

## Agenda Item 1C



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# EXPOSURE DRAFT

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## 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 200, Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance With Generally Accepted Auditing Standard***
  - ***section 220, Quality Control for an Engagement Conducted in Accordance With Generally Accepted Auditing Standards***
  - ***section 240, Consideration of Fraud in a Financial Statement Audit***
  - ***section 330, Performing Audit Procedures in Response to Assessed Risks and Evaluating the Audit Evidence Obtained***
  - ***section 450, Evaluation of Misstatements Identified During the Audit***
  - ***section 501, Audit Evidence—Specific Considerations for Selected Items***

- **section 510, Opening Balances—Initial Audit Engagements, Including Reaudit Engagements**
- **section 540, Auditing Accounting Estimates, Including Fair Value Accounting Estimates, and Related Disclosures**
- **section 550, Related Parties**
- **section 560, Subsequent Events and Subsequently Discovered Facts**
- **section 580, Written Representations**
- **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 708, Consistency of Financial Statements**
- **section 725, Supplementary Information in Relation to the Financial Statements as a Whole**
- **section 800, Special Considerations—Audits of Financial Statements Prepared in Accordance With Special Purpose Frameworks**
- **SAS No. 132, The Auditor's Consideration of an Entity’s Ability to Continue as a Going Concern**

**March \_\_, 2017**

**Comments are requested by June \_\_, 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](mailto:shazel@aicpa.org).**

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## **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 will supersede AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*, and paragraph .09 of AU-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole*, if released as final. In addition, for audits of ERISA plan financial statements, 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 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) requested the ASB take a fresh look at the auditor reporting model for ERISA plan audits to provide better insight to the public regarding the scope of the responsibilities of management and the auditor, 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 ERISA. The Chief Accountant of the DOL and DOL staff participated in the task force and ASB deliberations and provided the task force with insights and recommendations as to areas where the DOL believes the auditor's report can be strengthened. The task force considered this information, as this proposed SAS was developed.

In May 2015, the Employee Benefits Security Administration (EBSA) of the DOL issued a report, *Assessing the Quality of Employee Benefit Plan Audits*, of its assessment of audit quality of 400 plan audits performed by 232 CPA firms. EBSA found that 39% of the audits had one or more major deficiencies with respect to one or more relevant requirements of generally accepted auditing standards (GAAS). 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.

Primarily in response to the above DOL report, the AICPA initiated is a holistic effort to enhance audit quality through multiple touch points, including potential changes to auditing standards, new tools guidance and training, and focused Peer Review efforts. The goal is to align the objectives of all audit-related AICPA efforts to improve audit performance.

With respect to possible new or revised auditing standards, the ASB considered whether audit quality can be enhanced by a redesigned auditor reporting model for audits of ERISA plan financial statements, taking into consideration the specialized nature of plan operations. The proposed SAS

reflects the ASB's proposal for a new reporting model for audits of ERISA plans that, among other things, changes the form and content of the auditors' report when management imposes a limitation on the scope of the audit, as permitted by ERISA. In addition, this proposed SAS includes a requirement to report findings from procedures performed on specific plan provisions relating to the financial statements.

Early in the development process, the task force concluded that the reporting model changes in this proposed SAS would also require performance requirements in addition to existing AU-C sections. Questions relate to those proposed requirements are included in the Issues for Consideration detailed below.

### ***Current Regulatory Environment***

In considering the scope of this Proposed SAS, the task force considered the current regulatory oversight responsibilities and related requirements for audits of ERISA financial statements, including the following:

- ERISA provides for federal government oversight of plan fiduciaries
- ERISA contains a requirement for annual audits of employee benefit plan financial statements by an independent qualified public accountant in accordance with GAAS.
- Under ERISA, the DOL and Internal Revenue Service (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 a financial reporting frameworks, for example US GAAP statements, nor does it set auditing standards.
- ERISA and DOL regulations require additional information to be disclosed in the financial statements or presented in the supplemental schedules.
- The IRS, DOL, and Pension Benefit Guaranty Corporation (PBGC) have consolidated their reporting and disclosure requirements into the Form 5500, *Annual Return/Report for Employee Benefit Plans*.
- 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.

### ***Potential Reporting Models***

The task force noted that the above-mentioned 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 as a potential reporting framework to adapt to enhance reporting for audits of ERISA plans. 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 as part of its broader project on the auditor reporting model, 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*. This is also consistent with the final standard issued by the International Audit and Assurance Board (IAASB) and preliminary positions advanced by the Public Company Accounting Oversight Board (PCAOB) in their exposure drafts related to auditor reporting. 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 on ERISA plan financial statements.

#### *Report on Findings*

The Task Force also discussed creating a reporting requirement for ERISA plans similar to the report on compliance in a Yellow Book audit. The ASB has supported exploring the development of new requirements in order to support the reporting of findings from procedures performed on specific plan provisions relating to the financial statements but also acknowledged that adopting such requirements will result in the need for implementation guidance and could lead to possible unintended consequences (see specific questions in the Issues for Consideration). The financial statement areas to be tested to inform the new reporting were based on information provided by the DOL related to areas of audit quality concern, along with other factors, that could have a direct effect on the financial statements. The new procedures are intended to leverage audit procedures performed as part of the financial statement audit, however as procedures specific to these areas would be required irrespective of the risk of material misstatement it is possible that they would result in additional audit work effort. It should be noted that the proposed SAS does not contain all the requirements necessary to provide an opinion and report on the ERISA plan financial statements and the requirements from other AU-C sections also apply.

#### *ERISA-Permitted Scope Limitation*

The ASB was asked to consider developing a specific auditor reporting model in situations when management imposes a limitation on the scope of the audit as permitted by ERISA. The DOL requested the ASB to consider ways to provide more transparency when an ERISA-permitted scope limitation exists. In response to this request, the task force determined that the auditor's report should better explain the auditor's responsibilities when such an audit engagement is being conducted. The task force was also asked to consider the audit evidence that is obtained from management who provides the auditor with 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 (or CFR 2520.103-12). The ASB supported the

development of a new form of report specific to an ERISA-permitted scope limitation to address those considerations.

#### *DOL's Proposed Revisions to the Form 5500*

In July 2016, the DOL's EBSA, the IRS, and the PBGC asked for public comments on proposed revisions to modernize and improve the Form 5500, *Annual Return/Report for Employee Benefit Plans* filed by private-sector employee benefit plans. One of the proposal's objectives is to improve the reliability and transparency of information reported regarding the employee benefit plan investments and other financial transactions. The proposed form revisions would be effective for plan year 2019 Form 5500 returns/reports. The task force will continue to monitor this project for changes that may conflict with the proposed SAS.

#### **Summary**

The proposed SAS includes the form and content of the auditor's report for an unmodified opinion, a new opinion when an ERISA-permitted scope limitation exists and reporting requirements on findings from procedures performed on specific plan provisions relating to the financial statements (either included in the auditor's report on the ERISA plan financial statements or issued as a separate report).

The proposed SAS would apply to audits of single employer, multiple employer, and multiemployer plans subject to ERISA.

#### **Effective Date**

The proposed SAS would be effective for audits of financial statements for periods ending on or after December 15, 2018.

#### **Amendments to Existing Standards**

The following changes summarize what the ASB believes would be the most significant amendments to existing standards if the proposed SAS is issued.

The proposed SAS supersedes AU-C section 700 for audits of ERISA plan financial statements. The proposed SAS contains many of the same requirements as AU-C section 700 and enhancements to the auditor reporting model for ERISA plans including:

- Engagement acceptance requirements in addition to AU-C 210
- New performance requirements that serve as a basis for a new reporting requirement, *Report on Specific Plan Provisions Relating to the Financial Statements*
- New required procedures when the ERISA-permitted scope limitation is imposed
- Written management representations in addition to AU-C 560.
- Considerations relating to the Form 5500 filing, which the auditors' report accompanies
- Expanded description of management's responsibilities
- Expanded communication on the ERISA supplemental schedules



- New form and content requirements of the auditor’s report when management instructs the auditor to limit the scope of the audit, as permitted by ERISA, including expanded auditor’s responsibilities relating to the certified information
- Required emphasis-of-matter paragraphs

### **Issue(s) for Consideration**

In drafting the proposed SAS, the ASB identified the following issues for which feedback has been specifically requested:

#### **Issue 1 – Required Procedures When an ERISA-Permitted Scope Limitation is Imposed**

Paragraph .20 of the proposed SAS requires audit procedures to be performed relating to the information certified by the qualified institution as permitted by ERISA. The objectives of the proposed procedures are to improve the execution and consistency in audit procedures related to limited scope audits as current practice varies resulting in inconsistent audit quality. The proposed SAS also provides examples of ways the auditor can evaluate the financial statement disclosures relating to such information, such as obtaining an understanding of the management’s selection and application of accounting principles which would include concluding on the appropriateness of selected investment valuation methodologies, and compliance with relevant fair value disclosures in the financial statements.

Respondents are asked to provide their views on whether (1) they believe the procedures and guidance will achieve the objectives of enhancing execution and audit quality in these engagements; and (2) whether any procedures that should be required are missing.

#### **Issue 2 - The Form and Content of the Auditor’s Report on ERISA Plan Financial Statements with the ERISA-permitted Scope Limitation**

The ASB believes that the wording of the current limited scope audit report may also be a contributing factor to audit quality deficiencies because of potential confusion regarding the auditor’s responsibilities in performing these engagements. As discussed in the background information, the proposed SAS is intended to provide more transparency into the audit procedures that are required by requiring a new form and content of the auditors’ report when the ERISA-permitted scope limitation is imposed by management (ERISA-permitted scope limitation). This new opinion includes a statement that in the auditor’s opinion, based on the audit and based on the use of the certification of the investment information which the auditor was instructed not to audit, the financial statements are fairly stated in all material respects in accordance with the applicable financial reporting framework.

Respondents are asked to provide feedback on whether (1) the form and content of the new opinion will increase audit quality through clarifying the auditors’ responsibilities and related reporting in limited scope engagements; and (2) the report provides sufficient clarity to users of the report with respect to the auditor’s responsibilities and matters reported.

#### **Issue 3 – Modifications to the Opinion in the Independent Auditor’s Report**

The proposed SAS also addresses the interaction of the new proposed reporting model for limited scope ERISA plan audits with existing requirements in AU-C section 705, *Modifications to the Opinion in the Independent Auditor's Report*. The proposed SAS indicates that AU-C 705 does not apply unless there is another limitation on the scope of the audit other than the ERISA-permitted scope limitation or there is a material misstatement of the ERISA plan financial statements. For example an auditor engaged to perform a limited scope engagements may determine that there is insufficient evidence to support benefit plan payments. In this situation, the reporting model proposed in the SAS would not be suitable, and the auditor would need to consider the requirements and guidance for modified opinions set forth in AU-C 705, including the modification for the scope limitation with respect to the certified information.

Respondents are asked for their views about the proposed interaction of AU-C section 705 and AU-C section 703 when the ERISA-permitted scope limitation is imposed by management including whether the guidance in paragraphs .31 and .34 is appropriate.

#### **Issue 4 - Required Emphasis-of-Matter Paragraphs**

Paragraph .115 of the proposed SAS requires the auditor to include an emphasis-of-matter paragraph in the auditor's report when certain situations exist. The required emphasis-of-matter paragraphs in the proposed SAS are intended to address certain situations that are required to be disclosed under U.S. generally accepted accounting principles (U.S. GAAP) and are based on information provided to the ASB by the DOL as to what a reader of the auditor's report would find useful.

Respondents are asked to consider whether the situations identified are appropriate for requiring the inclusion of emphasis-of-matters paragraphs in the auditor's report. Respondents are also asked to consider whether there are additional situations that should result in a required emphasis-of-matter paragraph.

#### **Issue 5 – Certain Requirements for Audits of ERISA Plan Financial Statements and Related Required Report on Specific Plan Provisions Relating to the Financial Statements**

Paragraphs .15–.16 of the proposed SAS requires the auditor to perform audit procedures on certain provisions relating to ERISA plan financial statements that are the basis for a new reporting element. The new requirements are focused on plan instrument provisions based on information provided by the DOL, along with other feedback, that could have a direct effect on the financial statements. As described in the background information, the auditor would be required to perform audit procedures with respect to the plan provision identified irrespective of the assessed risks of material misstatement.

Respondents are asked to provide feedback about the required procedures discussed in paragraphs .15–.16, and the reporting of findings discussed in paragraphs .118 - .123 of the proposed SAS, including views regarding:

- a. With respect to the required procedures in paragraphs .15-.16-
  - a. Will including the requirements for the auditor to perform and report on procedures related to the specific plan provision areas achieve the objective to enhance audit

- quality with respect to matters that could have a direct effect on the financial statements?
- b. Does the proposed SAS provide appropriate guidance on achieving these requirements?
  - c. Are there procedures related to other specific areas that should be included to enhance the usefulness of the findings?
- b. With respect to reporting on the findings resulting from performing procedures related to the areas in Paragraphs .118-.123, are there issues or other considerations related to:
- a. The determination of which findings are “clearly inconsequential” and therefore do not have to be reported, including consistency in application in practice?
  - b. Whether the findings should also include any matters identified by management or the plan administrator. [Note: As currently drafted, the proposed SAS requires the auditor to include findings that were noted as part of the auditor’s work performed in relation to paragraphs .15–.16.]
  - c. Whether the reporting illustrations related to findings are clear and result in sufficient information to the user of the report?
  - d. The requirement that the auditor report findings that management/the plan administrator does not have an obligation (regulatory or otherwise) to report?
  - e. Confidentiality as it relates to reporting findings, including:
    - i. Disclosure of information not previously made public by the benefit plan
    - ii. Possible disclosure of confidential information including considerations related to state laws regarding confidentiality?
    - iii. Unintended consequences of including the findings in the report, including how such findings may impact the plan administrators’ remediation of findings or their ability to use the IRS Employee Plans Compliance Resolution System (EPCRS) to remedy mistakes in the plan?
  - f. Whether there are alternatives to reporting the findings in the auditor’s report that would achieve the objectives related to enhancing audit quality?
- c. Do respondents believe the required additional procedures and reporting will result in additional costs and if so can respondents provide views as to the extent of those costs?

**Issue 6 – Required Procedures Related to the Form 5500**

The DOL's audit quality study identified that the auditors are inconsistent in the procedures performed with regard to the Form 5500 as well as consideration of the reconciliation between the Form 5500 and the financial statements that is an ERISA requirement. In response, the ASB concluded that the procedures in paragraphs .36 - .48 would improve consistency as the auditors' report on the financial statements that accompany the Form 5500 filing. The proposed procedures are based on AU-C 720 *Other Information*, however the Form 5500 is not deemed to be an annual report as defined in that SAS.

Respondents are asked for their views as to whether the proposed procedures would achieve the objective of increased consistency with respect to identifying information in the Form 5500 that may be relevant to the financial statement audit.

### **Issue 7 - Amendments to Other AU-C Sections**

The Appendix to the proposed SAS include amendments to various other AU-C sections to properly scope the proposed SAS in GAAS.

Respondents are asked whether (1) the proposed amendments to the AU-C sections are appropriate; and (2) whether there are other sections of the AICPA *Professional Standards* that would need to be amended for this proposed SAS.

### **Guide for Respondents**

Respondents are asked to provide comments on Issues 1 – 7 as well as on the content of the proposed SAS and the proposed effective date. 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 June \_\_, 2017, for one year. Responses should be sent to Sherry Hazel at shazel@aicpa.org and received June \_\_, 2017.

### **Comment Period**

The comment period for this exposure draft ends on June \_\_, 2017.

## ***Auditing Standards Board***

(2016–2017)

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