Clark Nuber PS

September 25, 2017

Ms. Sherry Hazel (Sherry.Hazel@aicpa-cima.com)
AICPA Auditing Standards Board

Re: Comments on Proposed Statement on Auditing Standards AU-C 703

Ms. Hazel and Members of the Auditing Standards Board:

We are pleased to provide our comments on the above-referenced proposed Statement of Auditing Standards. Clark Nuber is a single-office regional CPA firm based in the Seattle Metro area. We have approximately 200 employees, and have been a member of the Audit Quality Center for Employee Benefit Plans since April 2004. Our firm currently audits approximately 200 employee benefit plans each year, utilizing a core EBP team of approximately 35 professionals that receive specialized training through both internal and external sources. Our EBP audit practice leadership is provided by an audit shareholder and audit principal that devote their entire practice efforts to audits of employee benefit plans.

Executive Summary

- We are in agreement that the severity and frequency of deficiencies noted in the EBSA's most recent report warrants a change in approach in regulating the audits and auditors of employee benefit plans. However, it is unclear as to what extent the proposed changes to the existing standard are the most effective means of enhancing audit quality or support the DOL's objectives in protecting participant retirement benefit assets.
- We agree that additional clarity on mandatory procedures, financial statement and supplementary information disclosure requirements, and auditor reporting obligations would reduce disparity among audit practitioners.
- We are concerned that the proposed statement has in part an overly prescriptive approach to audit procedures and mandatory disclosures. Rather than "raising the performance bar" through clarification of the expectation of mandatory procedures alone, we believe a more effective approach would include clarification of procedures and some enhancement of reporting requirements, a more stringent screen for firms to have the opportunity to perform EBP audits, and a more effective means of removing auditors that do not comply with the standards from this practice area.
- We are also concerned that certain elements in the "Report on Findings" section of the proposed standard (specifically paragraphs 119 - 124) will create additional reporting disparities and substantial increased costs with limited additional benefit.

We offer further comments on the proposed standard, using the requested format, below:

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

Item 1.1: Will the procedures and guidance achieve the objectives of enhancing execution and consistency in these engagements and if not, why; and

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Response: The procedures cited in paragraph 20 are consistent with the guidance outlined in the existing AICPA Employee Benefit Plan Audit and Accounting Guide and commercially available practice aid materials. Accordingly, we believe that the audit practices of qualified independent plan auditors who have been consistently following the Guide will not change significantly. By bringing the guidance into AU-C 703, it is likely that adherence to intended practices will be enhanced. However, the degree of audit quality enhancement is uncertain, as we believe the guidance in the proposed AU-C is already being adhered to by firms that have appropriate quality control procedures in place within their firm's assurance practice.

Item 1.2: Whether any procedures that should be required are missing, and if so, describe them.

Response: We did not notice any obvious omissions in audit procedures.

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

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

Item 2.1: Will 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;

Response: The enhanced disclosures outlined in paragraphs 94 (a) - (c) do provide more transparency on the nature of the limited scope certification, the statutory framework under which it is permissible, the qualifications of the issuer of the certification, and the limited procedures applied by the auditor with respect to certified information. We are also pleased with the additional clarity provided in the opinion paragraph itself - this is a significant improvement over the "disclaimer of opinion" paragraph under current standards.

Item 2.2: 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;

Response: The auditor's understanding of his or her responsibilities must be present prior to engagement acceptance, and are normally documented in the letter of engagement in the acceptance process. Therefore, in our opinion, inclusion of this language in the auditor's report itself is certainly not detrimental, but unlikely to significantly enhance audit quality.

Item 2.3: Will better describe management's responsibilities for the financial statements, and if not, why;

Response: Yes, the proposed report content will better describes management's responsibilities. We agree that is it extremely important to document management's understanding of their responsibilities as noted in paragraphs 96 (a) - (d); however, we see limited value in adding these statements to the audit report. These items are all acknowledged by management in the execution of appropriate engagement and representation letters, and we believe the users of the financial statements of employee benefit plans (management and regulators primarily) do not receive a greater benefit or clarity by inclusion in the auditor's report.

Item 2.4: Will provide sufficient clarity to users with respect to the auditor's responsibilities and matters reported, and if not, why.

Response: While it cannot be denied that the content of paragraphs 101-102 adds clarity to the auditor's responsibilities, in our view, the inclusion in the auditor's report is unnecessary and inconsistent with the current audit report content for non-EBP financial statements.

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

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

Item 3.1: 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.

Item 3.2: Whether 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.

Response: No additional comments upon or objections to the proposed language.

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.

Response: The guidance in paragraph 116 is helpful. There will undoubtedly be other examples of matters that warrant the inclusion of an Emphasis of Matter (EOM) paragraph, but the examples provided seem adequate to guide the auditor's decision making in this area.

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

Item 5.1: the current reporting of internal control deficiencies to those charged with governance is sufficient; and/or

Item 5.2: there are other reporting considerations the ASB should evaluate.

Response: We agree with the ASB's conclusion on this matter. The financial statements and auditor's report effectively become a public record by virtue of the DOL's archiving procedures for the Form 5500. Matters related to internal controls are intended for the use of those charged with governance and management and should not be a matter of public record.

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:

Item 6.1: 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?*

- *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?*

- *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?*

Item 6.2: 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?*
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?*
f. *There are alternatives to reporting the findings in the auditor's report that would achieve the objectives related to enhancing audit quality?*

Item 6.3: 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?

Response: We strongly disagree with the proposed requirement of reporting on specific plan provisions either as a component of the auditor's report on the financial statements, or as a separate report that is made reference to in an Emphasis of Matter paragraph in the auditor's report. Our objection to the requirement is based upon the following:

1. This appears to be a departure from auditor's reporting responsibilities for non-EBP financial statements. The audit reporting requirements for audits of governmental entities and certain recipients of federal, state or local grants do provide some precedence for this level of reporting, however, in those instances there is a direct financial and contractual link to reporting on internal controls and compliance with laws and regulations. While acknowledging the favored tax exempt status for employee benefit plans, we do not see a corollary linkage to government funds that would support this level of compliance reporting.

2. The enhanced audit performance and reporting obligation will have a significant incremental cost to plan sponsors or plan participants, either directly or indirectly. The incremental costs would likely be a minimum of $2,000 per engagement for a relatively small plan that may have fee range of $10,000 - $15,000 under the current standards (a 13-20% cost increase). Justifying the additional cost of audits for expanded regulations to clients would be difficult, and some sponsors may be tempted to mitigate cost increases by changing audit firms in search of lower fees. In the end, the engagement of firms that offer substantially lower fees could actually degrade the audit quality.

3. We believe there would be significant divergence in practice amongst audit firms on establishing a working definition of "clearly inconsequential" findings that do not meet the 'reportable' threshold, with a possible bias to not report matters due to cost and perception of DOL audit risk. Additional guidance on assessing findings as "clearly inconsequential" would be beneficial if this requirement goes forward.

4. The proposed SAS indicates that certain procedures would be required to be performed irrespective of the assessed risks of material misstatement. Circumvention of the plan auditor's assessment of the risk of material misstatement to the financial statements in matters of compliance with laws and regulations could substantially increase the cost of the audit with limited benefits to the plan participants. We would recommend an approach that clarifies "best practices" in compliance matters that might have a material direct or indirect effect on the financial statements through illustrative case studies and examples to alert auditors to situations where additional procedures may be warranted.

5. AU-C 260 already establishes a framework for reporting control deficiencies to those charged with governance. Findings stemming from control deficiencies (which often have implications for compliance to laws and regulations) are thus already subject to auditor consideration of further reporting.

The enhanced procedures and related reporting in this aspect of the proposed standard gives some indication of EBSA's desire to further support its own compliance enforcement initiatives. Such an objective is understandable purely from a resource constraint perspective. However, we would again pose the question as to whether a general approach that impacts every plan subject to audit is the best use of plan sponsor, independent auditor resources and in many cases, the assets of the plan. An alternative to this approach could be to modify the Form 5500, Schedule H, Part III to include a "Yes/No" response to questions that are key to compliance, such as: Did the plan's independent auditor issue a required communications letter reporting a control deficiency (ies) or other matters? All "Yes" responses could then be segregated/flagged by EBSA to determine if they should separately request a copy of said required communications letter to determine if further inquiry/investigation is warranted. This will likely limit the number of Form 5500 filings that must be screened and prevent the details of control deficiencies and other matters from public disclosure.

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?

Response: The procedures outlined in paragraphs 36-48 will be helpful in achieving consistency in practice and reporting results.

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-

Item 8.1: 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;

Item 8.2: the proposed amendments to the other AU-C sections are appropriate; and

Item 8.3: whether there are other sections of AICPA Professional Standards that might need to reflect the provisions of this proposed SAS.

Response: The proposed additional language in auditor's reports regarding management's and auditor's responsibilities is largely duplicative of understandings shared and documented in the communications between those charged with governance and management and the auditor in the engagement letter and representation letter. Therefore, it would seem that third party users of the EBP financial statements would be the primary beneficiaries of the expansion of the auditor's report (new reporting model). Based on our practice experience, the third party user group is very limited, consisting primarily of the IRS and EBSA-DOL. Adopting the proposed reporting model with the expectation of notable enhancement of the quality of EBP audits is unrealistic, other than perhaps the change in standards discouraging smaller firms with limited expertise and/or EBP audit clients concluding that the added costs of compliance does not justify the additional required investment in continuation in this practice area.

Issue 9—Proposed Effective Date

This proposed SAS is effective for audits of ERISA plan financial statements for periods ending on nor 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.

Response: Assuming a new SAS is adopted and published by June 30, 2018, we believe the proposed effective date is not sufficient to allow preparers, auditors and others the necessary time to understand and implement the new standard and relating conforming amendments. We recommend that the effective date is rolled back at least one year.

These comments were prepared by Clark Nuber Audit Shareholders Shawn Hansen and David James, both of whom have had substantial experience and training in the audits of employee benefit plans. Please contact Shawn Hansen at 425-451-7237 if you have any comments or questions regarding the matters discussed above.