THE EMPLOYEE BENEFIT
Forum
current issues in retirement benefit planning

qualified PLANS LLC

The Importance of Internal Controls

SITUATION: We want to avoid making any mistakes in administering our retirement plan that could jeopardize our plan's tax-qualified status.

QUESTION: We've heard the IRS recommends the use of internal controls to help plan sponsors avoid mistakes. What are internal controls and how can they help?

ANSWER: Internal controls are business processes designed to detect and prevent mistakes in the administration of retirement plans. They should include procedures to regularly review your plan operations and update your plan documents.

DISCUSSION: Internal controls can help you address plan administration mistakes, maintain the plan's tax-favored status, and avoid incurring penalties. If the IRS selects your plan for audit, the process will start with the agent evaluating the plan's internal controls. Whether the agent performs a focused or expanded audit of the plan is determined by the strength of the internal controls. Plus, if an error is found, how strong your internal controls are may be a factor in determining any sanction amount.

A **plan operations review** helps verify that your plan is operating according to its written terms. Two items the IRS recommends you look at are whether employee loans and distributions were made according to plan rules and if eligible employees were included in the plan in a timely manner.

A **plan document review** helps determine whether your plan needs updating due to changes in the law or in plan operation. A few months before your next plan year begins, check with us to see if you need to amend your plan for these reasons.

Which practices and procedures your plan uses will depend on your organization, plan type, and its features. Some common internal control procedures include:

- 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 years of service for eligibility and vesting were accurately determined
- Verifying marital status and spousal consent for plan distributions
- Ensuring participants received required minimum distributions

A Look at Plan Contributions

Employers and participants both are contributing more to retirement plans. According to the Plan Sponsor Council of America's 56th Annual Profit Sharing and 401(k) Survey, the average company contribution increased to 4.5% of pay in 2012 from 4.2% in 2011 (the most recent data available). Participant contributions rose from 6.4% of pay in 2011 to 6.8% of pay in 2012.

The survey also noted that in 2012:

- 87.6% of eligible employees had a balance in a defined contribution plan
- Matching contributions were made by 95.3% of employers
- 47.2% of plans used auto enrollment
- About 90% of plans that used auto enrollment used it only for new employees
- Nearly 52% of plans used a 3% default deferral rate
- About 35% of plans used a default deferral rate of 4% or greater
- Nearly 60% of plans automatically increased the default deferral rate over time

IRS Guidance for In-plan Roth Rollovers

The American Taxpayer Relief Act of 2012 (ATRA) included a provision that expanded the ability of plan participants to convert pretax 401(k), 403(b), and governmental 457(b) accounts to after-tax designated Roth accounts. But without guidance from the IRS, some plan sponsors were hesitant to offer or expand in-plan Roth conversions. Now, the IRS has issued guidance (Notice 2013-74).

Background

Prior to ATRA, a plan amount was not eligible for an in-plan Roth rollover unless it satisfied tax law rules for distribution and was an eligible rollover distribution. After ATRA, plans offering designated Roth accounts could permit participants to roll over money to an in-plan Roth account without meeting the usual rollover requirements. Plan sponsors wanted clarification on which assets could be converted.

New Guidance

The new guidance makes clear that a plan may permit in-plan Roth rollovers of elective deferrals, matching contributions, and nonelective contributions — and related earnings — regardless of whether the amounts satisfy the conditions for distribution. To be eligible, an amount must be vested. A plan may limit the types of contributions eligible for an in-plan Roth rollover and the frequency of such rollovers, subject to the nondiscrimination requirements that normally apply to plan benefits, rights, and features.

Any amount rolled over is still subject to the distribution restrictions that applied to the amount before the in-plan Roth rollover. For example, if a 401(k) plan participant who is still employed makes an in-plan Roth rollover from a pretax elective deferral account before age 59½, that amount and any earnings may not be distributed from the plan before the participant reaches age 59½ or another qualifying event occurs.

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Choosing the Right Retirement Plan

You want a retirement plan that will make the most of potential tax advantages and meet other goals you may have for your plan as well. Below we answer questions you may have if you're considering changing or adding a plan.

What choices do I have? You might look at 401(k), profit sharing, SEP (Simplified Employee Pension) or SIMPLE (Savings Incentive Match Plan for Employees)plans.

Why should I consider a 401(k) plan? As you can see in the table below, offering your employees a 401(k) plan gives them the opportunity to save more on a pretax basis than the other types of plans. If your company also chooses to contribute to the plan, those contributions are tax deductible within certain limits.

But because a 401(k) offers flexible features, it may be more costly to administer than some other plans. A 401(k) requires annual reporting and, generally, annual testing to ensure that the plan does not discriminate in favor of highly compensated employees.

What advantages does a SEP or SIMPLE plan offer? SEP and SIMPLE plans are easy to set up and administer. With a SEP plan, your business contributes to individual retirement accounts established for you and your eligible employees. Within tax law limits, you choose how much you want to contribute for the year, if at all. Your employer contributions are tax deductible within certain limits.

SIMPLE plans generally are available to businesses with no more than 100 employees that don't offer another retirement plan. They can be structured as a SIMPLE 401(k) or SIMPLE IRA plan. Employees can contribute to the plan. Although your company must contribute, those contributions are tax deductible.

How about a profit sharing plan? You have a lot of flexibility with a profit sharing plan. Employer contributions may be made according to a formula written into your plan or at your discretion and are tax deductible within limits. Employees usually are not permitted to contribute to a profit sharing plan unless it has a 401(k) feature.

Comparing Retirement Plans

	401(k)	Profit Sharing	SEP	SIMPLE
Employee Contributions[1]	Elective deferrals of up to $17,500 plus catch-up contributions of $5,500 for participants age 50 or older	No	No[2]	Elective deferrals of up to $12,000 plus catch-up contributions of $2,500
Employer Contributions	Allowed but not mandatory	Discretionary contributions	Discretionary contributions	Must match employee contributions up to 3% of pay or contribute 2% of pay for all eligible employees
Maximum Annual Contribution[1]	Smaller of $52,000 or 100% of participant's compensation[3]	Same as 401(k)	Smaller of $52,000 or 25% of participant's compensation	$12,000 (plus $2,500 catch-up) deferral plus employer contribution (see above)
Maximum Deduction	25% of all participants' compensation plus employee deferrals	25% of all participants' compensation	Same as profit sharing plan	Same as maximum contribution

[1] Dollar amounts are the 2014 tax law limits. The IRS adjusts the annual limits for inflation.
[2] Elective deferrals are allowed if the plan is a salary reduction SEP (SAR-SEP) established before 1997.
[3] Compensation is generally limited to $260,000 in 2014.

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*From the **DESIGN** of a plan that best meets your needs to expert **ADMINISTRATION** of your plan, as well as ongoing **CONSULTATION** to deliver optimum satisfaction, Qualified Plans provides you with our professional expertise and the power of partnership to achieve the long-term results you deserve.*

RECENT DEVELOPMENTS In Benefit Plans

Retirement Income Projections. A study by the LIMRA Secure Retirement Institute reports that nine out of 10 employees view retirement income projections as "somewhat" or "very" helpful in retirement planning. Of those who said the projections were less than "very" helpful, 45% said they didn't understand the calculations behind the projections or were not confident in the accuracy of the results. About 40% thought the information was too hypothetical, and 17% felt the projections didn't consider all of their retirement savings.

Midyear Changes to Safe Harbor Contributions. The IRS has standardized the rules for midyear reductions or suspensions of employer nonelective and matching safe harbor contributions. Final regulations allow you to reduce or suspend safe harbor nonelective contributions if (1) your business is operating at an economic loss for the plan year *or* (2) prior to the beginning of the plan year, you provide participants with a notice stating that the plan may be amended during the year to suspend or reduce safe harbor contributions *and* that the reduction or suspension will not apply until at least 30 days after all eligible employees are provided with notice. Additionally, under the new regulations, safe harbor matching contributions may be reduced or suspended by a midyear amendment if substantially similar requirements are satisfied. The change for nonelective contributions generally applies to plan amendments adopted after May 18, 2009, and the change for matching contributions for plan years beginning in 2015.