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Member of the Wolf Financial Group

Employee Benefit Plan

Better Ways ▲ Better Results

A NEWSLETTER FOR EMPLOYEE BENEFIT PLAN SPONSORS

SUMMER 2008

Automatic Enrollment - Yes or No?

Automatic enrollment, where participants are automatically enrolled in the plan at a stated deferral rate unless they make an affirmative election to defer at a different rate or not at all, has been a plan design feature of 401(k) plans since 1998. However, plan sponsors were extremely reluctant to adopt these designs due to the uncertainty of the level of liability the sponsors were undertaking from both an administrative and fiduciary standpoint.

Effective January 1, 2008, the Pension Protection Act (PPA) gives 401(k) plan sponsors a much clearer picture of their exposure with regard to auto enrollment plans. In fact, many feel that because of the PPA, an automatic enrollment plan coupled with a minimum level of employer contribution can actually reduce the sponsor's exposure.

Known as a Qualified Automatic Contribution Arrangement (QACA), this plan design couples an auto enrollment feature with an employer contribution to eliminate the need for certain discrimination tests.

Participants covered by the QACA are automatically enrolled at a minimum 3% deferral rate. The deferral rate automatically increases each year to a maximum deferral rate of 10%. Similar to the traditional safe-harbor plan designs that preceded the QACA, a

minimum level of employer contribution must be made in the form of a match or a non-elective contribution.

The matching formula requires a contribution of 100% of the first 1% of compensation deferred and an additional 50% of the next 5% of compensation deferred (for a maximum employer matching contribution of 3.5% of compensation).

The non-elective contribution remains unchanged from the traditional safe-harbor designs at 3% of compensation regardless of 401(k) contribution.

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In addition to the QACA, the PPA introduced the Qualified Default Investment Alternative (QDIA). As would be expected, the introduction of an auto enrollment feature to a plan increases the number of participants who become default invested in a plan.

Sponsors that follow the provisions set forth by the PPA, which are too numerous to discuss here, will enjoy fiduciary protection for the QDIA.

A second feature which distinguished the QACA from the traditional safe-harbor plan design is the ability for the sponsor to place a two year vesting schedule on employer contributions made pursuant to a QACA. Employer contributions made under traditional safe-harbor plans were 100% vested immediately.

When considering all of these factors, a 401(k) plan with a QACA will encourage participants to defer dollars for their retirement, force them to make an affirmative election not to participate, and place them in a QDIA, as prescribed by the Department of Labor, if they fail to make an investment election.

For these reasons, many feel that the QACA plan design can actually reduce the plan sponsor's exposure to litigation.

So, should you do it? The national average for participation in automatically enrolled 401(k) plans is between 85% and 95%. For non-automatically enrolled plans it is 66%. Here are some of the pros and cons:

The Pros

Participants who are auto enrolled tend to stay enrolled. It eliminates potential claims from people who did not get in the plan since every employee must affirmatively elect out in writing.

QACAs generally eliminate most of the plan's discrimination testing, thereby eliminating excess contribution for highly compensated employees (i.e. owners.)

Auto enrollment is better for manufacturing type sponsors than professional or white collar companies.

The Cons

Plan participants who are not committed for the long-term will opt out leaving small balances to be administered or distributed. It automatically increases matching contributions.

Potential lawsuit may arise from auto-enrollees from lost retirement saving and the administration of special requirements for qualified default investment alternatives (QDIA).

Auto enrollment is less favorable for companies with "questionable workers" such as transient, seasonal, or undocumented workers.

Automatic enrollment is effective in raising participation rate among eligible workers. The effects are particularly promising for middle and lower income households who have the greatest need to increase their savings.

Employees who would otherwise fail to sign up whether due to simple inertia, procrastination, disorganization, or misunderstanding would become participants automatically. ■

If you would like to know more, please call Barry Shaw at (630) 545-4515.

Frequent Form 5500 Faux Pas

by Raymond J. McFaul, Jr.

You've either recently filed or extended your Form 5500 if you are a calendar year filer, so now might be a good time to review some of the most common errors when it comes to filing the form.

1. Forgetting to sign the form According to the DOL, this is the #1 reason for rejecting a Form 5500. Remember that the form must be signed in 2 places on page 1 and on the Schedule SSA if it is attached. Schedule P, which often required a signature, no longer exists.

2. Forgetting to attach the extension (Form 5558). Another popular reason for receiving one of those sweet little inquires from the DOL is forgetting to attach the Form 5558 to your extended Form 5500. If your return has been extended with a Form 5558, item D on Part I of the 5500 should be checked while the 5558 should be placed behind the 5500 and before any attached schedules.

3. Forgetting to attach the 'Schedule of Assets Held at Year End' to the Schedule H. While this may not get you a letter from the DOL, the Schedule of Assets (Held at End of Year) is frequently omitted as an attachment to the Schedule H. The schedule is typically prepared by the plan's auditor and included as a supplemental schedule to the IQPA report while the 5500 is often prepared by a different party. If Box 4i on Schedule H is checked 'Yes', the Schedule of Assets (Held at End of Year) should be included directly behind the Schedule H and not just as a supplemental schedule to the IQPA report.

4. Failure to claim an exemption of the IQPA report requirement in Box 4k of Schedule I. If you are filing a Schedule I then you are filing the Form 5500 as a small plan, most of which are exempt from the IQPA report requirement (see the 5500 filing requirement for a detailed explanation of the exemption). However, if you do not claim the exemption in Box 4k of the Schedule I, you will get a nice request for the report from the DOL.

5. Reporting too many participants on Line 7i of Form 5500. This one is very common. Line 7i of Form 5500 is asking for the number of participants that separated from service with a vested benefit and were required to be reported on the Schedule SSA. In other words, how many participants were reported on the SSA with an Entry Code of 'A'? Preparers often include the total number of participants reported on the SSA under all of the Entry Codes.

6. Failure to report a name and/or EIN change on Line 4 of Form 5500. This one can be a real headache to straighten out. If there has been a change to the plan sponsor's name and/or EIN, make sure this is indicated on Line 4 of Form 5500. If not, EBSA will now think these are two different plans and you've doubled your pain. For the former

name/EIN, they'll be looking for a return (which isn't coming). For the new name/EIN, they'll be wondering why this is your first return.

7. Final return with assets at the end of the year. If the plan still has assets, the plan still has a Form 5500 filing requirement. This is not up for debate. Sponsors often think that if they have terminated their plan they no longer have to file the 5500 (while they are in the process of distributing the funds). When all of the assets have been distributed and you do get to finally file that final Form 5500, make sure to indicate that all of the plan assets were distributed (Schedule H – Box 4k, Schedule I – Box 4j) or, you guessed it, expect a letter from the DOL.■

For more information, call Ray McFaul, vice president, Wolf Financial Management LLC, at 630-545-4738.

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Forfeitures

Accumulating and non-allocating forfeitures over a long period of time can result in plan qualification failures. It is recommended that forfeitures be used to offset employer contributions or expenses quarterly or no less than yearly.■

403(b) Alert

As we noted in our last issue, new regulations regarding 403(b) plans have taken effect.

Several new requirements are in effect for 403(b) plans which will cause many to be subject to ERISA. Many may also require an audit which means audit procedures for 2008 will be required. ■

Financial Statement Preparation

Some CPA firms, especially the larger national firms, as a matter of internal policy regarding independence and internal control issues, will not prepare an audit client's financial statements.

This can cause some consternation for you as audit clients, since you do not want to use your limited valuable resources to prepare the financials or feel additional expertise is needed.

We have worked with clients and auditors to resolve this issue by outsourcing the financial statement preparation to our firm. Since we have experience with both auditing and preparing financial statements including footnotes, we can very effectively and efficiently prepare the financial statements and work with your auditors. ■

If you would be interested in this service, call Barry Shaw at (630) 545-4515.