Secrets to a Successful

2010 403(b) Audit and 5500 Filing

May 24, 2011

Meet the Presenters

Mike Webb, Vice President, Retirement Services

Donna M. Massanova, Partner, Employee Benefit Plans

Gregory L. Needles, Partner, Employee Benefits and Executive Compensation Practice

Amy Pocino Kelly, Partner, Employee Benefits and Executive Compensation Practice

2010 Plan Year Audit and 5500 Issues

2010 Plan Year 5500 Issues

- Form 8955-SSA (Former Schedule SSA)
- Audits: Year 2
- Schedule C

Form 8955-SSA (Former Schedule SSA)

- Brand new requirement for 403(b) Plans
- Report of terminated employees whose vested benefits remain in the plan to the Social Security Administration
- Was part of the 5500 filing until 2009, when the public disclosure of the 5500 was incompatible with the private information (social security numbers) present on the form

Form 8955-SSA (Former Schedule SSA)

- Now a separate form, filed with the IRS only
- Requirement was supposed to commence with the 2009 plan year, but delayed since new form was unavailable
- Final form for 2009 expected no earlier than end of March, must be filed by due date of 2010 5500 filing (8/1/2011, unless extended to 10/17/2011) for calendar year plans

Form 8955-SSA (Former Schedule SSA)

- 2010 Form not expected until later this year; since the due date of the 2010 filing will be the same as for 2009 (8/1/2011, unless extended), the 2009 form may be used

- Final form for 2009 provided May 2, 2011, must be filed by due date of 2010 5500 filing (8/1/2011, unless extended to 10/17/2011) for calendar year plans. FAQ clarified that a single 2009 form can be used to report both 2009 and 2010 information

Audits: Year 2

- For large plans, initial (2009) audits were difficult, if not impossible, due to nature of 403(b) plans
  - Assets NOT held in trust
  - Many service providers did not have infrastructure in place to report assets at plan level
  - Individual contracts owned by employee served as a barrier to audit

DOL/GAAP Conflict

- DOL permitted an exemption for certain plan assets from 5500 reporting requirements with the issuance of the 2009 Field Assistance Bulletin (“FAB”) IF the following criteria were met:
    - the contract or account was issued to a current or former employee before January 1, 2009;
    - contributions ceased prior to January 1, 2009;
    - all of the rights and benefits under the contract or account were legally enforceable against the insurer or custodian by the individual owner of the contract or account without any involvement by the employer; and
    - the individual owner of the contract is fully vested in the contract or account.

DOL/GAAP Conflict

- However, generally accepted accounting principles (GAAP) require auditors to account for and verify such assets regardless of the whether the DOL states such assets are reportable on the 5500 to issue a clean opinion

- Such assets were difficult/impossible to verify, which is why DOL granted the exemption in the first place (Catch-22!)

DOL/GAAP Conflict

- **The result:** many plans did not receive “clean” audit opinions, instead receiving qualified, adverse, or disclaimed audit opinions, modifications due to the 2009 FAB were considered acceptable for DOL requirements

- DOL did not reject 5500s for such opinions if resulting from exempted pre-2009 contract issues, but such opinions are clearly not desirable on a go-forward basis, and will remain with the plan into perpetuity unless additional information is obtained, audited and these contracts are scoped into the audit

Other Audit Issues

- Opening Balance Issue
  - If opening balances for last year could meet the objective of completeness, this will carry forward
  - However, if opening balances met the objective of completeness for 2009, there is no issue for 2009 and future years
  - Many plan sponsors reported requests from auditors to provide historical data for prior years to be difficult as to the number of years often requested in order to certify opening balances

Other 403(b) Audit Issues

- Comment letters from the Auditor

  - Have you received communication in the form of a letter from the Auditor?

  - How does this communication affect the plan, management and the audit?

  - What do these letters communicate?

SAS 115 – Overview

- The Auditing Standards Board issued **SAS No. 115**, *Communicating Internal Control Related Matters Identified in an Audit*, for audits of financial statements.

- The terms are defined in the new standard as follows:

  - A *material weakness* is a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis.

  - A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

- The new standard eliminates the list of conditions that are ordinarily considered to be significant deficiencies and pares down the list of conditions considered to be indicators of material weaknesses.

Common Causes of Internal Control Comments

- Lack of reviewing the SAS 70s for the service providers
- Lack of reconciling information received from the service providers to the plan sponsor’s records (specifically plan assets to participant accounts, contributions posted to the Plan)
- Lack of monitoring the Plan and related investments
- Issues with ineligible wages being included in deferral calculations
- Proper application of Universal Eligibility
- Lack of plan sponsor fiduciary oversight
- No review of benefit payment calculations
- Timeliness of contributions

Improving the audit process for 2010

- Most audits should be less difficult in general, since the auditors will have a year of experience with the plan under their belts

Improving the audit process for 2010

- Plan sponsor should conduct a “lessons learned” meeting with auditor and vendor to recap 2009 process and remedy any issues for 2010.

- Plan sponsors with multiple plans/vendors should consider consolidation to simplify audit and many other administrative processes.

Schedule C

- It has always been the required disclosure of expenses for the plan. Exception: Insurance company commissions/fees, which are required to be reported on Schedule A
- However prior version of schedule was generally limited to direct compensation of $5,000 or more
- New schedule includes direct compensation and certain “eligible” indirect compensation paid by PLAN (NOT employer)
- Limited to LARGE plans (100+ participants)

Compensation Definitions

- Direct compensation largely unchanged
  - Direct charge against plan assets (including forfeitures)
  - In connection with
    - Services rendered to the plan
    - An individual's position within the plan

Compensation Definitions

- Indirect compensation changed from vague definition (little clarity as to what to include, except for finder's fees) to specific definition with examples in the form of DOL FAQs:

  http://www.dol.gov/ebsa/faqs/faq_scheduleC.html

  http://www.dol.gov/ebsa/faqs/faq-sch-C-supplement.html

Indirect Compensation

- Compensation NOT paid directly by the plan or plan sponsor
- Generally, these are expenses charged against plan investments
- Litmus test:
  - Would compensation have been paid anyway if service in question was NOT provided (or transaction in question had NOT taken place?)
  - If yes, compensation is NOT indirect compensation

Eligible Indirect Compensation

- Fortunately for bundled service providers, for whom it might be extremely difficult to allocate indirect compensation among its client base, not all reportable compensation is, in fact, eligible indirect compensation.

- Eligible indirect compensation is defined as fees that are charged against plan investments that directly affect investment return.

Eligible Indirect Compensation

- If indirect compensation is "eligible" and certain disclosures are provided, the source of such compensation need not be identified on Schedule C, only the entity that provided the disclosures.

- Many bundled service providers are taking full advantage of this exception.

Why is Schedule C Important?

- In the age of increased fee transparency, knowledge is not only power, it is a requirement!
- Plan Fiduciaries must account for and control plan expenses– difficult to do if one is not aware of all expenses.
- Schedule C is an excellent starting point for fulfilling this aspect of one's fiduciary duty.
- Unfortunately, vendors are often providing incorrect, or inconsistent, Schedule C information

Why is Schedule C Important?

- Schedule C provides a listing of most, but not all plan expenses.
- Use it as a negotiating tool to obtain the remaining pieces of the puzzle (e.g. required revenue, spread on general account, providers who receive only eligible expenses).
- You can ultimately use the Schedule C information to obtain fee reductions, service enhancements or both, although a Request for Proposal process may be required to maximize the plan's purchasing power.

Questions

Disclaimer

This communication is provided as a general informational service to clients and friends of Morgan, Lewis & Bockius LLP. It should not be construed as, and does not constitute, legal advice on any specific matter, nor does this message create an attorney-client relationship