

August 8, 2017

Michael Santay, Chair, Auditing Standards Board
Darrel Schubert, Chair, Employee Benefit Plan Reporting Task Force
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036

Transmitted via email to sherry.hazel@aicpa-cima.com

Dear Sirs:

We appreciate this opportunity to provide our feedback and suggestions on the proposed Statement on Auditing Standards, Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA. We recognize the concerns of both the AICPA and Department of Labor (DOL) regarding the overall quality of employee benefit plan audits industrywide and acknowledge the continuing need to review and enhance the professional performance and reporting standards related thereto. We kindly request your review and consideration of our specific comments to the proposed changes and also offer other suggestions as to how benefit plan auditing can be improved.

Novak Francella LLC is one of the largest providers of employee benefit plan audits nationwide with a practice concentration of almost exclusively multiemployer plans. We conduct over 300 plan audits annually of plans with varying plan assets ranging up to approximately \$3 billion.

Our partners are actively involved in the employee benefit plan community and currently hold leadership positions in the International Foundation of Employee Benefit Plans and the AICPA Employee Benefit Plan Quality Center, among others. As stakeholders in the industry, we submit our thoughts with the intention of promoting technical excellence among auditing professionals and embracing the AICPA's initiative to reduce employee benefit plan audit failure.

We believe that good audits evolve foremost from proper planning and suggest enhanced auditor education be included as any audit quality initiative. We offer some additional suggestions at the conclusion of this letter.

Please find our comments regarding the specific issues enumerated in the proposed standard:

Issue 1 - Required Procedures When an ERISA - Permitted Audit Scope Limitation is Imposed

Limited scope audits are an insignificant part of our practice and we offer no comments on Issue 1.

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

Limited scope audits are an insignificant part of our practice and we offer no comments on Issue 2.

Issue 3 - Modifications to the Opinion in the Independent Auditor's Report

Limited scope audits are an insignificant part of our practice and we offer no comments on Issue 3.

Issue 4 - Required Emphasis-of-Matter Paragraphs

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.

Paragraph 116 of the proposed SAS states that "the auditor's report on ERISA plan financial statements should include an emphasis-of-matter paragraph...". The wording eliminates auditor's judgement in these situations. Any of these items could be considered immaterial to the financial statements, as a whole, and an emphasis may actually be misleading. Insisting they be included in the auditor's report could actually decrease transparency as a result.

A primary objective of the auditor's report is to opine as to the fairness and reasonableness of the financial statements under Generally Accepted Accounting Principles. Most of the situations identified for emphasis would already be disclosed in the footnotes or readily apparent in the statements themselves. Users relying on the report tend to look directly for the "unmodified" opinion and excessive ancillary information could unintentionally taint the reader's view of the report.

Issue 5 - Reporting Internal Control Deficiencies

Respondents are asked to provide feedback on whether

- **The current reporting of internal control deficiencies to those charged with governance is sufficient; and/or**
- **There are other reporting considerations the ASB should evaluate.**

We believe that the current requirements to communicate with those charged with governance, the internal control deficiencies identified during the audit are sufficient.

Issue 6 - Certain Requirements for Audits of ERISA Plan Financial Statements and Related Required

Report on Specific Plan Provisions Relating to the Financial Statements

Respondents are asked to provide feedback about the required procedures discussed in paragraphs 15 - 16, and the reporting of findings discussed in paragraphs 119 - 124 of the proposed SAS, including views regarding the following:

1. With respect to the required procedures in paragraphs 15 - 16

- a. Will these requirements enhance the consistency and quality of the audit work performed relating to matters that could have a direct effect on the financial statements, including related disclosures, and if not, why?**

No. Quality firms already perform all procedures necessary to render an opinion on the financial statements. Firms that currently fail to comply with existing audit requirements are not likely to perform additional procedures. This could result in putting those firms at an unfair advantage over firms that perform the additional procedures as their audit costs will increase. The end net result could be reduced overall audit quality for those buyers of audit services who select firms primarily on price.

- b. Does the proposed SAS provide appropriate guidance on achieving these requirements, including**

- i. which provisions of the plan instrument should be tested; and**

- ii. to what extent testing should be performed?**

The proposed standard requires the auditor to "... perform substantive procedures irrespective of the risk of material misstatement." The concept of risk-based auditing was adopted within the past twenty years and has been used as the basis auditors use to judge whether financial statements are presented fairly. The

proposed SAS would require auditors to perform procedures well beyond what is necessary to render an opinion on the financial statements. The cost to do so would be substantial and who would benefit? Quality firms would follow the new requirements. Lesser quality firms would not. This could result in less work for quality firms and more work for lesser quality firms.

The extent of the procedures required to be performed is not given. Auditors understand how to audit to avoid material misstatements in the financial statements.

Does the proposed standard seek absolute assurance?

c. What procedures related to other plan provisions or specific areas of the financial statements should be included in the required testing to enhance the usefulness of the proposed reporting of the findings?

Overall, we believe that the objective of improving consistency and audit quality in a robust way will not be met by codifying required procedures into the final SAS. These procedures are already familiar to practitioners who perform quality audits and have been included in the industry's Audit Guide for many years. For practitioners who do not perform quality audits, the desired effect may only be realized on a limited scale.

Specific comments regarding the required procedures are:

15.a Whether eligibility provisions are administered in accordance with the plan document?

For single employer plans this should already be done as a part of participant data testing. For multiemployer plans eligibility is typically based in contributions made and does not need to be tested (unless there is a waiting period).

15.b Whether benefit payments or claim payments are in accordance with the plan instrument?

This should already be tested adequately in existing employee benefit audits.

15.c Whether vesting provisions are administered in accordance with the plan instrument?

This should already be tested adequately in existing employee benefit audits.

15.d Whether employer and employee contributions are calculated in accordance with the plan instrument, including that compensation upon which contributions are based is consistent with the definition of compensation in the plan instrument?

This should already be tested adequately in existing single employer benefit plan audits. This procedure would not be applicable to multiemployer plans where contributions are based on hours paid or on work performed in compliance with the applicable collective bargaining agreement.

- 15.e Whether prohibited transactions identified by management or as part of the audit have been appropriately reported in the supplemental schedules?

Existing requirements to report such failure to the governing parties and/or to consider withdrawal from the engagement are adequate.

- 15.f Whether expenses have been allocated properly between plans?

Testing whether a proper allocation has been made should be done as part of already existing audit procedures. This is particularly important in multiemployer plans where it is very common for many plans to share expenses.

- 15.g Whether assets are fully allocated to the participants accounts in accordance with IRS Revenue Ruling 80-155 and the plan instrument?

This should be done in accordance with the existing auditing procedures. The extent to which testing should be done should be based on materiality.

- 15.h Whether forfeited amounts were utilized in accordance with plan provisions?

This is done in accordance with existing auditing procedures.

- 15.i Whether account activity was recorded in accordance with plan provisions?

This is done in accordance with existing auditing procedures.

- 16.a Whether the plan has performed, passed, corrected, or intends to correct relevant IRC compliance tests?

This is done in accordance with existing auditing procedures.

- 16.b Whether investment income, expenses, and fees have been properly allocated?

This is a duplication of 15.i and should not have been separately identified as a required procedure.

2. **With respect to reporting on the findings resulting from performing procedures related to the areas in paragraphs 119 - 124, whether there are opportunities to enhance the proposed requirements and guidance including whether:**
- a. Including the list of individual areas tested is appropriate and if so whether there are other items that should also be included (if not, why not).**
 - b. The requirement to exclude findings that are “clearly inconsequential” is appropriate, and if so is there guidance the ASB can consider to drive consistency in application in practice?**
 - c. 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.]**
 - d. The reporting illustrations included in the Exhibits to the proposed SAS specific to reporting the findings are clear and result in sufficient information to the user of the report?**

We do not believe a Report on Findings should be included as part of the financial statements.

The Auditing Standards Board has already concluded that it was not necessary to disclose in a separate section of the auditor’s report the identified significant deficiencies or material weaknesses in internal control identified by the auditor. The current requirement to discuss those matters in accordance with AU-C Section 265 was considered sufficient. Why then require the items identified as a result of testing proposed in paragraphs 15 and 16 in the auditor’s report in a statement of findings? Significant deficiencies and material weaknesses in internal control are likely to be far more significant than the findings as a result of the procedures prescribed in paragraphs 15 and 16.

Other comments on this matter include:

- The auditor is performing the procedures in Paragraphs 15 and 16 not to form a conclusion or opinion, and not pursuant to an assessment of risk or materiality, but merely to report that they were performed and to report on any findings that resulted. Therefore, in practice the report may hide vast inconsistencies in audit quality, and foster an overreliance on the auditor’s ability to detect and report noncompliance findings.
- The user will have difficulty determining the potential effect of the findings on the plan’s operations, qualification or financial position. For example, under the proposed reporting model, the auditor is not required to quantify the findings or provide more than general information. Furthermore, the user has no way of assessing whether the finding was a result of numerous errors, one error that was not significant (but not clearly inconsequential), or the size of

the sample being tested. For example, one reported finding when the auditor tested 100 transactions is less serious than one reported finding when the auditor tested 10 transactions.

- The user will have difficulty determining whether the findings of noncompliance have been remediated. The auditor is not required to repeat findings from prior years if not remediated.
 - The reporting model does not allow the auditor to present findings in a way that characterizes their severity or magnitude, either individually or in the aggregate, so that the user can differentiate between those findings the auditor may consider to be insignificant and those considered to be more serious.
- e. There may be unintended consequences from including the findings in the auditor's report, and if so, what those unintended consequences may be and how might they be mitigated?**

Because the auditor's report is attached to the plan's Form 5500 filing, which is posted online and publicly available, the readers include not only the plan participants but anyone in the general public. A few unintended consequences may ensue, such as:

- Plan sponsors of multiemployer plans, who are an equal representation of labor union and management individuals, may be especially sensitive to findings being publicly available and their magnitude potentially inflated. Relations between labor and management, and between labor union officers and their rank-and-file members, are at times contentious, and the findings could become political fodder.
- The statement of findings would likely have severe legal consequences for multiemployer plans. The findings of noncompliance could lead to actual or potential litigation.
- Plan participants may become unduly alarmed regarding findings included in the report, even though the findings could be only routine operating errors, perhaps even already corrected. They may reduce or withdraw their participation in the plan, which could harm their ability to save for retirement - the very reason the plan was established.
- Plan sponsors may need to provide additional communications to participants to explain the findings, and seek assistance from professionals to do so, taking away from their ability to carry out other responsibilities.

- Plan sponsors may avoid the reputational risk involved in having findings reported publicly and seek lower quality auditors who agree not to report findings, thwarting the very objective that this proposed SAS set to achieve.
- The needed review of the statement of findings by plan management and legal counsel could cause additional time constraints to finalizing the audit.

f. There are alternatives to reporting the findings in the auditor’s report that would achieve the objectives related to enhancing audit quality?

We believe that findings of noncompliance should be communicated with plan management and, if appropriate, plan governance. The auditor should evaluate the effect of such noncompliance on the financial statements, in accordance with the provisions of AU-C 250.

3. Whether the required additional procedures and reporting of findings will result in additional costs, and if so, views as to the extent of those costs and whether they outweigh the potential benefits of enhanced audit quality?

We believe that the additional procedures and reporting of findings will obviously increase the cost of performing an audit, undoubtedly in the first year of implementation and ongoing.

The consideration of what will be reported as a finding of noncompliance with plan provisions will ultimately be a matter of legal determination, causing plan management to increasingly seek legal counsel as a part of developing the report on findings and any management responses, driving up costs even more.

The cost that is harder to quantify is the “human cost” that may arise out of the unintended consequences described above. If participants are ultimately harmed by an overreliance on the auditor’s ability to detect noncompliance, an overreaction to findings reported, or the failure of this proposed SAS to improve audit quality, their ability to obtain needed benefits is jeopardized.

Issue 7 - Required Procedures Relating to the Form 5500

Respondents are asked for their views about whether the proposed procedures in paragraphs 36 - 48 of the proposed SAS would achieve the objective of increased consistency with respect to identifying information in the Form 5500 that may be relevant to the audit of ERISA plan financial statements, and if not, why?

The purpose of a financial statement audit is to enable the independent auditor to render an opinion on the fairness of the financial statements. In proposed paragraphs 36-48 the auditor is charged with responsibility for the Form 5500. Extending the auditor’s

responsibility to documents in addition to the financial statements is extending the auditor's legal liability to a form that the auditor may or may not prepare. If the auditor does prepare the Form 5500 care should be taken to prepare the return in a manner consistent with the financial statements. The requirements in paragraph 36 to 48 extend the auditor's responsibility too far.

Issue 8 - Proposed New Reporting Standard and Amendments to Other AU-C Sections

Respondents are asked whether

- a. The proposed approach of creating a new reporting model for reporting on ERISA plan audits (AU-C section 703) will better describe management's and the auditor's responsibilities in these engagements;**

The present auditor's report has stood the test of time. A longer audit report is likely to lead to increased litigation and to lessen transparency. The accounting profession abandoned the long form auditor's report, for good reason, many years ago. To return to a version of a long form report is misguided.

- b. The proposed amendments to the other AU-C sections are appropriate; and**
- c. Whether there are other sections of AICPA Professional Standards that might need to reflect the provisions of this proposed SAS.**

The document explaining the proposed SAS is 135 pages in length. There are better ways of addressing the problem with employee benefit plan auditing than the proposed SAS. We will address these ways in our conclusion.

Issue 9 - Proposed Effective Date

The proposed effective date for the proposed SAS is for ERISA plan audits of financial statements for periods ending on or after December 15, 2018. Respondents are asked whether the proposed effective date provides sufficient time for preparers, auditors, and others to adopt the new standard and related conforming amendments.

We believe that the proposed effective date does not allow enough time to implement the changes in practice that the proposed SAS would bring about, as well the necessary outreach to clients, service providers, legal counsel and users who would all be affected by the revisions in practice and reporting.

Conclusion

We believe auditor education should be the cornerstone of any initiative to increase audit quality. Added reporting requirements could identify plan operational matters requiring attention but do not necessarily increase the quality of the audit work being performed. We offer the following additional suggestions:

1. All auditors of employee benefit plans should be required to join the AICPA EBP Audit Quality Center.
2. The continuing education requirements for all CPAs and their professional staff who audit employee benefit plans should be strengthened. A substantial annual requirement of 24 hours of employee benefit plan CPE should be required.
3. Peer review requirements for employee benefit plan auditors should be strengthened.

We appreciate the efforts of the Auditing Standards Board in this matter and hope that our comments and recommendations are worthy of consideration. If you need further information or certification of our comments, please contact Patrick Stines.

Very truly yours,



NOVAK FRANCELLA LLC