# Oh, The Brutal Mistakes That 401(k) Plan Sponsors Make

**By Ary Rosenbaum, Esq.**

A 401(k) plan has so many moving parts, that errors do happen. I always say that if you want to find a mistake within a plan, you will eventually find one. However, there is a simple difference between common mistakes and outright, brutal mistakes. What is worse about some of these brutal mistakes is that they're often avoidable. This is what this article is all about.

**Not doing a Simple Google search about your providers**

I will still loathe myself for not doing a simple Google search on the waterproofing contractor for my home that I hired many years ago. A simple Google search would have determined that they received multiple complaints from the local government licensing office and that the guy running the business couldn't legally own the business since he lost his Podiatry license for Medicare fraud. If I screw up with selecting a provider for my home or my money, that's on me. A plan sponsor isn't so lucky, as a plan fiduciary. A true story is that a person who owned and ran a Third Party Administrator (TPA) firm is sitting in Federal prison for stealing millions from his plan sponsor client. A simple Google search would have shown that the same person was barred by the Securities and Exchange Commission from the securities business for fraud. Unfortunately, the TPA business isn't as regulated as the securities industry, so this huckster was able to start a TPA business, and then steal millions. I'm not saying that the retirement plan industry is full of con artists, because it's not, but a Google search is free.

**Not keeping any documents**

Whether it's a valuation report, a plan amendment, or a plan restatement, it's amazing how plan sponsors can't keep anything plan-related. We live in a day where every important document can be scanned as a PDF, so there is nothing to throw out. Why is that important? I've seen too many plan sponsors make the brutal mistake of not keeping all their plan documents and amendments since the start of the plan. That's a problem because the Internal Revenue Service (IRS) takes the position that if you don't have a copy of a required plan document or amendment, then they act as if you never have had it done. That becomes a problem for a plan sponsor who gets hit with a penalty for not having plan documents that they did, but don't have a copy of. I've also seen plan sponsors with other issues because they don't have copies of valuations and asset statements that they should have. There is no excuse for not having what you're supposed to have.

**Not having an ERISA bond**

Unlike fiduciary liability insurance, an ERISA bond is required for any ERISA-covered plan. An ERISA bond is to protect plan assets from theft by a plan fiduciary, it is no liability protection for plan fiduciaries. It is legally required and if a plan sponsor answered that they don't have an ERISA bond on Form 5500, I will attest that may be an error that the Department of Labor (DOL) will use to conduct a random plan audit. Even if a plan sponsor has an ERISA bond, one of the issues is that since plan assets increase, the coverage no longer fits the applicable coverage. The bond must provide coverage for persons handling plan funds in an amount no less than 10% of the number of funds handled by the person in the previous year. The bond amount cannot be less than $1,000 and does not need to be more than $500,000 per plan official per plan (or $1 million for plans that hold employer securities). Plan sponsors have to make sure the bond they have is an actual ERISA bond, as I know several plans that discovered on audit that their bond was a crime policy. I hate surprises and as plan fiduciaries, you should too. The one time I had a client that could have used an ERISA bond, they didn't. The plan was under a Department of Labor audit and the plan had all their assets at the custodial firm of their financial advisor. The financial advisor was a guy by the name of Bernie Madoff.

**Handling an audit by themselves**

Years ago, a financial advisor who gave me many referrals asked about me representing one of his clients who was contacted by the IRS for a 401(k) plan audit. Then, the financial advisor advised me that the plan sponsor client wanted to handle the audit themselves, because they didn't want the audit to become an adversarial

process. By its nature, an IRS and DOL audit is adversarial. The government auditor isn't there to make friends, they're there to review a 401(k) plan. Maybe the audit is random, and maybe it's because of an error on the Form 5500 or maybe there was a participant mistake. Regardless of the reason, a 401(k) plan sponsor representing themselves, has a fool for a client. 401(k) plan sponsors don't know how to manage the audit process themselves. While they will rely on their TPA to provide many of the plan record requests, plan sponsors are ill-equipped to deal with the government agent. One of the biggest problems for plan sponsors in handling their audits is that they volunteer information and they shouldn't. If plan sponsors are given a direct question, they give a direct answer. Anything else they volunteer could lead them to trouble. Too often, a 401(k) plan sponsor will screw up an audit, that I'm called in for relief as if I'm the second coming of Goose Gossage. Sometimes, it's too late and the plan is on the verge of disqualification. Recently, I've been contacted by a handful of plans where the plan sponsors and their non-attorney professionals tried to manage the process and they managed it poorly. Like closing the barn door after the horse, it's usually too little and too late.

**The missing 5500 and failing to properly correct that**

Every 401(k) plan that falls under ERISA has to file an annual tax return called Form 5500. Even if you don't have employees and fall under ERISA, you will have to file a Form 5500 if your Solo 401(k) plan hits $250,000 in assets. Form 5500 must be completed seven months after the end of the month the plan year ends, with an option to extend the deadline for two and a half months. The costliest error is not filing Form 5500 on time, you can't afford to miss a Form 5500. A lot of the time, a plan sponsor isn't aware that they are late in filing until they receive a letter from the IRS or DOL stating the plan sponsor didn't file one. It's normally a year after it was due and includes a substantial penalty. While there is a 3-year statute of limitations for a filed Form 5500, there is no statute of limitations for a Form 5500 that hasn't been filed. That is probably the only thing I ever remember from the Tax Practice and Procedure class in my tax LLM program. Late-filed returns are subject to penalties from both the IRS and DOL, so it's very important to file on time. The IRS penalty for late filing of a 5500-series return is $250 a day (up to a maximum of $150,000). The DOL penalty for late filing can run up to $2,670 per day, with no maximum. Plan sponsors can get letters from the DOL, where they get penalized $100,000 for one missing return. The problem is I've had clients with 5-6 late returns where the penalties could have been in the millions. Luckily, there is an affordable way out. If a plan sponsor has a late Form 5500 to file, one of the great things out there is the DOL's Delinquent Filer Voluntary Compliance Program (DFVCP). It gives the plan sponsor the opportunity to pay reduced civil penalties for voluntarily complying with the annual reporting requirements, instead of getting a six-digit penalty letter. To be eligible to reduce these potential penalties through the DFVCP, you will have to apply to a plan sponsor. If the plan is under IRS or DOL audit or you get a penalty letter from either, you are going to find yourself no longer eligible for the DFVCP. Sometimes, your third-party administrator (TPA) is at fault for a late or missing 5500, but the problem is that you will foot the bill. If your plan required an audit for Form 5500 because it has 100-120 or more participants with an account balance and you didn't include it, you're treated as if you never filed it. The maximum penalty to pay under the DFVCP is $4,000 for a plan that is audited, which is an absolute bargain compared to what the DOL and/or IRS would penalize a plan sponsor for one or multiple missed Forms 5500. There is one huge problem with the DFVCP and that's if it's done incorrectly. You have to file through the DOL's DFVCP portal and file the delinquent 5500s around the same time with the DFVC Program box on top of the Form 5500 checked. There have been plan sponsors that have paid the $4,000 program fee and still get penalized for a late return because they didn't check that box.

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