The Time Is *Now* to Gear Up for the New 403(b) 5500 Requirements!

A guide to help plan sponsors navigate the new filing rules.

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Though much has been written about the impact of the final 403(b) regulations on 403(b) plans, the vast new responsibilities for 403(b) plan sponsors under the final 5500 regulations have been the subject of a lot less attention. However, if plan sponsors do not begin preparations soon, they could find themselves unable to meet their 5500 reporting obligations for 2009.

The Highlights of the Final Regulations

The final regulations state the ERISA 403(b) plans will be subject to the same reporting rules as 401(k) plans, beginning with the 2009 filing due on July 31, 2010 for calendar-year plans. The *entire* 5500 will be required to be completed, including all applicable schedules. Also, plans with 100 or more participants (as defined below) *must* be audited by an independent accountant. Finally, all returns *must* be filed electronically.

Why Should I Care?

The consequences of failure to comply with the Final 5500 regulations have been viewed by many as draconian: Uncapped DOL penalties of up to $1,100 per day, with even the potential for criminal penalties if it is determined that the failure to file a complete and accurate 5500 was intentional.

Who Must File

Before we delve into greater detail regarding the new requirements, it is important to note that the final 5500 requirements *do not apply* to a number of 403(b) plan sponsors. Public K-12 Schools, for example, are *never* subject to ERISA, and are thus are not required to file a 5500 under any circumstances. 3121(w) Steeple Churches, Qualified Church Controlled Organizations (QCCOs; church secondary schools are a common example), and 414(e) religious organizations (e.g., church hospitals) are subject to ERISA only in the rare event that they affirmatively elect ERISA by attaching a statement of such election to their initial 5500 filing. Thus, the vast majority of church organizations are not required to file a 5500. Finally, 501(c)(3) organizations whose plans consist solely of elective deferrals and otherwise satisfy the DOL Safe Harbor for exemption from ERISA (29 C.F.R § 2510.3-2(f)), which generally limits employer involvement in the plan to that of a simple conduit of employee contributions to plan vendors, would not be subject to ERISA and thus would not be required to file a 5500. *Benefits* counsel should always be consulted if there is any doubt as to the ERISA status of a 403(b) plan, given the noncompliance penalties described above. If you fall into one of these aforementioned categories of plan sponsor, congratulations; you can skip the remainder of this article!

The 5500 Requirements — Current State vs. Future State

Through the current (2008) filing, the 5500 requirements for ERISA were the simplest of any plan type: only six questions (1–5 and 8) were required to be completed, including such challenging questions as "Plan Sponsor Address." In addition, *no schedules* of any type were required to be completed. Due to their simplicity, many service providers included a "signature ready" 5500 filing at little or no extra charge, which is the service equivalent of providing free ketchup with your hamburger.

Unfortunately, the days of simplicity end with the 5500 filing for 2009. *All* questions on the main 5500 form will be required to be completed, as well as *all* applicable schedules.

The Next-to-Impossible-to-Satisfy Audit Requirement

In addition, all plans with 100 or more participants *must* engage an independent qualified public accountant (an added plan expense) to audit the 403(b) plan and produce an audit report that must be attached to the 5500 filing. Even under normal circumstances, such audits, which include payroll audits for active plans, are onerous; audits are the number one reason that qualified plans such as 401(k) plans obtain extensions of time to file their 5500s.

In addition, there are complexities associated with 403(b) plans that will render the completion of 403(b) audits a next-to-impossible task. First of all, there has never been an audit requirement in the 35-year history of ERISA 403(b) plans; thus, many service providers may not have the structure in place to report auditable financial information such as a statement of net assets or activity at the plan level. In addition, any audit requires detailed financial data from the year prior to the year of the review in order to be completed. Thus, service providers will not only be required to provide auditable financial data for 2009, but for 2008 as well.

Another often-overlooked complexity is that an audit covers not only any and all active plan vendors, but any vendor utilized since the enactment of ERISA in 1974 where ERISA plan assets remain (note that the difference between ERISA and non-ERISA assets is a complex issue beyond the scope of this article). Imagine the response you will receive from a plan vendor that you used back in the '70s, '80s or '90s to a request for auditable financial data for assets that remain with that vendor!

Fortunately, on July 20, 2009, the Department of Labor issued Field Assistance Bulletin 2009-02, which declared that most assets with any ERISA vendors to whom contributions ceased prior to January 1st, 2009 are *not* plan assets for 5500 purposes, and thus will not be required to be reported on the new 5500 beginning in 2009. However, such assets *remain* plan assets for all other ERISA purposes.

However even if contributions to a particular vendor ceased prior to January 1st, 2009, ERISA 403(b) assets with inactive vendors MUST be reported in the following two circumstances:

1. If the contracts are less than 100 percent vested; this may be an issue for the relative minority of ERISA 403(b) plans with vesting schedules, especially those who switched vendors relatively recently, and;
2. Where the rights of the contract are not 100 percent enforceable by the individual contract owner (the participant) without any involvement by the employer. This would seemingly mean that *group* (as opposed to *individual*) annuity contracts/custodial agreements are not subject to the exemption and *must* be reported on the 5500. The DOL did clarify that group contracts with *individual certificates* may be eligible for the relief, provided the rights of the contract were 100 percent enforceable by the participant. Group contracts are less problematic than individual contracts for 5500 reporting purposes, because many vendors can report assets in group contracts at the plan level.

Finally, the majority of 403(b) plan assets are invested in individual annuity contracts and custodial accounts, which are participant-owned, as opposed to group contracts, which are employer-owned. It is quite possible that a service provider may not be able to pull together the data for all individual contracts by employer, which means that it would be impossible to comply with any audit request. And all it takes is one plan vendor's inability to provide financial data to potentially jeopardize the completion of an entire audit.

For more details on the intricacies of plan audits, the American Institute of Certified Public Accountants (www.aicpa.org) has written some excellent material regarding 403(b) plans; simply access the website and search the term "403(b)".

How to Avoid the Next-to-Impossible-to-Satisfy Audit Requirement

Unfortunately, there is no way for large plans to avoid the plan audit requirements (unless they are a church plan or other entity exempt from ERISA described above, in which case the 5500 requirements may be avoided entirely).

Even for small plans, it may be impossible to avoid the audit requirement due to the way the DOL counts "participants" for purposes of whether an audit is required. The definition of participant in this case is extremely broad, including a) terminated employees with assets remaining in the plan, b) beneficiaries of deceased employees with assets in the plan (inherited accounts) and c) employees who are *eligible* to make voluntary contributions to the plan, whether or not they actually contribute. Thus, even an organization with 25 employees, for example, may be subject to audit if the plan has been around for many years and there are enough former employees with account balances in the plan so that the participant count exceeds 100. However, it should also be noted that participants whose plan assets solely consist of accounts with vendors to whom contributions ceased prior to January 1, 2009, subject to the restrictions described above, would ***not*** be counted for purposes 5500 reporting and determining whether a plan is large enough to be audited.

There is a design element that employers who are on the brink of the 100 participant requirement can control, however. Generally, it is considered best practice in 403(b) plans to provide all employees with the opportunities to make elective deferrals to the plan (though not necessarily to receive employer contributions) under what is called the “universal availability” rule. However, the IRS does permit exclusions for limited classes of employees (employees who normally work less than 20 hours per week, for example). If the exclusion of such classes of employees would cause the participant count to dip below 100, thus resulting in the avoidance of the time and expense of an audit, the plan sponsor may wish to consider amending its 403(b) plan to exclude such employees. In addition, if the plan has an automatic cash-out provision for small account balances of former employees, ensuring the timely administration of the cash out provision can reduce participant counts as well.

It should also be noted that there is an audit exception for small plans on the cusp of becoming large plans. If a plan was under 100 lives as of a prior year and grows to 100-120 lives at the beginning of the following year, an audit may be avoided if the plan filed a “small plan” filing for that prior plan year (this type of filing has no audit requirement). As long as the counts for these plans remain at or below 120 participants in the future, an audit can be avoided. Of course, 403(b) plans were not subject to these rules for the 2008 filing. However they would remain exempt from the audit requirement in 2009, if the 403(b) plan could have filed as a “small plan” for 2008.

The Audit Requirement — What if You’re Stuck with it?

If your ERISA plan consists of 100 or more participants as defined above, the audit cannot be avoided. In order to satisfy the audit requirement, advance preparation is *essential*, and those preparations should commence as soon as you have finished reading this article. *Now is the time* to engage a plan auditor to address all of thee complicated audit issues. In addition, you and/or the auditor should inventory all the vendors you have worked with in then last 35 years where ERISA plan assets may remain and work with benefits counsel to confirm a) whether such assets are exempt from the 5500 requirements per the DOL Field Assistance Bulletin, or b) if not exempt that such vendors will be able to satisfy the new audit requirements by providing 2009 ***and*** 2008 auditable financial data.

Other New Requirements

All plans holding any assets with Insurance Companies (active or non-exempt inactive) will be required to complete Schedule A, Insurance Information. Schedule A reports the dollar amount of all commissions/fees paid to third parties, and vendors are required to provide either a completed schedule or the information necessary to complete the schedule. Fortunately, for 403(b) vendors who are unable to provide the information for the reasons described above, there is a procedure to report vendors who are unwilling/able to provide Schedule A information at no consequence to the plan sponsor.

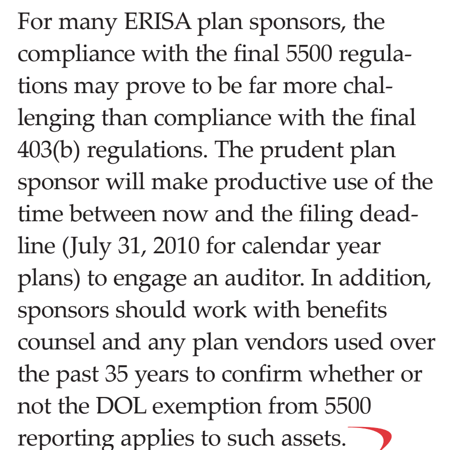
Large plans (100 participants or more) will be required to complete Schedule C, Service Provider information. Schedule C reports the dollar amount of all compensation plan *by the plan* (as opposed to the employer) to those entities who receive at least $5,000 in compensation (including indirect compensation such as revenue sharing). However, if a service provider receives only indirect compensation, the dollar amount of such compensation is not required to be reported.

All plans will be required to file their 5500 returns electronically, beginning with the 2009 filing. The DOL’s EFAST website (www.efast.dol.gov) has created some Webinars and other guidance on the issue of electronic filing; hopefully it will not prove to be as onerous as the audit requirement.

All plans, even those not subject to audit, will be required to report financial information. Large plans must report detailed financial information on Schedule H, while small plans must report summary financial information on Schedule I. All plans must rely on all of their active and non-exempt inactive vendors to provide such information, which, as previously discussed, may be difficult or impossible for certain vendors to provide.

Conclusion

For many ERISA plan sponsors, the compliance with the final 5500 regulations may prove to be far more challenging than compliance with the final 403(b) regulations. The prudent plan sponsor will make productive use of the time between now and the filing deadline (July 31, 2010 for calendar year plans) to engage an auditor. In addition, sponsors should work with benefits counsel and any plan vendors used over the past 35 years to confirm whether or not the DOL exemption from 5500 reporting applies to such assets.



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