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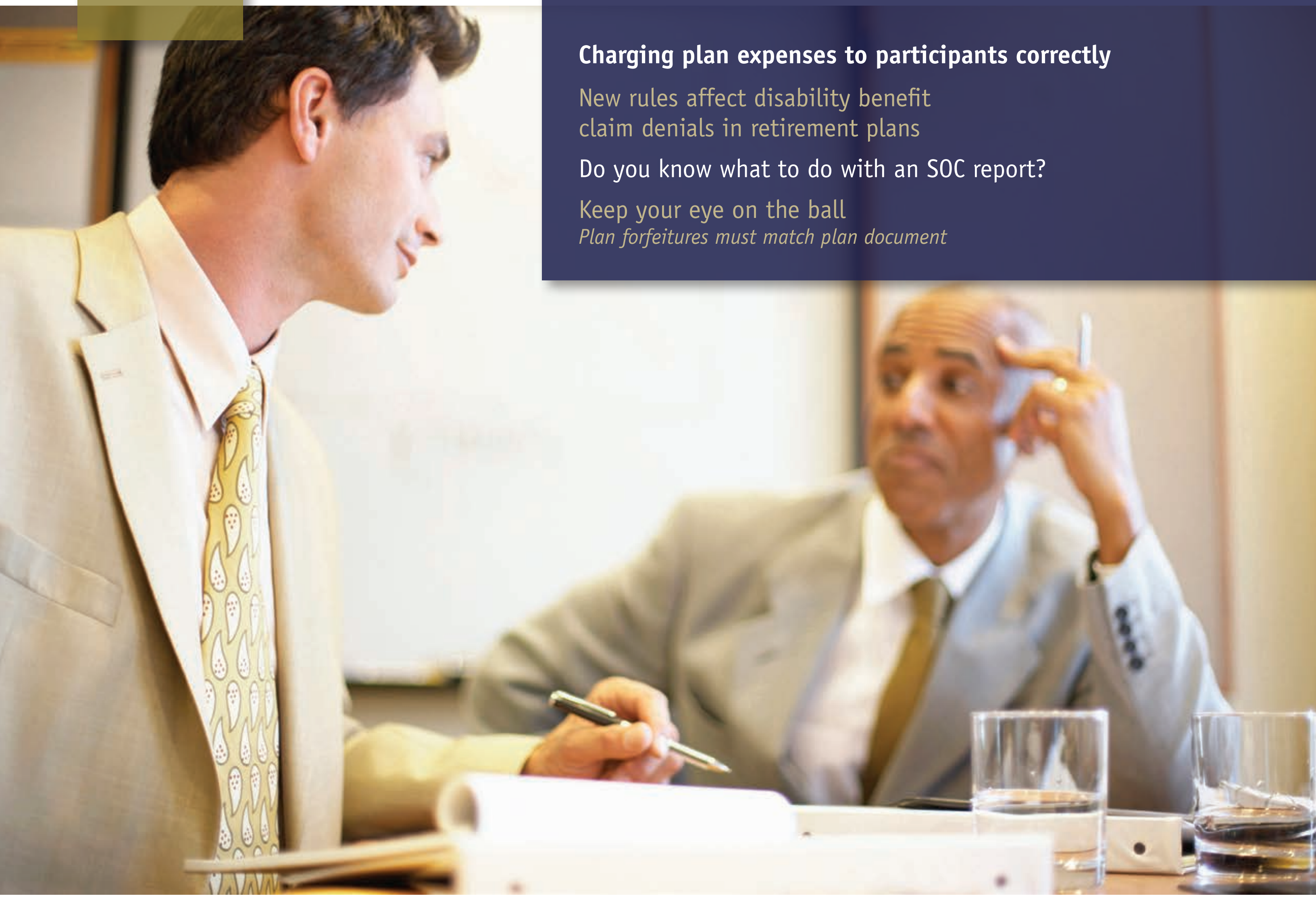
Employee Benefits Update



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Charging plan expenses to participants correctly

Shaving a few basis points off plan participants' annual returns on their retirement plan accounts can put a significant dent in their asset accumulations by the time they're ready to retire. For that reason, the question of which plan expenses are charged to participants, and which must be borne by the plan sponsor, is a critical issue to resolve correctly. Improperly allocating expenses to participants could be a serious fiduciary breach. The good news is that there's plenty of guidance on the matter.

Making the distinction

The basic dividing line is administrative vs. "settlor" functions, and their associated costs. The former can be charged to the plan, and the latter must be paid for by the plan sponsor. Here's the distinction: Administrative expenses cover services that benefit the plan participants exclusively, and settlor expenses primarily benefit the sponsor. Also, expenses incurred to implement certain settlor expenses are administrative.

The distinction isn't always clear-cut. And if participants derive some benefit from settlor services, a portion of the associated costs can be charged to the plan.

Settlor expenses

Unambiguous settlor functions include those incurred during the period the plan is being set up, such as plan design consulting and conducting provider searches. When the plan is operating, settlor expenses include the cost of amending the plan (when amendments are at your option, and not required by new laws or regulations), and costs associated with addressing regulatory issues. For example, if your plan document was found to be deficient by regulators, legal and consulting fees and penalties would be settlor expenses. So too would be costs associated with operational errors, such as missing IRS Form 5500 filing deadlines and failing to credit participant accounts on time.

Finally, if you terminate your plan, the associated legal and consulting fees would be settlor expenses.

Administrative expenses

Most other expenses you can think of are administrative, and thus can be paid from plan assets. In the plan start-up phase, that would include the cost of setting up participant accounts, including recordkeeping, billing and trust arrangements.

Ongoing operational services like custodial charges, participant recordkeeping, portfolio management, changing investment options, IRS Form 5500 preparation, discrimination testing, processing distributions and loans, audits, mailing statements, and mandatory plan amendments are all administrative.

Finally, certain charges associated with terminating a plan also can be charged to the plan. Those include investment surrender charges and plan provider contract termination fees.

DOL scenarios

Not all situations are cut-and-dried. The Department of Labor (DOL) has offered guidance, in the form of six fact patterns, to help plan sponsors categorize expenses properly. In one scenario, a plan sponsor decided to kill two birds with one stone by expanding the scope of its annual individualized retirement plan benefit statement sent to participants. In addition to the basic retirement plan statement, the employer added information about other programs, including the medical, dental and vision benefits, along with other programs such as its fitness center, annual picnic and holiday party. That more than doubled the cost of producing and distributing the booklet.

If participants derive some benefit from settlor services, a portion of the associated costs can be charged to the plan.

In the period prior to expanding the booklet, the employer charged its entire cost to the plan. But how much of the larger booklet could be charged? According to the DOL, "the plan sponsor should pay for that portion of the booklet that relates to non-plan matters." It also noted those expenses must be "reasonable." This suggests that a slick, glossy booklet might not be deemed reasonable, nor would one printed at an above-market price by a friend of the plan administrator.

The DOL said that the plan sponsor should "be given considerable deference regarding their disclosure decisions," but must "be able to explain their disclosures and justify" the resulting costs.

In another scenario, a defined benefit plan sponsor amended its plan document to provide for a participant loan program and an early retirement window. During the same period, tax law changes took effect impacting all retirement plans. These events triggered four charges from different entities that took care of the work:

1. The cost of amending the plan to comply with tax law changes,
2. The cost of routine nondiscrimination testing,
3. The cost of establishing the participant loan program, and
4. The cost to amend the plan to create the early retirement window and obtain an IRS determination letter to gain the IRS's blessings of that new plan design.

The DOL states that the first two items are administrative, because they're operational in nature. The third is a settlor function, because the plan fiduciaries have "no implementation obligations under the plan until such time as the plan is amended." And the fourth charge involves both settlor costs (amending the plan), and administrative costs (obtaining the determination letter, an implementation necessity following adoption of the plan amendment).

When in doubt

When in doubt about the appropriateness of charging a particular expense to your plan, it's prudent to make sure it falls into the administrative category before doing so. While some expenses are easier to categorize than others, be sure to consult with your advisor if you have any concerns. □

Compliance Alert

Upcoming compliance deadlines:

9/17* Extended deadline for S corporation tax returns (IRS Form 1120S)

9/17* Extended deadline for partnership tax returns (IRS Form 1065)

9/30** Summary Annual Report (SAR) due for Form 5500 that was due July 31, unless extension was granted (for returns extended to October 15, SAR deadline is December 15)

** This reflects an extended due date, as the 15th falls on a Saturday this year.*

*** This date falls on a Sunday. Historically, the IRS hasn't extended this deadline.*

New rules affect disability benefit claim denials in retirement plans

Does your retirement plan (or other ERISA-regulated benefit, including nonqualified "top hat" plans) contain a disability benefit? If so, do you know about the new DOL rules that took effect in April 2018? The new regulations, in the works since 2015, pertain to disability claims and the processes governing appeals of a denial of disability benefits. Sponsors of 401(k) plans and defined benefit pension plans have until the end of this year to amend their plans to reflect the new rules.

More disclosure

A key aspect of the new rules is increased disclosure requirements. If the claims adjuster rejects a disability claim, you'll now need to provide a more detailed explanation than before. For example, you must explain the principles and standards applied in making the determination. Previously, you only had to tell the claimant that you would provide that list on request.

You also must now inform the claimant that, on request, he or she is entitled to the entire case file. Under the previous rule, claimants were entitled to that information, but only as part of an appeals process. In addition, you need to explain why you didn't accept the recommendation of the medical or vocational professional who had supported the employee's benefit request.

Additional requirements

The new rule states that, if an employee appeals a claim rejection, you cannot introduce new information that wasn't included in the original decision-making process to support your original decision. The rules give an exception to that, however: You can introduce new evidence if you give the employee an opportunity to rebut it.

Other new procedural requirements call for plans to write all required communications with respect to claims and employees' rights in a cultural and linguistic style appropriate to the recipient and assure that the person determining the validity of the claim in the appeal process is impartial.

The rules now treat some rescissions of disability benefits the same way as a denial of benefits, subjecting that rescission to the standards of the revised regulation. Finally, if you deny a disability benefit claim in a way that violates the regulations, the employee can bypass your appeals process and directly pursue the claim in the court system.

Time for action

The regulations apply only to plans with claims adjudicators who determine eligibility for the disability benefits. So if your plan gives that authority instead to, for example, the Social Security Administration (even if the benefit itself is provided by your plan), the new regulations don't apply. Now is the time to make sure you're in compliance with the new rules. Contact your employee benefits advisor to find out more. ◻

Do you know what to do with an SOC report?

Service organization control (SOC) reports come in several varieties. They generally pertain to service organizations, like retirement plan recordkeepers or third party administrators (TPAs). The American Institute of Certified Public Accountants (AICPA) determines the scope of each SOC report.

Types of SOCs

The AICPA has three categories of SOC reports on the services provided by a service organization:

SOC 1: ICFR: Report on Controls at a Service Organization Relevant to User Entities' Internal Control over Financial Reporting. If your retirement plan is being audited, the auditor might look for your service providers' SOC 1 reports to assess his or her comfort level with those service providers' financial statements. There are two subcategories of SOC 1 reports that have different emphases.

SOC 2: Trust Services Criteria: Report on Controls at a Service Organization Relevant to Security, Availability, Processing Integrity, Confidentiality or Privacy. This report, if it paints a good picture, should give you comfort that, among other things, your plan participants' identities won't be stolen by a hacker. As with SOC 1, there are two SOC 2 subcategories.

SOC 3: Trust Services Criteria for General Use Report. These are described as "general use reports" that don't go into the same level of depth as SOC 2 reports.

The success or failure of the SOCs can impact an organization's reputation, financial statements and stability.

Reason for SOCs

Service organizations generally can provide these reports more efficiently and cost effectively than qualified plans and have made these services the focus of their business model. They generally pay to have their control systems reviewed by CPAs, who can in turn create the appropriate SOC report from the assembled information. These reports "are designed to help service organizations that provide services to other entities build trust and confidence in the service performed and controls related to the services," according to the AICPA. The success or failure of the SOCs can impact an organization's reputation, financial statements and stability.

As part of your due diligence procedure, when vetting prospective service providers for your retirement plan, review their SOC reports. If that step was overlooked in past years, request and review the SOC reports they can provide. In addition, have your CPA also read them to make sure you didn't overlook any red flags.

If the reports raise any issues, document your concerns and monitor the providers' progress toward addressing them. And if that doesn't happen, it's probably time to start a fresh vendor search. ◻

Keep your eye on the ball

Plan forfeitures must match plan document

It's a routine matter for employees to forfeit retirement plan benefits. Even so, plan sponsors can't afford to become blasé about it; ERISA demands more than an "easy come, easy go" attitude about the matter.

Forfeiting benefits

Generally, defined contribution plan participants can forfeit benefits when they leave their companies with unvested dollars still sitting in their accounts (except under circumstances described below). Those forfeited dollars can come from two sources: matching contributions you've made to their deferrals, and/or nonelective contributions you've made on their behalf.

Participants' own contributions to the plan are, of course, immediately vested.

The amount of the unvested dollars typically classified as forfeited depends on the vesting schedule you've adopted in your plan document, and the timing of an employee's departure. For example, if you use a three-year cliff vesting schedule, all employer funds set aside for participants who leave before three years are (normally) forfeited, and after three years, participants are 100% vested.

With a graded vesting schedule, if your plan requires the maximum six years of service before full vesting, participants would only be entitled to keep 20% of matching or other employer contributions after two years of service, 40% after three, and so on until

reaching 100% after six years of service. (You can opt instead for faster graded vesting schedules if you want to be more generous; ERISA only sets outer limits.) Of course, participants' own contributions to the plan are immediately vested, as are qualified nonelective contributions and employer safe harbor contributions.

Defining forfeiture

All of this assumes, however, that your plan document defines forfeiture and what happens to nonvested benefits when an employee leaves. For example, the document may state that, if the participant is 0% vested, he or

How to handle forfeited funds

However you define forfeiture, you have to do something with the unvested dollars left in the plan when a participant leaves the company. So, what are your options? Let's summarize:

You can redeploy those dollars toward your commitments to matching or nonelective contributions to plan participants. Or if you're feeling generous, allocate them to participant accounts. To do so, however, you'll need to have language in your plan document that describes how those funds would be allocated among participants and eligibility requirements. Also, these allocations would count toward the participant's limit on total annual additions, so you might not be able to allocate all forfeitures that way.

You can also use forfeited dollars to pay reasonable plan expenses. Finally, you can use them to restore previously forfeited amounts to participant accounts. That is, if a former employee returns within the five-year window and returns previously distributed funds, as required, the dollars forfeited by other employees get recycled into the nonvested accounts of those returning employees.

Chances are, you won't need to exercise this last option because it's not a common occurrence for former participants to return within five years and restore distributions they took when they left. Still, it's a good tactic to be aware of should the need arise.

Whichever path you choose, you have a deadline to get it done: the end of the plan year following the plan year in which the forfeiture occurred.

she forfeits the account immediately on termination of employment. In addition, the document may provide that the unvested portion of a terminated participant's account will be forfeited in the year of termination or after a five-year break in service. Forfeitures are generally held in a "forfeiture account" to be used when the plan document specifies. Generally, plan sponsors use forfeitures to pay plan expenses, reduce employer contributions and/or use in addition to any employer contributions being made.

Why might you hold forfeitures for a period of five years? Under ERISA, a former plan participant who returns to the company and rejoins the plan within five years has another crack at claiming those unvested assets. If the company had used these funds prior to the participant's return, it will need to make contributions to the plan to restore the account.

In either case, however, ERISA sets a high bar for returning employees to regain title to those assets. Specifically, if the former employee had received a distribution of any vested funds when leaving the company, that employee would have to return all of those dollars to the plan before having the opportunity to get those unvested dollars back. And if the returning employee cleared that first hurdle, the unvested funds to be restored would still be unvested.

Be consistent

Plan recordkeepers must keep scrupulous records of every penny in your plan and which of the many buckets they belong in. Review how your recordkeeper is tracking forfeitures. Finally, be sure that the way you're handling forfeitures is consistent with the fine print in your plan document that prescribes these procedures. ◻

The solution for skyrocketing audit fees

Finding ways to cut costs while maintaining quality seems to be at the top of every executives to do list. As the person responsible for your organization's employee benefit plan audit, we can help you not only reduce your audit costs but also provide a higher level of service.

Pension auditors must sift through enormous amounts of financial data in accordance with the requirements of numerous laws, regulations and professional standards. If they don't know what they're doing, they can easily get lost in the numbers, run up large fees and fail to provide an accurate assessment of a plan's financial status.

Pension audit specialists

Insero & Co. specializes in pension plan audits. Our professionals have extensive experience in this area and to ensure that our audits meet the highest standards of quality, our firm is a member of the American Institute of Certified Public Accountants (AICPA) Employee Benefit Plan Audit Quality Center and is registered with the Public Company Accounting Oversight Board (PCAOB).

Insero & Co. is the independent registered public accounting firm for many companies that file a form 11-K with the Securities and Exchange Commission. We currently perform audits for more than 150 plans ranging in size from 100 to 60,000 participants, and from $1 million to more than $10 billion in assets.

Big firm capabilities, small firm attentiveness

As our many satisfied clients will testify, we offer the comprehensive benefit services of a large national firm, but at less cost and with a higher level of service. With more than 125 accountants, professional consultants and support staff, our firm is large enough to bring robust resources to bear on almost every client need, yet small enough to provide the personal attention and relationship-based service that is important to our clients.

The culture of Insero & Co. is hands-on and proactive, shaped by the old-fashioned notion of doing what is in the best interest of the client. In addition to pension and corporate audits, we provide a full range of tax, accounting and consulting services, including internal audit/Sarbanes-Oxley services, outsourced accounting and wealth management.

Go with the experts

We would welcome the opportunity to discuss your audit or other needs and put our expertise to work for you. Please contact Vince Leo at 585-697-9683 or Mike Giess at 585-697-9639 and let us know how we can be of service.

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