ERISA Section 103(a)(3)(C) audits of employee benefit plans

The AICPA Employee Benefit Plan Audit Quality Center has developed this primer to provide a general understanding of ERISA Section 103(a)(3)(C) audits of employee benefit plans under the Employee Retirement Income Security Act of 1974 (ERISA). This document provides a general description of the statutory and regulatory basis that permits the plan administrator[1] to make the ERISA Section 103(a)(3)(C) audit election, what constitutes a proper certification from a qualified institution, management's responsibilities, the ERISA Section 103(a)(3)(C) audit in the current environment, and the effect of the ERISA Section 103(a)(3)(C) audit election on the independent auditor's responsibilities.

The plan administrator is identified in the plan document as having responsibility for managing the day-to-day administration and decisions for the plan. This primer uses the term management to include the plan administrator as described in the DOL's Rules and Regulations for Reporting and Disclosure under ERISA as well as to other members of management.

Statutory and regulatory basis

Congress and the U.S. Department of Labor permit ERISA Section 103(a)(3)(C) audits of ERISA plans.

In 1974, Congress enacted ERISA to help protect retirement benefits for workers covered by private pension plans. In addition to establishing minimum standards for benefit accrual, funding and vesting, ERISA section 103(a)(3) requires employee benefit plans with 100 or more participants to be audited by an independent qualified public accountant. However, ERISA section 103(a)(3)(C) allows the plan administrator to instruct the auditor not to perform any auditing procedures with respect to investment information prepared and certified by any bank or similar institution or by an insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency, and further that acts as trustee or custodian.

ERISA's independent audit requirements are administered and enforced by the U.S. Department of Labor (DOL). The DOL issued implementing regulations in 29 CFR 2520.103-8 - *Limitation on scope of accountant's examination*, and 29 CFR 2520.103-12, *Limited exemption and alternative method of compliance for annual reporting of investments in certain entities,* which establishes regulatory requirements to meet the ERISA Section 103(a)(3)(C) audit election.

The U.S Securities and Exchange Commission does not permit ERISA Section 103(a)(3)(C) audits to be included with Form 11-K filings with the SEC under the Securities Exchange Act of 1934.

Qualified institutions

Only qualified institutions can certify information.

The DOL established requirements for qualifying institutions to certify information to the plan administrator in 29 CFR 2520.103-5 - *Transmittal and certification of information to plan administrator for annual reporting purposes*. Under DOL regulations, investments held by a bank, trust company, or similar institution or by an insurance company that is regulated and subject to periodic examination by a state or Federal agency, and related information do not have to be audited provided the plan administrator elects to instruct the plan's independent auditor to perform an ERISA Section 103(a)(3)(C) audit and the institution holding the assets certifies the required information as specified under DOL regulations.

In an Advisory Opinion to PaineWebber Inc. dated August 3, 1993, the DOL clarified that an institution must be subjected to routine examinations by a state or Federal agency in order to be considered a qualifying institution for purposes of certifying investment information and, as such, an institution that is not so regulated would not qualify:

> *"Inasmuch as securities brokerage firms are not regulated, supervised, and subject to periodic examination by a state or Federal agency, it is the Department's position that the term "similar institution," as used in 29 C.F.R. § 2520.103-8, does not extend to such entities."*

Although brokerage firms and investment companies generally would not meet the eligibility requirements for certifying information under the ERISA Section 103(a)(3)(C) audit election, some of those institutions may have established separate trust companies that may be eligible to meet the requirements of a qualified institution.

Proper certifications

Information must be certified as both complete and accurate and signed by an authorized person.

To meet the requirements for the ERISA Section 103(a)(3)(C) audit election, the qualified institution must certify both the completeness and accuracy of the required information, and the certification must be signed by a person authorized to represent the institution. An example of such certification provided in the regulations follows:

> The XYZ Bank (Insurance Carrier) hereby certifies that the foregoing statement furnished pursuant to 29 CFR 2520.103-5(c) is complete and accurate.

Certifications that only state the information is either accurate or complete, but not both, or are not signed by an authorized individual, do not meet the DOL requirements for a proper certification.

In situations in which an ERISA Section 103(a)(3)(C) audit is to be performed on a plan funded under a master trust arrangement or other similar vehicle, the plan administrator would need to obtain separate individual plan certifications from the trustee or the custodian for the plans' ownership interest in the trust or for the allocation of the trust assets and the related income activity to the specific plan.

In some cases, the trustee or custodian may not certify all of the plan's investment information. For example, the trustee or custodian may exclude investments from the certification, or plan management may change trustees or custodians during the plan year so each trustee or custodian held the assets for part of the year, and only one of the trustees or custodians will certify investment information for part of the year. In such cases, a certification from all trustees or custodians should be obtained by the plan administrator to ensure that the entire plan year is covered.

Plan administrator's responsibilities

The plan administrator is responsible for determining that the conditions of the ERISA Section 103(a)(3)(C) audit have been met and for preparing the plan's financial statements and disclosures.

Only the plan administrator can request the plan auditor to perform an ERISA Section 103(a)(3)(C) audit when all requirements are met. The plan administrator is responsible for determining that the conditions of the ERISA Section 103(a)(3)(C) audit election have been met. The DOL reinforced this position in a letter addressed to the AICPA in 2002:

> *"Consistent with the obligation of employee benefit plan administrators to file complete and accurate annual reports, it is the responsibility of the administrator to determine whether the conditions for limiting the scope of an accountant's examination, as set forth in ERISA and the department's regulations, have been satisfied."*

The plan administrator's responsibility for determining that the conditions of the ERISA section 103(a)(3)(C) audit election have been met includes determining that the investment information is prepared and certified by a qualified institution as described in 29 CFR 2520.103-8 and that the certification meets the requirements in 29 CFR 2520.103-5, including that the certification is signed by an authorized person and states that the investment information is certified as both complete and accurate.

In addition, the plan administrator's responsibility for preparing the plan's financial statements and disclosures includes the responsibility for determining that any certified investment information that is included in the financial statements is appropriately measured, presented, and disclosed in accordance with the applicable financial reporting framework. Accordingly, it is important that the plan administrator review the certified investment information that will be included in the financial statements to determine that the investments have been valued as of the plan's year-end and that the method for determining their fair value is in accordance with the applicable financial reporting framework.

If the plan administrator determines that the certification is not acceptable, the plan administrator would need to take appropriate steps to obtain an acceptable certification or engage the independent auditor to perform a non-section 103(a)(3)(C) audit, whereby the auditor performs further audit procedures on the investments and investment information.

If investments are excluded from the certification as discussed in the "Proper certifications" section above, those assets would not be eligible for the ERISA Section 103(a)(3)(C) audit election. In such cases, the plan administrator would be responsible for engaging the independent auditor to perform audit procedures on those investments that are excluded from the certification.

Effect on the auditor's responsibilities

An ERISA Section 103(a)(3)(C) audit restricts testing of certified investment information, but audit procedures need to be performed on other non-investment information and investment information that has not been certified.

When the auditor is instructed by the plan administrator to perform an ERISA Section 103(a)(3)(C) audit, the auditor has no responsibility to test the accuracy or completeness of the investment information certified by the qualified institution, obtain an understanding of internal control maintained by the certifying institution over investments held and investment transactions executed for the plan, or assess control risk associated with assets held and transactions executed by the institution. As such, the auditor would not need to obtain or review a SOC 1 report from the plan's certifying trustee or custodian relating to the certified investments.

However, the auditor is required at the engagement acceptance phase to inquire about how management determined the certifying entity is a qualified institution under DOL regulations, and during the audit, to review management's assessment of whether the entity is a qualified institution. The auditor also is required to obtain from management and read a copy of the certification; identify which investments are certified; compare the certified investment information with the related information presented and disclosed in the financial statements and ERISA-required supplemental schedules; and 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. The auditor also is required to obtain additional representations from management regarding its responsibilities when electing an ERISA Section 103(a)(3)(C) audit.

Plan investments not held by a qualified institution and any other investment or investment information not covered by the certification, including investment elections and income allocations to participant accounts should be subjected to appropriate audit procedures. This means that the independent auditor will perform audit testing—including understanding and documenting internal control and assessing risks—on the non-investment activity of the plan, such as participant eligibility, employee and employer contributions, benefit payments, and plan administrative expenses. A SOC 1 report relating to those areas should be obtained to enable the plan administrator and the auditor to review the controls over those activities. AU-C Section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA* describes the independent auditor's responsibilities in an ERISA Section 103(a)(3)(C) audit.

ERISA Section 103(a)(3)(C) audits in the current environment

Challenging valuation issues have arisen with certain investment options.

When the ERISA section 103(a)(3)(C) audit election was established by ERISA in 1974 the majority of plan investments were held in common stocks, mutual funds, bonds and other marketable securities with readily available prices provided by independent pricing services Since ERISA was enacted, many plans have shifted their investment line-ups to include "alternative investments" such as limited partnerships, private equity funds, and hedge funds which are less marketable, and whose market values are based on valuations determined by the fund administrator rather than independent pricing services.

Under ERISA, plan custodians or trustees are required to transmit and certify certain required information as described above, which reflects information that is considered to be part of the institution's "ordinary business records." The typical custodial service provided by trustees and custodians includes reporting values that are based on the best information available to them at the time the trust statements are produced. If the plan is invested solely in assets with readily determinable fair values, such as exchange-traded securities or other marketable securities, the trustee or custodian typically obtains values from nationally recognized pricing services.

However, in cases where the plan invests in assets without readily determinable fair values, the values in the trust statement may be a pass-through of the values provided by the fund issuer or general partner, or provided by a boutique vendor or broker for nonmarketable securities. In those cases, the reported values are based on the best information available to the trustee and custodian at the time the trustee or custodial report is prepared, which may or may not be fair value as of the plan's year end. Plan sponsors may also direct the trustee or custodian to use prices provided by a designated investment manager or fiduciary. The plan sponsor's contract or service agreement with the trustee or custodian will generally indicate how assets are to be valued and accounted for in periodic and annual reporting.

It is important to note that qualified institutions generally do not perform the fair value analysis required by generally accepted accounting principles (including the analysis required when using net asset value as a practical expedient) as part of the asset valuation and certification process. Management's responsibility does not necessarily end with the plan's receipt of the certification from the bank trustee. A fair value measurement analysis, which is beyond the scope of a certifying institution's production of annual statements and ordinary business records, is still required for all investments, especially for alternative investments or those assets that have not been priced by an independent source. This analysis is required to ensure that the value of the plan assets is consistent with the applicable accounting framework and ERISA requirements, regardless of whether the auditor is engaged to perform an ERISA Section 103(a)(3)(C) audit.

In addition to the changes in plan investment types, plan structures have also become much more complex. As discussed in the "Proper certification" Section above, there are reasons why some assets may not be covered by a certification at all. As such, it is important that plan administrators evaluate whether these ERISA Section 103(a)(3)(C) audit elections continue to make sense for their plan audits.

The auditor's report

An auditor would issue an ERISA Section 103(a)(3)(C) audit opinion in accordance with AU-C section 703when performing an ERISA Section 103(a)(3)(C) audit.

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.

Following is an example, excerpted from AU-C section 703, of an auditor's report with an unmodified ("clean") opinion for a defined contribution pension plan ERISA Section 103(a)(3)(C) audit. AU-C section 703 also includes example ERISA Section 103(a)(3)(C) auditor's reports with modified opinions.

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. [fn 31]

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.

[fn 31] If the note to the financial statements does not identify the names of the qualified certifying institutions and periods covered, then such information may be included in the auditor's report.

- the information in the accompanying financial statements related to assets held by [fn 32] 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 for [*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, there is a substantial likelihood that, individually or in the aggregate, they would influence the judgment made by a reasonable user based on the 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

[fn 32] This sentence may need to be modified when the certification is provided by an insurance entity, which provides benefits under the plan or holds plan assets.

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 [fn 33] and certified to by a qualified institution agrees to, or is derived from, in all material respects, the information

[fn 33] See footnote 32.

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*]

Additional resources

AICPA Audit and Accounting Guide, ***Employee Benefit Plans***, provides information about the ERISA Section 103(a)(3)(C) election and provides guidance on the auditor's responsibility when engaged to perform an ERISA Section 103(a)(3)(C) audit.

The AICPA EBPAQC Plan Advisory ***Valuing and Reporting Plan Investments*** may serve as a tool to assist the plan sponsor in understanding their responsibility in valuing and reporting plan investments.

29 CFR 2520.103-8 – Limitation on Scope of Accountant's Examination, provides ERISA guidance on the ERISA Section 103(a)(3)(C) audit election.
http://www.dol.gov/dol/allcfr/ebsa/Title_29/Part_2520/29CFR2520.103-8.htm

DOL *Advisory Opinion to Mr. Richard Bentley, Paine Webber Inc*., dated August 3, 1993, clarifies definition of an institution qualified to issue a certification. http://www.dol.gov/ebsa/programs/ori/advisory93/93-21a.htm