**403(b) Plan Annual Audits: Identifying Costly Reporting Errors, Evaluating Alternative Solutions**

TUESDAY, FEBRUARY 20, 2018, 1:00-2:50 pm Eastern

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403(b) Plan Annual Audits: Identifying Costly Reporting Errors, Evaluating Alternative Solutions

TUESDAY, FEBRUARY 20, 2018

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403(b) Plan Annual Audits: Identifying Costly Reporting

Kimberly Flett
Course Objectives

- Best practices for audit preparation
- Benefit plan audit experiences
- Relevant forms and regulations: Form 5500/Form 8955
- Common 403(b) operational errors
- Describe general features of a 403(b) plan
- Beginning balance considerations
403(b) PLANS

What Are They?

Internal Revenue Code (IRC) §403(b) plans - also known as “tax-sheltered annuity plans”

Retirement plans often offered by governments, schools, hospitals, churches, charities and certain other IRC §501(c)(3) tax exempt organizations

Law and regulatory changes since 1986 have slowly been eliminating any differences between 403(b) plans and 401(k) type plans - recent changes continue that trend.
## Features Of 403(b) Plans

<table>
<thead>
<tr>
<th>Eligible Groups</th>
<th>403(b)</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Universal Availability for deferrals</td>
<td>• May restrict groups from eligibility for employer contributions</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Plan Participant</th>
<th></th>
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</thead>
<tbody>
<tr>
<td>All employees with the following <strong>possible allowed</strong> exclusions:</td>
<td></td>
</tr>
<tr>
<td>• Non-resident aliens</td>
<td></td>
</tr>
<tr>
<td>• Those eligible for another salary deferral plan of sponsor</td>
<td></td>
</tr>
<tr>
<td>• Those who contribute &lt; $200 per year</td>
<td></td>
</tr>
<tr>
<td>• Service &lt; 20 hrs per week and expected &lt; 1,000 hrs per year</td>
<td></td>
</tr>
<tr>
<td>• Students of a university</td>
<td></td>
</tr>
</tbody>
</table>

| Trust Requirements | No trust requirement |

<table>
<thead>
<tr>
<th>Plan Documents</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>• Plan Document required as of December 31, 2009</td>
<td></td>
</tr>
<tr>
<td>• Prototypes available in 2010</td>
<td></td>
</tr>
<tr>
<td>• May consist of individual contracts</td>
<td></td>
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</tbody>
</table>

<table>
<thead>
<tr>
<th>Transfers to Other Plans</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Portability:</td>
<td></td>
</tr>
<tr>
<td>• Previous Rev Proc 90-24 allowed tax free transfers outside of Plan without any approval</td>
<td></td>
</tr>
<tr>
<td>• After Sept 2007, requires approval of sponsor or considered taxable</td>
<td></td>
</tr>
</tbody>
</table>
### Features Of 403(b) Plans

<table>
<thead>
<tr>
<th>Funding Investment Requirements</th>
<th>Limited to Insurance annuity contracts (including traditional annuities and pooled separate accounts) and shares of registered investment companies</th>
</tr>
</thead>
<tbody>
<tr>
<td>Funding Timing Requirements</td>
<td>...as of the earliest date on which such contributions can be reasonably segregated from the employer’s general assets</td>
</tr>
</tbody>
</table>
| Non-discrimination testing      | • Required for employer contributions  
• No ADP testing, due to Universal Availability for deferral contributions |
# Features Of 403(b) Plans

<table>
<thead>
<tr>
<th></th>
<th>403(b)</th>
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</thead>
</table>
| **Distributions**| - Outlined in Plan Document  
- Terms vary by age of contract and type of investment (restrictions on withdrawal rate) |
| **RMD (Required Minimum Distribution)** | - Only post-1986 balances are subject to RMD rules.  
- Pre-1987 balances may be paid out over a longer period of time. |
| **Contribution Types** | - Employee deferrals  
- Employer match  
- Catch up deferrals  
- Roth  
- Additional catch up deferrals for employees with 15+ yrs of service  
- Terminated employees can continue to make contributions for 5 years following severance |

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IRS Regulations - 2009 Was A “Do-Over” Year

Final IRS Regulations — issued July 24, 2007 — First regulations in 43 years — Applies to **ALL** 403(b) plans

Effective:
- Plan years beginning on or after January 1, 2009
- Written document requirement was delayed to December 31, 2009
- Prototype Plan (for public schools) issued April 14, 2009

May have significantly changed and/or increased the administrative burden and exposure for the “plan sponsor”
IRS Rev Proc 2017-18: Preapproved 403(b) Plan Document

- Identifies March 31, 2020, as the last day of the remedial amendment period for 403(b) plans using pre-approved plan documents
  - Includes standard, non-standard and volume submitter plans
  - Does not apply to individually designed plans

2009
- Written plan document (no IRS approval)

2020
- Plans to be restated into pre-approved document (if sponsor wants reliance)

- Adopting by March 31, 2020, the plan will be deemed to have retroactively satisfied the requirements (as of January 1, 2010)

- Anticipate future guidance regarding amendments made after March 31, 2020
Significant Provisions

► Elimination of special reporting rules for Code section 403(b) plans
  - [Link](http://www.dol.gov/ebsa/regs/fedreg/final/20071116.pdf)

► In turn, 403(b) Plans covered under Title 1 of ERISA are subject to:
  - Completion of Form 5500
    - Participants include those “eligible” under Universal Availability Rule and all former participants with account balances
  - Large Plans require engagement of an independent qualified public accountant (IQPA) to conduct an independent financial statement audit of plan
### Significant Provisions

<table>
<thead>
<tr>
<th>Is the 403(b) plan an ERISA plan?</th>
</tr>
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<tr>
<td>Generally, where there are employer contributions and/or</td>
</tr>
<tr>
<td>Where the employer exercises “control” of the plan</td>
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<th>Generally excluded from the Form 5500 &amp; audit requirements:</th>
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<tr>
<td>“Governmental plans” under ERISA section 3(32)</td>
</tr>
<tr>
<td>“Church plans” under ERISA section 3(33)</td>
</tr>
<tr>
<td>Plans that comply with DOL “safe harbor” rules under DOL regulation 29 C.F.R. § 2510.3-2(f)</td>
</tr>
</tbody>
</table>
2017 Form 5500

► IRS-only questions that were not required to be completed on the 2016 return have been removed.
  • Includes prepare information, Schedules H and I Lines 4o and 6a - 6d regarding distribution during working retirement and trust information, Schedule R Part VII
► Authorized Service Provider Signatures have been updated in order to sign on behalf of the plan sponsor.
► Line 4 of the Form 5500 has been updated for filers to indicate the name of the plan has changed.
► Schedule MB Line 6c has been updated to add mortality codes.

► Similar changes made to Form 5500 SF
► On Form 5500 EZ the Principal Business Activity Codes have been updated to reflect updates to the North American Industry Classification System.
Fees and Penalties: Department of Labor and IRS

- The penalty for failure to timely file Form 5500 will be adjusted for inflation by January 15th of each year
  - The penalty is $2,140 per day for penalties assessed after January 13, 2018 where violations occurred after November 2, 2015.
  - Important to check the Federal Register for any possible inflation adjustments that may occur after the 5500 is published for the year.

- Additional sanctions for ERISA violations include:
  - Failure to provide the Department of Labor requested documentation equals $152 per day not to exceed $1,527 per request.
  - Failure to furnish reports such as benefit statements to certain former participants and beneficiaries or maintain records is $29 per violation.
## Notable Proposed Changes to Form 5500

<table>
<thead>
<tr>
<th>Expanded disclosures for plan audit report</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Limited scope audit certification to be attached</td>
</tr>
<tr>
<td>• Name of audit engagement partner and audit matters</td>
</tr>
<tr>
<td>• Auditor’s communications with those charged with governance</td>
</tr>
<tr>
<td>• Audit firm’s peer review information</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Detailed investment / compliance information</th>
</tr>
</thead>
<tbody>
<tr>
<td>• More detailed reporting on general classes of investments with an emphasis on alternative, hard to value assets and collective investment vehicles</td>
</tr>
<tr>
<td>• New questions regarding plan operations, service provider relationships, financial management of plans</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Additional service providers / fees information</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Require reporting of indirect compensation for service providers and types of compensation</td>
</tr>
<tr>
<td>• Reporting thresholds would correspond with those in the 408(b)(2) regulation</td>
</tr>
</tbody>
</table>

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<tr>
<th>New reporting for group health plans</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Eliminates current exemption from Form 5500 reporting for small insured/unfunded group health plans</td>
</tr>
<tr>
<td>• Creates a new Schedule J (Group Health Information)</td>
</tr>
</tbody>
</table>

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<th>Audit requirements</th>
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<td>• May be affected due to changing the audit count threshold to participants with actual account balances</td>
</tr>
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</table>

Not a comprehensive list!
Agenda

• Defining “the Plan”
• Universal availability – audit implications
• Beginning balance considerations
• Consideration of excludable contracts
• Auditors opinion
• Plan (policy) loans vs participant loans
• Understanding plan investments
• Continuing engagements
Defining “The Plan”

• How many plans are there?
  • Multiple plans vs multiple vendors

• ERISA vs. Non-ERISA
  • Generally if the employer is involved with the plan, it falls under ERISA

• Written plan documents
  • Must contain all material terms, such as eligibility, benefits, limits, distribution provisions
  • Must identify providers who have contracts under the Plan
    • Provider can be active or inactive
  • *Written plan must be the same as plan operation*
Who is eligible to participate?

Universal availability: All employees must be allowed the opportunity of elective deferrals if any employee may elect to elect to have the organization make 403(b) elective deferrals.

• Applies to public schools and exempt organizations.
• Not applicable to churches or church controlled organizations
• Concept of nondiscrimination – ADP testing is not required
Limited optional exclusions

- Employees that are eligible to participate in another plan
- Nonresident aliens
- Employees who normally work less than 20 hours a week
- Employees that wish to defer less than $200/year
Beginning Balance Considerations
Field Assistance Bulletin ("FAB) 2009-02

- For Form 5500 reporting purposes, certain assets can be excluded
- Issued July 20, 2009
- Provides guidance to DOL Field Offices
- Provides Enforcement Relief for Form 5500 filings
  - Does NOT provide audit relief
- Relief is granted for contracts or accounts that meet 4 criteria
FAB 2009-02

The Four Criteria

1) Contract or account was issued to a current or former employee before January 1, 2009

2) Employer ceased to have any obligation to make contributions (including employee salary reduction contributions) and in fact ceased making contributions before January 1, 2009

3) All rights and benefits under the contract or account are legally enforceable against insurer or custodian of contract by the individual owner, without any employer involvement

4) The individual owner of contract is fully vested

All of these contributions must be met to qualify for enforcement relief
Consideration of Excludable Contracts

• The FAB allows, but does not require, that contracts and/or accounts be excluded
• The FAB applies to both large and small plans
• Current or former employees with contracts excludable under this relief are not counted as participants
  o Note: This does not change the IRS’s Universal Availability Rule
• The FAB also applies to years beyond 2009
Impact On The Auditor’s Opinion

• ERISA and current regulations require audit be performed in accordance with US Generally Accepted Auditing Standards (GAAS) – all plan assets to be reported

• Exclusion by plan sponsor of contracts and/or accounts that meet criteria of the FAB will likely prevent auditor from being able to issue an unqualified opinion

• The FAB provided that DOL/EBSA will not reject a 403(b) plan Form 5500 filing **solely** because audit’s report is qualified, adverse or disclaims an opinion (other than a “limited scope” disclaimer allowed under 29 CFR 2520.103-8) due to exclusion of pre-2009 annuity contracts and/or custodial accounts meeting **all** 4 criteria
Note:
Regardless of the type of opinion issued, auditor is still required to complete all other audit procedures (e.g., contributions, distributions, etc.)
Participant loans vs. Loans to Participants

- Loans “inside” and/or “outside” of the Plan
- Account balance is used as collateral
- Loan is between participant and the insurance company
Investments

Investment vehicles

- Annuity Contracts from an insurance company
- An annuity is an insurance contract that provides a guaranteed investment. The annuity contract can be variable or fixed
- A custodial account invested in mutual funds
- A retirement income account set up for church employees

Assets are not held in a trust as other qualified plans
Limited-scope versus Full-scope

Limited-scope audits:

• Reliance on certification from a reputable trustee/bank/insurance carrier – institution approved under DOL guidelines. (Ex: No broker/dealers or investment companies)
• There are often multiple service providers for one plan
• NOTE: Make sure all investments are certified, some may be excluded or have a separate certification.

Full-scope audits:

• Additional testing of investment transactions
The Bottom Line

❖ Auditor is responsible for following GAAS and still needs to audit available information
  • Auditor is responsible to conduct an audit; cannot limit test work due to a scope limitation or because auditor is issuing a qualified or an adverse opinion

❖ Auditor is responsible for issuing the appropriate opinion which includes disclosing reasons for any qualifications

❖ Ongoing issue, especially with “new” clients with un-modified opinions
  • Auditor may need to determine whether opening balance testing was performed for 2009
What does this mean going forward?

Change in auditor

- Opinion – cannot take the prior firms opinion at face value
- Prior auditor review
  - Work on opening balances
  - Consideration of excludable contracts

New Audits

- Client acceptance
- Initial audit procedures
- Opinion

Continuing Engagements

- More contracts identified
- Change in service providers
  - Contract restrictions
Common 403(b) Operational Errors
And Fixes
With you today

WENDY SCHMITZ
Assurance Director
Carolinas Employee Benefit Plan Practice
BDO USA, LLP

wschmitz@bdo.com
Common 403(b) Findings

- Lack of understanding of fiduciary oversight
  - Investment monitoring
  - Internal controls
Common 403(b) Findings

Lack of Understanding of Regulatory Requirements

- Audit requirement
- # of Plans
- ERISA vs. Non-ERISA plans

Generally excluded from the Form 5500 & audit requirements:

- “Governmental plans” under ERISA section 3(32)
- “Church plans” under ERISA section 3(33)
- Plans that comply with DOL “safe harbor” rules under DOL regulation 29 C.F.R. § 2510.3-2(f)

Is the 403(b) plan an ERISA plan?

- Generally, where there are employer contributions and/or
- Where the employer exercises “control” of the plan
Common 403(b) Findings

Plan documents

- ERISA
- Multiple Accounts
- Prototype Plans
- Lacking regulatory updates
Common 403(b) Findings

- Missing participant records

- Eligibility provisions
  - Universal Availability provisions
  - Especially for part time and adjunct employees
Common 403(b) Findings

- Incorrect employer contributions
- Late remittance of employee deferrals
Common 403(b) Findings

Failure to properly apply plan’s definition of compensation

- Especially for stipends and other non-base contract compensation
Common 403(b) Findings

- Many of the errors found in testing at the participant detail level
- Not appropriate to extrapolate participant level errors
403(b) Plans

Determine materiality of error / potential impact

Determine if additional footnote disclosures are required

Audit Implications of Errors

Determine if additional supplemental schedules are required

If material and F/S are not corrected, qualified disclaimer opinion?
DOL Correction Methods

- Title I of ERISA generally applies to employee benefit plans, except for gov’t, church, unfunded excess benefit plans

- Title I includes fiduciary standards and reporting requirements

- The DOL’s Employee Benefits Security Administration (EBSA) enforces Title I of ERISA
  - VFCP- Voluntary Fiduciary Correction Program
    - Delinquent participant contributions
    - Participant loan violations
    - Purchases, sales and exchanges with PII
  - DFVCP- Delinquent Filer Voluntary Corrections Program
    - Late or non-existent Form 5500 filings
IRS Correction Methods

► Title II of ERISA includes tax qualification requirements and prohibited transaction excise taxes

► The IRS enforces Title II of ERISA
  – EPCRS- Employee Plans Compliance Resolution System
    • Self-Correction Program
    • Voluntary Correction Program (VCP)
    • Audit Closing Agreement Program (CAP)

► General principle= put participant in the same place as they would have been had the error not occurred, including lost earnings

► Covers most operational errors
403(b) Plans

IRS Revenue Procedures

► Revenue Procedure 2013-12 ("EPCRS") incorporated 403(b) Plans
► Previously, no correction method available for 403(b) operational errors
► Includes a 403(b) Plan Fix-It Guide
► Revenue Procedures 2016-51 recently revised 403(b) plan issues and limits
403(b) Plans

Provides guidance specifically directed at 403(b) plan sponsors for help with qualification or operational plan failures.

First step since the new regulations that the IRS is taking to ensure compliance under these types of plans.

**IRS - 403(b) Plan Fix-It Guide**

Included is a Voluntary Correction Program Submission Kit.

The tool addresses 10 potential errors for these plans.