Plan Sponsor Digest

Issue 4, 2017

Your Challenge, Our Solutions™

Could your plan's internal controls be stronger?

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) 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.

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

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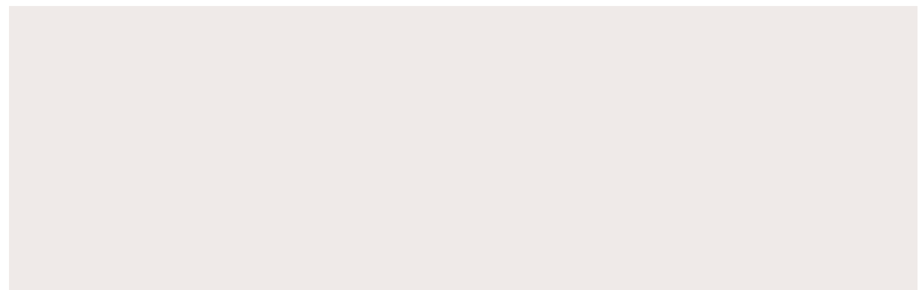


deferrals, including employees who terminated during the year. The plan sponsor should have procedures in place to ensure that the proper payroll information is provided and used in the testing calculations. Certain information regarding family relationships, officer status, and companies under common 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 (see page two for the 2017 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.

FAQs about required notices

As we move into the final months of the year, employers should be aware of various notices they may have to provide to their 401(k) plan participants before year-end. Below we answer some questions about the notices most likely to be required.

When does the safe harbor plan notice have to be distributed?

If your 401(k) plan has a safe harbor design, you must provide eligible employees with a written notice at least 30 days and not more than 90 days before the beginning of every new plan year. The notice must describe your plan's safe harbor provisions and the employees' rights and obligations under the plan. For employees who become eligible to join the plan after the start of the year, notice must be provided not more than 90 days before but no later than the date the employee becomes eligible.

The safe harbor notice can be a standalone notice or combined with the automatic enrollment notice and/or with the qualified default investment alternative notice. For employers that want to combine notices, the IRS has a sample notice available on its website *(www.irs.gov/pub/irs-tege/sample_notice.pdf)*.

When do we need to give participants notice of our plan's automatic enrollment feature?

You must provide employees with an automatic enrollment notice when they are hired, just before they become eligible to participate in your plan, and annually at least 30 days before the beginning of the plan year. The notice must explain the employee's right to decline automatic enrollment, to make changes to the election amount, and to opt out of the plan altogether. For example, the sample notice mentioned above meets the automatic enrollment

notice requirements by explaining: (1) to whom a plan's automatic enrollment features apply, (2) what amounts will be deducted from an employee's compensation and contributed to the plan, (3) what other amounts the employer will contribute to the employee's plan account, (4) when the plan account will be vested, and (5) how the employee can change his or her contributions.

What if our plan uses a qualified default investment alternative (QDIA)?

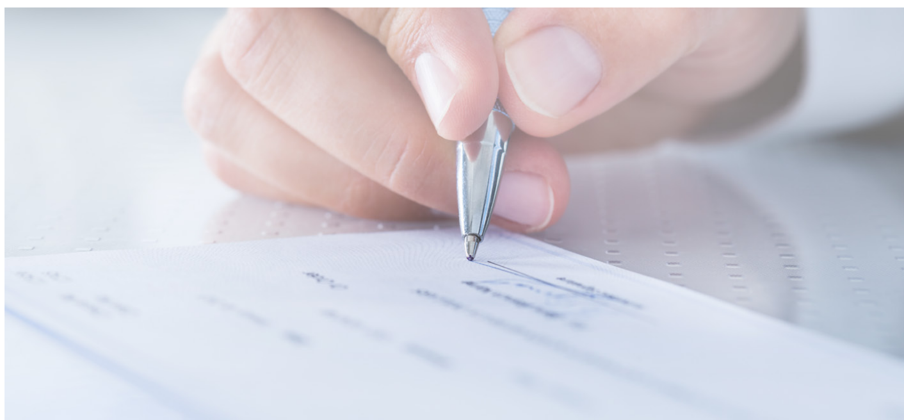
Plans that use a qualified default investment alternative (QDIA) for investments made on behalf of employees and plan beneficiaries who fail to direct the investment of their 401(k) plan account balances must provide a QDIA notice. The notice must reach employees and beneficiaries at least 30 days before (1) they are eligible to participate in the plan or (2) the first investment in a QDIA is made on

their behalf or on or before the date of eligibility if they have the opportunity to withdraw investments from the QDIA within 90 days of the first deposit. They also must receive an annual QDIA notice within a reasonable period of at least 30 days before the beginning of each plan year.

The QDIA notice must explain the employee's rights under the plan to designate how his or her contributions will be invested and, if he or she doesn't make any investment election, how the assets will be invested. The notice also must describe the QDIA, including the investment objectives, risk and return characteristics, and any fees and expenses involved. And it must explain the employee's right to transfer assets invested in the QDIA to other plan investment alternatives, as well as where to obtain information about other plan investments. Employees must be given a reasonable period after receiving the notice and before the beginning of the plan year to make investment choices.

The notice may not be provided in a summary plan description or a summary of material modifications. However, employers can provide the required description of the QDIA in a separate, simultaneously furnished document, such as the default investment's prospectus.

Ready for RMD time?



With year-end getting closer, you may want to review your plan's procedures in preparation for making required minimum distributions (RMDs) to retired employees and beneficiaries.

Generally, plans must make RMDs to retired participants who have reached age 70½ and to any current employees who own 5% or more of the company and are age 70½ or older. (Alternatively, a plan may provide for RMDs to all participants after age 70½, including retirees and current employees regardless of their company ownership status.) RMDs also must be paid to beneficiaries of a deceased employee's qualified plan account.

Under the general rule, retirees and more than 5% owner/employees must take their first RMD by April 1 of the year following the year they turn age 70½. Your plan must make subsequent RMDs by December 31 of each year. Other rules apply to beneficiaries.

Please contact us if you have questions about making your plan's 2017 RMDs.

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