

## PAINLESS 403(b) PLAN AUDITS

### What and How to Prepare

With the advent of new pension regulations that affect not-for-profit organizations, plan sponsors of 403(b) plans are facing sweeping changes to their audit requirements this year. Beginning with the 2009 plan year (plan years beginning on or after January 1, 2009), all ERISA 403(b) plans are subject to the same Form 5500 reporting requirements as qualified retirement plans (seven months after year-end, with a two-and-a-half month extension). For 2009 calendar-year-end plans, the due date is July 31, 2010 with an extension to October 15, 2010. For June 30, 2010 fiscal-year-end plans, the due date is January 31, 2011 with an extension to April 15, 2011.

If your organization has never had an audit, the process, since it is new to you, may be daunting. If you are familiar with the audit process, the daily activity may be the same. However, you may now need to gather documents and information that you haven't previously maintained. The challenge for plan sponsors—and their auditors—is to make the audit process as painless as possible. The audit should, and can, be a smooth operation.

#### Audit Objectives and Requirements

An audit should not be a dreaded time of year. If the audit is planned and completed properly, there should be minimal disruption to your operations and your staff. A key to accomplishing this is to ensure that all required audit steps are performed without lost or down time to your staff and organization. An audit firm that understands not only the accounting rules but the Department of Labor (DOL) requirements can achieve a smooth audit.

The secondary goal of the audit is to complete all the requirements well in advance of the statutory deadline.

not a bank, insurance company, or similar institution, then a certification may not be valid and a full-scope audit will be required.

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So how do you know if your plan requires an audit? Generally, plans with 100 or more eligible participants are subject to the audit requirement. Eligible participants include active participants, individuals who have account balances but are no longer employed by the sponsor, and those who are employed by the sponsor but who have chosen not to defer any salary. Typical plans subject to the audit requirement include defined contribution; defined benefit; health and welfare; and beginning with the 2009 plan year-end, 403(b) plans.

#### Full- or Limited-Scope Audit

If your plan requires an audit, there are two types of audits that can be conducted—full scope and limited scope. A full-scope audit will cover all components of the financial statements, whereas a limited-scope audit includes all of the accounts of your financial statements except for investments and investment income which are covered by a certification. As auditors, we rely on information obtained from your trustee or custodian as it relates to the valuation of investments and the income generated from such investments. For limited-scope audits, you will need a proper certification from your trustee or custodian. If your trustee or custodian is

If you have a 403(b) plan, you may be wondering whether it falls under the new audit requirements. Generally, the answer is it does if you can answer yes to all of the following questions:

- Is the sponsor of your plan a college or university, or a tax-exempt organization?
- Does the plan fall outside of the DOL Safe Harbor Rules?
- Were there more than 100 eligible participants at the beginning of the year?

If you are unsure about whether your plan is subject to the audit requirement, consult your legal advisor for clarification. Be aware that if you are required to undergo an audit and fail to do so, civil penalties can be assessed by the Internal Revenue Service.

#### Regulatory Issues and Obstacles

The most talked about regulatory issue for 403(b) plans is the DOL Field Assistance Bulletin (FAB) 2009-02 which was issued in July 2009. This bulletin provided a safe harbor for 403(b) plans. If your plan meets all of the criteria outlined below, then you may fall below the eligible participant level and an audit is not required. This FAB provides “transitional relief” to those plan sponsors where the administrator does not treat annuity contracts and custodial

accounts as part of the plan assets for the purposes of ERISA's annual reporting requirement. As such, those participants would not be included in the participant count. How do you know if your contracts and/or accounts fall under the safe harbor rule? They must meet all of the following criteria:

- The contract or account was issued to a current or former employee before January 1, 2009
- The employer ceased to have any obligation to make contributions and, in fact, ceased making contributions to the contract or account before January 1, 2009
- All of the rights and benefits under the contract or account are legally enforceable against the insurer or custodian by the individual owner of the contract or account without any involvement by the employer
- The individual owner of the contract is fully vested in the contract or account

Let's assume that at the beginning of the year there were 120 participants in the plan; however, 50 participants fall under the safe harbor rule as of the beginning of the plan year. As a result, there are now 70 participants as of the beginning of the plan year. Hence, the plan is no longer required to undergo an audit in accordance with Title I of ERISA.

This issue is extremely important as the completeness of participant data and records from prior year(s) is a keystone of the audit. Without the ability to determine whether all of the participants are included, an auditor may not be able to draw a conclusion that would yield an unqualified audit. Historically, the DOL has rejected all audits without an unqualified or limited scope opinion. If the auditor is unable to determine if all of the participants are included in the scope of the audit, then historically the audit opinion would be other than an unqualified or limited scope opinion. The DOL has indicated that plan sponsors need to do the best they can to determine all of the participants included in the plan as well as the participants' information. It's important to obtain all pertinent participation information, including current-year address, and other

critical data. Sponsors have been compiling participant information by reviewing the prior-year participant records and following the trail of payments from the current and past years for vendors and/or contracts. Once again, the DOL asks that administrators make a good faith effort to locate all of the participants and/or vendors and contracts.

### Working Effectively with Your Auditor

A smooth and painless audit is accomplished when the auditor and the auditee work together to make the audit an efficient exercise. Advance preparation is key to a smooth and effective working relationship with your auditor.

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**The most important key to an efficient and painless audit is communication between you and your auditors.**

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You should provide all pertinent plan documents prior to the start of actual fieldwork. These may include your plan document, summary plan description, current-year plan amendments, determination letter, minutes of the board or investment committee, adoption agreement, trust agreement with trustee/custodian, service agreement with your third-party administrator, plan amendments, fidelity bond, IRS determination letter or opinion letter, change of name authorization, and sample participant enrollment kit.

It's important that you understand the audit plan. If you are unsure about what your auditors will be doing, then you will not be well prepared to work with them. If the audit plan changes, be sure to get an update so you can assist the auditors appropriately. **The most important key to an efficient and painless audit is communication between you and your auditors.** Ensure that you get an update as to progress and open items throughout all phases. Communicate your needs and concerns (if any) in the execution of the audit plan. Ensure that you understand what the audit team expects out of the whole process and that they receive everything they need to get the engagement completed in a timely manner. It behooves both parties to ensure that fieldwork is completed in the agreed-upon time and that the auditor

does not have to leave the field and return due to missing information. This leads to inefficiencies and time delays. In addition, be sure to convey to the audit team what you want and expect out of the audit exercise so your expectations are met.

### What J.H. Cohn Brings to an Audit *How We Work*

We understand the challenges that not-for-profit organizations face in complying with the new 403(b) regulations. Our employee benefit plan professionals have the necessary experience in employee benefit plan auditing, reporting, and compliance consulting to assist tax-exempt

organizations in meeting their fiduciary requirements. Our employee benefit plan practice provides these services to more than 450 plans.

As your auditor, our responsibility is to ensure that the audit is planned and carried out according to mutual expectations. On the first day of scheduled field work, we will arrive with the documents that we previously requested for planning purposes as per our arrangement letter so your staff does not have to retrieve the information for us once we arrive on site. Most important, throughout the process, we maintain constant communication with you. Another important role we assume is assistance with the preparation of your plan's financial statements.



## **Planning**

In advance of any work, you will be required to sign an engagement letter. This document outlines the scope of the engagement and the understanding you have with J.H. Cohn and what we will do for you. Review the fee structure and ensure that it meets your expectations. Along with the engagement letter you will receive an arrangement letter which sets forth the schedules to be prepared by your staff and other information that we require to be made available to us on the first day of fieldwork.

The most important planning function and a required aspect of the audit is for us to gain an understanding of—and document—your internal controls. You can assist us with this procedure by:

- Providing write-ups of policies and procedures of key plan-related transactions/cycles (new audits)
- Updating any changes in your policies and procedures since your last audit
- Assisting us with our walkthrough procedures to document the internal controls
- Obtaining and being familiar with Third-Party Administrator (TPA) and Trustee SAS 70 reports and what current user controls you are responsible for. We use a SAS 70 to reduce the amount of testwork that we do on certain areas. If you are not performing the user controls that are required by the trustee or custodian, we may not be able to reduce our testing, which will result in a longer audit and additional cost.
- Preparing the confirmations that are sent to active and non-active participants. It saves time and money if you facilitate the process of helping us obtain the signed or electronic responses.
- Having the discrimination testing completed early
- Facilitating interviews we are required to conduct in order to document the consideration of fraud risks. We may need to speak with plan administrator(s); key payroll employees; Human Resources employees; and finance department employees, if your accounting is done internally.

In addition, ask your TPA, trustee, or custodian to send the “auditors package” directly to us well in advance of planned fieldwork. This package should include items such as:

- Appropriate certification (for limited-scope audits)
- Summary trust statements
- Participant statements
- Forfeiture activity
- Participant loan balances and activity
- Distributions
- Activity by investment
- SAS 70 reports
- Required annual compliance testing

## **Fieldwork (Including Testing)**

Since the ultimate result of the audit is compliance with Generally Accepted Accounting Principles (GAAP), as well as DOL rules and regulations, there is required testing that we need to conduct and complete, including the following:

- As your auditor, we must ensure that you are remitting participant contributions in a timely manner. Be prepared with a schedule showing how much is due to be remitted by pay period and when it was remitted, i.e., how many days after the pay period. The DOL requires all plan sponsors to deposit employee deferrals into the plan as soon as the money can be segregated from the general assets of the sponsor.
- Another of our requirements is to document the total contributions per your records and agree this to plan records. Have evidence ready of total contributions as per your general ledger or other documents. We will reconcile the contributions to the Form W-2s or equivalent.
- We will request files and records for a specified number of participants (based on size) and test that contributions were made in accordance with the participant’s wishes and that the participant is eligible to participate in the plan. Items that will be needed include payroll journals, employee files, and enrollment records.
- Also needed is documentation on a specific number of participant distributions (based on size). Necessary documents include distribution request and a copy of the check, if applicable.

- New and existing loans must be tested for loan compliance, based on size. Items that will be needed include loan authorization/request, amortization tables, etc.
- With regard to investments of a limited scope due to certification of balances from the trustee, it would be helpful to gather additional information such as determination of fair value disclosures (formerly SFAS 157) and classification of contributions.
- For full-scope investments, we need assistance in gathering information to test the investment balances including audited financial statements for investments such as common collective trusts (CCTs), pooled separate accounts (PSAs) or alternative investments; internal financial statements for hedge funds or similar assets; and appraisal or valuation reports.

## **Reporting**

Once the audit is complete, we will provide an audit report that consists of the following:

- Financial statements, including Statement of Net Assets Available for Benefits, Statement of Changes in Net Assets Available for Benefits, and Notes to Financial Statements
- Supplemental Schedules to be Attached to the Financial Statements, including Schedule of Assets (Held at End of Year), Schedule of Assets (Acquired and Disposed of Within Year), Schedule of Reportable Transactions, and Schedule of Delinquent Participant Contributions

## **IRS Form 5500**

IRS Form 5500 should be prepared by the trustee or the third-party administrator. The Form 5500 should be completed prior to the issuance of financial statements and the data contained within should reconcile to the audited financial statements.

For the Form 5500, there is an electronic filing requirement for all plans beginning January 1, 2009 utilizing the DOL ERISA Filing Acceptance System (EFAST2). All plan sponsors must register with EFAST2 for “filing signer” credentials. All forms will be posted online as public information along with a copy of the audited financial statements.

In addition to answers to the basic information included on the Form 5500, beginning and year-end participant counts are required. Several schedules also must be attached and filed, including:

- Insurance information (Schedule A)
- Service provider information (Schedule C)
- Direct filing entity information (Schedule D)
- Financial transaction schedules for prohibited transactions (Schedule G)
- Financial information (Schedule H)

Large plans must attach a complete set of financial statements that have been audited. These financial statements will be open to the public.

### ***What You Receive From Us (In Addition to the Audit Report)***

Our communication to plan management, throughout the audit and at its completion, is covered by SAS 114, *The Auditor's Communication with Those Charged with Governance* and SAS 115, *Communication of Internal Control Related Matters Identified in an Audit*. The latter covers "material weaknesses" and "significant deficiencies." There is also the management letter, which addresses matters that are not deemed as serious as those included in SAS 115.

### **A Painless Audit is Possible; It Comes Down to Careful Planning and Preparation**

Lay the groundwork now to ensure your plan's compliance with the new requirements.

The new filing and audit regulations may seem daunting, but your accounting firm can help clarify the issues and help you prepare for your audit. Together with your auditor, you can achieve a smooth, timely, and successful audit. ■

*For more information, contact Evan Zuckerman, CPA, J.H. Cohn partner and director of the Firm's Employee Benefit Plans Practice, at [ezuckerman@jhcobn.com](mailto:ezuckerman@jhcobn.com) or 973-228-3500.*

For more information on J.H. Cohn's Employee Benefit Plans Practice, [click here.](#)

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