employee benefits update

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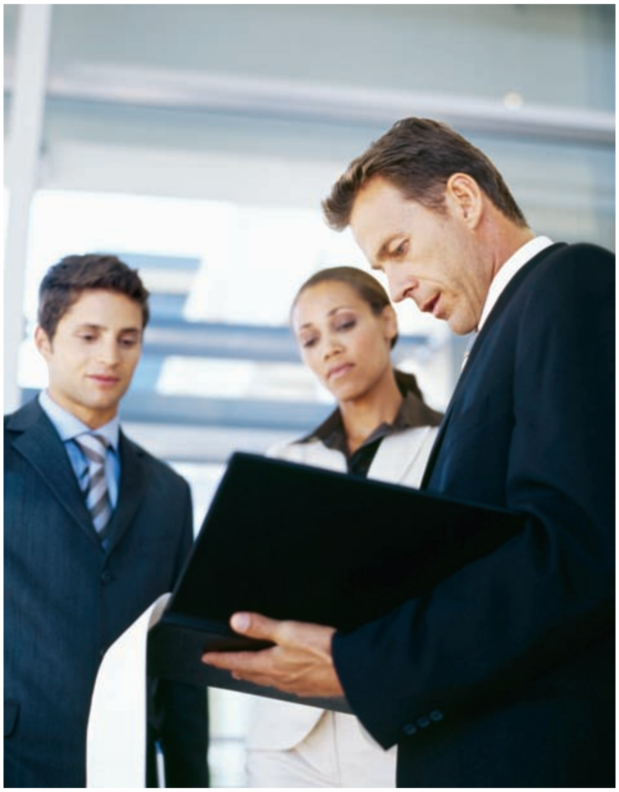
Does your benefit plan require a Form 5500 audit?

When filing Form 5500, "Annual Return/Report of Employee Benefit Plan," some benefit plans are required to include an opinion from an independent qualified public accountant (IQPA). The IQPA examines the plan's financial statements and schedules to ensure they're presented fairly and in conformity with Generally Accepted Accounting Principles (GAAP). The financial statements and IQPA opinion are often referred to collectively as the "audit report."

Which plans must include an audit?

The so-called "100 participant rule" determines whether a particular plan is required to include an audit report with its Form 5500. A return/report filed for a plan that covered 100 or more participants at the beginning of the plan year should use the "large plan" requirements.

A return/report filed for a pension benefit plan or welfare benefit plan that covered fewer than 100 participants at the beginning of the plan year should follow the "small plan" requirements. If your total participant count as of the first day of the plan year is less than 100, you generally don't need to include an audit report with your Form 5500. For the plan to be exempt from this requirement, at least 95% of the plan assets must be "qualifying" plan assets. And any person who handles plan assets that don't constitute qualifying plan assets must be bonded in accordance with ERISA. The amount of the bond may not be less than the value of the qualifying plan assets.



A slight variation in the general rule exists within what is commonly referred to as the "80-120 participant rule." If the number of participants is between 80 and 120, and a Form 5500 was filed for the previous plan year, you may elect to complete the return/report in the same category (large or small plan) that you filed for the previous return/report.

For example, if a return/report was filed for the 2006 plan year as a small plan, including applicable schedules, and the number of participants at the beginning of the 2007 plan year is between 100 and 120, you may elect to complete the 2007 Form 5500 and schedules as a small plan.

What are the large-plan exceptions?

Generally, if a plan chooses to report as a large plan, the IRS requires the plan sponsor to file an audit report. But some limited exceptions to this requirement exist.

For example, employee welfare benefit plans that are unfunded, fully insured, or a combination of unfunded and insured don't have to file an audit report. And neither do employee pension benefit plans that provide benefits exclusively through allocated insurance contracts or policies fully guaranteeing the payment of benefits.

If one plan year is seven or fewer months, the IRS will defer the audit requirement for the first of two consecutive plan years. But you must still provide the financial statement, and your audit report for the second year must include an IQPA opinion on both the previous short year and the second year.

In addition, certain welfare benefit plans aren't required to include an IQPA opinion if:

- Benefits are paid solely from the employer's general assets,
- The plan provides benefits exclusively through insurance contracts or through a qualified HMO, the premiums of which are paid directly by the employer from its general assets or partly from its general assets and partly from employee contributions, or
- The plan provides benefits partly from the sponsor's general assets and partly through insurance contracts or a qualified HMO.

Know the rules

It is important to understand when an audit report is required. Not including a required report could result in the plan facing a civil suit. But you don't want to pay for an IQPA if you don't need to. For assistance in determining your best course of action, consult your plan advisors.

403(b) plan audit requirements

Late last year, the Department of Labor (DOL), the IRS and the Pension Benefit Guaranty Corporation published final regulations and revisions to the 2007 Form 5500. These include major reporting requirement changes for 403(b) plans.

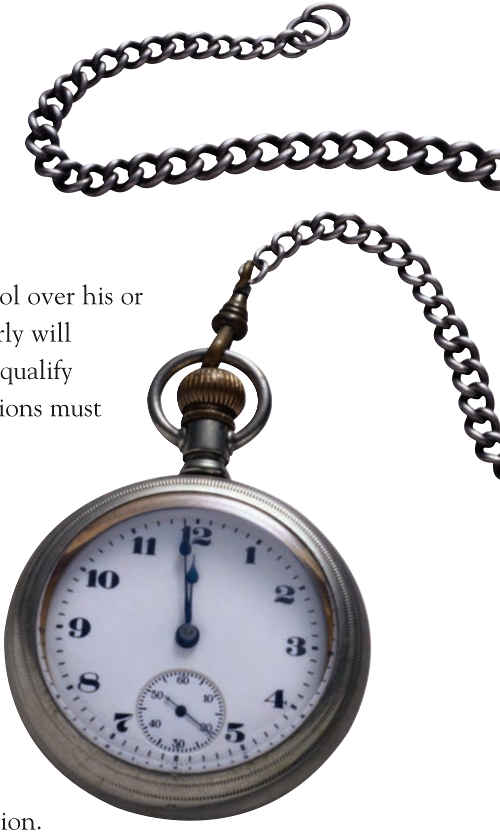
In the past, if they were required to file a Form 5500, 403(b) plans were generally exempt from the requirement to include an audit report. But, over the years, legislative changes morphed the 403(b) plan rules into other similar employer-based plans. It was also found that appropriate oversight could help correct the large number of violations taking place within these plans.

Under the final regulations, 403(b) plans will now be subject to the same reporting requirements as 401(k) and other similar plans. This includes the requirement that an audit report be attached to large plan filings.

The DOL did soften the blow somewhat by indicating that these new requirements would not take effect until the changeover to full electronic filing occurs. This is currently slated to happen with plan years beginning on or after Jan. 1, 2009.

The time is now

QUALIFIED DEFAULT INVESTMENT OPTIONS A NEW REALITY



What happens to a participant's contribution when money is put into that participant's account but he or she hasn't completed the election form? Should the plan accept the money? And, if so, which fund is the appropriate fund to place the money in?

Plan sponsors have wrestled with these questions for years. Fortunately, the Pension Protection Act of 2006 (PPA) has provided guidance as to how to direct this money while also providing fiduciaries with some measure of protection.

The new law

In December 2007, the Qualified Default Investment Alternative (QDIA) became a reality. When a participant fails to exercise control over his or her accounts, using a QDIA properly will grant some relief to fiduciaries. To qualify for this relief, however, five conditions must be met:

1. You must place assets into a QDIA when a participant fails to direct the investment after being given the opportunity to do so.
2. You must provide notice to the participant that describes the QDIA arrangement along with some basic QDIA information.

3. You must give the participant the opportunity to direct investments out of the QDIA and into one of the plan's other investment alternatives.

4. You can't impose QDIA fees or expenses on the participant if he or she removes the money from the QDIA within a specified time frame.

5. You must offer a broad range of investment options.

It's important for plan sponsors to familiarize themselves with all five conditions and to have procedures in place to ensure they're followed.

Acceptable QDIA investments

As mentioned, you must place the assets into a QDIA when the participant fails to direct the investment after being given the opportunity to do so. Acceptable QDIA investments include the following:

Lifecycle or targeted-retirement-date funds. These funds are a mix of equity and fixed-income considerations that take into account the participant's age, target retirement date or life expectancy.

Balanced funds. These funds consist of a mix of equity and fixed-income considerations consistent with the target risk appropriate for the plan participants taken as a whole.

When a participant fails to exercise control over his or her accounts, using a QDIA properly will grant some relief to fiduciaries.

Managed fund accounts. An investment management service allocates a participant's assets among equity and fixed-income considerations based on the participant's age and retirement date.

Capital preservation funds. You can place a participant's contributions in one of these, but only for the first 120 days.

The QDIA may not hold or acquire employer securities unless the employer securities are held or acquired by a regulated financial institution or acquired as a matching contribution from the plan sponsor or at the participant's direction. In addition, the QDIA must be managed by an investment manager, a plan trustee, a plan sponsor who is named fiduciary or a registered investment company.

Providing notice

You must provide notice to the participant that describes the QDIA arrangement. It must be in plain language and include:

- A description of the circumstances under which the account will be invested in the QDIA,
- An explanation of the participant's right to direct his or her investments,
- A description of the QDIA,
- A description of the right to invest in any of the plan's other investment alternatives, and
- An explanation of where to obtain investment information.

You have to give this notice to the participant at least 30 days before he or she becomes eligible to participate in the individual account plan or 30 days before the plan invests the participant's account in the QDIA. If the plan allows for automatic contributions, the participant must receive the notice before, or at the time of, plan eligibility. In addition, you must give notice annually at least 30 days before each subsequent plan year.

You also have to give participants some basic information about your plan's QDIA. This includes prospectuses for the QDIA and, if requested, information relating to proxy voting rights.

Additional requirements

In addition to abiding by the requirements about the types of acceptable QDIAs and notice, the plan must allow for at least a quarterly opportunity to direct investments out of the QDIA and into one of the plan's other investment alternatives. And if the defaulted participant directs his or her money out of the QDIA within the first 90 days after investment, you cannot charge the participant's account for QDIA fees and expenses.

Finally, as defined in ERISA, the plan must offer a broad range of investment options. They must be diversified, be distinct with respect to risk and return, and enable the participant to achieve a portfolio with risk and return within the range appropriate for a like participant.

Fiduciary relief

If your QDIA meets all of the above requirements, the plan will be granted some fiduciary relief should a loss or breach result from an investment in a QDIA.

But meeting the QDIA requirements doesn't release the fiduciary of its obligation to select and monitor the plan's default investment options. The relief also doesn't extend to transactions prohibited under ERISA involving conflicts of interest and other improper influences.

In addition, the fiduciary relief granted by the QDIA ties in to another PPA facet: automatic enrollment. One of the obstacles that automatic enrollment previously faced was the challenge of what to do with the automatic contributions when the participant failed to complete an election form.

Although automatic enrollment and default investment options have been found to help employees effectively save for retirement, employers often shied away from offering both of these features because some states had passed unfavorable laws regarding automatic enrollment.

Automatic enrollment and its associated safe harbor provisions were a major piece of PPA, and QDIAs may help alleviate remaining concerns about automatic enrollment. Plan sponsors can now direct funds into a QDIA with less concern about the possibility of breach or loss from a default investment. PPA also rendered moot the state laws regarding automatic enrollment, so both features may be of greater interest for many retirement plans in the future.

It all adds up

The new QDIA seemingly answers many lingering questions about what to do when a participant fails to make an investment election. By following the guidelines and maintaining your fiduciary protection, your plan and its participants can benefit from automatic enrollment and default investment options.

Investment alternative for qualified plans offers pros and cons

At some point, one of your qualified plan participants may inquire about having access to a self-directed brokerage account as an investment alternative. Although these accounts do provide participants with greater choices, they also pose some risks to plan sponsors, and opinions among sponsors vary regarding the wisdom of offering them. Let's take a closer look at the pros and cons of this option.

What are they?

Generally, employer-sponsored retirement plans offer participants a variety of mutual fund choices. With the amount of information about investing accessible on the Internet, participants are becoming more investment savvy. As a result, participants may push for more options within plans that will give them the flexibility to buy stocks, bonds and other investment choices outside the mutual funds offered in your plan.

Self-directed brokerage accounts offer one way to do this within a qualified plan. Under these arrangements, the participant opens up an account with a brokerage firm and is able to buy and sell stocks, bonds and other securities through the broker. The employee exercises control over the account, which includes working with the broker to buy, sell and manage the securities.

Plan sponsors must agree to offer self-brokerage accounts within a plan — a participant cannot simply open an account without approval. And you can limit the choices as to where the participant may open his or her account as well as choose the investment advisor that he or she will work with.

If you do decide to have a self-directed brokerage account option, you must make it available to all participants. But self-directed accounts usually have a minimum balance or contribution requirement to open and maintain the account. So, in practice, minimum balance requirements may prevent some employees from participating.

What are the pros for plan sponsors?

Attracting and maintaining your employees' participation in your qualified plan is one benefit of allowing such an arrangement. If the participant is more knowledgeable about investments than the average participant, successfully running one of these accounts can boost his or her morale.

And if you have employees holding off on participating in your qualified plan because they want more control of their investments, having access to a self-directed account could sway them to participate. These accounts may also help recruit new employees interested in having more power over their retirement funds.

Offering self-directed brokerage accounts can also help plan sponsors meet their fiduciary requirements under ERISA, which requires plan sponsors to provide enough diversification to allow participants to make prudent investment choices.

Not providing self-directed accounts, however, doesn't mean that sponsors are neglecting their fiduciary obligations. Nonetheless, having more investment choices can help. ERISA relieves plan sponsors from losses that are a direct result of the participant's investment decision-making.

… And the cons?

On the downside, recordkeeping can be complicated for sponsors who allow employees to pick and choose their brokerage platforms on the open market. Generally, self-directed accounts don't track contributions by source type such as deferrals and match. This puts more cost on the plan sponsors who must track these deposits.

Also, if a participant is able to make contributions and withdrawals from these accounts indiscriminately, he or she may be more likely to make mistakes. This, in turn, exposes the plan to the possible need for corrections for errors and omissions. So if you're planning to offer self-directed accounts in your plan, designate the option under the plan name and require trustee approval for contributions and withdrawals.

Educating participants

When all is said and done, self-directed accounts work well for companies with many participants, of which a substantial number have large account balances and will take the time to make prudent investment choices. Conversely, these accounts don't work so well for companies with high turnover, small qualified plan balances and limited participation.

If you decide to offer self-directed brokerage accounts, be sure to educate your participants in how they work. That way, if a participant makes a poor investment choice, you'll be more likely to be able to successfully argue against being held liable for any losses. ⏱

457(b) plans: A potential winner for eligible organizations

Within the Internal Revenue Code (IRC) is a retirement plan provision that can potentially double the allowable annual contribution for certain employees of specific types of employers. You'll find it in Section 457(b).

A 457(b) plan is a nonqualified retirement plan similar to qualified plans such as 401(k) and 403(b) plans. But 457(b)s are available only to state and local government employers or nonprofit organizations. These plans allow employees to contribute money to the plan using salary reductions. Eligible participants can contribute up to the IRC limit in effect for the current plan year ($15,500 in 2008). Both the contributions and earnings within the plan are tax-deferred.

None of this may sound too unfamiliar, but, when you factor in a couple of key concepts, 457(b) plans quickly distinguish themselves. First, nonprofit organizations must limit their 457(b) plan to a select group of management or highly compensated employees. This is the polar opposite of 401(k) plan requirements.

The second major factor applies to both governmental and nonprofit 457(b) plans. In the past, participants had to reduce the maximum contribution to a 457(b) plan dollar-for-dollar by contributions that the participant made to other plans. But, under the current law, participants don't have to coordinate their 457(b) plan contributions with their 401(k) or 403(b) plans.

This means that, for 2008, a participant could conceivably contribute $15,500 to both a 457(b) *and* a 403(b) plan, for a total annual contribution of $31,000. Factor in catch-up contributions for those age 50 or older and the amount climbs to $36,000 for nongovernmental 457(b) plan participants and $41,000 for governmental plan participants.

For eligible employers, it might be a good idea to look into a 457(b) plan. By offering one, you may not only be able to more readily attract and retain key employees, but also greatly please your existing ones.

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