BEST PRACTICES


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PREPARING FOR A 403(b) AUDIT

Audits are new territory for many 403(b) plan sponsors but being well prepared will go a long way toward helping them through the process.

In this series on 403(b) plan audits and compliance issues, we'll follow the fortunes of Worthy Academy, a tax-exempt private school covering grades 6 through 12. When it was founded in the mid-1970s, employees were permitted to maintain individual 403(b) annuity contracts or custodial accounts or contracts. Worthy later added matching contributions, adopted a plan document, and otherwise complied with applicable provisions of ERISA Title I, including annual filing of Form 5500.

Worthy's first task is to determine whether its 403(b) plan requires an audit. Although it seems like an easy question to answer, it's actually rather complicated. The general rule requires an audit if the plan has 100 or more participants on the first day of the plan year in question. Special rules apply when the participant head count fluctuates between 80 and 120.

For purposes of the head count, Worthy must count all employees who meet plan eligibility requirements. It must also count participants who've separated from the organization but still have an account balance on the first day of the plan year. Worthy had 125 participants as of January 1 (95 are contributing, 15 are eligible not contributing, and 15 are separated with money in the plan).

Another factor that complicates the audit determination is found in DOL Field Assistance Bulletin (FAB) 2009-02. FAB 2009-02 allows the plan sponsor to exclude certain contracts from plan assets subject to audit. A contract that meets all of these criteria commonly is referred to as a "pre-2009" contract. Plan sponsors may need assistance determining whether contracts satisfy the criteria. It's worth taking some time and effort to identify pre-2009 contracts, as it might allow the sponsor to postpone an expensive audit process for several or more years. This is because it may exclude, from its 100-participant head count, employees and former employees whose plan accounts consist only of pre-2009 contracts.

There's need for caution in this area, however, because participants (and related investments) that have been excluded under FAB 2009-02 may need to be re-included in the participant head count subject to the conditions explained in FAB 2010-01. FAB 2010-01 provides guidance on the scope and conditions for relief when contracts are moved to a new service provider, when final contributions are remitted, and when loan payments are forwarded. Your CPA, TPA, or RIA may help a sponsor to determine whether an audit is required.

Worthy isn't able to exclude any of the 15 contracts maintained by former employees. Even though they all predated January 1, 2009, none of them satisfied the criteria relating to "no employer involvement" because distribution forms require Worthy's approval.

Once a plan sponsor has determined that an audit is required, it must decide who will be the auditor's primary contact. This person should have a working knowledge of the day-to-day operation of the plan and be readily available to the auditor.

The next step is to assemble the plan documents and related records. This will include identifying all service providers and obtaining copies of the:

- plan document
- summary plan description
- auditor's package
- fidelity bond
- investment policy statement
- Form 5500

The sponsor will want to be familiar with these documents because once the auditor has reviewed them, the auditor will interview the sponsor's staff about its operation of the plan. This is done to develop an understanding of how the plan operates (otherwise known as the system of internal controls) and to identify risks of operational defects and/or misstatement of the financial statements. The auditor may also interview selected service providers, such as the TPA, based on identified risks and involvement with the transactions.

The auditor will also discuss the plan sponsor's fiduciary review process. It's important to identify all fiduciaries and to understand the services they provide. Sponsors are required to document their review of the services provided to the plan, the compensation paid by the plan for these services, and the changes to services or investment funds that were made or contemplated during the plan year. The new fee disclosure rules will substantially increase their responsibilities. Sponsors may consider engaging an RIA to assist them, especially if their plan offers unrelated investment funds.

Next, the auditor will visit the plan sponsor's office to examine personnel, payroll and other records of transactions that were reported during the plan year. The auditor will ask questions and obtain copies of records of specific transactions, such as participant loans and distributions. Sponsors can expect the auditor to spend time with the administrator, and possibly other staff members, to advise of the auditor's findings and to provide an opportunity to ask questions.

This article is the first in a series of three articles aiming to break down and demystify the plan audit process. Subsequent chapters will identify the most common operational and compliance defects that are found during the audit process, and will outline correction methods that 403(b) plan sponsors may use to resolve plan failures.

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