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June 1, 2017

Ms. Sherry Hazel
Audit and Attest Standards Team
American Institute of Certified Public Accountants (AICPA)

By e-mail to: sherry.hazel@aicpa-cima.com

Re: Proposed Statement on Auditing Standards, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*

Dear Ms. Hazel:

We are pleased to have the opportunity to comment on the Exposure Draft Proposed Statement on Auditing Standards (the ED or the proposal) entitled *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, issued by the AICPA's Auditing Standards Board (ASB or the Board) on April 20, 2017. However, we have many significant concerns with the content of the proposal. We hope the Board will withdraw this proposal or modify it substantially to address our concerns. (For your information, our firm is a member of the Employee Benefit Plan Audit Quality Center, and the undersigned is a former member of the ASB.)

In summary, we find the proposal to be seriously flawed in many ways, most particularly with regard to "limited scope" audits of employee benefit plans (EBPs) that are subject to ERISA. In fact, the proposal is far more objectionable than anything previously proposed by the ASB, or any of its predecessor AICPA auditing standard-setting bodies, in the undersigned's 50-year career or in the almost 30-year history prior thereto. Quite frankly, we see it as too far-reaching, ill-advised, ill-conceived, illogical, and self-contradictory.

We are focusing this response principally on what we see as the most objectionable provisions in the ED rather than by offering our views directly in response to the "issues" identified in the ED (except for Issue 9) because we believe eight of the nine questions posed by the Board in those issues are framed largely in language that is not sufficiently focused on the critical issues but rather, they tend to obscure them and are somewhat biased toward soliciting basically supportive comments from respondents.

Our overall concerns. Our overall view is based primarily on the observation that, for no apparently justifiable reason, the Board is proposing to capitulate to the demands of the Department of Labor (the DOL) to satisfy its regulatory objectives (which in our opinion appear to extend beyond its statutory purpose and authority under ERISA). Accordingly, it is proposing to mandate procedures and reporting language, most of which have little or nothing to do with providing financial statement users with assurance as to the absence of material misstatements therein, the sole purpose of a financial statement audit.

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In 2010, the Employee Benefits Security Administration of the DOL authorized and published the results of a study entitled the "Advisory Council Report on Employee Benefit Plan Auditing and Financial Reporting Models" (https://www.dol.gov/agencies/ebsa/about-ebsa/about-us/erisa-advisory-council/employee-benefit-plan-auditing-and-financial-reporting-models). It is acknowledged in that report (in part IIIA on p.3) that ERISA §103(a)(3)(A) requires that auditors be engaged "on behalf of all plan participants," but also that "plan participants generally do not directly use financial statements." There is much evidence in this report that in many respects, its authors significantly misunderstood the respective roles and responsibilities of auditors and management with regard to financial statements. For example, it incorrectly states that the purpose of an audit report is "to help assure participants that there is a high likelihood that the plan financial statements accurately set forth the financial condition of the plan, and that participant records are appropriately maintained."

AU-C secs. 320.02-.06 tells auditors that what is material is information that "could reasonably be expected to influence the economic decisions of users made on the basis of the financial statements." If not the plan participants, who are the users? The regulators? And what economic decisions are made based on the financial statements? Since there are no identifiable users who make economic decisions based on the financial statements, how then should one determine what is material for risk assessment and audit scope purposes?

Pursuant to the ED, the ASB would, without any apparent justification, require auditors to issue reports that are significantly inconsistent with sound audit and other reporting standards and principles (and even one ethical standard) cited below that have been in place for decades, that are tried and true, and that apply without exception to all other audit or other attestation services for all entities other than EBPs subject to ERISA.

As written, the proposed standard appears to be written as a virtually standalone standard for EBPs as if to assume that auditors have no familiarity with or access to the other, generally applicable standards. Consequently, it is unduly laden with redundant guidance that is well established and clearly articulated in other standards. In addition, the proposed standard is replete with unnecessary internal redundancies relative to EBS audit engagements with somewhat different characteristics, *e.g.*, those with or without ERISA-authorized scope limitations. We would much rather see a more streamlined standard that focuses more on what is different about these engagements and relies more on cross-referencing than on redundancies and other unnecessary verbiage. This would unencumber the final standard and make it far easier to navigate and use.

As for the proposed effective date (Issue 9), unless the proposal is entirely withdrawn as written and re-issued in a form that is appropriately streamlined with unnecessary content removed as recommended herein, we believe the effective date of a final standard should be delayed, as necessary, (1) until a clear and readable updated audit guide is approved and made available, and (2) to allow sufficient time for firms and subscription providers to develop appropriate practice aids.

Our more detailed comments below relate to our principal areas of concern and are topically arranged under these three captions (the first two of which are the most egregious):

- Limited scope audits
- Reporting on specific plan provisions
- Proposed auditor responsibilities regarding Form 5500

Limited scope audits. Under the proposal (paras. 102, 104 and 106), despite a severely limited audit scope imposed by the client, auditors would be required to issue an unmodified opinion, based in part on the custodian's unaudited certification (to which only limited procedures would be applied), rather than a disclaimer.

The text of the ED and Illustration 3 (of a proposed limited scope audit report form) shown in the Exhibit (para. .A148) of the proposed standard are inconsistent with the general provisions of AU-C secs. 705.10-.13, which apply to reporting on a management-imposed scope limitation, although the ED proposes no amendment to secs. 705.10-.13 to provide an exception in reference to sec 703. This oversight would leave a glaring contradiction between the two standards. We firmly believe AU-C secs. 705.10-.13 should stand unmodified, without exception.

Moreover, the proposed reporting model for limited scope audits is clearly inconsistent, in our opinion, with the longstanding "General Standards Rule" in the *Code of Professional Conduct*, which requires CPAs to "obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed" (ET sec.1.300.001.01(d)). No amendment to this ethical requirement has been proposed, and we believe such a proposal would be beyond the authority of the ASB. We firmly believe ET sec.1.300.001.01(d) should likewise stand unmodified, without exception.

As provided in AU-C secs. 705.10-.13, an auditor has three possible ways to deal with an unresolved client scope limitation. The most extreme of the three possible courses of action, of course, would be for the auditor to withdraw from the engagement, for example, when management's integrity is in doubt. Normally, however, when the possible effects on the financial statements of any misstatements undetected due to the scope limitation could be both material and pervasive in the auditor's judgment, a disclaimer of opinion on the financial statements (as has historically been the case for these EBP engagements) would be required but if only material, but not pervasive, a qualified opinion (AU-C secs. 705.10-.13), which would necessarily begin with words like, "except for the effects of any adjustments ...") may be issued.

In this proposal, however, the Board would have auditors skip over "Plan B" (a qualified opinion, which might be justifiable in unusual circumstances when in the auditor's judgment, the level of pervasiveness is acceptable). We do not believe the standard should allow for such auditor judgment (with caution). But in the ED, the Board by-passed that option and jumped to a self-contradictory unmodified opinion that is characterized as based in (significant) part on unaudited information. Why? What is driving this conclusion? How would this troublesome report language contribute to the achievement of the DOL's regulatory objective? Who then is supposed to benefit from such a meaningless, groundless (and outlandish) opinion?

We view the proposed limited scope reporting model as having the effect of severely diluting and diminishing the value of audit reporting and the attest function, in general. To emphasize by way of analogy the palpable absurdity of the proposed opinion, we can see the custodian as akin to a material, self-managing subsidiary. The subsidiary's management controls its assets, keeps its books and sends unaudited financial statements to the parent for consolidation. How could the parent's auditor express an unmodified opinion in reliance on these unaudited financial statements?

The limited scope report form proposed in Illustration 3 of the Exhibit (para. .A148) appears inappropriately to be modeled in certain respects after the traditional report form commonly used for dividing responsibility between participating component audit firms that now resides in AU-C 600. However, the critical distinction is that under AU-C 600, the reporting auditor's reliance is placed on audited, not unaudited information, and even when making reference to the work of a component auditor, the reporting auditor must take considerable overall responsibility for the direction, supervision, and performance of the audit engagement.

Alternatively, one might view the custodian's certificate as a sufficiently reliable piece of evidence like a third party confirmation (which para. A45 of the ED firmly and correctly states that it is not). Here the critical distinction is that unlike a confirmation, such a certificate does not independently confirm information that was previously recorded by the audit client; it is the sole source of such information. Moreover, reference would never otherwise be made in an audit report to a confirmation, the work of an auditor's specialist (AU-C 620.14) or any other single piece of audit evidence when it significantly supports an unmodified opinion. Why, then, should we do so when, as is proposed, it provides no support?

As explained in para. A48(b)-(c), the proposed requirement of para. 20(d) would require an auditor, based solely on management's inquiries, to ascertain if investments subject to an ERISA-authorized scope limitation "are measured, presented and disclosed in accordance with the applicable financial framework" and "how investments at fair value are leveled in the fair value hierarchy table." In view of the plan management's probable ignorance of such matters in almost all cases when a qualified custodian institution is employed, and the inherent lack of reliability of management inquiries, it is highly doubtful that such inquiries would have any value to the DOL or anyone else. This proposed requirement should be omitted from any final standard.

Admittedly, except as noted in the foregoing paragraph, the proposed mandatory procedures (para. 20(a)-(d)) that would be applied to investments subject to limited scope reporting, which are not mandated by ERISA, would not be burdensome, but these procedures would afford little or no assurance as to the reliability of the content of the plan custodian's certificate. However, if the final version of the proposal were to require that auditors obtain a type2 SOC-1 report on the effectiveness of the relevant internal controls applied by the custodian to the data reported in the certificate (which it does not even suggest), it would somewhat strengthen the audit process and provide some additional measure of reliability. However, we do not see that additional reliability as sufficient to overcome the need for an overall disclaimer of (or possibly a qualified) opinion as would be prescribed in AU-C secs. 705.10-.13.

Reporting on specific plan provisions. The ED contains a newly proposed requirement (para. 121) to report on specific plan provisions relating to the financial statements (either in the primary audit report or presented supplementally) disclosing auditor findings from applying certain mandated procedures (paras. 15-17 and A15).

It is clear that these proposed mandatory procedures would likely add considerable time to many EBP ERISA audits and present other problems discussed below, yet would afford little or no assurance (1) as to the reliability of the financial statements because it would have only a remote potential, if any, for identifying a material misstatement, once again, the sole objective of a financial statement audit, or (2) of identifying material instances of noncompliance (based on their lack of any prescribed minimum scope). Despite these severe limitations on the usefulness or value of such a report, it would be attached to Form 5500 and, therefore, be available (inappropriately, in our opinion) to the public.

In almost all circumstances, the probability of a material misstatement that would require adjustment to the plan's financial statements as a result of noncompliance would be extremely remote even in the case of the most egregious violation of plan provisions (or even ERISA or DOL requirements). In such regard, it is highly unlikely the DOL would assess a penalty against plan assets or revoke the tax qualified status of a plan (as suggested in paras. A13 and A39 of the ED) as that would adversely affect participants, the very people the plan exists to benefit and the DOL exists to protect. Instead, it is far more likely that any penalty would be assessed against the responsible employer/sponsor or other administrator or a custodian of plan assets. The same would be true for the IRS. On the other hand, there is some risk that an employer fails to make a mandated matching contribution or that improper plan distributions represent an unrecorded receivable (unlikely to be material), which risks justify performing eligibility and transaction tests. Nevertheless, in our opinion, these risks do not justify the separate report on specific plan provisions

In this connection, the proposal would require auditors to perform substantive testing "without regard to the risk of material misstatement" (counter to the basic underlying principles of modern, risk-based financial auditing). But even in audits performed to enable an opinion on compliance (which is not proposed), the scope of audit procedures employed is based on the auditor's assessment of the risk of material noncompliance.

This proposal is essentially for a report on compliance, although because it would not require issuing an opinion on compliance, it would resemble, in some ways, an agreed-upon procedures report. But the ED neither prescribes nor requires reporting the scope of such procedures. Therefore, the scope is left to the auditor's discretion (rather than set by or agreed to by the users as would be required in an agreed-upon procedures engagement), and it is subject to second guessing by regulators (upon examination), peer reviewers, or litigants, especially when one's work is compared to other auditors who may tend to overaudit. In fact, a self-defensive desire to pre-empt such second guessing may likely cause many auditors to overaudit. In addition, the ED would require auditors to apply judgment in deciding which findings are "inconsequential" (which is undefined) and, therefore, not reportable. (Since it is the auditor's report, the auditor must bear responsibility for such judgments, even if made in consultation with those charged with governance as suggested in para. A136.) Such auditor judgments are prohibited under the attestation standards (AT-C secs. 215 and 315) that apply to agreed-upon procedures engagements, as is distribution or use of such reports to or by those who have not agreed to the procedures.

We believe the proposed requirement for reporting on specific plan provisions would probably entail significant additional work as for many auditors compared to current practice and, accordingly, would add considerable administrative costs to many EBP audits subject to ERISA, whether of limited scope or not. Those additional costs, if not to be borne by employer/sponsors would necessarily reduce plan assets and, thus, have the unfavorable result of being borne by employee participants. In addition, if the Illustration 3 report form for limited scope audits were to be adopted as proposed, it could be a reason for auditors to decline to accept such engagements thus causing a reduction in competition and further increases in administrative costs. We see as another possible consequence that some small business employers will discontinue their EBPs rather than absorb such additional costs (which we see as unwarranted). As a result, working people would be forced to rely on IRAs for tax deferrals that due to limitations, would be substantially lower than with defined benefit plans, thus having the direct effect of reducing their disposable income currently and in retirement.

Proposed auditor responsibilities regarding Form 5500. Proposed procedures regarding Form 5500 are based on AU-C sec. 720 although, for no apparent reason, it is not considered a "document containing audited financial statements," as defined in AU-C sec. 720.02. Also for no apparent reason, the ED (paras. 37 and A69) would allow auditors to issue an audit report prior to the availability of an unissued Form 5500 while retaining responsibilities with respect to the 5500 after the audit report date. We believe AU-C sec. 720 should be amended so Form 5500 is covered by its definition of "document containing audited financial statements" because we believe it is inherently unreasonable for a standard to hold auditors responsible for client actions after the report date (except in connection with SEC registrations). The standard should preclude issuance of an audit report before the unissued Form 5500 is made available to the auditor and require that the terms of the engagement provide so.

Conclusion. We believe the likely primary reason the DOL is pressuring the auditing profession for these changes in our standards is that the DOL, itself, has no statutory authority either to set auditing standards or require compliance testing and reporting. But why should the profession yield to such pressure by requiring its members to perform procedures and issue reports that are inconsistent with its otherwise applicable standards and are not required by law or regulation? In our opinion, there should be no exceptions made in our auditing standards for ERISA-compliant EBP audits. And if the DOL wants a compliance audit and report such as is provided in in the attestation standards (AT-C sec. 315) for examination or agreed-upon procedures engagements or the Single Audit Act model for "major" federal programs, we believe it should ask Congress to amend ERISA.

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We are aware and acknowledge that our comments on the ED will become part of the public record of the AICPA and will be made available on the AICPA's website until a final standard is issued.

Any questions about our firm's views may be addressed to the undersigned at hlevy@pbtk.com or 702/279-5389.

Very truly yours,

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