TESTIMONY OF
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BEFORE THE ERISA ADVISORY COUNCIL

WORKING GROUP ON
CURRENT CHALLENGES AND BEST PRACTICES FOR
ERISA COMPLIANCE FOR 403(b) PLANS

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I am pleased to appear before the Working Group on behalf of the American Institute of Certified Public Accountants for which I serve as Chair of its 403(b) Plan Audit Task Force and Chair of the Employee Benefit Plan Audit Quality Center Executive Committee. The Employee Benefit Plan Audit Quality Center is a firm-based voluntary membership center with over 2,100 CPA member firms that audit employee benefit plans.

My remarks today will focus on the initial year implementation issues that have arisen from the Department's regulations requiring independent audits of 403(b) plan financial statements, and whether there is any need for additional guidance from the Department. Specifically, I will address how the Department's guidance issued to-date has affected plan financial statement audits, discuss initial audit year implementation challenges and results in general, and conclude my remarks with our recommendations for the Working Group's consideration.

<u>Background of 403(b) Financial Statement Audit Requirement</u>

In November 2007 the Department issued regulations which, for the first time, required ERISA-covered 403(b) plans with 100 or more eligible participants to submit an annual audit of their financial statements beginning with their 2009 Form 5500 filings. Thus these 403(b) plans would be subject to the same reporting and audit requirements that currently exist for section 401(k) plans.

Because many 403(b) plan sponsors had not previously maintained plan-wide accounting records and reporting systems, many if not most plan sponsors were expected to –and indeed ultimately did- face significant challenges in establishing plan accounting records and proper controls, identifying all participant accounts to be included as plan assets, determining beginning account balances, obtaining other financial information to be included in the plan's financial statements, and ultimately obtaining an unqualified opinion on the plan's financial statements from their independent auditors.

DOL Guidance Issued

In response to concerns about the existence and completeness of plan accounting records, the Department issued Field Assistance Bulletin (FAB) 2009-02, *Annual Reporting Requirements for 403(b) Plans*, to provide enforcement relief for 403(b) plan administrators that make good faith efforts to transition to the new reporting and audit requirements. DOL FAB 2009-02 allowed the plan administrator to exclude certain pre-January 1, 2009 annuity contracts and custodial accounts for ERISA reporting purposes if they meet certain criteria. It is important to note that while the Department provided enforcement and reporting relief to plan sponsors, the Department did not provide any relief from the requirement for plans to have an independent audit of their financial statements under generally accepted auditing standards. The audit requirement exists in ERISA section 103(a) (3) (A) and requires the plan administrator of an employee benefit plan to engage an independent qualified public accountant to audit the financial statements using generally accepted auditing standards (GAAS), and to prepare an opinion as to whether the financial statements (and any supplemental schedules required to be included in the annual report) are presented fairly in conformity with generally accepted accounting principles (GAAP). The DOL FAB 2009-02 states that the DOL will not reject a 403(b) plan Form 5500 on the basis of a qualified, adverse or disclaimed opinion if the accountant expressly states that the sole reason for such an opinion was because such pre-2009 contracts and accounts were not covered by the audit or included in the plan's financial statements.

The Department also issued Field Assistance Bulletin (FAB) 2010-01, *Annual Reporting and ERISA Coverage for 403(b) Plans*, which supplemented DOL FAB 2009-02 and addressed questions the DOL received concerning the scope of FAB 2009-02 and the safe harbor regulations at 29 CFR 2510.3-2(f). DOL FAB 2010-01 states that if, as part of the audit the auditor was engaged to perform, the auditor discovers that contracts were incorrectly excluded under DOL FAB 2009-02 from the plan's financial statements, the DOL expects that the auditor will alert the plan administrator. If the plan administrator and auditor do not agree with how to resolve issues relating to excluded contracts, the DOL expects these issues to be noted in the audit report.

Initial Audit Year Challenges and Considerations

The initial year of 403(b) plan audits presented many unique challenges for plan sponsors, administrators, vendors and auditors. These challenges included basic issues such as determining how many plans the sponsor had (such as, whether the sponsor had a single plan with multiple vendors or multiple plans or whether there was an "old" plan and a separate "new" plan), determining whether the plan was an ERISA or non-ERISA plan and whether the plan met the DOL safe harbor rules exempting the plan from Title I of ERISA.

Additional challenges included assessing the adequacy and organization of critical plan documents, identifying all current and former participant accounts to be included as plan assets, the disaggregation of recordkeeping information and multiple service provider concerns (including gathering complete and accurate information from all vendors for all years, and the ability of trustees to confirm existence of plan assets), so-called "missing" participants and “orphan” contracts, determining beginning account balances, and the applicability of the enforcement relief in FAB 2009-02.

Other areas presenting challenges included assessing the adequacy of the plan’s internal control over financial reporting, investment valuation and reporting issues and obtaining other financial information to be included in the plan’s financial statements.

Plan sponsors and auditors also needed to consider whether insurance contracts were allocated or unallocated contracts. DOL Advisory Opinion 2010-01A which addressed whether a specific vendor’s contracts should be deemed to be a fully allocated contract for annual DOL reporting purposes if certain conditions were met. Other challenges included determining whether “fair value” for GAAP financial reporting purposes is equivalent to “contract value” for DOL regulatory reporting purposes; loans made to participants outside the plan that used plan assets as collateral ,and the plan sponsor’s “good faith” efforts to comply with the DOL reporting and audit requirements. Auditors also considered fraud risks and additional audit risk factors including the size of the plan and the number of years the plan is in existence, fiduciary oversight, and the availability and completeness of a SAS No. 70 report including any internal control issues at the service provider that were identified.

The nature, timing, and extent of auditing procedures applied by the auditor are a matter of professional judgment and varied with such factors as the length of time the plan has been in existence, adequacy of past records, efforts to establish beginning balances, and the complexity of the plan's operations (such as the number and consistency of vendors).

Initial year audit procedures included testing the accuracy and completeness of the beginning balances of reported contracts and accounts. Auditors sought to find alternative auditable evidence and had long and frequently difficult conversations with their clients. In circumstances where historical records (such as payroll records and participant data) did not exist or were not available for the reported contracts and accounts, and the amounts of reported contracts and accounts were material, auditors needed to consider modifying their reports when auditors could not obtain and examine evidence supporting these contracts and accounts..

Auditors also needed to consider modifying their report for an incomplete presentation of the plan’s assets if the plan administrator elected to exclude some contracts or accounts from the plan’s financial statements that met the requirements of FAB 2009-02.

Further, auditors were required to communicate deficiencies identified during the audit that upon evaluation were considered significant deficiencies or material weaknesses.

So as you can surmise the initial audit year had many challenges and issues for many 403(b) plan sponsors, administrators, vendor and auditors which resulted in significant effort, time and cost to comply with the new reporting requirements.

Recommendations

- The Department should continue to have formal dialogue with the 403(b) plan sponsor, vendor and audit communities on the continued application of the audit and reporting requirements.

- The Department should evaluate other alternative regulatory reporting approaches for those plans that may never be able to prepare full plan financial statements on accordance with generally accepted accounting principles.

- The Department should revisit the Plan Asset Rules in CFR 29 CFR 2510.3-101 to consider whether certain contracts and accounts (for example, 90-24 transfers; pre-January 1, 2009 contracts and accounts) can be excluded from plan assets and thereby provide additional reporting and audit relief.

- The Department should issue guidance on the appropriateness of loans to participants made outside the plan in which plan assets (i.e.- participant account balances) are used as collateral.

Conclusion

Thank you for your interest in this important matter and the opportunity for me to testify before the Working Group today. I will be happy to answer any questions.

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