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**An Ounce of Prevention is Worth a Pound of Cure  
(for all Plans: Retirement, Health, etc.)  
by John C. Hughes**

We have been advising clients about this for years, but it is now more deserving of your attention than ever. The Internal Revenue Service and the Department of Labor have been increasingly vocal in their unsurprising assertions that they review Form 5500s in determining which plans to audit and/or inquire about. As such, it is more important than ever that the Form 5500 (and the schedules and attachments **including the audit report**) be properly completed, **and reviewed**, to ensure that red flags are not needlessly or inappropriately raised.

Some of the developments giving rise to these heightened concerns include:

- IRS and DOL statements in newsletters and during webinars, conferences, etc. to the effect that particular responses on a Form 5500 may trigger an audit or other review (and in general both agencies are stepping up compliance/enforcement efforts and the overall focus on internal controls). In fact, this was the primary topic of discussion at the June 2013 IRS TE/GE Advisory Council meeting in San Francisco, attended by senior IRS and DOL representatives and Jeff Mandell, Idaho's appointed attorney.
- The recent DOL Inspector General report that is critical of both the Employee Benefits Security Administration ("EBSA" - the benefits arm of the DOL) and the current processes and regulations regarding audit reports. The Inspector General report will very likely increase EBSA's sensitivities to the issue and probably result in its increased scrutiny of the audit reports that are filed with Form 5500s. Often, the reports are illustrative of an auditor who has little experience with benefit plans and who makes erroneous or inappropriate statements.
- The advent of the electronic Form 5500 filing system, "EFAST2." This system allows easier identification of problem issues because the substantive information on the Form 5500 can be electronically culled. It no longer takes a person sitting at a desk to identify an employer's responses that are conflicting, raise concerns, and/or do not make sense in the context of other responses (or prior years' responses).

- The IRS' 401(k) Questionnaire Project. The IRS views this recent tool as extremely useful for examinations and outreach. The government is now moving to use similar initiatives for other types of plans, specifically including government and other tax-exempt plans.
- The DOL's new 408(b)(2) (employer-level) and 404a-5 (participant-level) fee disclosure rules.

Some of the typical problems we encounter relative to Form 5500s include:

- Conflicting figures and information between the Form 5500 and the audit report.
- Reporting of a plan problem, be it a DOL or IRS failure, when there actually is no such problem.
- Schedule C's completion in a manner that contradicts the instructions. The relatively new Schedule C is complicated, and we often see that it is completed improperly. It will be easy for the government's computer systems to identify these discrepancies and flag them for follow up.
- Anomalies in the participant counts from one year to the next. Yes, the system can compare responses to questions from prior years. This particular issue might grab the attention of the government because it might signal a "partial termination." Often times, the counts are simply wrong due to the inattention of the preparer; this is easily remedied. If there is a partial termination, identifying it and taking the appropriate steps is important – before the government makes you.
- Incorrect codes on Line 8 regarding the plan characteristics. These also are very easily identifiable and fixable, but a very common error nonetheless.
- Incorrect completion of Line 3 regarding the identity of the plan administrator. Hard to believe, but true. And common!
- Lacking schedules. Most notably, we frequently see that the schedule required to be prepared and submitted in response to a "yes" answer on Schedule H or Schedule I regarding late deposits is overlooked and is not filed with the Form 5500.
- Reporting (or overlooking the reporting of) a prohibited transaction as the result of noncompliance with the ERISA Section 408(b)(2) regulations. These are the new regulations that require service providers to make disclosures to plan sponsors regarding service provider fees, expenses, and services. Have you received these disclosures, reviewed them, had them reviewed by competent counsel, and ensured they are compliant with the law?

- “Other” responses. There are several locations on the Form 5500 labeled “Other.” Entries on these lines, if made, beg the question – “what does that entry represent?” To avoid unnecessary questions from the IRS and DOL, it is advisable to avoid making entries described as “Other.” In our experience, the entry usually is more properly made elsewhere on the form, on a line where there is an actual description of the entry that will not so easily prompt an inquiry (and which is more appropriate in any event).
- Late deposit reporting. In addition to a missing schedule, as noted above, the numbers regarding late 401(k) or other employee contribution deposits are frequently misreported. The issue itself very often is misidentified and categorized incorrectly. For example, we see preparers characterize a qualification failure, like a missed deferral, as a late contribution when indeed a qualification failure is an entirely different, and more serious violation. Although it is an important problem that must be appropriately addressed, reporting a qualification failure as a late deposit on Form 5500 does not accomplish that objective.

The Form 5500 is signed under penalty of perjury by the employer, and for that reason alone its accuracy should be confirmed.

Another pervasive issue involves poor practices relative to documenting the Form 5500 filing. This may not prompt an audit, but it might lead to the imposition of significant penalties (or at a minimum a time-consuming and burdensome argument with the IRS or DOL). Given the potentially substantial monetary penalties and opportunity for conflict, it is imperative that the Form 5558 (Application for Extension of Time to File Certain Employee Plan Returns) be timely filed **and proof of mailing/filing maintained**. Similarly, proof of filing of the Form 5500 by the obtaining of a “Filing Received” message, consistent with DOL guidance, should be obtained. An email from the plan’s third party administrator does not have the same effect. Finally, the guidance requires that the employer plan sponsor retain a complete, manually signed copy of the filing. We very often see that many of these simple steps and rules are ignored.

Lack of vigilance is now more apparent/easier for the government to identify, and the government is taking notice. Please let us know if we can assist in a review of your Form 5500 and help you avoid uninvited and unnecessary governmental scrutiny of your plan.

For additional information, or if you have questions, please contact  
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