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Avoiding Common Retirement Plan Operational Oversights

Retirement plans, such as 401(k) plans, are subject to numerous regulatory and operational requirements that frequently make proper plan administration difficult. Failure to meet these requirements not only opens the plan to Federal penalties, but threatens the maintenance of its qualified tax status.

In this article, we examine the top operational oversights that we have encountered when auditing employee benefit plans.

Untimely Remittance of Employee Contributions to the Plan

One of the most common operational errors is related to the timing of when employee deferrals are contributed to a plan. Department of Labor ("DOL") regulations state that employee contributions must be remitted to the plan as soon as practicable, but in no event later than the 15th business day following the end of the month in which the amounts are contributed by employees or withheld from their wages.

The "15th of the month" guideline, however, is not a safe harbor. The intent of the DOL's remittance rule is that employee contributions are deposited into a plan as soon as administratively feasible. If the plan sponsor, therefore, has demonstrated that it can remit employee contributions to the plan within two days after a specific payroll date, for example, then they have demonstrated that it is administratively feasible on a go-forward basis and hence should always deposit the employee contributions within two days after a pay date.

It is important to create a formal policy for employee contribution remittances and incorporate controls to ensure that you are following that policy. A rule of thumb used by many of our clients is to set the policy to be the same length of time that it takes to pay payroll taxes.

Miscalculation of Eligible Compensation

The next most common operational defect that we see is the miscalculation of eligible compensation. The definition of eligible compensation is set by the plan sponsor in the plan document; it is not the same for all plans. In defining compensation, the plan sponsor must determine if, in addition to base salary or hourly wages, items such as bonuses, automobile allowances, and vacation pay are considered eligible compensation.

Once the definition is set, it should be communicated to the payroll department so such items can be properly applied when calculating employee deferrals and related employer matching contributions.

We find that the definition of eligible compensation is generally applied properly when a plan is first established. However, when we discover errors in the amount of compensation used to calculate employee deferrals and the related employer matching contribution, it usually occurs when a new payroll code is established in the plan sponsor's payroll system. For example, vacation pay may have been included in base pay in the past and the plan sponsor later decided to track vacation pay separately. The new payroll code for vacation pay should be coded as either eligible or ineligible compensation based on the definition of eligible compensation that is included in the plan document. We also find that eligible compensation is not applied correctly when manual computations of employee deferrals or employer matching contributions are performed. This often happens when an employee is terminated and they receive their last pay check. Knowing the correct definition of eligible compensation and properly applying it is essential to the operations of the plan.

Misapplication of the Eligibility Requirements of the Plan

Similar to the definition of eligible compensation, employees' eligibility to participate in a plan is defined in the plan document. The eligibility requirements are different from plan to plan and can vary within the same plan with regard to employee and employer contributions. Generally, employees are eligible to make salary deferrals to a plan when they are hired. However, they may need to be employed by the plan sponsor for a certain period of time before they can begin receiving employer contributions. Often, we discover that employees are erroneously included in the employer matching contribution portion of the plan before meeting the eligibility requirements. Understanding the eligibility requirements of your plan will assist you in operating the plan in accordance with the plan document while also helping you avoid costly corrections.

Mistakes can happen, but by realizing the common operational oversights, you can implement procedures to help avoid making them to your plans. If an operational defect does occur, both the Internal Revenue Service and the DOL have various correction programs available to help preserve the qualified tax status of your plan.

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