



employee benefits update

june/july 2007

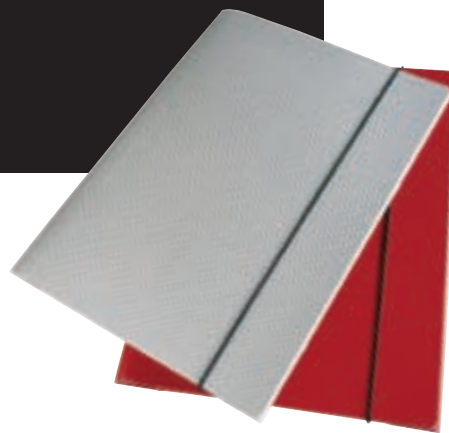
PERIODIC BENEFITS STATEMENTS

**Do yours meet the
new requirements?**

**What you need to know about
the top-paid group election**

Form 5500 filing deadline nears
Changes affect filing requirements

**Disclose your plan fees
and expenses properly**



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Do yours meet the new requirements?

Changes under the Pension Protection Act of 2006 (PPA) require periodic benefits statements to plan participants and beneficiaries. These rules became effective for plan years beginning after Dec. 31, 2006. (Special rules apply to collectively bargained plans.) Therefore, for calendar year plans, these changes are in effect for the 2007 plan year.

Statement timing

If your plan allows participants to direct their own investments, you must supply a benefits statement to plan participants each calendar quarter. For a defined contribution plan that doesn't allow participant direction, such as a profit sharing plan, you must supply benefits statements to participants annually. The new rules still consider plans that treat loans as participant-directed to be non-participant-directed for this purpose.

For a defined benefit plan, you must provide benefits statements at least once every three years to certain participants. This includes participants with a nonforfeitable accrued benefit and those who are employed when the statement is furnished.

Department of Labor (DOL) guidance provides a safe harbor of 45 days after the end of the applicable time period to provide the statement. So, the first statement — for the first quarter of 2007 — for a calendar year plan that allows participant direction was due no later than May 15, 2007. The second quarter statement is due no later than Aug. 15.

For a calendar year defined contribution plan that doesn't allow participant direction, the first statement deadline is Feb. 14, 2008. For a calendar year defined benefit plan, the first deadline is Feb. 14, 2010.

Statement information

The benefits statements must include specific information. For plans that permit participant direction, the statement must explain:

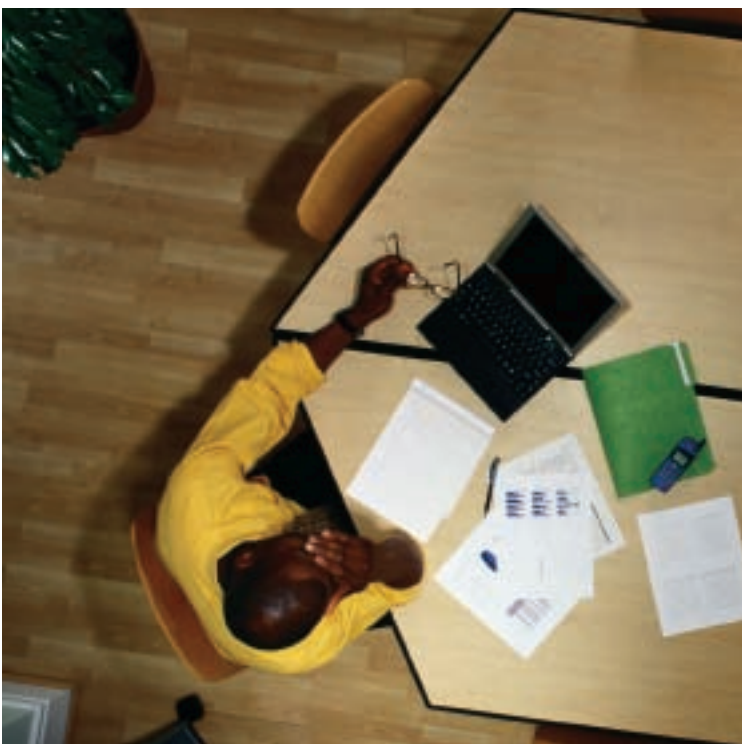
Any restrictions and limitations imposed by the plan.

For example, if your plan doesn't allow participants to invest in life insurance, you must communicate this on the statement. But you don't have to indicate limitations or restrictions imposed by investment funds, or by state or federal security laws.

Required statement information may be provided by more than one source and on more than one document.

The importance of a diversified investment portfolio for long-term retirement security. The explanation must be worded in a manner that the average participant and beneficiary will understand. The IRS has a sample statement that includes this language. You can find this language on the Internet at http://www.dol.gov/ebsa/regs/fab_2006-3.html.

Where to go for sources of information on individual investing and diversification. You must direct participants to the DOL Web site <http://www.dol.gov/ebsa/investing.html>.



A coordinated effort

Plan administrators will need to work with their investment providers and third-party administrators (TPAs) to adjust their systems to accommodate the new rules for periodic benefits statements under the Pension Protection Act of 2006 (PPA). For the required quarterly statements to plan participants who direct their own investments, plan administrators must determine which information the financial institution will provide and which information the TPA will furnish.



This will most likely change current procedures in other ways as well. For example, instead of providing *annual* statements showing each participant's vesting percentage along with an explanation of any permitted disparity or floor-offset arrangement, TPAs now may have to provide this information *quarterly*.

Sponsors must consult both their TPA and investment provider to determine the implications from PPA's required disclosures that could affect their plan's design.

All statements — regardless of whether the plan allows participant direction — must include the participant's total account balance, the value of each investment as of the end of the applicable period, the vesting percentage for each participant and an explanation of any permitted disparity or floor-offset arrangement.

Some plans have multiple service providers. In this situation, the required statement information may be provided by more than one source and on more than one document. For example, the financial institution holding the plan assets may provide the required investment information, and the third party administrator (TPA) may supply the participants' vesting percentages. (See "A coordinated effort" above.)

If there will be multiple sources, the plan administrator must provide information to the participants and beneficiaries before the first statements are due that explains how and when the different information will be provided to them.

Statement format

Statements can be in printed format, electronic format or any other appropriate form that is reasonably accessible to participants and beneficiaries.

You can provide statements on a secure Web site, as long as you notify participants and beneficiaries of how to access the Web site and when the information will be available to view. The notice also must explain that

they have a right to request and obtain a paper version of the information free of charge.

The DOL permits the electronic form (including Web-site access or e-mailing of statements) for these statements if:

- 】 The participant can access the statement at work and access to the system is an integral part of his or her duties,
- 】 There is an actual receipt for transmitted information (return-receipt),
- 】 Confidentiality of personal information is protected, and
- 】 The participant is able to obtain a paper version upon request and at no charge.

Providing the statement electronically may be an efficient and cost-effective way for sponsors to fulfill the PPA requirement.

New requirement concerns

Some in the benefits community have raised concerns about the new requirements. For example, for administrators who prepare statements on an accrued basis, the employer may not make its decision on the amount of profit sharing contribution for the year until much later than the 45-day due date. The DOL has indicated that it's considering providing further guidance on this issue. In the meantime, be sure your plan follows the periodic statement rules as outlined above. 🕒

What you need to know about the top-paid group election

Chances are, some of your employees are considered “highly compensated employees” (HCEs). But being classified as an HCE can result in some limitations for both the employee and employer. Electing to limit the number of HCEs in your qualified plan is known as the “top-paid group limitation” or “top-paid group election.” Let’s take a closer look at when and how to do this.

Who is an HCE?

An employee is considered an HCE if his or her compensation for the look-back year (the 12-month period preceding the current plan year) is more than a set dollar amount. The IRS sets this amount and for 2007 it is \$100,000. Because compensation is already

determined for the look-back year, the employee’s compensation for the current year has no bearing on the employee’s HCE status for that year.

Being classified as an HCE brings its own set of issues. For example, the average deferral percentage (ADP) test may limit 401(k) deferrals, and the average compensation percentage (ACP) test may limit matching contributions. And if your plan uses a new comparability or tiered allocation formula, it may restrict profit-sharing allocations.

What is the top-paid group election?

You may elect — but aren’t required — to limit the number of employees who satisfy the HCE test. Under the top-paid group election, an employee satisfies the HCE compensation test only if:

- › He or she was in the top 20% of compensation for all employees for the look-back year, and
- › His or her compensation for the prior year exceeded the required dollar amount.

To determine the maximum number in the top-paid group, the 20% limitation is applied to the total number of employees, disregarding excludible employees, as discussed below.

You may elect — but aren’t required — to limit the number of employees who satisfy the HCE test.

The top-paid group election doesn’t affect whether an employee is an HCE under the 5% owner test. For example, if an employee owns 5% or more of the company during the plan year but isn’t part of the 20% top-paid group, the employee would still be considered an HCE because of the 5% owner test.



Who is excludible?

But not all employees qualify for the top-paid group election calculation. You must exclude employees from the top-paid group if they:

- › Haven't completed at least six months of service by the end of the year,
- › Normally work less than 17½ hours per week,
- › Normally work less than six months per year, or
- › Are under 21 years old.

These exclusions apply only to determining the number of employees in the top-paid group. The excluded employees can still be counted as part of the top-paid group, and are thus considered HCEs.

For example, if you had 80 total employees in the prior (look-back) year but had to exclude 20 under the age and service categories, you would calculate your top-paid group by taking the remaining 60 employees and multiplying it by 20% to arrive at 12. But when determining the 12 employees in the top-paid group, you would consider all 80 employees.

The above-mentioned exclusions are solely for the purpose of determining the top-paid group. They have no relation to your plan's eligibility conditions.

Why make the election?

In some situations, having a smaller number of HCEs will produce a more favorable result. For example, Jane made \$100,000 in the look-back year and deferred the maximum contribution of \$15,500. With the top-paid group election, she is considered a nonhighly compensated employee because she isn't in the top 20%.

With Jane's high deferral percentage rate, having her in the nonhighly compensated employee group should help the nondiscrimination testing results under the ADP test. This may be a particularly effective tactic in small plans that are maintained by professional groups, such as law firms and physicians, where more than 20% of employees may be highly compensated.

How do you make the election?

If your plan document contains an HCE definition, the document must also state the election. A plan document doesn't have to contain an HCE definition unless an HCE classification affects the allocation of contributions.



If your plan document doesn't include an HCE definition, you can make the election without having to add the definition or provide for the election in the plan. Once you make the top-paid group election, it applies to the plan year in which it's effective, as well as all subsequent plan years until you revoke it. If your plan document specifies that the top-paid group election applies, you must adopt an amendment to revoke the election.

The top-paid group election applies for all testing purposes for any plan year in which the employer has this election in effect. If you maintain two or more retirement plans with different plan years, the election to use the top-paid group limitation must apply to all plan years that begin in the same calendar year.

Is there a deadline for the election?

In the past, there was no set deadline for making or revoking the top-paid group election for a particular year. But under the Pension Protection Act of 2006, if you want to make the top-paid group election and your plan doesn't allow it, you must amend the plan by the end of the plan year. (This provision became effective Jan. 1, 2006.)

Is it right for you?

Deciding whether the top-paid group election is right for you can be determined only by looking at each plan. But in the right situation, it can benefit both the participant and the plan. 🕒

Form 5500 filing deadline nears

CHANGES AFFECT FILING REQUIREMENTS

July 31, 2007, is the deadline to file your 2006 Form 5500 for calendar year benefit plans. The 2006 form and its schedules have undergone many changes in the past year. Moreover, plan sponsors can expect significant changes in Form 5500 filing requirements in the future.

2006 plan year filing changes

The Department of Labor (DOL) has made changes to many of Form 5500's required schedules that affect several areas including:

Voluntary Fiduciary Correction Program (VFCP).

On Schedules H and I (financial information schedules for large and small plans), lines 4a and 4d refer to the VFCP. Sponsors that fulfill the VFCP requirements and the prohibited transaction exemption (PTE 2002-51) don't need to file Form 5330, "Return of Excise Taxes Related to Employee Benefit Plans," with the IRS.

Welfare plans. The 2006 Form 5500 expands lines 6 and 7 to include when an individual is no longer a participant or beneficiary. An individual is no longer a welfare plan participant when he or she is ineligible to receive any benefits, even if on a contingency basis, or isn't deemed a participant under the plan.

Schedule SSA. The 2006 Form 5500 clarifies Schedule SSA instructions. This schedule is the

annual registration statement that identifies separated participants with deferred vested benefits. You can't attach separate documents for additional participants reported on Schedule SSA. Instead, you must use Schedule SSA page 2 for this purpose.

Schedule T replacement. The elimination of Schedule T, "Qualified Pension Plan Coverage Information," on the 2005 Form 5500 caused some confusion. The 2006 instructions clarify that the information that was contained in Schedule T is now reported on Schedule R, "Retirement Plan Information," line 9. Specifically, don't file Schedule R if lines 1 through 8 are left blank. Check both boxes at line 9 if both tests (ratio percentage test and average benefit test) are satisfied — especially in the case of multiple-employer plans. Moreover, the three-year testing cycle previously available on Schedule T doesn't apply any longer, so you must complete line 9 each year.

Statute of limitations. Schedule P, "Annual Return of Fiduciary of Employee Benefit Trust," which was used to establish the statute of limitations on the assessment or collection of taxes by the IRS, is no longer required. Previously, once you filed Schedule P, the IRS had to assess any tax within three years of the filing date. If the IRS didn't make an assessment, it couldn't collect taxes after the three-year period. Now the statute of limitations is set with the filing date of Form 5500.



2007 plan year and beyond

For plan year 2007 (to be filed in July 2008), the Form 5500-EZ threshold (the level of assets in the plan that subjects it to a filing) increases from \$100,000 to \$250,000. Plans below this amount are exempt from filing. Additionally, limited reporting rules will apply to plans that cover 25 or fewer participants in the 2007 plan year. You can expect more IRS and DOL guidance on these issues.

For the 2008 plan year — for which you'll file your Form 5500 in July 2009 — the DOL will institute mandatory electronic filing. A new Form 5500-EZ will be a simplified version of current filings. Expected to be only two pages long, it will be used for plans with fewer than 100 participants and plans that are eligible for the small plan audit waiver.



Stay on top of requirements

All of the bells and whistles still need to be worked out for the 2007 filings and beyond. But as the DOL and IRS work to make reporting simpler, plan sponsors should stay current with the new filing requirements. 🕒

Disclose your plan fees and expenses properly

Each year, retirement plans must file a Form 5500, “Annual Return/Report of Employee Benefit Plan,” to report their plan fees and expenses. Changes made by the Department of Labor (DOL) on the current Form 5500, as well as on the proposed 2008 Form 5500, indicate the DOL's increased interest in the reporting of plan fees and expenses.

You can pay plan expenses with plan assets as long as the plan document doesn't specifically prohibit it. While some plan documents specify that employers must pay plan expenses, most provide that either employers or plan assets can pay plan expenses. If this isn't the case, you can amend your plan document to allow payments of future expenses to be made from plan assets.

Plan expenses must be reasonable and specifically related to fiduciary actions, as opposed to employer activities. Fiduciary expenses include activities related to the administration of the plan. Expenses such as plan establishment and termination and items that benefit the employer are considered “settlor” expenses and can't be funded from plan assets.

Recent changes by the DOL that are of particular interest affect the following:

Schedule A, “Insurance Information.” You must file Schedule A to report commissions and fees directly or indirectly related to an insurance policy or contract between an insurance company and a plan, if the insurance broker's or agent's eligibility for payment is based, in whole or in part, on the value of the insurance contract or policy. This includes nonmonetary forms of compensation such as prizes, trips, gifts and memberships that are a direct result of the policy or contract.

Schedule C, “Service Provider Information.” Beginning with the 2008 Form 5500, reportable compensation for Schedule C will include not only money, but also indirect compensation such as finders' fees, placement fees and commissions on investment products.

The Form 5500 is due July 31 for calendar year plans. With ongoing changes to Form 5500, it's important for plan sponsors to keep updated with the most current rules.

Link, Murrel & Company

Benefits Services That Help You Succeed

As a business person, you know that a good employee benefits program is critically important to your success. Without one, you simply can't attract and keep the quality employees you need to compete — or provide the benefits you want for yourself and your family.

But choosing the right plan for your specific business — and then administering it effectively — can be difficult.

It requires a thorough understanding of your needs and goals, as well as of the many plan options and the complex laws governing them. It also requires careful accounting, timely reporting and watchful coordination of the specialized legal, investment and other services involved.

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- › 401(k) or 403(b) plans
- › Profit sharing plans
- › SIMPLEs and SEPs
- › Cafeteria or Flex plans
- › Employee Stock Ownership Plans (ESOPs)
- › Recordkeeping and audits
- › Compliance and reporting
- › Eligibility and testing
- › Trust accounting
- › Plan termination

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Our emphasis on developing proactive, personal and value-added relationships with our clients has helped us build a strong reputation for quality, reliability and performance that exceeds expectations.

Our membership in the American Institute of Certified Public Accountants' Employee Benefit Plan Audit Quality Center provides you with even further assurance that Link, Murrel & Company adheres to the highest standards in performing quality employee benefit plan audits.

We hope you enjoy this issue of Employee Benefits Update and that it provides you useful information. Recommendations contained in this newsletter may not be appropriate in certain situations. Before implementing any of the ideas suggested, please contact our office for further inquiry.



Wm. Gary Crouch - Director of Accounting and Audit Department and Director of Quality Control

Mr. Crouch joined Link, Murrel & Company in 1990. He is the Director of Accounting and Auditing Services and Director of Quality Control for the firm. He is directly involved in auditing and accounting services for a wide variety of companies. These companies include, but are not limited to, manufacturing, construction, finance and retail.

We invite you to call Gary Crouch or Annie Wu at (949) 261-1120 to answer any questions you might have about various benefit programs or about current ERISA, DOL and IRS compliance issues.



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