

## EMPLOYEE BENEFIT PLAN ADMINISTRATORS: TOP PITFALLS TO AVOID THIS YEAR

### There Is Zero Tolerance for Any Lapse in Fiduciary Responsibility

Recent investment scandals and the sharp decline of the market have contributed to a more focused look at the fiduciary responsibilities of employee benefit plan administrators and whether or not they are being carried out in accordance with the Employee Retirement Income Security Act of 1974 (ERISA). The state of today's economy and the resulting employee layoffs and company consolidations are also factors to consider. The Department of Labor (DOL) has always kept fiduciary liability on the forefront of compliance matters. Plan administrators—those individuals at a company that have ultimate responsibility for the plan—need to be aware that having a fidelity bond for the plan does not cover the fiduciaries in the event of liability—there must also be fiduciary liability insurance.

An administrator's failure to completely and correctly carry out any fiduciary responsibility puts every participant's contributions at risk. The plan administrator could also be held personally liable for any losses stemming from penalties or a perceived lack of due diligence. A significant omission or mistake could be deemed an operational defect, which would require remedial action by the plan.

Issues that may affect fiduciary responsibility include plans in bankruptcy or merger, alternative investments, participant loans and hardship distributions, eligible compensation, timely remittance of employee contributions, and partial termination.

#### Plans in Bankruptcy or Merger

The DOL has made it clear that a plan administrator's fiduciary responsibility does not wane just because a plan (or its sponsor) is in bankruptcy or the sponsor is merging with another organization.

With regard to companies that have filed for bankruptcy, ERISA requires "that promised pension benefits be adequately funded and that pension monies be kept separate from an employer's business assets and held in trust or invested in an insurance contract." Some plan administrators may think that because a sponsor or the plan is in bankruptcy, they do not have to monitor the plan with the same fervor. If anything, the opposite is true. If an employer declares bankruptcy, the retirement funds must be managed and kept secure from that company's creditors. Similarly, a merger where the existing plan will be merged into another plan does not negate any of the administrator's fiduciary responsibilities. Although a plan may be deemed frozen—no new contributions are being made to the plan while the merger is completed or resolved—it must be maintained in the same manner as it was before it was frozen and merged.

#### Alternative Investments

Many retirement plans, especially for larger companies, are invested in so-called alternative investments, those vehicles that are more complex than a traditional common stock or bond, and ultimately

more difficult to value. These investments may include real estate, private equity, venture capital, or commodities. Plan administrators must ensure that the proper due diligence is conducted—understanding the nature of the investments and the strategy used by the fund manager in selecting these investments and how they are valued. Controls must be put in place to reduce the risk of any loss. In addition, these investments must be properly accounted for in the plan's financial statements. Alternative investments should be completely vetted before entering the investment platform by the fiduciaries to ensure that the investment option meets the existing investment policy and will not harm the participants' interests.

#### Participant Loans and Hardship Distributions

When an employee takes a loan out of his or her 401(k) plan, he or she must repay it, either through payroll deductions or through scheduled check payments.

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Many of the employee layoffs that have occurred over the past two years have some companies realizing that former employees still have loans outstanding. If the loan is not being reimbursed to the 401(k) plan, it must be deemed a distribution. As a result, the employee must be issued a Form 1099 so the appropriate taxes are paid on the distribution. Plan administrators must monitor all loans made to past and present employees and flag those for which the employee has defaulted on the payments.

In the case of a hardship distribution, a participant may request a distribution that is limited to the maximum distributable amount of their account. This is different from a loan since a loan is generally limited to 50 percent of a participant's account balance or a maximum of \$50,000. In addition, a hardship distribution is not required to be paid back while participants' loans must be repaid. It should be noted, however, that the employee is not allowed to make contributions to his or her account for six months following the distribution of loan funds.

### Eligible Compensation

A key mandate of the plan administrator is to operate the plan in accordance with the proper definition of eligible compensation as it is outlined in the plan document. The accuracy of this amount is very important because it forms the basis for the employee's contribution and also the employer's matching contribution. Some plans improperly include fringe benefits in their calculation of eligible compensation. Conversely, some companies neglect to include incentive bonuses in the calculation of eligible compensation. Eligible compensation is generally defined by the plan document. If the matching contribution is incorrect because the underlying compensation figure is inaccurate, the employer may have to contribute additional monies to the plan in response to the error. It is important to review on an annual basis the procedures in place to calculate eligible compensation for all employees.

### Timely Remittance of Employee Contributions

Another issue that is surfacing with some frequency is when companies do not remit participants' contributions to their plan in a timely manner. Typically, a

of the partial termination rules, an employee would not be entitled to the unvested portion of the employer's money deposited in the plan. Today, anyone who is part of a layoff which caused the partial termination can walk

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## The issues posed by today's current economic conditions and more stringent regulations are challenging to all companies that sponsor employee benefit plans.

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company is required to deposit a contribution into an employee's account as soon as the money can be reasonably segregated from the general assets of the company. The DOL has recently issued a ruling that provides for a safe harbor for small plans where employee contributions can be deposited as long as seven days after the money is withheld from the employee. A small plan is defined as one with 100 or fewer participants. However, for large plans, those with over 100 participants, the DOL has indicated that there will be no safe harbor for contributions of participants' monies. As such, if the company can segregate the employees' money in one day, then the company should release that money to the plan the same day. Some companies are remitting the contribution in 25 or even 30 days as they float the cash in between investments in an attempt to realize gains from employee contributions.

This practice, once detected by the DOL, can create penalties and result in financial hardship for the company. The company will need to credit each participant's account the greater of the IRS statutory interest rate or the actual earnings of the funds. The best practice is to avoid the arbitrage exercise and make prompt deposits into employee accounts.

### Partial Termination

If your company had a partial termination, be aware that a distribution for an affected participant must be at 100 percent of his or her account balance regardless of the vested amount. Before the establishment

away with the entire proceeds of his or her account. This is something that companies and their plan administrators may not realize, since they may have laid off workers in small increments in the past. Generally, once a company lays off 20 percent of its plan participants for similar reasons (i.e. economic layoffs, plant closings, etc.), the partial termination rules apply.

### For 403(b) Plans Only

The new Form 5500 reporting requirement represents sweeping changes to the administration of 403(b) plans of not-for-profit organizations and higher education institutions. Specifically, beginning with the 2009 Form 5500, ERISA-covered plans with 100 or more eligible participants will be required to file audited financial statements with their Form 5500. Plans with less than 100 eligible participants may be able to file using a new Short Form 5500 and are generally exempt from the audit requirement. Those organizations with a plan year-end of December 31, 2009 must file the Form 5500 by July 31, 2010.

### IRS Form 5500

The new IRS Form 5500 must be e-filed and every individual who is responsible for signing the Form 5500 must register with the ERISA Filing Acceptance System (EFAST2). All signers must register at [www.efast.dol.gov](http://www.efast.dol.gov) to obtain an electronic password. This all-electronic system is designed to speed the delivery and acceptance of the forms and to facilitate the release of certain plan information as mandated by the Pension Protection Act.

## J.H. Cohn Can Help

J.H. Cohn has significant experience assisting companies of all sizes with their employee benefit plans. We perform audits of defined benefit plans, health and welfare plans, and defined contribution plans. As a member of the Employee Benefit Plan Audit Quality Center, established by the American Institute of Certified Public Accountants, J.H. Cohn is committed to meeting the highest standards and staying abreast of all technical regulations and pronouncements.

We can help you:

- Navigate complex ERISA requirements;
- Determine compliance with various regulations, avoiding potentially significant penalties;
- Implement sophisticated solutions to help overcome challenges and concerns; and
- Provide suggestions for improving efficiencies and reducing costs in your plan administration.

As outlined by the DOL, the Internal Revenue Service, and other regulatory agencies, the fiduciary responsibilities of a plan administrator are diverse. Strong internal controls will help ensure the viability of your plan for the benefit of your employer and all of the plan's participants. No matter what employee benefit plan challenges or issues arise or what changes are taking place in your business, the professionals at J.H. Cohn are well-prepared to assist you. ■

*For more information, please contact Evan Zuckerman, CPA and Partner, at [ezuckerman@jhcohn](mailto:ezuckerman@jhcohn) or 1-877-704-3500.*

For more information on J.H. Cohn's Employee Benefit Plans Industry Practice, [click here](#).

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