

Top 10 Most Common Control Deficiencies

It's time to take the Hedman Partners Employee Benefit Quiz again...

For any employee benefit plan ("EBP"), internal control deficiencies unfortunately appear for a number of reasons. During our 2010 EBP audits, we found mostly familiar trends with the deficiencies in the administration of the plans, as well as a few surprises. Our top 10 most common control deficiencies that we encountered are included in this quiz. Give yourself 10 points to start and for each deficiency that applies to your plan, subtract one point.

1. Participant evidence of plan activity – What did you want HR do to?

Moving up from our #3 deficiency last year is the lack of documentation with respect to participant enrollment, deferral election or distribution request. We noted that certain documentation was not always retained for each employee participating in the plan or employed. Examples include date of hire, date of birth, date of termination, current rate of pay, signed forms declining participation in the plan, signed election change forms, deferral feedback reports noting electronic requests for changes in deferral percentages, and signed withdrawal request forms. In addition, we noted that personnel files for terminated participants were not always available for review during the audit. The plan sponsor has a fiduciary responsibility to all participants to maintain supporting documentation, whether an active employee or not. In addition, lack of audit evidence can incur additional time and audit costs.

We recommend that a thorough review of all employee files be conducted to ensure all proper documentation as noted above is readily available. In addition, we recommend that personnel files for all participants in the plan be retained and available for review, even if the participant has terminated employment with the plan sponsor.

___ If you feel your personnel files lack adequate documentation, subtract 1.

2. Definition of Plan Compensation – What is your plan's definition of plan wages?

Whether due to a change in payroll service provider or errors related to payroll calculations, using the incorrect plan compensation definition for purposes of calculating employee deferrals and employer contributions rose to our #2 deficiency this year, up from #4.

Deferrals should be withheld on ALL wages paid unless the plan document specifically states otherwise. If the plan sponsor failed to do this, the plan sponsor should consult with an ERISA specialist to determine the appropriate correction to the plan. If the plan document allows for no deferrals on certain types of pay, such as vacation, bonuses, stock options, unused sick, etc., then adequate documentation should be retained in the personnel file to eliminate potential claims of improper deferrals and to facilitate efficient audit testing of this area.

When an employee enrolls in a plan, they expect their deferrals and any employer contributions to be calculated and deposited into their participant account as requested by them and as represented in the summary plan description they received upon enrollment. An error in calculating employee deferrals and any related employer match constitutes a plan operational failure. These types of failures warrant correction at the plan sponsor's expense, or may expose the plan sponsor to additional penalties or in rare circumstances, disqualification of the plan's tax status.

We recommend that the plan's management establish procedures to ensure that payroll and human resources departments are well versed in the provisions of the plan document, as these provisions relate to their functions. In addition, if a third-party payroll service provider has made upgrades to their program, a thorough review of all calculations should be performed to ensure there were no unintended modifications to the payroll processing set-up. Finally, we recommend that the plan's management review their calculation of eligible pay on an annual basis, or as any changes are made, and periodically "spot-check" the calculation to ensure the proper amount of earnings is being used.

___ If you have not recently reviewed and tested the deferral and employer contribution calculations to determine compliance with your plan document, subtract 1.

3. Review of Service Provider Information – Do you know what your service provider is reporting?

Tied for #2 this year was a lack of reconciliation to third party reporting. If you rely on the controls of your third-party service providers and don't always perform reviews of the plan activity that was recorded, you might be missing plan level and participant level errors that warrant correction. We have found contributions recorded to the wrong participant, incorrect census data prepared and used for non-discrimination testing results, and more. We recommend that the plan sponsors perform various periodic reviews and reconciliations of information provided by the third-party service providers including:

- a. reconciling total plan assets per the participant detail (the sum of the individual participant account balances) to total plan assets reported by the trustee or custodian
- b. reconciling total contributions (including loan repayments) made to the plan per the plan sponsor's payroll registers to total contributions received by the plan per the trustee or custodian
- c. agreeing individual demographic data included in new employee personnel files to the corresponding information included in the participant detail provided by the trustee or custodian
- d. agreeing a sample of individual participant activity to individual participant statements, such as distributions, loan repayments and contributions.

___ If you have not reconciled plan activity with information provided by any service provider, subtract 1.

4. Timely Remittance of Participant Deferrals – DOL reviews are on the rise!

We understand that the DOL has increased reviews specifically related to late remittances. DOL Reg. 2510.3-102 states “that amounts contributed by a participant to an employer, or amounts withheld from wages are plan assets **as of the earliest date on which such contributions can reasonably be segregated** from the employer’s general assets, but in no event to exceed the 15th business day of the month following the month in which the contributions are received by the employer or withheld from a participant’s wages”. This is **NOT** a “safe harbor” deadline. If you have historically remitted contributions within 5 days of the end of the pay period, the DOL can take the position that 5 days is reasonable and assess late remittance penalties on all remittances made more than 5 days following the end of a pay period. When a single employer plan sponsor wires deferrals to the trustee or custodian, the DOL generally has utilized a timeframe of 3 business days.

If you do have late remittances, then you also need to report late remittances on Form 5500, Schedule H, Part IV, line 4a. If your plan reported late remittances on your Form 5500, the DOL will be expecting the plan to correct for these late remittances either through their Voluntary Fiduciary Correction Program (“VFCP”) or other acceptable methods. Per Form 5500 instructions, late remittances should continue to be reported on the Form 5500 until the year after corrections have been made, regardless of the correction method chosen.

___ If you have not made timely remittances, subtract 1.

5. Complete Census Information – Garbage in... garbage out

One of the most significant advantages of a defined contribution plan is its qualified tax status. This allows employers to have tax deductible contributions, deferral of taxation on plan earnings, tax exemption of participant contributions, and tax-free rollovers for participants to other qualified plans. One requirement to the qualified tax status is annual nondiscrimination testing performed utilizing complete census information. In a surprising jump from one of less common errors, this error was our fourth most noted deficiency. We noted errors such as incorrect demographic data related to date of birth or date of hire. In addition, compensation or deferral and match amounts were not in agreement with related payroll records. Finally, there were instances where the census prepared did not include all employees or eligible participants. When incorrect census information is utilized for the nondiscrimination testing, the results of that testing can not be relied upon. This will generally result in the preparation of a complete census in order to resubmit the census for retesting, at the plan sponsor’s expense. Not only can this error therefore lead to additional expenses, it can also lead to potential excise taxes if revised testing reveals corrections that are necessary to comply with the testing. We recommend preparing the census and reconciling it to the W-3 totals at the same time the W-2’s are prepared in January. Not only will this provide a benchmark for complete testing information, but it will also help you comply with the 2 ½ month deadline for making corrections if necessary.

___ If you do not reconcile your census information prior to submitting for testing, subtract 1.

6. Employer Contributions – We get a deduction... it should be correct!

Just like employee deferrals, employer matching contributions should be calculated in accordance with the plan document or based on the discretionary formula as determined by the plan sponsor. Plan participants expect to receive what they are promised. If a participant's deferral was incorrectly calculated, more than likely, any related employer match is also incorrect. Or, if the plan allows for profit sharing contributions, all eligible participants need to be included in the calculation and provided the benefit as defined in the plan document. We noted all of these types of errors throughout the course of our engagements this year. If there are any errors related to employer matching or employer contributions, the plan sponsor should consult with an ERISA specialist to determine the appropriate correction to the plan.

___ If you are not testing to confirm your employer contribution is calculated correctly and allocated in accordance with your plan document, subtract 1.

7. Nondiscrimination Testing – It's reconciled... now what do you want me to do with it?

As noted in #5 above, not only is preparing the census correctly important, but submitting it for testing timely is another way to avoid costly mistakes. The IRS and DOL want your non-discrimination testing done within 2 ½ months after the plan year-end, including any corrections necessary to pass the tests. Corrections made as a result of testing errors can affect how a participant reports their taxable income. Also, issues related to employer acquisitions and controlled group testing should be addressed upon the date of acquisition. Both the IRS and the DOL could view these as potential operational errors of the plan upon review or audit.

As already discussed in #5 above, we recommend that the plan sponsor prepare and submit its nondiscrimination testing data at the same time it reviews its annual W-2/W-3 data. By reconciling total compensation reported to the third party administrator against total payroll per the annual Form W-3 and submitting the data by January 31, the plan sponsor will ensure that the nondiscrimination testing is performed timely and accurately.

___ If you have not completed testing within 2 ½ months of year end, subtract 1.

8. Plan Committee Minutes – Documentation is the best defense!

It is important that the party responsible for the "governance" of the plan adequately document the due diligence they exercise over operations of the plan, including selection of an investment policy and investment alternatives to offer participants who defer their earnings into the plan's investments, and monitoring investment performance against the plan's objectives. Many plans fail to maintain formal minutes for actions taken by the plan sponsor's administrative committee or board of trustees. What more can we say? Document, document, document! It is always your best defense.

___ If you do not always document your plan decisions and review of plan activity in formal minutes, subtract 1.

9. SSAE No. 16 (formerly SAS No. 70) Review of User Controls – SSAE what?

One of the most common responses we hear when reviewing the controls at a client is “our recordkeeper does that” or “our payroll service provider does that”. Do you know if your third party service provider does “that” correctly? Most trustees, custodians and payroll service providers have periodic SSAE No. 16, Type II reports issued by service auditors. The SSAE No. 16 reports detail internal controls and the related tests and operating effectiveness of these controls conducted by the independent auditors for the third party service providers. In addition, most third party service providers have “qualifications” to their controls defined as “User Controls”. The results of the service providers’ control testing are dependent upon these user controls being in operation by the plan sponsor. Many plan sponsors fail to review these reports and implement the user considerations noted by the service providers as necessary in order to rely on their controls.

We recommend that plan administrators obtain and review the latest SSAE No. 16, Type II report from their service providers in order to become aware of the controls that need to be in place by plan management. Hedman Partners maintains these reports for use in our audits and can provide a copy upon request.

___ If you do not read the SSAE No. 16 reports, subtract 1.

10. Plan benefit payments – Show me the money!

There are IRS requirements related to the distribution of plan assets. In addition, distributions that are elective in nature, such as in-service and hardship distributions, must not only meet Internal Revenue Code requirements, but must be specifically addressed in the plan document. During our engagements this year, we noted a new type of deficiency with respect to internal controls and plan distributions. We noted a few occurrences of in-service distributions when the plan did not allow for this type of distribution, or distributions that were processed incorrectly with respect to eligible participants and vesting. While some of these errors can be corrected, the time and expenses can be costly.

We recommend that plan administrators perform a detailed review of the plan’s provisions with respect to how distribution of plan assets can be made. If errors in the payment of these benefits or in the vesting calculation related to these payments are identified, an ERISA specialist should be consulted in order to determine the best method for correction.

___ If you have not recently reviewed the methods available for plan participants to request a distribution, subtract 1.

How well did you do?

Drum roll please...

Total Score of 10 - ____ = ____

- 10 points - Things seem to be running great.
- 9 points - Looking good.
- 8 points - Start making time to review your procedures for improvements.
- 7 points or less - You are at risk. Depending on how you lost points, you could find yourself in a costly position of having to make corrections or answer to the DOL. A thorough review of plan procedures could be warranted.

Although some deficiencies noted were common, we did see a rise in some less common deficiencies from the prior year. We aren't sure if this is economy related, meaning less personnel to oversee plan operations, or a cause and effect relationship of some other kind. Given the uncertainty in our economy, less available personnel throughout most companies and increased DOL reviews of plan operations and definitions, these potential deficiencies in plan operations are becoming more likely to occur. At Hedman Partners, our experienced and knowledgeable staff has developed effective and efficient procedures for reviewing plan controls and procedures. Generally, in less than one day's time, we can provide you with suggestions to get you a score of 10.

Please feel free to contact us should you have any questions on the deficiencies noted or have questions related to your plan:

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This information is meant to be a general overview of typical employee benefit plans - related issues encountered by employee benefit plan administrators and is not meant to be a comprehensive review of any specific employee benefit plan topic.

Nothing herein should be construed as offering accounting advice.

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