Briggs & Veselka Co.
CPAs and Business Advisors

10 Common Retirement Plan Audit Red Flags

In a recent industry presentation, members of the Briggs & Veselka Co.'s Employee Benefit Plan Audit team - Kevin Hengst, Mandy Bobeck, and Calvin Upton - highlighted some of the common "what if" audit plan questions that are crucial for administrators. Below is an annotation of their discussion:

#1 Defining "Compensation"

Most people assume that compensation should be easy to calculate, right? In most cases, compensation is pretty straight forward and using W-2 wages as eligible wages, is acceptable. However, each benefit plan is different and each benefit plan <u>defines</u> the type of compensation it is. This means that the definition of compensation will vary from plan to plan and a thorough understanding of all aspects of compensation is needed by all plan administrators.

It is also important to consider that employee contributions and employer contributions made by the Plan Sponsor are often driven by compensation. The same holds true regarding compliance testing (401k tests, non-discrimination tests for Highly Compensated Employees and Non Highly Compensated Employees). Contributions are the driver of the 401k plan; once you have identified the variables of compensation, you should understand the inclusions and exclusions.

Compensation is a hot topic for both the Department of Labor and the Internal Revenue Service, and subject to audit if a plan is selected for examination.

#2 The Risk of Not Following the Eligibility Requirements

The risk is that some employees may be enrolled at improper times, too early or too late, or not given the opportunity to participate at all. Governance and compliance of the plan's eligibility requirements lies in the Plan Sponsor, as does the responsibility for any corrections. All plans define their own eligibility requirements. Defining eligibility is just as important as defining those that are ineligible to enter the plan, such as non-residents, part-time or commissioned employees, or union members.

The key to eligibility, is that a plan cannot be discriminatory; which is defined as only established for highly compensated employees.

#3 Defining Late Deposits

The DOL's definition of a late deposit is as soon as administratively feasible, but, in no circumstance later than the 15th business day of the following month. This includes both participant contributions and loan repayments withheld from payroll. You can be penalized by the DOL if you remit such funds within four days, if you have demonstrated an ability to remit such funds within 2-3 days following payroll. Safe harbor (for small plans) is generally seven business days.

The DOL says that someone being on vacation is no longer an excuse. There should be a designated back-up person, or, payroll should be processed before you leave on your trip.

In regards to appropriate corrective actions, first things first - remit the funds immediately and calculate the lost earnings. Excise tax may be assessed on lost earnings. If you plan to file through the Voluntary Fiduciary Correction Program, you can use the DOL VFCP calculator. If you are correcting outside of DOL VFCP, you should use an alternative measure (the amount for lost earnings will be different).

With late remittances, you must also ensure that Form 5500, Schedule H, Part 4a is checked 'Yes' with the appropriate amount of late contributions, including loan repayments. According to the DOL, checking this part of the Form 5500 does not put you at a greater risk of going through a DOL audit than it does by simply filing your Form 5500.

#4 Take the Appropriate Corrective Actions for an Oversight in Calculating Employee Contributions/Limits (IRS Annual Contribution/Salary Limits)

Refunds of excess contributions are allowed. They are due by March 15th of the following year. Make sure you establish plan features to prevent such occurrences on a routine basis. To prevent such oversight, the Plan Administrator should have a good understanding of what the limits are each year. The IRS will change the contribution and benefit limits every year, depending on cost of living.

Plan Sponsors can set up compensation limits in payroll and/or with custodian. The other option is to establish rules and guidelines with participants at the start of the plan year in regards to their limitations. Make sure to obtain an understanding of whether they want to max out. For highly compensation employees, you should be mindful of plan participation. If there is low plan participation, it may result in excess deferral refunds.

#5 Vesting – How to Take the Appropriate Corrective Actions When Misunderstanding the Vesting Period

Vesting is the participant's reward for their time with the employer. For designated employer contributions, the vesting schedule is defined within the plan document and related adoption agreement. In the case that you misunderstand the vesting period and the participant receives less money distributed than they were entitled to (for example, participant was awarded 20% vesting, when they should have been 40% vested) – the next step would be to refund such forfeitures withheld inappropriately, that were awarded to the plan. In the case that the participant receives more money distributed then they were entitled to (for example, participant was awarded 40% vesting, when they should have only been 20% vested) - the Plan Sponsor should fund those forfeitures back to the plan, and increase the forfeiture balance.

#6 Use of Forfeiture Accounts

When participants leave the plan and forfeit their balances, these funds become a forfeiture within the plan. Management of this account is a challenge that Plan Sponsors run into because they may not understand the uses of this account. As many of the topics we have discussed thus far, the use of forfeitures has to abide by the provisions that are defined in the plan's adoption agreement and plan document.

The Plan Sponsor may feel they have flexibility under this account; however, under an audit, both the DOL and the IRS will review how forfeitures are being used and determine that they are being used in accordance to regulations and under plan guidelines.

If your plan has a forfeiture account, it is a Plan Sponsor's "best practice" to review that forfeiture account to determine that the use or reallocation of forfeitures is being properly reviewed on an annual basis. It is important to remember that under ERISA, the Plan Sponsor is responsible for exercising discretion over the administration and requires the Plan Sponsor to follow the terms on the plan.

#7 Missed Break-in Service Rules and How to Make Employees Restart Their Eligibility Requirements

The break in service rule applies (typically) after 1 year. For eligibility purposes, if a participant terminates employment and then is rehired, they may lose credit for prior service under the plan's break in service rules. If this occurs, and a participant loses credit when they shouldn't have, the Plan Sponsor will need to make the participant whole again, as if there was no break-in service. They are allowed to start contributing again on their date of rehire.

We suggest careful review of the current adoption agreement and summary plan description. Make sure you understand all IRS rules.

#8 Incorrect Tax With Holdings

Three areas to remember **–** 1.) If under age 59 ½, then a 10% tax may apply; 2.) No tax should be withheld on Roth deferrals; 3.) Rollovers have no tax withholdings.

Most distributions are subject to 20% federal income tax withholding.

#9 Defined Responsibilities for the Plan Administrator and the Third Party Administrator (TPA)

As a Fiduciary, you still have a duty to ensure that the TPA is processing all plan distributions appropriately, in accordance with the plan document and on behalf of participant elections. Make sure you maintain all distribution details in the participant files.

#10 Mishandled Employee Request

This is becoming less of an issue as the participants' requests are being handled electronically. We see the most issues when the payroll and retirement plan systems are separate. An example would be when the participant makes an election on the plan's website, the payroll change has to be manually entered to be reflected in the payroll.

For a no-obligation discussion on the possible impact and steps you should take now, contact either Kevin, Mandy, or Calvin.

Kevin Hengst is an Audit Principal in Briggs & Veselka's EBP group, where he consults employee *benefit plans, non-profit organizations, and mid-sized for-profit companies in various industries. Contact him at khengst@bvccpa.com.*

Mandy Bobeck is a Senior Audit Manager in Briggs & Veselka's EBP group, where she consults hedge fund management, investment advisors, chemical manufacturing, and hospitality industries. Contact her at abobeck@bvccpa.com.

Calvin Upton is a Senior Audit Manager in Briggs & Veselka's EBP group, where he consults with employee benefit plans, hospitality, and manufacturing industries. Contact him at cupton@bvccpa.com.