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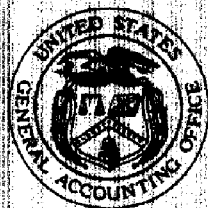
United States General Accounting Office

Report to the Secretary of Labor

August 1994

PENSION PLANS

Stronger Labor ERISA Enforcement Should Better Protect Plan Participants





United States
General Accounting Office
Washington, D.C. 20548

**Health, Education, and
Human Services Division**

B-225405

August 8, 1994

The Honorable Robert B. Reich
The Secretary of Labor

Dear Mr. Secretary:

This report describes the results of our review of certain aspects of the Department of Labor's enforcement of the Employee Retirement Income Security Act of 1974 (ERISA). By strengthening the enforcement program, Labor can better protect an estimated 200 million plan participants and beneficiaries and \$2.5 trillion in assets held by private pension and welfare plans.

Labor's Pension and Welfare Benefits Administration (PWBA) enforces ERISA's prohibited transaction and fiduciary requirements that ensure private pension and welfare plans operate in the best interest of plan participants, reporting and disclosure requirements that ensure plans provide financial and other information to the federal government and plan participants, and bonding requirements. Our report discusses the need to improve Labor's (1) enforcement strategy, (2) methodology for targeting pension and welfare plans for investigation, and (3) use of penalties to increase ERISA compliance.

To perform our work, we reviewed selected PWBA enforcement documents; analyzed information from PWBA's Case Management System and PWBA's 10 area offices; and interviewed PWBA headquarters, area office, and other officials. For more details on our review scope and methodology, see appendix I.

Results in Brief

While Labor's enforcement program has improved since 1986, it can be strengthened by taking steps to ensure maximum use of investigative resources. PWBA has never evaluated its current enforcement strategy, which requires the allocation of a substantial percentage of resources to investigate "significant issue" cases involving financial institutions and service providers with a high potential for ERISA violations. Such an evaluation is needed to determine whether PWBA is focusing on the right issues and whether the allocation formula produces the greatest results, as measured by such quantitative indicators as dollars recovered and participants impacted.

Furthermore, PWBA has done little to assess the effectiveness of computer targeting programs developed to systematically select pension and welfare plans for investigation of potential fiduciary violations. Investigators need this information so they can use programs with the highest probability of identifying plans with violations. However, PWBA has no plans to test the programs in 1994 and has taken few steps to correct weaknesses in the procedures used in the past to test programs.

The enforcement program also can be strengthened by increasing the use of penalties authorized by ERISA to deter plans from violating the law. Opportunities to identify and penalize plans for not filing required annual reports are probably being missed since PWBA, because of a lack of staff, does not routinely follow up on Internal Revenue Service (IRS) referrals of plans that report financial and other information one year but not the next. Because of a lack of legal resources in the Labor Solicitor's Office, PWBA has not been able to take legal action to penalize welfare and certain pension plans involved in prohibited transactions. Also, given the restrictive legal requirements that have limited the use of penalties for violations of ERISA fiduciary requirements, PWBA needs to determine whether additional administrative guidance, changes to the law, or both are needed to remedy confusion associated with the penalty and enhance PWBA's penalty enforcement.

Background

Labor and IRS have primary responsibility for enforcing ERISA requirements. PWBA enforces prohibited transaction, fiduciary, reporting, disclosure, and bonding requirements. IRS enforces participation, vesting, and funding requirements.

Labor established its current ERISA enforcement strategy in December 1986 after being criticized by us and others for not having a comprehensive, consistent long-term strategy for enforcing the law and selecting plans for investigation. Since that time, the strategy has focused on investigating "significant issue" cases with a high potential for fiduciary violations, such as untimely cash deposits or other imprudent management practices. These cases involve financial institutions that hold or manage plan assets, such as banks and trust companies, and service providers that provide plans with dental, vision, legal, accounting, and other services. Through program year 1993 (October 1, 1992, to September 30, 1993), the strategy called for PWBA to allocate at least 50 percent of its investigative resources to significant issue cases, with no less than 20 percent to be spent on

either financial institution or service provider cases. The remaining resources were to be devoted to investigating general cases.

The goal of PWBA's strategy is to achieve the greatest possible ERISA compliance by using resources effectively. PWBA believes that investigations of significant issue cases have a broader impact than investigations of individual cases because financial institutions and service providers often serve many plans and many participants. Consequently, when a fiduciary violation by a financial institution or service provider is corrected, dollar recoveries and the number of plans and participants affected are usually larger than when a violation by an individual plan is corrected.

PWBA has implemented the strategy by setting forth specific requirements for its 10 area offices through its annual planning process. For example, PWBA's 1994 program year planning guidance required a balance among types and sizes of plans selected for general investigations, with a general rule that no more than 5 percent of all such cases should involve plans with fewer than 50 participants. The guidance also emphasized investigations of multiple employer welfare arrangements (MEWA) and employee stock ownership plans (ESOP) as significant issue cases.

PWBA uses several methods to select financial institutions, service providers, and pension and welfare plans for investigation. The methods include referrals from IRS and other agencies, complaints from participants, manual review of financial and other information on plans' annual Form 5500 series reports,¹ spinoffs from other investigations, special area office projects, and computer targeting.

In 1990, PWBA developed a number of unique computer targeting programs that search automated Form 5500 series information for characteristics that PWBA believes indicate a high potential for ERISA violations. PWBA initially developed 95 programs, but reduced the number to 81 for 1994 and subsequent program years to eliminate duplicate and other unproductive programs. The computer targeting programs are used primarily to identify pension and welfare plans for investigation, although some programs can be used to identify financial institutions and service providers. PWBA believes the targeting helps focus its resources.

¹Most pension and some welfare plans annually file with IRS a Form 5500, 5500-C, or 5500-R report that contains financial and other information. Information from these forms is computerized by IRS and shared with Labor.

The type of investigation conducted depends on the circumstances of the case. For example, PWBA must open a limited review for all plans chosen to test the computer targeting programs. Such reviews inquire into one or more specific aspects of a plan or other entity operation to quickly determine whether a complete fiduciary or criminal investigation is warranted. In addition, PWBA may open a fiduciary or criminal investigation without conducting a limited review when the available evidence is sufficient to justify doing so.

When violations are identified, ERISA authorizes Labor to assess civil penalties against the violators. Labor may assess a penalty of up to \$1,000 per day against a plan administrator who fails or refuses to file a Form 5500 series report or whose report is rejected for failing to include material information. When welfare plans or pension plans that do not qualify for tax exemption are found to have violated ERISA's prohibited transaction requirements, Labor may assess parties in interest² a penalty up to 5 percent of the prohibited transaction and up to 100 percent if the transaction is not corrected within 90 days. Labor must, with certain exceptions, assess a penalty against a fiduciary or any person who knowingly participated in a fiduciary breach that occurred on or continued after December 19, 1989. The fiduciary penalty is equal to 20 percent of the recovery amount agreed to in a settlement agreement with Labor or contained in a court order.

Enforcement Program May Not Maximize Use of Resources

Since 1986, PWBA has increased its enforcement activities and improved its enforcement results, as measured by such quantitative indicators as dollar recoveries and participants impacted. However, the enforcement program may not ensure that scarce investigative resources will be used as effectively and efficiently as possible in the future. Most area offices reported that allocating fewer resources to significant issue cases and more resources to general cases would improve enforcement results. Officials in three area offices said that the universe of financial institutions or service providers with a high potential for ERISA violations may be diminishing. Furthermore, area offices may not be using computer targeting programs with the highest probability of identifying plans with ERISA violations because PWBA has not determined the effectiveness of the programs. In addition, area offices waste some resources handling and tracking cases referred to and received from IRS and other agencies upon which no action is taken.

²As related to ERISA welfare or pension plans, a party in interest includes fiduciaries, employees, persons who provide services to a plan, employers or employee organizations whose members are covered by a plan, or others (29 U.S.C. 1002 (14)).

Enforcement Activities Increased and Results Improved

PWBA's enforcement activities have increased since program year 1986—the last full program year before the current strategy was implemented. PWBA Case Management System data show that by program year 1993, the number of cases opened had more than doubled from 1,420 in 1986 to 3,250 and the number of cases closed had increased from 1,674 to 2,998. These enforcement increases were partly caused by an increase in the number of limited reviews needed to test computer targeting programs. For example, 1,480 of the 2,998 cases closed in program year 1993 had been opened to test computer targeting programs. The increase was also influenced by a 37-percent increase in area office enforcement staff, which grew from 266 in 1986 to 365 in 1993.

Enforcement results also have improved since program year 1988—the first full program year under the significant issue strategy. PWBA uses a number of quantitative indicators to measure the effectiveness of its enforcement program. They include dollar recoveries, number of plans impacted, number of participants impacted, number of cases with monetary recoveries,³ number of cases with other fiduciary results (fiduciaries removed, diversification, investments stopped, and administrative practices changed), number of cases with nonfiduciary results (reporting, disclosure, and bonding violations), number of cases with criminal indictments, number of individuals indicted, number of cases referred for litigation (civil cases to Labor's Solicitor and criminal cases to the Justice Department), and number of cases with litigation filed. When assessing enforcement efforts, PWBA also considers such qualitative effects as presence in the community and changes in industry practices and behavior. Case Management System data show that all but one quantitative indicator improved between program years 1988 and 1993, as shown in table 1.

³Monetary recoveries include assets that were restored to the plans and prohibited transactions that were corrected.

Table 1: Comparison of Selected Quantitative Enforcement Indicators for Cases Closed During 1988 and 1993

Indicator	1988	1993
Dollars recovered (millions)	\$103	\$183
Plans impacted	33,824	72,199
Participants impacted (millions)	7.16	21.00
Cases with monetary recoveries	244	303
Cases with other fiduciary results	82	125
Cases with nonfiduciary results	227	187
Cases with criminal indictments	9	29
Individuals indicted	12	41
Cases referred for litigation	57	117
Cases with litigation filed	27	38

The improved results stemmed from both significant issue and general case investigations. Significant issue cases, which are generally more complex and time consuming than general cases, accounted for 29 percent of all cases opened in program year 1993, 33 percent of all cases closed, and 46 percent of total investigative time.

At the same time, as illustrated in table 2, significant issue case investigations closed during program year 1993 produced higher monetary recoveries; affected more plans and participants; and resulted in more cases with criminal indictments, individuals indicted, and cases referred for litigation. General case investigations identified more plans with fiduciary and nonfiduciary violations, and resulted in more cases with litigation filed. With the exception of cases with criminal indictments and individuals indicted, similar results occurred in most program years since 1988.

Table 2: Comparison of Selected Quantitative Enforcement Indicators for Significant Issue and General Case Investigations Closed in 1993

Indicator	Significant issue cases	General cases
Dollars recovered (millions)	\$107	\$76
Plans impacted	69,678	2,521
Participants impacted (millions)	17.08	3.91
Cases with monetary recoveries	107	196
Cases with other fiduciary results	44	81
Cases with nonfiduciary results	48	139
Cases with criminal indictments	18	11
Individuals indicted	27	14
Cases referred for litigation	79	38
Cases with litigation filed	18	20

Information obtained through a questionnaire we developed and distributed to PWBA's 10 area offices indicated that some of the improved enforcement results since program year 1986 are attributed to the significant issue strategy. At least eight area offices reported increases in dollar recoveries, plans and participants covered, and indictments between program years 1986 and 1992. Half the area offices said the number of plans with fiduciary violations (that is, cases with monetary recoveries and other fiduciary results) had increased. Moreover, at least half of these offices said the increases resulted in part from the strategy. (See question 1 in app. II.)

Changing the Significant Issue Strategy May Further Improve Enforcement Results

Despite the success of the significant issue strategy since 1986, most area offices believe that refocusing investigative resources would further improve enforcement results. In response to our questionnaire, six area offices said that fewer resources should be allocated to significant issue cases and seven said that more resources should be allocated to general cases. Most of these area offices said that reallocating investigative resources would enable them to maximize dollar recoveries, court-ordered corrections, voluntary corrections, and criminal convictions, while increasing the pension industry's awareness of Labor's enforcement role. In addition, nine area offices wanted more discretion over the size of the plans they investigate. (See questions 2 through 4 in app. II.)

Six of the seven area offices we visited indicated that it may be time to change the significant issue strategy. Four of the six said that the resource allocation requirement should be reduced. Two of these four and one other office said that the universe of financial institutions or service

providers was diminishing. Four offices offered suggestions for refocusing resources, including spending more time on small plans, defined contribution plans,⁴ defined benefit plans sponsored by bankrupt sponsors, and plans that offer life insurance.

PWBA headquarters officials noted enforcement difficulties associated with some of these suggested alternatives. For example, civil recoveries from plans with bankrupt sponsors are often limited because typically there are insufficient assets available. Criminal prosecution in cases involving small dollar amounts is sometimes difficult because U.S. Attorney offices do not have the resources to pursue all cases. Some area offices have worked with state and local prosecutors on small cases the U.S. Attorney offices might have opted not to pursue.

In addition, the PWBA Field Focus Group established by Labor in 1993 as part of President Clinton's effort to "reinvent" the government recommended that the ERISA enforcement strategy be revised. In its October 5, 1993, report to the Assistant Secretary for Pension and Welfare Benefits Administration, the Group said that the strategy may no longer focus enforcement efforts properly; they noted that enforcement efforts should change as issues change and should respond to new developments. The Group recommended that no more than 20 percent of available time be devoted to any particular strategy component and that strategy issues, projects, and emphasis be chosen annually and run no more than 2 years.

PWBA revised its resource allocation formula for program year 1994. It reduced the requirement for significant issue cases from 50 percent to 40 percent and removed the requirement that at least 20 percent of investigative resources be spent on either financial institution or service provider cases.

While reducing the resource allocation formula was partially responsive to the Field Focus Group recommendations and may be viewed favorably by area offices that told us the prescribed formula was too high, the change does not respond to the Focus Group's recommendation that strategy issues be chosen annually and last no more than 2 years. Moreover, PWBA had no empirical data showing that 40 percent is the resource allocation formula that produces the greatest enforcement results. Information provided by two of the seven area offices we visited indicated that the staffing resources needed may differ by area. One area office suggested

⁴Defined contribution plans are pension plans that provide an individual account for each participant and base benefits on accumulated contributions, earnings, and forfeitures to the account.

that the resource allocation should be between 25 and 33 percent and one suggested that it should be between 30 and 40 percent; five did not suggest a formula.

In commenting on a draft of this report, Labor said that it never represented that the formula would produce the greatest enforcement results. Rather, Labor said, the formula was established to make certain that area offices paid sufficient attention to significant issues and that policy priority was firmly established. Labor now believes that specific direction from headquarters on the formula is probably unnecessary.

Little Done to Determine Effectiveness of Computer Targeting Programs

Results of a PWBA consultant's tests of computer targeting programs available from 1990 to 1993 do not provide sufficient information to determine the effectiveness of those programs.⁵ The consultant reported that 14 of 19 programs tested the first 2 years were "general successes" based on PWBA's interim criteria.⁶ Under these criteria, a program was deemed successful if limited reviews required by area offices for test purposes were converted to full investigations more than 5 percent of the time.⁷ This 5 percent rate is PWBA's estimated "baseline" conversion rate for investigations resulting from manual review of Form 5500 series data. Instead of actual results, conversion rates were used as success indicators because PWBA wanted timely results and some investigation results are not known for 3 years. Ideally, test results would be based on completed investigations and actual violations identified.

PWBA revised its computer targeting programs for program year 1994, but made no specific plans to test the programs. In April 1994, headquarters officials told us that PWBA would be reevaluating computer targeting program testing and would consider the recommendations in our September 30, 1993, letter to the Assistant Secretary for Pension and Welfare Benefits Administration. (See app. III.) In that letter, we pointed out the following weaknesses in testing procedures used to evaluate the predecessor programs:

⁵Mathematica Policy Research, Inc., *Evaluation of Selected Computer Targeting Programs* (May 22, 1992) and *Evaluation of Selected Plan Year 1989 Computer Targeting Programs* (Feb. 28, 1994).

⁶Programs were tested to determine whether they were general and specific successes. The general success rate included targeted cases that identified any type of violation. The specific success rate included targeted cases that identified the specific violation the program was designed to discover.

⁷To be considered successful with Labor's desired level of confidence, the conversion rate for sampled cases had to be at least 5 percentage points higher than the 5 percent baseline rate. That is, the conversion rate had to be greater than 10 percent.

- Because PWBA did not randomly select plans for investigation (it selected the highest ranking plans), test results were not representative of all plans identified by the targeting programs.
- By using a more appropriate sampling formula, PWBA could test the programs with fewer investigations than required in the past.

These weaknesses should be corrected if PWBA continues to test one program at a time. In addition, we continue to believe that PWBA may be able to target plans more effectively and efficiently by using multivariate analysis to analyze computer targeting programs in combination with one another rather than individually.

Staff Resources Are Wasted Handling Referrals on Which No Action Is Taken

PWBA and other federal agencies waste scarce staff resources handling referrals of cases with suspected fiduciary violations on which no action is taken. For example, data reported by area offices to PWBA headquarters showed that PWBA did not investigate over 90 percent of the 3,894 IRS referrals it received between 1990 and 1993, usually because the referrals involved small plans (1,595 cases), plans that had already corrected the identified violation (681 cases), or plans with bonding (504 cases) or other nonfiduciary violations. At least nine area offices said that they had not opened investigations on some referrals from IRS and other agencies in program year 1992 for these same reasons. (See questions 10 through 13 in app. II.)

While information on the cost associated with such referrals is not readily available, area offices estimate that the cost is small. About half of PWBA's area offices estimated costs of handling such referrals.⁸ These offices estimated that they spent about \$4,600 in fiscal year 1992 on 535 referrals from IRS and other agencies on which the area offices took no action. They also estimated that they spent about \$1,600 in fiscal year 1992 to refer 115 cases to other agencies that took no action on the cases. (See questions 20 through 21 in app. II.)

A Labor/IRS memorandum of understanding governing coordination between the two agencies requires that IRS refer to PWBA all plans with identified ERISA violations. PWBA area office and IRS district office officials said that the agreement leaves IRS no discretion in deciding which cases to refer. As a result, referrals are made regardless of whether corrective action has already been taken or whether the plan has terminated.

⁸The estimates were for administrative costs and costs of staff time used to decide on and prepare documentation related to processing referrals.

Moreover, IRS refers cases that PWBA does not investigate because of PWBA's focus on large plans. PWBA program planning guidance limits the time area offices can expend investigating plans with fewer than 50 participants, but the bulk of IRS referrals involve such plans. PWBA headquarters officials told us that despite the inefficiency, they want all identified violations referred to the area offices so the offices can decide whether to open an investigation.

PWBA's Field Focus Group suggested revising the Labor/IRS memorandum of understanding. Among other things, the Group recommended that existing procedures be revised to eliminate IRS referrals of plans with fewer than 10 participants and to require IRS to refer reporting violations directly to PWBA's Office of the Chief Accountant (OCA), which enforces ERISA reporting requirements.

Opportunities for Increased Use of Penalty Authority

PWBA has not fully used the penalty authority provided by ERISA. PWBA may be missing opportunities to identify and penalize plans that violate reporting requirements because PWBA does not routinely follow up on all IRS referrals. Lack of legal resources has hindered PWBA from assessing more penalties for prohibited transactions by welfare plans and pension plans that do not qualify for tax exemption. In addition, restrictive legal requirements have limited the assessment of penalties for fiduciary violations.

Opportunities for Increased Use of Reporting Penalties

OCA does not routinely follow up on IRS service center referrals of plans that file a Form 5500 series report one year but not the next.⁹ Officials in the IRS Memphis Service Center told us that in September 1992 the center sent OCA the names of approximately 4,000 to 5,000 plans that had not filed a Form 5500 series report in program year 1992 but had filed in a previous year. Service center officials said that while some plans may not have filed because they terminated, merged with another plan, or had some other valid reason, other plans likely had no valid reason for not filing. An OCA headquarters official told us that no action had been taken on these or similar referrals from other IRS service centers because OCA does not have enough staff.

OCA has had several projects to identify plans with reporting violations. To encourage compliance by late filers and nonfilers, PWBA offered a "grace period" from March through December 1992 during which plan

⁹Form 5500 series reports are sent to one of four IRS service centers.

administrators who had failed to file annual reports could file those reports and pay a reduced penalty. Before 1992, PWBA made a special effort to identify plans with over 100 participants that failed to include an accountant's report with their annual reports. In late 1993, PWBA began a program to identify nonfilers from information in master trust filings with Labor.

Assessment of Prohibited Transaction Penalties Hindered by Lack of Legal Resources

From 1990 through 1993, PWBA assessed penalties on 11 of 48 welfare or unqualified pension plans found to have prohibited transaction violations. Officials in PWBA headquarters and the Labor Solicitor's Office said that the other violators were not assessed penalties because plans often challenge the penalty in court and the Solicitor's Office did not have enough staff to pursue all these cases. In addition, Labor pointed out in its comments on a draft of this report that such cases often involve small dollar amounts, but consume substantial litigation resources.

Officials in five area offices told us that PWBA should be in a better position to pursue such cases when the Labor Solicitor's Office is decentralized. Under a memorandum of understanding signed by PWBA and the Solicitor's Office in fall 1993, civil penalty litigation under ERISA was decentralized to four regions that had not previously handled litigation. Among other changes, the agreement called for two additional staff in the Solicitor's Offices for each of the four regions.

Restrictive Legal Requirements Limit Assessment of Fiduciary Penalties

Restrictive legal requirements have limited PWBA's ability to assess penalties against fiduciaries or other persons who knowingly participate in a fiduciary breach. Penalties may be assessed only against fiduciaries or knowing participants in a breach who, by court order or settlement agreement, restore plan assets. If (1) there is no settlement agreement or court order or (2) plan assets are returned by someone other than a fiduciary or knowing participant, the penalty may not be assessed.

Area office officials told us that without settlement agreements they could not assess penalties against some violators. In some cases, area offices said, violators restored plan assets after receiving a PWBA letter requesting voluntary compliance, but avoided penalties by claiming that the asset restoration was independent of PWBA's enforcement efforts or by simply not replying to the letter. Area offices noted other cases where asset restoration and associated settlement agreements were delayed when violators refused to take corrective action unless PWBA forgave the penalty.

Area office officials also said they were unable to assess penalties in cases in which a party other than the fiduciary or knowing participant restored the plan assets.

Many area offices told us that the fiduciary penalty is complicated and confusing despite guidance from headquarters. Temporary guidance issued in April 1991 states that PWBA must assess a fiduciary penalty if the fiduciary or knowing participant restores assets in response to a voluntary compliance letter. The guidance also states that if the fiduciary or knowing participant restores assets after receiving such a letter but claims the action was voluntary, PWBA may not assess the penalty because there is no settlement agreement. The guidance further states that if the fiduciary or knowing participant restores assets after receiving a voluntary compliance letter but remains silent on the reason for the action, a penalty should be assessed unless special circumstances indicate that it should not be assessed. Area office officials said that they need additional guidance regarding which fiduciary actions in response to voluntary compliance letters constitute settlement agreements and what parties are subject to the penalty.

The importance of the fiduciary penalty and associated problems is growing. For example, the number of cases approved for penalty assessment letters increased from 10 in 1991 to 105 in 1993. Moreover, area office officials believe the numbers will increase as more cases are identified with fiduciary violations occurring after the effective date of the penalty—December 19, 1989.

Conclusions

Labor's ERISA enforcement program has improved since 1986, but further strengthening the program would better protect millions of private pension plan participants and trillions of dollars in assets held by those plans. To ensure that it is maximizing the use of scarce investigative resources, PWBA needs to determine whether financial institutions and service providers warrant continued enforcement emphasis and, more specifically, whether 40 percent of its investigative staffing resources should be devoted to such efforts. Moreover, PWBA needs to determine whether the amount of resources allocated to significant issue investigations should be tailored for each area office.

PWBA also needs to determine the effectiveness of its computer targeting programs to identify plans with ERISA violations so area offices can use the most successful programs as soon as possible. However, PWBA's targeting

testing procedures have been inadequate. Furthermore, at the time of our review, PWBA had no specific plans to test its current programs and had taken few steps to correct weaknesses in the procedures used to test the predecessor programs.

The ERISA enforcement program can also be strengthened by making better use of penalties authorized by ERISA. By not routinely following up on referrals from IRS, PWBA is likely to miss opportunities to identify and penalize plans that have violated ERISA reporting requirements. Lack of legal resources has hindered PWBA's use of penalties against welfare and unqualified pension plans involved in prohibited transactions, but decentralizing legal services may allow area offices to more aggressively pursue such penalties. Given the restrictive legal requirements that have limited the use of the fiduciary penalty, the expected growth in cases involving this penalty, and the decentralization of legal services, PWBA needs to determine whether additional administrative guidance, changes to the law, or both are needed to remedy confusion associated with the penalty and enhance PWBA's penalty enforcement.

Recommendations to the Secretary of Labor

We recommend that you direct the Assistant Secretary for Pension and Welfare Benefits Administration to take the following actions to strengthen the ERISA enforcement program:

- Evaluate the significant issue strategy to determine (1) whether financial institutions and service providers continue to be the issue areas with the greatest potential for achieving maximum ERISA enforcement results and (2) whether 40 percent is the resource allocation formula that will provide the greatest enforcement results or whether the formula should be tailored for each area office.
- Begin testing the revised computer targeting programs as soon as possible. If PWBA opts to test each individual program using the same criteria described in our September 30, 1993, letter to the Assistant Secretary, PWBA should (1) randomly select plans for testing so results can be projected and programs properly validated and (2) use a formula to set a sample size that will require less calendar and staff time to test each program. PWBA should also test the feasibility of using multivariate analysis to target plans for investigation.
- Increase the use of penalties authorized by ERISA by establishing procedures to routinely review referrals of potential reporting violators from IRS service centers and using decentralized legal staff to help assess prohibited transaction penalties when warranted. PWBA should also

determine whether additional administrative guidance, changes to the law, or both are needed to remedy confusion associated with the penalty and enhance PWBA's penalty enforcement.

Agency Comments and Our Evaluation

In providing comments on our draft report, the Assistant Secretary for Pension and Welfare Benefits Administration agreed that Labor's ERISA enforcement program should maximize the use of resources, but generally disagreed with many of our recommendations. Labor said that its current strategy and computer targeting leverage enforcement resources, which are extremely limited in view of the large universe of participants and plans covered by ERISA. Labor also said that recent and anticipated changes should improve the program. We commend Labor for striving to improve its ERISA enforcement program, but continue to believe that implementing our recommendations will further strengthen the program.

Enforcement Strategy

In commenting on our recommendation to evaluate the significant issue strategy, Labor said that it has reviewed and refined its enforcement strategy over the last 4 years and is in the process of making substantial changes that should further improve the program. It is also planning to delegate more authority to area offices to establish criteria for opening investigations. In addition, Labor is looking to reduce the time mandated for national enforcement initiatives and allow more latitude for area office initiatives and local conditions.

Our report discusses some recent strategy refinements, such as decentralization of legal services and reduction of the significant issue resource allocation formula. Labor said that these changes were brought about by the collective judgment of agency officials and years of experience with its enforcement strategy. We also revised our report to mention Labor's belief that providing specific headquarters direction on the amount of resources to be allocated to significant issues will probably no longer be necessary. As part of our continuing oversight of the enforcement program, we plan to monitor Labor's progress in implementing these strategy changes and any others resulting from needed changes identified during our recommended evaluation of the significant issue strategy.

Computer Targeting

Labor believes, and we agree, that computer targeting testing protocol should use enforcement staff and resources judiciously. However, Labor

generally disagrees with our recommendations to (1) randomly select plans for testing so results can be projected and (2) use a selection formula that lowers the number of plans needed to test programs. Labor also raised concerns about the resources that would be required to carry out our multivariate analysis recommendation.

We continue to believe that PWBA should randomly select plans for testing if it wants to validate the programs as currently defined. If, as Labor believes, the purpose of testing is to identify the levels of success of investigations of the highest ranking plans identified by the programs one year and project those success levels to the highest ranking plans in future years, random sampling would not be necessary. On the other hand, as noted in our September 30, 1993, letter to the Assistant Secretary for Pension and Welfare Benefits Administration, this approach would not validate each of PWBA's 81 computer targeting programs because the success rate for the highest ranking plans may not be the same as the rate for other plans identified by the programs.

We also believe that implementing our recommendation to use a sampling formula that requires fewer plans to test programs would help Labor achieve its goal of making judicious use of staff and resources. Resources freed by investigating fewer plans could be used to test more of the 81 individual programs each year so area offices could use the most successful programs as soon as possible. Alternatively, these resources could be used to carry out other enforcement activities. Of course a larger number of plans would be needed to test programs if, as Labor suggests, the purpose of testing is to determine the relative success of the programs or the level of confidence desired by PWBA is higher than originally sought.

Further, we believe that implementing our recommendation that Labor test whether multivariate analysis is a more effective and efficient way to target investigations is consistent with Labor's desire for judicious use of resources. The test, at a minimum, should determine whether the additional resources needed to assess all applicable characteristics for each plan reviewed would be offset by the decreases in resources needed to review a smaller total number of plans. Test results should address Labor's concern about the availability of limited resources to fulfill its enforcement responsibilities.

Use of Penalties

In commenting on our recommendation to make greater use of civil penalties as an enforcement tool, Labor said that it seeks to deter

would-be violators through aggressive litigation and substantial penalties. For example, Labor said that it had prioritized the use of limited resources in a highly effective way to carry out its reporting compliance responsibility. It said that a program initiated in 1994 to identify nonfilers, among other things, will include following up on the welfare plan listing received from IRS. Labor also said that its 1992 "grace period" program encouraged late filers and nonfilers to voluntarily submit previously unfiled annual reports. We are reviewing this program as part of another assignment and cannot comment on its merits at this time. However, we revised our report to recognize these efforts.

Labor also said that decentralizing legal services to area offices may result in more opportunities to assess penalties for prohibited transactions involving welfare plans or nonqualified pension plans. Labor pointed out that the usefulness of such penalties may be limited because cases often involve small recovery amounts and require substantial resources to litigate. We revised our report to explain Labor's position on decentralized legal services. We also recognize that when deciding whether to assess this optional penalty, Labor should consider the expected costs and revenues, as well as other potential benefits such as the deterrent effect.

Labor acknowledged difficulties with applying the fiduciary penalty, noting that the authorizing law provides fixed, narrow restrictions rather than broad flexibility. We revised our report to emphasize the difficulty PWBA area offices have had assessing the penalty and highlight the growing importance of the fiduciary penalty. Based on our work and Labor's comments, we believe that headquarters needs to determine whether additional administrative guidance, changes to the law, or both are required to remedy confusion and enhance PWBA's penalty enforcement.

Other Matters

In addition to commenting on the specific sections of our report, Labor raised some general concerns about our draft report. Labor said that it was concerned about the reliability of many conclusions drawn from our area office questionnaire because some questions were subject to interpretation and responses would reflect a range of variables depending on the circumstances of the area office.

In developing the area office questionnaire, we recognized that some questions might be subject to interpretation and took steps to minimize the subjectivity. Before sending the questionnaire to PWBA's 10 area offices, we discussed its contents and language with officials in PWBA headquarters

and 2 area offices and incorporated their suggestions and comments as appropriate. After the questionnaire was completed, we visited five area offices to discuss their responses and made changes, as necessary, to ensure we reported them properly.

In addition, Labor said that it was concerned about the impact of differences in perspectives between area office directors and the agency's policy leadership regarding the results of certain enforcement efforts. Citing two national initiatives as examples, Labor pointed out that enforcement efforts may be viewed as successful in qualitative terms, such as changing industry practices, but not in quantitative terms, such as the number of fiduciary violations. Such differences, Labor said, may have affected area office answers and had a major impact on the validity of our conclusions. We revised our report to clarify that while PWBA considers "qualitative" effects when assessing its enforcement efforts, we analyzed only quantitative indicators.

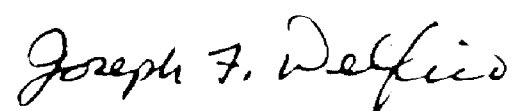
Finally, Labor said that it would have been useful for us to discuss our questionnaire results with top-level officials before preparing our draft report to determine whether there were any national policy issues that should have been taken into consideration. Before completing this report, we provided PWBA's Deputy Assistant Secretary for Program Operations with a detailed briefing on the results of our work. However, no national policy issues were raised by Labor officials at this meeting.

As you know, the head of a federal agency is required by 31 U.S.C. 720 to submit a written statement of actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations no later than 60 days after the date of the report. A written statement must also be submitted to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of the report.

We are providing copies of this report to the Chairman and Ranking Minority Members of the Senate Committee on Labor and Human Resources and House Committee on Education and Labor, various other Senate and House committees and subcommittees, interested Members of the Congress, and other interested parties. We also will make copies available to others upon request.

If you or your staff have any questions about this report, please call me on (202) 512-7215. Major contributors to this review are listed in appendix IV.

Sincerely yours,

A handwritten signature in cursive script that reads "Joseph F. Delfico".

Joseph F. Delfico
Director, Income Security Issues

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Abbreviations

ERISA	Employee Retirement Income Security Act of 1974
ESOP	employee stock ownership plan
IRS	Internal Revenue Service
MEWA	multiple employer welfare arrangement
OCA	Office of the Chief Accountant
PWBA	Pension and Welfare Benefits Administration

Detailed Scope and Methodology

We used information from several sources to understand Labor's enforcement program. We reviewed our previous reports; applicable sections of the Employee Retirement Income Security Act of 1974, as amended, and the Internal Revenue Code; selected federal regulations; and the Pension and Welfare Benefits Administration's Enforcement Strategy Implementation Plan, program planning guidance for program years 1986 to 1994, Sources of Cases Studies for program years 1987 through 1990, and the Field Focus Group report sent to the Assistant Secretary for Pension and Welfare Benefits Administration on October 5, 1993. We interviewed officials in Labor's PWBA headquarters and seven area offices, Office of the Solicitor, and Office of the Inspector General, as well as representatives of selected outside interest groups. We visited IRS's Memphis Service Center to determine firsthand how Form 5500 series reports are processed. And we sent a questionnaire to PWBA's 10 area offices (see app. II).

To assess PWBA's current enforcement strategy, we analyzed selected statistical data from PWBA's Case Management System reports for program years 1987 through 1993 and information from the questionnaires received from PWBA's 10 area offices. We discussed the enforcement strategy with officials at PWBA headquarters and in seven area offices. To determine whether PWBA's enforcement activity changed, we compared the number of cases opened and closed during the last complete program year before the strategy was implemented, 1986, with the number opened and closed during the latest complete program year, 1993. To determine the effect of PWBA's enforcement program, we compared selected quantitative indicators for the first complete program year after the strategy was implemented, 1988, with comparable indicators for program year 1993. To determine the effect of the strategy, we compared selected quantitative indicators for significant issue investigations with comparable indicators for general case investigations for program year 1993. The indicators used for these analyses included dollar recoveries, number of plans impacted, number of participants impacted, number of cases with monetary recoveries, number of cases with other fiduciary results, number of cases with nonfiduciary results, number of cases with criminal indictments, number of individuals indicted, number of cases referred for litigation, and number of cases with litigation filed. We did not attempt to analyze qualitative effects, such as changes in industry practices or behaviors.

To assess PWBA's computer targeting efforts, we reviewed Mathematica Policy Research, Inc.'s planning document and reports on computer targeting test results dated May 22, 1992, and February 28, 1994. We also

Appendix I
Detailed Scope and Methodology

tabulated the area office questionnaires to determine which methods of targeting area office officials viewed as the most effective. In addition, we discussed the computer targeting methodology with PWBA headquarters and area office officials.

To assess PWBA's case referral procedures, we discussed the procedures with officials in PWBA headquarters and seven area offices, as well as with officials in IRS headquarters and six IRS key district offices. We reviewed the memorandum of understanding between Labor and IRS. We also analyzed tracking documents and selected headquarters reports to ascertain whether Labor or IRS acted on referrals and, if not, why.

To analyze Labor's use of ERISA penalty authority, we analyzed information in PWBA's Case Management System and tabulated the area office questionnaire results. We reviewed selected case files. With officials in the Labor Solicitor's Office and in PWBA headquarters and seven area offices, we also discussed barriers to the use of penalties.

Our work was done primarily between April 1992 and December 1993, with selected information updated as of mid-June 1994. The work was performed in accordance with generally accepted government auditing standards. However, we did not independently verify all information provided by the area offices.

Results of Mail Questionnaire to PWBA Area Offices

U.S. General Accounting Office

Questionnaire on ERISA Enforcement for Pension
and Welfare Benefits Administration Area Offices

The United States General Accounting Office (GAO) is studying the Department of Labor's (DOL's) enforcement of the Employee Retirement Income Security Act of 1974 (ERISA). As part of this study, we are conducting a survey of all DOL Pension and Welfare Benefits Administration (PWBA) Area Offices to determine what methods are used to enforce ERISA.

To assist us, we would appreciate your completing and returning the enclosed questionnaire to us within the next three weeks. The questionnaire asks you to provide information about your area office's experiences enforcing ERISA and focuses on:

- o- changes in DOL's enforcement efforts resulting from the current strategy that was implemented in January 1987;
- o- the use of the computer targeting programs made available since June 1990 to identify plans and other organizations for investigation;

- o- the process of making referrals to and receiving referrals from other federal agencies, including the Internal Revenue Service (IRS); and
- o- the application of ERISA penalties for fiduciary, reporting, and prohibited transaction violations.

A pre-addressed business reply envelope is enclosed for your convenience. If you have any questions or comments about this questionnaire, please call Mr. Robert Brady on (215) 574-4039. In the event that the business reply envelope is misplaced, please return the questionnaire to:

U.S. General Accounting Office
Attn: Mr. Robert Brady
Suite 760
841 Chestnut Street
Philadelphia, PA 19107

**Appendix II
Results of Mail Questionnaire to PWBA Area
Offices**

In this questionnaire, when we refer to "your area office," we mean both your area office and the district office, if any, in your jurisdiction.

ENFORCEMENT STRATEGY

1. In PART A, please estimate whether your area office's investigations had more, about as many, or fewer of each of the following in FY 1992 than in FY 1986. In PART B, please tell us to what extent any differences you indicated were a result of the change in enforcement strategy between FY 1992 and FY 1986. For rows 1 - 10, N = 10.

Number of...	PART A						PART B					
	Don't know	Far more in FY 1992 than in FY 1986	More in FY 1992 than in FY 1986	About as many in FY 1992 as in FY 1986	Fewer in FY 1992 than in FY 1986	Far fewer in FY 1992 than in FY 1986	N/A; there was no change or Don't know	To a very great extent	To a great extent	To a moderate extent	To some extent	To little or no extent
	(1)	(2)	(3)	(4)	(5)	(6)	(1)	(2)	(3)	(4)	(5)	(6)
1. geographic areas covered		1	1	8			4			2		4
2. plans covered		4	4	1	1		1		3	3	1	2
3. plan participants covered		5	4	1			1	1	4	2	1	1
4. criminal cases opened		7	3					4	3		1	2
5. cases referred to the Department of Justice		5	4		1			4	3			3
6. indictments		4	5	1				4	1	1		4
7. convictions and guilty pleas		5	5					4	1	1		4
8. civil cases opened		4	5	1					2	2	3	3
9. plans found with fiduciary violations		1	4	3	2		1		1	4	3	1
10. dollars recovered		4	4		2			1	2	3	2	2
11. Other (PLEASE SPECIFY.)												
a. Fiduciary removed		1						1				
b. Civil suits filed			1							1		

**Appendix II
Results of Mail Questionnaire to PWBA Area
Offices**

2. We are interested in your opinion on the optimal allocation of staff years for investigations. Consider the staff years your area office allocated to investigations in FY 1992. To best enforce compliance with ERISA with the same number of staff years as in FY 1992, should your area office allocate more, about as many, or fewer staff years to investigations of each of the following? For rows 1 - 3, N = 10.

Staff years allocated to:	Far more (1)	More (2)	About as many (3)	Fewer (4)	Far fewer (5)
1. Service providers	1		3	5	1
2. Financial institutions	1		3	5	1
3. General cases	1	6	3		
4. Other (PLEASE SPECIFY.)					
a. Testing cases (N = 1)					1
b. Small plans (N = 1)	1				
c. MEWAS (N = 2)			1	1	
d. ESOPS (N = 1)		1			
c. Health plans (N = 1)		1			

**Appendix II
Results of Mail Questionnaire to PWBA Area
Offices**

3. Consider the allocation of staff years reflected in your response to Question 2 on the previous page. To what extent is each of the following a reason why you chose this allocation? (CHECK ONE FOR EACH.) For rows 1 - 6, N = 10.

	To a very great extent (1)	To a great extent (2)	To a moderate extent (3)	To some extent (4)	To little or no extent (5)
1. It would maximize the number of dollars recovered.	2	3	4		1
2. It would maximize the number of court ordered corrections resulting from civil litigation.	1	1	4	3	1
3. It would maximize the number of violations voluntarily corrected.	2	3	3	1	1
4. It would maximize the number of criminal convictions and guilty pleas.	1	2	1	2	4
5. It would maximize the number of plan participants covered.	1		2	2	5
6. It would increase the pension industry's awareness of DOL's presence as an investigative agency.	3	2	1	2	2
7. Other (PLEASE SPECIFY.)					
a. Disappointed with strategy results overall (N = 1)	1				
b. Investigations generated by strategy took too long (N = 1)		1			
c. Investigations generated by strategy were unproductive (N = 1)		1			

Appendix II
Results of Mail Questionnaire to PWBA Area
Offices

4. To best enforce compliance with ERISA, should your area office have greater discretion over the allocation of its staff years for investigations of different size plans? (CHECK ONE.) N = 10

- 1. [5] Definitely yes
- 2. [4] Probably yes
- 3. [1] Probably no
- 4. [] Definitely no

COMPUTER TARGETING PROGRAMS

5. Overall, were the computer targeting programs used during FY 1992 more effective, as effective, or less effective at identifying plans with ERISA violations than the computer targeting programs used during FY 1989? (CHECK ONE.) N = 10

- 1. [1] FY 1992 programs far more effective
- 2. [2] FY 1992 programs more effective
- 3. [3] FY 1992 programs as effective
- 4. [2] FY 1992 programs less effective
- 5. [1] FY 1992 programs far less effective
- 6. [2] Don't know

**Appendix II
Results of Mail Questionnaire to PWBA Area
Offices**

6. During FY 1992, how effective at identifying plans with ERISA violations were investigations initiated in each of the following ways?
If you did not initiate any investigations in this way, please check N/A. (CHECK ONE FOR EACH.) For rows 1 - 7, N = 10.

	N/A - none initiated in this way (1)	Very effective (2)	Moderately effective (3)	Somewhat effective (4)	Not effective (5)
1. Investigations initiated by referrals		4	5	1	
2. Investigations initiated by complaints		7	3		
3. Investigations initiated by manual Form 5500 review	1	2	3	4	
4. Investigations initiated as area or district office projects	1	1	3	3	2
5. Investigations initiated to test computer targeting programs			2	4	4
6. Investigations initiated by computer targeting programs excluding testing	4		2	3	1
7. Spinoff investigations initiated because they were related to earlier investigations.		8		2	
8. Other (PLEASE SPECIFY.)					
a. Annuity project (N = 1)			1		
b. News articles (N = 1)				1	

**Appendix II
Results of Mail Questionnaire to PWBA Area
Offices**

7. Excluding mandated testing of computer targeting programs, how often did your area office use computer target programs during FY 1992? (CHECK ONE.) N = 10
1. [1] Frequently
 2. [4] Occasionally
 3. [3] Rarely
 4. [2] Never
8. Listed below are some factors that might encourage or discourage your area office's use of computer targeting programs, excluding mandated testing of computer targeting programs. Please indicate whether each factor encouraged, discouraged or neither encouraged nor discouraged your area office's use of computer targeting programs during FY 1992. (CHECK ONE FOR EACH.) For rows 1 - 3, N = 10.

	Greatly encouraged (1)	Encouraged (2)	Neither encouraged nor discouraged (3)	Dis-couraged (4)	Greatly dis-couraged (5)
1. The effectiveness of computer targeting programs at identifying plans with ERISA violations.	1	1	3	5	
2. The completeness, accuracy, or recency of targeting information from PWBA's Office of Enforcement (OE).		2	7	1	
3. The number of staff available.	1		5	3	1
4. Other (PLEASE SPECIFY.)					
a. _____					
b. _____					

**Appendix II
Results of Mail Questionnaire to PWBA Area
Offices**

9. Suppose your area office did not have to conduct mandated testing of computer targeting programs. Of the staff years used by your area office to conduct these tests during FY 1992, about what percentage would have been committed to each of the following? (ENTER THE PERCENTAGES.)

1. Investigations initiated by referrals	(N=7) 10 - 25% Mdn = 10%
2. Investigations initiated by complaints	(N=8) 9 - 80% Mdn = 27.5%
3. Investigations initiated by annual Form 5500 review	(N=9) 10 - 50% Mdn = 34%
4. Investigations initiated as area or district office projects	(N=7) 10 - 34% Mdn = 10%
5. Investigations initiated by computer targeting programs excluding testing	(N=7) 5 - 33% Mdn = 20%
6. Spinoff investigations initiated because they are related to earlier investigations.	(N=5) 1 - 20% Mdn = 10%
7. Other (PLEASE SPECIFY.)	
a. Miscellaneous	(N=1) 10%

b. _____	_____ %

	Total - 100 %

REFERRALS TO AND FROM OTHER AGENCIES

Once again, in this questionnaire, when we refer to "your area office" we mean both your area office and the district office, if any, in your jurisdiction.

10. The word "referral" means an instance in which DOL provides information to, or receives information from, other agencies on plans, service providers, financial institutions, and other organizations for enforcement action or other purposes.

How many referrals were made to your area office by other agencies during FY 1992? (ENTER NUMBER.)

(N=8) 11 - 170 Mdn = 69 referrals from other agencies

**Appendix II
Results of Mail Questionnaire to PWBA Area
Offices**

11. In PART A, please enter the number of these referrals that each of the following agencies made to your area office during FY 1992. If "None" enter "0". In PART B, please enter the number of these referrals that had been opened for investigation by your area office as of August 1, 1993. If "None" enter "0".

	<u>PART A</u> Number of referrals this agency made to your area office during FY 1992 <u>(ENTER NUMBER.)</u>	<u>PART B</u> Number of these referrals that had been opened for investigation as of August 1, 1993 <u>(ENTER NUMBER.)</u>
1. Internal Revenue Service (IRS)	11-157 N=9 Mdn=54	1-15 N=9 Mdn=4
2. Federal Deposit Insurance Corporation	1-3 N=3 Mdn=3	3-3 N=2 Mdn=3
3. Comptroller of the Currency	1-4 N=4 Mdn=2	1-3 N=4 Mdn=2
4. Federal Bureau of Investigation	1-5 N=5 Mdn=1	1-5 N=4 Mdn=1.5
5. U.S. Attorney's Office	1-15 N=3 Mdn=2	1-2 N=2 Mdn=1.5
6. State Insurance Agencies	2-7 N=2 Mdn=4.5	1-2 N=3 Mdn=2
7. Pension Benefit Guaranty Corporation	2-10 N=4 Mdn=3.5	2-9 N=3 Mdn=3
8. Other (PLEASE SPECIFY.)		
a. _____	1-18 N=5 Mdn=3	1-6 N=4 Mdn=3.5

**Appendix II
Results of Mail Questionnaire to PWBA Area
Offices**

12. Please consider your answers to Question 11. Were there any referrals that your area office had not opened for investigation as of August 1, 1993?

1. No (GO TO QUESTION 14.)
2. Yes

13. Consider all the referrals to your area office by other agencies during FY 1992 that were not opened for investigation by your area office as of August 1, 1993. For about how many of these referrals was each of the following the main reason why they were not opened for investigation? (CHECK ONE FOR EACH.) For rows 1-6, N = 10.

	None (1)	Few (2)	Some (3)	About half (4)	Most (5)	All or almost all (6)
1. Referral involved plan(s) with too few participants	1		3	2	3	1
2. Referral involved plan(s) with small assets	4	1	3		1	1
3. Referral involved finding a violation that would result in a small monetary recovery	4	1	5			
4. Referral involved plan(s) with bonding, reporting, or other non-fiduciary violations	1	1	5	1	2	
5. Referral was made too close to the expiration of the statute of limitations for the violation	5	4	1			
6. Referring agency took corrective action		3	5	1	1	
7. Other (PLEASE SPECIFY.)						
a. Not an issue N = 2		2				
b. Case already open N = 2		2				
c. No jurisdiction N = 1		1				
d. Plan sponsor terminated N = 1		1				
e. Need more information N = 1		1				

**Appendix II
Results of Mail Questionnaire to PWBA Area
Offices**

14. How many referrals did your area office make to the IRS during FY 1992? (ENTER NUMBER.)

5-50 N=10 Mdn=20.5

15. As of August 1, 1993, on about how many of the referrals your area office made to IRS in FY 1992 had IRS taken no action? (ENTER NUMBER.) N = 10

[1] None (GO TO QUESTION 17.)

OR

2 - 26 N=9 Mdn=11

16. For about how many of these referrals was each of the following the main reason IRS took no action? (CHECK ONE FOR EACH.)
For rows 1 - 4, N = 9.

	None (1)	Few (2)	Some (3)	About half (4)	Most (5)	All or almost all (6)
1. IRS applied a different expiration date to the statute of limitations than your area office did.	3	2	3			1
2. IRS decided that the referral did not involve a taxable violation.	4		4	1		
3. IRS determined that the applicable excise tax was less than \$XXX.*	2	3	3			1
4. IRS had not yet decided what action to take as of August 1, 1993.	4	1	4			
5. Other (PLEASE SPECIFY.)						
a. No audit potential N = 2		1			1	
b. Violation corrected N = 1		1				
c. Other commitments N = 1						1
d. Prior case closed N = 1		1				
e. Outside IRS agreement N = 1		1				

* This amount was specified on the questionnaire sent to respondents.

**Appendix II
Results of Mail Questionnaire to PWBA Area
Offices**

17. How many referrals did your area office make to agencies other than the IRS in FY 1992? (ENTER NUMBER.)

0 - 6 N = 6 Mdn = 1

18. As of August 1, 1993, how many of the referrals that your area office made to agencies other than the IRS in FY 1992 had not been opened for investigation by these agencies? (ENTER NUMBER.)

[10] Don't know (GO TO QUESTION 20.)

OR

_____ referrals not opened for investigation

19. For about how many of these referrals was each of the following the main reason that they were not opened for investigation by these agencies? (CHECK ONE FOR EACH.) N = 0

	None (1)	Few (2)	Some (3)	About half (4)	Most (5)	All or almost all (6)
1. Referral involved plan(s) with too few participants						
2. Referral involved finding a violation that would result in a small monetary recovery						
3. Referral was made too close to the expiration of the statute of limitations for the violation						
4. The agency had not yet decided what action to take as of August 1, 1993.						
5. Other (PLEASE SPECIFY.)						
a. _____						
b. _____						

**Appendix II
Results of Mail Questionnaire to PWBA Area
Offices**

20. In estimating cost for this question and Question 21, include any administrative costs, as well as staff time used to decide on and prepare documentation related to processing referrals.

Please estimate the total cost to your area office in FY 1992 of preparing referrals to all agencies that were neither acted upon by these agencies nor were pending as of August 1, 1993. (ENTER AMOUNT.)

\$75 - 1000.00 N = 5 Mdn=\$150.00

21. Please estimate the total cost to your area office in FY 1992 of handling referrals from all agencies that your office neither acted on nor were pending as of August 1, 1993. (ENTER AMOUNT.)

\$100 - 2000.00 N = 6 Mdn=\$525.00

PENALTIES AND OTHER ENFORCEMENT ACTIONS

This section asks about decisions regarding whether or not to impose penalties or take other enforcement actions on various types of violations.

Reporting violations - 502 (c) (2)

22. During FY 1992, how many plans did your area office refer to PWBA's Office of Chief Accountant (OCA) to issue a notification letter identifying reporting violations? (ENTER NUMBER.) N = 10

[2] None

OR

1 - 9 plans N = 8 Mdn=4

23. During FY 1992, for how many plans did your area office issue a notification letter identifying reporting violations? (ENTER NUMBER.) N = 10

[2] None (GO TO QUESTION 26.)

OR

1 - 23 plans N = 8 Mdn=9

Appendix II
Results of Mail Questionnaire to PWBA Area
Offices

24. As of August 1, 1993, how many of the plans you identified in Question 23 had not been referred by your area office to OCA to assess penalties or take other enforcement actions? (ENTER NUMBER.) N = 8

[4] N/A, all had been referred to OCA (GO TO QUESTION 26.)

OR

1 - 18 plans N = 4 Mdn=5.5

25. Of those plans you entered in Question 24 above, how many were not referred to OCA for each of the following reasons? (ENTER NUMBERS.)

1. Your area office determined that ERISA did not provide for a penalty. 4 - 18 N=2 Mdn=11

2. Your area office had not yet decided whether to refer it to OCA. 3 N=1

3. Other (PLEASE SPECIFY.)

a. Being processed 1 N=1

b. Violation corrected 4 - 10 N=2 Mdn=7

26. During FY 1992, how many referrals with potential reporting violations did your area office receive from the IRS? (ENTER NUMBER.) N = 10

[8] None (GO TO QUESTION 29.)

OR

5 - 8 N = 2 Mdn=6.5

27. As of August 1, 1993, how many of these referrals had not been sent by your area office to OCA to assess penalties or take other enforcement actions? (ENTER NUMBER.) N = 2

[1] N/A, all had been sent to OCA (GO TO QUESTION 29.)

OR

8 N = 1

**Appendix II
Results of Mail Questionnaire to PWBA Area
Offices**

28. Of those referrals you entered in Question 27 on the previous page, how many had **not** been sent to OCA for each of the following reasons? (ENTER NUMBERS.)

1. Your area office determined that ERISA did not provide for a penalty.
2. Your area office had not yet decided whether to send it to OCA.
3. Other (PLEASE SPECIFY.)

a. Violation corrected	4	N=1
b. Small plan	4	N=1

Fiduciary violations - 502 (l)

29. During FY 1992, for how many plans did your area office issue notification letters identifying fiduciary violations? (ENTER NUMBER.)

[0] None (GO TO QUESTION 33 ON PAGE 18.)

OR

5 - 64 N = 10 Mdn=39.5

30. As of August 1, 1993, for how many of these plans had your area office **not** issued penalty assessment letters? (ENTER NUMBER.)

[0] N/A, all had been issued penalty assessment letters (GO TO QUESTION 33 ON PAGE 18.) N = 10

OR

2 - 58 N=10 Mdn=38

**Appendix II
Results of Mail Questionnaire to PWBA Area
Offices**

31. How many of those plans you entered in Question 30 on the previous page had not been issued penalty assessment letters for each of the following reasons? (ENTER NUMBERS.)

- | | | |
|---|----|----------------|
| 1. Penalty assessment letters were awaiting approval by OE. | 2 | N=1 |
| 2. Penalty assessment letters were not sent because OE determined that ERISA did not provide for a penalty. | 2 | 32 N=8 Mdn=2.5 |
| 3. Penalty assessment letters were not sent because your area office determined that ERISA did not provide for a penalty. | 12 | 56 N=9 Mdn=33 |
| 4. Penalty assessment letters were not sent because the Secretary of Labor waived the penalty. | | |
| 5. Penalty assessment letters were not sent because the penalty was completely offset by another DOL penalty or IRS excise tax. | | |
| 6. Other (PLEASE SPECIFY.) | | |
| a. Settlement agreement being negotiated | 4 | N=1 |
| b. Being processed | 1 | N=1 |

32. As of August 1, 1993, what was the total dollar amount of penalties your area office had assessed for fiduciary violations identified in FY 1992? (ENTER AMOUNT.)

50 - 158,000.00 N=10 Mdn=\$28,002

Appendix II
Results of Mail Questionnaire to PWBA Area
Offices

Prohibited transactions - 502 (i)

33. During FY 1992, for how many welfare and non-qualified pension plans did your area office issue a notification letter identifying a prohibited transaction? (ENTER NUMBER.) N = 10

[1] None (GO TO QUESTION 36.)

OR

1 - 8 N=9 Mdn=3

34. As of August 1, 1993, how many of these plans had **not** been referred by your area office to OE to assess penalties? (ENTER NUMBER.) N = 9

[4] N/A, all had been referred to OCA (GO TO QUESTION 36.)

OR

1 - 8 N=5 Mdn=3

35. How many of those plans you entered in Question 34 above had **not** been referred for each of the following reasons? (ENTER NUMBERS.)

- | | |
|--|-----------------|
| 1. Your area office determined that ERISA did not provide for a penalty. | 1 - 8 N=5 Mdn=1 |
| 2. Your area office had not yet decided whether to send it to OE. | |
| 3. Other (PLEASE SPECIFY.) | |
| a. Violation corrected | 1 N=1 |
| b. Waived | 1 N=1 |
| c. Too small | 1 N=1 |
| d. Did not meet OE criteria | 3 N=1 |

Appendix II
Results of Mail Questionnaire to PWBA Area
Offices

36. In the space below please list any suggestions you might have about improving the penalty assessment process. N = 9

37. In the space below please list any suggestions you might have about improving the referral process. N = 6

**Appendix II
Results of Mail Questionnaire to PWBA Area
Offices**

38. In the space below please list any criteria that you think might be effective at identifying plans with ERISA violations that were not included in the computer targeting programs. N = 3

39. In the space below please list any other suggestions you might have about ways of improving the computer targeting programs. N = 5

**Appendix II
Results of Mail Questionnaire to PWBA Area
Offices**

40. In the space below please list any other suggestions you might have about ways to maximize your enforcement effort. N = 7

41. Please enter the name, title, and telephone number of the person in your area office we should contact for questions about the information recorded in this questionnaire.

Name: _____

Title: _____

Phone: (____) _____

42. If you have any other comments or questions, please write them below. N = 4

Thank you.

September 30, 1993, GAO Letter to Assistant Secretary for Pension and Welfare Benefits Administration

GAO

United States
General Accounting Office
Washington, D.C. 20548

Human Resources Division

B-254775

September 30, 1993

The Honorable Olena Berg
Assistant Secretary for Pension
and Welfare Benefits Administration
Department of Labor

Dear Ms. Berg:

We are evaluating certain aspects of the Department of Labor's enforcement of the Employee Retirement Income Security Act of 1974 (ERISA). As part of our evaluation, we are reviewing the methods the Pension and Welfare Benefits Administration (PWBA) uses to target pension and welfare benefit plans for investigation of possible violations of ERISA's fiduciary requirements.¹

PWBA can improve its computer targeting. This correspondence discusses weaknesses in PWBA's procedures for testing computer targeting programs and suggests that multivariate analysis may be a more effective and efficient way to target plans for investigation. We also provide alternatives for your consideration. We are presenting our views on this matter at this time because PWBA is considering revising its computer targeting programs. Additional comments will be presented in our final report on ERISA enforcement.

BACKGROUND

Computer targeting is one of several methods that PWBA uses to select plans for investigation of possible ERISA violations. PWBA developed computer targeting as a substitute for manual review of financial and other information in plans' form 5500 series reports;² it is not

¹Fiduciary requirements concern how plans are to be operated in the best interest of participants. For example, they require that anyone with control over a plan act with care, skill, prudence, and diligence.

²Most pension and some welfare plans annually file with the Internal Revenue Service a form 5500, 5500-C, or 5500-R report which contains financial and other plan information.

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a replacement for such other selection methods as following up on complaints and referrals.

PWBA currently has 96 unique computer targeting programs that search automated form 5500 series information to identify plans that PWBA believes are likely to violate ERISA. Each program uses a different characteristic or combination of characteristics that PWBA believes is an indicator of a potential ERISA violation.³ In addition, over two-fifths of the programs identify only plans that exceed certain dollar or other thresholds. PWBA established thresholds, not only to identify plans that it believes are most likely to violate ERISA, but also to restrict the number of plans identified to a manageable level. For most of the remaining programs, there was insufficient automated information available to establish thresholds when PWBA developed them, so the programs identify only the highest-ranking plans.⁴ In conjunction with revising its computer targeting programs, PWBA is considering establishing thresholds for almost all programs.

The programs also sort plans in highest-ranking order, usually based on dollar amounts or ratios. Programs with thresholds sort only the plans that exceed the thresholds. The other programs sort all identified plans. PWBA headquarters makes information about plans identified by the programs available to its field for their consideration in selecting plans for investigation.

PWBA began testing some computer targeting programs in fall 1990. For testing purposes, PWBA headquarters requires field offices to do limited investigations of certain plans identified by each tested program and, based on the results, decide whether to convert the limited investigations to full investigations. PWBA then calculates the conversion rate for all plans included in each tested program. If the conversion rate exceeds 5

The data is computerized by the Service and made available to Labor.

³Because PWBA considers these characteristics to be sensitive investigative information, we do not discuss specific characteristics in this letter.

⁴The programs identify the 40 highest-ranking plans in each of PWBA's 15 field office for each of seven 3-month cycles.

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percent,⁵ PWBA deems the program a success. This 5-percent "baseline" conversion rate, instead of actual investigation results, is being used as an indicator of success because PWBA wants timely evaluation results and some investigation results are not known for 3 years or longer.

PWBA determined that 324 plans must be investigated to evaluate each program. This number was derived from a formula designed to establish the sample sizes needed to determine whether the difference between two proportions, based on samples from two independent populations, is statistically significant. The number was developed using statistical principles that assume the use of random sampling to project results to the universe being tested and reflects PWBA's desire to be 80-percent confident that it will not reject a successful program or accept an unsuccessful program. When programs identify fewer than 324 plans, PWBA investigates all identified plans.

Under current testing procedures, over 10 years and more than 200,000 staff hours will be needed to test all 96 programs. PWBA has not been able to test all computer targeting programs because its field office resources are limited. In addition to testing computer targeting programs, field offices investigate plans based on complaints, referrals, and other indications of violations. PWBA spent over 37,500 staff hours testing 14 programs in 1991 and 1992. Seven other programs are being tested in 1993.

COMPUTER TARGETING CAN BE IMPROVED

PWBA's computer targeting could be more effective and efficient. PWBA could design program thresholds to better identify plans likely to violate ERISA. By randomly selecting plans for investigation, PWBA could project test results to all plans identified by the targeting programs; current test results cannot be projected. With these changes, PWBA could properly validate its programs. In addition, by using a more appropriate sampling formula, PWBA could test the programs with fewer investigations than currently required. PWBA may also be able to target plans more effectively and efficiently by analyzing computer

⁵A private consultant's report on the fiscal year 1991 test results stated that 5 percent was the estimated conversion rate for investigations resulting from manual review of financial and other plan data, without computer-assisted targeting.

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targeting programs in combination with one another, rather than individually.

Properly Validating Programs
by Randomly Sampling Plans

PWBA cannot properly validate its computer targeting programs using current testing procedures. Validation involves determining, with a certain degree of confidence, whether the projected conversion rate for all plans identified by a targeting program exceeds PWBA's 5-percent baseline rate. But the test results cannot be projected to all plans identified by the program because PWBA investigates only the highest-ranked 324 plans identified by each program.

Enforcement officials in PWBA headquarters told us that they want to investigate only the highest-ranking plans because they do not want to use their limited staff investigating other randomly selected plans that they believe are less likely to violate ERISA. However, PWBA has no empirical evidence that the highest-ranking plans are most likely to violate ERISA. Test results only reflect the conversion rate for the highest-ranking plans, which may not be the same as the rate for the other plans identified by the program. To validate a program with statistical confidence, PWBA must randomly select plans from all plans identified by the program.

In addition, PWBA's thresholds are sometimes too restrictive. When PWBA uses a threshold to limit the number of plans identified by a program, some plans that PWBA believes are highly likely to violate ERISA are excluded from the program universe. We believe that the identity of all plans that PWBA believes have a high probability of violating ERISA should be valuable information for PWBA's field offices, although they likely would not be able to investigate all of them because of limited resources.

We believe that PWBA could validate each program with about half as many investigations as required under current procedures by using a more appropriate sampling formula. Instead of a formula appropriate for comparing two proportions, as was used to establish the current sample size, PWBA should use a formula appropriate for establishing the sample size needed to detect a minimum difference between test results and a baseline. The baseline for testing the programs is the 5-percent conversion rate. Using such a formula, PWBA could reduce

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its sample size for each program from 324 to 176 or fewer plans.⁶

More Effective Targeting Possible
Using Multivariate Analysis

PWBA may be able to target plans more effectively by using multivariate analysis.⁷ Using this technique, PWBA could analyze combinations of programs to determine how well the combinations as well as the individual programs identify plans with a high probability of violating ERISA.

Multivariate analysis simultaneously assesses several independent variables to determine the relationship between them and a dependent variable. The technique involves developing a mathematical model that can be used to predict the dependent variable when values for the independent variables are known. Reliable information about the dependent and all independent variables is required.

We believe that PWBA could use multivariate analysis to construct a model from the results of computer targeting program investigations. Characteristics (the independent variables) for a plan not yet investigated would then be entered into the model to predict the likelihood of the plan's conversion from a limited to a full investigation (the dependent variable). Plans with the highest probability of conversion would be the best candidates for investigation. Also, because a wider range of values for the characteristics would be considered, PWBA would have more comprehensive data with which to establish thresholds. The model could be refined continually, and programs could be retained or dropped as the results of newly completed investigations are incorporated.

To use multivariate analysis, PWBA's investigations would need to consider all applicable characteristics in deciding whether to convert limited investigations to full investigations. However, our preliminary ERISA enforcement

⁶Assuming an infinite universe, a random sample of 176 plans would be sufficient to test programs and show at an 80-percent confident level that a successful program will not be rejected or an unsuccessful program will be accepted. The sample size would decrease with substantial decreases in the universe size. For example, for a universe of 250 the sample size would be 104.

⁷There are some multivariate analytical techniques, such as logistical analysis, that would be appropriate for PWBA's use.

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work indicates that PWBA's field offices do not systematically consider all applicable characteristics during limited investigations. The offices consider only the characteristics used in selecting the plan for investigation and others they incidentally identify during their investigation.

We believe that multivariate analysis may also be a more efficient method of testing programs. While no formulae exist for establishing sample sizes for multivariate analysis models, a reasonable model likely could be developed on the basis of a smaller total number of plans than under the current system where programs are analyzed individually. The total number of plans needed may be reduced because data on all characteristics for every investigated plan would be considered in validating all programs. However, time saved from investigating fewer plans would be at least partly offset by the additional time required to consider all applicable characteristics during limited investigations.

CONCLUSIONS AND RECOMMENDATIONS

PWBA can improve its current procedures for testing the effectiveness of its targeting programs. PWBA investigates the highest-ranking plans to satisfy enforcement goals rather than investigating randomly-selected plans to test its programs. In addition, some thresholds are too restrictive. Because of this, PWBA's current testing methodology will not result in a valid assessment of the effectiveness of the 96 programs. Moreover, the current sampling procedures are inefficient because they require investigating more plans than necessary to test programs.

We recommend that you revise the way PWBA designs and tests computer targeting programs. At a minimum, you should randomly select plans for testing so that results can be projected and programs properly validated. You should establish program thresholds to identify all plans with a high probability of violating ERISA. You should also use an appropriate formula to set the sample size to minimize calendar and staff time spent on testing.

Developing and testing individual targeting programs may not be the most effective and efficient way to target plans. Combining plan characteristics to obtain the total impact of all characteristics on a particular plan's conversion probability--using multivariate analysis--could be a better approach. We recommend that you test the feasibility of using multivariate analysis to target plans for investigation. If data is not readily available on

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investigation conversions and all applicable characteristics which is needed to do multivariate analysis, you should begin systematically gathering such data.

I would appreciate your views on these matters and any specific action PWBA plans to take with respect to our recommendations.

If you or your staff have any questions about the matters discussed in this correspondence, please call me at (202) 512-7215.

Sincerely yours,


Joseph F. Delfico
Director, Income Security Issues

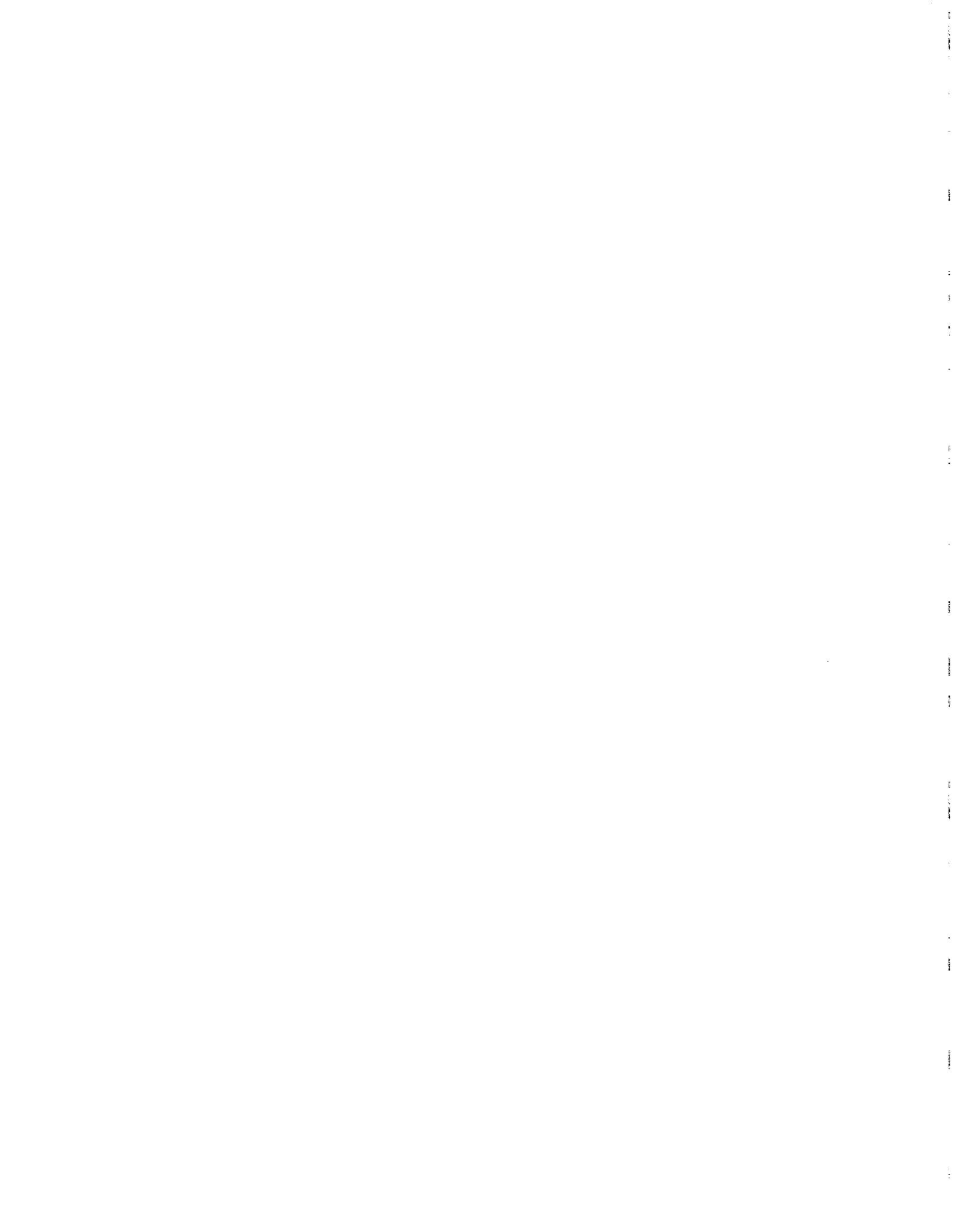
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