No. 2017-16
20 April 2017

To the Point

AICPA — proposed guidance

Auditors would perform more tests and provide more information in reports on ERISA plans

The proposal could result in the auditor reporting findings that the plan sponsor has no obligation to report in the financial statements or Form 5500

What you need to know

- The AICPA proposed an auditing standard that would require the auditor to test certain plan provisions in all audits of Employee Retirement Income Security Act (ERISA) plans and report its findings in its auditor's report.
- The proposal would change the form of the auditor's report for audits in which management imposes the ERISA-permitted scope limitation. The report would state that management is responsible for determining whether the scope limitation is permissible based on its evaluation of whether the certified investment information is complete and accurate, among other things.
- Auditors of ERISA plans would also have to obtain more written representations from management than they do today.
- Comments are due by 21 August 2017. We encourage plan sponsors to review the proposal, discuss it with their auditors and ERISA counsel and consider providing comments.

Overview

The Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) proposed a Statement on Auditing Standards[1] for financial statement audits of employee benefit plans that are subject to ERISA in an effort to improve the quality of these audits and the relevance of the auditor's report.

Building a better working world

The ASB launched the project at the request of the chief accountant of the US Department of Labor (DOL), whose staff participated on the ASB task force that developed the proposal. The chief accountant asked the ASB to enhance auditor reporting to provide better insight to the public regarding the responsibilities of management and those of the auditor, including when management imposes a limitation on the scope of the audit, as permitted by the DOL's Rules and Regulations for Reporting and Disclosure under ERISA.

This publication focuses on how plan sponsors would be affected by the proposal, which would be effective for audits of financial statements for periods ending on or after 15 December 2018.

Key considerations

Specific plan provisions

The proposal would require the auditor to test certain plan provisions (e.g., whether eligibility provisions are administered in accordance with the plan instrument) in all ERISA plan audits and report its findings in its auditor's report. The ASB chose the provisions specified in the proposal based on information the DOL provided about its concerns about audit quality and other factors that could have a direct effect on the financial statements. Auditors would be required to test these provisions regardless of the risk of material misstatement.

Some auditors currently perform aspects of this testing, but they may not perform the extent of testing that would be required, and they don't report their findings in the auditor's report. For example, the auditor may test eligibility provisions for the employer matching contribution but not for an immaterial profit sharing contribution.

Under the proposal, the auditor would be required to include in the auditor's report any findings identified in the audit, unless the findings are "clearly inconsequential." Management would be allowed to write a response to the findings that could describe corrective actions taken by the plan, state that management intends to correct the findings or state that management believes the cost of correcting them would exceed the benefits. The auditor could include management's response in the auditor's report and add a paragraph to the report disclaiming an opinion on it.

How we see it

- While we support the ASB's objective of enhancing audit quality, this requirement could result in the auditor reporting information that the plan sponsor has no obligation to report in the financial statements or the annual Form 5500 the plan files with the DOL. Because the auditor's report is attached to the Form 5500, plan participants and regulators would have access to it. As a result, regulators could learn about plan errors before the plan administrator has a chance to correct them using the Internal Revenue Service's Employee Plans Compliance Resolution System.

- This requirement could result in more work for the auditor, the plan sponsor and the plan's ERISA counsel because auditors would likely identify more findings than they do today and the sponsor would likely want to review the descriptions of any findings included in the auditor's report.

- If this requirement is included in any final standard, plan sponsors may want to consider performing internal compliance reviews to prepare for their annual financial statement audits.

ERISA-permitted audit scope limitation

For audits in which management imposes the ERISA-permitted audit scope limitation, the auditor would be required to issue a new form of report that describes the responsibilities of management and the auditor, among other things.

The report would have to state that management is responsible for determining whether the audit scope limitation is permissible in the circumstances. To make this statement in the auditor's report, the auditor would have to obtain new written representations from management acknowledging management's responsibility for (1) determining whether the audit scope limitation is permissible, (2) evaluating whether the certification of investment information is prepared by a qualified institution, (3) evaluating whether the certified investment information is complete and accurate and (4) determining whether the certified investment information is appropriately measured, presented and disclosed.

The DOL already expects management to perform this evaluation when management imposes the ERISA-permitted audit scope limitation, but the DOL continues to identify inappropriate uses of the scope limitation. Requiring these responsibilities to be described in the auditor's report and requiring the auditor to obtain these representations from management are intended to improve management's awareness of their responsibilities.

The auditor would no longer disclaim an opinion when management imposes the ERISA-permitted audit scope limitation.

The auditor also would no longer disclaim an opinion in these types of audits (assuming no other scope limitations exist). Instead, the auditor would issue a special form of opinion stating that, based on the audit and on the use of the certification of the investment information that the auditor was instructed not to audit, the financial statements are fairly presented, in all material respects, in accordance with the applicable financial reporting framework.

The other-matter paragraph relating to supplementary information required by ERISA would describe the auditor's responsibilities and provide a special form of opinion on whether the supplemental schedules are fairly stated in all material respects in relation to the financial statements as a whole and whether they are presented in conformity with the DOL's Rules and Regulations for Reporting and Disclosure under ERISA.

The proposal attempts to address inconsistencies in today's audits by requiring auditors to perform certain procedures related to the certified investment information and describe these procedures in the auditor's report. For example, the auditor would be required to evaluate whether the form and content of the certified investment information presented and disclosed in the financial statements are in accordance with the applicable financial reporting framework.

How we see it

We believe the proposal would enhance audit quality by clarifying the responsibilities of management and auditors when management imposes the ERISA-permitted audit scope limitation.

Written representations

For all ERISA plan audits, the auditor would be required to obtain the following new written representations from management:

- A representation that management has provided the most current plan instrument, including plan amendments
- An acknowledgment of management's responsibility for administering the plan and determining that the plan's transactions that are presented and disclosed in the financial statements are in conformity with the plan's provisions

- A representation that management has maintained sufficient records with respect to each of the participants, in accordance with ERISA, to determine the benefits due or that may become due to participants

These representations would be described in the auditor's report as management's responsibilities for the financial statements. If management refuses to provide them, the auditor would need to take appropriate actions, including determining the possible effect on the opinion in the auditor's report.

Reporting internal control deficiencies

The ASB is also seeking comment on whether the current requirement that auditors report internal control deficiencies to those charged with governance is sufficient. At the request of the chief accountant of the DOL, the ASB considered requiring the auditor's report to include a description of significant deficiencies or material weaknesses in internal control identified during the audit but decided that wasn't necessary.

Endnotes:

[1] Proposed AU-C Section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA.*