IRS 403(b) Plan Regulations: What Your Organization Should Know

September 2008 CAPLAW Update
Reprinted with permission from Grant Thornton's Not-for-Profit Tax and Accounting Alert, August 2008

On July 23, 2007, the IRS issued the first comprehensive regulations for 403(b) plans in 43 years. The IRS's new rules bring 403(b) plans closer to the standards set for 401(k) plans and may result in significant changes for tax-exempt organizations and their employees. The new rules are effective for 403(b) plan years beginning on or after Jan. 1, 2009.

How does this apply to my organization?
A 403(b) tax-sheltered annuity plan is a retirement plan offered by schools, hospitals, churches, charities and certain other tax-exempt organizations. 403(b) plans allow employees to defer some of their salary to make pre-tax contributions to the plan. In addition, contributions can be made via employer contributions (including matching and discretionary contributions), employee after-tax contributions, or any combination of these.

The new IRS regulations clarify several points on employer responsibility and require organizations to have a written plan document in place. Additionally, in an effort to ease the administrative burden, the new IRS rules have the effect of encouraging employers to limit the number of investment vendors offered to employees while introducing due-diligence expectations that impact daily plan management.

In addition to the IRS regulations, in November 2007, the Department of Labor (DOL) issued amended regulations eliminating an exemption granted to 403(b) plans from detailed annual Form 5500 reporting and audit requirements under Title I of the Employee Retirement Income Security Act (ERISA). The removal of this exemption subjects ERISA-covered 403(b) plans to the same Form 5500 reporting and audit requirements as 401(k) plans effective with their 2009 Form 5500 filings.

A 403(b) plan generally will be covered under ERISA if there are employer contributions or employer involvement in the plan exceeds the limitations permitted under the DOL's safe harbor regulations. (For further information, see DOL Field Assistance Bulletin 2007- 02.) Large ERISA-covered plans (generally plans with 100 or more eligible participants at the beginning of the plan year) will be required to file audited financial statements.

- **Charitable organizations and school plans.** 403(b) plans sponsored by charitable organization and schools are covered by ERISA if the plans have the characteristics described above.

- **Governmental and church plans.** Governmental plans (plans established or maintained by the U.S. or any state government or any political subdivision, agency or instrumentality thereof for the benefit of its employees) and church plans (plans established by a church, convention or association of churches for the benefit of its employees or their beneficiaries) are specifically exempt from ERISA.

Specific changes your tax-exempt organization should be aware of include:

- **Written plan documentation.** Going forward, every 403(b) plan must be maintained under a formal written plan document. The new regulations indicate that the IRS requires that a single plan be adopted for any program even when there are multiple investment providers. Plans will need to outline the multiple lines of responsibility among employers, investment firms and any other parties involved with the plan; moreover, the organization's 403(b) plan will be required to operate under the terms of the written plan.

- **Changes to Form 5500 reporting.** Currently, 403(b) plans have simple reporting requirements as it pertains to Form 5500. However, with the DOL's amended regulations, ERISA-covered 403(b) plans will now require the same extensive reporting and independent audit requirements (as applicable) that apply to corporate 401(k) plans.

- **Large 403(b) plans now need an annual audit.** For large (plans with 100 or more eligible participants at the beginning of the plan year) ERISA-covered 403(b) plans that are now subject to audit (see Form 5500 Reporting and Independent Audit Requirements overview) the time and effort required to conduct a benefit plan audit could be significant. Numerous records will be required to complete the task and all vendors involved in your 403(b) plan will likely need to submit information. Keep in mind that although the new, large-plan audit requirement will not be in effect until the 2009 plan year, ERISA requires the presentation of comparative statements of net assets. As such, when a plan's financial statements have not been previously audited, the auditor will need to apply procedures to ensure that the accounting principles used by the plan in both the current and preceding year are consistent. The initial audit of the plan will likely require significant audit effort as the auditor will need to perform procedures to test the completeness and accuracy of plan and participant-level information going back numerous years The nature, timing and extent of the auditor's auditing procedures are a matter of judgment, and will vary depending on numerous factors (e.g., the adequacy of records, the number of investment providers and fund choices, the significance of beginning balances, the potential for previously unidentified operational errors, the level of fiduciary oversight, adequacy of internal controls, etc.).

- **Increased employer responsibility**. The new IRS rules impose due diligence and compliance criteria which require increased oversight and administration on the part of employers. This includes, among other things, ensuring that 403(b) plans are maintained pursuant to a written plan document and that the plan satisfies the 403(b) regulations in both form and operation and contains the terms and conditions for eligibility, limitations and benefit under the plan. Employers will also be required to act in the best interest of the plan participants.

AICPA resources

The American Institute of Certified Public Accountants (AICPA) recently released a set of tools to help your organization meet the new requirements.

- **403(b) Plans Primer**. The AICPA Employee Benefit Plan Audit Quality Center has developed this primer to provide Center members with a general understanding of 403(b) plans. [**Editor's Note**: This publication is available online here. The AICPA Employer Benefit Plan Audit Quality Center has many other useful publications on its website here.]

- **403(b) Filing and Audit Requirements**. The AICPA Employee Benefit Plan Audit Quality Center has developed this summary of 403(b) retirement plan filing and audit requirements. [**Editor's Note**: This publication is available online here.]

- **403(b) Getting Started: Meeting the New Form 5500 Reporting and Audit Requirements**. The AICPA Employee Benefit Plan Audit Quality Center has suggested steps plan sponsors and administrators can take now to help their plan meet the new filing and audit requirements. [**Editor's Note**: This publication is available online here.]

Questions?

For additional information, contact Debbie Smith, Grant Thornton partner-in-charge of Professional Practice Quality for employee benefit plan audits, at 630.873.2518 or your local Grant Thornton client-service partner.

Editor's Note: For additional information on the new 403(b) rules, you can order a recording and materials from CAPLAW's audio conference entitled "Complying with the New 403(b) Plan Rules." To order, call CAPLAW at (617) 357-6915 or visit our website at www.caplaw.org for more information