

Common Compliance Errors (and How to Prevent Them)

Given the complexity of employee benefit plan administration, it comes as no surprise that errors occur. Unfortunately, if left unresolved, these errors can lead to sanctions — and even to a plan losing its tax-favored status. If compliance errors are discovered, consultation with experienced professionals will likely be necessary to ensure that appropriate steps are taken to correct the errors.

Among compliance errors, the Internal Revenue Service (IRS) and Department of Labor (DOL) have identified these as some of the most common:

1) Failure to update plan documents. The number-one compliance error is the failure to keep the governing plan documents current. Often, this is simply a result of not keeping up with new legislation and regulations. This can be compounded by the fact that legislative/regulatory changes are often arcane and highly technical. Sponsors may not fully understand them or feel that the changes don't apply to their plan. Sometimes, discretionary changes are made by plan sponsors but are not reflected in the plan documents. Other times, necessary updates may not be made following a merger or acquisition, or when service providers change.

Prevention: The IRS suggests that plan documents be reviewed at least annually (the IRS's annual year-end "cumulative review" provides an overview of required changes). Make sure that any amendments made to the plan documents are also reflected in the Summary Plan Description (SPD). Finally, keep signed and dated copies of plan documents and any amendments indefinitely.

2) Late deposit of 401(k) deferrals and participant loan payments. Plan sponsors are required to deposit these funds as soon as they "can reasonably be segregated from the employer's general assets." But, in no event, should deposits be made later than the 15th business day of the following month. Problems occur when employers try to stretch the limits (the "15th business day" is the outside maximum and not a safe harbor). Or, an employer with a bi-weekly payroll may deposit employee deferrals only once a month in order to avoid additional 401(k) record keeping fees.

Prevention: In the DOL's view, deferrals and participant loan payments should be consistently deposited throughout the year within one or two days of posting payroll. So, establish policies and procedures to ensure timely deposits — and follow them. For example, train several employees to handle deposits so that it is performed even if someone is away on vacation. (Note: DOL does have a small company — less than 100 participants — safe harbor. Please call if you would like to confirm these requirements.)

3) Failure to properly apply the plan's definition of compensation. Compensation definitions are critical for accurately calculating participant deferrals, employer contributions and the Average Deferral Percentage (ADP) and Actual Contribution Percentage (ACP) tests. Problems typically arise when the employer and/or plan administrator are not aware that the plan documents contain different definitions of compensation for different plan purposes (e.g., including/excluding commissions, bonuses or other taxable fringe benefits).

Prevention: The IRS recommends that plan sponsors perform annual reviews of compensation definitions and ensure that the person in charge of determining compensation is properly trained to understand the plan document. Likewise, it is critical that the plan's payroll service provider has properly coded wages to match plan provisions.

4) Exclusion of eligible employees. All eligible employees must be given the opportunity to participate in the plan. Problems can occur when there is a disconnect between how the sponsor and third party administrator (TPA) interpret plan “year of service” requirements or the TPA does not receive sufficient data to track excluded employees (e.g., leased or temporary employees). Similarly, employees who elect not to make elective deferrals may be mistakenly treated as ineligible employees.

Prevention: *Plan documents should contain specific definitions of “employee” and “eligibility,” and all employees should be asked to complete an enrollment form regardless of whether they wish to make a deferral. The service of excluded employees should be closely monitored (in case someone transfers to a non-excluded class or works more than expected hours). Finally, records should be maintained that clearly show employees have been notified of their eligibility (e.g., at orientation or near an approaching eligibility date).*

5) Failure to meet hardship withdrawal requirements. Particularly in the current economy, plan sponsors may be facing increased requests for hardship withdrawals. Unfortunately, there is much room for error here. In essence, employees are only eligible for a hardship distribution due to an “immediate and heavy financial need.” Here, the participant must exhaust every reasonable financial means available prior to requesting a hardship distribution — including taking the maximum available as a loan from the 401(k) plan. Problems can occur when proper documentation of an allowable hardship does not exist (e.g., copies of unpaid medical bills within the past six months, an eviction notice, etc.). In other cases, the employer may fail to suspend salary deferrals for participants who receive hardship distributions (a participant’s right to defer is suspended for six months following a hardship withdrawal).

Prevention: *These errors often occur as a result of a lack of communication between the employer and plan administrator. Employers need to be familiar with the hardship provisions included in their plan documents and implement procedures to ensure that the provisions are followed. Prior to authorizing a hardship withdrawal, consult with ERISA counsel or another trusted advisor to review the hardship application and supporting documentation.*

Making it Right

The good news is that a variety of correction programs are available to assist plan sponsors in correcting errors in plan administration — either through self-correction or with governmental agency approval. These programs include the IRS's Employee Plans Compliance Resolution System (EPCRS) and the DOL's Voluntary Fiduciary Correction Program (VFCP) and Delinquent Filer Voluntary Compliance Program (DFVC).

Here, it is critical for sponsors to consult with qualified professionals in determining the best way to make a correction.

Often, the best offense is a good defense. The IRS recommends that plan sponsors identify a trusted source for receiving timely summaries of applicable changes. Of course, it is always wise to implement policies and procedures to ensure that errors are minimized.

Our experienced benefit plan experts can provide valuable guidance for avoiding and correcting fiduciary compliance and prohibited transaction issues. Please contact our office today for assistance.

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