Audit advisory

SAS No. 136: *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*

This advisory is intended to inform members about AICPA Statement on Auditing Standards No. 136, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, as amended (EBP SAS). Codified in new AU-C section 703 of the AICPA *Professional Standards*, the EBP SAS prescribes certain new performance requirements for ERISA plan financial statement audits and changes the form and content of the related auditor's report to improve audit quality and enhance the communicative value and transparency of the auditor's report. It includes new requirements in all phases of an audit of ERISA plan financial statements including engagement acceptance, risk assessment and response, communication with those charged with governance, performance procedures, and reporting.

This advisory:

- Discusses how the new EBP SAS may affect your ERISA audits
- Provides information about the effective date and adoption of the standard
- Describes how the new EBP SAS interacts with other auditing standards
- Highlights new requirements for ERISA section 103(a)(3)(C) audits (previously referred to as "limited scope" audits)
- Summarizes changes to the form and content of the auditor's report, including reporting on the ERISA-required supplemental schedules
- Explains other key provisions of the new EBP SAS.

Effective date and adoption

AU-C section 703 is effective for audits of ERISA plan financial statements for periods ending on or after December 15, 2021. This means that 2021 year-end audits being performed in 2022 will be required to follow the performance and reporting requirements of this SAS, including using the new form of the auditor's report. Early adoption is permitted. AU-C section 703 includes transitional implementation reporting guidance upon initial adoption when performing an ERISA section 103(a)(3)(C) audit.

How the EBP SAS may affect your ERISA audits

AU-C section 703 includes changes that will need to be implemented for all ERISA audits, including management acceptance, management representations, communications with those charged with governance, and the auditor's report. And if your firm performs ERISA Section 103(a)(3)(C) audits (previously referred to as "limited scope" audits) additional performance and new reporting requirements also apply.

AU-C section 703 requires the auditor to perform certain procedures when planning and performing the audit that in the past were not expressly required. You will want to be sure that all EBP audit staff are properly educated about the new requirements in AU-C section 703, and that they understand any changes to your firm's audit approach to ERISA audits.

How the EBP SAS interacts with other auditing standards

The standard is not all-inclusive; when performing an ERISA audit, all the AU-C sections apply, except for the following, which are not applicable to an ERISA audit because those requirements and related application material are specifically covered in AU-C section 703:

- AU-C section 700, *Forming an Opinion and Reporting on Financial Statements.* The EBP SAS replaces AU-C section 700, *Forming an Opinion and Reporting on Financial Statements*, in its entirety when performing an audit of ERISA plan financial statements.

> Note: AU-C sections 705, *Modifications to the Opinion in the Independent Auditor's Report,* and 706, *Modifications to the Opinion in the Independent Auditor's Report,* address how the form and content of the auditor's report are affected when the auditor expresses a modified opinion or includes an emphasis-of-matter or other-matter paragraph in the auditor's report. AU-C section 701, *Communicating Key Audit Matters in the Independent Auditor's Report,* addresses the auditor's responsibility to communicate key audit matters in the auditor's report when the auditor is engaged to do so. Auditors should comply with AU-C sections 701, 705 and 706 when performing ERISA audits. AU-C section 703 provides the auditor with specific guidance on when and how to apply AU-C section 705 when performing an ERISA section 103(a)(3)(C) audit.

- Paragraph .09 of AU-C section 725, *Supplementary Information in Relation to the Financial Statements as a Whole.*

In addition, AU-C section 703 contains incremental requirements to AU-C section 210, *Terms of Engagement*; AU-C section 250, *Consideration of Laws and Regulations in an Audit of Financial Statements*; AU-C section 260, *The Auditor's Communication With Those Charged With Governance*; and AU-C section 580, *Written Representations*.

A new name and type of audit opinion - ERISA section 103(a)(3)(C) audits (previously referred to as “limited scope” audits)

An audit performed pursuant to ERISA section 103(a)(3)(C) will no longer be referred to as a "limited scope audit" but rather going forward referred to as an "ERISA section 103(a)(3)(C) audit." AU-C section 703 includes new performance and reporting requirements specific to ERISA section 103(a)(3)(C) audits.

AU-C section 703 notes that an ERISA section 103(a)(3)(C) audit is unique to EBPs and is not considered a scope limitation, therefore the auditor would no longer issue a modified opinion (typically a disclaimer of opinion) due to information that is certified by a qualified institution. An independent auditor performing an ERISA Section 103(a)(3)(C) audit would issue an ERISA-Section 103(a)(3)(C) auditor’s report in accordance with AU-C Section 703 that contains a two-pronged opinion that is based on the audit and on the procedures performed relating to the certified investment information. It provides an opinion on whether the amounts and disclosures in the financial statements not covered by the certification are presented fairly, in all material respects, in accordance with the applicable financial reporting framework, and an opinion on whether the certified investment information in the financial statements agrees to or is derived from, in all material respects, the certification.

Changes to form and content of auditor’s report

Report on audited financial statements

AU-C section 703 significantly changes the form and content of the auditor’s report. It also includes reporting guidance when the auditor identifies a material inconsistency or material misstatement of fact between the substantially complete draft Form 5500 and the ERISA plan financial statements that requires revision of the audited ERISA plan financial statements or the Form 5500 and management refuses to make the revision.

For the first time, Generally Accepted Auditing Standards (GAAS) requires an ordering of certain report elements for all audit engagements, including ERISA audits. AU-C section 700 applies to all entities except for ERISA plans for which AU-C section 703 applies. For non-section 103(a)(3)(C) audits the “Opinion” section is required to be placed first, followed by the “Basis for Opinion” section. The “Basis for Opinion” section is new for all entities for which an opinion is issued, which includes a statement that the auditor is required to be independent. For ERISA section 103(a)(3)(C) audits the “Nature and Scope of the ERISA Section 103(a)(3)(C) Audit” section is required to be placed before the opinion and basis for opinion sections. AU-C section 703 also requires the use of specific headings.

AU-C section 703 requires a statement in the “Opinion” section that the plan is an employee benefit plan subject to ERISA. It also contains new requirements specific to ERISA audits relating to management’s responsibilities for the financial statements, including for the following:

- maintaining a current plan instrument, including all plan amendments,
- administering the plan,
- determining that the plan’s transactions that are presented and disclosed in the financial statements are in conformity with the plan’s provisions, and
- maintaining sufficient records with respect to each of the participants, to determine the benefits due or which may become due to such participants

AU-C section 703 includes illustrative auditor’s reports. In addition, it includes reporting guidance for the auditor’s report for audits:

- Conducted in accordance with both GAAS and another set of auditing standards.
- Where prior period financial statements were audited by a predecessor auditor.

- Where prior period financial statements were not audited.

For an ERISA Section 103(a)(3)(C) audit:

The reporting requirements related to ERISA Section 103(a)(3)(C) audits are different from those for non-section 103(a)(3)(C) audits, as follows:

- The first section of the auditor's report should include a description of the scope and nature of the ERISA Section 103(a)(3)(C) audit and should have the heading "Scope and Nature of the ERISA Section 103(a)(3)(C) Audit."
- The "Opinion" section is required to directly follow the "Scope and Nature of the ERISA Section 103(a)(3)(C) audit" section and provides a two-pronged opinion that is based on the audit and on the procedures performed relating to the certified investment information. It provides an opinion on whether the amounts and disclosures in the financial statements not covered by the certification are presented fairly, in all material respects, in accordance with the applicable financial reporting framework, and an opinion on whether the certified investment information in the financial statements agrees to or is derived from, in all material respects, the certification.
- The management responsibilities section includes an additional sentence stating that the election of the ERISA Section 103(a)(3)(C) audit does not affect management's responsibility for the financial statements.
- The auditor's responsibilities section should state that:
    - the audit 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 the applicable financial reporting framework.
    - accordingly, the objective of the 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 the applicable financial reporting framework.

Report on ERISA-required supplemental schedules

For an audit not subject to ERISA Section 103(a)(3)(C), AU-C section 703 requires the auditor to report on whether the ERISA-required supplemental schedules are fairly stated, in all material respects, in relation to the financial statements as a whole. AU-C section 703 also requires the auditor, in situations in which the auditor's report on the audited financial statements contains an unmodified or a qualified opinion, to include a statement about whether, in the auditor's opinion the *form and content* of the information in the accompanying schedules are presented in conformity with the Department of Labor's Rules and Regulations for Reporting and Disclosure under ERISA.

Other key provisions of the EBP SAS

AU-C section 703 includes new requirements in all phases of an audit of ERISA plan financial statements. Other key provisions include the following:

***Engagement Acceptance*.** AU-C section 703 includes new engagement acceptance requirements in addition to the preconditions for an audit in AU-C section 210, *Terms of Engagement.* It requires that the auditor obtain the agreement of management that it acknowledges and understands its responsibilities for the following (which can be done through the engagement letter):

- 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 plan 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.

- Providing to the auditor, prior to the dating of the auditor's report, a draft of Form 5500 that is substantially complete. Paragraph 2.47 of the 2020 AICPA Audit and Accounting Guide, *Employee Benefit Plans* (the EBP Guide), defines a draft of Form 5500 that is substantially complete as one that includes the forms and schedules that could have a material effect, involving both qualitative and quantitative considerations, on the information in the financial statements and ERISA-required supplemental schedules.
- When management elects to have an ERISA Section 103(a)(3)(C) audit, determining whether
  - an ERISA Section 103(a)(3)(C) audit is permissible under the circumstances,
  - the investment information is prepared and certified by a qualified institution as described in 29 CFR 2520.103-8,
  - the certification meets the requirements in 29 CFR 2520.103-5, and
  - the certified investment information is appropriately measured, presented, and disclosed in accordance with the applicable financial reporting framework.

As part of engagement acceptance when management elects to have an ERISA Section 103(a)(3)(C) audit, the auditor is required to inquire of management about how management determined that the entity preparing and certifying the investment information is a qualified institution under DOL rules and regulations.

Risk Assessment. The EBP SAS requires that the auditor:

- Obtain and read the most current plan instrument for the audit period, including effective amendments, as part of obtaining an understanding of the entity sufficient to perform risk assessment procedures.
- Consider whether to test specific plan provisions as part of risk assessment. Because of the nature of ERISA audits, it would be rare for the auditor, based upon the assessed risks of material misstatement at the relevant assertion level, not to test any relevant plan provisions. AU-C section 703 includes an appendix A that provides some examples of plan provisions often included in a plan instrument by audit area.

Planning and Fieldwork. AU-C section 703 requires that the auditor perform the procedures necessary to become satisfied that received and disbursed amounts (for example, employer or employee contributions and benefit payments) reported by the trustee or custodian were determined in accordance with the plan provisions. When designing and performing audit procedures, the auditor is required to consider:

- Relevant plan provisions that affect the risk of material misstatement at the relevant assertion level for classes of transactions, account balances, and disclosures.
- Whether management has performed the relevant IRC compliance tests, including but not limited to, discrimination testing, and has corrected or intends to correct failures, as applicable, in accordance with AU-C 250 requirements.

The auditor also is required to evaluate:

- Whether prohibited transactions identified by management or as part of the audit have been appropriately reported in the applicable ERISA-required supplemental schedules.
- Whether items identified that are not in accordance with the criteria specified (for example, not in accordance with the plan instrument), are reportable findings, which are defined in AU-C section 703 as matters that are one or more of the following:
  - An identified instance of noncompliance or suspected noncompliance with laws or regulations.
  - A finding arising from the audit that is, in the auditor's professional judgment, significant and relevant to those charged with governance regarding their responsibility to oversee the financial reporting process.
  - An indication of deficiencies in internal control identified during the audit that have not been communicated to management by other parties and that, in the auditor's professional judgment, are of sufficient importance to merit management's attention.

The EBP Guide provides information about what may constitute a reportable finding

When management elects to have an ERISA Section 103(a)(3)(C) audit, the auditor also is required to:

- Evaluate management's assessment of whether the institution is qualified.
- Identify which investment information is certified
- Perform the following procedures on the certified investment information:
    - Obtain from management and read the certification as it relates to investment information prepared and certified by a qualified institution.
    - 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 relating to the certified investment information to assess whether they are in accordance with the presentation and disclosure requirements of the applicable financial reporting framework.
- Perform audit procedures on the financial statement information, including the disclosures, not covered by the certification as well as noninvestment-related information based on the assessed risk of material misstatement. Plans may hold investments in which only a portion are covered by a certification by a qualified institution. In that case, the auditor should perform audit procedures on the investment information that has not been certified.

Documentation. If the auditor has determined that it is not necessary to test any relevant plan provisions as part of risk assessment, the auditor is required to document the considerations in reaching such conclusion.

Review of Draft Form 5500. AU-C section 703 requires the auditor to make appropriate arrangements with management to obtain the draft Form 5500, and read the draft Form 5500 in order to identify material inconsistencies, if any, with the audited ERISA plan financial statements prior to dating the auditor's report. If the auditor identifies a material inconsistency, he or she should determine whether the audited ERISA plan financial statements or the draft Form 5500 needs to be revised. If during the review of the Form 5500, the auditor becomes aware of a material misstatement of fact, he or she is required to discuss it with management and, depending on management's response, take appropriate action as required by AU-C section 703.

Communications with Management and Those Charged with Governance. Under AU-C 703, the auditor is required to make certain EBP-specific communications with management and/or those charged with governance. For example (this is not a complete list):

- Reportable findings (as defined in AU-C section 703) should be communicated in writing to management and those charged with governance in a timely manner in accordance with the requirements in other relevant AU-C sections.
- The auditor is required to discuss with management prohibited transactions with a party in interest of which the auditor has become aware that have not been properly reported in the applicable ERISA-required supplemental schedule.
- The auditor should communicate with those charged with governance the auditor's responsibility with respect to Form 5500, procedures performed relating to Form 5500, and the results of those procedures.

The EBP SAS also addresses what the auditor should do when a material inconsistency between the draft Form 5500 and the ERISA plan financial statements is identified or when the auditor becomes aware of a material misstatement of fact.

For an ERISA Section 103(a)(3)(C) audit, if:

- The auditor has concerns about whether the entity preparing and certifying the investment information is a qualified institution, the auditor is required to discuss his or her concerns with management. If management does not provide sufficient information that supports its determination that the entity preparing and certifying the investment information is a qualified institution, then the auditor should discuss his or her concerns with those charged with governance and determine the implications for the audit.

- The auditor becomes aware that the certified investment information in the financial statements and related disclosures is incomplete, inaccurate, or otherwise unsatisfactory, the auditor should discuss the matter with management and perform additional procedures to determine the appropriate course of action.

The auditor should not issue a written communication stating that no reportable findings were identified during the audit.

Management Representations. The EBP SAS requires that the auditor obtain certain written management representations in addition to those required by AU-C section 580, as follows:

- That management has provided the auditor with the most current plan instrument for the audit period, including all plan amendments.
- Acknowledgement of its responsibility for administering the plan and determining that the plan's transactions that are presented and disclosed in the ERISA plan 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.
- When management elects to have an ERISA Section 103(a)(3)(C) audit, acknowledgement that management's election of the ERISA Section 103(a)(3)(C) audit does not affect its responsibility for the financial statements and for determining whether:
    - an ERISA Section 103(a)(3)(C) audit is permissible under the circumstances
    - the investment information is prepared and certified by a qualified institution as described in 29 CFR 2520.103-8
    - the certification meets the requirements in 29 CFR 2520.103-5, and
    - the certified investment information is appropriately measured, presented, and disclosed in accordance with the applicable financial reporting framework

Reporting. AU-C section 703 includes new reporting requirements as follows:

When identified prohibited transactions have not been appropriately reported in the applicable ERISA-required supplemental schedules and management and those charged with governance will not change the schedules, the auditor is required to:

- Modify the opinion on the supplemental schedule, when the effect of the transaction is material based on the financial statements as a whole.
- Include additional discussion in the other-matter paragraph in the auditor's report on the supplemental schedules describing the prohibited transaction if the effect of the prohibited transaction is not material to the financial statements.
- If the prohibited party-in-interest transaction is material and is also considered a related party transaction, and that transaction is not properly disclosed in the notes to the plan financial statements, modify the auditor's opinion on the financial statements due to a departure from the applicable financial reporting framework.

Additional resources

AICPA resources

AICPA AU-C section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, addresses the auditor's responsibility to form an opinion on the financial statements of EBPs subject to ERISA and addresses the form and content of the auditor's report issued as a result of an audit of ERISA plan financial statements.

The 2020 AICPA Audit and Accounting Guide, *Employee Benefit Plans,* provides guidance for performing EBP audits in conformity with SAS No. 136, including interpretive guidance related to certain new procedures required by the EBP SAS.

At a Glance, *New auditing standards for employee benefit plans*, provides a brief overview of the EBP SAS.

Learning About the New Employee Benefit Plan Auditing Standard — Questions and Answers, includes FAQs to provide practitioners a better understanding of the EBP SAS.

EBPAQC resources

Plan Advisory, *New audit standard for employee benefit plans: An overview for plan management*, provides plan management with an understanding of the changes to audits of employee benefit plan financial statements subject to ERISA following the issuance of SAS No. 136).

Changes are coming to your employee benefit plan audit provides information to assist auditors in talking to their clients about the EBP SAS.

Plan Advisory, *ERISA Section 103(a)(3)(C) audits*, provides plan sponsors, administrators and trustees with an understanding of ERISA Section 103(a)(3)(C) audits of employee benefit plans under ERISA.

Topix Primer, *ERISA Section 103(a)(3)(C) audits of employee benefit plans,* provides a general understanding of ERISA section 103(a)(3)(C) audits of employee benefit plans under ERISA.

Documentation of the auditor's review of an ERISA Section 103(a)(3)(C) audit certification assists auditors in documenting their evaluation of whether a certification provided by a qualified institution meets the requirements for electing an ERISA 103(a)(3)(C) audit.

Common deficiencies in ERISA Section 103(a)(3)(C) audit certifications helps plan administrators understand their responsibilities for determining the acceptability of an ERISA Section 103(a)(3)(C) certification; auditors understand their responsibilities for determining whether a certification can be relied upon to perform an ERISA Section 103(a)(3)(C) audit; both plan administrators and auditors identify common deficiencies in certifications. It also includes an illustration of a proper certification.

Conditions for plan management to elect an ERISA Section 103(a)(3)(C) audit assists plan management in assessing whether the conditions for electing an ERISA Section 103(a)(3)(C) audit have been met.