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To the Point

AICPA — final standard

AICPA issues final standard that changes the requirements for ERISA plan audits and auditor's reports

The AICPA is trying to improve the quality of ERISA plan audits and increase the relevance of auditor's reports on these financial statements.

What you need to know

- The AICPA issued a new standard that requires auditors of employee benefit plans subject to ERISA to consider plan provisions that affect the risk of material misstatement when designing and performing audit procedures and to communicate "reportable findings" in writing to those charged with governance.
- Auditors in what are currently called ERISA-permitted limited scope audits are required to perform specific procedures, including evaluating management's assessment of whether the entity certifying the investment information is a qualified institution, and can no longer disclaim an opinion solely because of the certification.
- While many auditors already meet these requirements, the AICPA is trying to make ERISA audits more consistent. The AICPA is also trying to increase the relevance of auditor's reports by changing their form and content and requiring the auditor to more clearly articulate management's responsibilities and those of the auditor.
- The standard requires auditors to read a draft of a plan's Form 5500 (the annual return/report of an employee benefit plan that is filed with the Department of Labor) that is substantially complete before dating the auditor's report.
- The standard is effective for audits of financial statements for periods ending on or after 15 December 2021, and early implementation is permitted. This publication has been updated to reflect the AICPA's decision to delay the effective date by one year due to the COVID-19 pandemic and to allow early implementation.

Overview

The Auditing Standards Board (ASB) of the American Institute of Certified Public Accountants (AICPA) issued a new **Statement on Auditing Standards** (SAS)[1] for financial statement audits of employee benefit plans that are subject to the Employee Retirement Income Security Act (ERISA) in an effort to improve the quality of these audits by making them more consistent and increase the relevance of the auditor's report.

The SAS enhances auditor reporting to provide the public with better information about the responsibilities of management and those of the auditor, including when management elects what is currently referred to as an ERISA-permitted limited scope audit and the standard calls an ERISA section 103(a)(3)(C) audit after the section of the law that allows this scope limitation.

The amount of extra effort an auditor will need to expend to comply with the standard will depend on whether it currently tests plan provisions and whether management has effective processes and controls for maintaining a current plan instrument, administering the plan and determining that the plan's transactions that are presented in the financial statements and disclosed in the notes are in conformity with the plan's provisions, including maintaining sufficient records with respect to each participant.

For ERISA section 103(a)(3)(C) audits, auditors will need to do more work if they don't already perform the required procedures. Management may also need to do more work to support these audits.

Key considerations

Considering plan provisions

When designing and performing audit procedures, auditors of employee benefit plans subject to ERISA are required by the standard to consider plan provisions that affect the risk of material misstatement (e.g., whether eligibility provisions are administered in accordance with the plan instrument) at the relevant assertion level for classes of transactions, account balances and disclosures.

The auditor is also required to communicate "reportable findings" resulting from these procedures, in writing, to those charged with governance, on a timely basis. Reportable findings include instances of noncompliance or suspected noncompliance with laws or regulations, findings that the auditor determines are significant and relevant to those charged with governance, and/or internal control deficiencies that the auditor determines merit management's attention.

How we see it

While many auditors already consider plan provisions that affect the risk of material misstatement when designing and performing their audit procedures and communicate their findings to those charged with governance, we believe the SAS will help drive consistency and improve audit quality.

ERISA section 103(a)(3)(C) audits

The standard refers to what are known as ERISA-permitted limited scope audits as ERISA section 103(a)(3)(C) audits because the ASB wanted to emphasize that the scope limitation in these audits differs from a typical audit scope limitation for which guidance is already included in the auditing standards. Under the new standard, an auditor engaged to perform such an audit can no longer disclaim an opinion solely because he or she did not audit the certified investment information. Instead, the auditor must express a new form of opinion that is unique to an ERISA section 103(a)(3)(C) audit.

The standard requires auditors to perform specific procedures when management elects an ERISA section 103(a)(3)(C) audit, which is currently known as an ERISA-permitted limited scope audit.

If management elects to have an ERISA section 103(a)(3)(C) audit, the standard requires the auditor to perform specific procedures with respect to the certified investment information and describe them in the auditor's responsibility section of the auditor's report. In addition to evaluating management's assessment of whether the entity issuing the certification is a qualified institution, the auditor is required to:

- Obtain the certification from management and read it
- Compare the certified investment information with the related information presented and disclosed in the ERISA plan financial statements and ERISA-required supplemental schedules
- Read the disclosures that relate to the certified investment information to assess whether they are in accordance with the presentation and disclosure requirements of US GAAP

Based on these procedures, the auditor is required to express an opinion on whether the certified investment information agrees with, or is derived from, in all material respects, the information prepared and certified by an institution that management has determined meets the requirements of ERISA section 103(a)(3)(C).

For all other amounts and disclosures, such as noninvestment-related information (e.g., benefit payments, contributions) and investment information that was not certified or was inappropriately certified, the auditor is required to perform audit procedures based on the assessed risk of material misstatement. Based on the audit and the procedures performed, the auditor expresses an opinion on whether these amounts and disclosures are presented fairly in all material respects in accordance with US GAAP.

Furthermore, the auditor must express an opinion on whether the form and content of the information in the ERISA-required supplemental schedules, other than the certified investment information, is presented, in all material respects, in conformity with the US Department of Labor's rules for reporting under ERISA.

The appendix of this publication provides an illustration of an auditor's report on financial statements for a defined contribution plan subject to ERISA when management elects an ERISA section 103(a)(3)(C) audit.

How we see it

If management elects an ERISA section 103(a)(3)(C) audit, it should be prepared to support its assessment of whether the entity issuing the certification is a qualified institution. Management should consider having discussions with the certifying entity to (1) confirm that the entity is a qualified institution and that the certification meets the ERISA requirements and (2) understand which investments and disclosures are certified and how the certified investment information is measured and presented.

Engagement preconditions and representations from management

As a precondition for all employee benefit plan audits, the auditor is required to obtain the agreement of management that it is responsible for maintaining a current plan instrument, administering the plan and determining that the plan's transactions are presented and disclosed in conformity with the plan's provisions, including maintaining sufficient records with respect to each of the participants to determine the benefits due or that may become due to such participants.

Additional preconditions for an ERISA section 103(a)(3)(C) audit include an acknowledgment from management of its responsibility to determine whether such an audit is permissible, whether the investment information is prepared and certified by a qualified institution, whether the certification complies with the ERISA regulations and whether the certified investment information is appropriately measured, presented and disclosed in accordance with US GAAP.

The standard also requires that auditors request that management provide written representations about these preconditions.

Form and content of the auditor's report

The standard changes the form and content of the auditor's report to align with changes required by SAS No. 134, *Auditor Reporting and Amendments, Including Amendments Addressing Disclosures in the Audit of the Financial Statements*, which the ASB issued in May 2019.

When management does not elect to have an ERISA section 103(a)(3)(C) audit, auditors are required to present the "Opinion" section first, followed by the "Basis for Opinion" section. For an ERISA section 103(a)(3)(C) audit, the "Scope and Nature of the ERISA Section 103(a)(3)(C) Audit" section is presented before the "Opinion" section.

The "Responsibilities of Management for the Financial Statements" section includes a new paragraph that describes management's responsibility for the evaluation of whether there are conditions or events, considered in the aggregate, that raise substantial doubt about the entity's ability to continue as a going concern, when the applicable financial reporting framework requires management to make that evaluation.

Auditors of ERISA plan financial statements are required to add a new paragraph to this section that describes management's responsibilities for maintaining a current plan instrument, 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, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants.

The "Auditor's Responsibilities for the Audit of the Financial Statements" section more clearly articulates the auditor's responsibilities for the audit.

Form 5500

The standard requires that the auditor make appropriate arrangements with management to obtain a draft Form 5500 that is substantially complete, including the forms and schedules that could have a material effect on the quantitative and qualitative information in the financial statements and ERISA-required supplemental schedules. The auditor is required to read the draft Form 5500 prior to dating the auditor's report to identify any material inconsistencies with the ERISA plan financial statements.

Auditors are currently able to issue their reports before the Form 5500 is substantially complete.

How we see it

Management should consider having discussions with the service provider that prepares the Form 5500 to make sure the auditor will have access to it on a timely basis.

Effective date

The SAS is effective for audits of financial statements for periods ending on or after 15 December 2021, and early implementation is permitted. The SAS was originally effective for periods ending on or after 15 December 2020, and early implementation was not permitted. But in response to the COVID-19 pandemic, the AICPA issued **SAS No. 141**[2] to delay the effective date and permit early implementation.

Endnotes:

[1] Statement of Auditing Standards No. 136, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*.

[2] Statement of Auditing Standards No. 141, *Amendment to the Effective Dates of SAS Nos. 134-140*.

Appendix: Example of an auditor's report on financial statements for a defined contribution plan subject to ERISA when management elects an ERISA section 103(a)(3)(C) audit

The following example of an auditor's report is one of several included in the SAS.

Independent Auditor's Report

[*Appropriate Addressee*]

Scope and Nature of the ERISA Section 103(a)(3)(C) Audit

We have performed audits of the financial statements of ABC 401(k) Plan, an employee benefit plan subject to the Employee Retirement Income Security Act of 1974 (ERISA), as permitted by ERISA Section 103(a)(3)(C) (ERISA Section 103(a)(3)(C) audit). The financial statements comprise the statements of net assets available for benefits as of December 31, 20X2 and 20X1, and the related statement of changes in net assets available for benefits for the year ended December 31, 20X2, and the related notes to the financial statements.

Management, having determined it is permissible in the circumstances, has elected to have the audits of ABC 401(k) Plan's financial statements performed in accordance with ERISA Section 103(a)(3)(C) pursuant to 29 CFR 2520.103-8 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. As permitted by ERISA Section 103(a)(3)(C), our audits need not extend to any statements or information related to assets held for investment of the plan (investment information) by a bank or similar institution or insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency, provided that the statements or information regarding assets so held are prepared and certified to by the bank or similar institution or insurance carrier in accordance with 29 CFR 2520.103-5 of the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA (qualified institution).

Management has obtained certifications from a qualified institution as of December 31, 20X2 and 20X1, and for the year ended December 31, 20X2, stating that the certified investment information, as described in Note X to the financial statements, is complete and accurate.

Opinion

In our opinion, based on our audits and on the procedures performed as described in the Auditor's Responsibilities for the Audit of the Financial Statements section

- the amounts and disclosures in the accompanying financial statements, other than those agreed to or derived from the certified investment information, are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America.
- the information in the accompanying financial statements related to assets held by and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

Basis for Opinion

We conducted our audits in accordance with auditing standards generally accepted in the United States of America (GAAS). Our responsibilities under those standards are further described in the Auditor's Responsibilities for the Audit of the Financial Statements section of our report. We are required to be independent of ABC 401(k) Plan and to meet our other ethical responsibilities, in accordance with the relevant ethical requirements relating to our audits. We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our ERISA Section 103(a)(3)(C) audit opinion.

Responsibilities of Management for the Financial Statements

Management is responsible for the preparation and fair presentation of the financial statements in accordance with accounting principles generally accepted in the United States of America, and for the design, implementation, and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free from material misstatement, whether due to fraud or error. Management's election of the ERISA Section 103(a)(3)(C) audit does not affect management's responsibility for the financial statements.

In preparing the financial statements, management is required to evaluate whether there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern [*insert the time period set by the applicable financial reporting framework*].

Management is also responsible for maintaining a current plan instrument, including all plan amendments, 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, including maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants.

Auditor's Responsibilities for the Audit of the Financial Statements

Except as described in the Scope and Nature of the ERISA section 103(a)(3)(C) Audit section of our report, our objectives are to obtain reasonable assurance about whether the financial statements as a whole are free from material misstatement, whether due to fraud or error, and to issue an auditor's report that includes our opinion. Reasonable assurance is a high level of assurance but is not absolute assurance and therefore is not a guarantee that an audit conducted in accordance with GAAS will always detect a material misstatement when it exists. The risk of not detecting a material misstatement resulting from fraud is higher than for one resulting from error, as fraud may involve collusion, forgery, intentional omissions, misrepresentations, or the override of internal control. Misstatements are considered material if, individually or in the aggregate, they could reasonably be expected to influence the economic decisions of users made on the basis of these financial statements.

In performing an audit in accordance with GAAS, we:

- Exercise professional judgment and maintain professional skepticism throughout the audit.
- Identify and assess the risks of material misstatement of the financial statements, whether due to fraud or error, and design and perform audit procedures responsive to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements.
- Obtain an understanding of internal control relevant to the audit in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the ABC 401(k) Plan's internal control. Accordingly, no such opinion is expressed.
- Evaluate the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluate the overall presentation of the financial statements.
- Conclude whether, in our judgment, there are conditions or events, considered in the aggregate, that raise substantial doubt about ABC 401(k) Plan's ability to continue as a going concern for a reasonable period of time.

Our audits did not extend to the certified investment information, except for obtaining and reading the certification, comparing the certified investment information with the related information presented and disclosed in the financial statements, and reading the disclosures relating to the certified investment information to assess whether they are in accordance with the presentation and disclosure requirements of accounting principles generally accepted in the United States of America.

Accordingly, the objective of an ERISA Section 103(a)(3)(C) audit is not to express an opinion about whether the financial statements as a whole are presented fairly, in all material respects, in accordance with accounting principles generally accepted in the United States of America.

We are required to communicate with those charged with governance regarding, among other matters, the planned scope and timing of the audit, significant audit findings, and certain internal control related matters that we identified during the audit.

Other Matter — Supplemental Schedules Required by ERISA

The supplemental schedules of [*identify the title of supplemental schedules and periods covered*] are presented for purposes of additional analysis and are not a required part of the financial statements but are supplementary information required by the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA. Such information is the responsibility of management and was derived from and relates directly to the underlying accounting and other records used to prepare the financial statements. The information included in the supplemental schedules, other than that agreed to or derived from the certified investment information, has been subjected to auditing procedures applied in the audits of the financial statements and certain additional procedures, including comparing and reconciling such information directly to the underlying accounting and other records used to prepare the financial statements or to the financial statements themselves, and other additional procedures in accordance with GAAS. For information included in the supplemental schedules that agreed to or is derived from the certified investment information, we compared such information to the related certified investment information.

In forming our opinion on the supplemental schedules, we evaluated whether the supplemental schedules, other than the information agreed to or derived from the certified investment information, including their form and content, are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

In our opinion

- the form and content of the supplemental schedules, other than the information in the supplemental schedules that agreed to or is derived from the certified investment information, are presented, in all material respects, in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.
- the information in the supplemental schedules related to assets held by and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information prepared and certified by an institution that management determined meets the requirements of ERISA Section 103(a)(3)(C).

[Signature of the auditor's firm]

[City and state where the auditor's report is issued]

[Date of the auditor's report]