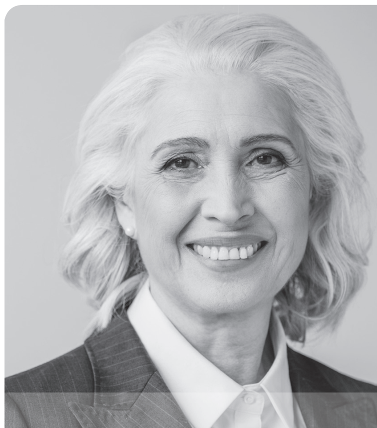

DRSUpdate

RETIREMENT SOLUTIONS FOR THE DIGITAL AGE

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Strengthen Your Plan With Solid Internal Controls

When it comes to operating a retirement plan, there are a lot of moving parts. A strong system of internal controls can help keep a plan operating smoothly and in compliance with the law.

What are internal controls? The IRS describes internal controls as policies and procedures designed to detect and prevent errors in a retirement plan.

How are internal controls beneficial? They can help a plan sponsor avoid mistakes that could jeopardize the plan's tax-favored status. If an insignificant operational error is discovered, the sponsor may be able to correct it using the IRS's Self-Correction Program (part of the Employee Plans Compliance Resolution System, or EPCRS) without contacting the IRS or paying any fees. However, the self-correction option is available only if the plan has established practices and procedures that are reasonably designed to promote and facilitate compliance with the law.

When the IRS selects a plan for audit, the agent conducting the audit begins by evaluating the effectiveness of the plan's internal controls. Whether the agent performs a focused or expanded audit is determined by the strength of the plan's internal controls.

Should a plan have procedures for reviewing the plan document? It should. A regular review of the plan document allows the sponsor to determine whether the plan needs updating. According to the IRS, during audits, employers often can't find documentation to prove that their plans were timely amended for current law. When this happens, the matter must be resolved using an audit closing agreement with the IRS. It is much less expensive to file for correction of a plan document failure using the IRS's Voluntary Correction Program, but this program is not available to plans under audit. Reviewing the plan document annually can reveal if any amendments are needed.

What internal controls should a plan have with respect to plan operations? The appropriate practices and procedures will depend on the organization sponsoring the plan, the plan type, and the plan's particular features. Knowing and following the terms of the plan is critical. Two items the IRS recommends looking at are whether employee loans and distributions were made according to plan rules and whether eligible employees were included in the plan in a timely manner.

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If a third-party administrator performs annual testing for the plan, it's important to keep the lines of communication open regarding all employees eligible to make elective deferrals, including employees who terminated during the year. The plan sponsor should have procedures in place to ensure that the proper payroll information is provided and used in the testing calculations. Certain information regarding family relationships, officer status, and companies under common control may need to be provided to ensure that the testing can be completed properly.

What are some examples of internal control procedures?

The IRS lists several on its website:

- Comparing salary deferral election forms with the actual amounts deducted from employees' paychecks
- Verifying the types of compensation used for allocations, deferrals, and testing
- Checking that plan service providers received accurate compensation and ownership records
- Monitoring annual contribution and compensation limits
- Confirming that years of service were accurately determined for purposes of eligibility and vesting
- Verifying marital status and spousal consent for plan distributions
- Ensuring that participants received required minimum distributions

Having strong internal controls around employee eligibility, plan contributions, plan distributions, plan testing, and plan administration is key to avoiding costly penalties and potential plan disqualification. Plan sponsors should consider the benefits of being proactive by conducting a compliance self-audit each year.

Check Your Fiduciary Liability Coverage

Employers that sponsor 401(k) and other defined contribution retirement plans should review their fiduciary liability policies to make sure they provide adequate protection. Here's some information you may find helpful when you check your coverage.

Fidelity Bonding Is Not Fiduciary Liability Insurance

Retirement plan fiduciaries face personal liability exposure that will not be protected by a fidelity bond. The pension law (ERISA) generally requires that every fiduciary of an employee benefit plan and any other person who handles plan money be covered by a fidelity bond. The fidelity bond protects the retirement plan against misappropriation of funds by individuals handling the plan's assets. However, the fidelity bond does not protect against claims for losses sustained because of a breach of fiduciary duty.

Fiduciary Liability Insurance Protection

Fiduciary liability insurance provides protection for trustees and other plan fiduciaries in the event of a breach of fiduciary duty. These policies typically cover settlements or judgments. Wrongful acts that may be covered by fiduciary liability insurance include:

- Negligent investment practices
- Failure to diversify investments
- Failure to file required reports
- Conflicts of interest
- Errors in computing eligibility
- Inadequate instructions to beneficiaries that cause a loss of benefits

The benefit plan itself can purchase fiduciary liability insurance. However, the policy must allow the insurer to seek recourse against the fiduciary if it is determined that the fiduciary breached his or her duty to the plan. Commonly, the employer purchases the insurance as part of the overall compensation package of company executives who assume responsibility over the company's benefit plan.

Check Coverage Carefully

Fiduciary liability insurance coverage varies widely from policy to policy, so it's important to check what is covered in your policy and determine if you need additional coverage.

Occurrence or claims-made policies. Most policies are claims-made policies that only cover claims made and reported during the policy period. Look to obtain an occurrence-basis policy that covers all acts that occurred during the policy period, no matter when claims are made.

Aggregation of wrongful acts. If "wrongful act" is defined vaguely in a policy, insist upon a clear, objective definition. A wrongful act is generally defined as a breach of duty under ERISA, another federal law, or state law. And, if multiple wrongful acts may be treated as part of an interrelated series of wrongful acts, negotiate the elimination of this provision. Otherwise, this aggregation provision may allow the insurer to allocate a new claim as part of a prior claim, which may limit what is paid on the claim (in the event that the policy's annual limit is unavailable to pay the claim).

Nonrecourse riders. If the policy is purchased with plan assets, the policy must allow the insurer to recover any paid losses from the fiduciary whose breach caused the loss. To protect themselves, individual fiduciaries can purchase nonrecourse riders. Under a nonrecourse rider, the insurer waives its subrogation rights against the fiduciaries in cases that do not involve fraud, willful neglect, or criminal wrongdoing.

Defense costs. To help ensure adequate defense coverage, fiduciaries may want to purchase a separate defense policy, since many policies count any costs of defending an action against the overall policy limit. Also, a policy may require you to accept defense counsel appointed by the insurer. Purchasing a separate defense policy will allow you to name your own defense counsel.

Punitive damages or fines. Since most policies will not pay punitive damages, you may want to negotiate coverage of punitive damages. Even if a policy covers the 20% penalty tax on fiduciary violations, it may not cover the 15% initial excise tax on prohibited transactions.

Mid Year Non-Discrimination Testing: Avoiding Failure

As part of our regular service to your plan, DRS performs the IRS mandated non-discrimination testing at the end of each plan year. These tests compare the deferral and match contribution percentages of your Non-Highly Compensated Employees (NHCEs) to that of your Highly Compensated Employees (HCEs). If the two percentages are within the IRS's acceptable range of each other, your plan is considered to be passing these tests. Likewise, if the percentages are outside of the IRS's acceptable range, then your plan is considered to be failing these tests and corrective action must be taken.

For those plans concerned they might fail their non-discrimination tests and those who would like to know how they are doing so far this year, DRS recommends running a mid year non-discrimination test. A mid year non-discrimination test projects how your plan would do on its non-discrimination testing if your participants were to continue contributing at the same levels they have so far throughout this year.

The real benefits of running a mid-year test depend upon the results. A passing projection can give a plan sponsor substantial peace of mind. The knowledge that everything should run smoothly at the end of the year is a rare commodity to be enjoyed. Conversely, a failing projection gives a plan sponsor time to react and prepare. How a plan corrects a failing test can impact the financial decisions of the corporation and the personal tax returns of all your HCEs. Therefore, early notice of a potential testing failure can remove the surprise from the testing results and give you, the plan sponsor, a critical opportunity to react.

Armed with the knowledge of a potential failure, a plan sponsor can take steps to improve year-end test results by reducing HCE contributions and increasing NHCE contributions through education programs and enrollment meetings. In many cases, this alone can be enough to turn a failing test into a passing one. Even if a plan sponsor does not attempt to improve the test results, knowledge of a failing test can be used to warn the HCE's of the potential impact to their personal tax returns.

If you think your plan could benefit from running mid year tests, you should contact DRS to initiate the process. For more information on these tests, including an estimate on the cost and a list of the census information DRS will need, you can call the DRS Plan Support Department at 888-377-4015 or email them at helpdesk@drs401k.com. They will be able answer all of your questions or direct you to someone who can.

Record Retention -- The "Paper" Trail

As plan sponsors are well aware, the pension law (ERISA) includes specific reporting and disclosure obligations with respect to qualified retirement plans. A lesser known fact is that ERISA also has specific requirements regarding the retention of plan records. Below we answer questions you and other plan sponsors may have about retaining records and the importance of a record retention policy.

Why would we need a record retention policy? A retirement plan, by its very nature, generates a large amount of documentation. Some records should be retained indefinitely. Others may be disposed of in time. Having an established document retention system that allows plan records to be reviewed, updated, and preserved or disposed of in an organized fashion fosters good administration and helps the plan comply with pension law. Such a system can also make required documents readily accessible for IRS review, if requested.

Who is responsible for retaining plan records? Under ERISA, the plan administrator -- which is often the plan sponsor -- is ultimately responsible for maintaining the plan's records.

What records do we need to keep? The list is long. First, you need to keep all records that support the information included in your plan's Form 5500 filings and other reports and disclosures. These supporting documents essentially include whatever records a government auditor might need to verify the accuracy of the original report or disclosure. You also need to keep records used to determine eligibility for plan participation and any plan benefits to which employees and beneficiaries may be entitled. Records include:

- The original signed and dated plan document, plus all original signed and dated plan amendments
- Employee communications including summary plan descriptions (SPDs), summaries of material modifications (SMMs), and anything else describing the plan that you provide to plan participants
- The determination, advisory, or opinion letter for the plan
- All financial reports
- Copies of Form 5500
- Payroll records used to determine eligibility and contributions, including details supporting any exclusions from participation
- Evidence of the plan's fidelity bond
- Documentation supporting the trust's ownership of the plan's assets
- Documents relating to plan loans, withdrawals, and distributions
- Nondiscrimination and coverage test results
- Employee personal information, such as name, Social Security number, date of birth, and marital/family status
- Employment history, including hire, termination, and rehire dates (as applicable) and termination details
- Officer and ownership history and familial relationships
- Election forms for deferral amount, investment direction, beneficiary designation, and distribution request
- Transactional history of contributions and distributions

How long do we need to keep the records? Generally, you should keep records used for IRS and DOL filings for at least six years after the filing date. Retain records relevant to the determination of benefit entitlement indefinitely (basically, permanently).

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IRS Limits for 2016, 2017 and 2018 Tax Years

Annual Compensation Limit – The maximum compensation which may be used to calculate benefits and contributions under a qualified retirement plan for the 2018 Plan Year. **$275,000**

Annual Defined Contribution Limit - Generally includes employer contributions, employee contributions, and forfeitures allocated to a participant's account under a defined contribution plan. **$55,000**

Highly Compensated Employee Threshold - An individual is considered highly compensated for IRS non-discrimination testing if the employee owned more 5% of the company in the current or prior year or if in the prior year the employee's compensation was more than the HCE threshold for that year. For example, to be considered an HCE in 2018, a participant must have made more than $120,000.00 in 2017. To be considered an HCE for 2019, a participant will have to make more than **$120,000** in 2018.

Annual Deferral Limit – The maximum any one participant may defer for the 2018 Plan Year. **$18,500**

Catch-Up Deferral Limit – For participants turning age 50 or older during the Plan Year, the maximum additional "catch-up" deferrals allowed for the 2018 Plan Year. **$6,000**

Annual Limits:	2016	2017	2018
Annual Compensation Limit [401(a)(17)/404(l)] :	$265,000	$270,000	**$275,000**
Annual Contribution Limit [415(c)(1)(A)] :	$53,000	$54,000	**$55,000**
HCE Threshold [414(q)(1)(B)] :	$120,000	$120,000	**$120,000**
Annual Deferral Limit [402(g)(1)] :	$18,000	$18,000	**$18,500**
Catch-Up Contributions [414(v)(2)(B)(i)] :	$6,000	$6,000	**$6,000**

Income Subject to Social Security - The maximum amount of earnings subject to social security taxes in 2018. **$128,400**

If you have not already done so, please update this information with your payroll department. If you have any questions regarding these limits or how they affect your plan, please feel free to contact our Helpdesk at 303-485-9000 or helpdesk@drs401k.com for assistance.

DRS Compliance Calendar for Defined Contribution Plans*

July 31, 2018 – Initial 2017 Form 5500 and 8955-SSA filing deadline or deadline for filing extension (5558)

July 31, 2018 – Deadline to file Form 5330 to report prohibited transactions and excess 401(k) contributions for 2017

July 31, 2018 – Deadline to distribute Summary of Material Modification (SMM) for plans with amendments effective in 2018

September 3, 2018 – DRS closed for Labor Day Holiday

September 30, 2018 – Distribute Summary Annual Report (SAR) for plans that did not extend their 5500 filing deadline

October 15, 2018 – Final filing deadline for 2017 Form 5500 if extension was filed prior to July 31, 2018

November 22, 2018 – DRS closed for Thanksgiving Holiday

December 1, 2018 – Deadline to distribute Safe-Harbor Notice, Qualified Default Investment Alternative Notice and Annual Automatic Contribution Arrangement Notice

December 15, 2018 – Extended deadline for distribution of SAR to participants

December 25, 2018 – DRS closed for Christmas Holiday

December 31, 2018 – Final deadline to correct failed ADP/ACP test via distributions or qualified nonelective contributions

December 31, 2018 – Required minimum distributions due under IRC Section 401(a)(9)

January 1, 2019 – DRS closed for New Year's Holiday

January 21, 2019 – DRS closed for Martin Luther King Jr. Holiday

January 31, 2019 – Mailing deadline for participant copies of 2018 1099-R's

January 31, 2019 – DRS Year-End Information Packet and Census Data Due

February 18, 2019 – DRS closed for President's Day Holiday

February 28, 2019 – Filing deadline for 2018 1099-R's and 1096

March 15, 2019 – Deadline to correct excess deferral and match for 2018 plan year testing failures without IRS penalties

April 1, 2019 – Required minimum distribution (RMD) begin date for participants attaining age 70 1/2 or retiring after age 70 1/2 in 2019

April 19, 2019 – DRS closed for Good Friday Holiday

April, 15 2019 – Deadline to process corrective distributions for excess deferrals

May 27, 2019 – DRS closed for Memorial Day Holiday

June 28th, 2019 – Deadline to process corrective distributions for failed ADP/ACP test from EACA plans without incurring 10% excise tax

July 4, 2019 – DRS closed for Independence Day Holiday

*assumes 12/31 Plan Year End

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files@drs401k.com

To submit your year-end census data:
yearend@drs401k.com

For audit support, tax forms, and testing inquiries:
compliance@drs401k.com

For quotes for new retirement plan services:
proposals@drs401k.com

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