AICPA

Employee Benefit Plan
Audit Quality Center

Common deficiencies in ERISA Section 103(a)(3)(C) audit certifications

Common deficiencies in ERISA Section 103(a)(3)(C) plan audit certifications

Contents

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Common deficiencies in ERISA Section 103(a)(3)(C) audit certifications

Introduction

Note: This tool 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 other members of management.

Under certain circumstances, plan management may elect to engage the auditor to perform an ERISA Section 103(a)(3)(C) audit, which allows plan administrators to instruct the auditor not to perform any additional procedures with respect to the investment information prepared and certified by a bank or similar institution or by an insurance carrier that is regulated, supervised, and subject to periodic examination by a state or federal agency. This election is implemented by Title 29 U.S. *Code of Federal Regulations* (CFR) Part 2520.103-8 that outlines the DOL's rules and regulations for reporting and disclosure under ERISA.

One of the most common deficiencies found in EBP audits by the Department of Labor (DOL) and AICPA Peer Review program is the improper use of the ERISA Section 103(a)(3)(C) election because the certification did not meet the requirements in the CFR for an acceptable certification. The certification should be prepared by a qualified institution, and should be in writing and signed, either manually or electronically, by a person authorized to represent the qualified institution. It should be specific to the plan subject to audit, and the investments and investment information covered by the certification should be as of and for the period ended on the financial statement date. The ERISA Section 103(a)(3)(C) election is available only if the qualified certifying institution certifies both the accuracy and completeness of the investment information submitted.

The Employee Benefit Plan Audit Quality Center has developed this tool to help plan management understand its responsibilities for determining the acceptability of an ERISA Section 103(a)(3)(C) certification; help auditors understand their responsibilities with respect to the certification; and to help both plan administrators and auditors identify common deficiencies in certifications. It also includes an illustration of a proper certification.

Plan administrator's responsibilities for determining the acceptability of an ERISA Section 103(a)(3)(C) certification

As noted in an Information Letter issued by the DOL in May 2002, consistent with the obligation of plan administrators to file complete and accurate annual reports, it is the responsibility of the plan administrator to determine whether the conditions for electing an ERISA Section 103(a)(3)(C) audit, as set forth in ERISA and DOL regulations, have been satisfied. In addition, the Information Letter notes that plan administrators also should take steps to make sure they understand the nature and scope of the certification the institution has provided before concluding that the certified information may be used to satisfy the administrator's obligation to report the appropriate value of the assets. The DOL observed that if there is a question as to whether a party providing a certification as an authorized representative of a financial institution holding plan assets is in fact authorized to represent the financial entity for this purpose, as may be the case where there is not an explicit statement of authority included as part of the certification, the plan administrator must take steps to resolve this question before authorizing an ERISA Section 103(a)(3)(C) audit.

As part of its fiduciary duties, the plan administrator is responsible for determining whether the financial statements and note disclosures related to investment information are prepared in accordance with the applicable reporting framework and in compliance with DOL rules and regulations. In situations in which the plan administrator becomes aware that adequate year-end valuation procedures have not been performed, and, therefore, the financial statements may not be prepared in accordance with the appropriate financial reporting framework, the plan administrator may request the qualified certifying institution to recertify or amend the certification for such investments at their appropriate year-end values, or to exclude such investments from the certification. If the trustee or custodian amends the certification to exclude such investments from the certification, the plan administrator is responsible for determining the fair values of such investments as of the plan year-end and engaging the auditor to perform further audit procedures on the investments excluded from the certification. If the certification is not amended, it is the plan administrator's responsibility to determine whether the financial statements and note disclosures related to such investment information are prepared in accordance with DOL rules and regulations and the appropriate financial reporting framework.

Auditor's responsibilities related to the certification

AU-C section 703, *Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA*, includes requirements for auditors regarding the certification, and the AICPA Audit and Accounting Guide, *Employee Benefit Plans* (Guide), includes suggested audit procedures for meeting those requirements. The Guide is recognized as an *interpretive publication.* Auditing standards require the auditor to consider applicable interpretive publications in planning and performing the audit because interpretive publications are relevant to the proper application of GAAS in specific circumstances. If the auditor does not apply the auditing guidance in an applicable interpretive publication, the auditor should document how the requirements of GAAS were complied with in the circumstances addressed by such auditing guidance.

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.

Although the auditor has no responsibility to test the accuracy or completeness of the investment information certified by the qualifying institution, if the auditor becomes aware that the certified information is incomplete, inaccurate, or otherwise unsatisfactory, further inquiry may be necessary, which might result in additional testing or modification to the auditor's report. In certain instances, an ERISA Section 103(a)(3)(C) audit may no longer be appropriate. If, for example, the auditor becomes aware that adequate year-end valuation procedures have not been performed and, therefore, the financial statements may not be prepared in accordance with GAAP, it is important for the auditor to communicate those findings to the plan administrator.

Common deficiencies in ERISA Section 103(a)(3)(C) certifications

No certification or incomplete certification

- The plan administrator instructs the auditor to perform an ERISA Section 103(a)(3)(C) scope audit but does not obtain a certification from the qualified certifying institution.
- The plan changed custodians during the year, and neither entity certified the investment information. For example, the Plan used Entity X during the 20X5 plan year, but changed to Entity Y on 12/31/X5. Neither Entity X nor Entity Y certified to the assets; for administrative ease the statements of Entity X showed the assets as liquidated and certified as a zero balance at 12/31/X5. Entity Y did not receive the assets until 1/9/X6 so appropriately could not certify as being held by Entity Y at 12/31/X5.
- The plan changed custodians during the year, and only received a certification from one of the custodians.

Omissions and errors in the certification

- The certification does not include the plan name.

- The certification is not attached to plan investment information, so it's not clear what information is certified.
- The qualified certifying institution certifies to either the completeness or accuracy of the investment information, but not both.
- The certification is not signed.
- The certification is signed by an individual who is not authorized to represent the qualified institution.
- The certification(s) do not cover the entire period under audit.
- The certification does not cover the stated period (for example, the plan was terminated during the year (on 6/30/X6) but the certification states that it is as of and for the period ended 12/31/X6).
- The certification does not include all investments (for example, it covers separate account assets but does not cover general account assets).
- The certification is issued by an entity other than a qualified institution (for example, a recordkeeper that is not a bank, trust company, or insurance company) or similar institution, and is not acting as an agent for a qualified institution (for example, brokerage arms of certain banks/providers or investment companies).
- Qualifying language that conflicts with the assertion that certified information is accurate and complete (for example, a certification containing the following disclaimer language may impair the usefulness of the certification: "Values reflected for publicly-traded assets are from unaffiliated financial industry sources believed to be reliable. Values for non-publicly-traded assets may be determined from other unaffiliated sources. Assets for which a current value is unavailable may be reflected at the last reported price, at par, or may be shown as having nominal or no value. Reported values may not be the price at which an asset may be sold. Asset values are updated as pricing becomes available from external sources, and may be updated less frequently than statements are generated."

Information improperly certified

- Plan investments are certified by two different custodians when only one of them held the assets.
- The incorrect entity certifies the plan's investment information. This can happen when plans change custodians/trustees or merge with another plan. For example, Plan A merged into Plan B on 1/5/X6, and the transfer of Plan A's assets occurred on 1/15/X6. Prior to the merger Entity A was custodian for Plan A, and Entity B was custodian for Plan B; Entity B is the custodian for the merged Plan B. Entity B "backdated" the merger transaction to 12/31/X5 for a smooth transition on recordkeeping and certified all investment information, even though the processing and actual receipt of Plan A's assets had not yet occurred, and Entity A still held those assets.
- The certified statements include assets that are held by a separate custodian.

Incorrect/improper information

- The entity certifies current year ESOP units and activity, but the shares are certified at prior year values.
- Plan investments are improperly categorized in the certification (for example, the plan invests in a hedge fund that is listed in the certification as mutual funds).
- The certification includes investments purchased after year-end.
- The certified statements list the incorrect asset value due to errors in cutoff. For example, a plan purchases assets on 12/30/X5 (trade date) but the entity certifies the asset value is zero assuming the transaction will take 2 days to settle, but the actual settlement date was 12/31/X5.
- The certified trust statements include contribution and investment activity from the next period, indicating poor cutoff.

ERISA Section 103(a)(3)(C) certification

Example ERISA Section 103(a)(3)(C) scope certification that complies with the requirements of 29CFR 2520.103-5c.

What to look for…

- ✓ Prepared by a qualified institution (or authorized agent).
- ✓ Specifies the plan name.
- ✓ Attached to (or included with) the plan investment information being certified.
- ✓ Covers the entire period under audit.
- ✓ The institution certifies to *both* the completeness and accuracy of the investment information (no caveats or other qualifying language).
- ✓ Signed by an authorized representative of the qualified institution.

<u>ABC Institution [letterhead]</u>

Re: XYZ Profit Sharing and 401(k) Plan And Trust

Enclosed are the certified Trust Statements for the above referenced Plan(s) for the following periods:

- Certified Trust Statement covering the annual period through 10/31/X5 and
- Certified Trust Statement beginning 11/01/X5 through the end of the reporting period

ABC National Bank hereby certifies that the information furnished pursuant to 29CFR2520.103-5c is complete and accurate.

Please contact your Plan Manager if you have questions.

Sincerely,

Jane Doe

Jane Doe
Vice President, ABC National Bank