary for Pension and Welfare Benefits, my charge is to protect and strengthen this nation's private-sector pension system. I can think of few pension bills currently before the Congress that would make such significant improvements in the safety of workers' benefits as the SECURE bill. This Subcommittee's interest in retirement security is greatly appreciated, and we in the Administration want to work closely with you, Mr. Chairman, and the other Members of this Subcommittee to enact this legislation during this session of Congress.

Administrations of both parties have called for most of the changes contained in this bill for over a decade. The Department of Labor's Inspector General and the General Accounting Office have identified these reforms as a high priority to safeguard pensions in America. It is time for Congress to act. Mr. Chairman, thank you for taking these important steps to fulfill our shared responsibilities.

THE PROBLEM

Repeal of Limited-Scope Audit

I want to begin my testimony today by asking the Subcommittee Members a question. How many of you would invest your money in a business whose auditors are prevented from reviewing all of the company's assets and operations and, as a result, decline to issue any opinion about the fair presentation of the financial statements? And yet, under the Employee Retirement Income Security Act of 1974 (ERISA), a law whose stated purpose is to protect the benefits of American workers, nearly **40 million** ERISA plan participants receive benefits from plans that have this type of audit.

Current law requires that larger pension plans, those with over 100 participants, receive an annual financial audit. Since there was no audit requirement prior to the enactment of ERISA, it is clear that Congress specifically contemplated that audits by independent, qualified public accountants would be a key element of ERISA's enforcement scheme to protect the hard-earned benefits of workers, retirees, and their families.

ERISA, however, permits plan assets held in certain regulated financial institutions, such as banks or insurance companies, to be excluded from the scope of an annual financial audit. If a plan administrator has elected a "limited-scope" audit, the regulated financial institution holding plan assets certifies as to the identity and value of the assets it holds. As a consequence of the plan administrator's decision to elect the limited-scope audit, the plan auditor is prohibited by professional auditing standards from rendering any opinion whatsoever. The auditor's opinion is "disclaimed," **even for assets not held by financial institutions and for plan operations that were examined.** The Department, plan sponsors and participants have no auditor's opinion to provide assurance that plan assets are secure.

The discretion to limit the scope of the audit was given to plan administrators when ERISA was enacted in 1974. While Congress clearly wanted plans to be audited, it also wanted to keep audit costs as low as possible. Congress also did not want plan auditors to duplicate the work of financial institutions' auditors. At the time that ERISA was being drafted, auditors were permitted to render what were known as "piecemeal opinions." A "piecemeal opinion," as the name suggests, was one in which the auditor rendered an opinion only on the assets the auditor actually reviewed and disclaimed an opinion on the other plan assets the auditor had not reviewed. While not ideal, this at least provided some assurance of the plan's integrity. However, by the time ERISA was enacted, the American Institute of Certified Public Accountants (AICPA) had issued a professional auditing standard prohibiting this type of opinion. The AICPA believed that piecemeal opinions tended to overshadow or contradict the overall opinion expressed by the auditor, potentially misleading users of the financial statements. Professional auditing standards now require that auditors express an opinion on an entity's financial statements "taken as a whole."

In our view, the limited-scope audit and resulting disclaimed opinions are inconsistent with the compliance structure Congress believed it enacted in 1974, i.e., a combination of self-policing, private rights of action and government oversight. I want to quote from a typical auditor's report where a limited-scope audit was elected to help you better understand what little value it has and what little comfort it provides:

> As permitted by Section 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974, the **[plan] Committee instructed us not to perform, and we did not perform,** any auditing procedures with respect to the information certified by . . . the Trustee of the Plan, except for comparing the information with the related information included in the financial statements and supplemental schedules . . . . **Because of the significance of the information that we did not audit, we are unable to, and do not,** express an opinion on the accompanying financial statements and supplemental schedules taken as a whole . . . . (Emphasis added.)

The lack of an opinion in these reports has made requiring an audit largely meaningless and tens of thousands of such audit reports are submitted every year.

About half of the nearly 70,000 plans that are required to have annual financial statement audits (34,200) receive limited-scope audits. More than **$950 billion** in plan assets out of an estimated $3 trillion subject to the audit requirement are **not subject to a meaningful audit**.

Neither plan participants nor the federal government can be certain that **nearly one trillion** in plan assets is secure. The very idea that workers' money held in trust for retirement purposes, some of which is insured by the Pension Benefit Guaranty Corporation, can escape a meaningful audit is unsettling. Significantly, so far as I am aware, the use of the limited-scope audit is not permitted by any other federal statute.

Another problem we encounter with the limited-scope audit is that auditors who are engaged to perform them believe that, since no opinion is rendered, he or she is not liable for any problems. This lack of accountability, coupled with a plan fiduciary's push to keep audit expenses low, unfortunately, acts as a real disincentive for thorough audit work. The limited-scope audit has become a mindless, mechanical process that does not focus on the safety of a plan's assets. It has become a way to satisfy the requirement to have an annual audit with the least amount of effort.

The ability to conduct a limited-scope audit undermines two of the primary goals the ERISA audit requirement seeks to achieve. First, independent public accountants can deter would-be wrongdoers by exposing the operations of a benefit plan to the "sunlight" of an audit done in accordance with generally accepted audit standards. Second, the limited-scope audit approach also impedes effective enforcement. This approach to ERISA enforcement builds on the private sector role of auditors to ensure that financial statements fairly reflect the financial condition of the entity audited, make full disclosures and comply with generally accepted accounting principles. It is obviously more efficient and effective to prevent problems from occurring through audits of plans than to expend government resources attempting to restore plan assets lost through fraud or abuse. The annual audit helps PWBA leverage limited enforcement resources by relying on the work of plan auditors to uncover and report problems to PWBA. PWBA currently has authorized staffing of 709 FTEs to administer and enforce all of ERISA's requirements for 750,000 pension and 2.5 million health plans. If we were to systematically review this universe plan-by-plan, we would reach each pension plan once every 170 years or so. With health plans added in, we would complete our review of each plan in 300 years.

PWBA's Experience with Full and Limited-Scope Audits

Full-Scope Audits

I want to describe for you a few cases that demonstrate the value of thorough, full-scope audits. One case was opened by PWBA's Atlanta Regional Office based on a review of the plan's audit report by our Chief Accountant's Office. The report described a possible ERISA violation by the plan trustees relating to the purchase of employer securities. The Atlanta Regional Office investigated and determined that the trustees, indeed, had violated ERISA but that the violations had already been corrected as a result of the auditor's report to the plan. We believe this example of self-enforcement is exactly what Congress had in mind when it required plans to be audited.

Another case, opened by PWBA's San Francisco Regional Office based on a review of an employee stock ownership plan's (ESOP's) full-scope audit report noted that the per share value of the plan sponsor's stock, in a little over one and one-half years, had fallen from $7.04 to $1.45. The investigation uncovered serious ERISA fiduciary violations and resulted in a settlement which restored $7.5 million to the plan participants.

A third example demonstrating the value of full-scope audits involved a profit sharing plan. The case originally was opened based on a review of its annual report (Form 5500) and full-scope audit opinion. The initial review indicated 99.7% of plan assets were invested in certificates of deposit through banks in which the trustees were substantial shareholders. The investigation confirmed that the investment was a prohibited transaction. Voluntary compliance was achieved by having the plan trustees redeem the certificates of deposit, totaling more that $5 million, and investing the proceeds in a diversified manner.

These three cases clearly demonstrate the value of full-scope audits. If an auditor discovers a significant problem, the report will notify the plan trustees about the problem and give them the opportunity to quickly correct it. If they do not correct the problem, we can institute enforcement action.

Limited-Scope Audits

Now I want to talk about a couple of cases that PWBA has had involving limited-scope audits that did not disclose violations of ERISA. An investigation was begun into potential losses of a pension plan sponsored by a major U.S. corporation. PWBA's investigation confirmed that the plan had, indeed, sustained large losses due to a plan investment manager making highly speculative investments. PWBA recovered $22 million for the plan. The limited-scope audit reports issued by the auditor gave no indications of problems with the investment manager or account balances.

The last case that I want to talk about involved a 401(k) plan. PWBA opened an investigation based on a referral from another investigative agency. In that case, the plan sponsor failed to make all of the employee contributions to the bank trustee. The plan's custodian/trustee included the uncollected contribution amount on the participants' statements even though the money had not been received. The limited-scope audit report and audited financials did not disclose the delinquent contributions. PWBA recovered about $590,000 in assets.

Before I leave my discussion of the repeal of the limited-scope audit provision, I want to talk about some of the criticism you may have heard about "rogue" accountants descending on banks, insurance companies and mutual funds if the limited-scope audit option were repealed. As I said previously, currently, 34,500 plans receive full-scope audits every year. In the more than 20 year history of ERISA, several hundred thousand full-scope audits have been performed, yet we've never received a complaint about an accountant from a bank, insurance company, or mutual fund regarding plan accountants "descending" on these institutions.

The repeal of the limited-scope audit provision does not mean that ERISA auditors must audit the books and records of financial institutions currently covered by the exception. Generally, under the bill, plan auditors are to use what is known as a "single audit approach" which uses a special report prepared by the auditors of affected banks and other institutions that speaks to the reliability of the information generated by the bank. Plan auditors, then, would be able to issue full-scope audit reports that provide assurance that plan assets are secure.

<u>Minimization of Costs</u>

While it is impossible to say with any real precision, based on information provided to us by the AICPA, we believe that any cost increase would be, on average, less than $4.00 per participant. I think that if you ask most plan participants, they would be very willing to pay a few dollars more every year to make their benefits secure.

The increases in audit costs also need to be considered in the proper perspective. They are very reasonable when you consider that for plans that receive a limited-scope audit, neither plan participants nor the federal government are getting anything of value.

OTHER PROVISIONS OF SECURE

Before I leave today, I want to talk about some other very important provisions of SECURE.

<u>Additional Requirements For Accountants</u>

We need to strengthen the standards for accountants who audit ERISA plans if the quality of their work is to be improved. Our recent review of the quality of ERISA plan audits bears this out. In our study, we found that 19% of plan audits were deficient and 33% of plan filings failed to satisfy ERISA's reporting and disclosure requirements. These audits included both full-scope and limited-scope audits. A prior study by our Inspector General's Office reached similar conclusions. The bill, if enacted, would help to improve employee benefit plan audits by requiring ERISA auditors to have an external quality control review and satisfy continuing education requirements relating to ERISA plan audits. The proposal would also grant the Secretary of Labor authority to impose additional qualifications or requirements on accountants necessary to protect the integrity of plan assets. We expect to work constructively with state licensing agencies and the AICPA in implementing these provisions.

Reporting Crimes Discovered During Audits

Under current law, there is no specific duty for an administrator of an employee benefit plan, or an accountant who conducts a plan audit, to disclose promptly to the Secretary information indicating that a crime involving the plan, such as embezzlement, bribery, or kickbacks, may have occurred. Under ERISA's current reporting rules, even the most egregious violations are not required to be reported until 210 days after the end of the plan year in which the offense occurred (which can be almost two years later).

While plan accountants and auditors are often the first line of defense against fraud, current rules permit this significant time lag between the detection of serious crimes and the filing of an annual report with the government. This legislation requires that the Secretary be notified by the plan administrator within five business days when he or she or the plan auditor discovers that there is evidence that certain specified, serious crimes like theft, embezzlement, bribery or kickbacks may have occurred. The plan accountant has the responsibility to notify us if the plan administrator fails to do so. Similar fast reporting requirements were enacted in the "Private Securities Litigation Reform Act of 1995." The sooner we are made aware of problems, the faster we can act to protect and restore plan assets.

<u>Civil Penalty</u>

The bill imposes a civil penalty of up to $50,000 against any plan administrator or an accountant who knowingly and willfully fails to report information required under the bill. The proposed civil penalty is discretionary and, if enacted, we intend to implement it by developing a penalty structure that would allow the $50,000 penalty to be assessed only in the most serious cases. The proposed penalties are designed to ensure compliance and are no more severe than those found in federal securities laws.

<u>ERISA Section 502(l)</u>

Finally, I want to talk about how the bill would affect ERISA section 502(l). Section 502(l) is a mandatory civil penalty paid by plan fiduciaries that applies to amounts paid under "settlement agreements" or court orders in cases in which the Secretary is a party. A "settlement agreement" is an agreement between PWBA and the fiduciary who we believe committed a violation of ERISA, where PWBA agrees to release its claim against the fiduciary in exchange for cash or other property being returned to a plan. Section 502(l) was added to ERISA by the Omnibus Budget Reconciliation Act of 1989 as an added enforcement provision, but has created real problems in enforcement.

Section 502(l) imposes a mandatory civil penalty on fiduciaries equal to 20% of the amount recovered in a fiduciary breach action. In practice, this mandatory 20% penalty has become a surcharge on settlements. It has distorted the process of negotiating settlements and has produced extensive litigation which may have been avoided by settlements. It has not resulted in the collection of significant revenues.

Section 502(l) has been extremely difficult to administer. Fiduciaries who correct their violations but refuse to enter into settlement agreements may avoid the penalty. At the same time, the mandatory nature of the penalty requires the Department to penalize the fiduciary who negotiates in good faith, settles with the Department and quickly restores a plan's losses. This penalty discourages people from coming forward and settling with the Department. The principal problem is the mandatory nature of the penalty. The existing provision penalizes the fiduciary who negotiates in good faith, settles with the Department and restores a plan's losses. This penalty discourages people from coming forward and settling with the Department rather than going to court.

This bill would make the penalty discretionary. I want to mention that this proposal came to us from our field staff, the people within PWBA who actually investigate and develop our cases. We strongly support this provision. I hope that the Members of this Subcommittee will keep this in mind as the SECURE proposal goes through the legislative process.

REVENUE EFFECTS

Overall, we believe that this bill would increase receipts by less than $500,000 over a five-year period. The civil penalty for failure to report crimes would raise revenues slightly. The changes to section 502(l) might result in a very minor revenue loss. Other provisions of the bill are not expected to have a revenue impact.

CONCLUSION

Mr. Chairman, in our view, H. R. 2290 is a thoughtful and balanced proposal that will result in improving audits being conducted by well-qualified accountants and will provide us with the information we need, when we need it.

Before I leave today, I want to remind the Members of this Subcommittee about some of the history on this legislative proposal. In November 1989, the Department of Labor's Office of Inspector General identified significant deficiencies in audits of private employee benefit plans. These findings generated congressional concerns about the protection of American workers' benefits. As a result, the Chairman of the House Subcommittee on Oversight, Committee on Ways and Means, and the House Subcommittee on Labor-Management Relations, Committee on Education and Labor, asked the General Accounting Office to identify problems in the performance of plan audits.

The GAO reached the same conclusions as DOL's Inspector General. Both DOL's Inspector General and the GAO have compared these accounting weaknesses in employee benefit plans with the savings and loan crisis. And the 1992 GAO report requested by Congress advocated audit reforms similar to those found in the SECURE legislation. Finally, audits of ERISA benefit plans have been reported as a major weakness in the Department's Federal Managers' Financial Integrity Act annual report for the last seven years.

Audit reform has been a bipartisan issue from the start. The Bush Administration introduced prior ERISA audit reform proposals substantially similar to those found in SECURE. Previous proposal sponsors have included Senators Kassebaum, Dole, Hatch, Jeffords and Simon.

Mr. Chairman, the clear message is that Congress needs to act now. We cannot afford to ignore these warnings any longer. I again want to commend you for your sponsorship of this bill and I look forward to working with you and the Members of the Subcommittee on this important project.

Thank you. I would be happy to respond to any questions that you or the Members of the Subcommittee may have.

Mr. SHAYS. Thank you.

Ms. Dalton, before calling you, I just want to recognize that the ranking member, Mr. Towns, is here, and I don't know if he has any comment that he wants to make before we continue.

Mr. TOWNS. No, just the fact that my opening statement is included.

Mr. SHAYS. And, let me use that as an opportunity to ask unanimous consent that all members of the subcommittee be permitted to place an opening statement in the record, and the record will remain open for 3 days for that purpose, and without objection, so ordered. And, I'd further ask unanimous consent that all witnesses be permitted to include their written statements in the record. Without objection, so ordered.

[The prepared statement of Hon. Edolphus Towns follows:]

ONE HUNDRED FIFTH CONGRESS

Congress of the United States

House of Representatives

COMMITTEE ON GOVERNMENT REFORM AND OVERSIGHT

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OPENING STATEMENT OF

**REP. EDOLPHUS TOWNS, RANKING DEMOCRATIC MEMBER
SUBCOMMITTEE ON HUMAN RESOURCES**

FEBRUARY 12, 1998

Mr. Chairman, thank you for holding today's hearing on limited scope audits. It is my understanding that the proposal to repeal limited scope audits has a long history which began when Mr. Lantos of California, held hearings as the Chair of this Subcommittee. Therefore, it seems that we have talked about the repeal of this exception to the audit rule for some time. Hopefully, today, we will resolve to do something about it.

Under ERISA, pension plans with more than 100 participants are required to obtain an annual financial audit. However, if funds of the plan are held by a bank, savings and loan or insurance company , the plan administrator may choose an audit that excludes those funds from review by an independent public accountant. Because the auditor cannot review some of the funds, his opinion about the soundness of the plan is incomplete.

When this exception was enacted, it was reasonable to assume that funds held in these institutions were safe. However, given the savings and loan catastrophe of the 1980's and the failure of several insurance company investment plans less than a decade later, we can no longer make that assumption.

Repeal of the limited scope exemption would provide additional information in the hands of the Department of Labor which may be used to correct plan deficiencies, detect risky investments or uncover criminal activity. The failure to require the complete review of plans opens the door to fraud and abuse. Weak or non-existent internal controls by plans enable sponsors and employers to defraud the plans by understating required contributions, charging exorbitant administrative costs or engaging in embezzlement.

As the Committee on Government Reform and Oversight, it is our mission to prevent waste, fraud and abuse in Federal programs. Although these pension plans are private, they are an important component of the retirement system and supplement Social Security retirement income. Therefore our commitment to the integrity of the Social Security system and the well-being of the thousands of senior citizens who depend on this income demands that we take action.

I believe we have a duty to assure retired workers that the money they rely upon is safe and secure.

Therefore, let me suggest that in addition to providing the Department of Labor with this valuable tool, we consider increasing the investigative and oversight staff responsible for reviewing pensions, increase penalties for pension fund fraud and increase efficiency by requiring the centralization of information for pension beneficiaries. Some people will complain about the costs of requiring such audits. However, it is my understanding that the Department of Labor's Inspector General has estimated that the costs of a full audit would be about $3 per year for each plan participant. This is a small price to pay for the peace of mind.

Mr. Chairman, I want to thank you for holding today's hearing and I look forward to hearing the testimony of our witnesses.

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Mr. SHAYS. You are on.

Ms. DALTON. Good morning, Mr. Chairman and members of the subcommittee. Thank you for inviting the Office of Inspector General to discuss our oversight of the Department of Labor's employee benefit plan activity. I'm here in my capacity as the Deputy Inspector General to present the views of the Office of Inspector General.

It is essential that employee benefit plans be afforded sufficient protections to ensure that more than $3 trillion of participant assets are adequately protected and are available when individuals retire.

In 1989, the Office of Inspector General reviewed the ERISA annual plan audit process. We concluded that significant changes were needed to increase protections for employee pension plan participants. We recommended the repeal of section 103, the Limited Scope Provision, which allows plan administrators to elect, under certain conditions, to have plan assets that are invested in regulated institutions excluded from the plan's audit. This exclusion was placed in ERISA under the presumption that the assets held in these institutions were already being audited.

Despite Federal and State regulation and oversight, transactions can, and do, go astray in these institutions. The savings and loan crisis made all Americans painfully aware of what can go wrong.

When the limited scope exemption is invoked for a pension plan audit, the plan auditor does not examine all of the plan assets for ownership, valuation, worth, or even their existence.

Because the assets excluded are generally significant, the plan auditor frequently declines to give an opinion on the plan's financial statements. Therefore, there is no opinion on the financial status of the plan.

In 1992, the General Accounting Office examined many of the same issues covered by our 1989 audit, and issued a report that supported our findings and recommendations. More recently, in 1996, the Pension and Welfare Benefits Administration performed a followup study and issued another report confirming the findings of both the 1989 audit and the 1992 report of GAO.

Mr. Chairman, eliminating the limited scope exemption will not guarantee that a plan's assets are fully protected, however, we believe that as one of the first lines of protection, it will permit more effective scrutiny and oversight of these funds, and decrease the potential for fraud and mismanagement.

Some employee benefit plan specialists have contended that requiring full scope audits will cause an undue reporting burden on small businesses. However, ERISA does not require plans with less than 100 participants to obtain an audit. Repealing the limited scope audit provision will not affect 91 percent of pension plans. In particular, it will not affect small business pension plans.

A major concern that the banks and financial institutions have raised has been the intrusion of additional auditors into their business operations. Fortunately, America's business community and the American Institute of Certified Public Accountants have already developed and implemented a partial solution to this problem. The AICPA has issued a pronouncement entitled, "Statement on Auditing Standards No. 70," which allows two groups of auditors, auditing financially interrelated companies, to rely on each other's work without duplication. In general, the plan auditor should not need to intrude into the operations of the financial institution. The financial institution's auditor would perform the necessary work and provide it to the plan's auditor.

The cost of a full scope audit, as compared to a limited scope audit, is not and should not be an issue in protecting the American workers' employee benefit plan assets. Assuming that the plan's auditors can rely and build on the work of the financial institution's auditor, a significant increase in pension plan audit costs would not be expected. The assurance given in a full scope audit makes it worth the price, particularly when compared to the lack of value in getting no opinion from the limited scope audit.

Finally, the OIG has also recommended that independent public accountants and plan administrators be required to report potentially serious ERISA violations directly to the Department of Labor. As you can imagine, public accountants have little incentive to report possible violations because of their relationships with their clients. Requiring public accountants to report potential violations to the Department would alleviate this problem.

In conclusion, the OIG believes that the proposed amendment contained in H.R. 2290 will fully address the issues that we have raised.

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

Mr. SHAYS. Thank you. We'll have questions after Mr. Clark makes his statement. Thank you.

[The prepared statement of Ms. Dalton follows:]

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

February 12, 1998

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

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

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

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

The Limited Scope Exemption

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

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

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

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

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

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

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

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

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

Increased Burden Associated with Full Scope Audits

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

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

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

Impact of Full Scope Audits on Banks and Financial Institutions

A major concern of banks and financial institutions is the intrusion of additional auditors into their business operations. We believe this concern has some justification. Fortunately, America's business community and the American Institute of Certified Public Accountants (AICPA) have already developed and implemented the solution to this problem. The AICPA has issued a pronouncement, Statement on Auditing Standards (SAS) 70, which allows two groups of auditors, auditing financially interrelated companies, to rely on each other's work without duplication. This pronouncement, which was effective in March 1993, sets forth the professional requirements an auditor must meet and the reporting standards an auditor must follow when relying on another auditor's work. Most important, SAS 70 will allow an employee pension plan auditor to accomplish a full scope audit and issue a full opinion while relying, when possible, on the audit work already accomplished by the financial institution's auditors. In general, the plan auditors should not need to intrude into the financial institution. The plan auditor and the financial institution auditor simply need to talk and share their work.

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

Increased Costs from Full Scope Audits

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

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

Reporting Serious Violations to DOL

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

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

Conclusion

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

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

Mr. CLARK. Mr. Chairman, and members of the subcommittee, I'm pleased to be here to discuss provisions in H.R. 2290, to strengthen employee benefit plan audits. GAO supports the provisions which are consistent with recommendations the GAO made in prior reports.

Prior to enacting ERISA, Congress found that participants were not adequately protected from mismanagement of their plans. To help address this problem, Congress established auditing requirements in ERISA to help participants monitor and evaluate their plans, in essence, self-enforcement, which was intended to be a cornerstone of the accountability model for employee benefit plans.

The audit requirements also help labor enforce ERISA's fiduciary standards. Those standards include requirements that plans be managed in participants best interests.

Under ERISA, however, plan administrators can exclude certain investments from the scope of audits, resulting in disclaimers of opinion by auditors. Disclaimers diminish the usefulness of audits by leaving significant gaps in information participants need to monitor and evaluate their plans, and by possibly creating confusion regarding assurances on those parts of plans not excluded from audits. Accordingly, GAO believes that Congress should repeal the limited scope exclusion.

GAO also supports provisions in H.R. 2290 to require direct reporting of ERISA violations to the Secretary of Labor and/or plan administrators, and to require plan auditors to participate in peer review programs. Direct reporting should result in more prompt reporting of violations and peer review should help to better ensure that auditors perform quality audits.

That concludes my summary.

[The prepared statement of Mr. Clark follows:]

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

[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)

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.

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.

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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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Mr. SHAYS. I'd like you all to give me the best reason why we shouldn't repeal the limited scope audit. We'll start with you, Ms. Berg.

Ms. BERG. The reason that you would hear most frequently, and it's the reason I addressed it directly in my testimony, is that it will increase costs of the audit. We recognize that. And, again, I think those costs have to be weighed, obviously, against the benefits in terms of the additional protection, a cost that we estimate in total of $50 to $150 million for all plans when we are talking about assets of $3 trillion.

Mr. SHAYS. Now, your's was $3 trillion, mine was $934 billion, or something like that.

Ms. BERG. The $3 trillion is all subject to the limited scope or full audits. Every year the plan administrator can make a choice which kind of audit to do.

Mr. SHAYS. I'm not clear. I'm sorry.

Ms. BERG. Sure. There are $3 billion in assets in plans that are subject to an audit.

Mr. SHAYS. Right.

Ms. BERG. And, every year the plan administrator can make a choice whether to do a full audit or a limited scope audit, that's why I said we're potentially affecting all $3 trillion. But, if you take any 1 year, it's about $950 billion.

Mr. SHAYS. About a third of it.

Ms. BERG. Exactly.

Mr. SHAYS. Ms. Dalton, the best reason why we shouldn't repeal the limited scope audit?

Ms. DALTON. I'd have to concur with Assistant Secretary Berg's reason, of the additional cost. There will be some additional cost, but, as Ms. Berg pointed out, we have to balance that with additional protections provided to the assets of plan participants.

Mr. SHAYS. Mr. Clark?

Mr. CLARK. There might be a good argument that if the limited scope was repealed and the full scope audits were provided for participants, that participants may not use those reports, or may not read those reports. And, I think that is a legitimate issue.

I would point out, though, that the purpose of the audit requirements are not—I would like to think are not designed just to detect problems or to alert the auditors, but more to provide a discipline on the part of the plans to provide audit coverage. Auditors, in doing a full scope audit, would hopefully have an opportunity to look at how the plan is managing itself, to provide suggestions, recommendations on how the plan can carry out its fiduciary responsibilities and the like.

When we looked at the quality of audits a number of years ago, one of the things that we found that concerned us greatly was the attitude or approach of the auditors going into an audit when they knew that they were going to have a disclaimer. Many of the auditors acknowledged, in conversations with us, that they were not as rigorous on the other parts of the plan that they would have been if they knew that they were going to do a full scope audit.

So, putting these audits on a par with everybody else I think just elevates the whole attitude, comprehensiveness and thinking on an audit, and ultimately that benefits the participants.

Mr. SHAYS. My sense was that originally they would render an opinion on that part which they audited.

Mr. CLARK. Right.

Mr. SHAYS. And, that general accounting practices no longer allows that to occur.

Mr. CLARK. That is correct.

Mr. SHAYS. What would happen if we went back to that process?

Mr. CLARK. Well, under generally accepted auditing standards and, again, these are standards that everybody has to follow in the country, the view of the profession is that the piecemeal opinion is not an effective way of providing audits. It causes confusion. You are only looking at part of what's going on. I think readers of a piecemeal opinion may be led to believe that things are OK, and they only have half the picture there.

Mr. SHAYS. I was just trying to address that one point that you made that seems logical. If you know that ultimately you don't have to render an opinion, it's almost pointless to do the audit on that part which is not exempt. At least you would have a handle on that part of it, which gets around that one argument you made.

Mr. CLARK. Right.

Mr. SHAYS. Mr. Towns.

Mr. TOWNS. Thank you very much, Mr. Chairman.

Let me begin by thanking you for holding this hearing. I think that this is a very important issue to discuss.

The question, of course, I think, Ms. Berg, that you mentioned, would you know how much this would be per person?

Ms. BERG. We estimate that it will be less than $4 per participant per year.

Mr. TOWNS. It seems to me that for peace of mind, and tranquility, and everything else, that people would probably be willing to pay that.

Ms. BERG. I certainly would.

Mr. TOWNS. I would think so.

If Congress fails to make this change in ERISA's auditing rules, what impact would this have on the security of pension plans and the Labor Department's enforcement program?

Ms. BERG. Well, again, we have been operating with the current state of affairs since the passage of ERISA, but it's now been a decade since the Inspector General and the GAO pointed out this problem.

We, in the Department, have limited resources. It's an enormous plan universe that we're responsible for, 700,000 pension plans, several million health benefit and other kinds of plans that we have to cover under ERISA, so the cornerstone, really, of protection is that independent outside look by the auditor. So, I believe we're missing an opportunity here to substantially strengthen the security of the system, if we don't take this action.

Mr. TOWNS. Just let me ask the GAO this question, thank you very much, Ms. Berg, are there any other areas of accounting where auditors are permitted to conduct a partial audit?

Mr. CLARK. None that we are aware of.

Mr. TOWNS. Since its enactment, ERISA has been amended to increase protections for various groups. How does this legislation fit into the theme of increased protection for plan participants?

Ms. BERG. I can't think of any proposal that's currently before Congress, or that's been undertaken in the time that I have been here, that I consider more important to the basic security of the pension system.

Mr. TOWNS. Because these pension plans are private, and some believe that the Federal Government should not play any regulatory role, what is your response to the Federal Government's involvement in this area?

Ms. BERG. Well, I'll certainly be happy to speak to that. Again, I was talking about the size of the universe that we're responsible for, and if you look at the number of investigators and people that we have to go out and investigate problems in the pension system, we are incredibly highly leveraged. In fact, there was a Brookings Institute report last year that called us the most leveraged agency in the Federal Government.

We return, for every dollar that is spent on our enforcement effort, we return something like $6 every year back to pension plans. So, I think, we are there, we are uncovering problems, and it's important that that message be there for any fiduciary who is responsible for these assets. I wish I could tell you that no one has ever attempted to use these moneys for other purposes than what they were intended for, but that simply isn't the case and we need to be there to effectively remind people that should they use the money held for pensions inappropriately they are likely going to suffer the consequences of that.

Mr. TOWNS. Any other comments on that?

Mr. CLARK. I would just add that all companies, publicly traded companies, are subject to regulatory oversight by the Securities and Exchange Commission. They have to get a full scope audit. All insured financial institutions are subject to regulation by a number of other regulatory agencies, and they, too, have to have financial statement audits, full scope audits. The suggestion certainly with respect to eliminating the limited scope audit would simply put all employee benefit plans on a basic par with what has long been considered the norm in this country—a set of financial statements and an annual financial statement audit by an independent public accountant.

Mr. TOWNS. Right.

One last question, Mr. Chairman.

I understand that your investigators file about 100 criminal complaints a year in the pension field. Do you believe that the repeal of the limited scope audits would increase the number of prosecutions?

Ms. BERG. Well, that's a little bit difficult to say. We won't know until we are into that world how it might affect the numbers, but we do know that a lot more of our recoveries, a lot more of the cases that we bring, are involving companies that have had the full scope audit.

So, my guess would be that we would see an improvement in the numbers, but I can't say that for certain.

Mr. TOWNS. Sounds like a good guess to me.

I yield back, Mr. Chairman.

Mr. SHAYS. Thank you.

Mr. Payne.

Mr. PAYNE. Thank you very much.

Since time is very limited, I just might ask a basic question. You mentioned, Mr. Clark, that if they did this full audit it would be so complicated and complete that you felt that, perhaps, people wouldn't read it and go through it. Wouldn't there be a way to simplify the report to knock that argument out?

Mr. CLARK. That's not something I've given any thought to. My sense is, though, most participants aren't going to read an audit report or the set of financial statements. I think what they are looking for is some assurance that there is a review, that that review is done by somebody who is independent of the process, and that they are being told in a summary sense that their assets are safe, and that things are being managed in a responsible manner.

I'm not sure simplifying the financial statements or the audit report would change that message any differently than simply repealing the limited scope and letting auditors give a full opinion.

Ms. DALTON. I would add that although the report is complicated, the participants would be aware that, yes, it had gotten an unqualified opinion that no problems were identified. Or, that yes, there were problems identified and I need to be concerned.

They may not understand all the details, but they would understand the summary report.

Mr. PAYNE. One other point that was brought out, I think, by Ms. Berg, is that one of the fears cited by banks and other regulated financial service institutions, which oppose a repeal of the limited scope audit exemption, is that such actions would grant independent public accountants virtually unlimited access to company records and documents unleashing a potential torrent of overzealous auditors creating intrusive and unnecessary burden on companies by the Government.

What is your—does this come out a lot when people are opposing this?

Ms. BERG. You made a very effective summary of the arguments that we hear, and I have to say I'm somewhat baffled by those arguments, because as I mentioned earlier, every year plan administrators elect whether to do a limited scope audit or a full scope audit, and roughly half of them, in the 20 years since the passage of ERISA, have elected to do a full scope audit.

Now, in that case, if we were going to have rampaging accountants all over financial institutions, that would be happening in half the audits that are done now. I have not heard people from financial institutions complaining about this, and I have to tell you, I've not found members of the business community or the plan sponsor community to be shy about letting us know when they have problems with ERISA.

Ms. DALTON. What generally happens with a full scope audit, in terms of the financial institution, is that the financial institution's auditor performs most, if not all, of the procedures. They look at the internal controls of the institution, and may perform some specific audit tests, and those are provided to the auditors that are auditing the plan. After review of those reports, they may find that it's not necessary, and often do find that it's not necessary to go anywhere near the records of the financial institution—they rely simply on the audit work that's been done by the financial institution's auditors.

So, in most cases where there's no problems, you shouldn't find that.

Mr. PAYNE. Thank you.

My time is running out, so I yield back the balance of my time.

Mr. SHAYS. Thank you.

I'm unclear as to why, of the $3 trillion, all potentially could apply for limited scope audits, all of the $3 trillion are potential candidates?

Ms. BERG. If they have money in a regulated financial institution.

Mr. SHAYS. And, all they need is 1 percent or half a percent?

Ms. BERG. Yes.

Mr. SHAYS. They could have the tiniest of tiny percents.

Ms. BERG. Yes.

Mr. SHAYS. And so, if they decide they want a limited scope audit, all they have to do is invest something in a regulated activity.

Ms. BERG. That's correct.

Mr. SHAYS. I'm struck with the fact that we do have some more questions for you, but I'm almost inclined to go to the second panel. Were you all planning to stay? What was your schedule here? You have to leave by 11? Do you have representatives here who could speak on your behalf?

Ms. BERG. Certainly.

Mr. SHAYS. Because I may like a response to what we hear, and maybe we'll—you've put the ball in play and we'll hear from our next panel, so you are free to go, but if you can stay it would be great. We would like someone to be able to speak for you afterwards if we want to bring them up.

Ms. BERG. Thank you.

Ms. DALTON. Thank you.

Mr. SHAYS. We're at recess.

[Recess.]

Mr. SHAYS. Sorry for the delay. I'll call this hearing back to order. Our second panel is comprised of Peter M. Kelly, member of Health & Employee Benefits Committee, U.S. Chamber of Commerce; Charles Leibold, vice president, Bankers Trust Co.; and Randi Starr, chairman, Employee Benefit Plans Committee, American Institute of Certified Public Accountants.

I believe that we need to swear the three of you in, and if there is anyone else who may come back and testify, that needs to be sworn in, for instance, the Deputy Assistant Secretary for Pensions and Welfare Benefits, Alan Lebowitz, if you would stand as well.

Would you all raise your right arms?

[Witnesses sworn.]

Mr. SHAYS. Thank you very much. I'd note for the record that all four people sworn in answered in the affirmative, and we'll begin as I called you.

STATEMENTS OF PETER M. KELLY, MEMBER OF HEALTH & EMPLOYEE BENEFITS COMMITTEE, U.S. CHAMBER OF COMMERCE; CHARLES H. LEIBOLD, VICE PRESIDENT, BANKERS TRUST CO.; AND RANDI L. STARR, CHAIR, EMPLOYEE BENEFIT PLANS COMMITTEE, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS

Mr. KELLY. Thank you, Peter Kelly for the U.S. Chamber.

Moving off of my prepared text I'd like to address some of the issues that were raised before. We heard there was a "hole in the audit," we heard there was "no audit," without an audit "no protection," "not subject to meaningful audit." Well, I'm sorry, Congressman, is the Comptroller of Currency Trust Department review process chopped liver? There is a very serious set of auditing that goes on. They are audited nine ways to Sunday, and they certify that these are accurate, that this is accurate information with respect to the regulated entities.

We are told that this is the only limited scope audit exception. It's not my field, but I understand in government contracting it is not uncommon for there to be limited scope audit where there are multiple contractors involved.

We heard about savings and loans, savings and loans are not subject to limited scope audit, never were, they didn't have trust powers, they are not subject to the exceptions.

Mr. SHAYS. I will ask a question, but just elaborate a little bit more on this.

Mr. KELLY. Well, savings and loans didn't have trust powers, they didn't have the regulated status, they were not—the fact that the savings and loan industry failed didn't raise limited scope audit issues, because they weren't investors who were subject to the protections of the limited scope audit.

A disclaimer doesn't mean that the balance of the assets aren't reviewed, or that there aren't obligations to review assets going to a regulated entity or coming out of a regulated entity. They are subject to audit, and if there's anything untoward found this is supposed to be disclosed.

In any event, to say that auditing is prevented begs the question when the answer is SAS 70, which also maintains that status quo, there isn't much achieved by that.

We've heard that the cost is $4 per person. The Department of Labor's own figures support a figure closer to $2,300 to $2,500 per plan. AICPA says 10 percent or 30 percent increase. Certainly, I don't think that Olena Berg was suggesting that 101 person plan is going to pay $404 more, I think that was an average.

Having said that, all three speakers before spoke about the 1996 Chief Accountant's assessment of audits. I'd like to take a moment to talk about that report. One thing we need to understand, the AICPA, working with the Chief Accountant at the Labor Department, has been doing a damn good job with a serious problem. There is a serious problem, and the serious problem has to do with the performance of the independent auditors that this bill will call upon to be the guardians of plans.

If we look at the 1996 assessment, there are a number of errors that were found in 1992 plan year audits. There were four identified among all those errors that related in any way to limited scope audit. I'd like to speak about those four, and then I suspect my time will be exhausted.

First of all, there is, within that report, an assessment of compliance with auditing standards. Only one example of auditing standards not being adhered to that had direct relevance to limited scope audit. That's in the sixth standard that has to do with the review of relevant evidence in performing the field work. There are 11 categories and many errors were found in those 11 categories. In the one of relevance to limited scope audits, 6 of the 262 audits that were reviewed, or 2.3 percent of the cases, involved a limited scope audit where either: one, a certificate was not received, as required by the limited scope audit; or two, the certificate on its face didn't cover all the assets and the auditor relied on it with respect to assets that weren't covered by the certificate. This was clearly not a mistake at the regulated entity level, it was a mistake at the auditor level.

Now, as I look at the other three examples, what we don't know is whether these are the same audits. They may very well be the same audits, but if you look at the ERISA there are three examples of ERISA reporting and disclosure errors that were identified in that assessment. I'll cover these in decreasing order of significance.

Seven audits were missing a footnote, in which the auditor is required to reconcile the information from different financial statements to point out the areas of difference and how they need to be reconciled. Those footnotes were omitted. That is not a mistake at the regulated entity level. That's a mistake at the auditor level, and represented 2.6 percent of the audits reviewed.

In six of the audits the auditor, frankly, misapplied the limited scope audit because they failed to view things like contributions and benefit payments when the limited scope audit only protects certified information from the auditor reauditing—i.e., buys, sells, gains, losses, in other words, investment information. In those six cases, the auditor relied upon the audit inappropriately, or on the certificate inappropriately and didn't look at the contributions and benefit payments. That's 2.3 percent of the cases.

In the final category of errors that has any relevance to limited scope audits are four auditors that erroneously claimed the availability of the exemption. I say "erroneously" because the entity was not a regulated entity entitled to the exemption.

So, what we have when we look at the assessment, the report, we have a disconnect between the recommended solution and the problem that was identified. There is a very real problem. I think, again, the Chief Accountant and AICPA have been doing a marvelous job in cracking down. There's reason to believe that these may all be the same auditors. They found a pattern of small, inexperienced audit firms having a predominant role in these mistakes.

Now, I understand that when a problem like this raises doubts about the confidence in independent auditors that it may be of some benefit from the accounting profession's point of view, to bring in some bystanders and blame it on them, the regulated investors, or to shift some costs on the employer while they buy some time to clean up their house. Again, I think the are doing a marvelous job.

From the Department of Labor Chief Accountant's point of view, this may signal that they simply don't have confidence in the independent audit system. They may need or they feel a need to rely on regulated entities more, to shift more of the burden to the regulated entity. That's an inappropriate solution from an agency with ERISA jurisdiction. Such a change needs to be done through committees with banking jurisdiction, with securities jurisdiction with respect to mutual funds, insurance. There are other areas of law that are involved here. We have to be careful about that.

But, when the day is done, that's not a good enough answer. ERISA said we need independent auditors, and that means we have to make the independent audit system work. Let's address the issues that were found in the 1996 report. Let's not identify the innocent culprit and wash our hands and say we've solved the problem by blaming somebody else for it. When the assessment proves there is no connection, there's a disconnect.

My written remarks will have to stand, because I'm sure my time is almost up. I will simply reiterate, we don't see the benefit in the change. We don't see the problem that exists. The cost is not justified. It distracts attention from the serious problems that do need to be addressed.

On the notice issue, there are a number of concerns: one, the hair trigger nature of the notice; two, there are, frankly, some basic civil liberties issues; three, there are existing rules that would reach situations where there are known violations. Here we are talking about a provision that would treat less favorably known evidence of possible events where it's an ERISA activity than if there's a traitor, if there's terrorism or murder of a Federal official involved, because of civil liberties concerns. If you are going to do that, then you've got to take it up with the Judiciary Committee and have the Constitution looked at in terms of how the notice operates.

Thank you very much.

Mr. SHAYS. Thank you, Mr. Kelly.

[The prepared statement of Mr. Kelly follows:]

Testimony
on

H.R. 2290

The Security and Enforcement Compliance for Retirement Under ERISA Act

Before the
Subcommittee on Human Resources
Of the
House Committee on Government Reform and Oversight

On behalf of the

U.S. Chamber of Commerce

Peter M. Kelly
February 12, 1998

My name is Peter M. Kelly. I am an attorney in the Chicago law firm of Murphy, Smith & Polk. I am a member of the U.S. Chamber of Commerce Health and Employee Benefits Committee. I appear before you today on behalf of the U.S. Chamber of Commerce, the world's largest business federation representing more than three million businesses and organizations of every size, sector, and region. We appreciate the opportunity to present our observations regarding the limited scope audit and the notification proposals contained in H.R. 2290, the Security and Enforcement Compliance for Retirement Under ERISA Act.

I am accompanied by David W. Kemps, Manager of Employee Benefits Policy at the U.S. Chamber of Commerce.

In order to fully respond to the Subcommittee's request for our views regarding H.R. 2290 without imposing unduly upon the schedules of the Subcommittee members and staff, I will speak from a summary of this formal submission. However, I ask that the full text of my remarks be submitted for the record.

I. ERISA's current auditing scheme

A. The current limited scope auditing protocols have proven to be Workable and Reliable.

The proponents of a repeal of the current auditing scheme set forth in ERISA have failed to demonstrate any significant harm that has resulted from the Congressional decision implicit in ERISA section 103(a)(3) to avoid imposing duplicative auditing costs on ERISA plans.[1] In fact, we would argue that the current auditing scheme has worked exceedingly well in providing protections for plan participants while helping to keep plan auditing costs to a minimum.

Under section 103(a)(3), the plan undergoes a full scope audit unless the portion of the plan's assets which are not to be audited by the ERISA auditor are held and invested by a regulated financial institution such as a bank, an insurance company, or a mutual fund that separately prepare financial statements regarding such assets and certify to the ERISA auditor that those financial statements are accurate. Duplicative ERISA auditing is not required for the simple reason that it is not necessary in order to provide plan participants with assurance that they are receiving accurate information regarding their plan's assets. Moreover, it is important to note that plan assets do not escape audit when a plan assets are held by a regulated financial institution and the plan thus chooses to exercise its right to engage in a limited scope audit. To the contrary, such plan assets are audited at the financial institution level, sometimes on numerous occasions.

Or course, where the organization handling investment of plan assets is not already subject to extensive regulatory requirements, ERISA auditing would not be duplicative and is required.

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[1] The decision to permit limited scope audits was a considered decision, not a technical defect in ERISA. House Conf. Rpt. 93-1280, 93[rd] Cong., 2d Sess., at 257 (1974).

For example, the Department of Labor has clarified that the limited scope audit exception does not apply to brokerage accounts.[2]

B. Proponents Of Change Have Not Demonstrated Any Deficiency In Limited Scope Audit Practices Which Justify The Disruption And Costs Of Requiring Duplicative Audits Of Assets Invested With Regulated Pooled Funds.

The attempt by proponents of the change in the limited scope audit rules to gin up examples of the need for this change have been unimpressive. In most cases cited by the Department of Labor there is no causal connection between the problem identified and the existence of the limited scope auditing scheme. In fact, in many instances the problem would not have been discovered any earlier if a full scope audit had been conducted. The examples do demonstrate that, while the ERISA auditor may have missed the problem, an ERISA co-fiduciary, the regulated pooled fund itself or some other persons familiar with the situation either solved the problem, brought it to the attention of Department of Labor's attention, or cooperated with the agency in rectifying the problem.

We would argue that the examples cited by the Department of Labor merely demonstrate that the limited scope audit rule functions quite effectively. In fact, because of the extensive regulatory oversight of the financial services industry, it is difficult to conceive of a pooled fund investor hiding or otherwise shielding plan asset discrepancies from the regulatory burdens imposed by the Comptroller of the Currency Trust Department Rules, Securities law obligations, or insurance regulations. In fact, if there is a plan asset irregularity, most likely it occurred prior to deposit with the financial institution. While we see no need for improving the auditing of such pooled funds, it would best be addressed by changing banking, securities or insurance laws, regulations and practices, not by increasing the costs and administrative burdens on ERISA plans by imposing redundant and costly auditing requirements.

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2 DOL Advisory Op. 93-21A.

C. There is no Clear Evidence that Repeal of the Limited Scope Auditing Rules Will Significantly Improve ERISA Protections.

Requiring ERISA auditors to broaden the scope of their opinion will clearly cost more money. In fact, the Department of Labor estimates that such costs will increase by up to $2,500 per plan. Yet, the additional protections afforded plans and plan participants is illusory at best.

Many financial institutions prepare SAS 70 Reports which detail the manner in which plan assets under their control are managed.[3] While the preparation of an SAS 70, and its use by the ERISA auditor, help relieve the costs of duplicative audits, the business community remains concerned that use of the SAS 70 may not provide sufficient protection from such duplicative effort. Proposals to allow the use of the SAS 70 Report, but providing ERISA auditors with the discretion to look beyond the SAS 70, simply leads to increased auditing and greater costs. While the increased auditing costs will eventually be passed along to the plan, increased protections will not necessarily flow from the enhanced scrutiny.

In our view, the enactment of H.R. 2290 will be like a heavily sugared breakfast cereal, expensive, attractively packaged, emotionally satisfying, but full of empty calories that provide little valuable fuel.

II. Immediate Notification Requirements Will Disrupt Plan Operations and Impede ERISA Enforcement.

A. Existing Rules Require and Reward Pro-Active Corrective Behavior and Penalize a Failure to Report Known Crimes.

The Chamber has no desire to protect wrongdoers or discourage responsible behavior by plan officials and their advisors. The existing strict ERISA fiduciary rules were enacted with the

U.S. Chamber's active support. Under ERISA, co-fiduciaries cannot sit idly by and ignore serious or even minor ERISA breaches of duty. To the contrary, a co-fiduciary who fails to act to prevent or correct misbehavior may find him or herself personally liable for the harm suffered by the plan as a result of misbehavior by another fiduciary.[4]

The IRS has developed programs to encourage self-corrective behavior by plans and plan sponsors. These programs are part of the broader movement towards responsible self-policing which is implicit in the income tax self-assessment system, the corporate government movement, and the federal sentencing guidelines. For example, under the sentencing guidelines an accountant and many other categories of persons holding positions of trust will be treated much more harshly if they fail to act to correct or disclose the commission of crimes.[5]

The allegations that no laws require persons to report criminal wrongdoing with respect to ERISA plans is simply erroneous. There is an established body of law that requires reporting which includes statutory and judicially imposed safeguards designed to assure that the reporting obligation is only imposed within the bounds of the constitution. For example, a person who "knows" a criminal offense has occurred (not merely suspects or has some "evidence" that an irregularity "may have" occurred) is obligated to report that crime under a provision of the criminal code that is fully applicable to the "irregularities" described in H.R. 2290.[6] The most directly relevant of these existing laws is the crime of Misprison of Felony:

> Whoever, having knowledge of the actual commission of a felony cognizable by a court of the United States, conceals and does not as soon as possible make known the same to

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3 AICPA Auditing Standards Board, Statement on Auditing Standards No. 70, Reports on the Processing of Transactions by Service Organizations.

4 ERISA § 405.

5 For a collection of relevant cases, *see Increase in Base Offense Level Under Sentencing Guidelines § 381, 18 U.S.C. Appx. § 381) for Abuse of Position of Public or Private Trust Significantly Facilitating Commission or Concealment of Offense,* 121 A.L.R. § 23 (1997).

6 18 U.S.C. § 4. *See also,* 18 U.S.C. § 3 and Internal Revenue Code § 6701.

> some judge or other person in civil or military authority under the United States, shall be fined under this title or imprisoned not more than three years, or both.[7]

The key difference between the notification rules of H.R. 2290 and the existing crime of misprision of felony, aside from the subject matter, is the safeguards that current law contain that assure the duty to report will not arise under vague and imprecise circumstances. The crime of misprision is only committed if the person charged knows that a crime has been committed. Under H.R. 2290 there is no such requirement. H.R. 2290 requires quick reporting (within five days) if the reporting person merely knows of some evidence that an ERISA irregularity "may have" occurred.

B. The Notifications Required by H.R. 2290 Will Result in Overreporting.

The hair trigger reporting rule proposed in H.R. 2290 will encourage over-reporting of all types. A few examples will suffice to illustrate the various ways in which human frailties will be magnified by this quick reporting obligation:

A. Concerned and Diligent but Misinformed. Some reports will be filed by well-intentioned persons who simply misunderstand what is required to be reported. This will lead to reports that involve simply minor administrative disputes that by no stretch of the imagination are criminal irregularities.

1. **Overly Cautious Whistleblowers:** The Department of Labor will no doubt be swamped with precautionary notifications by persons who simply resolve disputes

[7] 18 U.S. C. § 4. This provision, most recently amended in 1994, has been a part of the Criminal Code of the United States since 1909 and has precedents in similar crimes which have been a part of the criminal laws of the United States since the original Criminal Code was enacted in 1790. It is a mistake to assume because of the archaic title of this crime and its long history that this provision of the Criminal Code is obsolete. On the contrary, it was most recently amended by Publ. L. 103-322 9 (1994) and it continues to be used throughout the federal criminal justice system. Most frequently, this criminal charge is used as a lesser charge in plea bargaining. However, it has also been used successfully in recent federal prosecutions. *See, e.g.*, U.S. Attorney Press Release 94/16/96), www.law.emory.edu *USAO/news/hearing.html*. As recently as 1980, the Supreme Court discussed the history and continued vitality of this provision. *Jenkins v. Anderson, Warden*, 447 U.S. 231, 244, n. 5 (1980).

in favor of filing. The result may be that they will develop a reputation for unnecessary filings and they will be ignored in a truly serious situation.

2. **Jumping the Gun: The "fire, ready, aim problem:"** Under normal circumstances, the determination of what has actually happened when an ERISA crime is suspected may be a difficult time consuming exercise. A diligent fiduciary or auditor may have suspicions well before he or she can say with confidence a violation has occurred. H.R. 2290 has such quick deadlines, such a vague trip wire, and such severe penalties that even persons of good faith will be encouraged to act with haste. Haste is not always the best approach, however, particularly when pointing a finger and making the serious charges that are involved in H.R. 2290 reporting.

3. **Malicious and Vengeful.** Notwithstanding the "good faith" element in the liability protection provision, bad faith may be difficult to prove. More importantly, bad faith reporting may cause irreparable harm long before false charges have been disproved. Congress should show greater respect for civil liberties and for power of consequences of false accusations than is evidenced by H.R. 2290.

4. **Preemptive strikes.** We should expect that wrongdoers when cornered will try to obscure their own responsibility and find an innocent scapegoat. You must expect cross notifications and persistent misinformation from wrongdoers including preemptive false notification containing plausible but false information.

C. The Notifications Required by H.R. 2290 will Discourage Timely Co-Fiduciary Action or Plan Sponsor Correction.

The filing of an H.R. 2290 notice will throw self-correction efforts into disarray while the Department of Labor considers what action to take, if any. In effect such a notice will immediately "federalize" a problem that ERISA intends fiduciaries to handle for themselves. This "pass the buck to Washington" approach will cause great harm because often the best results are achieved from early intervention by other fiduciaries familiar with the situation. In the meantime it is doubtful the Department of Labor will have the resources necessary to produce as favorable a result as the result that could be obtained by fiduciaries on the scene. From the point of view of plan participants it is difficult to see how participants are well served when immediate fiduciary self-help opportunities were lost because the problem was sent to Washington. Of equal concern is the likelihood that H.R. 2290 notice requirements will encourage some fiduciaries to distance themselves from day-to-day plan operations to avoid gaining specific knowledge of the type that could trigger a notice obligation.

D. Diluting Enforcement Resources.

If only a fraction of the excessive, misleading and significant reports we foresee are received by the Department of Labor, the Department will have trouble distinguishing the important notices they now receive from the junk notices they will receive due to the extreme effects of H.R. 2290. The net effect will be to deaden the Department's sensitivity to the truly significant notices.

E. The Constitutional and Civil Liberties Concerns with H.R. 2290 Should be Addressed by the Appropriate Committee.

The limitations of the misprision of felony provision reflect a balancing between civil liberties and the obligations of all citizens to cooperate in the enforcement of laws. Under this provision a reporting obligation arises only when there is sufficient reason to believe the accusation of a crime will not be defamatory and the reporting person has sufficient accurate information to assure the report will not be merely vindictive. It is instructive that the Criminal Code does not impose the hair trigger reporting proposed in H.R. 2290 in cases as serious as murder, treason, terrorism or other crimes that must be viewed at least as serious as the ERISA irregularities addressed by H.R. 2290.

The H.R. 2290 reporting obligations operate like a blanket standing subpoena addressed to all ERISA accountants and plan administrators without any of the safeguards applicable to individually drafted subpoenas. Unlike H.R. 2290 reporting obligations, subpoenas have only limited duration and may be challenged for vagueness by motion to quash. A penalty for violating a subpoena may only be assessed after a due process court hearing, whereas the H.R. 2290 penalties may simply be assessed by the Department of Labor.

If special reporting obligations are to be imposed on ERISA plan administrators and accountants under H.R. 2290, they should be afforded the same civil liberties protections afforded to others. Therefore, H.R. 2290 should not be reported by any other committee of Congress until it has received a clean bill of constitutional health from the Judiciary Committee.

III. Conclusion

The U.S. Chamber of Commerce stands ready to work with this Subcommittee and its staff to advance reasonable proposals to improve the enforcement of ERISA. But, we respectfully submit H.R. 2290 is not such a proposal.

Mr. SHAYS. Was Ms. Starr next? Did I call you? Thank you.

Mr. Leibold.

Mr. LEIBOLD. Good morning, I'm Chuck Leibold, a vice president with Bankers Trust Co., of Des Moines, IA, a locally owned community bank. I'm here today representing the American Bankers Association.

This morning I'd like to concentrate my comments on section 2 of H.R. 2290, which would amend ERISA's limited scope audit provisions so that a plan accountant, when offering an opinion on the plan's financial statements would rely on the work of independent accountant to issue to the bank what is known as an SAS or SAS 70 report.

Mr. Chairman, I share the concern of the Assistant Secretary and Deputy Inspector General with regard to safety of pension plan assets. However, from what I see day to day in my own institution, and from my knowledge of operations of bank trust departments in general, I can assure you that pension assets held by banks are adequately reviewed on a regular basis.

Part of this review at my bank is conducted by an outside firm, to which we have outsourced the internal audit function. In our case, this is KPMG Peat Marwick. The review occurs at both the trust department level and the overall bank level.

In addition, our State and Federal bank regulators examine our trust department on a regular basis. The three Federal bank regulatory agencies, the Federal Reserve, the Office of the Comptroller of the Currency and the FDIC, as well as many State bank regulators have experienced examiners who specialize in trust and custody. These examiners spend significant amounts of time testing our transactions, to assess whether the bank's policies, procedures and controls are working properly. They also assess the adequacy of the bank's audit department, whether in house or out sourced.

To give you an idea of the extent of these bank examinations, I have brought with me the materials used by the Federal Reserve Board, the Comptroller and the FDIC in their assessment of bank trust departments, this mountain of books you see here. I know that each of these agencies would be happy to discuss with you and your staff the type and scope of exams that they conduct on a regular basis in our banks.

SAS 70 reports are often duplicative of what bank regulators and bank auditing departments review as part of their exams. Why then do some banks obtain these reports, while others don't? The prime reason is that some pension plan customers are demanding the report. This is particularly true where banks are now providing services to customers with multiple locations all across the country. These plan customers may not know the bank or its trust department employees and, thus, they demand a SAS 70 report.

For some banks like my own, our customers and their CPAs generally know the bank and its employees well. They also know that banks are highly regulated and that we routinely undergo extensive examination.

For many banks across the country who already obtain a SAS 70 report, this legislation would not appear to present a problem. However, the legislation does contain some significant potential difficulties that I have described in my written statement.

Unfortunately, for many small banks, like my own, this legislation would force us to begin to obtain a very expensive accounting report, which would largely duplicate work already being done.

A recent bank survey indicated that the annual cost of a SAS 70 report ranges anywhere from $18,000 to $75,000 annually. All banks surveyed responded that the outside accounting firm relied on internal work, requiring anywhere from 100 to 1,000 hours of bank audit staff time.

Mr. Chairman, these are hard costs that the bank needs to either pass on to its customers or simply absorb as an internal cost of doing business. While the elimination of the limited scope audit or the enactment of H.R. 2290 will affect all sizes of banks, its difficulties will cause a small bank like my own to incur significant additional expenses that we will probably not be able to pass on to our customers, and for little, if any, demonstrable benefit.

Our options will be to reduce our profitability and, hence, the return to all local owners, or attempt to pass on these extra costs and, perhaps, become uncompetitive in the marketplace or saddle our customers with an unnecessary extra expense. In either event, the implications for our bank, our customers and our shareholders are negative. Many communities have only one locally based source of fiduciary services, and these local trust departments may become less viable.

This is an expensive solution to a problem or problems that really have not been adequately identified by the Department of Labor. If there is a specific problem, such as difficult to value investments, like real estate, venture capital, limited partnerships, the ABA supports a more targeted solution, such as the solution which the Department arrived at on the timing of transfer of employer/employee contributions. We would be very happy to work with the Department to develop such a solution to specific issues.

I'd like to offer a specific suggestion that may better address pension security concerns for assets that are held outside of a bank's control. A potential solution would be to change ERISA's limited scope audit provision to allow an accountant to issue an opinion on the plan's financial statements, even if plan assets are held by a bank or insurance company. Since a bank is a highly regulated entity, and bank regulators and bank internal or external auditing departments are already doing the necessary testing the pension plan accountants would do, it makes sense to continue the limited scope provision as to assets held by a bank. A plan, however, may have assets held by other entities that may not receive the high level attention that the banking industry does. These assets can, and should, be scrutinized by the plan's accountant, and he or she should be able to render an opinion on those assets.

The ABA's solution would require plan auditors to scrutinize all plan transactions and to look closely at plan assets held outside of a bank or an insurance company, as they would have to issue an opinion and could not include these items under cover of a limited scope disclaimer. The ABA hopes that this targeted solution, along with our offer to work with the Department of Labor in regards to any specific issues they may have, will satisfy the concerns raised by the Department and the Deputy Inspector General.

Mr. Chairman, I'd like to thank you and the rest of the subcommittee for your time and for allowing me to testify today. I'll answer any questions when the time comes.

Mr. SHAYS. Thank you, Mr. Leibold.

[The prepared statement of Mr. Leibold follows:]

Testimony of Charles H. Leibold
On Behalf of the American Bankers Association
Before the Subcommittee on Human Resources
Of The
Committee of Government Reform and Oversight
U.S. House of Representatives

February 12, 1998

I would like to thank the Chairman and the distinguished members of the Subcommittee for the opportunity to discuss the issues raised by proposals to repeal the limited scope audit exemption. I am Charles (Chuck) Leibold, a Vice President with Bankers Trust Co. of Des Moines, Iowa. I am here representing the American Bankers Association. In my testimony today, I'd specifically like to address Section 2 of H.R. 2290, which would repeal ERISA's limited scope audit provision that allows a plan accountant to rely on statements certified by a bank or insurance company.

The American Bankers Association brings together all categories of banking institutions to best represent the interests of the rapidly changing industry. Its membership – which includes community, regional and money center banks and holding companies, as well as savings associations, trust companies and savings banks – makes ABA the largest banking trade association in the country.

ABA opposes the adoption of Section 2, for the following reasons:

- While the problem it is intended to address is less than clear, the proposed solution is far broader than needed.
- Current bank regulation, together with the extensive supervision, examination and enforcement of the bank regulatory agencies, makes the provision unnecessary for banks and trust companies.
- At the same time, the proposal would impose a huge additional cost on banks and trust departments with no demonstrable benefit to employee benefit plans and their beneficiaries.
- Currently, the Congress and the Administration are seeking ways to broaden participation in and coverage of employees by retirement plans. This proposal will negate these efforts by adding costs and regulatory burdens on plans which will discourage employers from adopting or maintaining plans.

Banks and trust companies have a long history of serving as fiduciaries to employee benefit and other trust accounts. It started decades before ERISA was enacted. That tradition carries on today. According to the Federal Financial Institutions Examination Council's 1996 data, 2600 banks and trust companies manage, on a discretionary basis, 265,000 employee plan accounts with $1.3 trillion in assets, and they hold, on a non-discretionary basis, another 13 million accounts with $4.3 trillion in assets.

Bankers Trust serves as trustee or custodian to nearly 200 pension plans. Many of these plans are for small businesses, typically those under 100 employees, although a significant minority of the pension plans we service have over 100 employees. Therefore, our institution would be affected by changes to the limited scope audit provision of ERISA.

Both the Assistant Secretary and the Deputy Inspector General have testified as to their concern over the safety of pension plan assets. Mr. Chairman, I certainly share their concern. However, from what I see day–to–day in my own institution and from my knowledge of operations of bank trust departments in general, I can assure you that pension assets held by banks are adequately reviewed on a regular basis. This review at Bankers Trust is conducted by an outside auditing firm, as our internal auditing department has been outsourced. In addition, our state and federal bank regulators examine our trust department on a regular basis. The three Federal bank regulatory agencies (the Federal Reserve Board, the Office of the Comptroller of the Currency and the Federal Deposit Insurance Corporation), as well as many state bank regulators, have examiners who specialize in trust and custody. They can be on-site for as long as three or four months each year at large institutions. They conduct extensive testing of transactions to assess whether the bank's policies, procedures and controls are working well. In the case of the OCC, separate examination program components exist for accounting and control, system reconcilement and control, cash, handling of overdrafts, securities income processing, dividend/income claims procedures, disbursement of trust assets, on and off premises custody of assets, securities trade processing, securities settlement, and securities lending among others. Each bank regulator also assesses the adequacy of the bank's audit department, which may be in-house or outsourced.

I also know that a number of large banks obtain what is commonly known as a "SAS 70" report. This audit report, prepared by a CPA firm, focuses on a bank's policies and procedures that may affect the processing of transactions for the bank's customers. Is an SAS 70 report sometimes duplicative of what bank regulators and bank auditors look for and conduct testing on as part of their exams? The answer is yes, to a certain degree. Why, you may ask, do some banks obtain SAS 70 reports? The answer is that some large pension plan customers are demanding these reports. This is particularly true as banks are now providing services to customers with multiple locations all across the country. Those pension plan customers may not personally know the bank or its trust department employees and thus they demand these types of SAS 70 reports. For some banks, their customers have known the bank, its reputation and its employees all of their lives; to them it is not a necessity to see a SAS 70 report. They already know that banks are highly regulated and that they routinely undergo extensive examination. Lastly, many smaller banks provide services to pension plans covering fewer than 100 employees and would not be subject to this provision.

The Assistant Secretary and the Deputy Inspector General have also testified that they support the repeal of the limited scope audit provision of ERISA. This is a position with which the American Bankers Association cannot agree. It would only lead to increased cost and burden without commensurate benefit. Instead, the ABA would like to work with the Department of Labor to address any specific concerns that it may have. It has been suggested that one of the Department's concerns deals with hard to value assets such as limited partnerships. If this is the problem, then repeal of the limited scope audit provision or the enactment of H.R. 2290 is not the right solution.

Section 2 of H.R. 2290, if enacted, would obligate a plan accountant to rely on a SAS 70 or other type of report provided by an independent accountant. For many banks across the country who already obtain a SAS 70 report from an accounting firm like Price Waterhouse or Ernst and Young, this legislation would not present a problem. However, the legislation does contain some potential difficulties that I would like to point out a little later. Unfortunately, for many small banks, like my own, this legislation, would force us to begin to obtain a very expensive accounting report which in many cases would be a duplicative effort. Our internal auditing department has been outsourced to the same accounting firms that would provide us with a SAS 70 report. Our other option would be to find the space for every plan's auditor to come into the bank once a year to do their own testing of our systems and controls in order to render an opinion on the plan's financial statements. For most banks this space is simply not available. It certainly is not available at my bank. Even if it were available, the staff time required to work with a succession of audit firms would dramatically impair the ability of our operations to function on a day-to-day basis.

What is the cost of a SAS 70 report? Several years ago one of my employee benefit colleagues conducted an informal survey about the cost of SAS 70 reports to bank employee benefit departments. When asked: "How much is the audit costing you?" – the response was anywhere from $17,500 to $75,000. All the banks responded that the outside accounting firm relied on work performed by the bank's own internal auditors. When estimating the time that the bank's internal auditors would spend on producing information given to the outside accounting firm – the responses ranged from 100 hours to 1,000 hours. Many small banks do not have internal auditors on staff. Instead, at these banks the audit function is outsourced to public accounting firms. These firms are already auditing, on an annual basis, the administrative and operational functions of these bank trust departments. To overlay a SAS 70 type of audit would simply result in duplication at significant additional cost.

Mr. Chairman, these are hard costs that the bank needs to either pass on to its employee benefit customers or to simply absorb as an internal cost of doing business. It is likely that the costs of purchasing a SAS 70 report will rise in the future, as the major accounting firms are merging.

This is an expensive solution to problems that have not been adequately defined by the Department of Labor. If the problem is with difficult to value investments, such as real estate, venture capital or limited partnerships, the ABA supports a more targeted solution, which we would be very happy to work with the Department to develop. In response to the needs of trustees to fairly value these assets, several knowledgeable independent appraisal and valuation services have become available in recent years.

You may be asking which types of plans contain these difficult to value assets. Experience shows that defined benefit plans, particularly very large ones with hundreds or thousands of employee participants, have these types of investments. Defined benefit plans are traditional pension plans where the amount of benefits payable to plan participants does not depend on the value of the assets held by the pension trust. Large defined benefit plans may contain such non-traditional investments to diversify their portfolios. Generally, these investments are small as compared to the investments of the defined benefit plan as a whole. In any event, the employer, not plan participants, bears the risk of investment loss in a defined benefit plan.

Less frequently these types of investments may also be seen in defined contribution plans. Many of my employee benefit colleagues have had the experience of working with an important bank customer such as a doctor, lawyer or dentist, whose defined contribution plan contains non-typical investments. These non-traditional investments are most commonly held in self-directed, segregated accounts of professionals, business owners, or other reasonably informed plan participants. As such, no participant, other than the investing participant, has any risk of loss as a result of the investment.

Once again, Mr. Chairman, let me point out that our bank as well as every other bank across the country has its trust department thoroughly reviewed and its systems tested by our bank regulators both state and federal. They do an excellent job. I have brought with me the materials used by the Office of the Comptroller of the Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve Board in their examinations of bank trust departments. I know each of the agencies would be happy to discuss with you and your staff the types of exams that these regulators conduct with respect to bank trust departments.

Mr. Chairman, if I may, I would like to point out some potential problems that the ABA has found in H.R. 2290. If this bill is enacted, the ABA has noted, after speaking to its members, that there still may be difficulties in addressing the concerns of a pension plan auditor. A SAS 70 report, for example, may cover a different reporting period than the plan's fiscal year so a plan auditor may decide to go into a bank and perform his or her own testing for the period of time not covered by the SAS 70 report. In addition, I would like to point out that there is no standardized SAS 70 report. These reports are customized, to some degree, for each institution. Thus, one plan's auditor may not accept the bank's SAS 70 report and demand additional information. Finally, a SAS 70 report may not cover the activities of sub-custodians. This is a significant issue for virtually all smaller banks that use such sub-custodial arrangements, for example, for access to national securities depositories. As smaller banks seek to maintain the ability to offer competitive products and services on an efficient and profitable basis, it is common to see multiple sub-custodians for different products and services. In the case of a large bank, the plan's auditor may demand information on a bank's international securities lending arrangements or its use of independent record-keepers.

While the provision will affect all size banks its difficulties will cause a smaller bank, like my own, to incur significant additional expenses that we will probably not be able to pass on to our pension plan customers and for little, if any, demonstrable benefit. Our options will be to reduce our profitability (and hence the return to our local owners) or attempt to pass on these extra costs and, perhaps, become uncompetitive in the marketplace. Either option carries with it negative implications for our bank, our customers, and our shareholders. Many smaller communities have only one local source of fiduciary services and those local trust departments may become unviable.

Finally, I'd like to spend a minute or two discussing what it is that a bank does for pension plans and offer another suggestion that may address pension security concerns for assets that are held outside of a bank's control.

After reviewing some of the Department of Labor's recent enforcement and litigation efforts in relation to pension plans, I have come to the conclusion that many of the problems that the DOL and the Office of the Inspector General have identified in these cases would not be solved by eliminating the limited scope audit provision in ERISA. They would, however, be solved by changing ERISA's limited scope audit provision, to allow an accountant to issue an opinion on the plan's financial statements where assets are held outside of a bank or insurance company. Since a bank is a highly regulated entity and bank regulators, bank auditing departments and in some cases, outside auditors are already doing the necessary testing that pension plan accountants would do, it makes sense to continue the limited scope audit provision as to assets held by a bank or an insurance company when they are acting as trustee or custodian. A plan, however, may have assets held by other entities that may not receive the high level attention that the banking industry does. These assets can and should be scrutinized by the plan's accountant and he or she should be able to render an opinion on those assets.

There is certainly potential for fraud and abuse concerning pension assets that are outside of the control of the banking industry. Pension plan auditors should scrutinize those assets closely. To develop more fully this suggestion, I would like to take a few minutes to discuss the movement of employee benefit funds and where the potential for fraud and abuse may be the greatest. The three forms of asset movement are plan contributions, plan investments and plan distributions. By tracking the movement of money, you can track the ways of misappropriating plan assets. The basics are these:

- Money comes into a plan - these are plan contributions
- Money gets invested in the plan - these are plan investments
- Money gets paid out of the plan - these are plan distributions

First, employee benefit assets can be misappropriated before they get into the trust when an employer fails to remit a contribution. Second, employee benefit assets can be improperly diverted through the investment process resulting in a diminution of employee benefit funds. Third, employee benefit assets can be distributed inappropriately, either as a benefit payment to a non-participant or to another improper recipient.

We are all well aware of the danger that contributions may not get to the trust and instead may be retained temporarily or permanently by the plan sponsor. Plan contributions are made periodically by the plan sponsor to the bank as trustee by check or wire. This is true whether the contributions are employee contributions or employer contributions. In most cases, all aspects of the contribution are unknown to the bank until the bank actually receives the funds, including the amount of the contribution, the timing of the contribution, and whether or not a contribution is due at all. This is due to a variety of reasons from fluctuating payroll to the discretionary nature of some types of contributions. There are even legitimate situations where a money purchase pension plan would not have a contribution, and the bank trustee would not be able to know or verify whether a contribution is required. Further, the correctness of the amount of the contribution is even more difficult to determine by a trustee.

Trust agreements clearly state that the trustee is only responsible for the funds that it actually receives. The purpose of the trustee is to safeguard what is set aside in the trust. The trustee is not a collection agent, nor is the trustee well suited to serve as one. The contributions are often discretionary and vary in amount from year to year, or from payroll to payroll.

Next, let's take the case of plan investments. Banks who serve as trustees of plans often have investment authority, and many controls are in place to protect the prudent investment of assets. Often, however, the bank is a directed trustee or custodian and another party has investment management discretion. When the bank is a directed trustee or custodian the decision as to what the assets of the plan should be invested in is left to someone else, sometimes in accordance with a written investment policy. The bank is then responsible for ensuring that the process of buying, selling, and holding the securities is carried out in a safe and secure manner. Whether acting as trustee or custodian, banks employ a "delivery versus payment" control environment that ensures that the assets of the pension plan are protected. This is the bank's operational system that is tested by the bank's auditors, the bank's regulators, and outside accounting firms in a SAS 70 report.

Finally, there are plan distributions. One possible way for a plan sponsor to steal from a plan is to direct a benefit payment to an individual who is not entitled to it (i.e., a fictitious participant, or a participant who has not yet separated from service with the employer). Trust agreements require the trustee to pay benefits as directed; as long as the direction is signed by the proper party that the plan sponsor has designated (usually the Plan Administrator), the trustee will pay the benefit. Secondarily, a plan sponsor can direct the trustee to pay a bill for excessive services or for services not rendered (which can be a subterfuge for indirect payments to the plan sponsor). If the plan document allows plan expenses to be paid by plan assets, the trustee will pay the bill submitted by the plan sponsor if the direction is signed by the proper party (again the Plan Administrator).

As I have described, only the operational details of how a bank carries out the purchase, sale, and safekeeping of plan investments are tested and described in a SAS 70 report. Fraud and abuse of plan assets in connection with plan contributions and disbursements are, for the most part, out of the control of a bank. These are instead controlled by the Plan Sponsor and the Plan Administrator. It is in these two areas where a plan's auditor may play a major role. By reviewing a plan's financial statements and transactions, a plan auditor may be able to determine that fraud has taken place. A plan auditor should be able to fully scrutinize transactions involving plan assets where the movement of money occurs outside the bank's control. That plan auditor should be able to issue an opinion on representations regarding these activities. ERISA can be changed to allow this without forcing the duplicative testing that would occur if banks were forced into purchasing SAS 70 reports or if the limited scope audit provision was repealed. I am aware however, that having these types of audits may increase cost to plan sponsors, enough so that the feasibility of providing a pension plan for their employees is no longer present.

The ABA is unaware of any situation where the lack of a full audit by a pension plan's auditor has led to any misuse of pension plan assets where the assets are held by a bank as trustee. Repeal of the limited scope audit or the enactment of H.R. 2290 will not have a significant impact in preventing plan asset misappropriation. If the Department nas identified valuations of hard-to-value assets as the problem to be solved by repeal of the limited scope audit provision or enactment of H.R. 2290; then other solutions that would better target the problem. The ABA would be pleased to work with the Department of Labor to identify and implement appropriate measures.

Mr. SHAYS. Ms. Starr.

Ms. STARR. Thank you, good morning.

I am currently chair of the AICPA's Employee Benefit Plans Committee. The AICPA has stated for many years that the repeal of the limited scope audit exemption will strengthen independent audits, which are a key element in adding protection to the private pension system.

As the first panel mentioned, we are not aware of any Federal program, other than ERISA, or any Government agency, that allows or accepts limited or restricted scope audits. For example, the SEC will not accept limited scope audit reports on employee benefit plans that are required to file Form 11-Ks with the SEC. These would include such plans as 401(k) plans that invest in employer securities. These audit scope restrictions prevent the auditor from auditing a significant amount of plan asset information and, therefore, auditors cannot make any independent conclusions about the fairness of the plan's overall financial statements as intended by Congress when ERISA was enacted.

You've heard a good bit about limited scope audits earlier, so I won't repeat all of that information, but, obviously, in virtually all cases this is such a significant restriction on the scope of the audit and, consequently, the independent accountant will not express an opinion on the overall fairness of the plan's financial statements.

In order for us to render an opinion, we cannot rely solely on a certification from the financial institution. Auditors need to understand the design and effectiveness of the internal controls used by a financial institution to execute and process the plan's transactions, to value investments, and to consider performing other tests that we consider necessary.

In a plan audit, the internal controls at the financial institution used to process these transactions are very critical to independently ensuring that the plan is properly credited with its share of investment income and expense, as well as ensuring that investments are properly valued.

In a limited scope audit, no audit procedures on investments are performed, except for comparing the information certified by the trustee with the information in the financial statements.

Over the last several years, the quality of certifications are changing. Things that we see these days are no signatures of any trust officer on the certification, rubber stamp signatures, signatures of secretaries, which may provide plan fiduciaries and independent accountants little or no assurance that the information has been carefully reviewed by an appropriate official of the financial institution.

I have seen certifications where the fair value of certain investments was clearly wrong, amounts had not changed from prior years even though they were clearly marketable, amounts were negative, shares were zero but there were still values being shown for them, and in each of these instances the financial institution did revise the plan's investment report because of these various errors.

Also, independent accountants are finding that institutions are adding a lot of caveats to the certifications that they provide us, that for all intents and purposes reduce or invalidate the assurances that the certifications are to provide.

Additionally, current practice also indicates that plan trustees are outsourcing various plan recordkeeping functions and investment activities, and yet, the trustees continue to sign a certification statement as to all investment activity. This practice brings into question whether or not the person signing the certification is truly knowledgeable of the outsourcing activities, as they relate to the plan's assets.

Often, particularly, some investment trust companies and insurance carriers, state they cannot provide all of the required information for the supplemental schedules because they state their systems do not maintain appropriate cost information. Yet, these are the same systems that report gains and losses on securities that users of benefit plan statements are to rely upon.

Some are concerned that the repeal of the limited scope audit exemption would result in many plan auditors knocking on the doors of banks and investment companies, so that auditors can audit the individual plan's investments. This fear of inefficient and intrusive auditing, auditor phobia perhaps, we believe is unfounded. As Ms. Berg indicated earlier, I have also not had any complaints from any institution complaining that we are sitting on their doorsteps to be able to go in and audit.

With over 20 years of experience, we have been able to come up with an efficient approach using the SAS 70 reports. Historical experience indicates that in full scope audits where a SAS 70 approach is used, the plan's independent accountant does not have to go in to the service organization.

Situations where the plan does need to go in usually is when there is not a SAS 70 report or the SAS 70 report indicates there are weaknesses at that financial institution.

Finally, I wanted to address the concern sometimes expressed over costs of doing a full scope audit. Plan audit fees are typically competitively negotiated and are on a fixed-fee basis, rather than an hourly basis. This reflects the fact that often these plan audits are ancillary services as part of the audit of the plan sponsor. Perhaps, to put it in a phrase you might better understand, loss leader is often a good phrase for doing the plan audits.

The incremental cost of a full scope audit is truly dependent upon the quality of the internal controls established by the plan and the outside service organizations and the nature of the plan's investments. For example, the incremental audit costs of a plan that has good internal controls, and holds assets in readily marketable investments that are easy to value, would likely be significantly less than the additional costs for a plan having the same amount of assets with poor internal controls and assets that are difficult to value.

Again, I would also like to take the opportunity to thank you and your committee, and would be happy to answer any questions.

[The prepared statement of Ms. Starr follows:]

Mr. Chairman, members of the Subcommittee, I am Randi L. Starr, Chair of the AICPA's Employee Benefit Plans Committee. The AICPA appreciates the opportunity to present its views today regarding repeal of the limited scope audit exception in ERISA. The AICPA is on record since 1978 supporting repeal of limited scope audits of employee benefit plans. It will strengthen independent audits which are a key element in adding protections to the private pension system.

Limited scope audits, which to our knowledge do not exist anywhere else in law but ERISA, allow plan administrators to place significant restrictions on the scope of independent audits of employee benefit plans' financial statements. We are not aware of any other federal program or agency, that allows or accepts restricted scope audits. Even the Securities and Exchange Commission will not accept limited scope audit reports from plans required to file with the SEC (on Form 11-k), such as 401(k) plans that invest in employer securities. Such audit scope restrictions generally prevent the auditor from auditing a significant amount of plan asset information. Thus auditors cannot make any independent conclusions about the plan's financial statements as intended by Congress when ERISA was enacted. ERISA's financial reporting and disclosure requirements, including independent audits, play an important role in ensuring participants and beneficiaries are provided with the information necessary to be knowledgeable about their plans. Congress should repeal the limited scope audit exception so that users of plan financial statements can have independent assurance on the completeness and fair presentation of the plan's financial statements.

ERISA requires administrators of plans with 100 or more participants to engage independent accountants to audit plans' financial statements in accordance with generally accepted auditing standards. The independent accountants' objective in an audit is to express an opinion on the fair presentation of the plan's financial statements. This includes plan assets, liabilities, income and expenses and additional disclosures necessary to prevent the financial statements from being misleading. In a defined benefit pension or health and welfare plan the benefits are specified and determinable. The primary objective of the defined benefit plan's financial statement is to provide information that is useful in assessing the plan's present and future ability to pay benefits when they are due (i.e., financial status).

In a defined contribution plan the benefits are generally based on participant and/or employer contributions, investment experience, expenses and allocated forfeitures. These factors will determine the value of the participants benefits at retirement. Any shortfalls in the valuation or existence of the assets, in effect becomes the responsibility of the plan participant.

The independent accountants' responsibility includes determining whether the plans' financial statements are fairly presented in accordance with generally accepted accounting principles and are free from material misstatements. The independent accountant evaluates the plan administrator's assertions in the plan's financial statements, including whether the plan assets exist or liabilities have been incurred, and the completeness of all transactions and accounts. The independent accountant also evaluates whether there is reasonable and appropriate valuation and allocation of assets, liabilities, income and expenses, and whether the information is properly classified, and disclosed in the financial statements. In planning and performing the audit, the independent accountant also considers the plan's internal controls over financial reporting and whether there are any material weaknesses or reportable conditions.

Limited Scope Restrictions on Plan Audits

Section 103(a)(3)(C) of ERISA allows plan administrators, at their discretion, to instruct their independent accountants not to audit certain assets held by a bank, or similar institution, or by an insurance carrier, that is regulated and supervised, and subject to periodic examination by a state or federal agency. In those situations, the plan administrator can request such institutions to certify that the plan assets and related information such as plan investment income and expenses, is accurate and complete. The plan asset information excluded from the independent accountant's audit generally represents a significant portion , or possibly even the entire portion, of the plan's assets and income. Thus, in virtually all cases, the independent accountant will conclude that this is a significant restriction on the scope of the audit and, consequently, the independent accountant will not express an opinion on the overall fairness of the plan's financial statements.

This is because, to render an opinion, independent accountants cannot rely solely on the certification from the financial institutions. Auditors also need to understand the design and effectiveness of the internal controls used by a financial institution to execute and process the plan's transactions, and to consider performing other tests of the plan information as necessary in the individual circumstances to support the auditor's opinion. This would include, for example, independently testing reported fair values of investments. In a plan audit, the internal controls at the financial institution used to process plan transactions is critical to independently ensuring that the plan is properly credited with its share of investment income and expenses, as well as ensuring that investments are properly valued.

As financial institutions increasingly rely on computers to process plan investment information, the established computer controls that produce information become increasingly important to the auditor. Some financial institutions produce computer-generated certifications having only computerized signatures on a computer-generated report of plan investment information, thus providing plan fiduciaries and independent accountants little or no assurance that the information has been carefully checked by an appropriate official of the financial institution. On a certification that I personally reviewed, I saw that the investment fair value information reported by the bank from one year to the next did not change. Clearly in this instance this was not correct and the bank had to revise the plan's investment report because of an error. Also, independent accountants are finding that institutions are adding caveats to the certifications that for all intents and purposes reduce or invalidate the assurances that the certifications are to provide. Current practice also indicates that plan trustees are outsourcing various recordkeeping and administrative functions of the plans yet sign the certification statement. This practice brings into question whether or not the person signing the certification is knowledgeable of the outsource activities as they relate to the plan's assets. Often , particularly trust companies and insurance carriers do not provide all of the required information for the supplemental schedules because their systems are unable to maintain appropriate cost information. Yet these are the same systems that report gains and losses on securities that users of benefit plan statements are to rely on.

Limited-scope audits result wholly from ERISA and the practices of plan administrators. The DOL estimates that in about half of the required plan audits, plan administrators have exercised this authority and restricted the scope of the required audits. Plan participants cannot be provided the full assurance contemplated by ERISA if the independent audit is restricted as currently permitted by ERISA. If the Congress wishes to remove this constraint on the usefulness of required audits, it need only repeal the authority for plans to restrict the scope of the audit.

Some have expressed concern that if Congress repeals the limited scope audit provision under ERISA, it would result in duplicative auditing and significantly increase the cost of plan audits. I will address these concerns.

Some are concerned that the repeal of the limited scope audit exception would result in many plan auditors knocking on the doors of banks and investment companies so that the auditors can audit the individual plan's investments held by those financial institutions. This fear of inefficient and intrusive auditing -- perhaps you can call it "auditor phobia" -- is unfounded. According to DOL estimates. half of all plans required to have independent audits have full scope audits. I have not heard from banks, insurance companies, etc. that currently have full scope audits that there are many auditors camped on their doorsteps.

With over twenty years of experience with these full scope audits, the auditing profession has developed an efficient "single audit" approach to auditing plans, or any other entity, that use an outside service organization to process transactions. It is known as a "SAS 70 approach," which refers to Statement on Auditing Standards No. 70. SAS 70 provides guidance for exactly those situations. SAS 70 reports -- which are prepared by the service organization's own independent auditors -- can allow the plan's auditor to obtain a report on the service organizations' internal controls used to process and record plan investment information. These SAS 70 reports are based on a separate engagement performed by the financial institution's own independent auditor to review the financial institutions internal controls placed in operation and their operating effectiveness. The plan's independent accountant reviews the SAS 70 report to obtain an understanding of the internal controls used to process plan transactions and to identify deficiencies or other findings that may affect the individual plans. If the SAS 70 report is limited as to its coverage of the servicer's controls, policies and procedures as they relate to the plan being audited, the plan's auditor may need to gain an understanding of the controls, policies and procedures not covered in the SAS 70 report.

Historical experience indicates that in full scope audits where a SAS 70 approach is used, in the vast majority of cases, the plan's independent accountant concluded that it was not necessary to visit or perform additional procedures at the service organization. This is particularly true when the service organization's independent accountant concludes that the servicer has effective internal controls in place for processing plan transactions during the plan's reporting year. Situations where the plan auditor needs to perform additional audit work at the service organization are very infrequent, and are most likely to occur if a SAS 70 report is not provided or does not address the effectiveness of the controls, or when internal control problems at the servicer are identified that effect the reporting of investment information in the plan's financial statements. It may also be necessary for the plan's independent accountant to perform additional work at the servicer if the plan has investments that are difficult to value, such as real estate, so that the independent accountant can review the appropriateness of the asset valuation methodology. Based on the portfolio of investments held by many plans, it is reasonable to conclude that if Congress repeals the limited scope audit exception in ERISA, financial institutions will not be inundated with auditors.

I also want to point out there is no duplicate auditing involved in full scope audits of plans and the independent financial statement audit of the financial institutions holding plan assets and executing plan transactions. The perspectives and objectives of these audits are quite different, and are at extremely different levels of materiality.

Limited Scope Audit Versus Full Scope Audit

I will now explain the additional audit work required in a full scope audit—that is, an audit under generally accepted auditing standards sufficient for the independent accountant to express an opinion—versus a limited scope audit currently permitted by ERISA.

In a limited scope audit the plan's independent accountant would receive a certification from the bank, insurance carrier, or similar institutions which represents that the plan's assets, income, purchases and sales exist and are properly valued.

In a full scope audit, the independent accountant has a responsibility to obtain an understanding of the internal controls used by the financial institution to process plan investment transactions, and to assess the effectiveness of those internal controls. As I previously mentioned, a SAS 70 report will normally provide the plan's independent accountant with sufficient evidence as to the effectiveness of the financial institution's internal controls over trust activities, such as the determination of unit values and share transactions, as well as whether the internal controls used to calculate the plan's share of investment income and expenses were properly designed and functioning as intended.

Also, in a full scope audit, the plan's independent accountant would normally independently test a sample of investment transactions, such as purchases, sales, realized and unrealized gains and losses, as well as test the calculation and allocation of investment earnings and expenses. Proper valuation and allocation of investments are especially important in defined contribution plans because the retirement benefits are based on amounts contributed to the participants individual accounts as well as the investment experience on such amounts.

In both types of audits, the independent accountant would have to perform auditing procedures on the supplemental information required by ERISA such as, the schedule of assets held for investment purposes, and the schedule of reportable transactions. The independent accountant is also required to understand and assess the effectiveness of the internal controls used by the plan sponsor to process plan transactions. Auditors would also review the financial institution's investment policies and method of determining fair value of investments.

Increased Costs

First, I want to dispel any notion that requiring full scope audits will make independent accountants millionaires overnight. Plan audit fees are typically competitively negotiated on a fixed-fee basis—rather than an hourly basis—and often reflect the fact that plan audits are performed as an ancillary service to the audit of the plan sponsor.

The incremental cost of a full scope audit is generally dependent upon the quality of internal controls established by the plan and outside service organization, and the nature of the plan's investments. For example, the incremental audit cost of a plan that has good internal controls and holds assets in readily-marketable investments that are easy to value (such as publicly -traded mutual funds) would likely be significantly less than the additional audit cost for a plan having the same amount of assets with poor internal controls and assets that are difficult to value.

We believe the benefits of a full scope audit to plan participants, plan administrators and sponsors and the DOL outweigh the incremental cost involved. Limited scope audits provides no independent assurances of a plan's financial status.

Conclusion

Mr. Chairman, I would like to take the opportunity to commend you and your Subcommittee for your interest and effort in this important area. Thank you for the opportunity to testify. I will now gladly try to answer any questions that you or members of the Subcommittee may have.

Mr. SHAYS. Thank you very much.

This is the first hearing to try to help us to see where we go with this, and I'm going to be very candid with you and say to you that I accept the basic premise that if you have a legitimate audit you don't want to duplicate.

Where I have a gigantic disconnect is that—well, I have a number of disconnects. I need to understand, first off, why some choose to utilize a limited scope audit and others, who could, don't. Why does that occur? We'll just go right down the line.

Mr. KELLY. OK. My understanding is, some larger plans insist on a full scope. There are some examples of——

Mr. SHAYS. You mean the directors of the plan say they want it?

Mr. KELLY [continuing]. Yes, the plan administrator decides they want a full scope.

Mr. SHAYS. Why?

Mr. KELLY. For whatever reason.

Mr. SHAYS. No, but for whatever reason isn't helpful.

Mr. KELLY. It may be that the plan is subject to SEC because of the example that was given of the 401(k) with employer securities involving employee money, where you've got to have a full scope audit. That would be typical of a situation where they'd do that.

It's not my experience that most employers would like that, they are perfectly satisfied with the entities they've chosen. They have fiduciary responsibility to choose them wisely.

I was somewhat alarmed to hear the discussion about inadequate certification. Primarily, as an organization representing plan sponsors, also representing some regulated investment companies, I've got to tell you that we would find it totally unacceptable if improper certifications were being given, and would insist, as co-fiduciaries, that that stop. This is the first time I've heard of that.

Mr. LEIBOLD. My experience has been that it truly is the larger plans that utilize the full scope, and one reason that we see for that is, frankly, the relative sophistication of the finance and accounting area of that plan sponsor.

In my market anyway, there are a large number of employers that may have 100, 200, 300 participants in their plans, who come under the 100 or greater rule, but I would not characterize them as having a sophisticated finance or accounting department that is used to working with auditors on a regular basis and utilizing full scope audits, they are very cost conscious employers. Most of these are small businesses, proprietorships, closely held businesses, that count their pennies and their nickels. It tends to be the much larger employers who are used to working with auditing firms on an ongoing basis that are utilizing the full scope.

Ms. STARR. I would say, based on the clients that I serve and the plans that I'm involved with, that those that select the full scope audit take their fiduciary responsibilities very seriously. They want to make sure that they have somebody else looking at these plan assets, looking at the entire plan, to make sure that the investments, the allocation of amounts in the defined contribution arena, have been appropriately handled, and I think that that is probably the biggest reason.

Cost does come up for those plans that choose not to. The nature of the investments is also another concern, when they are very simple mutual funds and that sort we would probably see a few more limited scope examples.

Mr. SHAYS. The standard financial accounting practices are basically established so that if you audit the entire plan you can make an opinion, is that correct?

Ms. STARR. If there is a significant amount of information, be that plan assets, claims paid if it was a health and welfare plan, where we were restricted and not allowed to look at it, we would have to disclaim an opinion.

Mr. SHAYS. And, that wasn't always the case. From day one you would render an opinion because of the significance of the information not audited. You were unable to express an opinion on the accompanied financial statement. I thought that had evolved.

Ms. STARR. No, that kind of a disclaimer has always been in auditing literature.

Mr. SHAYS. As part of the limited scope audit?

Ms. STARR. The unique aspect of the limited scope audit, which was truly a negotiated opinion back in 1975–1976 area, was the idea of, yes, we disclaim on the financial statements, but we go in the next paragraph to indicate, and you may or may not have that in front of you, that we have audited the other aspects of the financial statements and that they are in compliance with the rules and regulations under ERISA. That is, basically, a piecemeal opinion that was outlawed probably prior to 1975, which is why I say it was a negotiated type of report between the Department of Labor and the accounting profession.

Mr. SHAYS. I'm sorry to be confused. Are you saying that what was presented to us earlier was only part of the story, that there was another——

Ms. STARR. There's just another paragraph, it's not that it's part of the story, there's just another paragraph that follows that.

Mr. SHAYS. But, the other paragraph matters to me. The other paragraph basically says we've looked at that part that we could look at, and found that to be in total compliance with——

Ms. STARR. Just in compliance with rules. We are not commenting on the fair presentation of the financial statements.

Mr. SHAYS. OK. Let me just try another step. Probably everybody here understands but me, but the bottom line for me is, your point, Mr. Kelly, and your point, Mr. Leibold, that you have viable audits, regulated 100 different ways. What was troubling to me when I first got into this issue was that I felt that a plan that was having problems could utilize a limited scope audit to hide problems in the plan, and that it could do so by simply picking up a small part of its overall plan in regulated activities thus enabling them to have a limited scope audit.

It was my belief that if part was in a regulated banking institution and so on, that they, basically, were free from having a thorough audit of the other part of their plan. Is that the case or not?

Ms. STARR. No. The requirement has always been that it is only the investments and investment-related activity that is certified by the financial institution that is exempt from audit.

Mr. SHAYS. And the auditor will give a solid opinion about that part that is unregulated?

Ms. STARR. No. We do not give—we do not have a—so long as the amount that is held by the financial institution is significant, and I put that in quotes only in that that's the independent judgment of each of the accounting firms, if it's significant, let me just give you a perspective from my firm that would say, if it's 10 percent or more we would not have to issue any type of report, we would give you a disclaimer, which is exactly what Olena read to you earlier.

Mr. SHAYS. Let's say 10. That's a good number to use. So what are you going to tell me about the 90 percent?

Ms. STARR. Nothing.

Mr. SHAYS. Well, that's stupid.

Ms. STARR. I don't disagree with you, but the issue being, if I could explain just for a moment, if that 10 percent was totally wrong, that would be material to the financial statements, and since you haven't allowed us, not you, but since we are not allowed to look at that 10 percent we can't make an assessment as to the overall fair presentation of the financial statements.

Mr. SHAYS. Yes, but you can make an assessment on the 90 percent, and you are telling me you don't?

Ms. STARR. We will not report on that 90 percent. We have a responsibility, as a profession, to perform audit procedures on those other 90 percent. If we were to find a GAP violation, something that was completely wrong and material, we would then have yet another paragraph in our report that would describe that answer. But, we do not give a positive statement on the other 90 percent.

Mr. SHAYS. Mr. Kelly?

Mr. KELLY. If I may, Congressman, what we're hearing about is the final imprimatur, the opinion that overlays all the accounting work that precedes it. I think the previous answer is extremely important. If anything is found with respect to the 90 percent, they have an obligation under 10 specific ethical standards, to find that and report it.

It will come out. It's kind of indirectly the same thing as a negative report at that point.

We heard a reference earlier to the fact that it was made unlawful to issue a piecemeal report. Nothing made it unlawful. The profession, in its own standards, dictates when it will and won't take a piecemeal approach versus this disclaimer approach.

But, whether it's a disclaimer with an obligation to disclose, or a piecemeal report, it may well be a distinction without a difference because of the thoroughness of the ethical standards requiring the review and the disclosure.

Mr. SHAYS. Well, I have a sense that you are trying to describe to me the difference between an audit and an opinion. In other words, you audit, but you may not express an opinion, and I'm wondering who is served by that, and I'm wondering why that would be the case. It seems to me that you could offer an opinion about the 90 percent you audited.

Ms. STARR. Well, I think to be fair, if I could, that is not the norm, that is, it's that small of a percent that would be sitting with——

Mr. SHAYS. Let's say 50 percent. I mean, if I had my pensions in that plan, I would at least like to know what you thought about the part that you audited. I'd like your opinion about it.

Ms. STARR. I think what the concern from the profession's side is that if I tell you about the half, and I haven't told you about the—I tell you about one half, but I haven't told you about the other half, you are going to assume everything, the fear is that you may assume everything is OK because you'll only focus on the words talking about the half that I did report on.

Mr. SHAYS. No, no. What I would want you to do is to say "we have audited 50 percent of the plan that was not regulated, and that in our opinion da, da, da, da, da, da," or, "we audited 45." I'd like to know, in fact, how much of my plan was in regulated activities and how much was not.

But, you know——

Ms. STARR. That's not allowed with our current professional standards to report in that manner.

Mr. SHAY [continuing]. And I'm wondering why. And the Board is in Wilton, right next door to me, so I'll be sure to have a nice visit.

But, Mr. Leibold, what's your opinion about that part of it?

Mr. LEIBOLD. Well, I think it points out a very important distinction and that is, the audit work is actually occurring on those part of the assets that aren't held in a regulated entity. It's almost a no news is good news kind of opinion, that if they don't affirmatively say something under their standards they have examined, those non-regulated——

Mr. SHAYS. Well, that's basically saying an opinion is irrelevant anyway. I mean, I don't think people can have it both ways. An opinion is there for a reason, otherwise don't have the opinion.

The lack of an opinion tells me something, and I have some sympathy, Mr. Kelly, with the basic view that you—first I have sympathy for a firm that doesn't want to encounter costs, and I have sympathy for the logic that says why duplicate something, but I feel like this is a contest between the entities, and it's like each wants their own way and they don't want to compromise and find something that would make sense, because right now it doesn't make sense to me. I think the present law doesn't make sense.

Mr. LEIBOLD. It would seem to me if the audit opinions, in fact, stated what it is, in fact, the auditors are doing, that would be a big part of the solution, because there are not any parts of the plan that are not being tested thoroughly. The question is what the language is of the opinion does not really state what's actually occurred in terms of the protections to the plan.

Mr. SHAYS. OK, let me just put it my way. I think what you are saying to me is that both the regulated and the unregulated have been audited, but no opinion has been expressed, and so, no big deal.

Mr. LEIBOLD. Not necessarily no big deal, but you are correct that no opinion has been expressed, and our question is, why not.

Mr. SHAYS. OK, what do you want? Do you want an opinion to be expressed?

Mr. LEIBOLD. I think it's very appropriate for an opinion to be expressed on the assets that are not part of the regulated entity, with a statement that the other assets not examined are subject to a regulated entity that is examined.

Mr. KELLY. And, I would concur with that answer.

Ms. STARR. I think one of the things maybe to step back and look at, I understand there are lots of entities that are regulated, you can certainly say, I would hope you would all say, pension plans are regulated in many, many different ways under ERISA and DOL regulations and rules. That did not preclude ERISA from saying, we want an independent audit, for those plans with 100 participants and more, we want an audit.

So, the fact that banks, and trust companies, and insurance companies, investment companies are regulated does not necessarily mean that they are looking at the financial statements and the financial position of that trust.

There are certainly aspects that would be the same, and we are extremely willing to utilize anything that is used for the regulatory process to prevent any type of duplicative auditing. But, I think to put it back in perspective, not having an opinion on the financial statements as to the overall presentation to me is a very significant statement that we are telling you.

Mr. SHAYS. Well, I'm trying to think of an analogy. We want to know the health of a pension plan, so I was just thinking, OK, someone goes for a physical, and you have two doctors in this process, and one doctor takes your blood pressure and something else, and he's under the regulated side, and the rest of the examination is done by another doctor. Now, in one sense the second doctor can't say, "well, you are in perfect health," because he didn't do your blood pressure, he did some other things that maybe he should have done. But, he knows that your blood pressure was measured. I guess what I'm trying to sort out is that you don't need to take the blood pressure twice. I mean, that would be the argument.

But, in another sense, I guess then what I'd want to know is, how confident can I be that that doctor did all those things, that he did take your blood pressure, and all the other things that I didn't do. And so, maybe you all can address, convince me, that you looked at the complete health of that and then I'll go to my colleagues. The problem is it's two doctors, not one, and so you are telling me, Ms. Starr, that one doctor doesn't have the right to say that person is healthy unless he's checked out everything, but in a sense it's been done.

So, is that a bad analogy or a good analogy?

Mr. KELLY. I think it's a wonderful analogy, it's a very good analogy.

Ms. STARR. I have—I guess, I mean, I have a concern in that in the normal instance the one doctor that you have just doing the blood pressure is actually the one who has done the blood pressure, the EKG, the cholesterol testing, the whatever, and I've only been able to look at—I'm really the one who has only done the blood pressure test, and yet, you'd like me to give you some report on the overall health of the plan.

Mr. KELLY. Congressman, what about an airline pilot that lands a plane in reliance on the air traffic controller who says that it's clear. There's an awful lot of lives that are at stake in relying on one another.

I think that a very fine distinction is being made by the profession, and I'm not sure that it's serving anybody's best interest. Either make the statement on the assumption that the regulated industry is certifying correctly, that its statements are fairly presented, or do it piecemeal.

Mr. SHAYS. Well, the problem with my analogy is that I'm thinking about it as the interaction. If you make the argument that one is totally separate, and that's been checked out, and this is totally separate, if there is somehow interaction between the two, and you can't assess the impact of the interaction, then I'm more inclined to agree with your position, Ms. Starr.

Ms. STARR. My understanding, and, please, I would ask for Chuck or others to clarify, there are a lot of options in there. In other words, the FDIC, the OCC, can do a complete physical exam or they may just pick and choose in certain years to look at certain parts of it. There is not an absolute requirement to do an opinion on the total trust company, on the total bank. There is some flexibility in what is being done on an annual basis. It is being done.

Mr. LEIBOLD. If I could respond to that. My experience has been there's not a lot of selectivity at all. There is a full audit of every aspect of our department every time there is——

Ms. STARR. From a compliance perspective, though.

Mr. LEIBOLD [continuing]. From account administration, to securities movement and control, to systems operation, to dual controls, to reporting of information, it's very broad based.

What you will find in terms of the options, there is basically a decision tree that happens under each one of these specific areas, and if you check and find item A is well done, you do not need to go check item B because item B only occurs if you've made a mistake in item A.

Mr. SHAYS. Well, you know, I'm going to go to my colleagues, but I'd like to ask, why isn't SAS 70 the answer? Why do you both object to that?

Mr. LEIBOLD. From our perspective, it's simply a matter of cost and benefit. Everything, basically, that would be done in an SAS 70 report is already being done through our examinations by regulators and our bank auditors.

It's really almost a question of who is the opinion addressed to. We are concerned, particularly, for banks my size or that middle-sized customer, say, with the 100 to 500 participants, where this is a meaningful cost item for work that, basically, is already being done and is already out there. We are not adding any true additional protections that don't already exist for our pension plan participants.

Mr. KELLY. And, my point of view is, SAS 70, basically, puts a lie to the objective of H.R. 2290, which is to have the independent auditor step in there and look at the assets to respond to, the comments that nobody is auditing.

If you look at SAS 70, there is still deference going on. In essence, the independent auditor is saying that because they've done it in this format we're not going to audit, yet, we will issue the opinion. That's, in essence, what SAS 70 does.

So, you have the additional expense, you have plan participants out there and readers of newspapers who think that suddenly the independent auditor is looking after their self-interest within the regulated entity. But it is not happening. That's why I referred to it as like the heavily sugared breakfast cereal, expensive, attractively packaged, satisfying, but full of empty calories. It doesn't accomplish anything.

Mr. LEIBOLD. If I could make one other quick point?

Mr. SHAYS. Sure.

Mr. LEIBOLD. Some technical issues with the SAS 70 involve whether you have overlapping audit periods. So, for example, if my SAS 70 report is done on a calendar year basis and we're looking with a June 30 fiscal year plan, the auditor may not be willing to rely on it.

In addition, there is really no generally agreed upon format for content or presentation of that in SAS 70, so I may spend a significant amount of money to buy one and then several different plan auditors may not, in fact, agree that it has everything in it that it ought to.

Mr. SHAYS. The regulated part, though, has different auditing periods as well, doesn't it?

Mr. KELLY. Correct, it does.

Mr. SHAYS. Well, we have basically four proponents of change and two opponents of change, and I am struck by the fact that I would want to know how much of a plan is not in the regulated part, and I would want to have an opinion about that part which is not under regulation.

To me that would be the minimum that I would want, and then I might want more.

Ms. STARR. If I could just comment on that just a little bit. The potential if you were to do it, if we could come up with a report that way, that would increase costs also, because instead of basing our materiality on the total plan's investments you are now asking us just to opine on the part of the investments that are not held by a financial institution, which would reduce the materiality threshold that we do our audits upon and, therefore, has the potential to increase costs.

So, to the extent cost is a concern——

Mr. SHAYS. I have to say, I'm missing the point. It seems to me right now it's a big loophole for the accounting firms, because they don't have to be quite as vigorous, because in the end they may have audited but they don't have to express an opinion.

The opinion is a basis for evaluating them. Their reputation is on the line and so on.

Ms. STARR. We are on the hook, when we issue an opinion you are absolutely right.

Mr. SHAYS. OK, but there's absolutely no reason, in my mind, that you can't issue an opinion on that part that you have audited. I mean, there's no way that you've reached me in saying why that can't happen. I mean, why can't it?

Ms. STARR. Well, obviously, I haven't been able to explain it well with respect to the piecemeal opinion. The concern is just that, you may understand the distinction between what was audited and what was not, others may not. Others may just read it.

Mr. SHAYS. Well, that's a little disingenuous, because you basically just say in your opinion, "we were only able to audit 55 percent of this plan, the part that wasn't regulated."

"On the 55 percent of the plan that we audited we are very comfortable da, da, da, da, da, da."

Now, the only way that I would have sympathy with your view, and I truly am going to come to my colleagues, is if somehow they were so intertwined, and I haven't heard anything that says they are. I was hoping that a case would be made because I'd like—if they are so intertwined that the part you couldn't regulate affects the part that you couldn't audit because it's invested in a regulated institution, then I would have sympathy for your not being able to come to an opinion.

Ms. STARR. But, it is the whole—it's the plan's financial statements, it's the security that comes from knowing that the total plan assets are there, because you can't—if I'm a participant, in your example of 55/45, does that mean one, you know, 45 percent of my assets are OK, but 55 percent are not OK? I mean, it is an integrated package that we are reporting on.

Mr. SHAYS. OK, if that's your answer, it's almost like, well, that's the fact now, and people are being fooled. The fact is, tell them the truth, this is what you regulated, this is not, the regulated is not being audited by you and, therefore, this is what you've done and this is what you are comfortable with. And, you could say that you can express no opinion on 45 percent of the plan that you have not looked at, and that's very honest, because it tells me you didn't look at that part of it.

Anyway, you've been patient.

Mr. TOWNS. Actually, Mr. Chairman, I want you to know you asked half of my questions.

Mr. SHAYS. If you would let me go a little longer, I could ask them all.

Mr. TOWNS. Let me come back to this whole cost situation. I'm concerned about costs, and I want to join you, Mr. Kelly, but I'm having some problems in my own mind, and I'm thinking in terms of the credit unions that have failed, I'm thinking in terms of banks that have failed, and even in insurance companies, you know, and if the cost that was quoted here earlier, and I'm not sure that's accurate, $4 per person, I think that people would pay that just to have peace of mind and to know that when they retire that it's going to be there, and I think they would not mind paying that.

Are you saying that it's going to cost more to do that?

Mr. KELLY. I'm saying that it's going to cost between $2,300 and $2,500 per plan. That may work out on the average. I don't know whether on average that's $4 per participant. We've heard that for the first time this morning. There are different sized plans. Obviously, if you have 101 employees it's going to be more than $404, and if you've got 10,000 employees, I think your per participant cost is a sliding scale, that it's going to be less per participant the larger the plan. It's going to be more per participant the smaller the plan. So, the plans in the range 100 to 200 or, the 100 to 500 participant ranges, are the ones that are going to be hit the hardest by this averaging of the cost, by this focus on the averaging of the cost.

Mr. TOWNS. Deal with my problem with the regulator's point that, you know, when you look at credit unions, you look at banks, and insurance, I mean, the regulators are there, and these failed, some of you even in my own district, so how do I——

Mr. KELLY. OK, but the issue really is, there are three ways to approach this. One is, there's no change necessary; another, we do something regulatory, and that has been occurring; and No. 3 is we pass legislation.

If we pass legislation by focusing on this $4 per participant to plans with regulated investors, the flaw is that we don't really address the problem. Auditors are now relying on the fact that they don't have to give the opinion. They are not following the procedures they are required to follow. That's what the 1996 study shows. The additional $4 cost imposed regulated money, doesn't address that directly at all.

The problem is, performance standards, with respect to the audit overall: one, the money coming in, the contributions, which are not insulated by the limited scope audit; two, the benefits going out, wherever they come from, are not protected by the limited scope audit; plus three, the unregulated money. There's the problem that we need to address. Again, I can't say it often enough, I applaud the Chief Accountant, that office is only 10 years old, I applaud the AICPA. I've spoken at their seminars. There's a real effort to discipline accountants that's going on. If the 1996 assessment showed us anything, it is that there has to be a much more rigorous approach to the whole issue of who can be an independent auditor. But the answer isn't to deflect the attention by going after regulated entities and putting in place something that affects that pot of money. That isn't where the assessment shows us the problem is.

Mr. LEIBOLD. If I could address your question with respect to failures. A couple things I would note there. First, I'm not aware of any bank failure that ever originated in a trust department. Typically, it's a credit issue.

But, I think even more importantly, trust assets, whether they are to be pension plan assets, personal trusts, are totally unaffected by a bank failure.

Mr. TOWNS. Right.

Mr. LEIBOLD. Those assets are completely separate from the banks, to the extent that we have separate vaults, separate computer systems, and, in fact, what happens in the case of an insolvency is that the FDIC seeks, as soon as possible, to find a successor fiduciary to take on those accounts, and I could provide to you, certainly, a copy of a letter I have here from the FDIC in 1991, explaining exactly how that process works. But, trust assets of any kind are totally insulated from any failure of the commercial bank.

From the cost standpoint, averages can be deceiving. I think the real serious blow to my bank and to my customers——

Mr. SHAYS. What size is your bank?

Mr. LEIBOLD [continuing]. Our bank is about $700 million in assets, our trust department is $2.1 billion, of which $470 million is employee benefit assets.

Mr. SHAYS. And, that's defined as a small bank?

Mr. LEIBOLD. Yes. We are at the upper end of the small banks, meaning we have all the products and services, we don't have the size.

Mr. SHAYS. You are a good bank and I should want to use your bank, but you are still small.

Mr. LEIBOLD. I pride myself, it's personal.

Mr. SHAYS. I understand.

Mr. LEIBOLD. I have a tee-shirt that says, "small is good," but with respect to——

Mr. SHAYS. But, you are big enough to be safe.

Mr. LEIBOLD [continuing]. With respect to our customers and ourselves, when you are talking $2,300 to $2,500 per plan, and I think there are some plans where we might be talking more, that is a significant cost element to these customers. It may be the kind of cost element that says, I need to reexamine why I have a qualified retirement plan, and I don't think we want that.

Mr. TOWNS. Well, I don't argue the point that it might not start there, but it could end up there. I mean, that's what I'm saying, and so I think that if you do not have the necessary auditing process in place, then you probably can up having this problem.

But, I don't understand if it's $4 why, you would not want to do it. I mean, I'm certain that if you surveyed all the people in the plan they would have no difficulty saying, if $4 is going to make certain that when I complete my work termination I would have my pension there, I don't think anyone of them would object to that.

And, I have not been convinced that it's not $4.

Mr. LEIBOLD. But, the participant doesn't pay that cost, the employer pays that cost. In no plans that we work with are those costs paid out of plan assets, they are paid directly by the employer, which then becomes a bigger number than $4.

I think, more importantly, again——

Mr. TOWNS. Well, let me get where I want to go, let me do it this way, let me be the banker for the moment and you be the Member of Congress, tell me what should be done, everybody except you, Ms. Starr.

Ms. STARR. Thank you.

Mr. LEIBOLD. I think the solution is, as we have mentioned before, to ask the auditors to specifically address the auditing that they do on the non-regulated assets, the non-regulated transactions. When you look at how a plan works, it's really a continuum, you have money starting with the employer or the employees that is contributed to the plan, you then have plan investments, and you then have distributions either to participants or to pay plan expenses in some cases.

Only that very narrow portion in the middle, where it's in trust, is the subject of the limited scope audit. They are doing the auditing, or should be doing the auditing, of everything else. They should be able to rely on State and Federal and bank auditors, three different potential levels of examination of the regulated portion, and fully examine, as they should be doing, the non-regulated portion and include those results in their discussion of the plan audit in their opinion, simply address what it is they are actually doing or should be doing already.

Mr. KELLY. As a Member of Congress, I'd ask you as the banker. If I pay you $4 per participant more as a plan sponsor, what additional protections do I get with respect to the unregulated money? I would expect your answer to be none. You get another audit or another layer of protection on the money you've already got audited, and some protection if the certificate is done properly.

So, that's why I refer to them as empty calories. It's $4 that doesn't buy you anything. We need to spend the money in a way that produces good decent independent audits. We need to spend enforcement resources and self-regulation and peer review resources on getting independent auditors to do what the auditing standards require.

Mr. TOWNS. So, you are saying we have a baseball bat trying to kill a gnat.

Mr. KELLY. We have a baseball bat—I'll tell you what we have, what we have is, we have a horse race, and at the end of the final corner, because we are being told that we need to run straight instead of go back to the finish line, because the finish line, as we've got these problems with audits, we got to address it and we're saying, no, the goal is over there. We are being pointed in the wrong direction. We are being told to hit it foul instead of fair.

Mr. LEIBOLD. I would agree with the baseball and the gnat, but we are missing the gnat.

Mr. SHAYS. Putting racing and baseball in the same analogy, that's not fair.

Mr. LEIBOLD. We are going to miss the gnat, is the problem, we've got the bat, but we're going to miss the gnat.

Mr. KELLY. Yes, we're hitting in the wrong direction.

Mr. TOWNS. I yield back, Mr. Chairman.

Mr. SHAYS. Let me do this. I want to say this is not a debate in society over who wins. What I'd love is for our three panelists to just sit over here. No, no, you all stay there. If the three panelists would come here and just help the two of us, the previous panelists, I apologize, if you would just, as you've listened to this, give us a sense of how administrations in both parties have responded to the fact that the limited scope audit is flawed and that both parties need to make improvements, since admittedly, that's the group that's entrusted with overseeing this.

I have sympathy for the fact that there's a part that I don't get a good handle on. That's the unregulated part. Someone gets a good handle, but I'd say it ain't me.

When you all have heard the arguments here, I want you to help us sort out where the lines of disagreement are, and then we'll go from there.

So, maybe you'd like to begin.

Ms. DALTON. I think one of the issues, from the independent public accountant's perspective, is that for part of the information that's not been inspected the limited scope audit, they don't have adequate assurance of what the information is, or the quality of it.

There are questions, as Randi raised, on the quality of the certificates that they are getting from the trust department, and all of these transactions are intermixed, so it's difficult for them to give us an opinion when they don't have adequate assurance about a portion of the funds that have been scoped out for audit review.

Mr. SHAYS. Does anyone want to add something to it?

Mr. LEBOWITZ. Mr. Chairman, I believe that the principal concern that we have is that the whole process of developing and conducting limited scope audits promotes sloppiness by everybody; sloppiness by the plan administrator who is simply looking, sometimes, just for the cheapest way of complying with a statutory requirement that an audit report be attached to the 5500, the annual report, sloppiness by the accountant, as we found in our quality review of audits, where when they are engaged to do limited scope audits, because they are not rendering an opinion and putting their name or the name of their firm at the bottom of that opinion, they are disclaiming responsibility for anything, inevitably there's sloppiness in the way they go about doing that work, and sloppiness, Mr. Chairman, in the way the bank carries out its responsibilities.

Mr. Kelly was concerned, and I agree with him completely, when he heard that there may be problems with the certification that banks are issuing. The certification is the document where the bank says to the plan, "this is what we hold and this is what its worth." That's the condition for a limited scope audit; that the bank or regulated entity certify, "we hold these assets and this is what it's worth."

Well, what we have found, and what our chief accountant's office found, is that in a good number of circumstances all the bank is saying is, "this is what our books and records say it's worth. We haven't done any work to determine whether it's really worth that or not, we are just telling you what someone else has told us."

So, the whole process is replete with sloppiness, and it's become, as Ms. Berg said in her written testimony, a mindless process designed solely to satisfy a statutory requirement for an audit, but without adding any value or sense of well being that participants and beneficiaries, plan sponsors and plan administrators, should have.

Mr. SHAYS. I want to respond to what you said, but I want to just ask you, Mr. Clark, do you have any comment to make, and then I'm going to——

Mr. CLARK. Yes, I do. I'd like to try a couple tacks here. The first is that from GAO's point of view, we do not support piecemeal opinions. I'm fond, personally, of saying that I know how to audit. I went to school, I'm certified, there's a body of standards out there that tell me how to do a complete audit. I think there's a general understanding and expectation on the public's part that when an auditor comes in and says everything is fine, everything is fine, and the auditor has to stand by that word.

The auditor has to be licensed by a state board. The auditor has responsibilities, of course, and is subject to certain liabilities.

I also know how not to audit, even though it's a little bit more difficult. Occasionally, GAO gets in the position of providing information, collecting information from other people, assimilating it, putting it in a report and sending it up to the Hill with all sorts of disclaimers that, you know, we didn't audit this. Our experience has been that that gets to be pretty iffy, because we are not sure everybody reads all those caveats.

But, I can assure you that the thing in the middle is a mess, it's a mess for auditors even when they are trying to be conscientious.

Mr. SHAYS. The thing in what middle?

Mr. CLARK. A half audit.

Mr. SHAYS. OK.

Mr. CLARK. A piecemeal audit, it's a mess for the auditor, trying to figure out when does my audit stop. Do people really understand how much work I've done? When my report comes out, I have no idea how somebody might read a report that says it's half and half or 55/45.

The second approach I want to take is, I'm intrigued by the analogy that you used, in terms of a physical, a health physical. Going back to ERISA, a cornerstone of ERISA was protection to the participant. The participant has a role in policing the plan. I'm somewhat responsible for my own retirement, and I'm somewhat responsible for my own physical health. I'm an accountant so I think I know what I'm doing when it comes to my retirement, but when it comes to my health I'm not. I don't like science, so I go to my doctor and I say to my doctor every 2 years, am I OK or not. I don't want to hear a lot of mumbo-jumbo, I don't want to read a lot of medical reports. Am I healthy or not?

Now, I'm going to take some tests, and I might have to take tests from a series of doctors. I might have to get an x ray from one doctor, and a blood test from somebody else, and who knows what. I want a call from my doctor, and I want my doctor to tell me if I am healthy or not. I don't want my doctor to say, well, you know, half of your body is healthy, the other half of the body, you know, I know you've had tests, and there's a bunch of doctors who tested that, and maybe you could give them a call or maybe they'll call you.

I'll pay you $4 to call them, listen to what they say, and come back to me and say, you're fine.

Mr. SHAYS. OK. I've loved all of your comments, but I would first respond to yours. If I had a chest x ray, and you did the chest x ray, and you told me you weren't going to tell me if I had cancer or not, because you couldn't tell about the other parts, I'd be pretty angry at you, too.

So, I would expect that based on the part that you looked at, you would be able to give me a solid, straight answer and not equivocate one way or the other.

So, I'd just flip that analogy and say, "yes, I would like to know about the other parts of me." But when I ask you specifically about the part you were responsible about, I want to know.

Mr. Lebowitz, you have probably helped me define my own uncertainty about this issue, because I've been in Congress now 11 years, and I found in the first few years that I would delegate certain parts of the job and nobody would take ownership. And so, finally what I did at the end was to say, "All four of you are doing equal parts, but, David, you are in charge, and if this screws up you are the person I'm going to hold accountable."

And so I have sympathy for your point that, in essence, nobody is taking ownership, and that's what I would like to deal with, but I'm not left with a feeling that taking ownership means that—well, I'm struggling with the idea, because I do think someone in the end has to be responsible. Someone in the end has to take ownership. So that would imply that they need to look at everything.

But, there are times when I say, "OK, you are responsible for this, I'm going to hold you accountable for this, and you are responsible for this." Right now, I agree that I think since no one has ownership you are not going to have excellence. I really buy that point, and I do think the system is——

Mr. KELLY. Congressman, there is somebody who has ownership.

Mr. SHAYS. OK, who is that?

Mr. KELLY. The plan administrator, maybe it's an investment committee, has fiduciary responsibilities. They've selected the independent accountant, they've selected the regulated investment entity, they have responsibility.

And, if they get one of these, I've got to tell you, if my co-panelist bank tells one of my clients that this certificate, without a signature, and that doesn't have the right assets, is OK, I'm not going to be happy, and I'm going to say redo it and do it right.

There is somebody in place, and, in fact, these audits are 7 months after the year, when we get the things like Notice, we get people with co-fiduciary responsibilities when there are problems that arise, and they have responsibility to be sure that they understand the audit. If there's a disclaimer, maybe the plan participant doesn't get to the bottom of the letter and find the disclaimer, but that plan administrator does, and that plan administrator is on the scene, had better do something about it.

And, I've got to tell you that there is some frustration about not getting piecemeal or not getting the total, but what's more frustrating is particularly what we've heard about—was the word lousy?

Mr. SHAYS. Sloppy.

Mr. KELLY. Sloppy, sloppy, I think if one message comes across from the study that was prepared 3 years ago, just 3 years ago, by a Chief Accountant who has been doing a yeoman's job only 10 years and has made tremendous changes, and the AICPA has made tremendous changes, I think we need a little bit more time before we rush off and we impose the burden on the people who aren't causing the problem.

Mr. SHAYS. Well; let me just say, being a Member of Congress for 11 years, I don't think you have to be concerned we are going to rush off and do something. You do not need to go to bed tonight fearful that when you wake up tomorrow this will be done somewhere the way you didn't want it.

Mr. TOWNS. Being your senior, I concur.

Mr. SHAYS. But, I do think we have a problem, and——

Mr. KELLY. We do, we do.

Mr. SHAY [continuing]. And I do think all of you have made very important points. Someone has got to take ownership, and the question is, can ownership be taken without having a total audit.

Let me throw out one thought. Why couldn't you say that even a plan that had a limited scope audit could only have it for 2 or 3 years, and then every 3 or 4 years it would have to have a full audit? It would get around some of the cost. Why are you shaking your head? That was a great idea.

Mr. LEIBOLD. It depends. For example, if a third of my customers have their plan come up each year, I have to get the SAS 70 every year anyway.

Mr. SHAYS. You have to what? I don't understand that.

Mr. LEIBOLD. The accounting profession is saying they are willing to rely on this SAS 70 opinion with respect to our controls, rather than doing their own investigation.

Mr. SHAYS. Right.

Mr. LEIBOLD. If you have, say, an every 3 year scenario, as you suggested, odds are a third of my customers come up every year, so it's just the same. I have to buy the opinion every year anyway.

And, my question is, if you are going to rely on a SAS 70, and not do your own independent testing, why won't you rely on virtually the same thing that's already being done by my bank examiners and by my bank auditors, who in our case happens to be the same firm that would do the SAS 70, without adding that extra layer of cost.

Mr. KELLY. In essentially the same format for a different set of regulations, or similar format for a different set of regulations. But you've got to get it into a new format.

And, if you focus on the fact——

Mr. SHAYS. Wait, there's something I'm missing here. I'm being told that about 40 percent have limited scope audits, correct?

Ms. STARR. About 50/50.

Mr. SHAYS. OK, let's say 50/50.

Ms. STARR. That's close enough.

Mr. SHAYS. I'm making an assumption that sometimes the plans that have limited scope audits don't ad infinitum have limited scope audits. Should I make that assumption? It's always the same 50?

Mr. KELLY. Probably.

Ms. STARR. There's little change.

Mr. KELLY. There's a good stability to it.

Mr. SHAYS. OK, so I made a false assumption. You are saying that, basically, the ones who choose not to use limited scope audit usually choose not to.

You are saying the ones that choose limited scope audit, that if they had to do it every 3 years, there would be 2 years where they didn't have to have a limited scope—where they could have a limited scope audit.

Mr. KELLY. The point was, if the plan doesn't have to have a full scope audit in 2 out of 3 years, they are investing with a regulated investor who still has to prepare the reports.

Mr. SHAYS. OK.

Mr. KELLY. It's a co-mingled investment. And, even if you were to say, OK, we'll approach it differently, and we'll go investor by investor, and we'll require each investor to do it every 3 years, you'll have plans that have multiple investors and they are off of the same 3-year sequence. It just kind of falls of its own weight at that point.

Mr. SHAYS. It was stupid idea.

Mr. KELLY. Well, no, I wouldn't say that.

Mr. LEIBOLD. No, I think it makes sense except for the way that we are set up to do things.

The key question for us is still, the kind of things they are wanting to rely on already exist, and I think that we can find ways to do that. If there are specific issues, like valuation of non-marketable assets, or the form of the certification, these are issues that our industries can get together and solve on a very targeted basis, again, rather than missing the gnat with the baseball bat.

Mr. SHAYS. Well, I'm going to close by saying, I do believe that the system leads to someone not taking ownership, and when that happens you've got a problem.

I do agree that you want to avoid, with all effort, duplications of what's being done. So, I want to find a way that someone ends up taking ownership. Saying that the plan administrator takes ownership is not the answer, because we are really auditing the administrator. We want to know what he is doing, in essence, and how good of a plan he or she runs.

So, anyway, this is fascinating, and you can have a good sleep tonight. It won't be a sudden decision.

Mr. KELLY. Not tomorrow?

Mr. SHAYS. Thank you, you've really been very helpful.

We'll call this hearing adjourned.

[Whereupon, at 11:43 a.m., the subcommittee was adjourned.]

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