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LEADERSHIP + QUALITY

August 21, 2017

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

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

Transmitted via email to Sherry Hazel at Sherry.Hazel@aicpa-cima.com

Dear Sirs:

Thank you for this opportunity to respond to the issues contained in the exposure draft described above. In light of the failure rate in employee benefit plan audits, illuminated by the Department of Labor's (DOL) review of audit files, we support efforts by the AICPA in its quest to improve audit quality, value and relevance of the auditor's report. We agree that maintaining the status quo is not acceptable. While we offer our comments to the issues identified, we wish to be clear that we do not believe the proposed changes to the auditing standards will accomplish the objective of improving quality and transparency in these audits, and may very well create unintended negative effects on the Plans and auditors. In our conclusion, we will also offer our suggestions as to how employee benefit plan auditing can be improved.

Lindquist LLP provides audit and accounting services primarily to Employee Benefit Plans. We currently provide these services to over 230 plans, which include multiemployer, multiple-employer and single-employer plans. The plans we serve include pension plans, health and welfare plans, apprentice plans and other types with Plan assets that range in size from approximately \$200,000 to over \$39 billion. Our Firm is among the few in the country where the vast majority of our practice is composed of employee benefit plan audits.

Lindquist LLP is recognized for its expertise in the benefit plan industry. Our partners have served in the past and also currently serve and/or participate on AICPA committees, International Foundation of Employee Benefit Plan Committees, Western Pension and Benefits Association, and State societies. Our involvement with these organizations includes participation, committee activities, as well as moderation and teaching at educational events for our primary industry.

The following are our comments regarding the specific issues identified by the Board:

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

Paragraph 20 of the proposed SAS requires audit procedures to be performed relating to the information certified by a qualified institution as permitted by ERISA. In particular, paragraph .20(d) of the proposed SAS requires the auditor to evaluate whether the form and content of the ERISA plan financial statement disclosures related to the information prepared and certified by a qualified institution are in accordance with the applicable financial reporting framework.

Respondents are asked to provide their views on whether

- The procedures and guidance will achieve the objectives of enhancing execution and consistency in these engagements and if not, why; and

We believe the procedures and guidance will not achieve the objectives of enhancing execution and consistency in these engagements. Experienced auditors of employee benefit plans are aware of possible certification issues and the required audit procedures and documentation relating to the limited-scope certification. In our opinion, it is unlikely that inexperienced auditors of employee benefit plans (those performing five or fewer employee benefit plan audits) will perform the additional procedures as written.

Being a member of the AICPA Employee Benefit Plan Audit Quality Center provides auditors the opportunity to access very meaningful tools related to employee benefit plan audits. The AICPA Employee Benefit Plan Audit Quality Center has provided “Limited Scope Audits of Employee Benefit Plans” Plan Advisory, which describes the statutory and regulatory basis for the limited-scope audit exemption, what constitutes a proper certification from a qualified institution, the plan administrator’s responsibilities for determining the acceptability of a limited-scope certification, the auditor’s responsibilities for determining whether a certification can be relied upon to limit the scope of the audit, the limited-scope audit in the current environment, the effect of the limited-scope audit exemption on the scope of the independent auditor’s testing and reporting, and common deficiencies in limited-scope certifications. We believe that this tool provides greater detail than the proposed requirements.

- any procedures that should be required are missing, and if so, describe them.

We did not note any procedures missing. However, as described above, the tool issued by the AICPA Employee Benefit Plan Audit Quality Center (“Limited Scope Audits of Employee Benefit Plans” Plan Advisory) in 2016 provides sufficient information.

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

As noted in the Background discussion, the DOL had requested the ASB to explore different reporting models in these circumstances, expressing a concern that the wording of the current limited scope auditor’s report, and resulting disclaimer of opinion typically issued, may be a contributing factor to audit quality deficiencies because of potential confusion regarding the auditor’s responsibilities in performing these engagements.

Respondents are asked to provide feedback on whether the form and content of the proposed auditor’s report, including the form and proposed content of the new form of opinion

- Provide improved transparency with respect to reporting on an audit of ERISA plan financial statements when an ERISA-permitted audit scope limitation exists, and if not, how could it be revised;

We do not believe that the form and content of the proposed auditor’s report will improve transparency with respect to reporting when an ERISA-permitted audit scope limitation exists. The “Basis for Limitation on the Scope of the Audit” section of the Auditor’s Report is concise and properly represents the responsibilities of Management and Auditor as permitted under current regulations. By adding “Management’s Responsibility for the Financial Statements and the Limitation on the Scope of the Audit” and “Auditor’s Responsibility (Including Responsibility for the Certified Investment Information)” we believe that the users of the financial statements will be further confused regarding responsibilities.

- Will improve the auditor’s understanding of his or her responsibilities in a limited scope audit resulting in potential improvements in audit quality, and if not, why;

We do not believe that the auditor’s report should be the vehicle in which to improve the auditor’s understanding of his or her responsibilities in a limited-scope audit. The opinion does not provide specific and detailed language to educate the auditor in problem areas with certifications. The AICPA Employee Benefit Plan Audit Quality Center provided “Limited Scope Audits of Employee Benefit Plans” Plan Advisory in 2016, which provides sufficient information to assist in the auditor’s understanding of his or her audit procedures responsibilities for a limited-scope audit.

- Better describe management’s responsibilities for the financial statements, and if not, why;

We agree that there is sometimes a lack of understanding on management’s part regarding responsibility for determining whether a limitation on the scope of the audit is permissible. We do not believe that adding a lengthy section to the opinion will help clarify this issue with management. We suggest that succinct verbiage be added to the certified investments footnote disclosure examples to help better describe management’s responsibilities.

- Provide sufficient clarity to users with respect to the auditor’s responsibilities and matters reported, and if not, why.

We believe that the auditor’s responsibility and matters reported sections provides too much information and will confuse the user of the financial statements. The “Auditor’s Responsibility (Including Responsibility for the Certified Investment Information)” may be confusing to the user of the financial statements in that it insinuates the Auditor is responsible. This information is imparted to users in the “Basis for Limitation on the Scope of the Audit” section of the Independent Auditor’s Report and is generally detailed in the financial statement footnotes in the Investments Certified disclosure.

Issue 3—Modifications to the Opinion in the Independent Auditor’s Report

The proposed SAS addresses the interaction of the new proposed reporting model for audits of ERISA plans when the ERISA-permitted audit scope limitation is imposed, with existing requirements in AU-C section 705. Specifically, the proposed SAS indicates that AU-C section 705 does not apply unless there is another limitation on the scope of the audit other than the ERISA-permitted audit scope limitation or there is a material misstatement of the ERISA plan financial statements.

Respondents are asked for their views about the proposed interaction of AU-C section 705 and the proposed SAS when the ERISA-permitted audit scope limitation is imposed by management including

- Whether the guidance in paragraphs 31 and 34 of the proposed SAS (a) is clear with respect to the auditor’s responsibilities for addressing the circumstances described previously, and (b) achieves the objective of providing transparent reporting to the users, and if not, suggested revisions.
- The form and content of the example reports (nos. 5–7) illustrating qualified and disclaimers of opinion regarding the application of the guidance in paragraphs 31 and 34.

The guidance provided in paragraphs 31 and 34 is difficult to read, follow and understand. In particular, illustrative reports 3 and 5–7 are confusing. In one instance, the illustrative reports effectively give an

unmodified opinion, and with a possibly small change in circumstances, a disclaimer of opinion is provided. The difficulty reading and understanding the proposed guidance will most likely create more audit failures and confusion for the financial statement users.

In our opinion, the use of the current limited-scope opinion (a disclaimer of opinion) is appropriate. The proposed new unmodified style of opinion will create confusion and reduce transparency. Use of a disclaimer of opinion renders this new guidance unnecessary.

We are also concerned about the length of the auditor's report as shown in the illustrative reports. Lengthy audit reports are not transparent, may not be understood, and may not even be completely read.

Issue 4—Required Emphasis-of-Matter Paragraphs

Paragraph 116 of the proposed SAS requires the auditor to include an emphasis-of-matter paragraph in the auditor's report when certain situations exist and are disclosed in the notes to the financial statements under U.S. generally accepted accounting principles. The required emphasis-of-matter paragraphs are intended to highlight certain situations that, when they occur, are considered fundamental to the users' understanding of the financial statements.

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.

The proposed change requires an emphasis-of-a-matter paragraph for the three identified situations, yet each of the three situations should involve auditor judgment to determine the significance of the effect to net assets. We also believe that there are additional situations the auditor should consider and our recommendation is that the verbiage be changed to the following:

"The auditor should consider including an emphasis-of-matter paragraph, under an appropriate heading in the auditor's report on ERISA plan financial statements, when there are plan amendments, minimum funding waivers were granted by the IRS, plan mergers, plan spin-offs, plan terminations including partial plan terminations, the plan is underfunded, a significant withdrawal of plan participants, significant prohibited transactions or any other issue having a significant effect on net assets and/or benefit obligations."

Issue 5—Reporting Internal Control Deficiencies

As noted in the Background discussion, the ASB concluded that the proposed SAS should not include a requirement to disclose, in a separate section of the auditor's report, a description of significant deficiencies or material weaknesses in internal control identified as part of the audit engagement and that it is sufficient for the auditor to communicate those matters to those charged with governance as required by AU-C section 265.

Respondents are asked to provide feedback on whether

- The current reporting of internal control deficiencies to those charged with governance is sufficient; and/or

We agree that the current requirements of AU-C section 265 are considered sufficient to communicate internal control deficiencies to those charged with governance.

- There are other reporting considerations the ASB should evaluate.

There are no other reporting considerations the ASB should evaluate.

Issue 6—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 require 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 noted in the Background discussion, the auditor would be required to perform audit procedures with respect to the specified plan provision 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 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, the proposed requirements for a new reporting element will not enhance the consistency and quality of audit work performed. While the objective of the proposed requirements is to improve the value and relevance of the audit report, our concern is that the changes would instead significantly increase audit fees without accomplishing the intended objective.

In developing the exposure draft, the Board took into consideration concerns raised by the Chief Accountant of the Department of Labor (DOL). We would like to reiterate that the DOL does not have the authority to establish the financial reporting framework for preparing employee benefit plan financial statements, nor does it set professional standards for auditing those financial statements.

The purpose of a financial statement audit is for the auditor to provide an opinion on the financial statements. ERISA requires an independent audit for assurance on the financial statements of a plan. ERISA does not require a compliance audit.

In May 2015, the DOL issued a report assessing the quality of 400 audits performed by 232 CPA firms, and reported that 39% of these audits had deficiencies. It is worth noting that 285 (71%) of the audits the DOL reviewed were performed by firms who do less than 25 employee benefit plan audits. The number of deficiencies in audits performed by firms who do not regularly perform this work is much higher than it would be for firms that specialize in employee benefit plan audits. While the DOL may have raised some legitimate concerns, their sample included a disproportionate number of firms who only perform a few employee benefit plan audits, which yielded a higher-than-normal deficiency rate.

With respect to the proposed required procedures in paragraphs 15–16 we foresee the following issues:

- 1. If some auditors are not adhering to the current set of standards, why would adding more requirements and a new reporting element change this? On the contrary, the proposed requirements may add confusion to the auditor's role and the purpose of the audit reports.*
- 2. The purpose of a financial statement audit is for the auditor to provide an opinion on the financial statements. As a part of the audit, auditors should already be performing testing of relevant plan provisions in order to support their opinion on the financial statements. However, the proposed changes would require an auditor to perform substantive procedures for specific plan provisions irrespective of the risks of material misstatement. The proposed SAS would*

add time to the audits without yielding additional audit evidence to support an opinion on the financial statements.

3. *Requiring the independent auditor to test specific plan provisions irrespective of the risks of material misstatement removes the auditor's ability to exercise professional judgement. Auditors employ concepts of materiality, and are required by GAAS to perform a risk-based audit. The proposed changes would diminish these concepts in employee benefit plan audits.*
4. *The proposed requirements would essentially shift part of the burden of compliance review from the DOL to the independent auditor.*

- 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?

No, the proposed SAS provides very little guidance on how these requirements would be achieved. Furthermore, the proposed guidance would require the auditor to perform testing of specific plan provisions irrespective of the risks of material misstatement, which does not contribute to the objective of providing an opinion on the financial statements.

- 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?

None, as we do not believe the proposed requirements add value to an auditor's opinion on the financial statements. Auditors should be permitted to exercise professional judgement and apply the concept of materiality when conducting employee benefit plan audits.

- d. 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).

No, including the list of individual areas required to be tested is not appropriate because it removes the auditor's ability to exercise professional judgement. It also requires auditors to perform testing in areas that may not be material to the financial statements.

- e. 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?

The term “clearly inconsequential” is subjective and may be misinterpreted or misunderstood. Furthermore, this term is used without regard to materiality; therefore, reported items may have little or no impact on the financial statements.

- f. 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.]

It would be inappropriate for the auditor to be required to report on matters identified by management or the plan administrator, unless they had a material effect on the financial statements.

- 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).

Requiring the independent auditor to report on specific plan provisions relating to the financial statements is outside the scope and intent of a financial statement audit. We believe that including the list of individual areas tested in a report, as proposed in paragraphs 119–124, is not appropriate for the following reasons:

1. *Substantive testing of specific plan provisions would be required irrespective of the risks of material misstatement; items that have little or no impact on the financial statements may be reported.*
2. *The information provided in the new reporting element could be misinterpreted by plan participants, contributing employers or others.*
3. *Because the information would be available to the public, there could be unintended consequences.*
4. *Employee benefit plans would bear the burden of additional audit costs as a result of this proposed new reporting element.*

- 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?

The term “clearly inconsequential” is subjective and may be misinterpreted or misunderstood. Furthermore, this term is used without regard to materiality; therefore, reported items may have little or no impact on the financial statements. One could also pose the question, clearly inconsequential to whom?

- 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.]

It would be inappropriate for the auditor to be required to report on matters identified by management or the plan administrator, unless they had a material effect on the financial statements.

- 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?

The reporting illustrations are clear; however, as noted above, we do not agree with the proposed requirements to add a new reporting element.

- 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?

Yes, we agree that there would be unintended consequences as a result of including findings in the auditor’s report. Small discrepancies that are immaterial to the financial statements would be made public and could be exaggerated and cause undue concern for plan participants, administrators and other users of the financial statements. Based on the reported findings, unwarranted legal action may be brought against employee benefit plans, which would further increase costs incurred by the plans.

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

The proposed changes will not enhance audit quality. If some firms are not adhering to the current set of standards, adding a new reporting element will not change this. What the proposed changes will do is shift the burden of reviewing the plan’s compliance matters from the DOL to independent auditors and shift the cost from the government to the plans themselves. The conclusion of this letter details our suggested alternatives.

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?

It goes without saying that the additional procedures will result in additional costs. The Board is proposing that procedures be performed “Irrespective of the Risk of Material Misstatement” and that findings (even if immaterial) be added to the audit report. This increases time spent on each audit that we do not believe yields any improvement to the quality of the audit. Furthermore, the concept is a reversal of the “risk-based auditing concept” that is the foundation of audit theory.

Issue 7—Required Procedures Relating to the Form 5500

The DOL’s audit quality study identified that the auditors are inconsistent in the procedures performed regarding 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 auditor’s report on the financial statements that accompany the Form 5500 filing. The proposed procedures are based on AU-C section 720, Other Information (AICPA, Professional Standards), however the Form 5500 is not deemed to be an annual report as defined in AU-C section 720.

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?

While we agree that the proposed procedures would improve consistency with respect to information in the Form 5500 and the audited financial statements, it really does not provide guidance for which items should be considered in the financial statements reconciliation note. The guidance in paragraphs A67 and A68 should be changed to include the following: “The auditor should compare the financial statements to the Form 5500. Any material inconsistencies of net assets or changes in net assets, and benefit obligations or changes in benefit obligations, should be presented to the plan sponsor to request changes to the Form 5500 or be included as a reconciliation footnote to the financial statements.”

Also, the proposed procedures in paragraphs 36–48 are currently explained and required in the AICPA’s Audit and Accounting Guide, Employee Benefit Plans (as per the guidance in AU-C Section 720-Other Information in Documents Containing Audited Financial Statements)

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

The proposed SAS would create a separate, stand-alone reporting section (intended as AU-C section 703) within the Audit Conclusions and Reporting section of the AU-Cs that would include new requirements for reporting on ERISA plan financial statements including a new opinion when an ERISA-permitted audit scope limitation is imposed by management. As such, this proposed SAS, if issued as a final SAS, would apply in place of AU-C section 700, Forming an Opinion and Reporting on Financial Statements (AICPA, Professional Standards) and therefore repeats much of the requirements and guidance currently in AU-C section 700. In addition, appendix A and B to the proposed SAS include amendments to various other AU-C sections in AICPA Professional Standards to properly scope the proposed SAS including amendments to reference both AU-C section 700 and AU-C section 703 in other areas of GAAS as appropriate.

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;

We believe that the proposed wording changes to the management and auditors responsibilities section of the opinion will add little if any value or audit quality improvement. The current report content and format work well.

- b. The proposed amendments to the other AU-C sections are appropriate; and

The proposed amendments to other AU-C sections appear appropriate.

- c. Whether there are other sections of AICPA Professional Standards that might need to reflect the provisions of this proposed SAS.

There may be other sections of our Professional Standards that could require changes; however, we think it's premature to identify more areas when we are hopeful that this exposure draft will change after comments are considered.

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.

The proposed effective date of audits for periods ending on or after December 15, 2018, is too early. If any of the proposed changes go into effect, it will take a lot of preparation and planning for auditors, other professionals, and the plans themselves to implement the new requirements. Our suggestion is to delay the proposed effective date by at least one year.

Conclusion

The Lindquist LLP partners are constantly engaged in assessing whether our work meets the highest expectations of our clients and others who would rely on our report. We commit to continually adhering to the standards of our profession and the requirements of government regulators. While we welcome opportunities to improve the quality of employee benefit plan audits, we do not believe that this proposed SAS will improve audit quality and transparency.

We do believe that there are other alternative actions that are more likely, in our opinion, to strengthen and improve audit quality. Our recommendations are as follows:

1. Peer review requirements for employee benefit plan auditors should be strengthened. The current requirement to include one employee benefit plan audit in the review sample should be re-evaluated (increased). In addition, experience/CPE requirements should be developed for the Peer Review team member(s) who is/are responsible for the review of benefit plan audits.
2. Membership in the AICPA Employee Benefit Plan (EBP) Audit Quality Center should be a requirement to audit employee benefit plans.
3. The current 8-hour continuing education requirement of the AICPA EBP Audit Quality Center is inadequate. The employee benefit plan audit and reporting issues are far more complex, in most cases, to rely on an 8-hour course to provide the necessary knowledge. We believe that the base education requirement should be 24 hours. The 24 hours should include at least 4 hours of Employee Benefit Plan tax-related training and at least 4 hours of specialized training if you are part of an audit team that audits more complex employee benefit plans (e.g., multiemployer, ESOP, etc.). Additionally, mandatory training should be incorporated specifically for "limited-scope audits."
4. Membership requirements of AICPA EBP Audit Quality Center should be re-evaluated. They appear to be relatively easy to comply with, which may explain why so many firms that do 1 or 2 plan audits ("dabblers") are in the Center. The goal is not to create an "exclusive club"; rather, we believe that these employee benefit plans are a specialized area that requires specialized knowledge and the membership requirements of the Center should reflect/encourage that concept.
5. Even without the recommendation in 4 above, the current membership requirements of the Quality Center should have an increased verification process, more than the current requirement of a "Designated Partner" completing a form and submitting it to the Center.

We are all aware that the DOL has and will continue to push Congress to eliminate the "limited-scope audit." While we agree that eliminating the "limited-scope exception" should produce a higher quality product, the DOL's recent report made it clear that "limited scope" was not the only issue with audit quality. The partners of Lindquist LLP believe that our recommendations discussed above will make a far greater impact on the quality of employee benefit plan audits, and we respectfully recommend withdrawing the exposure draft and redeliberating the concept.

Lindquist LLP appreciates the Board's consideration of these comments and recommendations. Please feel free to contact Barry T. Omahen, Managing Partner (925)-498-1546, if you have any questions or wish to discuss any of the comments we have provided.



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