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AUDIT  CONDUCT

Ann L. Combs  
Assistant Secretary, Employee Benefits Security Administration  
Office of Regulations and Interpretations  
Room N-5669  
US Department of Labor  
200 Constitution Avenue NW  
Washington, DC 20210

December 12, 2006

**Re: Request for Information – Independence of Employee Benefit Plan Accountants**

Dear Ms. Combs:

I was pleased to hear that the Department of Labor (the Department) would be soliciting comments from interested parties regarding the independence rules applicable to benefit plan auditors. As a CPA who consults on ethics, independence and compliance matters for the accounting profession, I feel I bring a rather unique perspective to this discussion. In recent years, I was senior staff in the American Institute of Certified Public Accountant (AICPA) Professional Ethics Division and also served as independence director in two of the Big 4 accounting firms' national offices.

I respectfully offer the following comments in response to the above-cited Request for Information.

- 1. Should the Department adopt, in whole or in part, current rules or guidelines on accountant independence of the SEC, AICPA, GAO or other governmental or nongovernmental entity? If the Department were to adopt a specific organization's rules or guidelines, what adjustments would be needed to reflect the audit requirements for or circumstances of employee benefit plans under ERISA?**

Benefit plan audits required under the Employee Retirement Income Security Act (ERISA) are performed under Generally Accepted Auditing Standards, or GAAS; therefore, Rule 101, *Independence* (ET§101), of the *Code of Professional Conduct* (the AICPA Code) applies to these engagements. The question is whether the AICPA standards provide sufficient safeguards to protect the various stakeholders of benefit plan audits. The *Conceptual Framework for AICPA Independence Standards* (ET§100.01, AICPA Code) defines employee benefit and health and welfare plans subject to ERISA as "public interest entities" (see paragraph 20 of the Framework, including footnote no. 5). The Framework states, "these entities are public interest entities because their audited financial statements are directly relied upon by significant numbers of stakeholders to make investment, credit, or similar decisions (for example, in the case of a publicly held company) or indirectly relied upon through regulatory oversight (for example, in the case of pension plans, banks, and insurance companies) and, therefore, the potential extent of harm to the public from an audit failure involving one of these entities would generally be significant". The Framework indicates that the nature and extent of safeguards (controls to mitigate or eliminate threats to independence) to be applied in a

particular matter depend on many factors, including whether the client is a public interest entity. With this in mind, the Department may wish to consider whether to supplement the AICPA rules applicable to benefit plan auditors with additional safeguards to achieve the level of stakeholder protection it deems necessary.

- 2. Should the Department modify, or otherwise provide guidance on, the prohibition in Interpretive Bulletin 75-9 on an independent accountant, his or her firm, or a member of the firm having a “direct financial interest” or a “material indirect financial interest” in a plan or plan sponsor? For example, should the Department issue guidance that clarifies whether, and under what circumstances, financial interests held by an accountant’s family members are deemed to be held by the accountant or his or her accounting firm for independence purposes? If so, what familial relationships should trigger the imposition of ownership attribution rules? Should the ownership attribution rules apply to all members of the accounting firm retained to perform the audit of the plan or should it be restricted to individuals who work directly on the audit or may be able to influence the audit?**

AICPA independence standards address independence in fact and appearance regarding financial interests and relationships by using a “covered member” approach (ET§92.06, ET§101.02, ET§101.17, AICPA Code). This approach focuses restrictions on members of engagement teams and other persons whose influence over or proximity to the engagement warrants such restrictions. Other regulators such as the Government Accountability Office (GAO), Securities and Exchange Commission (SEC) and the Public Company Accounting Oversight Board (PCAOB) have embraced this approach, which would significantly enhance the Department’s rules.

- 3. Should the Department issue guidance on whether, and under what circumstances, employment of an accountant’s family members by a plan or plan sponsor that is a client of the accountant or his or her accounting firm impairs the independence of the accountant or accounting firm?**

For the same reasons noted in my response to Question 2, I believe the Department should apply the “covered member” approach used in the AICPA Code (ET§101.02) in regards to employment of an accountant’s family members.

- 4. Interpretive Bulletin 75-9 states that an accountant will not be considered independent with respect to a plan if the accountant or member of his or her accounting firm maintains financial records for the employee benefit plan. Should the Department define the term “financial records” and provide guidance on what activities would constitute “maintaining” financial records. If so, what definitions should apply?**

Yes. The profession needs further guidance and clarification of what constitutes maintenance of financial records. The Department may wish to evaluate whether its concerns relate to self-review, management participation, or other threats to independence and on that basis consider whether the AICPA’s interpretation, *Performance of nonattest services* (ET§101.05) is sufficient to mitigate independence threats or requires additional safeguards to protect stakeholder interests.

- 5. Should the Department define the terms “promoter,” “underwriter,” “investment advisor,” “voting trustee,” “director,” “officer,” and “employee of the plan or plan sponsor,” as used in Interpretive Bulletin 75-9? Should the Department include and define additional disqualifying status positions in its independence guidelines? If so, what positions and how should they be defined?**

No. I believe these terms are generally understood by benefit plan auditors. In addition, the list of disqualifying status positions is quite comprehensive. The AICPA Code has parallel restrictions, which also draw in any person acting as a fiduciary to the plan (as defined in ERISA) and the performance of certain investment advisory functions (ET§101.05).

- 6. Interpretive Bulletin 75-9 defines the term “member of an accounting firm” as all partners or shareholder employees in the firm and all professional employees participating in the audit or located in an office of the firm participating in a significant portion of the audit. Should the Department revise and update the definition of “member?” If so, how should the definition be revised and updated?**

Yes. As previously indicated, a “covered member” approach would be consistent with the profession’s independence rules.

- 7. What kinds of nonaudit services are accountants and accounting firms engaged to provide to the plans they audit or to the sponsor of plans they audit? Are there benefits for the plan or plan sponsor from entering into agreements to have the accountant or accounting firm provide nonaudit services and also perform the employee benefit plan audit? If so, what are the benefits? Should the Department issue guidance on the circumstances under which the performance of nonaudit services by accountants and accounting firms for the plan or plan sponsor would be treated as impairing an accountant’s independence for purposes of auditing and rendering an opinion on the financial information required to be included in the plan’s annual report? If so, what should the guidance provide?**

Where auditors are able to provide services within certain constraints, the profession’s standard setters and regulators, including the GAO, SEC, PCAOB and AICPA have permitted auditors to provide certain non-audit services to their clients. Some believe that smaller clients in particular may be harmed by banning or severely limiting non-audit services by auditors; they argue that hiring a second accounting firm to perform services can be significantly more costly than having the auditor, who is more familiar with the client’s business, perform the services. Of course, the various regulators and standard-setters have determined that certain types of services pose too great a risk of impairing the auditor’s independence to be permitted.

In the case of benefit plan audits, the Department would need to consider whether non-audit services the plan auditor performs at the sponsor level impact the auditor’s independence with respect to the benefit plan and if they do, whether and to what degree these services should be permitted.

- 8. Interpretive Bulletin 75-9 requires an auditor to be independent during the period of professional engagement to examine the financial statements being reported, at the date of the opinion, and during the period covered by the financial statements. Should the Department change the Interpretive Bulletin to remove or otherwise provide exceptions for “the period covered by the financial statements” requirement? For example, should the requirement be changed so that an accountant’s independence would be impaired by a material direct financial interest in the plan or plan sponsor during the period covered by the financial statements rather than any direct financial interest?**

I believe the Department should align the application period of its financial interest rules to those used by the AICPA and other regulators. The AICPA and others do not apply these particular rules during the period covered by the financial statements although generally, the point is moot unless the plan is a new attest client. For example:

In 2006, I own shares of ABC Company; I do not audit the ABC Company or its benefit plan(s). ABC asks me to perform an audit of its benefit plans beginning with the 2006 financial statement year-end. I dispose of my stock and agree to become the plan's auditor. Once I am performing the audit, the fact that I held an interest during the period covered by the financial statements cannot possibly affect my objectivity since I am no longer a shareholder. Said another way, there is nothing I could do (or not do) this year as auditor of the plan that would benefit me; I am no longer able to financially gain or lose due to fluctuations in ABC's stock price. By disposing of my financial interest before becoming the plan auditor, I effectively retain my independence.

**9. Should there be special provisions in the Department's independence guidelines for plans that have audit committees that hire and monitor an auditor's independence, such as the audit committees described in the Sarbanes-Oxley Act applicable to public companies?**

I do not believe that special provisions are needed as SEC rules, if applicable, should suffice.

**10. What types and level of fees, payments, and compensation are accountants and accounting firms receiving from plans they audit and sponsors of plans they audit for audit and nonaudit services provided to the plan? Should the Department issue guidance regarding whether receipt of particular types of fees, such as contingent fees and other fees and compensation received from parties other than the plan or plan sponsor, would be treated as impairing an accountant's independence for purposes of auditing and rendering an opinion on the financial information required to be included in the plan's annual report?**

This is another area where the Department may wish to consider supplemental safeguards to AICPA Rule 101. The commission and contingent fee rules are addressed in the AICPA Code in ET§503 and ET§302, respectively. These rules are not included in the AICPA independence standards; therefore technically, they would not be required under GAAS although AICPA members still would be bound by them.

**11. Should the Department define the term "firm" in Interpretive Bulletin 75-9 or otherwise issue guidance on the treatment of subsidiaries and affiliates of an accounting firm in evaluating the independence of an accounting firm and members of the firm? If so, what should the guidance provide regarding subsidiaries and affiliates in the evaluation of the independence of an accountant or accounting firm?**

The AICPA Code provides guidance in this area. *Application of rules of conduct to members who own a separate business* (ET §505.03) provides that an entity controlled by a member (individually or with other members of his or her firm) would be bound by the Code, including all independence requirements. Similar to rules on commissions and contingent fees, these rules exist outside of Rule 101 and would therefore apply to AICPA members only. The Code also provides specialized guidance for "alternative practice structures" (ET§101.16), which addresses the application of independence rules to entities related to an accounting firm (e.g., "American Express" model). The Department may wish to adopt an affiliate definition based on control (as espoused in ET§505.03). If the Department believes a firm affiliate exists when ownership by the accounting firm does not provide control, I would suggest the Department consider an explicit definition which provides clear and definitive guidance (e.g., using established criteria such as the existence of significant influence).

- 12. Should the Department’s independence guidance include an “appearance of independence” requirement in addition to the requirement that applies by reason of the ERISA requirement that the accountant perform the plan’s audit in accordance with GAAS?**

No. I believe this would be redundant as the AICPA Code addresses the appearance of independence in its *Conceptual Framework for AICPA Independence Standards* and Interpretation 101-1 (ET§101 and ET§101.01, respectively).

- 13. Should the Department require accountants and accounting firms to have written policies and procedures on independence which apply when performing audits of employee benefit plans? If so, should the Department require those policies and procedures be disclosed to plan clients as part of the audit engagement?**

I believe the Department should require firms to have written policies and procedures on independence specific to audits of employee benefit plans. Disclosure of the policies and procedures may not be particularly meaningful to plan participants, although other stakeholders such as plan fiduciaries and the Department would likely find the information useful.

- 14. Should the Department adopt formal procedures under which the Department will refer accountants to state licensing boards for discipline when the Department concludes an accountant has conducted an employee benefit plan audit without being independent?**

Yes. I believe the Department should adopt a formal procedure for referring such cases to the state boards, AICPA, or other regulators, as appropriate.

- 15. Should accountants and accounting firms be required to make any standard disclosures to plan clients about the accountant’s and firm’s independence?**

The standard audit report indicates that the accountant is independent. I do not believe that any further disclosures are necessary.

Again, I appreciate the opportunity to respond to this important request for information. I would be happy to elaborate on any of the points made in this letter.

Sincerely,



Catherine Allen, CPA