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Via E-mail: Sherry.hazel@aicpa-cima.com

Michael J. Santay, Chair, Auditing Standards Board
American Institute of Certified Public Accountants
1211 Avenue of the Americas
New York, NY 10036

Re: Proposed Statement on Auditing Standards (SAS), AU-C Section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*

Dear Mr. Santay:

BDO USA, LLP appreciates the opportunity to respond to the request for comments on the Auditing Standards Board's (ASB) proposed Statement on Auditing Standards (SAS), *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans (EBP) Subject to ERISA* (Exposure Draft). We support the ASB's efforts to enhance the reporting model for audits of ERISA plans to improve the quality of EBP audits; specifically, we support increasing the transparency in reporting, and describing the responsibilities of plan management and the auditor. However, we have significant, fundamental concerns with an approach that reports findings from certain audit procedures performed in the auditor's report that is attached to the plan's Form 5500 filing, which is publicly available. We also object to issuing a "clean" opinion when plan management imposes a limitation on the scope of the audit as permitted by ERISA.

In this letter, we have provided suggestions for areas of improvement and refinement of certain concepts presented in the proposal that we believe will enhance the ASB's desired goals for this project. In particular, we request that the ASB consider bifurcating this proposal into two separate projects: one project focused on enhancing the reporting models for audits of ERISA plans (with implementation in the near future) and a second project related to the specific auditing procedures performed and reporting on specific provisions relating to the plan instruments (with implementation delayed until certain concepts presented in the Exposure Draft have been further refined).

We believe immediate attention to enhancing the reporting models for audits of ERISA plans will ultimately prove beneficial to the overall quality of EBP audits. We support the ASB's efforts to communicate the auditor's responsibilities when performing an ERISA-permitted limited scope audit and to provide a more descriptive explanation in the auditor's report of the audit procedures performed in a limited scope audit. We also concur with the proposed requirements to obtain management representation for the limited scope certification and related investment information. We view splitting the proposed SAS into two projects as a crucial factor, since doing so will provide the additional time necessary to refine the new required procedures and reporting with the input of the profession.

In Issue 6 below, we discuss areas of improvement and enhancement of concepts regarding the specific procedures to be performed and the reporting of findings thereon discussed in the Exposure Draft. In our view, additional dialogue and consideration prior to implementation are

needed since the current proposed procedures and reporting of findings would hinder audit quality and increase both liability and cost. We do not believe the proposed procedures are comprehensive, nor do they address all applicable provisions. Perhaps most importantly, they do not take into consideration the auditor's risk assessment, which is a fundamental component to the assurance process. The higher level of perceived assurance resulting from performance of the proposed procedures and the reporting of findings based on the results of those procedures in the auditor's report may result in unintended consequences such as an increase in fiduciary liability to the plan sponsor and professional liability to the auditor.

While we recognize that the economic impact of the proposed standard is outside of the purview of the ASB, we wish to point out there are likely increased costs associated with the implementation, which may have unintended consequences. Typically, EBP audits are already very price sensitive and we do not think these additional costs are going to be any more favorably received (or absorbed) by plan and plan sponsors than current audit costs. If permitted by the plan provisions, plan sponsors may direct their plans to absorb the costs, which is ultimately borne by plan participants as a plan expense that decreases the participant's retirement benefits. Fee pressure is also an issue for those charged with plan governance. A number of sponsors already seek the "low cost" audit provider for these audits (to the detriment, in some cases, of the quality of the audit); unfortunately we envision this proposed standard as continuing to drive this behavior.

As requested by the ASB, we have addressed the following issues from the Exposure Draft for consideration:

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

We concur that the inclusion of procedures and guidance when an ERISA-permitted scope limitation is imposed will help achieve the desired objectives. We believe they are crucial to improve the execution and consistency of audit procedures to address concerns identified by the Department of Labor's (DOL) Audit Quality Study.

However, we suggest that certain procedures in paragraph 20 be made more descriptive to avoid vague terminology and inconsistencies in practice. For example, in paragraph 20(b), the procedure states the auditor is to "evaluate," which may be misunderstood and result in inconsistent application. In this particular instance, we propose using more specific terminology, such as "inquire" or "inspect."

In addition, we are concerned that the requirement in paragraph 20(d) to evaluate the form and content of disclosures mandates a higher level of responsibility for EBP auditors than auditors in other assurance engagements¹. Our preference is that this requirement be removed; however, if the ASB decides to retain this requirement, we ask that "evaluate" be replaced with wording more consistent with the wording found in paragraph A48 (which reads "obtain an understanding," "inquire of management," "consider the appropriateness"). Such clarification would facilitate more consistent auditor application.

¹ We understand the ASB has a project focused on disclosures and we suggest aligning any requirements relating to disclosures with the results of that project.

Please note that our comments noted here would also need to be considered in conjunction with the auditor's report wording discussed in paragraph 102.

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

Overall, we agree that the proposed form and content of the auditor's report provides greater transparency and clarity to users of the financial statements with respect to reporting when an ERISA-permitted audit scope limitation exists, with the exception of the wording in the auditor's opinion paragraph, as described in our comments in the next paragraph. We appreciate the clarity provided throughout the proposed report on the limitation on the scope of the audit as permitted by ERISA and the addition of further detail regarding management and auditor responsibilities.

While we concur with the specific management responsibility in paragraph 96(d) of maintaining sufficient records, we are concerned that this wording could cause unintended issues during the audit due to the subjective nature of what is considered "sufficient records." In addition, the auditor's responsibilities in paragraph 102(b) and 102(d) that refer to evaluating management's assessment and the form and content of disclosures are vague, as previously noted in our response to Issue 1 above. Additionally, we believe users of the financial statements may misinterpret the term "evaluate" to indicate that the auditor is providing a higher level of assurance than is actually provided. Avoiding vague or undefined terminology, wherever possible, would allow for consistent interpretation and provide greater clarity to users of the financial statements about the level of assurance expressed.

The proposed auditor's opinion wording for an ERISA-permitted audit scope limitation described in paragraph 106 may be misleading to users of the financial statements. The opinion wording appears to indicate that the auditor is giving an opinion that "the financial statements present fairly, in all material respects." We believe such wording is not suitable, given the materiality of plan investments for which the ERISA permitted scope limitation applies, and instead consider the current disclaimer of opinion to be appropriate.

Also, we note that the example wording in paragraph 106 and in the example auditor's report (Illustration 3) states that the auditor "was instructed not to audit..." However, as neither the proposed standard nor the example auditor's report states that the investment information was not audited, we request the ASB consider adding language to clearly state that the investment information was not audited (in addition to the language that indicates the auditor was instructed to not audit such information).

If the ASB does continue to allow the ERISA permitted-audit scope limitation opinion, we ask that the ASB consider the applicability of guidance currently in paragraph 118 that refers to the form and content of the supplementary information.

As mentioned throughout this letter, we do not support the reporting of findings (described in paragraphs 110-112) on specific plan provisions relating to the financial statements and

recommend that such reporting should be communicated directly with plan management and those charged with governance. Refer to our response in Issue 6 below for further details.

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

We agree that the guidance in paragraphs 31 and 34 is clear as to the auditor’s responsibilities for modifying the opinion in the auditor’s report when there are other limitations on the scope of the audit (e.g., those beyond an ERISA-permitted audit scope limitation imposed by management) or when there is a material misstatement of the plan financial statements. The guidance in paragraph 34 that precludes certain aspects of the report when these other scope limitations or a material misstatement exist achieves the objective of providing transparent reporting.

Issue 4—Required Emphasis-of-Matter Paragraphs

In our opinion, the existing auditing standards provide sufficient guidance for Emphasis-of-Matter paragraphs and there is no need for an Emphasis-of-Matter paragraph further identifying specific situations (such as significant plan amendments, minimum funding waivers granted by the IRS, and significant changes in the nature of the plan), as indicated by paragraph 116. Such a requirement for the situations identified in paragraph 116 would require a greater level of reporting for EBPs than would be required for other entities and does not appear to be warranted since this information is generally disclosed in the footnotes to the financial statements.

If the ASB decides to prescribe such situations, we recommend that paragraphs 116(a) and 116(c) define or provide guidance as to the terms “significant plan amendments” and “significant changes,” respectively. For plans that are subject to filing Form 11-K, clarification would be appreciated as to how auditors should address the divergence between a report prepared in accordance with the PCAOB standards and with the proposed standard. For example, the PCAOB does not require specific Emphasis-of-Matter paragraphs.

Issue 5—Reporting Internal Control Deficiencies

We agree that the current reporting, as required by AU-C section 265, *Communicating Internal Control Related Matters Identified in an Audit*, is sufficient for the auditor to communicate internal control deficiencies to those charged with governance.

Issue 6—Certain Requirements for Audits of ERISA Plan Financial Statements and Related Required Report on Specific Plan Provisions Relating to the Financial Statements

We concur that clarifying the proposed procedures would improve the audit consistency and quality. However, we suggest the proposed standard focus on required objectives and principles inherent in a quality EBP engagement rather than attempting to specify procedures that are already comprehensively addressed in the existing guidance available to EBP auditors, such as the AICPA’s extensive Audit and Accounting Guide for Employee Benefit Plans Audits (AICPA Guide). Instead of stipulating required procedures, the proposed standard could instead direct the auditor to the available guidance for the procedures. We believe it may be simpler to utilize the Guide, since it is updated on an annual basis and kept aligned with current industry practice, rather than having to revise authoritative guidance.

Paragraph 15 states that certain substantive procedures should be completed “irrespective of the risks of material misstatement.” This wording adds an additional compliance audit requirement that is inconsistent with the financial statement audit objective, which is based on the auditor’s risk assessment. By including such specific procedures, the proposed standard removes auditor judgment and does not allow sufficient flexibility for the auditor to develop appropriate audit procedures based on their understanding of the nature and risk of the plan. We understand that such specificity as to the procedures may be desirable from the ASB’s view as setting a potentially better minimum level of audit quality, but a potential consequence may be that auditors are less likely to challenge the audit procedures performed and to design higher-level procedures targeting the specific risks identified for the plan. This lessened focus on auditor risk assessment may actually promote what is often referred to in the auditing profession as the “checklist mentality.”

While we do not support inclusion of specific procedures in the proposed standard, if such procedural guidance is retained, we have the following suggestions and comments:

- The current list of procedures in the Exposure Draft is not comprehensive as it does not make reference to all financial statement areas nor all plan types. For example, the proposed standard makes no reference to notes receivable from participants and focuses primarily on defined contribution plans while ignoring other plan types.
- While the Exposure Draft prescribes certain procedures, it does not define the expected amount of testing that would be considered acceptable. For instance, while we appreciate that the proposed standard refers to the auditor’s professional judgment, further clarification of the term “some relevant testing” in paragraph A16 is needed to ensure audit quality and consistency in practice.
- Paragraph 15 states substantive procedures should be performed. However, paragraphs 15(a) and 15(c) state the procedures are to be “administered in accordance,” which could be interpreted that these are compliance procedures. More appropriate wording for these procedures may be to state that the provisions are “in accordance with the plan instrument,” which is consistent with substantive audit procedures.
- In the middle of the discussion of plan provision procedures to be performed, paragraph 15(e) switches to a discussion of prohibited transactions identified by management. As such transactions are not relevant to nor encompassed by plan provisions, paragraph 15(e) would be incorporated more appropriately in paragraph 16.
- We request clarification in paragraph 15(h) for how the auditor should address forfeiture treatment by service providers that does not align with IRS Rev Ruling 84-16 and Treasury Regulations 1.401-7(a), as cited in paragraph A29. One of the challenges of the proposed standard is stipulating auditor procedures where there is continuing diversity in practice and/or evolving thought leadership from the regulators. It is for precisely this reason that

we request that the proposed standard be bifurcated, as noted in our initial comments, to permit the necessary discussions and clarifications and why we have noted that the AICPA Guide may be a preferable source for guidance relative to the procedures, as its annual updates can take into account the necessary changes.

- In paragraph 15(i), we request clarification as to how the auditor should address situations where the nondiscrimination testing has not yet been performed.

We support the ASB's goal of improving audit quality, but do not recognize how reporting on findings resulting from performance of specific procedures will, in and of itself, raise the quality. Audit quality, we believe, is incorporated into the audit process as the audit procedures are properly planned, designed and executed. Our conclusion, as noted throughout this letter, is that the reporting in paragraphs 119-124 would impede audit quality and, as such, we favor the removal of the reporting requirements from the proposed SAS.

We understand and support the regulatory expectation that plan sponsors have the responsibility to address and correct plan errors at the participant level without regard to materiality, but do not think it is beneficial or appropriate to report such findings in the auditor's report or in a separate report. In our opinion, EBP audits should adhere to the same guidance as other assurance engagements, as found in AU-C section 260, *The Auditor's Communication With Those Charged With Governance*, and as such communicate findings with plan management and those charged with plan governance.

Furthermore, we are concerned that the reporting of findings within the auditor's report may result in a chilling of open communication between auditors and with plan sponsors and those charged with plan governance and as a result negatively impact audit quality. Occasionally, we find sponsors are hesitant to use regulatory correction programs, due to unwarranted concerns that those plans may be more likely to be selected for DOL or IRS audits/examinations. Sponsors likewise may be concerned that having plan findings included in public documents through inclusion in the Form 5500 filings available on the EFAST2 website will subject their plans to greater likelihood of regulatory audit, examination and/or litigation. We consider these disincentives for transparency as hindrances to enhanced audit quality.

We also anticipate that plan sponsors may be influenced to select those auditors, who are more inclined to deem such findings as "clearly inconsequential" (as defined in the proposed SAS) and therefore find that reporting of those items is unnecessary. If sponsors are motivated to identify auditors willing to avoid reporting findings, this may benefit less qualified audit firms, which would be contrary to the desired objective of increasing audit quality.

Reporting of the findings may also result in increased time being incurred on the audit since such matters will need to be vetted by both auditors and plan sponsors prior to the report issuance and, in some instances, plan sponsors may also require ERISA legal counsel to review the findings. This may delay the timely filing of the Form 5500. Additionally, the costs associated with this new reporting requirement may not result in the intended benefits to plan participants and users of the financial statements.

While we recognize that the auditor is not being asked in paragraph 122(b) to provide an opinion on the compliance with plan provisions, we are concerned that users of the financial statements may misinterpret the reporting on the plan provisions to be equivalent to the auditor rendering an opinion on “compliance with plan provisions.” Such misunderstanding could potentially lead to an increase in legal liability for the plan or the inability of the plan to obtain the necessary insurance.

Should the ASB retain the report findings requirement, we ask that only those findings that have not been corrected by the plan sponsor as of the report issuance date be reported. The reporting should exclude findings that had been previously identified and corrected (either through self-correction or through a formal regulatory correction program) by the plan sponsor. In addition, we request refinement of the following concepts:

- For plans subject to filing Form 11-K, please clarify how to address the divergence between a report prepared in accordance with the PCAOB standards and the report required under the proposed standard. For example, the PCAOB does not require the reporting of findings.
- In paragraph 18, clarification of the term “clearly inconsequential” would improve consistency of application in practice.
- The wording in the auditor’s opinion under the *Reporting on Specific Plan Provisions Relating to the Financial Statements* section would be improved, in our opinion, by adding an indication that “the audit was not designed to identify all instances when the plan and plan transactions are not in accordance with those specific plan provisions.”
- Paragraph A139 provides an option to let management insert a response to the auditor’s report on findings. Even if the auditor may add a paragraph to the report disclaiming an opinion on such a response, this permits plan management the opportunity to make written assertions regarding findings that may not have been fully researched at the time of the report issuance. We disagree with this approach for two primary reasons: first, this permits management to comment when not permitted to do so in any other audit reporting situation and secondly, it adds an unnecessary layer of complexity to the reporting process that would not, in our opinion, benefit the users of the plan financial statements. If the Board is committed to providing this forum for plan management, we request that the ASB consider how to address situations where management makes claims with which the auditor does not necessarily agree.
- In paragraph 122(b), please provide clarification as to how the auditor’s procedures regarding the plan provisions do not provide an opinion or assurance on the compliance with the plan provisions. We request that the ASB incorporate stronger language regarding the limited nature of the auditor’s work (such as, “due to the nature of the prescribed testing, the auditor’s procedures do not provide assurance regarding the overall

compliance with the plan provisions nor does it provide assurance regarding the correctness of the individual participant accounts”).

- While we believe that inclusion of management commentary in the auditor’s report is inappropriate, should this be allowed, we then request removal of the option from paragraph A140 permitting plan management to include a response that “management believes the cost of correcting the finding would exceed the benefits to be derived from doing so.” While we acknowledge that there are instances where plan sponsors may determine that such course of action is appropriate, management should not be allowed to assert this in situations where the issue may not have been fully vetted or where the auditor has concerns that the sponsor is taking perhaps an aggressive stance. Given that it would be problematic to put safeguards and restrictions on such assertions, we think it would be prudent to simply remove this as an option.
- In paragraph A143, additional guidance and clarification would be helpful as to what is meant by whether a matter is “relevant” to the plan.
- On page 124 of the Exposure Draft, for the wording that reads “During our audit, we did not have any findings relating to whether the plan and plan transactions are in accordance with specific plan provisions...”, we suggest that the ASB clarify that the auditor did not have any *significant* findings, if the auditor is indeed permitted to exclude insignificant findings.

Similar to what we noted in our initial comments, yes, we believe the additional required procedures and reporting of findings will likely result in increased and potentially significant costs without a clear and direct increase in audit quality. For example, based on the phrase in paragraph 15, “that irrespective of the risk of material misstatement” substantive procedures should be performed, we believe this would result in increased testing of immaterial items. Additionally, the proposed standard is likely to put increased cost pressure on EBP audits that already suffer from an inaccurate perception by sponsors that these are low risk, commodity engagements. For the majority of plans, we think it is unrealistic to expect that plans and plan sponsors will absorb these costs. Unfortunately, “quality” audit practitioners may decide to leave the marketplace if their firms cannot support and grow a profitable EBP practice.

Issue 7—Required Procedures Relating to the Form 5500

In our view, the procedures proposed in paragraphs 36-48 are consistent with those procedures outlined in the AICPA Guide and align with a goal of greater consistency for audit procedures. Given that these procedures are already specified for the auditor in this readily available guidance, this illustrates our earlier comments in Issue 6 above that the proposed SAS may achieve the objective more efficiently by referring the auditor to the AICPA Guide for the specific procedures.

If more specific guidance for the procedures is left in the proposed standard, we recommend that the wording in paragraphs 36-48 be revised to make reference to “the Form 5500, including all required schedules and attachments” to conform with the Form 5500 instructions. As currently written, these paragraphs only refer to the Form 5500, which may be misinterpreted to exclude the related schedules to the Form 5500.

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

As noted in our earlier comments, we concur with the ASB’s proposed approach of describing management and auditor’s responsibilities. The proposed standard, as currently written, incorporates more than just reporting guidance and therefore a different location in the AU-Cs other than the Audit Conclusions and Reporting section would be more appropriate. However, if the proposed SAS is changed to focus solely on the new reporting model for ERISA plan audits (with no procedural guidance included), we would agree with the suggested location within the Audit Conclusions and Reporting section.

Issue 9—Proposed Effective Date

We believe the proposed effective date should be extended. If the ASB does bifurcate this into two separate projects, as suggested in our initial comments, we suggest implementing the first project (focused on enhancing the reporting models for ERISA plan audits of financial statements) with an effective date for periods ending on or after December 15, 2019. Additional time would be required for the second project related to the specific procedures performed and reporting on specific provisions relating to the financial statements after refinement of the concepts presented in the Exposure Draft. At a minimum, an effective date for the second project should be no earlier than for financial statements for periods ending on or after December 15, 2020, to allow sufficient time for adoption.

If the ASB continues with the proposed standard as currently drafted, the proposed effective date (e.g., for periods ending on or after December 15, 2018) does not provide sufficient time to adopt for the following reasons:

- Due to the significance of the proposed changes in the specific procedures, reporting of findings from those specific procedures and the changes in the auditor’s report, audit firms will need to develop training programs and quality control processes to address these changes.
- Adequate time will be needed by plan management and those charged with plan governance to understand and address the implications of the changes to the expanded auditor’s report to ensure successful implementation.

For these reasons, we suggest an effective date no earlier than for periods ending on or after December 15, 2020.

Other Comments

In addition to our above comments addressing the issues identified by the ASB, we also wish to provide the following comments:

- We request the ASB consider the effects of the outcome of the DOL's proposal to improve and modernize the Form 5500 Annual Return/Reports, which was released in 2016.
- The proposed SAS would benefit from the inclusion of additional "plain English" discussion as to how the new reporting model does (or does not) change certain auditor procedures and how the extent of reliance on the auditor's report has not necessarily changed. We ask that the ASB address the extent and nature of the auditor's procedures in order to clarify to the user that only a small percentage of the entire participant account population has been tested. We believe these (and similar) edits to the proposed SAS will improve the usefulness and clarity of the new reporting model to the financial statement users.
- Paragraph 14 indicates "the auditor should obtain and review the most current plan instrument, including effective amendments..." There are some key distinctions regarding this guidance that may need additional clarification. For instance, the appropriate, properly executed plan instrument and related amendments in effect during the plan period under audit may not be necessarily the "most current." The "most current" plan instrument also may not necessarily comply with regulatory restatement requirements. Additionally, older versions of the plan instrument and amendments may continue to have relevance if they govern how certain portions of the plan participant population are treated (such as for vesting, etc.). As previously suggested, such clarification and guidance may be more efficiently available through utilization of the AICPA Guide.
- Paragraph 110 of the Exposure Draft indicates that no reference would be made in the auditor's opinion to findings in situations where the report was modified due to those findings. If the reporting of findings is retained, we suggest the proposed standard include such a reference in the auditor's opinion in order to more clearly identify to the user those findings that impact the report.

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In conclusion, while we have identified a number of key concerns, comments and suggestions that we believe would help to refine the proposed SAS, the ASB's efforts represent a crucial opportunity for the profession to enhance EBP audit quality. Our firm is committed to being a positive force for the necessary changes to ensure higher quality audits are achieved across the profession.



We appreciate your consideration of our comments and suggestions and would be pleased to discuss them with you at your convenience. Please direct questions to Beth Garner, Partner, National Employee Benefit Plan Practice Leader (bgarner@bdo.com) at (404) 979-7143 or Darlene Bayardo, Director, National Assurance (dbayardo@bdo.com) at (714) 913-2619.

Very truly yours,

BDO USA, LLP

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