

August 18, 2017

Ms. Sherry Hazel
AICPA
1211 Avenue of the Americas
New York, NY 10036

By e-mail: Sherry.Hazel@aicpa-cima.com

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

Dear Ms. Hazel:

The New York State Society of Certified Public Accountants (NYSSCPA), representing more than 26,000 CPAs in public practice, business, government and education, welcomes the opportunity to comment on the above-captioned exposure draft.

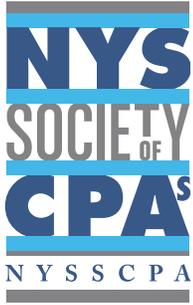
The NYSSCPA's Auditing Standards and Employee Benefits Committees deliberated the proposed accounting standards update and prepared the attached comments. If you would like additional discussion with us, please contact Michael J. Corkery, Chair of the Auditing Standards Committee, at (631) 845-5252, or Ernest J. Markezin, NYSSCPA staff, at (212) 719-8303.

Sincerely,

A handwritten signature in black ink that reads "Harold Deiters III". The signature is written over a faint, semi-transparent watermark of the NYSSCPA logo.

Harold L. Deiters III
President

Attachment



**NEW YORK STATE SOCIETY OF
CERTIFIED PUBLIC ACCOUNTANTS**

**COMMENTS ON
PROPOSED STATEMENT ON AUDITING STANDARDS (SAS)—*FORMING AN
OPINION AND REPORTING ON FINANCIAL STATEMENTS OF EMPLOYEE BENEFIT
PLANS SUBJECT TO ERISA***

August 18, 2017

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New York State Society of Certified Public Accountants

Comments on

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

General Comments

We welcome the opportunity to respond to the AICPA Auditing Standards Board's (ASB) Exposure Draft: Proposed Statement on Auditing Standards (SAS)—*Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA* (the ED).

We understand that the AICPA has endeavored to improve the quality of employee benefit plan (EBP) engagements over many years, through its quality center, training programs, publications and audit alerts, and the emphasis given in its peer review programs to audits of financial statements of EBPs subject to the Employee Retirement Income Security Act of 1974 (ERISA). We further understand that the U.S. Department of Labor (DOL), which oversees such audits, has not been satisfied with the quality of a significant percentage of the audits that it has reviewed. In our view, this ASB proposal represents an attempt to be responsive to the concerns of the DOL and to improve the quality of such audits in the eyes of the regulator by modifying the professional standards governing these types of engagements, but we believe the proposal will not accomplish that objective.

While we are generally supportive of the AICPA's and DOL's initiatives to improve the quality of EBP audits, we firmly believe the ED as proposed will likely not result in any meaningful improvement in EBP audit quality. Moreover, the proposal, if adopted substantially as written, will unnecessarily add time to EBP audits that are currently being performed in accordance with professional standards by the majority of EBP auditors without enhancing the quality of the audits. We further believe that many auditors will have difficulty passing on to their clients the additional costs likely to arise from the proposal. Consequently, we believe that it is likely that many auditors will reach the decision to resign as auditors from marginally profitable EBP audits, with such audits potentially being awarded to the group of auditors that the DOL believes are currently performing deficient audits. In essence, we believe that the ED will not result in "bad actors" becoming "better actors."

We do not support nor fully understand the reasoning that would create a separate array of auditing and reporting standards that seem to contradict fundamental auditing concepts and current standards. We believe the proposed form of reporting on limited scope audits would cause auditors to breach a basic ethical requirement by issuing an unqualified opinion when the most significant asset (investments) and related revenue and disclosures are unaudited. This view is based on ET Sec. 1.300.001.01(d), which requires a "...reasonable basis for conclusions...for any professional services performed." We would anticipate that the ASB has or will consider the apparent contravention.

We think that the structure of the ED, with the “Issues for Consideration” (the structured questions) identified and to which respondents are requested to provide views tends to eclipse some of the substantive issues inherent in the ED that are critical, and potentially discourages respondents from challenging the acceptability of the underlying premise used to frame the proposed standard. In our view, the most problematical parts of the ED are the proposed guidance on limited scope engagements and on reporting on specific plan provisions. Accordingly, we have separated the remainder of our comments into two sections: Principal Concerns followed by Responses to Issues for Consideration.

Principal Concerns

Limited Scope Audits – A primary subject area of the proposal is limited scope audits of EBPs, as are permitted under ERISA. An ERISA-permitted limited scope audit is one in which management instructs the auditor not to extend the audit to information related to assets held for investment of the plan (investment information) that is appropriately prepared and certified by a qualified bank or similar institution or insurance carrier.

Under extant standards (AU-C Secs. 705.10-.13), when the auditor is requested by the client not to audit material parts of an entity’s financial statements, that typically precludes the auditor from issuing an unqualified opinion and effectively requires a disclaimer of opinion, but only when the subject matter of the omissions are both material and pervasive. The standard appears to provide that in some circumstances, when a matter is judged not to be pervasive, auditors may issue a qualified opinion. However, because the definition of “pervasive” contained in the ASB Codification’s glossary indicates that if an item is material, it is impossible to conclude that a material item is not pervasive, thus precluding the viability of a qualified opinion as a reporting option as AU-C Secs. 705.10 -.13 appear to suggest.

Accordingly, a disclaimer of opinion has historically been seen as the only reporting option available under these circumstances. The DOL has expressed its dissatisfaction with these circumstances under a belief (that in our view is unfounded) that audit work has often been unacceptable because some auditors may believe the disclaimer language shelters them from responsibility to appropriately audit other areas of the financial statements that are not covered by the scope limitation. We further believe that the DOL’s conclusion, that if the reporting proposed in the standard were adopted, it would lead to better auditing, is fundamentally flawed because behavioral changes are not likely to result from changes in prescribed reporting language.

The ED proposes that the auditor issue an unmodified opinion on the financial statements of an EBP even when ERISA allows the auditor to scope out the investment and related accounts, provided that the audit report communicate that the unmodified opinion is based in significant part on (unaudited) information “certified” by the custodian (assuming no auditing or reporting issues other than the DOL-permitted scope restriction).

Although unaudited, under the proposal, the investments would be subjected to four management inquiry procedures (which would not allow the auditor to provide any degree of assurance on these accounts) and the auditor would need to determine that the custodian is duly “qualified” to

issue the certification (generally, a bank or insurance company that is subject to state or federal oversight). The ED would also require the auditor to evaluate whether the investments are measured, presented and disclosed in accordance with the applicable accounting framework based solely on unverified management inquiries. Because these procedures do not provide any degree of assurance, we view it as a disconnect to suggest that they afford any reasonable basis for an unmodified audit opinion.

The crux of the issue is that the investment accounts may be, and often are, over 90% of the assets and a substantial percentage of income when the investment return has been good. In our view, the unverified custodian's certification does not qualify as audit evidence, and we object to its characterization as such in paragraph A45 of the ED. The custodian does not independently confirm information that was previously recorded by the client; the custodian, in fact, generates that information. Therefore, the custodian's certification would not be reliable and would provide auditors with little or no reliable audit evidence to support an unmodified opinion. Moreover, we are not aware of any precedent in any other reporting literature for referencing a solitary piece of evidence such as a confirmation or the work of a specialist, no matter how significant, as partial support for an opinion.

We are also concerned that AU-C Sec. 320, Materiality in Planning and Performing an Audit, which provides that risk assessment and materiality for audit scope purposes be determined on the information that could reasonably be expected to influence the economic decisions of users made on the basis of the financial statements, cannot be extrapolated in these limited scope engagements. Since materiality is to be determined based on the needs and perceptions of financial statement users, we considered the question: Who are the users? A DOL-published study in 2010, *Advisory Council Report on Employee Benefit Plan Auditing and Financial Reporting Models*, states that auditors are engaged on behalf of all plan participants but that plan participants generally do not directly use EBP financial statements. If the participants are not the primary users, who are? Is the primary user then the regulator, the DOL? And if one is unable to judge materiality quantitatively, how can one determine, based on the assessed risk of material misstatement, the appropriate scope of audit procedures to be applied to information not covered by the custodian's certification (as would be required by paragraphs 20 and A43) or render an opinion as to the absence of a material misstatement?

If, on the other hand, we were to assume a hypothetical yet unidentifiable user to determine materiality quantitatively based on the financial statements, taken as a whole (*i.e.*, including the audited and unaudited information), the application of materiality to determine scope for the audited elements would result in performance materiality amounts that exceed 100% of the value of the population not carved out by the scope limitation. In essence, materiality concepts for scoping of work are not meaningful for these limited scope engagements because of the relatively small size of the items not scoped out. Depending on the size of populations being tested, we believe practice has evolved such that at times arbitrary, ostensibly "judgmental" sample sizes, such as 25 items, are often used to satisfy the DOL but with little or no theoretical justification or any basis to extrapolate results, and with no way to evaluate the precision of such tests. We believe this area should be considered by the ASB before a final standard is issued.

Unlike the proposed unmodified opinion to which we object, we believe some auditors would see a qualified opinion as an effective compromise and a viable alternative to a disclaimer that could satisfactorily address the concerns of the DOL, but for, in our view, the unfortunately overreaching definition of “pervasive” in the Codification’s glossary.¹ As now written, the glossary definition effectively eliminates the option of a qualified opinion by eliminating pervasiveness as a separate and distinct reporting consideration and forces a disclaimer whenever the subject matter is material.

In cases where a disclaimer has been historically illustrated and used for limited scope audits of EBPs, a qualified opinion might be more acceptable to the DOL than a disclaimer and viewed by many as more appropriate despite the materiality of the unaudited information because it is easily isolated and, therefore, not pervasive (given that the following change in definition is made).

To enable such auditor judgments, the definition of pervasive would have to be contracted so as to be consistent with the general English usage of the term by deleting the overreaching last two bullets therein, thus separating materiality and pervasiveness into independent considerations, which we believe they should be.

We also believe that AU-C Secs. 705.10-13 should be amended so that the possible alternative of a qualified opinion instead of a disclaimer of opinion is articulated more prominently and thereby less likely to be overlooked by EBP auditors.

Consequently, to overcome the DOL’s observations that the typical disclaimer issued historically is often the primary cause of performing insufficient work in other areas of the audit, we believe that the qualified opinion option might be (a) emphasized in the text of the final standard as generally preferable to a disclaimer for limited scope EBP audits and (b) shown in the appropriate illustrative report rather than replaced with an unmodified opinion, as proposed.

Lastly, we believe the final standard should clearly emphasize that when a disclaimer is deemed appropriate by the reporting auditor, it will not relieve the auditor from applying sufficient audit procedures in all areas of the audit not related to the subject matter of the disclaimer.

Reporting on Specific Plan Provisions – Paragraph 121 of the ED proposes a new requirement to report on specific plan provisions either in the report on the financial statements or in a separate report. The standard would require performance by EBP auditors of certain substantive procedures regardless of the risk of material misstatement (paragraphs 15-17 and A15). These procedures are not mandated by law or regulation but, nevertheless, are procedures that are being recommended by the ASB, perhaps as an accommodation to pressure from the DOL, which is not itself authorized under ERISA to mandate such procedures or the related reporting. We believe adopting this part of the proposed standard without a Congressional mandate would be a bad precedent.

¹ Pervasive effects on the financial statements are those that, in the auditor’s professional judgment:

- Are not confined to specific elements, accounts, or items of the financial statements;
- If so confined, represent or could represent a substantial proportion of the financial statements, or
- With regard to disclosures, are fundamental to users’ understanding of the financial statements.

Although the ED states that these procedures would have to be performed without regard to the assessed risk of material misstatement, we believe that the populations (including participants' accounts) to be subjected to these procedures will necessarily have a low likelihood of material misstatement that could affect the audited financial statements. Instances of noncompliance might result in fines or other penalties most likely being assessed against plan sponsors and administrators, thus, having no effect on the plan's financial statements. Accordingly, these procedures would have no relevance to a financial statement audit. Nevertheless, the ED asserts that this reporting would be part of an EBP audit.

These types of procedures, if required, would be more useful and acceptable to auditors in the context of agreed-upon procedures (AT-C Secs. 215 and 315), but do not fit that framework for two significant reasons: (1) the auditor would have to decide the scope of the procedures, rather than the users, and (2) distribution of the report would not be restricted to designated users. Further, we believe such a report would not be meaningful to the DOL or users since, under the ED, it would not disclose the scope of the procedures performed.

The purpose of the proposed procedures would be to test for instances of noncompliance with plan provisions and we believe the ED may likely be viewed as also implying that the procedures would be required without regard to the assessed risk of material noncompliance with plan provisions. The proposed report would only broadly describe the objectives but not the scope of the tests performed and findings (instances of noncompliance); no opinion on compliance would be rendered. Given the varying judgment of auditors in deciding how much to test and how to test, there will be inconsistency in the resulting reporting. Without a prescribed scope, these procedures would have only a remote likelihood of identifying material instances of noncompliance.

We question whether there is a significant cost/benefit relationship between the work involved in the proposed testing, and the findings, which the ED would limit by excluding matters that are determined (in the auditor's judgment, subject to discussions with the client) to be "inconsequential," an undefined judgmental term that does not appear in the auditing literature (see our response to Issue 6 in this letter).

We believe a more appropriate reporting framework than a separate or integrated report that would be available to the public, as proposed, would be reporting to the plan administrator about instances of noncompliance noted during the audit in an auditor communication, possibly in conjunction with other auditor's communications required under AU-C sec. 260. By doing so, we believe the event of non-compliance would be elevated to the appropriate level of "Those Charged with Governance" potentially resulting in faster remediation of the matter. Furthermore, we do not believe this communication should be included for public access with the Form 5500.

Auditor's Review of Form 5500 – Paragraphs 37 and A69 of the ED would allow an auditor to issue the audit report before obtaining and reviewing the unissued Form 5500. We believe that, except with regard to SEC registrations, it is both inappropriate and impractical to extend an auditor's responsibility to perform any procedures after the report date. Accordingly, the final standard should require the auditor to obtain and review the draft Form 5500 before issuing an audit report. This can be provided for in the letter of engagement.

Responses to Issues for Consideration

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

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

Response: We believe there are no procedures proposed in the ED that would enhance the execution and consistency of performance in these engagements such as to contribute in a meaningful way in support of an unmodified opinion as proposed.

The foregoing notwithstanding, we support:

- The proposed requirement of paragraph 20. c. to “evaluate management’s assessment of whether the entity issuing the certification is a qualified institution under DOL rules and regulations.” We view this procedure as reasonable and consistent with the objectives of the DOL and the auditor representations that would be made in any report without regard to the nature of the opinion to be issued, and
- A requirement that is missing from the proposal is for auditors to seek a SOC-1 report (preferably, type 2) without regard to the nature of the opinion to be issued. We likewise view this procedure as reasonable and consistent with the objectives of the DOL.

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 opinion;

- *provides improved transparency with respect to reporting on an audit of ERISA plan financial statements when an ERISA-permitted scope limitation exists, if not how could it be revised;*
- *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;*
- *better describes management’s responsibilities for the financial statements, and if not why.*
- *provides sufficient clarity to users with respect to the auditor’s responsibilities and matters reported, and if not, why;*

Response: Rather than provide transparency, we believe the proposed report form (particularly the unmodified opinion) has considerable potential to mislead users into ascribing undue value and reliability to the unverified custodian’s certification as a form of audit evidence, which as previously mentioned, we firmly believe it is not. Further, we believe the proposed reporting model would be confusing to readers and to auditors by suggesting that the auditor based an audit opinion in significant part on information that was not audited.

Therefore, we do not believe the proposed reporting language will improve the auditor's understanding of his or her responsibilities in a limited scope audit or result in potential improvements in audit quality. We believe only procedural guidance included in a future auditing standard or supporting audit guide, practice aids, and mandatory continuing professional education training, but not reporting language, would have any likely positive impact on an auditor's understanding of his or her responsibilities or the quality of his or her performance.

We have no issue with the current or proposed audit report language describing management's responsibilities for the 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 AU-C section 703 when the ERISA-permitted audit scope limitation is imposed by management including:

- *whether the guidance in paragraphs .31 and .34 of the proposed SAS (i) is clear with respect to the auditor's responsibilities for addressing the circumstances ...[when there is another limitation on the scope of the audit or there is a material misstatement of the financial statements], and (ii) 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.*

Response: For the reasons set forth in the General Comments section of this letter, we see no conceptual justification for carving out engagements with scope limitations that would be covered by a new EBP standard (AU-C 703) from also being governed by AU-C 705 without regard to the nature of the limitation. Any new AU-C 703 should be to supplement, as necessary, and not to replace AU-C 705.

The illustrative reports should be faithful to the standard as finalized and issued.

Issue 4—Required Emphasis-of-Matter Paragraphs.

Respondents are asked to consider whether the situations identified [in paragraph 116 of the ED] 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: We believe that the matters listed in paragraph 116 should be characterized as discretionary "examples of circumstances when the auditor may consider it necessary to include an emphasis-of-matter paragraph" for ERISA-governed EBPs similarly to those listed in AU-C 706.A2. However, we do not believe their inclusion should be mandated by the standard since they do not appear to rise to the level of significance of those listed in AU-C 706.A14 (Exhibit B).

Issue 5—Reporting Internal Control Deficiencies.

Respondents are asked to provide feedback on whether

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

Response: Subject to any effects of implementing our recommendation to obtain a SOC-1 report with respect to Issue 1, we are satisfied with the current reporting requirements relative to internal control deficiencies.

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

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

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

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

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? 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?

2. With respect to report 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?

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?

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: Our views about the proposed requirements for reporting on specific plan provisions are set forth in the General Comments section of this letter. Accordingly, we have not addressed in detail all of the specific questions presented in Issue 6.

Our most significant underlying assessment related to this Issue is that the proposed procedures would have little chance of identifying a material misstatement in the plan’s financial statements and, therefore, have little relevance to the objective of a financial statement audit, nor would they result in a positive effect on audit quality. They are more closely related to compliance auditing, which the DOL currently has no statutory authority to require plans to obtain or auditors to perform.

Additional reasons as to why we are not supportive of this part of the proposal include the following:

- Any findings that would be reportable under this proposal would be unrelated to common financial reporting objectives and not likely to be understood by users other than the regulator;
- If this part of the proposal is incorporated in a final standard, we believe requiring auditors to be responsible for determining what findings are “inconsequential” and, therefore, not reportable, without providing a functional definition or guidance is unsound and will lead to excessive reporting and unproductive time spent by auditors, clients and regulators; and
- The costs of such procedures would likely be substantial and necessarily be borne by the plans, thereby reducing plan assets available for benefits, or if absorbed by employers may likely drive economic consequences such as costs passed on to consumers without commensurate societal benefits.

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: As stated in the General Comments section, we see no justification for allowing an ERISA EBP auditor to issue an audit report without first examining a completed Form 5500 prior to its filing and, thus, extending an auditor’s responsibility to perform procedures after the report date. Accordingly, we believe it is essential that the final standard should require the auditor to obtain and review the draft Form 5500 before issuing an audit report, except for situations where the auditors appropriately qualify their report for the scope limitation resulting in their inability to perform such procedure.

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

Respondents are asked whether

- a. the proposed approach of creating a new reporting model for reporting on ERISA plan audits (AU-C section 703) will better describe management's and the auditor's responsibilities in these engagements;*
- b. the proposed amendments to the other AU-C sections are appropriate; and*
- c. whether there are other sections of AICPA Professional Standards that might need to reflect the provisions of this proposed SAS.*

Response: As we commented in our response to Issue 3, we believe any new AU-C 703 should be to supplement, as necessary, and not to replace AU-C 705 for ERISA EBPs. We do not believe there is any likelihood that the proposed approach will better describe management's and the auditor's responsibilities in these engagements.

Except for our recommendation to modify the ASB glossary definition of "pervasive," we believe it is inappropriate to comment further on parts b. and c. of Issue 8 until the proposal has further evolved in response to comments similar to those offered in this letter.

Issue 9—Proposed Effective Date.

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: Notwithstanding our aforementioned concerns about the proposed ED, if adopted as proposed in a relatively short time, we believe it would be extremely burdensome and unreasonable for practitioners to have to implement its proposed requirements effectively for periods ending as soon as on or after December 15, 2018.