PLAN SPONSOR
Digest

Wealth Management

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Your Challenge, Our Solutions™

Strengthen your plan with solid internal controls

Plan sponsors should conduct a compliance self-audit each year to identify errors that could jeopardize their plan's tax-favored status.

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.

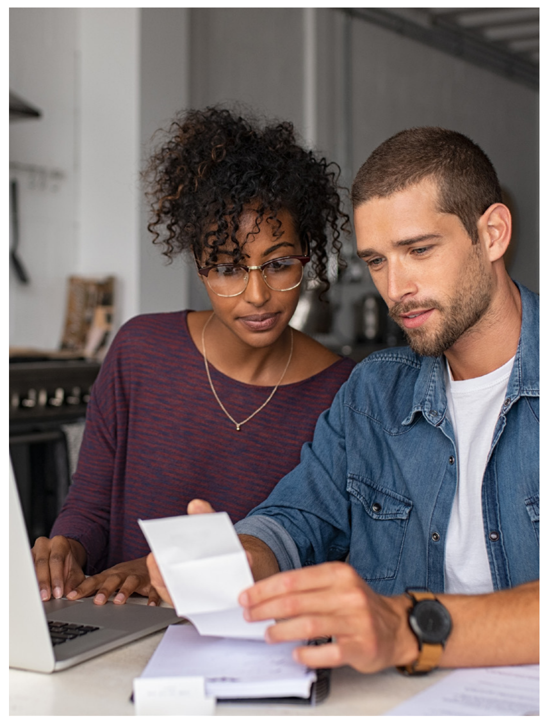
How are internal controls beneficial?

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



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Continued from page 1

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 deferrals, including employees who terminated during the year. The plan sponsor should have procedures in place to confirm 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 see 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
- Reviewing 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
- Overseeing 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 low balance accounts

These cashout rules may allow plans to remove low balance accounts of former employees.

Workforce reductions over the past couple of years have left some employers with a lot of low-balance plan accounts owned by former employees. These accounts can be expensive to maintain and burdensome to administer. Below, you will find answers to commonly asked questions about handling these small accounts.

Can we just distribute small accounts to the former employees?

Check your plan's provisions. Under federal law, plans can provide that, if a former employee has not made an affirmative election to receive a distribution of his or her account assets or to roll those assets over to an IRA or another employer's plan, the plan can distribute the account—as long as its balance does not exceed $5,000. For accounts valued at $1,000 or less, the plan can simply send the former employee a check for his or her balance. Distributions of more than $1,000 must be directly transferred to an IRA set up for the former employee. Accounts valued at $1,000 or less may also be rolled over for administrative convenience.

Should nonvested assets be included when determining whether a mandatory distribution can be made?

You only have to include the value of the former employee's nonforfeitable accrued benefit. If the employee was not fully vested in any portion of the account when he or she left your employ, you do not have to count the nonvested portion.

What about rollovers?

A plan may provide that any amounts that a former employee rolled over from another employer's plan

Continued on page 3

Continued from page 2

(and any earnings on those rolled over assets) are to be disregarded in determining the employee's nonforfeitable accrued benefit. Thus, you may be able to cash out and roll over accounts greater than $5,000. Note that rolled over amounts are included in determining whether a former employee's accrued benefit is greater than $1,000 for purposes of the automatic rollover requirement.

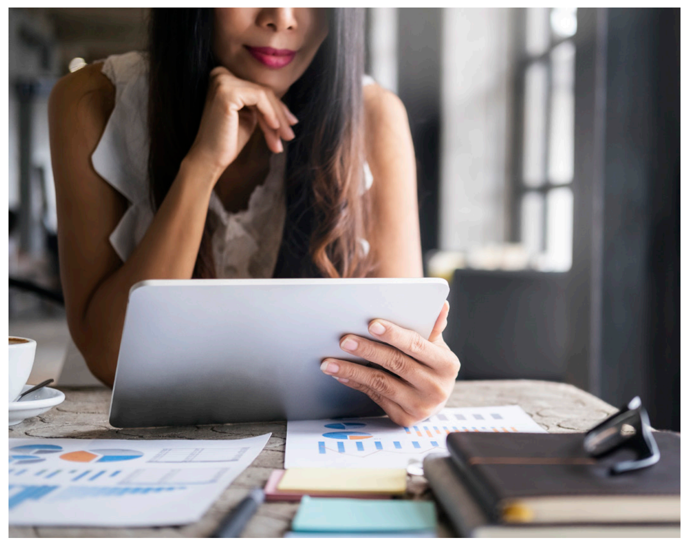
What requirements do we have to meet when rolling over a small account?

To fulfill your fiduciary duties as a plan sponsor, the following requirements must be met:

- The rollover must be a direct transfer to an IRA set up in the former employee's name.
- The IRA provider must be a state or federally regulated financial institution, such as an FDIC-insured bank or savings association or an FCUA-insured credit union; an insurance company whose products are protected by a state guaranty association; or a mutual fund company.
- You must have a written agreement with the IRA provider that addresses appropriate account investments and fees.
- The IRA provider cannot charge higher fees than would be charged for a comparable rollover IRA.
- The investments chosen for the IRA must be designed to preserve principal and provide a reasonable rate of return and liquidity. Examples include money market mutual funds, interest-bearing savings accounts, certificates of deposit, and stable value products.

Do we have to provide disclosures?

Yes. Before you cash out an account, you must notify the former employee in writing, either separately or as part of a rollover notice, that, unless the employee makes an affirmative election to receive a distribution of his or her account assets or rolls them over to another account, the distribution will be paid to an IRA. As long as you send the notice to the former employee's last known mailing address, the notice requirement generally will be considered satisfied. In addition, you must include a description of the plan's automatic rollover provisions for mandatory distributions in the plan's summary plan description (SPD) or summary of material modifications (SMM).



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