

## Testing Descriptions

As soon as you return the completed information, HBCG will begin the reconciliation and testing process. The tests are required by the IRS to make sure your Plan is operating within the terms of your Plan document and in a nondiscriminatory manner.

The various tests are described below for your convenience. Of necessity, the descriptions are brief. The reference to the Internal Revenue Code (IRC) follows each test description.

### **CONTRIBUTION LIMITATION - IRC Section 402(g)**

A plan participant may elect to defer a set dollar amount each calendar year. The IRS sets the maximum amount each year on a calendar-year basis and the maximum applies in total to each plan in which an employee defers contributions. (2003- \$12,000 and \$2,000 catch-up, 2004 - \$13,000 and \$3,000 catch-up)

*(This calculation is based on the calendar year, not the plan year, which may or may not be on a calendar basis. In order to be eligible to make a Catch-up contribution the participant must have attained age 50 by the end of the calendar year and must exceed one of the following limits— 402(g), 415(c), plan's deferral limit, or the ADP limit)*

### **ACTUAL DEFERAL PERCENTAGE TEST (ADP) - IRC Section 401(k)(3)**

The ADP test limits how much elective deferrals made by the highly compensated employees may exceed the elective deferrals made by the non-highly compensated employees.

*(The IRS sets a limit on gross compensation that may be used for this calculation, 2003 gross compensation \$200,000, 2004 gross compensation \$205,000)*

### **ACTUAL CONTRIBUTION PERCENTAGE TEST (ACP) - IRC Section 401(m)(2)**

If your Plan permits employer matching contributions, an ACP test will be performed on your Plan in addition to the ADP test. The principle is the same as for the ADP test. Matching contributions made for highly compensated employees may not be substantially more than those made for non-highly compensated employees.

*(The IRS sets a limit on gross compensation that may be used for this calculation, 2003 gross compensation \$200,000, 2004 gross compensation \$205,000)*

### **ANNUAL ADDITIONS - IRC Section 415(c)**

The IRS limits the maximum contribution made by or for each participant to \$40,000 in 2003. Annual additions include all of the following contributions:

- Employee Deferral Contributions
- Employer Matching Contributions
- Employer Discretionary Profit Sharing Contributions
- Forfeitures allocated to participants' accounts

*(The IRC Section 415(c) limit for is the lesser of 100% of compensation or \$40,000)*

### **TOP HEAVY TEST - IRC Section 416**

Generally, a Plan is Top Heavy if, as of the determination date, the total account balances of the key employees exceed 60% of the total account balances of all non-key employees. The determination date for a new plan is the last day of the first plan year. For an existing plan, the date is the last day of the preceding plan year.

If your Plan is Top Heavy, it will have to satisfy minimum vesting and minimum contribution requirements as described in your Plan's trust and Adoption Agreement document.

## File Format for Census Data

If you are able to provide census information on diskette instead of on paper, please use the following column by column description for the necessary file layout. Please return the diskette along with the completed compliance package, or attach the file to an email at [compliance@hunterbenefits.com](mailto:compliance@hunterbenefits.com), and fax or mail the compliance package separately.

Column A	<b>Social Security Number</b>
Column B	<b>Name</b>
Column C	<b>Date of Birth</b>
Column D	<b>Date of Hire</b>
Column E	<b>Date of Termination</b>
Column F	<b>Termination Reason</b> (ie: Termination of Employment, Death, Disability or Retirement)
Column G	<b>Leave of Absence</b> (ie: Military Leave, Maternity Leave/Paternity Leave)
Column H	<b>Date of Rehire</b> - If an employee was terminated and then rehired
Column I	<b>Hours Worked</b> - Number of hours an employee worked during the plan year
Column J	<b>Date of Participation</b> - Date Employee started participating in the plan
Column K	<b>415 Compensation</b> - Gross compensation for the plan year
Column L	<b>Partial Year Compensation</b> - 415 Compensation from the date of participation through the end of the plan year. If an employee's date of participation is in the year 2003, compensation is needed from the date they began to participate. (i.e.: If an employee started participating 4/1/03, we need the compensation from 4/1/03 through 12/31/03)
Column M	<b>Salary Deferrals</b> - Amount of salary deferrals contributed for the plan year
Column N	<b>Employer Match</b> - Amount of matching contributions made for the plan year
Column O	<b>Section 125 Contributions</b> - If you have a cafeteria 125 plan, we need the amount of contributions
Column P	<b>Ownership %</b> - Percentage the employer/employee owns of the company
Column Q	<b>Highly Compensated Employee</b> - An employee is considered highly compensated if he or she: <ul style="list-style-type: none"><li>➤ Was <u>more than a 5% owner</u> any time during the current year or preceding year</li><li>➤ earned compensation from the employer in excess of \$90,000 during the preceding year (2002 Plan Year). (current year compensation not considered)</li></ul>
Column R	<b>Key Employee</b> - Who is an employee a Key Employee? Employees or former employees who, at anytime during the plan year, met any one of the following criteria: <ul style="list-style-type: none"><li>➤ An officer having annual compensation greater than \$130,000</li><li>➤ A <u>more than a 5% owner</u> of the employer</li><li>➤ A <u>more than a 1% owner</u> with compensation over \$150,000</li></ul>
Column S	<b>Section 318 Attribution</b> - List if an employee is a spouse, child, grandchild or parent of an owner.

## New Small Plan Audit Exemption Requirements

Previously, small plans were automatically exempt from the audit requirement. Under the new rules for plan years beginning after April 17, 2001, the requirement is waived for small plans for each year if the following conditions are met:

1. At least 95% of the assets of the plan constitute "qualifying plan assets" (defined below), or any person who handles plan assets that do not constitute qualifying plan assets is bonded in accordance with section 412 of ERISA for the amount of such non-qualifying assets.
2. The Summary Annual Report, required to be provided to plan participants each year, includes additional information (detailed below).
3. The administrator makes available for examination, or furnishes copies, free of charge, to any participant or beneficiary who requests a statement from any regulated financial institution or evidence of any bond required by this regulation.

### Qualifying Plan Assets

If at least 95% of plan assets are "qualifying plan assets," the plan need not obtain additional bonding. For this purpose, qualifying plan assets are defined as any of the following:

1. Qualifying employer securities as defined in ERISA section 407(d)(5).
2. Any participant loan meeting the requirements of section 408(b)(1) of ERISA.
3. Assets held by any of the following institutions:
  - a. Bank or similar financial institution
  - b. Insurance company
  - c. A registered broker-dealer
  - d. Any other organization authorized to act as trustee for individual retirement accounts under Internal Revenue Code section 408.
4. Shares issued by a registered investment company such as a mutual fund company.
5. Investment and annuity contracts issued by an insurance company.
6. Assets in individual accounts of participants or beneficiaries over which the participants or beneficiaries have the opportunity to exercise control and where statements from a registered financial institution of such assets are furnished at least annually to the participants or beneficiaries.

**Example:** A retirement plan has 60% of its assets invested in mutual funds, 20% in bank certificates of deposit, 17% in annuity contracts and 3% in real estate limited partnerships. Since 97% of the assets are considered qualifying plan assets, the plan would not be subject to the additional bonding requirement.

The determination as to the percentage of plan assets that constitute qualifying plan assets is generally made as of the first day of the plan year. Special rules apply, based on estimates, for the initial plan year.

Where the new small plan audit rules require that a bond be obtained, it need not be in addition to this long-standing 10% bonding requirement. The 10% bond may be enough to satisfy the audit exemption bonding requirement, or an additional bond may need to be purchased to make up the difference.

*Example: A plan has 92% of its assets in qualifying plan assets. Since this amount is less than the required 95%, a bond is required for 8% of the plan assets. But since the plan already has a 10% surety bond, no additional bond must be obtained.*

If the plan had only 85% of its assets in qualifying plan assets, an additional bond for 5% of plan assets would be needed.

### **Additional Summary Annual Report Information**

A summary of Form 5500, called the Summary Annual Report, must be provided to each plan participant and beneficiary. Small plans will now have to include the following additional information in the Summary Annual Report in order to be exempt from the audit rules:

1. The name of each regulated financial institution holding or issuing qualifying plan assets and the amount of such assets reported by the institution as of the end of the plan year. However, this does not include employer securities, participant loans that satisfy ERISA section 408(b)(1) and participant-directed individual accounts.
2. The name of the surety company issuing the bond, if more than 5% of plan assets are non-qualifying assets.
3. A notice indicating that participants and beneficiaries may, upon request and without charge, examine or receive copies of:
  - a. Evidence of the required bond, and
  - b. Statements received from the regulated financial institutions describing the qualifying plan assets.

A notice stating that participants and beneficiaries should contact the Regional Office of the U.S. Department of Labor's Pension and Welfare Benefits Administration if they are unable to examine or obtain copies of the regulated financial institution statements or evidence of the required bond, if applicable.