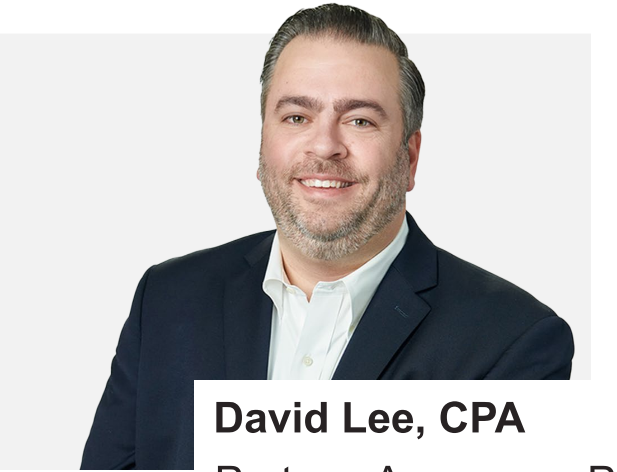
10 Operational Errors + Ways to Prevent Them

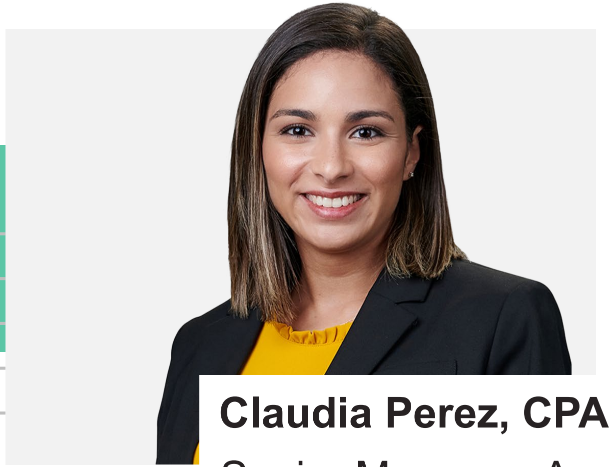
February 15, 2024

S+H

Meet the Presenters



David Lee, CPA
Partner, Assurance Practice
dlee@smith-howard.com



Claudia Perez, CPA
Senior Manager, Assurance Practice
cperez@smith-howard.com

Agenda

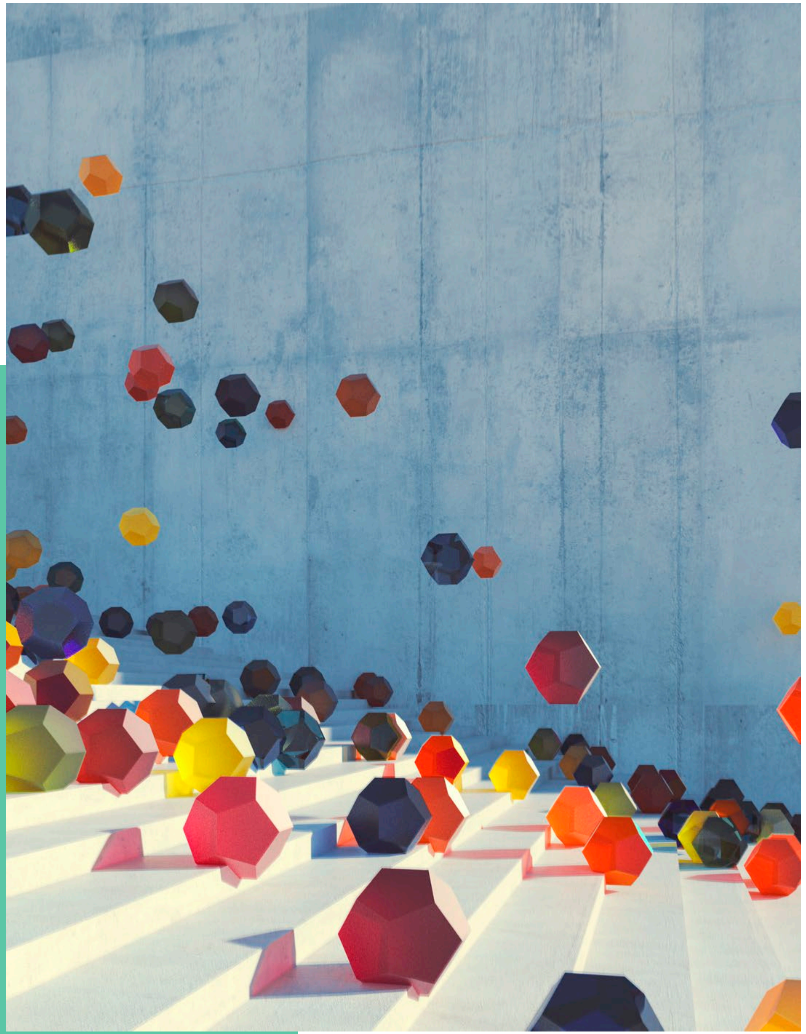
Top 10 Operational Errors

Plan Impact

Ways to Prevent These Errors

Q+A

Poll Question 1



Why This Matters

Significance

The Plan Administrator is responsible for:

- The plan's tax qualified status and compliance with applicable rules and regulations.
- The oversight of processes performed by third party service providers.
- Administering the plan in accordance with the plan provisions.

The best prevention against operational errors is good internal controls and timely monitoring.

SMITH+HOWARD

#10: Failure to Timely Amend the Plan for Legislative Changes

S+H

Failure to Timely Amend the Plan for Legislative Changes

SECURE 2.0: Plan amendments generally don't need to be made until the end of the first plan year beginning on or after January 1, 2025; however, plans must be operated in accordance with the effective date of each new provision.

Preventative Measures:

+ Know when your plan needs a required legislative amendment.
+ How?
    + Retirement Plan Advisors, Third-party Administrator (TPA), ERISA Attorney.

Corrective Actions:

+ Correct through plan amendment.
+ File a Voluntary Correction Program (VCP) application through the IRS.

#9: Failure to Correct Failed ADP/ACP Nondiscrimination Tests in a Timely Manner

S+H

Failure to Correct Failed ADP/ACP Nondiscrimination Tests in a Timely Manner

Common Errors:

- Nondiscrimination tests not performed timely (but generally have until the end of the following plan year to satisfy)
- Corrective qualified non-elective contributions (QNECs) not made or made incorrectly, or refunds of excess contributions not returned timely
- Failing to follow the testing procedures expressly provided under the terms of the plan document
  - For example, using the wrong definition of compensation; applying or not applying the top-paid group election depending on the plan terms

Failure to Correct Failed ADP/ACP Nondiscrimination Tests in a Timely Manner

Corrective Actions:

Method 1 – Determine the amount necessary to raise the ADP or ACP of the NHCs to the percentage needed to pass the tests.

+ Make qualified nonelective employer contribution (QNECs) for the NHCEs to the extent necessary to pass the tests.
+ You must generally make QNECs for all eligible NHCEs.
+ These contributions must be the same percentage for each participant.

Failure to Correct Failed ADP/ACP Nondiscrimination Tests in a Timely Manner

Corrective Actions:

Method 2 – Excess contributions are assigned/distributed to the HCEs.

- You should notify the employee that the excess contribution is not eligible for favorable tax-free rollover. The refunded excess contribution is taxable to the HCE in the year of distribution. You should report the refunded excess on a Form 1099-R.
- That same dollar amount is contributed as a QNEC to the plan and allocated based on compensation to all eligible NHCEs.
- Matching contributions (and earnings) related to the excess contributions distributed to the HCEs are forfeited.

Preventative Measures:

- Consult with Retirement Plan/Compliance Advisors, Recordkeeper or TPA.

Poll Question 2

SMITH+
HOWARD

#8: Failure to Apply Forfeitures Timely and Correctly

S+H

Failure to Apply Forfeitures Timely and Correctly

- Plan document states how forfeitures may be used:
  - Generally, use forfeitures to pay plan expenses or reduce employer contributions in the plan year they occur.
  - Can also reallocate to participants.
- IRS regulations stipulate that forfeitures must be used within one year.
- Plans cannot continue to carryover unallocated funds.
- Forfeitures cannot be distributed back to the Plan Sponsor.

Failure to Apply Forfeitures Timely and Correctly

Common Errors:

+ Forfeiture balances are allowed to accumulate over the years.
+ Used for a purpose not allowed by the plan document.
+ Distributed back to the plan sponsor.

General Correction:

+ Must place plan in the position it would have been in had the error not occurred.
+ Prohibited transaction issues may arise.

#7: Failure to Follow Participant Loan Rules

S+H

Failure to Follow Participant Loan Rules

Common Errors:

- Failure to properly set up payroll to collect loan repayments
- Collecting excess loan repayments when the loan has been paid off

Corrective Actions:

- Depending on how late loan repayments are:
  - True up of loan repayments by re-amortizing loan
- Returning excess loan repayments withheld to the participant

SMITH+HOWARD

Failure to Follow Participant Loan Rules

Preventative Measures:

- Have a loan policy and follow it.
- Review participant loans monthly:
  - For proper authorization.
  - Accordance with plan provisions.
  - Timely repayment is set up in payroll system.
  - Review for past due amounts.

SMITH+HOWARD

#6: Failure to Issue Required Minimum Distributions (RMD)

S+H

Failure to Issue Required Minimum Distributions (RMD)

Effective January 1, 2023, increase in RMD age to 73

Common Errors:

- Timeliness.
- Completeness.

Impact:

- Excise tax of 50% to the participant on the amount of required distribution if it is not made timely. SECURE 2.0 Act drops the excise tax rate to 25%; possibly 10% if the RMD is timely corrected within two years.
    - Mechanism exists to request relief.
- Plan qualification failure (operational failure).

Failure to Issue Required Minimum Distributions (RMD)

Corrective Actions:

+ Fix through the VCP to get participant penalty waived and plan qualification preserved.

Preventative Measures:

+ Review birthdates in your census, note those meeting RMD and follow up with your TPA.

#5: Failure to Properly Administer Automatic Enrollment

S+H

Failure to Properly Administer Automatic Enrollment

SECURE 2.0 Provision: Required automatic enrollment for new plans after January 1, 2025

Common Errors:

+ New employees meeting eligibility are not admitted to the plan.
+ Timeliness of enrollment.
+ Auto-escalation issues.

Best Practice:

+ Proof of opt out.

Failure to Properly Administer Automatic Enrollment

Corrective Actions:

- Various correction options depending on when the failure is found and corrected.
- Correction includes 100% of employer contribution, lost earnings and possible 25% or 50% missed deferrals if not corrected timely.

Preventative Measures:

- Monitoring reports from your TPA as they are responsible for enrollment.
- Comparing TPA reports to payroll reports.

Poll Question 3

#4: Failure to Follow the Plan’s Eligibility Requirements

S+H

Failure to Follow the Plan's Eligibility Requirements

Universal Availability in 403(b)s

Common Errors:

+ Participant is enrolled too early or too late
+ Improper exclusion
+ Improper inclusion

Causes:

+ Improper understanding/application of eligibility requirements
+ Lack of understanding of who is responsible (service provider vs plan sponsor)
+ Incorrect census data
+ Rehires

Failure to Follow the Plan's Eligibility Requirements

Corrective Actions:

- 100% of missed match.
- Make a corrective contribution to the plan for the employees that compensates for their missed deferral opportunity.

Preventative Measures:

- Provide proper notification to employees of their eligibility to participate in the plan at least annually.
- Have established procedures for identifying and contacting eligible employees and follow them.
- Review TPA reports timely and reconcile to Plan Sponsor data.

#3: Failure to Properly Calculate Employee Elective Deferrals

S+H

Failure to Properly Calculate Employee Elective Deferrals

Common Errors:

- Employee deferral percentages are not entered correctly or timely into the payroll system
- Failure to properly classify between pre-tax, after-tax and Roth elective deferrals
- Discrepancies between recordkeeper and payroll

Failure to Properly Calculate Employee Elective Deferrals

Corrective Actions:

+ If deferrals are too high, distribute excess to the employee.
+ If excess matching or profit sharing was calculated, forfeit the excess.
+ If error results in an under contribution, make a corrective contribution for the affected participants.
+ Always adjust for calculation of earnings.

Preventative Measures:

+ Monitoring of changes in elective deferrals made through recordkeeper website.
+ Elective deferral reconciliation between recordkeeper and payroll.

#2: Failure to Use the Correct Definition of Plan Compensation

S+H

Failure to Use the Correct Definition of Plan Compensation

+ Compensation is defined in the Plan Document.
+ Compensation definition is critical for accurately calculating participant deferrals, employer contributions, and ADP and ACP testing.
+ Know compensation elements that are included and excluded for both deferrals and employer contributions.

Failure to Use the Correct Definition of Plan Compensation

Common Errors:

+ Using the same definition for all contribution types – the plan may have different definitions of compensation for employer contributions and employee elective deferrals.
+ Excluding bonuses, overtime and/or commissions when the plan's definition includes those items (or vice versa).
+ Excluding certain fringe benefits or stipends, such as cash rewards, car allowances or taxable group term life, when the plan's definition includes those items (or vice versa).
+ Excluding certain compensation paid after severance from employment, when plan's definition includes those items (or vice versa).

Failure to Use the Correct Definition of Plan Compensation

Corrective Actions:

+ If deferrals are too high, distribute excess to the employee.
+ If error results in excess matching or profit sharing, forfeit the excess.
+ If error results in an under contribution, make a corrective contribution for the affected participants.
+ Always adjust for calculation of earnings.

Failure to Use the Correct Definition of Plan Compensation

Preventative Measures:

- Check payroll service providers and/or in-house payroll.
  - Proper wage coding.
  - Monitor payroll conversions/upgrades.
- Understand definition of compensation impact when you have changes in recordkeepers or Plan amendments.

#1: Failure to Timely Remit Deferrals

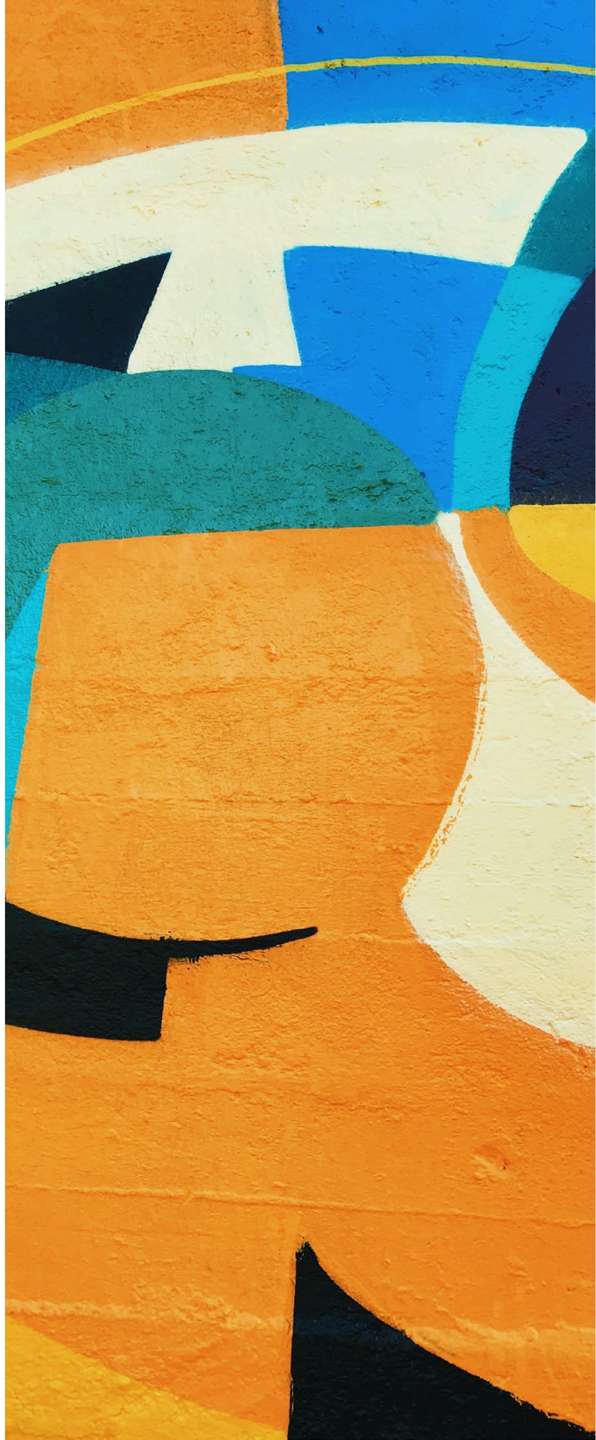
S+H

Failure to Timely Remit Deferrals

- The rule is “earliest date contributions can reasonably be segregated from employer’s general assets” or “as soon as administratively feasible” but no later than the 15th business day of the month following the month in which they were withheld.
- Applies to elective deferrals and loan repayments.

Common Error:

  - Failure is considered a prohibited transaction by the IRS and DOL as the plan sponsor is using plan assets.



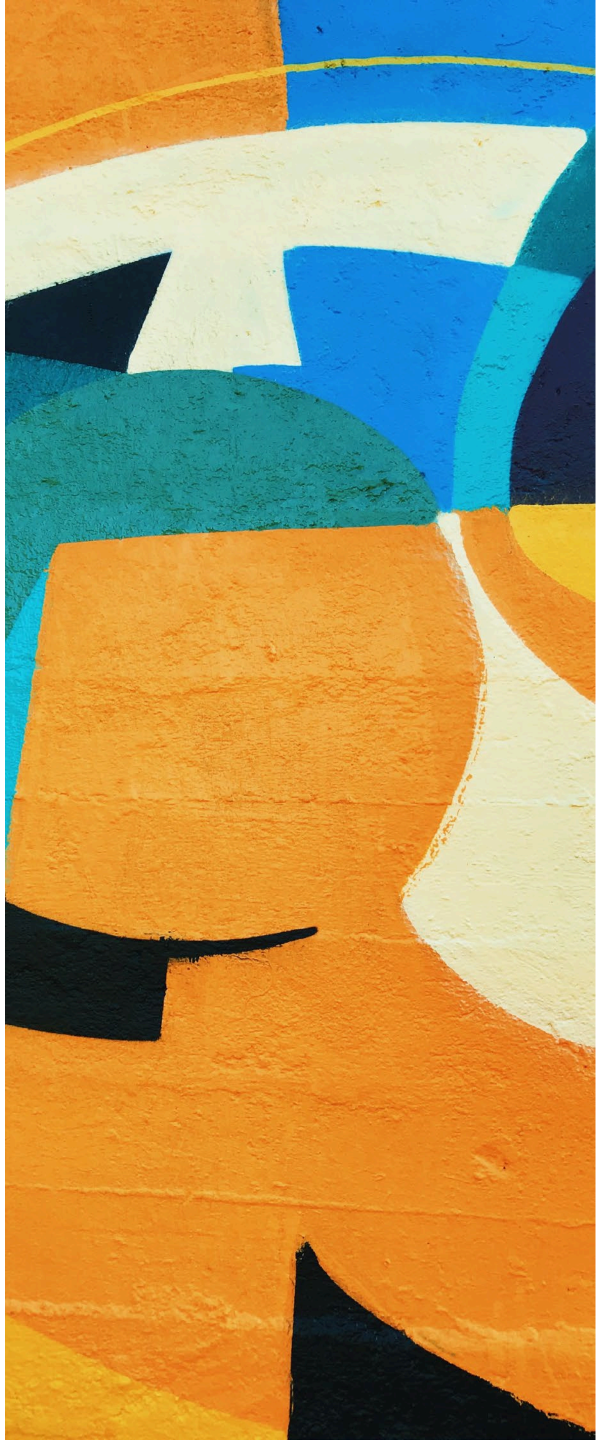
Failure to Timely Remit Deferrals

Corrective Actions:

- Includes depositing missed deferrals, lost earnings, possibly filing under the Voluntary Fiduciary Compliance Program and excise tax.

Preventative Measures:

- Establish and implement a remittance policy.
- Eliminate manual processes.
- Use a schedule of remittances and reconcile to the trust timely.
- Spot check a sample of participants each payroll and reconcile.
  - Deferrals and loan payments.
  - Total transfer to the trust.
  - Individual allocation to investments.



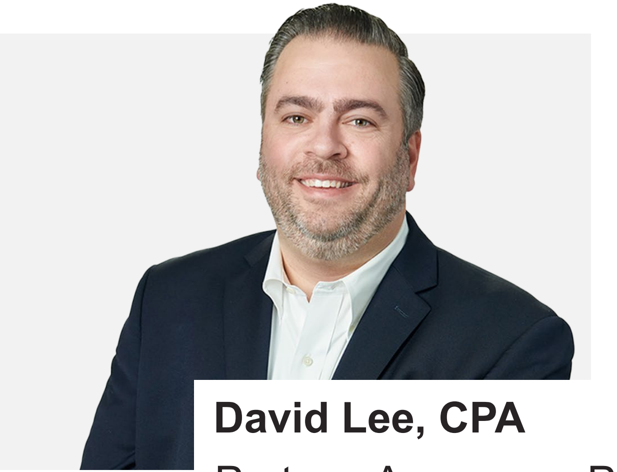
Summary of Prevention Policies + Programs

S+H

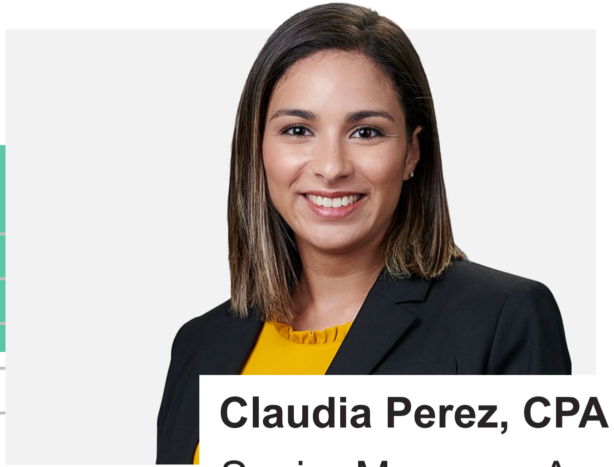
Summary of Prevention Polices + Programs

+ Read and understand your Plan Document and Adoption Agreement.
+ Establish controls and keep manual processes to a minimum.
+ Communicate well with:
  + Service providers (i.e. recordkeeper and/or TPA).
  + Outside payroll provider/in-house payroll department.
+ Review, reconcile reports and spot test periodically.

Questions? Contact us.



David Lee, CPA
Partner, Assurance Practice
dlee@smith-howard.com



Claudia Perez, CPA
Senior Manager, Assurance Practice
cperez@smith-howard.com

Thank you.

S+H