

Agenda Item 2C



EXPOSURE DRAFT

PROPOSED STATEMENT ON AUDITING STANDARDS

AU-C SECTION 703, FORMING AN OPINION AND REPORTING ON FINANCIAL STATEMENTS OF EMPLOYEE BENEFIT PLANS SUBJECT TO ERISA

(Amends

- **SAS No. 122, Statements on Auditing Standards: Clarification and Recodification,**
 - ***section 510, Opening Balances—Initial Audit Engagements, Including Reaudit Engagements***
 - ***Section 700, Forming an Opinion and Reporting on Financial Statements***
 - ***Section 705, Modifications to the Opinion in the Independent Auditor's Report***
 - ***Section 706, Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor's Report***
 - ***section 800, Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks [AICPA, Professional Standards, AU-C sec. 800]***

February __, 2017

Comments are requested by May __, 2016

Prepared by the AICPA Auditing Standards Board for comment from persons interested in auditing and reporting issues.

Comments should be addressed to Sherry Hazel at shazel@aicpa.org.

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Exposure Draft

Proposed AU-C section 703, <i>Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA</i>
Proposed Amendments to AU-C section 510, <i>Opening Balances—Initial Audit Engagements, Including Reaudit Engagements</i>
Proposed Amendments to AU-C section 700, <i>Forming an Opinion and Reporting on Financial Statements</i>
Proposed Amendments to AU-C section 705, <i>Modifications to the Opinion in the Independent Auditor’s Report</i>
Proposed Amendments to AU-C section 706, <i>Emphasis-of-Matter Paragraphs and Other-Matter Paragraphs in the Independent Auditor’s Report</i>
Proposed Amendments to AU-C section 800, <i>Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks</i>

Explanatory Memorandum

Introduction

This memorandum provides background to the proposed Statement on Auditing Standards (SAS) *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*. This proposed SAS is specific to audits of financial statements of employee benefit plans that are subject to the Employee Retirement Income Security Act of 1974 (ERISA), hereinafter referred to as an ERISA plan. For audits of ERISA plan financial statements, this proposed SAS would apply in place of AU-C 700, *Forming an Opinion and Reporting on Financial Statements*, and paragraph .09 of AU-C 725, *Supplementary Information in Relation to the Financial Statements as a Whole*. In addition, this proposed SAS contains incremental requirements to AU-C section 210, *Terms of Engagement*, and AU-C section 580, *Written Representations*.

Background

The Auditing Standards Board (ASB) continues to work on improving the communicative value and relevance of the auditor's report. In January 2015 a special task force (the task force) of the Auditing Standards Board (ASB) was formed to consider a proposal to improve the quality of employee benefit plan (EBP) audits by strengthening the EBP auditor's report.

The Chief Accountant of the Department of Labor (DOL) asked the ASB to rethink the auditor reporting model for EBP audits to help auditors better understand their responsibilities and to provide users with more information about what auditors do, including when management imposes a limitation on the scope of the audit, as permitted by the DOL's rules and regulations for reporting and disclosure under the ERISA. The Chief Accountant provided the ASB with specific suggestions on ways to improve auditor reporting for employee benefit plans.

The ASB considered whether quality behavior can be driven by a redesigned auditor reporting model for audits of ERISA plan financial statements. The ASB took a comprehensive look at the reporting model for employee benefit plans, taking into consideration the specialized characteristics of plans. The proposed SAS reflects the ASB's suggestions for a new reporting model for audits of ERISA plans that, among other things, better describes the auditor's responsibilities for obtaining sufficient appropriate audit evidence about whether, in specific areas, the plan is being administered in accordance with the plan document and for when management imposes an ERISA-permitted scope limitation on the audit.

DOL Audit Quality Study

In May 2015, the Employee Benefits Security Administration (EBSA) of the DOL issued a report, *Assessing the Quality of Employee Benefit Plan Audits*, which found deficiencies in the quality of audit work performed by independent CPAs with respect to financial statement audits of ERISA employee benefit plans for the 2011 plan year.

EBSA's assessment of audit quality included a statistical review of 400 plan audits performed by 232 CPA firms. EBSA found that 61% of the audits fully complied with professional auditing standards or had minor deficiencies. EBSA found that 39% of the audits had one or more major deficiencies

with respect to one or more relevant GAAS requirements which would lead to a rejection of the Form 5500 filing. EBSA also found that 17% of the auditor's reports reviewed in their study failed to comply with one or more of ERISA's reporting and disclosure requirements.

AICPA Enhancing Audit Quality Initiative

The AICPA launched the Enhancing Audit Quality (EAQ) initiative in May 2014, followed by the 6-Point Plan to Improve Audits in May 2015. EAQ is a holistic effort to consider auditing of entities, including plans, through multiple touch points, especially where quality issues have emerged. The goal is to align the objectives of all audit-related AICPA efforts to improve audit performance.

Task Force Considerations

The proposed SAS is intended to address the auditor's responsibility to form an opinion and report on the audit of financial statements of employee benefit plans subject to ERISA. It also addresses the form and content of the auditor's report issued as a result of an audit of ERISA plan financial statements. The proposed SAS applies to single employer, multiple employer, and multiemployer plans. Early on in the process of developing this proposed SAS, the task force realized that in considering changes to the reporting model for ERISA plans, there would need to be some changes to the performance requirements as well. The enhanced performance requirements are intended to highlight those areas of an ERISA plan audit that are often overlooked by auditors to support the new reporting requirements.

Current Regulatory Environment

In considering the DOL's request, the task force noted the current regulatory environment in which employee benefit plans operate. The following is a summary of the considerations that informed the decisions that the task force made.

- ERISA provides for federal government oversight of management's operating and reporting practices for employee benefit plans.
- ERISA contains a requirement for annual audits of employee benefit plan financial statements by an independent qualified public accountant in accordance with generally accepted auditing standards (GAAS).
- Under ERISA, the DOL and IRS have the authority to issue regulations governing the administration of employee benefit plans, including reporting and disclosure requirements to be included in an annual filing with the DOL.
- The DOL does not establish the financial reporting framework, for example the DOL does not set generally accepted accounting principles for employee benefit plan financial statements, nor does it set auditing standards.
- The IRS, DOL, and PBGC have consolidated their reporting and disclosure requirements into the Form 5500, *Annual Return/Report for Employee Benefit Plans*, to minimize the filing burden for plan administrators and employers.
- ERISA and DOL regulations require additional information to be disclosed in the financial statements or presented in the supplemental schedules.

- ERISA requires the auditor to report on whether certain supplemental schedules, as identified in ERISA section 103, are presented fairly, in all material respects, in relation to the financial statements as a whole.

Given the ERISA requirement for a GAAS audit, the task force believes the reporting model needs to be developed within GAAS because moving outside such a model would violate ERISA. For example, the reporting for employee benefit plans could not be developed as an agreed upon procedures engagement under the attestation standards because that would not comply with the ERISA audit requirement. Accordingly the task force considered ways in which to enhance the audit requirements specific to employee benefit plans, with the goal of improving audit quality.

DOL's Proposed Revisions to the Form 5500

In July 2016, the DOL's Employee Benefits Security Administration (EBSA), the Internal Revenue Service, and the Pension Benefit Guaranty Corporation asked for public comments on proposed revisions to modernize and improve the Form 5500 Annual Return/Report filed by private-sector employee benefit plans. The proposed form revisions would begin with the plan year 2019 Form 5500 series returns/reports.

Potential Reporting Models

The task force noted that the DOL recommendations contained many similarities to generally accepted government auditing standards (GAGAS). GAGAS, also known as the Yellow Book, provides a framework for conducting audits of government entities, entities that receive government awards, and other audit organizations performing Yellow Book audits. Under the Yellow Book a financial statement audit consists of an audit performed in accordance with GAAS and also includes reports on internal control over financial reporting and on compliance with provisions of laws, regulations, contracts, and grant agreements that have a material effect on the financial statements. GAGAS incorporates by reference the American Institute of Certified Public Accountants (AICPA) Statements on Auditing Standards (SAS).

Accordingly, the task force considered the Yellow Book model when discussing ways to enhance reporting. The task force noted that GAAS cannot require employee benefit plans to comply with the Yellow Book because that would violate ERISA, therefore the task force provided various alternatives to the ASB for consideration, including models that required reporting on internal control over financial reporting and reporting on compliance.

At the October 2016 ASB meeting the ASB discussed whether the auditor's report should include the details of the communications the auditor makes to those charged with governance about significant deficiencies and material weaknesses identified in an audit, and concluded that this should remain a communication with management and those charged with governance, as required by AU-C 265, *Communicating Internal Control Related Matters Identified in an Audit*. Therefore, the proposed SAS does not include a requirement to include a separate report on internal control over financial reporting in the auditor's report.

The ASB also discussed creating a reporting requirement for ERISA plans similar to the report on compliance in a Yellow Book audit. The ASB supports a new reporting element to report the findings from procedures performed on specific plan provisions relating to the financial statements. The financial statement areas to be tested to inform the new reporting relate to areas that are often

overlooked in an ERISA plan audit and may have a direct effect on the financial statements. The proposed SAS notes however, that the requirements in the proposed SAS do not contain all the procedures necessary to provide an opinion on the ERISA plan financial statements.

The proposed SAS creates a separate standard specific to forming an opinion and reporting on ERISA plan financial statements that includes the form and content of the auditor's report for an unmodified opinion, a new opinion when an ERISA-permitted scope limitation is imposed and the new report on findings from procedures performed on specific plan provisions relating to the financial statements.

ERISA-Permitted Scope Limitation

The ASB was asked to consider revising the auditor's report when management imposes a limitation on the scope of the audit as permitted by ERISA. The DOL asked the ASB to consider ways to provide more transparency into an audit with an ERISA-permitted scope limitation because the report should better explain the auditor's responsibilities when an audit is performed with the ERISA-permitted scope limitation. The task force was asked to think of ways to report on such audits, to provide transparency into the audit work that is performed, and to consider the audit evidence that is obtained from management who is required to provide a certification from a bank or similar institution or insurance carrier which is regulated, supervised, and subject to periodic examination by a State or Federal agency, provided that the statements or information regarding assets so held are prepared and certified to by the bank or similar institution, or insurance carrier, in accordance with Title 29 U.S. Code of Federal Regulations (CFR) Part 2520.103-5 and CFR 2520.103-8. The ASB supported the development of a new form of report specific to the ERISA-permitted scope limitation.

Effective Date

The proposed SAS would be effective for audits of financial statements for periods ending on or after December 15, 201__

Changes From Existing Standards

The following changes to existing standards summarize what the ASB believes would be the most significant changes to existing standards if the proposed standard was issued.

As noted in the *Introduction*, the proposed SAS is intended to apply to ERISA plans in place of AU-C section 700 and contains many of the same requirements as AU-C section 700. Some of the enhancements to the auditor reporting model for ERISA plans include:

- Expanded engagement acceptance procedures
- Highlighted procedures for audits of ERISA plans
- New required procedures for audit of ERISA plans when the ERISA-permitted scope limitation is imposed
- Expanded written representations
- Considerations relating to the Form 5500 filing

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- Expanded description of management's responsibilities
- Expanded report on supplementary information
- New form and content of the report when the ERISA-permitted scope limitation is imposed, included expanded auditor's responsibilities relating to the certified information
- Required emphasis-of-matter paragraphs
- New Report on Specific Plan Provisions Relating to the Financial Statements

Issue(s) for Consideration

Reporting on Internal Control Over Financial Reporting

As noted previously, the ASB discussed whether the auditor's report should include the details of the communications the auditor makes to those charged with governance about significant deficiencies and material weaknesses identified in an audit, and concluded that this should remain a communication with management and those charged with governance, as required by AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit*. Therefore, the proposed SAS does not include a requirement to include a separate report on internal control over financial reporting in the auditor's report.

The ASB is seeking feedback from commenters on the following questions:

1. Should the proposed SAS include a requirement for an ERISA plan auditor's report to include the details of the communication the auditor makes with those charged with governance about significant deficiencies or material weaknesses, or both, identified in an audit?

[Other questions?]

TO BE DETERMINED BY ASB

Guide for Respondents

Comments are most helpful when they refer to specific paragraphs, include the reasons for the comments, and, where appropriate, make specific suggestions for any proposed changes to wording. When a respondent agrees with proposals in the exposure draft, it will be helpful for the ASB to be made aware of this view, as well.

Written comments on the exposure draft will become part of the public record of the AICPA and will be available for public inspection at the offices of the AICPA after May __, 2017, for one year. Responses should be sent to Sherry Hazel at shazel@aicpa.org and received May __, 2017.

Comment Period

The comment period for this exposure draft ends on May __, 2017.

Auditing Standards Board

(2016–2017)

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