

# DOL Office of Inspector General: EBSA Needs to Provide Additional Guidance

The AICPA Employee Benefit Plan Audit Quality Center recently issued a summary of the DOL Office of Inspector General's report: *EBSA Needs to Provide Additional Guidance and Oversight to ERISA Plans Holding Hard-to-Value Alternative Investments*.

## Highlights from the Report

**Our recommendation** is that Plan fiduciaries overseeing plans with alternative investments should read the DOL OIG report and re-evaluate their current roles. There appears to be some disagreement between the DOL's Office of Inspector General ("DOL OIG") and the Employee Benefit Security Administration ("EBSA") as to what Plan fiduciaries roles and responsibilities are over alternative investments. Page 17 of the report states:

*In its response, EBSA takes the position that the fact that a portfolio is professionally managed should somehow affect the plan administrator's role and responsibilities, and appears to endorse the practice of plan administrators relying on values provided by the alternative investment itself ("the role of 'plan management' would be to monitor...these professional advisors"). We disagree. The responsibility for accurately reporting fair values cannot be outsourced or delegated to a party other than plan management. The potential conflict of interest that can arise when investment managers report asset values cannot be underestimated. As a result, plan administrators should not and cannot rely on values provided by investment managers without conducting their own, independent due diligence.*

We cannot be certain as to where enforcement actions will settle, but the DOL Office of Inspector General believed that over 90% of the plans with alternative investments they inspected, the fiduciaries were deficient because they had not obtained independent valuations or could not demonstrate appropriate analytical process. Specifically, page 11 of the report states that:

*Given this lack of guidance, we found that in approximately 90 percent of plans in both the “enforcement” (39 out of 46) and “plans” samples (42 out of 45), representing about \$24 billion in assets, the associated plan administrators either had not obtained independent valuations or could not demonstrate they had applied an appropriate analytical process to determine the fair market value of all hard-to-value alternative investments. Plans in our samples reported values and performance that were passed on to them from other entities, often the investment entity. Plans did not demonstrate written documentation relating to the valuation as necessary for a determination of how, and on what basis, an asset was valued, and therefore whether that valuation reflected an asset’s fair market value. EBSA has previously stated that it would be contrary to prudent business practices for a fiduciary to act in the absence of such written documentation of fair market value.*

## **EBSA’s Response**

However, EBSA’s response suggests that the DOL OIG may be overstating the issue. EBSA stated in their response “the specific analysis required of a fiduciary, however, will vary depending on the individual facts and circumstances” and that “there is no explicit requirement under ERISA of the Department’s regulations that requires plans to obtain independent valuations of hard to value assets.” EBSA also states that “for EBSA to adopt a specific “independent valuation” requirement for plan administrators or other

fiduciaries to obtain valuations of hard to value assets would require EBSA to engage in notice and public commenting.” EBSA also indicated that the role of professional investment managers and consultants in the selection and monitoring of hard to value investments matters, as well as whether the assets are independently audited.

As the report suggests, hopefully EBSA will provide additional oversight and guidance to ERISA plans that hold hard-to-value alternative investments so that plan fiduciaries can ensure they are properly carrying out their duties. However, until that time, plan fiduciaries should consider re-evaluating their current oversight of alternative investments in light of this recent report.

## **From the AICPA Employee Benefit Plan Audit Quality Center**

The DOL Office of Inspector General (OIG) recently conducted a study to determine if the DOL Employee Benefit Security Administration (EBSA) is providing adequate oversight of employee benefit plans that hold alternative investments. The OIG study was prompted by concerns by various parties, including the AICPA, IRS and GAO, over plan assets invested into alternative and hard-to-value investments. As of 2010, employee benefit plans had amassed almost \$3 trillion in alternative investments, of which EBSA estimated between \$800 billion and \$1.1 trillion were hard-to-value. The OIG report noted that EBSA faces challenges meeting its mission because some plans have increasingly shifted assets from traditional investments, such as stocks and bonds, into an array of complex, hard to define alternative investments, such as common collective trusts, private equity funds, limited partnerships, hedge funds, and real estate.

### **Plan Management**

The OIG believes plans are using poor practices in valuing

these investments. In a sample of ERISA plans reviewed, the OIG found that plan management could not always demonstrate that it prudently monitored and valued all plan assets invested in hard-to-value alternative investments. In approximately 90 percent of the sample of plans reviewed by the OIG, plan administrators either did not obtain independent valuations or demonstrate an analytical process to determine their fair market value. Plans also relied on client statements and general partners' estimated values without additional analysis to ensure the alternative investments were reported at fair market value.

The OIG report noted that **plan administrators cannot easily determine the fair market value of alternative investments** for a number of reasons:

- **Alternative investment entities may be unaudited**, not listed on any national exchange, and not subject to state or federal regulation.
- **Plans are not required to obtain an independent valuation** to demonstrate the fair market value of these types of investments.
- **ERISA allows plans to elect a "limited scope audit"** for purposes of filing the Form 5500 Annual Return/Report. In such audits, Plan financial statement auditors perform no auditing procedures to test for existence or valuation of plan assets held and "certified" by a qualifying financial institution.
- **Financial institutions holding these plan assets need not certify** for purposes of a limited scope audit that they are reporting the assets at fair market value, but only that the records are "complete and accurate."
- **The financial institutions' records may only be a pass through of estimated values** the institutions received directly from the alternative investment entity, which gives rise to a conflict of interest when it comes to reporting investment losses.

## Values of Alternative Investments

The OIG report observes that a potentially unaudited investment entity – which may have an incentive to report gains and asset growth rather than losses – can provide the values of alternative investments to a financial institution which, in turn, transmits these values to plan administrators without employing any audit procedures, analyses, or due diligence to verify the information provided by the investment entity. This lack of transparency and accountability places participants and beneficiaries at increased risk for losses. EBSA and the Securities and Exchange Commission (SEC) have filed numerous civil actions and made significant recoveries totaling more than \$900 million against plan management and fiduciaries for losses to plan participants and beneficiaries resulting from hard-to-value alternative investments.

To view the DOL OIG report, including the scope, methodology, and EBSA response, click [here](#).

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