A quarterly recap of recent publications from BDO's ERISA Center of Excellence.

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BDO

A NOTE FROM BDO'S NATIONAL ERISA PRACTICE LEADER

As filing season comes to a close, there's a distinct opportunity for sponsors to examine the health of their employee benefit plans. The results of your audit can be the catalyst to starting conversations relating to improvements, modifications or amendments to your plan.

In the past quarter, insights from BDO's ERISA Center of Excellence have covered topics ranging from Cybersecurity as part of a plan sponsor's fiduciary duty to how tax reform might affect ESOP valuations. We also delve into plan fees and compliance issues you should be aware of.

While you're enjoying a slower pace over the next couple of months, be thinking about how your benefit plan can better serve your employees in 2019 and beyond. Our team is always here and happy to help!

Sincerely,

BETH GARNER
National Practice Leader, ERISA

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Retirement Plan Sponsors: Is Cybersecurity Part of Your Fiduciary Duty?

We've all received suspicious-looking emails asking us to provide personal information to redeem a prize that we've won or alerting us that someone we know needs financial help. By now, most of us recognize these scams—and don't open the email.

But what if the message looked like it was coming from an official, known source? Would you open an email you thought was coming from your 401(k) service provider or the sponsor of your retirement plan?

It's vitally important for plan sponsors to consider questions like these because retirement plans and the $28 trillion that they currently hold in the United States are major targets for cyber hackers. Cyber criminals are becoming increasingly sophisticated in targeting entities that manage vast amounts of assets and personal data—two characteristics inherent in retirement plans and their service providers.

Today, protecting stakeholders' data is no longer just an issue that information technology departments need to worry about. By law, fiduciaries to 401(k) and other retirement plans have a duty to act in the best interests of the participant—and protecting sensitive online information is part of that job.

UNDERSTANDING THE THREAT

Communications about plan benefits contain significant amounts of personal data including: Social Security number, birth dates, home address, salary, password and general payroll information. Service providers to retirement plans store much of that material as well. As a fiduciary to the plan, the plan sponsor has a responsibility to make sure all that information—whether it is stored directly or by a third-party service provider—is kept safe.

Just as stolen identities are often used to hack credit card accounts, they can be used by criminals to access 401(k) and other retirement accounts. If cyber criminals gain access to the proper information about a participant, they may be able to trick an ill-prepared call center employee into releasing additional account information or making an unauthorized distribution, loan or transfer.

In many cases, security breaches will trigger state and federal fines for plan sponsors, as well as expose them and their service providers to lawsuits by participants. In addition to these legal costs and potential damage to the company's reputation, data breaches are extremely disruptive and time-consuming to deal with for plan sponsors, service providers and participants alike.

RECOMMENDATIONS FOR PLAN SPONSORS

While it's impossible for any organization to be completely bullet proof when it comes to cybersecurity, there are basic steps that plan sponsors can take to improve data protection strategies and limit the threat of an attack. The Department of Labor's Advisory Council on Employee Welfare and Pension Plans describes many of these practices in its report, Cybersecurity Considerations for Benefit Plans.

The report outlines cybersecurity issues that are specific to retirement plans and suggests that plan sponsors create a cybersecurity strategy that addresses the specific Plan concerns that complement the company's overall cybersecurity plan. The DOL's Advisory Council stressed that because each plan is unique, its cybersecurity management should be more than a checklist that simply mirrors language used across the industry. Instead, the cybersecurity plan should be tailored to the distinct characteristics of the benefit plan, its systems and its participants.

Before a breach happens, plans should have a risk management strategy in place. The DOL report identifies several considerations for plan sponsors as they develop their strategies, including:

- Establishing who is responsible for designing, documenting, implementing and maintaining the strategy
- Creating a process for eliminating unnecessary data to reduce cyber risks
- Evaluating service provider security programs and documenting how they will gain access to sensitive data
- Understanding current insurance coverage arrangements to determine whether additional protection is needed to adequately safeguard the plan sponsor and participants

Other organizations have developed initiatives that can help plans sponsors deal with cyber threats. The American Institute of Certified Public Accountants (AICPA) developed a cybersecurity risk management framework, **SOC for Cybersecurity**, to assist organizations as they communicate relevant and useful information about the effectiveness of their cybersecurity risk management programs. The AICPA also has created a **Cybersecurity Resource Center** to help organizations learn how to best protect data.

In September 2017, the SPARK Institute, an organization focused on strengthening U.S. retirement policy, issued its **Industry Best Practice Data Security Reporting** to help plan sponsors understand how record keepers should communicate—to plan consultants, clients and prospects—the full capabilities of their cybersecurity systems. In 2014, the National Institute of Standards and Technology created its **Framework for Improving Critical Infrastructure Cybersecurity**, setting guidelines to manage cyber risks.

BDO INSIGHT: START WITH THE BASICS— AND KEEP CUSTOMIZING

Given the complexity and rapidly evolving nature of cybersecurity threats, developing a plan to address and mitigate these risks can feel extremely daunting for plan sponsors. But as with any challenging endeavor, knowing where to start is essential. Building on the DOL's recommendations above, BDO recommends that the following actions be part of a plan sponsor's cybersecurity efforts:

- Identify what information you manage that could be at risk
- Monitor what service providers are doing to address risks at their organizations
- Review existing frameworks and current industry developments through resources provided by the AICPA, SPARK, DOL and others
- Review the AICPA's SOC for Cybersecurity and ask service providers if they have adopted those practices
- Understand your organization's broader cybersecurity plan and identify ways it should be tailored to address the unique risks that retirement plans and participants face

These basic steps are just a starting point. It's critical to remember that every plan and every organization is unique. No checklist or set of industry best practices will be sufficient in protecting your plan and your participants from the growing threat of data breaches.

BDO provides a range of cybersecurity services and solutions to help plan sponsors fulfill their fiduciary obligations in these areas, including: cyber risk assessment and security testing; cybersecurity strategy, policy and program design; and incident response planning. BDO can help you assess your plan's current needs and assist in implementing an appropriate cybersecurity strategy today.

Pension Benefit Guaranty Corp. Streamlines Disaster Relief Procedures

Victims of natural disasters will no longer need to wait for extension instructions from the Pension Benefit Guaranty Corp. (PBGC) to meet certain deadlines, thanks to a new policy issued in July 2018.

The PBGC announced in the July 2 Federal Register that victims of natural disasters may use the Internal Revenue Service (IRS) instructions for late filings and deadlines found in its disaster relief news releases. Victims will need to look at the IRS statement to determine whether they qualify, and they will need to notify the PBGC that they are eligible for the extension. For premium filings, the agency will not impose any late fees or interest on the payment if made within the relief timeframe.

In the past, the PBGC, which serves as the insurance backstop for defined benefit plans, has waited for the IRS to issue its disaster relief policy before following with an announcement. Filers had to wait for the PBGC to respond to the IRS announcement to make sure the PBGC was going to provide disaster relief. In many instances, the follow-up information was boilerplate and did not give any new details.

The July 2 Federal Register notice serves as a one-time announcement outlining the qualifications and procedures to follow each time the IRS issues a disaster relief news release. The notice clarifies how the PBGC relief is tied to the IRS disaster relief news; it also explains other details including the types of filings covered, how to notify the PBGC and exceptions to the rule.

In addition, filers will be able to request relief for issues not covered by the general announcement.

The agency's new policy applies to disasters covered by an IRS disaster relief news release on or after July 2, 2018.

EVENTS AND NOTABLE DATES

Upcoming Events and Happenings

AICPA Employee Benefit Plans Accounting, Auditing and Regulatory Update
December 10 – 11, 2018; Washington, D.C.

Key Upcoming Deadlines

- **December 1:** Deadline to deliver QDIA, Auto-Enrollment, and Safe Harbor Notices to participants
- **December 14: Summary Annual Report due**
- **December 31:** Age 70½ Required Minimum Distributions due to participants who have begun receiving distributions

ERISA Center of Excellence

BDO's ERISA Center of Excellence is your source for insights on emerging regulations, industry trends, current topics, and more. Visit us at **www.bdo.com/erisa** or follow along on Twitter: **@BDO_USA** and **#BDOERISA**.

How Tax Reform Could Affect ESOP Valuations

The Tax Cuts and Jobs Act of 2017 (TCJA) was the most sweeping change to the tax code since the mid-1980s. There were only a few provisions in the law that apply to employee stock ownership plans; the reduction of corporate taxes in particular will have a significant impact on stock valuations in these types of defined contribution plans. As a result, companies with ESOPs should begin thinking about what a potential surge in their stock valuations in 2018 could mean for their funding strategies.

The TCJA lowered the top corporate federal tax rate from 35 percent to 21 percent. The change is significant for all companies, and especially companies that have ESOPs because it:

- Generates additional cash flow for a company
- Could boost net profits, which in turn would increase the value of the stock in the ESOP
- Could result in a higher repurchase obligation because of the higher value of the stock in the ESOP

For C Corporations, the increased repurchase obligation may not be difficult to manage. In many cases, the rise in the repurchase obligation will be offset by increased cash flow as a result of the lower corporate tax rate.

For S Corporations or other pass-through entities, however, managing the increased repurchase obligation may be trickier. Because the tax obligation is passed through to the shareholders of the company, which in this case is a qualified retirement plan exempt from federal income tax, managing the higher repurchase obligation may be more difficult because there is no cash windfall from the lower corporate tax rate.

Because the reduction in the tax rate is so significant, ESOP-owned companies should consider taking a serious look at their plan in 2018. It's possible that existing cash-management policies may not support the obligations under the new tax structure. Companies also need to understand how other changes enacted through the TCJA could affect their valuations and cash flows.

HOW ESOPS ARE STRUCTURED AND VALUED

An ESOP is a type of defined contribution plan that has been around since the mid 1950s. Unlike a 401(k) that invests in a wide range of investments, an ESOP invests primarily in the employer's own stock. As a result, employees collectively own part or all of a company.

As of 2015 (the most recent data available), there were nearly 7,000 ESOPs with about $1.3 trillion in assets and 14.4 million participants, according to data from the National Center for Employee Ownership. ESOPs receive special tax treatment and have been used primarily by private companies as a way to retain and incentivize employees and/or provide an exit strategy for company owners who want an alternative path to liquidity. ESOPs are not cookie-cutter strategies; they are uniquely structured to benefit each company, its owners and employees.

When a participant retires or leaves a company, the ESOP provides a benefit that is based on an employees' account balance, which comprises shares of company stock. For privately-held companies, federal law requires that the ESOP buys the shares back from the participant. This future requirement to purchase vested and allocated shares from all participants is called a repurchase obligation. Depending upon how the plan is structured, and on the type of distribution to be made, payments may be completed over time or in a lump sum.

The amount of a company's repurchase obligation is directly related to the value of its stock. For companies that aren't publicly traded, an independent appraiser will determine the company's valuation using one or a combination of three methods: discounted cash flow analysis, evaluation of comparable publicly traded companies or analysis of recent sales of comparable private companies. Generally speaking, the TCJA has been a tailwind to companies' profitability and cash flows—leading to higher stock valuations regardless of which method is used.

OTHER TAX REFORM FACTORS TO CONSIDER

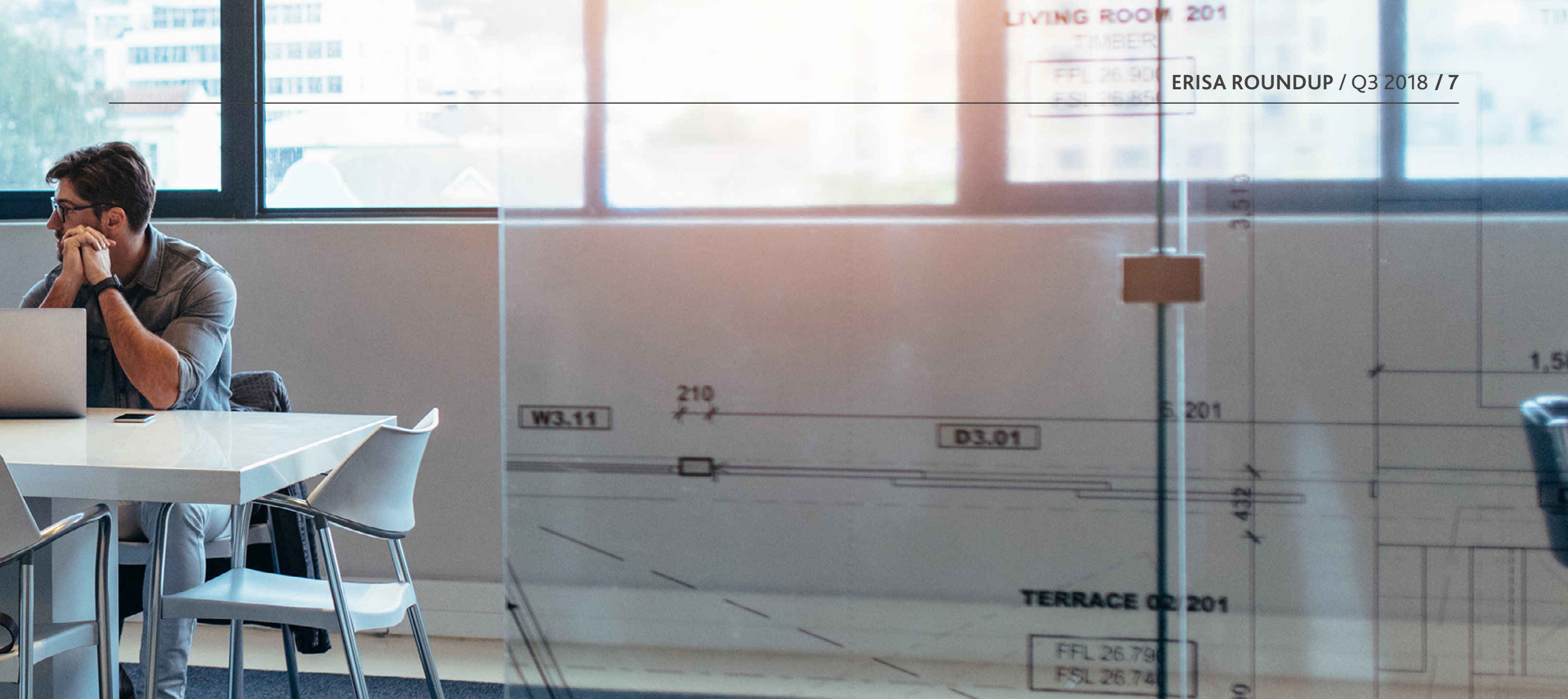
While the reduced tax rate has boosted corporate profitability, the TCJA implemented other changes that could negatively affect a company's profitability and tax liability. Most notably, the law decreases the maximum allowable interest deductions for businesses to 30 percent of earnings before interest, taxes, depreciation and amortization (EBITDA) until 2022. After that, the limit becomes even more restrictive, at 30 percent of earnings before interest and taxes (EBIT).C Corporations with ESOPs may need to restructure loans to avoid hitting the limit on the amount of interest they can deduct. S Corporation ESOPs are exempt from federal income tax.

The TCJA also includes changes that could affect how employees plan for the capital gains taxes related to a potential sale of stock to an ESOP. Starting in 2018, the amount of state and local income taxes (including property taxes) that can be deducted from a taxpayer's gross income is limited to $10,000. This new limitation—previously there was no limit—can be significant for employees who sell shares back to an ESOP and realize large capital gains on the stock in 2018 or beyond, particularly those who live in high-tax states such as California, New York, New Jersey and Illinois. In some cases, employees who sell appreciated shares to an ESOP may want to consider taking advantage of Internal Revenue Service Section 1042, which allows taxpayers to defer capital gains taxes on the sale of stock to an ESOP if the proceeds are reinvested in qualified replacement property and other requirements are met.

BDO INSIGHT: KNOW YOUR REPURCHASE OBLIGATION

Companies with an ESOP need to prepare for a potential increase in valuations in 2018 because of the reduction in corporate tax rates and other changes in the new tax law. In many cases, a repurchase obligation study is a good place to start. The study will help the company realize its repurchase obligations on an ongoing basis, gain visibility into its expected future cash flows and develop an updated funding strategy for the ESOP. This will help companies make well-informed decisions about their long-term capital spending strategies across the business.

It's also important for companies to realize that there are many other aspects of the TCJA, beyond the reduction in corporate tax rates, that can influence a company's profitability and tax liabilities. Companies need to take a holistic view of how the law will affect their future growth prospects, cash flows, valuations and repurchase obligations. BDO's ESOP Advisory Service experts are available to help you understand the TCJA and how it impacts your defined contribution plan.



Fees for 401(K) Services: What Plan Sponsors Need to Know

Political candidates who don't know the cost of a gallon of gas or a movie ticket usually wind up paying that price with voters and losing on election day. Likewise, many plan sponsors are finding themselves on the losing side of lawsuits because they allowed their defined contribution plan to pay unreasonable service fees.

Plaintiff's class action lawsuits against excessive fees dominated Employee Retirement Income Security Act (ERISA) litigation in 2017, according to Seyfarth Shaw's annual Workplace Class Action Litigation Report. Of the $2.72 billion spent by employers on the top 10 aggregate workplace class action settlements, nearly $928 million came from the 10 largest ERISA settlements. That is up from $807 million in 2016.

Seyfarth Shaw expects more of these lawsuits to come in 2018. That is bad news for many employers because defending and settling lawsuits can significantly affect an organization's bottom line. For example, in a case settled in May, plaintiffs alleged that Philips North America LLC paid too much for its investment management and administrative services. While the company said in court documents that it did nothing wrong, a U.S. District Court preliminarily approved a $17 million payment to participants in its 401(k) plan.

In today's litigious environment, it's risky for plan sponsors be unaware of how much service providers are charging. Even successfully defending an allegation of paying excessive investment or administrative fees can be costly in terms of time, resources and money. BDO has found that many plan sponsors are calculating and analyzing their plan fees on a regular basis. As a result of those reviews, many are able to reduce service provider fees. Federal law binds plan sponsors with the duty of acting in the best interest of the participant, so it's imperative to understand the liability associated with not knowing the types of fees, how they can be charged and how to determine whether the payment is reasonable.

KNOWING YOUR FEES

While plans can have varying types of fees, the two largest are investment and administrative fees. The **investment fee** is typically the largest 401(k) service charge and is usually charged as a percentage of the assets invested. This fee, often referred to as the expense ratio, is what is paid to manage the investments offered in the 401(k) plan.

Another form of investment fees are 12b-1 or revenue sharing fees. These are charges from mutual funds for their marketing and other distribution materials. These fees were sanctioned in the 1980s as a way to bring investors to mutual funds to lower the overall cost of the investment. Often, this charge is rolled into the expense ratio of a 401(k) plan.

The **administrative fee** is what is paid to service providers to run the plan; record keepers, accountants and legal services fall under this umbrella. According to NEPC's **2017 Defined Contribution Plan and Fee Survey**, 53 percent of plan sponsors pay a fixed fee per participant for record keeping services. This may be charged to plan participants directly or be covered by a portion of the fund expense ratio.

According to NEPC, the median plan record keeping fee for 2017 was $59 per participant, compared to $64 in 2015. The median investment fee ratio was 0.41 percent, compared to 0.46 in 2015.

It is important to note that as your plan grows in size, you have the ability to access lower cost class shares and effectively lower your annual expense ratio. When was the last time you revisited and renegotiated your plan fees with your service provider?

HOW FEES AFFECT PARTICIPANTS

According to a 2013 Department of Labor (DOL) paper on **401(k) fees**, regardless of how the charges are paid, plan sponsors need to evaluate each arrangement on a regular basis. One of the reasons for this is because fees have a significant impact on the amount participants can save for retirement.

The DOL gave a simple example of an employee with 35 years left until retirement with $25,000 in a current 401(k) account. Using an average 7 percent rate of return over 35 years, no annual contributions and an annual service fee of 0.5 percent, the employee's balance would grow to $227,000 at retirement. Changing the fee to 1.5 percent under the same scenario would lower the final balance to $163,000. So, a 1 percentage point difference in fees reduced the final account balance by 28 percent.

The important element to remember is that service providers need to give plan sponsors clear information on how much they are charging for services. The DOL instituted two rules in 2012 to help all parties understand how much is being charged and paid. The first rule instructs providers to give plan sponsors clear detail on their charges. The second requires plan sponsors to show participants how much they are paying for their 401(k).

Interestingly enough, even with this information, 37 percent of participants surveyed by **TD Ameritrade** earlier this year still think they don't pay any 401(k) plan fees.

BDO INSIGHT: KNOW YOUR FEES AND DOCUMENT YOUR PROCESS

It's important for plan sponsors to remember that every service offered in a 401(k) plan has a cost. Education, online tools, investments, legal and other elements that providers might say are included or free all contribute to the overall cost. It's up to the plan sponsor to determine whether the overall fees are reasonable. In today's environment, plan sponsors who don't address these issues or don't conduct periodic reviews of service fees may likely find themselves in a very costly lawsuit.

There are plenty of benchmarking services available to plan sponsors to see how your plan stacks up with similar-sized plans or industry. Usually investment advisors help with this feature, but there are several online services that can help. For Us All, a 401(k) advisory group, gives general guidance on investment fees, all-in bundled arrangements based on number of employees and other useful statistics. For example, For Us All uses data from other sources including the 401(k) Book of Averages to show that for a company with 50 to 199 employees, the national average expense ratio for funds is 1.09 percent

There isn't a one-size-fits all solution for determining what's reasonable; what makes sense for one plan may not be appropriate for another. As a result, it's important for plan sponsors to document the process they use when choosing investments and service providers. Also, it's important to remember that reasonable doesn't always mean least expensive, nor does it suggest that higher fees generate better returns.

All of the components of a plan's decision-making process need to follow written policy statements. Having policy statements outlining the plan's purpose, the fiduciary obligations, selection process, how fees will be charged, paid and communicated, as well as other procedures, will help plan sponsors discharge their responsibilities more effectively.

IRS Finalizes Regulations Around Forfeitures Funding for QNECS and QMACS

On July 20, 2018 the IRS finalized regulations that allow forfeitures from 401(k) plans to fund qualified nonelective contributions (QNECs) and qualified matching contributions (QMACs), which are frequently used to correct certain contribution testing failures. The final regulations follow the proposed regulations released on January 18, 2017 (82FR 5477). These regulations apply to taxable years beginning on or after the date of publication of the final regulations however, plans may rely on the proposed regulations for periods preceding the proposed applicability date.

Forfeitures are generated when an employee is terminated before the employer's contributions to their qualified retirement account have fully vested and cannot be returned to the employer. Forfeitures must remain in the plan to be allocated under a forfeiture formula, used as an employer contribution or pay plan expenses. However, under the prior rules, employers could not use forfeitures to fund QNECs and QMACs.

QNEC and QMAC are commonly used by employers to correct testing failures where the rules that limit the disparity between average deferrals and matching contributions of highly compensated employees and non-highly compensated employees are not satisfied.

Under the corrective contribution rules, QNEC and QMAC contributions must be fully vested which prohibited the reallocation of forfeitures as QNECs and QMACs since those amounts were not fully vested when contributed.

Under the new regulations, forfeitures can be used for QNECs and QMACs as long as the forfeitures are vested when allocated to the plan participants' accounts although they are not fully vested when contributed to the plan. The use of forfeitures to fund QNECs and QMACs is a valuable expansion that plan sponsors and service providers had been advocating.

Rules around QNECs and QMACs were also expanded by Congress through the Bipartisan Budget Act of 2018 (P.L. 115-123) passed in February 2018. The funds eligible for a section 401(k) hardship withdrawal were broadened to include earnings on elective deferrals as well as QNECs, QMACs, and the associated earnings of both, elective for plan years after December 31, 2018.

These rules coupled with the relaxed hardship withdrawal rules from this year's earlier budget bill, plan sponsorship becomes even more attractive to employers.

401(K) Plan Compliance: What Plan Sponsors Need to Know

Defined contribution plans, and 401(k) plans in particular, offer myriad benefits for workers and employers, and these plans can be powerful tools to help organizations attract and retain talent. Despite these benefits, only 62 percent of private sector employees have access to a defined contribution plan, according to the Bureau of Labor Statistics. This figure drops to 41 percent for companies with 50 to 99 people.

One of the reasons that companies, especially smaller ones, are hesitant to offer a 401(k) plan is that setting one up may seem like an intimidating process. There is a litany of rules to understand and comply with, as well as forms that must be filed and decisions that need to be made. Then, once the plan is established, there are additional annual requirements involved in operating the plan.

For most companies, though, plan compliance doesn't need to be a barrier to offering a 401(k) plan to employees. Thanks to advances in technology, many 401(k) service providers are well-equipped to run the plan while you tend to your business's needs. It's important to remember that even if you hire a third-party administrator (TPA), you are still responsible for making sure the plan is compliant.

To help demystify the process of establishing and maintaining a 401(k) plan, we provide an overview of the steps to ensure your plan is working within the rules set by the federal government.

ESTABLISHING A PLAN

Whether you hire an outside administrator or establish a 401(k) in-house, there are four basic items that need to be addressed at the start:

- **Plan document:** This is the 401(k) roadmap. It describes the type of plan you have established and includes details about investment, participation and vesting guidelines. The plan document also designates fiduciaries and administrators and identifies the roles they play. Participants receive an abbreviated version, which is called the Summary Plan Description.
- **Trust:** As a fiduciary and plan sponsor, you must act in the best interest of the plan participants. This includes setting up a trust to make sure the plan assets are held in an account that is used solely for 401(k) participants and not mixed with other company funds.
- **Recordkeeping system:** Sponsors need an accurate way to track the inflows and outflows of the plan's assets. The recordkeeper is a key resource in tracking this information as well as helping prepare the annual report and other federally required documents.
- **Employee statements and notices:** In addition to the Summary Plan Description, other communications participants must receive account statements; disclosure statements for plan features, blackout periods, fees, expenses, investment options and performance; and the Summary Annual Report, which is a digest of the information found in Form 5500.

OPERATING A PLAN

Once a plan has been established, there are certain responsibilities that all sponsors face while the plan is being operated. Here are some of the most important elements plan sponsors need to maintain or monitor to ensure that the plan is compliant with federal law.

- **Plan contribution and compensation limits:** The Internal Revenue Service (IRS) sets these limits annually. Eligible participants can contribute up to $18,500 in 2018, and participants 50 and older can make an extra $6,000 in catch-up contributions. The total amount a participant can receive on all contributions is the lesser of 100 percent of the employee's pay or $55,000. For certain employees with compensation over an annual threshold, currently $275000, there are caps on funding limits imposed by the IRS.
- **Required Minimum Distributions (RMDs):** Participants who are age 70.5 or older and are not working for the company must start receiving an annual benefit distribution from the plan. More than 5% owners and certain relatives must take an RMD regardless of employment status.
- **Other distribution rules:** For traditional 401(k) plans, money is deposited pre-tax, accumulates tax free, and gets taxed when withdrawn; there may be other tax implications for early withdrawals before age 59.5. Contributions to Roth 401(k) plans are made using after-tax income, and distributions, including growth, are tax-free.
- **Form 5500:** This publicly available form goes to the IRS and Department of Labor each year and provides information about the plan and how it operates.
- **Testing:** Plans must undergo non-discrimination testing every year to make sure they benefit all employees equally, and not a specific group (such as highly compensated employees) more than another.
- **Deadlines:** Like the Form 5500, there are certain reporting deadlines to deliver plan information to various federal agencies. In addition, employer contributions must be completed by a certain date to be considered tax deductible. The safe harbor for small plans is 5-7 days but there is no safe harbor for most large plans. These rules are relatively subjective based on facts and circumstances.

BDO INSIGHT: KNOW YOUR FIDUCIARY RESPONSIBILITIES

There are many benefits of offering a 401(k) plan. Studies have shown that companies that offer plans typically see higher levels of loyalty and productivity and lower levels of stress among employees. In addition, contributions provide tax deductions for the employer. Smaller companies can see additional tax credits in the first three years when offering a 401(k) plan.

Yet, these benefits come with many deadlines, formulas and procedures that need to be followed. So, it's important to do your homework and be aware of 401(k) reporting and disclosure requirements. A trusted plan professional can help oversee the process, but working with a provider doesn't relieve you of your fiduciary duty to run the plan in the best interest of its participants. Your BDO representative can help you through this process and explain the federal requirements in running a 401(k) plan.

Using EPCRS to Correct Retirement Plan Errors

Everyone makes mistakes, and for plan sponsors, the ability to identify and remedy errors is essential for maintaining the plan's tax benefits. For plan sponsors who may have deviated from their plan documents, or need to make other corrections, the Internal Revenue Service (IRS) provides three options to fix errors so organizations can keep all the tax advantages that come with their retirement benefits.

The program, called the Employee Plans Compliance Resolution System (EPCRS), has a three-tiered approach to resolving issues in all types of plans. As you might guess, the more complicated the issue, the more the IRS gets involved. Here, we'll explain some of the common failures and the remedies available to plan sponsors.

TYPES OF ERRORS

The types of errors that plan sponsors make and that may need corrections generally fall into four main categories:

- **Operational issues:** plan sponsor does not follow provisions in the plan
- **Plan document failure:** plan document is written in a way that violates tax-qualification requirements
- **Demographic complications:** plan operates in a way that fails non-discrimination, participation or other coverage issues that undo tax qualification requirements
- **Employer eligibility:** Employer adopts a plan that doesn't fit its tax designation; for example, government organizations cannot adopt 401(k) plans

THREE LEVELS OF CORRECTIVE MEASURES

The IRS provides three options for fixing issues. The first is a do-it-yourself, voluntary program called the **Self-Correction Program (SCP)**. This allows the plan sponsor to fix the issue without informing the IRS or paying a fee. To qualify, plan sponsors must have more than a plan document; they must have established practices and procedures. Also, this remedy is only for operational failures. For example, complications with vesting, eligibility, auto-enrollment are all common operational problems that qualify for SCP. Additionally, the self-correction program must be corrected within the time frame noted for significant errors. Insignificant errors can occur at any time.

Plan sponsors interested in using SCP should follow Revenue Procedure 2016-51, Section 6. It's important to note that plans have until the end of the second plan year after the problem occurred to complete the correction.

The second remedy is called the **Voluntary Correction Program (VCP)** and is available for all types of errors. This is a more involved program that is used when multiple corrections are needed or when a plan sponsor isn't sure how to proceed. Plan sponsors must notify the IRS of mistakes as well as show how issues will be corrected. After receiving the plan sponsor's submission, the IRS will issue a letter called a Compliance Statement that will recap the failures and the IRS-approved corrective measures. The plan sponsor has 150 days from receiving the Compliance Statement to fix the problems.

The benefit of the VCP is that it provides certainty: the IRS designates what to do, and the plan should be operating to IRS standards if the remedies are followed correctly. One drawback, however, is that VCP requires a fee. The cost used to be based on the number of participants, but now it's based on plan assets. The table can be found **here**.

Plan sponsors interested in using VCP should start by filling out form **8950** and **8951**. In addition, there may be other forms required, so it's important to follow the directions in **Revenue Procedure 2016-51, Part V**.

The last program is called the **Audit Closing Agreement Program (Audit CAP)**. This is available when a plan is under audit and has multiple issues or any error that the IRS requires correction of. The IRS starts with a sanction or closing fee to determine the penalties for the violations. The regional agent will review the facts and circumstances to determine the fee, but a bit of subjectivity is in play, too. In many cases, plan sponsors may choose to work with a service provider to negotiate the maximum payment amount. The IRS notes that the fee will be higher than what plan sponsors would pay under VCP and will reflect the severity of the issues in the plan.

If the plan sponsor and the IRS cannot come to an agreement on the correction or the fine, the plan will be disqualified. Plan sponsors who are required to comply with an Audit CAP should review **Revenue Procedure 2016-51, Section 14**, for more details.

BDO INSIGHT: BE PROACTIVE AND DOCUMENT YOUR ACTIONS

Operating a retirement plan is not always easy, and it's inevitable that plan sponsors will run into issues on occasion. The key is to address problems as quickly and efficiently as possible, so errors do not trigger an IRS audit.

While the IRS gives solid information, plan sponsors may not find everything needed to do the self-correction. In this case, plan sponsors may need to ask the IRS for a self-determination letter. Also, there are other issues—such as fiduciary violations or missed Form 5500 filings—that the EPCRS cannot fix.

Even when using the SCP, plan sponsors should document every step made to correct all failures. This records the plan sponsor's process as well as helps establish procedures going forward. In all the EPCRS programs, the objective is to restore the plan to where it would have been had the errors not happened. Your BDO representative is available to help walk you through the EPCRS process.

First-Time Plan Audits: What to Expect

Growing beyond 100 employees is an important landmark in a company's history. While companies may view crossing this threshold as cause for celebration, the Department of Labor (DOL) may view it as a trigger for increased scrutiny of your employee-benefit plan. Certain employee benefit plans with 100 or more eligible participants may be required to engage an independent auditor (referred to as an Independent Qualified Public Accountant or IQPA) to audit the plan's financial records.

Going through an audit for the first time can be a daunting task. Your auditor will ask for information you might expect, such as employee census and payroll data, plan documents, plan financial statements, contribution deposit history, and more. What you might not expect is getting requests for that information from previous years, or for a sample of participants over a certain timeframe to check for past errors. It's a lot of data to supply, so keeping good records and planning ahead is paramount. A solid auditor with benefit plan audit experience can be extremely helpful in guiding plan sponsors through the first-time process.

UNDERSTANDING THE 100-PARTICIPANT THRESHOLD

Generally, when a plan has 100 or more eligible participants, it's considered a "large plan" for reporting purposes, which requires an annual examination from an IQPA. The audit must be included in the plan's annual report – filed with the DOL on a Form 5500 – and is due within seven months of the end of the plan year. It may be extended to nine and one half months of the end of the plan year.

While 100 participants is the general threshold for large-plan status, the DOL does provide some wiggle room. Plans that have between 80 and 120 eligible participants at the beginning of the plan year are allowed to file their Form 5500 in the same way they did the year prior. For example, a plan that had 70 participants on January 1, 2017 and filed as a small plan for 2017, and then grew to 115 participants by January 1, 2018, may elect to file as a small plan again—and avoid an audit—for the 2018 plan year. An audit would not be triggered in this example until the eligible participants exceeded 120 as of the first day of the Plan year.

It's important to understand how to count plan participants by beginning with the definition of eligible participant as outlined in your plan document. The qualification may include age or service requirements, so it's important to keep good records for those criteria. For 401(k) plans, the number of eligible active employees are counted even if they have never elected to participate and don't have an account. Former employees who have left their 401(k) funds in the plan are also included in the participant count. The participant count for welfare benefits are less inclusive than for 401(k) plans because an employee must elect and make any required payments for coverage in order to be considered a participant.

WHAT TO EXPECT

To ensure a smooth process, plan sponsors should anticipate the auditor's requests and gather certain plan records in advance of the auditor's visit. Often, the plan's record keeper or third-party administrator can assist or provide the necessary information, including:

- Plan documents and amendments (including the Internal Revenue Service's opinion letter on the plan document)
- Summary plan description and any modifications
- Agreements with service providers, especially record keeper and plan custodian
- Plan committee minutes
- Documentation of the plan's internal control processes
- Employee census (list of all paid employees for the year including key demographic data)
- Payroll records
- A listing of contributions remitted to the trust, by pay period
- Trust and recordkeeping reports
- Independent appraisal for company stock or other non-traditional investments held by the 401(k)
- Distributions, loans or other plan activity
- Proof of insurance coverage for employee crime (fidelity bond)
- Prior Form 5500 filings

Remember, your auditor works outside your company and needs to get a good understanding of how your plan works. It's important to offer full disclosure of any issues related to the plan, such as operational errors or contributions remitted late to the plan. Just like the plan sponsor has a fiduciary duty, the auditor's job is to protect the interests of the participants by ensuring the plan is operated in accordance with the plan document and the laws that govern qualified plans. During the process the auditor might identify issues that put the plan's qualified and tax exempt status in jeopardy if not fixed. While beyond the scope of an independent audit, a knowledgeable auditor can help the plan sponsor understand how to avoid the same mistake in the future and formulate a plan of action including an introduction to a tax specialist that can help you utilize a variety of IRS and DOL programs to fix any issues the plan might have.

Your auditor may prepare a draft of the report or review a draft prepared by plan management. It should include financial statements and related footnote disclosures, as well as supplemental information as required by the DOL. After you approve the report, the auditor will give you a formal copy, which will be attached to the Form 5500 by the person responsible for E-filing the annual report.

BDO INSIGHT: PLAN AHEAD AND FIND THE RIGHT AUDITOR

The DOL can reject your 5500 if it finds errors in the audit report, which may result in fines or other severe penalties. Three years ago, the DOL evaluated the **quality of audit work** being performed on employee benefit plans by independent qualified public accountants and found that nearly 40 percent of audits had major errors that would cause the department to reject a company's Form 5500.

As a plan fiduciary, it's critical to work with a competent, experienced independent auditor—especially if you're going through an audit for the first time. Although the audit process may seem daunting, it can go smoothly with a little bit of planning and organization. Even if your plan hasn't crossed the 100-participant threshold yet, it's never too early to start strengthening your record-keeping systems and thinking about what information you may need to provide down the road. In the end, the audit helps strengthen benefit plan policies and processes.

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