Agenda Item 4

Reports on ERISA Audits

Objective

To discuss the development of auditor's reports specific for employee benefit plans.

Task Force

The Employee Benefit Plan Reporting Task Force (the EBP task force) members are:

- Darrel Schubert (Chair)
- Josie Hammond
- Jerry Murray
- Scot Philips (TIC representative)
- Alice Wunderlich
- Michael Auerbach (DOL)

Background

In December 2014, Chuck Landes, Bruce Webb, Darrel Schubert, and Linda Delahanty met with representatives of the Department of Labor (DOL) to discuss ways to improve the quality of employee benefit plan (EBP) audits by strengthening the EBP auditor's report. The DOL asked us to rethink the EBP auditor's report to help auditors better understand their responsibilities and to provide users with more information about what auditors do. The DOL provided specific suggestions on ways to improve the auditor's report for plans.

In January 2015 a special task force of the ASB was formed to consider the DOL's proposed revisions to the auditor's report. The EBP Auditor Reporting Task Force (EBP task force) met on February 25-26, 2015 in Washington DC and held a conference call on March 26, 2015, to consider the DOL's proposed revisions to the auditor's report and brainstorm other ways to improve EBP auditor reporting.

Employee Benefit Plans – Differences from Private Companies and Public Business Entities

The EBP task force believes that the conclusions reached by the Financial Accounting Standards Board (FASB) that says employee benefit plans should not be treated as private companies or public business entities when setting accounting standards, due to their unique characteristics and related specialized accounting, supports the ASB's project to consider an auditor's report specific to employee benefit plans.

The FASB concluded in FASB Accounting Standards Update No. 2013-12, *Definition of a Public Business Entity*, that employee benefit plans have unique characteristics that differ from both private companies and public companies. The needs of users of employee benefit plan financial statements are specific and more focused when compared with the needs of financial statement users of both public companies and private companies. Employee benefit plans follow accounting guidance that often is tailored to the unique nature of the plans.

After considering those factors, the FASB decided that employee benefit plans should not be included in the definition of public business entity for financial reporting purposes and should not be included in the scope of the Guide, *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies*.[1] Instead, the FASB will consider, on a standard-by-standard basis, whether all, none, or some employee benefit plans should be permitted to apply financial accounting and reporting alternatives under U.S. GAAP, using factors such as user needs and resources.

Further, in an EBP Expert Panel discussion memorandum "Observations About Current Employee Benefit Plan Accounting" submitted in October 2013 to the FASB, the EBP Expert Panel included relevant information relating to employee benefit plans to highlight how employee benefit plans differ from both private and public companies. See the appendix to this issue paper for a summary of the information provided in the discussion memorandum.

The EBP task force believes the specialized characteristics of plans, as described previously, provides a foundation for developing an auditor's report that is specific to employee benefit plans.

AITF discussion

At the April 9, 2015 AITF meeting, Darrel Schubert provided the AITF with an update of this project and asked for their initial feedback. Overall the AITF supported the EBP task force continuing to move forward with this project. The AITF questioned the timing of this project and

[1] On December 23, 2013, the Financial Accounting Standards Board (FASB) and the Private Company Council (PCC) issued the *Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies* (the Guide). The primary purpose of this Guide is to assist the FASB and the PCC in determining whether and in what circumstances to provide alternative recognition, measurement, disclosure, display, effective date, and transition guidance for private companies reporting under U.S. GAAP. This Guide provides considerations for the PCC and the Board in making user-relevance and cost-benefit evaluations for private companies under the existing conceptual framework. The Guide is intended to be one of the tools to help the FASB and the PCC identify differential information needs of users of public company financial statements and users of private company financial statements and to identify opportunities to reduce the complexity and costs of preparing financial statements in accordance with U.S. GAAP. The Board's decisions about the types of business entities that would not be included in the scope of this Guide and the basis for conclusions for those decisions are provided in FASB Accounting Standards Update No. 2013-12, *Definition of a Public Business Entity—An Addition to the Master Glossary*.

whether this project should align with the ASB's overall auditor reporting project. The AITF also provided feedback on certain of the proposed changes. The AITF's feedback is being considered by the EBP task force.

Issues for ASB discussion

Issue 1 — Scope of Changes

The EBP task force has been asked to consider the DOL proposals to revise the auditor's report for employee benefit plans (EBP) and to consider other ways to improve EBP auditor reporting. The EBP task force has been exploring alternative ways of reporting based on current performance standards for an EBP audit.

As the task force discussed the DOL proposals, and brainstormed other ideas, the task force believes that certain ideas may require a change in what an auditor does in an EBP audit. To facilitate the auditor reporting, there may need to be a change in the procedures performed by an auditor in an EBP audit. This would require either changes to the procedures included in the AICPA Audit and Accounting Guide *Employee Benefit Plans*, such as the limited-scope audit procedures, or new performance auditing standards specific to employee benefit plans.

The task force questioned whether they should limit their work to reporting on what auditor's currently do on EBP audits or whether the ASB would support a broader project to determine the best way to report on EBP audits, even if that reporting would result in a change in auditor performance.

Action Requested of the ASB

Does the ASB believe the EBP task force should limit their proposals to only reflect auditor reporting on current performance standards or does the ASB support a broader project, such that the EBP task force can explore EBP reporting ideas that may also change auditor performance on such audits?

Issue 2 — Addressee

The DOL proposed addressing the auditor's report to the primary users of the financial statements that is, the trustee, participants and their beneficiaries, and the U.S. Department of Labor. Currently, EBP auditor reports are typically addressed to the plan committee or administrator (the parties who engaged the auditor).

ERISA section 103(a)(3)(A) requires the plan administrator to engage, on behalf of all plan participants, an independent qualified public accountant, who shall conduct such an examination of any financial statements of the plan, as the accountant may deem necessary to enable the accountant to form an opinion as to whether the financial statements and schedules required to be included in the annual reports are presented fairly, in conformity with generally accepted accounting principles.

Paragraph .24 of AU-C 700 *Forming an Opinion and Reporting on Financial Statements* requires the auditor's report to be addressed as required by the circumstances of the engagement. The auditor's report is normally addressed to those for whom the report is prepared. The report may be addressed to the entity whose financial statements are being audited or to those charged with governance. A report on the financial statements of an unincorporated entity may be addressed as circumstances dictate (for example, to the partners, general partner, or proprietor). Occasionally, an auditor may be retained to audit the financial statements of an entity that is not a client; in such a case, the report may be addressed to the client and not those charged with governance of the entity whose financial statements are being audited.

The EBP task force did not object to expanding the addressee to include the participants and their beneficiaries because ERISA requires the plan administrator to engage an auditor, on behalf of all plan participants. The EBP task force had more difficulty with including the DOL. The EBP task force noted that auditor's reports for SEC filers are not addressed to the SEC. In addition, governmental reports are not addressed to the OIG or federal agencies. The EBP task force will investigate privity issues related to whom the report is addressed.

Action Requested of the ASB

Does the ASB support expanding the addressee to include participants and their beneficiaries?

Issue 3 — Emphasis-of-Matter Paragraphs

The DOL recommended that the auditor's report include additional information about the financial statements and the audit through the use of emphasis-of-matter (EOM) paragraphs. The DOL provided a list of topics to be included, many of which do not have related GAAP disclosures.

The EBP task force discussed requiring an EOM paragraph to be included in the auditor's report related to certain issues, when such topics are disclosed in the financial statements. At the April 9, 2015 AITF meeting, the AITF expressed a view that EOM paragraphs could only be required when GAAP requires the matter to be disclosed in the notes to the financial statements, and in the auditor's professional judgment it is of such importance that it is fundamental to users' understanding of the financial statements.

The EBP task force also discussed the possibility of including key audit matters (KAM), as described in ISA 701 *Communicating Key Audit Matters in the Independent Auditor's Report* because some of the items the DOL would like to include in the auditor's report could fall under the KAM criteria. Overall, the task force was not in favor of including KAM in the auditor's report for employee benefit plans and expressed concerns with considering KAM for EBP auditor reporting before the ASB has discussed the issue for all audits.

The DOL request for matters to be included in EOM paragraphs included items such as:

- For health and welfare plans, address excess obligations over plan assets (what are managements plans to make the plan whole?).
- For mergers and terminations, address if there will be any significant effect on the participants.
- Address hard to value asset considerations, including ESOPs
- For limited scope audits, discuss those assets that were audited (not covered by the certification), that is, what the auditor audited.
- For limited scope audits, discuss what the auditor did to audit the valuation of investments certified as complete and accurate, but not certified as to fair value.
- For DB plans, address pertinent information regarding any funding deficiency issues (is it in danger or in critical status).
- Alert participants to any transfer of benefit obligations to non ERISA covered status (benefit defeasance issues)
- For multiemployer plans, address and discuss any pertinent funding issues at the individual employer level, overall funding issues or considerations and the collective bargaining agreements

Action Requested of the ASB

Does the ASB believe the task force should consider requiring the addition of EOM paragraphs in the EBP auditor's report, to the extent these items are required to be disclosed in the notes to the financial statements?

Does the ASB believe the task force should consider including KAM in the EBP Auditor's Report before the ASB has deliberated whether KAM should be permitted for all entities?

Issue 4 — New Section "Report on the Significant Accounts and Disclosures"

The DOL requested a new section be added to the auditor's report that would discuss significant plan accounts and disclosures and provide an opinion on those significant accounts.

The task force discussed the DOLs proposal and believes that providing an opinion on such accounts (possible through AU-C 805 *Special Considerations—Audits of Single Financial Statements and Specific Elements, Accounts, or Items of a Financial Statement*) would not be appropriate and suggested as an alternative to include an other-matter paragraph in the auditor's report that would identify which accounts and disclosures were considered material and were subject to audit. The task force suggested including language to clarify that no opinion was being given on these accounts individually.

At the April 9, 2015 AITF meeting, the AITF expressed concerns with this type of reporting for EBP audits when other entities do not include such reporting. The EBP task force will consider whether this would be more appropriate to include in limited scope audits only. This would enable users of the limited scope auditor's report to better understand what is audited in a limited scope audit. This section would not be included in a full scope audit report. The EBP task force will also consider criteria to help the auditor determine which of the material accounts are significant to include in the auditor's report.

Action Requested of the ASB

Does the ASB support the task force's recommendation to consider including an other-matter (OM) paragraph in limited scope audits only, to provide users with information on which accounts were considered material by the auditor and therefore was subjected to audit procedures?

Issue 5 — Compliance and Other Matters

The DOL requested a new section be added to the auditor's report that would address the tests the auditor performs, in connection with the audit, of the plan's compliance with certain provisions of laws, regulations, plan documents, and other agreements.

The task force believes that this form of reporting could be helpful to include in the auditor's report because there are many aspects of an ERISA audit that are compliance in nature. The task force recognizes however, that such form of reporting would require an identification of which compliance tests are considered within the scope of what is being reported on. The task force does not believe that a broad reference to DOL rules and regulations would be appropriate, but rather there would need to be a determination of the significant compliance areas that may have a direct effect on the financial statements being audited. The task force asked the DOL to provide a listing of the compliance tests that they believe are of most importance and which they would like to be covered by this compliance report. In addition, the EBP Expert Panel will also discuss the main areas of compliance that are tested as part of an EBP audit. There is a possibility that reporting on compliance could change the performance procedures of an ERISA audit.

Action Requested of the ASB

Does the ASB support the task force in continuing to explore whether this form of compliance reporting would have merit to be included in the auditor's report?

If so, does the ASB believe it should be limited to those compliance tests that would have a direct effect on the financial statements and therefore would be performed as part of the financial statement audit?

Appendix

The follow is a summary of how employee benefit plans have specialized characteristics, as provided in the discussion memorandum "Observations About Current Employee Benefit Plan Accounting" submitted in October 2013 to the FASB by the EBP Expert Panel,.

1. The users of a plan's financial statements include the Department of Labor (DOL), IRS, Pension Benefit Guaranty Corporation (PBGC), the Securities and Exchange Commission (SEC) (for Form 11-K filers), as well as plan sponsors, trustees, and plan participants. All Form 5500s are filed electronically with the audited financial statements, when applicable, and are available on the DOL website via the EFAST2 system.

2. Plan financial statements that are filed with the Form 5500 are due 7 months after year end and can be extended an additional 2 ½ months. ERISA plans that file with the SEC using the ERISA format are due 180 days after their year-end (if filing under the SEC format, plan financial statements are due 90 days after year end). Because of the timing of the issuance of these financial statements, plan participants in defined contribution plans are not able to use them to make investment decisions. Similarly, plan sponsors of defined benefit pension plans do not use plan financial statements to make investment or funding decisions due to the timing of the financial statements.

3. Information related to employee benefit plans is available to plan participants in timelier ways other than the financial statements, such as through the provider websites, periodic participant statements, summary annual report, or prospectuses. Much of the reporting is driven by ERISA regulations.

4. Employee benefit plans do not have investees in the traditional sense of the term because the participant does not purchase a unit of ownership of the plan; rather, it is the collection of investments intended to provide benefits at a future date. Employee benefit plans are designed with a long-term perspective in mind. For example, in participant-directed defined contribution plans, participants need to determine their asset allocations that will take them to retirement, based on risk tolerance and how many years they have left before retirement. This information is typically obtained from provider websites, information brochures, and prospectuses.

5. Employee benefit plans are tax-exempt entities that are established for a different purpose than either a private company or a public company. The objective of the plan financial statements is to provide information that is useful in assessing the plans' present and future ability to pay benefits. In addition, in a defined contribution plan environment, the amount invested in the plan is generally at the discretion of the participant, based on their level of participation and their own retirement planning.

6. Employee benefit plans are often managed by human resources personnel, rather than personnel who are skilled in finance or accounting. In addition, because of their specialized characteristics, plan sponsor management frequently lack the specialized financial reporting knowledge needed for plans. Many are hands-off, relying heavily on third-party administrators for satisfying reporting requirements. When an audit is not required by regulations, financial statements are rarely prepared.

7. Employee benefit plans are similar to private companies in that most preparers of plan financial statements learn about new financial accounting and reporting guidance from their public accountants and that those educational updates generally coincide with planning procedures of the audit of the plan's year-end financial statements.