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AICPA Washington Report

March 13, 1989, Volume XVIII, Issue 2

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GENERAL ACCOUNTING OFFICE

The public accounting profession has "taken positive actions which demonstrate a commitment to addressing concerns about audit quality and the accuracy and reliability of financial disclosures," the GAO stated in a recently released report. In the report, entitled "CPA Audit Quality: Status of Actions Taken to Improve Auditing and Financial Reporting of Public Companies," the GAO found that the accounting profession "has made substantial progress in addressing problems by expanding the auditor's responsibilities to: 1) evaluate internal controls; 2) provide early warning of a company's financial difficulties; 3) design the audit to provide reasonable assurance of detecting material fraud; and 4) improve communication to the financial statement user and the management of public companies." The GAO also noted that the accounting profession has "amended professional standards to require continuing professional education and quality reviews and adopted a revised code of ethics to help ensure auditor independence and objectivity." The GAO study was requested by Rep. John Dingell (D-MI), the chairman of the House Energy and Commerce Subcommittee on Oversight, which has conducted a series of hearings since 1985 on auditing and financial reporting under the Federal securities laws. In large part, the GAO study reports on implementation of recommendations made by the National Commission on Fraudulent Financial Reporting, commonly known as the Treadway Commission after its chairman, former SEC Commissioner James Treadway. In releasing the GAO report, Rep. Dingell said, "The GAO found that the accounting profession has made substantial progress in addressing the Treadway Commission's proposals, and the profession deserves credit for that." Copies of the GAO report, GAO/AFMD-89-38, are available from the GAO by calling 202/275-6241 or by writing to P.O. Box 6015, Gaithersburg, MD 20877.

"Pension Plans: Labor and IRS Enforcement of the Employee Retirement Income Act" is the title of a recently released GAO report which was requested by Rep. J.J. Pickle (D-TX), chairman of the House Ways and Means Subcommittee on Oversight. The report examines the efforts of the Department of Labor and the IRS to enforce provisions of the Employee Retirement Income Security Act of 1974 (ERISA) that are related to pension plans. The Labor Department focuses its enforcement on ensuring compliance with ERISA's fiduciary standards. The IRS is primarily responsible for administering and enforcing ERISA's participation, vesting, and funding standards, as well as for determining whether plans qualify for favorable tax treatment under the Internal Revenue Code. Specifically, information was examined relating to the number of pension plans the Labor Department and IRS review as part of their enforcement activities, the number of plans cited for violations, the number and type of violations found and results of actions taken against plans cited for violations, and the average number of staff-hours spent on a pension plan review. The most often cited violations by IRS during FY 1986 and 1987 concerned prohibited transactions, minimum funding, and participation and coverage requirements. Prohibited transactions made up about 40 percent of the violations found during these years. Revocations of plans' tax-qualified status by IRS increased from 78 in FY 1985 to 167 during FY 1986 before declining to 45 in FY 1987. During the first nine months of FY 1988, IRS revoked the tax-qualified status of 27 plans. Copies of the report, GAO/HRD-89-32, are available from the GAO by calling 202/275-6241 or by writing to P.O. Box 6015, Gaithersburg, MD 20877.

LABOR AND TREASURY, DEPARTMENTS OF; AND PENSION BENEFIT GUARANTY CORPORATION

Revised annual return/report forms, Form 5500 Series, filed by administrators of employee pension and welfare benefit plans under ERISA and the tax code have been issued by the Departments of Labor and Treasury and the Pension Benefit Guaranty Corporation (see the 3/1/89 Fed. Reg., pp. 8631-41). Revisions to the Form 5500 Series were proposed in the 9/19/86 Federal Register (see the 9/22/86 Wash. Rpt.).

The agencies said the revised forms affect the financial and other information required to be reported and disclosed by employee benefit plans filing Form 5500, for plans with 100 or more participants, and Forms 5500-C and 5500-R, for plans with fewer than 100 participants. Form 5500-EZ is not included as part of the proposal. Major changes to Form 5500 include: modifying the financial statements, which includes a more detailed break-out of administrative expenses; limiting the reporting of party in interest investments by increasing reliance on the disclosures in the accountant's report; consolidated reporting of interests in common/collective trusts, master trusts, pooled separate accounts, registered investment companies, and 103-12 investment entities; requiring the reporting of financial information to more closely conform with FASB standards; raising the payment threshold for the reporting of service provider information to $5,000 in a plan year; reporting of service provider information, trustee information and accountant/actuary termination information on Schedule C (a new schedule for the 1988 plan year); and a requirement that a terminated accountant and actuary be furnished a copy of the reported reasons for the termination and a notice of their right to send comments to the Department of Labor. Changes to Form 5500-C include changes to the statements of assets, liabilities, income and expense, and elimination of service provider termination information. Changes to Form 5500-R include a requirement that certain basic financial information be reported concerning the plan, i.e. total assets, liabilities, and net assets at the beginning and ending of the plan year, net income (loss), plan contributions and total benefits paid during the plan year. The revised forms are effective for plan years beginning on or after 1/1/88. For further information after reading the notice, contact George M. Holmes, Jr. at the Labor Department at 202/523-8515.

In a related action, the Department of Labor issued a final rule relating to the annual reporting requirements under Part 1 of Title I of ERISA (see the 3/1/89 Fed. Reg., pp. 8624-30). The amendments were proposed in the 1/2/87 Federal Register (see the 1/19/87 Wash. Rpt.) and are necessary to conform to revisions to the Form 5500 Series discussed above. Other technical revisions are included in the final rule to update reporting requirements and to eliminate duplication of instructions to the Form 5500 Series. The regulation is effective for reporting for plan years beginning on or after 1/1/88. For further information after reading the final rule, contact Ronald D. Allen at the Labor Department at 202/523-8515.

SECURITIES AND EXCHANGE COMMISSION

The time period during which certain registered management investment companies must select an independent public accountant is the subject of a proposed rule issued by the SEC (see the 3/8/89 Fed. Reg., pp. 9843-47). Currently, each such company must select its accountant at a board of directors' meeting held within 30 days before or after the beginning of the company's fiscal year (the 60 day window) or before the annual meeting of shareholders in that year. The proposed rule would set out the following alternative time periods during which the accountant may be selected: 1) 90 days before or after the beginning of the fiscal year (the 120 day window) or 2) 30 days before or 90 days after the beginning of the fiscal year (the 120 day window). Under the proposed rule, the 180 day window would be available only to registered management investment companies that are part of a family of investment companies whose members have staggered fiscal year ends, are organized in a jurisdiction not requiring them to hold annual meetings of shareholders, and do not hold such meetings. The 120 day window is available to all other companies that are organized in a state that does not require annual shareholders' meetings. The SEC said it was proposing the change because of "numerous applications that have been filed seeking an exemption from the 60 day window." Comments must be received on or before 5/8/89. For further information after reading the proposed rule, contact Brian P. Kindelan at the SEC at 202/272-2048.

TREASURY, DEPARTMENT OF

Modifications to the reporting requirements for corrective distributions of excess deferrals and excess contributions from qualified plans are the subject of Notice 80-32 which was issued recently by the IRS. The Technical and Miscellaneous Revenue Act of 1988 (TAMRA) retroactively amended sections 402(g)(2) and 4979(f)(2) of the Internal Revenue Code of 1986 which prescribe when excess deferrals, excess contributions and excess aggregate contributions are includible in gross income. Under TAMRA, the income allocable to a corrective distribution of an excess deferral shall be treated as earned and received in the year of distribution, rather than in the year of deferral, for taxable years after 1986, the IRS said. The principal amount of the excess deferral is still includible in gross income in the year of deferral. The notice describes the effects of the TAMRA amendments on the corrective distribution reporting procedures of Notices 87-77 and 88-33 issued previously by the IRS. Notice 89-32 is scheduled to be published in Internal Revenue Bulletin 1989-12, dated 3/20/89. For further information after reading the notice, contact the Employee Plans Technical and Actuarial Division of the IRS at 202/566-6783/6784 between 1:30 and 4:00 p.m. EST.

The proper tax treatment of employer-provided tuition assistance received by employees in 1988 under section 127 of the Internal Revenue Code of 1986 is the subject of IRS Notice 89-33. The IRS said the Technical and Miscellaneous Revenue Act of 1988 retroactively restores for an employee's first taxable year beginning after 12/31/87 the exclusion from gross income for up to $5,250 of educational assistance provided by an employer. The notice said that the section 127 exclusion is not available for taxable years beginning after 12/31/88. In addition, after 1987 the exclusion does not apply to graduate-level courses. Specifically, the exclusion does not apply to students who have a bachelor's degree or who are receiving credit toward a more advanced degree. The special rules outlined in the notice apply to educational assistance programs in effect on 12/31/87. Under the rules, employees may deduct from the gross income shown on their Form W-2 the amount of education assistance included in the gross income figure, in order to arrive at their adjusted gross income. The IRS said employees should also file Form 1040 and attach Form 2106, Employee Business Expenses. Notice 89-33 is scheduled to be published in Internal Revenue Bulletin 1989-12, dated 3/20/89. For further information after reading the notice, contact Monice Rosenbaum at the IRS at 202/343-6954.

The first meeting of the Assistant Commissioner (Employee Plans and Exempt Organizations) Employee Plans Ad Hoc Group has been scheduled for 3/22/89 (see the 3/1/89 Fed. Reg., p. 8621). The agenda includes the following: Tour of service center for overview of service center operations and employee plans return processing; discussion of employee plans determination and examination of programs; and discussion of employee plans technical issues. The meeting is scheduled to begin at 8:30 a.m. at the IRS Atlanta Service Center located at 4800 Buford Highway, Atlanta, GA. The IRS said that because of security requirements and limited conference space, notification of intent to attend the meeting must be made with Jane Baniewicz no later than 3/13/89. Ms. Baniewicz may be reached at 202/566-9204. For further information after reading the meeting notice, contact Ms. Baniewicz at the above telephone number.

The election of special treatment for certain losses on deposits in an insolvent or bankrupt financial institution is the subject of Notice 89-28 issued by the IRS. The Technical and Miscellaneous Revenue Act of 1988 (TAMRA) amended section 165(1) of the Internal Revenue Code to provide an election to treat reasonably estimated losses incurred on deposits in insolvent or bankrupt financial institutions (the

deposits in which are not Federally insured), as ordinary losses. The IRS said the election is limited to qualified individuals and is effective for taxable years beginning after 12/31/81. A "qualified individual" is defined in the notice as one who is not 1) a one percent or more owner of the financial institution; 2) an officer of the financial institution; or 3) a person who is related, within the meanings of section 165, to any such owner or officer." Substantive rules relating to the ordinary loss election and a related casualty election, as well as procedural rules for electing the special loss treatment are included in the notice. Notice 89-28 is scheduled to appear in Internal Revenue Bulletin 1989-12, dated 3/20/89. For further information after reading the notice, contact Arthur E. Davis III at the IRS at 202/377-9581.

Regulations will be issued addressing the use of partnerships to avoid the Tax Reform Act of 1986 repeal of the General Utilities doctrine, the IRS said in Notice 89-37. The doctrine permitted a corporation to distribute appreciated assets to its shareholders without recognizing gain. Since enactment of the law, the Internal Revenue Code generally requires a corporation to recognize gain upon the distribution of appreciated property. The IRS said it has determined that, in certain circumstances, the acquisition by a partnership of stock in one of its corporate partners results in avoidance of General Utilities repeal. These circumstances are present to the extent the corporate partner, in substance, relinquishes an interest in appreciated property in exchange for an interest in its stock. The IRS said it intends to prescribe regulations under its general rulemaking authority to provide for gain recognition by a corporate partner in such circumstances. Furthermore, the IRS said it has determined that, in order to carry out the purposes of the repeal of the General Utilities doctrine, a partnership distribution to a corporate partner of the stock of such corporation should be characterized as a redemption of the corporate partner's stock with property consisting of its partnership interest. Therefore, the Service will issue regulations providing that section 311(b), rather than the general nonrecognition rule of section 731(a) of the Code, will be applicable whenever a partner receives a distribution of its own stock. Accordingly, the IRS said, under section 311(b), gain, but not loss, with respect to the partner's partnership interest will be recognized and this rule will apply to all such distributions of corporate stock occurring after 3/9/89. The IRS said it also intends to adopt rules under which gain will be recognized at the time of, and to the extent that, any transaction has the economic effect of an exchange by a corporate partner of its interest in appreciated property for an interest in its stock owned or acquired by the partnership. The IRS also said it is considering whether a de minimis rule might be appropriate. The deemed redemption rule will apply to any transaction occurring after 3/9/89. In addition, certain transactions that would be subject to the regulations to be issued also may be subject to taxation under the "substance over form" principle, the IRS said. Notice 89-37 is scheduled to be published in Internal Revenue Bulletin 1989-13, dated 3/27/89. For further information after reading the notice, contact John N. Geracimos at the IRS at 202/566-3651.

SPECIAL: WAYS AND MEANS SUBCOMMITTEE ANNOUNCES HEARING ON EUROPE 1992

The first in a series of hearings on the European Community (EC) program to complete its internal market consolidation by the end of 1992 has been scheduled by the House Ways and Means Subcommittee on Trade. The hearing is scheduled for 3/20/89 in Room 1100 of the Longworth House Office Building in Washington, D.C. beginning at 11:00 a.m. The series of hearings regarding Europe 1992 will focus on specific directives and regulations that may affect U.S. access to the EC market and the operations of U.S. companies in Europe. Aspects of the EC's program that are of particular interest are proposed changes in border measures such as tax policies,

reciprocity and national treatment policies, merger and acquisition policies, and government procurement practices, as well as developments and effects in major sectors such as services. The Subcommittee is soliciting testimony from the private sector on efforts being undertaken to identify, assess, and react to developments and policy issues in the EC internal market consolidation. Requests to testify must be made by telephone to Harriet Lawler or Diane Kirkland by the close of business 3/14/89; they may be reached by calling 202/225-1721. The telephone request should be followed by a formal written request to Robert J. Leonard, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, Room 1102, Longworth House Office Building, Washington, D.C. 20515. For further information, contact the Ways and Means Committee staff at 202/225-1721

For further information contact Shirley Twillman at 202/737-6600.

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