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THE NEWSLETTER OF THE BDO EMPLOYEE BENEFIT PLAN AUDIT PRACTICE

EBP COMMENTATOR

HIGHLIGHTS FROM THE AICPA'S DECEMBER 2012 EBP CONFERENCE

The American Institute of Certified Public Accountants (AICPA) held its Employee Benefit Plans (EBP) Accounting, Auditing and Regulatory Update conference (AICPA Conference) in Washington, D.C. this past December. Topics included issues noted from 2011 plan audits, regulatory updates, accounting and auditing issues expected to significantly impact upcoming 2012 plan audits, and Accounting Standard Updates (ASUs).

LOOKING BACK AT 2011 AUDITS

There were some concerns cited from audits performed last year that may be useful to plan sponsors. A key area of concern was the wide divergence in the application of the fair value measurement disclosures (see Winter 2011 edition of the *EBP Commentator*). It was noted that fair value disclosures should be properly broken out by *class*, rather than by category, of investments. While materiality (or the lack thereof) is often cited as the justification for inadequate or incorrect classification of investments, proper classification is necessary in order to comply with the applicable financial reporting framework and to ensure correct presentation and disclosure on the supplemental schedules to the financial statements.

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Attendees were reminded that any year-to-year changes made by the plan sponsor to the classification of investments by level (e.g., Level 1, 2 or 3) should be properly categorized. In other words, if the change in the investment's level as assigned by the sponsor can be attributed to the sponsor gaining a greater and/or more accurate understanding of the underlying investment (as opposed to changes made in the observability of the investment inputs), the change would most likely need to be categorized in the financial statement footnotes as a correction of an error and not as a reclassification. Note that the disclosure provisions are not required for revisions resulting from a change in valuation technique or its application.

Using NAV (net asset value) as the "practical expedient" when classifying investments depends, in part, on the inputs and the redemption restrictions. Attendees were reminded to ensure that the disclosures are complete, including disclosure of any restrictions or unfunded commitments.

The MAP-21 pension legislation (which was discussed in the Fall 2012 edition of the *EBP Commentator*) resulted in some companies re-evaluating and re-characterizing their 2011 receivables and 2012 contributions for defined benefit plans. It was emphasized at the conference that a plan's funding policy is different from the plan's revenue recognition policy and that ASC 960 should be used to evaluate whether to recognize a contribution receivable for financial statement purposes.

▶LOOKING AHEAD TO 2012 AUDITS

Various ASUs were discussed for their potential impact on 2012 plan audits:

ASU 2011-03

ASU 2011-03, *Reconsideration of Effective Control for Repurchase Agreements*, simplifies the accounting for transfers of financial assets and eliminates the need to assess "ability" criteria in regards to a determination of effective control over those assets. There is also some confusion as to which plans would be subject to the 2011-03 disclosure requirements (as discussed further below). It is effective for the first interim or annual period beginning on or after December 15, 2011.

ASU 2011-04

Effective for annual periods beginning after December 15, 2011, ASU 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs,* will require additional disclosures regarding the measurement of fair value of plan investments. These disclosures will differ between public and nonpublic entities.

All entities (both public and nonpublic) will need to disclose the following: describe the reason for the fair value measurement, include a description of the valuation techniques and inputs for Level 2 and 3 investments as well as a description of the valuation processes used in Level 3 investments (including how policies are made and changed), disclose transfers between Level 2 and 3 and quantify the significant unobservable inputs for Level 3 investments.

Public entities only must provide additional disclosure of transfers between Level 1 and 2 as well as a narrative description of the sensitivity of fair value measurement categorized within Level 3 of the fair value hierarchy to changes in unobservable inputs. It was noted that some of the information on unobservable inputs (such as discounted cash flows, prepayment rates, etc.) may be difficult for plan sponsors to obtain.

The overall expectation is that both plan sponsors and plan auditors will have more work in regards to the fair value measurement disclosures. For plan sponsors, the additional expected effort includes ensuring that appropriate processes surrounding Level 3 investments are both being performed and appropriately documented, such that the plan auditors are able to gain a sufficient level of comfort regarding the Level 3 investments.

Implementation of ASU 2011-03 and 2011-04

Implementation of both ASU 2011-03 and 2011-04 has been impacted by uncertainty surrounding which types of plans would be affected by these ASUs and to what extent. Both ASUs are effective prospectively for public and nonpublic entities, with some 2011-04 disclosures exempted for nonpublic entities. Plans required to file under Form 11-K are subject to both ASUs since such plans have been defined as public entities. It is unclear, however, whether the definition of nonpublic entity applies to plans not subject to 11-K filings. These plans are neither public entities nor private entities (the term "private entity" has been defined and these plans are clearly excluded from the definition). ESOP plans are also subject to this uncertainty, which is a concern for ESOP plan sponsors since the detailed ASU 2011-04 disclosures of information from company stock valuation reports could reveal sensitive plan sponsor information. The definition of nonpublic is currently being re-examined by the FASB – stay tuned.

ASU 2011-09

ASU 2011-09, *Compensation – Retirement Benefits – Multiemployer Plans (Subtopic 715-80): Disclosures about an Employer's Participation in a Multiemployer Plan,* primarily impacts the sponsor's financial statement disclosures, not the plan's financial statements. It expands disclosures to increase the awareness of risk and commitments related to participation in multiemployer plans. For public entities, it is effective for fiscal years ending after December 15, 2011. For nonpublic entities, it is effective for fiscal years ending after December 15, 2012 (see related article in the Fall 2011 edition of the *EBP Commentator*).

ASU 2012-04

ASU 2012-04, *Technical Corrections and Improvements,* updates the definition of "fair value" through all of the technical literature and conforms it to ASC 820. Certain provisions of the ASU were effective immediately upon issuance. For those portions of the ASU that were afforded transition through a new effective date, they are effective for fiscal periods beginning after December 15, 2012 (public entities) and for fiscal periods beginning after December 15, 2013 (nonpublic entities).

In discussing the upcoming revised AICPA audit and accounting guide for employee

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benefit plans (which can be a resource for plan sponsors, as well as auditors), attendees were encouraged to refer to the Financial Reporting Executive Committee (FinRec) positions as a potentially useful source of accounting guidance for plans. While the FinRec positions are not authoritative, the new guide is expected to contain some FinRec recommendations and the suggestion is that the EBP industry follow the FinRec recommendations. The new guide is expected to be released in spring 2013.

We would be remiss if we didn't mention one of the key topics at the conference – the clarified auditing standards. While these clarified standards are of primary concern to plan auditors, it is helpful for plan sponsors to have some familiarity with them and the potential impact on the plan audit. The clarified standards (SAS Nos. 122-126) are the result of the Auditing Standards Board's Clarification and Convergence Project (commonly called the "Clarity Project") to redraft and recodify all of the existing auditing standards generally accepted in the United States of America (which were previously designated as SAS Nos. 1–121). As stated by the AICPA, the overall intent of the project was to make U.S. GAAS "easier to read, understand, and apply." The clarified standards are generally effective for audits of private company financial statements for periods ending on or after December 15, 2012. As a result, some of the more significant changes you (as the plan sponsor) will see include the following: changes in the plan audit engagement letter, the management representation letter and the auditor's opinion.

The AICPA website includes a page devoted to a variety of materials and resources (including videos) that are available to facilitate a better understanding of the clarified standards and the potential impact on your plan audit. See http://www.aicpa.org/interestareas/frc/auditattest/pages/improvingclarityasbstandards.aspx

THE BOTTOM LINE: Highlights from December 2012 AICPA EBP Conference

Key Issues and Developments

- Fair Value Measurement Disclosures
- MAP-21 Impact
- Current FASB Project – Are EBPs nonpublic entities?
- Clarified Auditing Standards

"COMING SOON".....
It Seems Like We Have Been Waiting Forever for Some Regulatory Updates – Are They Finally Here?

As new rules and regulations become effective, additional guidance is frequently needed or anticipated. Regulators often use the term "coming soon" to indicate when guidance will actually be issued. However, soon doesn't always seem like soon enough. This has been the case for plan sponsors and auditors awaiting Department of Labor (DOL) guidance regarding the updated definition of "fiduciary" and an IRS update on its Employee Plans Compliance Resolution System (EPCRS).

▶WHO IS A FIDUCIARY?

The DOL proposed an updated and broader definition of "fiduciary" in October 2010. (See the Fall 2011 and Fall 2012 editions of the *EBP Commentator*.) Under the Employee Retirement Income Security Act of 1974 (ERISA), plan fiduciaries are held to very high standards and must act solely in the best interest of the plan's participants and beneficiaries. After twice extending the period for both written and oral comments (due to the large volume of comments received), the proposed regulation was ultimately withdrawn in 2011 with the expectation that it would be re-proposed "soon" after, in 2012. At the AICPA Conference, Assistant Secretary of Labor of the Employee Benefits Security Administration, Phyllis Borzi, discussed the DOL's continuing efforts to re-craft the regulation taking into account the significant number of comments, noting that hopefully the re-proposed regulation would be issued "soon." We will continue to keep you posted since the updated definition is expected to result in greater clarity in determining which individuals are plan fiduciaries and therefore subject to the stringent ERISA fiduciary requirements.

▶EPCRS UPDATE

The benefit plan industry has been eagerly anticipating an update from the IRS to the EPCRS guidance since it was last updated in 2008 (Rev. Proc. 2008-50). The EPCRS program was established by the IRS to encourage plan sponsors to correct errors by providing specific correction methods for some of the most common plan issues that arise. While this correction program has always garnered interest, much of the anticipation is related to guidance needed for Internal Revenue Code (IRC) section 403(b) plans. In 2007, the IRS issued the first comprehensive regulatory guidance for 403(b) plans in over 43 years and the DOL also modified its guidance and requirements for 403(b) plans. Since then, plan sponsors and auditors have needed additional guidance and answers to properly correct 403(b) plan issues.

In this case, the wait is over. On December 31, 2012, the IRS released Revenue Procedure 2013-12, an updated version of the EPCRS, which modifies and replaces Revenue Procedure 2008-50. The new Revenue Procedure is generally effective April 1, 2013, but plan sponsors may elect to apply provisions of the procedure on or after December 31, 2012. Some highlights of the revised program include:

- Expanded corrections for 403(b) plan failures to include certain operational failures as well as a failure to adopt a written plan document.
- Eliminated the use of the IRS lost participant program (due to the discontinuation of the program on August 31, 2012).
- Revised submission procedures for the Voluntary Correction Program (VCP), including new forms and consolidation of other forms as well as a new address for submissions. The recently released Forms 8950 and 8951 must be included on all VCP submissions made on or after April 1, 2013. See the revised forms for the appropriate address to use for submissions.
- Provided consistent rules for correction of missed deferrals in 401(k), 403(b) and SIMPLE IRA plans, as well as procedures for self-correcting certain Section 415 failures within specified time limits.
- Reduced submission fees in certain instances.

If you're interested in taking advantage of the EPCRS program, let us know. BDO can assist you, the plan sponsor, by helping to proactively identify plan issues as they arise and determine the appropriate correction methods available.

INTERNAL CONTROLS CHECK-UP

EFFECTIVE INTERNAL CONTROLS ARE ESSENTIAL FOR YOUR BENEFIT PLAN – THEY CAN HELP PREVENT COSTLY MISTAKES THAT COULD JEOPARDIZE THE PLAN'S TAX-QUALIFIED STATUS.

As you're probably already aware, plan management can no longer hire a third-party administrator and let the plan operate on "auto-pilot." Just as it is a prudent step to maintain personal health by scheduling an annual physician check-up, an internal controls check-up on your plan is an important fiduciary task. And, just like a physician may ask probing questions to analyze possible health risks, we have developed questions to help you determine possible risk areas for your plan. Each of the following questions addresses some of the common issues we've found during plan audits.

Is your plan documentation and operation up-to-date with recent law changes?

The IRS publishes information regarding required plan amendments at: http://www.irs.gov/Retirement-Plans/Recent-Guidance-That-May-Require-Interim-or-Discretionary-Amendments. We recommend using the IRS website or checking with your plan document provider to ensure your plan is in compliance. If there are any missed amendments, the plan sponsor can correct by adopting the necessary amendments and filing a VCP under the IRS EPCRS. (Also see the related article above.)

Does your plan document properly reflect current plan operations?

Differences between what the plan document says and what is actually done in administering the plan are the source of many plan defects. In general, most plan defects can be fixed under the EPCRS. The guideline for correction of plan errors is a reasonable correction method that makes affected participants "whole." In other words, the end result should put the participants in the same financial position as if the operational plan defect never happened.

To mitigate operational errors, we suggest plan sponsors be proactive and compare the terms of the plan document to the actual day-to-day operation of the plan on at least an annual basis to ensure the plan document is being followed correctly. When a plan document is updated, ensure that updates to the plan terms are correctly communicated to all providers and fiduciaries (including Human Resources, payroll and the plan recordkeeper).

Some of the most commonly found plan defects are listed below. All of these errors can be corrected using the EPCRS:

- *Does the definition of compensation used for calculating contributions or benefits agree with the plan document?* An annual review of the payroll system can help ensure that the compensation used in plan-related calculations is in agreement with the plan document and includes/excludes different sources of compensation based on the terms of the plan document. Be especially alert to such errors when there are either changes in the payroll system or the plan document. For instance, mistakes are common when there is a change in service providers, a new plan document is established or when the company adopts a new payroll system without a complete review to ensure the system conforms to the plan document.

- *Have all eligible employees been given the opportunity to participate in the plan?* Effective controls are especially important to ensure eligible employees are identified and offered the opportunity to defer elective contributions to the plan in a timely manner. Even if you utilize a third-party service provider to handle this task, plan management is still responsible to ensure eligible participants are provided an opportunity to participate in the plan. Some of the internal controls that may need to be in place include monitoring of employee census information to identify newly eligible employees and review of documentation related to newly eligible employees.

- *Have participant loans been made in accordance with the plan document?* Understand your plan document's rules for participant loans. Procedures are needed to prevent inaccurate loan issuances (which are

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INTERNAL CONTROLS CHECK-UP

prohibited transactions). Plan management should ensure that loan issuances and repayments follow the terms of the plan document, including the loan amount, the interest rate, the loan term and repayment terms. The plan document provisions should be clearly communicated with third-party service providers to ensure the provider accurately administers the loans.

- *Have hardship distributions been made in accordance with the plan document?* Some plan sponsors are seeing an increase in hardship distributions due to the downturn in the economy. Be sure personnel in charge of approving those requests fully understand the plan document's provisions for hardship distributions. Even if the request is handled by the third-party service provider, the plan sponsor is still responsible to ensure that hardship distributions meet the plan requirements. Also, once the hardship distribution is made, monitoring and controls should be in place to ensure that the participant is properly suspended from making contributions to the plan based on the terms of the plan document.

Has all necessary compliance testing been performed?

Even if all of the testing has been performed, a review of the compliance testing can help determine whether the information used in the testing was correct. For instance, does the testing information match the payroll system and were the highly compensated and non-highly compensated employees classified properly? All corrections should be made for any compliance testing failures (this includes the return of any excess contributions and making any qualified non-elective contributions on behalf of non-highly compensated employees). Typically, errors in the testing can be corrected under the EPCRS.

Have all employee deferrals and participant loan repayments been deposited timely?

Keep in mind that it is the procedures and internal controls at your company that dictate the amount of time it should take to segregate the deferrals and loan repayments. The best way to determine whether the deposits were made timely is to evaluate all of the remittances that were made to the plan (or should have been made to the plan). For each remittance that should have been made, plan management should determine the earliest date that the assets could have been segregated from the general assets of the plan sponsor and then compare that date to the actual deposit date. This comparison should be done for all remittances to the plan during the year to check whether the internal controls over the remittances worked for the entire year. If any remittance was past the date that plan management determined to be reasonable, the remittance is considered late.

Any late remittance is a prohibited transaction, which should be corrected as soon as possible. (Note that the applicable earnings resulting from the late deposit will also need to be remitted to the plan.) The plan sponsor can also file under the DOL Voluntary Fiduciary Correction Program (VFCP) and receive a letter of “No Action” from the DOL related to the late deposits.

In order to prevent late remittances, the plan sponsor should determine the earliest time period in which the plan sponsor can reasonably segregate plan assets (e.g., the employee deferrals and loan repayments to the plan) from the general assets of the plan sponsor and establish procedures to ensure that all plan deposits are made within that time period (even if plan personnel take vacation or have an emergency).

Has the Form 5500 been filed and the Summary Annual Report distributed to all the plan participants?

You can check to see if your plan's filings have been made by going on the DOL's EFAST2 system. A missing Form 5500 should be filed as soon as possible. Delinquent filers may file the late Form 5500 and pay a filing fee under the Delinquent Filers Voluntary Compliance Program (DFVCP).

If you anticipate needing possible improvements or corrections for your plan, first make sure there are appropriate internal controls in place. Under the EPCRS, a plan sponsor has the ability to either self-correct or file under the VCP. For a plan to be able to use the self-correction method, the plan sponsor must have established internal controls designed to promote compliance with the applicable DOL or IRS requirements. Second, the fixes must be made in a timely manner. For significant errors, the plan sponsor has only two years following the year in which the mistake occurred to correct under the self-correction program.

Once you have made needed corrections, continue to monitor and improve the plan's internal controls as it also may help your plan in the event of an IRS audit or inquiry. Under a recent pilot program for large plans, IRS examiners were instructed to test the adequacy of the plans' internal controls with the expectation that adequate internal controls were an indicator of fewer areas of noncompliance. The IRS website has some helpful documents regarding plan internal controls and best practices for plans.

In summary, just as possible health risks found during an annual physical would not be ignored, any plan issues or mistakes identified during your plan's internal controls check-up should be addressed (and, as soon as possible). If you need any assistance in this area, please feel free to contact BDO. We can help you identify issues through a customized compliance review and develop specific solutions for fully correcting any errors under the above-mentioned programs.

FRIENDLY REMINDERS...

Fair Value Measurement Disclosures

Now is the time to work with your plan service providers to ensure you have the information needed to properly prepare the disclosures related to ASU 2011-04. Your auditors will request your support for such disclosures.

Internal Control Reports under SSAE No. 16, *Reporting on Controls at a Service Organization* (SOC 1 Reports)

Don't forget to request and review the SOC 1 reports applicable for your plan's service providers. Remember that the auditors will need to see evidence that you considered which controls documented in the SOC 1 report are applicable to your plan and whether those controls appear to be functioning appropriately. Complementary user entity controls (e.g., formerly known as "user controls") are those that the service provider auditor expects to be functioning properly at the plan sponsor.

Year-End Reports

Request the year-end plan reports needed for your auditors (sometimes called the "audit package"). Coordinate with your service providers to request online access to plan reports for your auditor. Also, consider requesting any of those "special" reports that you or the auditor had difficulty obtaining last year. The plan sponsor should review the reports for overall accuracy and reasonableness.

Form 11-K Filing Deadline

This is 180 days after the plan's year-end. Generally, for calendar year-end plans, this would be Monday, July 1, 2013 (due to the 180th day falling on the weekend).

Form 5500 Filing Deadline

This is seven months after the plan's year-end. Generally, for calendar year-end plans, this would be Wednesday, July 31, 2013. An extension of 2 ½ months is available (by filing Form 5558). If extended, the deadline for a calendar year-end plan would be Tuesday, October 15, 2013.

MARK YOUR CALENDAR

AICPA Employee Benefit Plans Conference

May 14-16, 2013
Grapevine (Dallas), Texas

This three-day event will provide you with updates on current issues affecting employee benefit plans, including recent and proposed changes in accounting, auditing, tax and enforcement regulations. Sessions are presented by regulators, standard setters and leading practitioners, including members of BDO's National EBP Group.

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BDO EBP PRACTICE

BDO is nationally recognized in the field of employee benefit plan consulting and auditing. We audit over 1,100 plans nationwide, ranging from 100 participants to close to 300,000 participants. Our engagements are staffed with accountants experienced with all types of audits including defined contribution (401(k), profit sharing, ESOP, and 403(b) plans), defined benefit (pension, cash balance) and health and welfare plans. We have extensive ERISA knowledge of audit and filing requirements, including full-scope, limited-scope, Form 11-K filings and Master trusts.

In addition, BDO has a National Employee Benefit Plan Audit Group that meets regularly to develop training and guidance and discuss updates in the industry and auditing practices. Our professionals are regular presenters at local, state and national seminars. BDO's professionals continue to be extensively involved with the American Institute of Certified Public Accountants (AICPA) National Conferences on Employee Benefit Plans. Many of our professionals serve in leadership roles in the accounting profession as senior advisors and are active members of several governing boards and CPA societies. For example, our professionals currently serve on various AICPA committees, such as the AICPA Employee Benefit Plan Audit Quality Center Executive Committee and the AICPA's Joint 403(b) Plan Audit Task Force (we are proud to have representation at the Chair level for these committees). BDO's EBP professionals have also served on the Employee Benefit Plan Expert Panel.

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