

An Ounce of Prevention

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Several major audit initiatives have been launched this year by government agencies involved with employee benefits. As a result, the agencies have identified areas of emphasis and common errors discovered during routine and random audits. What follows is a break down by agency of the targeted areas.

United States Department of Labor

Thanks to electronic filing, the Department of Labor (DOL) now has the ability to search Forms 5500, in addition to non-governmental sources, for targeted concerns. The DOL's priorities are:

- Delinquent employee contributions (Criminal Project)
- Insolvent employers
- Employee stock ownership plans (employer securities valuations)
- Multiple employer welfare benefit plans
- Fees of consultants and service providers
- Review of low volume financial auditors

Non-project or random audits are largely triggered by participant or service provider complaints.

Of increased concern is the willingness of the DOL to seek criminal, rather than civil sanctions, for violations uncovered in project or routine audits. For criminal violations, ERISA has essentially only one misdemeanor provision, but three felony provisions. The DOL trumpets on its web site: 281 criminal investigations, 97 guilty pleas and 96 individual indictments. If the business or profession of the plan sponsor involves required licensing, a felony conviction will often be a bar to continuing the business.

In a recent West Michigan case, the DOL initiated a felony prosecution for an employer who had been delinquent in transmitting less than \$20,000 of employee contributions over a four-year period. The case was resolved with a misdemeanor plea, which preserved the employer's professional license.

Pension Benefit Guaranty Corporation

The Pension Benefit Guaranty Corporation (PBGC) is targeting defined benefit pension plan sponsors who cease operations at any facility with a resulting 20 percent decrease in participants. This can be the result of a closure by the employer or occur inadvertently in a merger or acquisition.

The event requires a notice to the PBGC under ERISA 4063(a) within 30 days and will trigger a request by the PBGC under ERISA 4062(e) for a prorata increase in funding as though the plan was terminating. The settlements with employers have been in the hundreds of millions of dollars.

Internal Revenue Service

The Internal Revenue Service (IRS) is pursuing four major employee benefit audit initiatives:

- Full scope 401(k) plan review and questionnaire
- Independent contractor status
- Fringe benefits, employee reimbursements
- Executive compensation

In addition, the IRS has identified the following recurrent failures on audit and through its voluntary correction program:

- Failure to timely amend a retirement plan
- Utilization of a definition of compensation different than that in the plan document
- Failure to follow plan eligibility provisions
- Impermissible in-service distributions
- Distribution errors – incorrect forms, incorrect tax reporting and failure to timely make distributions
- Insufficient records retention or internal controls
- Erroneous 401(k) ADP and ACP nondiscrimination testing
- Improper 401(k) matching calculations
- Automatic enrollment failures

Often, the violations, if left uncorrected, have collateral consequences that are as large as the potential tax sanctions. For example, misclassification of independent contractors not only leads to increased employment tax liability but also can generate large claims for entitlements to retirement and health care benefits and claims by states for unpaid taxes and unemployment and workers' compensation payments and coverage.

Prevention and Correction

The best defense against an audit in these areas is a compliance review that surveys the areas of likely DOL, PBGC or IRS emphasis, followed by voluntary correction of any issues or failures.

An easy place to start is with a review of the plan's annual reporting Form 5500. From that form we can pinpoint areas of concern and often avoid triggering follow-up questions or compliance audits. In addition, we can advise you of the availability and terms of DOL and IRS correction programs that resolve compliance issues and avoid more severe audit sanctions.

Even if a review has not occurred before a notice of audit, there is often sufficient time to conduct a review and make necessary corrections before the auditor arrives. Such a review demonstrates a good-faith effort to comply and often mitigates or eliminates any audit sanctions.
