ISSUES IMPACTING EMPLOYEE BENEFIT PLANS

As the landscape of employee benefit plans changes, employers are faced with new challenges. Changing regulations and increased emphasis on particular aspects of reporting and fiduciary responsibility, accurate and timely completion of employee benefit plan (EBP) audits and establishing effective controls for plan administration, have become mainstream tasks in plan fiduciary management.

Many companies rely on internal employees to maintain compliance for their plans. However, small and middle market companies tend to be more vulnerable with regards to compliance as many do not have the internal expertise to address compliance with plan provisions or keep up with changing regulations.

Regrettably many mistakes can be made by 401(k) plan administrators that go unnoticed until the Internal Revenue Service (IRS) or Department of Labor (DOL) audits or examines a plan.

Preparation is critical and the time to be sure you have required information compiled is before you receive an audit request. To prevent any unwanted surprises, SC&H Group's Employee Benefit Plan Audit Team has selected the most common mistakes made in administering a 401(k) plan:

1. PLAN DOCUMENTS ARE NOT UPDATED TO REFLECT TAX LAW CHANGES.

Ever heard of the HEART Act or the Pension Protection Act? How about the required amendments to Sections 415 and 401(a)(35)? The IRS frequently issues revenue rulings and other pronouncements that require plans be amended to accommodate the applicable tax law changes. For example, in response to Hurricane Irma, the IRS provided for special rules for loans and hardship withdrawals resulting from losses suffered during the hurricane. Plan sponsors should consult with the plan's recordkeeper to make sure the plan has been properly amended.

2. THE PLAN DOES NOT OPERATE IN ACCORDANCE WITH THE PLAN DOCUMENTS.

The plan adoption agreement defines all of the properties and policies of a plan. The IRS issues a determination letter which qualifies a plan's tax-exempt status based on the plan document; therefore, it is imperative that a plan follows the governing documents. Plan administrators should implement a periodic review of plan policies and procedures to ensure compliance with the plan documents and consider amending the plan when policies and procedures change.

3. THE PLAN FAILS TO FOLLOW THE DEFINITION OF COMPENSATION PRESCRIBED IN THE PLAN DOCUMENTS.

The IRS allows a plan administrator to define compensation for plan purposes in the plan documents. Typically, the definition of compensation is defined as 1) all W-2 compensation, 2) W-2 compensation subject to income tax withholding, or 3) all compensation received; and is further classified as either inclusive or exclusive of pre-tax deductions. Options to exclude bonuses, commissions, and similar compensation may also be elected. Plan administrators should review payroll records and plan documents to ensure the company's payroll provider is properly withholding deferrals based on the plan's definition of compensation.

Special Note: If a plan is several years old and has had several amendments, the plan administrator needs to check with your recordkeeper to see if the plan should obtain an updated determination letter from the IRS.

4. EMPLOYER CONTRIBUTIONS ARE NOT MADE TO ALL APPROPRIATE EMPLOYEES.

Plans often prescribe different eligibility requirements for employee salary deferrals and employer matching and discretionary contributions. Service requirements, age requirements, and employment status requirements commonly differ among these types of contributions. To ensure compliance with a plan's requirements, the plan administrator

should thoroughly review the list of participants receiving employer contributions and compare the data to the requirements within the plan documents. One should pay special attention to service requirements, as plan documents may be written to credit employees with a year of service after working 1,000 hours, which is approximately 6 months.

Special Consideration: Eligibility requirements are often difficult to interpret. A company should ensure its plan requirements are clear. Special attention should be given to plans with automatic enrollment features to ensure all employees eligible are included in the plan. If employees opt out of participating, written authorization should be included in the employee file.

Special Consideration: Many companies have experienced high employee turnover in recent years. To the extent termination benefits are being paid in the final paycheck with com-pensation, ensure that the proper withholdings for benefits have been made.

5. THE PLAN FAILS NONDISCRIMINATION TESTING.

401(k) plans should be designed to benefit most if not all employees; however, plans are not permitted to excessively benefit executives and highly-compensated employees. A plan's recordkeeper should be able to determine the compliance status of a plan and recommend necessary corrections. A plan administrator should be aware of notifications from the recordkeeper, as failure to correct issues timely can lead to excise taxes against the plan and the risk of losing plan qualification.

Consistent failure of the ADP and ACP tests indicates a low participation rate from non-highly-compensated employees. To prevent future compliance issues, a company should consider increasing efforts to promote the plan or adopting an automatic enrollment provision. If all else fails, adopting a safe-harbor provision may be an option, which leaves a plan exempt from ADP and ACP testing.

Special Consideration: Recently, many companies experienced downturns in employee count due to terminations, or lower compensation due to forced leave without pay. Many plans

may experience failure to comply with non-discrimination test and may be required to correct contribution levels of highly-compensated employees.

A plan sponsor should work with its payroll provider to ensure employees do not contribute more than the above maximum amounts.

6. ELIGIBLE EMPLOYEES HAVE BEEN EXCLUDED FROM PARTICIPATING IN THE PLAN.

Plan documents are very specific on eligibility requirements and effective dates for participant entry into a plan. Plan sponsors with a manual enrollment process or a small HR function may accidentally exclude an eligible employee from enrollment into the plan or may not provide adequate notice for the employee to enroll him or herself. As part of the hiring process, a plan administrator should ensure an employee's eligibility has been properly determined and that necessary communication has been made to the employee and plan recordkeeper. If your plan has an automatic enrollment provision, employees not wishing to participate should be required to sign an opt-out form to prevent future administrative issues.

7. THE PLAN ALLOWED PARTICIPANTS TO DEFER AMOUNTS TO THE PLAN IN EXCESS OF THE MAXIMUM ALLOWED PER THE INTERNAL REVENUE CODE.

For 2014, employees may only contribute up to a total of $17,500 to tax-exempt retirement plans. Deferrals are also limited to the first $260,000 of total compensation. Participants over age 50 ½ may contribute up to an additional $5,500 in "catch-up" contributions to the plan, which should be accounted for separately for easier tracking.

A plan sponsor should work with its payroll provider to ensure employees do not contribute more than the above maximum amounts. At year-end, the plan administrator should review the plan census data for issues with total contributions and contact the recordkeeper to process corrective distributions to participants exceeding those contribution limits.

SC&H Group audits over 125 employee benefit plans annually — including 401(k), 403(b), defined benefit, and health and welfare plans.

8. EMPLOYEE DEFERRAL CONTRIBUTIONS WITHHELD FROM PAYROLL HAVE NOT BEEN REMITTED TO THE PLAN TIMELY.

DOL regulations stipulate that employers are required to remit participant contributions to qualified plans as soon as they can be reasonably segregated from the employers' general assets, but not later than the 15th business day following the end of the month in which amounts are contributed by employees or withheld from their wages. Generally, deposits of employee deferrals should be made at least as quickly as employer withholding taxes are deposited. The DOL also looks at trends in remittance. For example, if an employer typically remits the employee contributions within 3 days of the pay date, however does not remit the contributions until 10 days after for one payroll period, this could be considered a prohibited transaction. The plan administrator should monitor remittances to ensure contributions are remitted timely as part of the closing process for each payroll.

9. PARTICIPANT LOANS DO NOT FOLLOW THE REQUIREMENTS OF THE PLAN DOCUMENT AND THE INTERNAL REVENUE CODE (IRC).

Loans to participants are strictly regulated in the IRC. Loans may not exceed the lesser of ½ of a participant's vested balance or $50,000, must have a reasonable interest rate, and may not be payable over a term longer than 5 years, unless for the purchase of a primary residence. Plan documents may also restrict the number of loans that may be outstanding from a participant at one time and the minimum principal amount of the loan. Interest rates may be expressly stated in the plan document or may vary with the prime rate or other rate commonly used by financial institutions. The plan administrator should review the plan loans regularly to ensure the interest rate remains reasonable compared to market rates. Documentation should be obtained from participants when they borrow for the purchase of a primary residence.

10. HARDSHIP WITHDRAWALS ARE NOT ADMINISTERED PROPERLY.

Hardship withdrawals are permitted in some plans based upon provisions of the plan document in extreme cases of financial hardship for participants. The IRS provides several specific examples of permissible safe harbor "hardships"; however, the ultimate decision to permit a hardship withdrawal lies with the plan administrator. The plan administrator should always sign off on the decision to accept a hardship withdrawal and should request documentation of the financial hardship to maintain in the participant's personnel file in order to have justification for the withdrawal.

Preventing these common mistakes may seem burdensome, however, once the proper policies and procedures are in place, management of the plan becomes much more effective and efficient.

About SC&H Group

SC&H Group audits over 125 employee benefit plans annually — including 401(k), 403(b), defined benefit, and health and welfare plans — and assists clients with many of the common difficulties in administering a benefit plan. If you have questions about your retirement plan or think you may need a retirement plan audit, please contact SC&H Group today.

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