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ERISA Newsletter

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Form 5500 Season Is Well Underway. Are You Prepared? John C. Hughes, Esq.



The annual Form 5500 preparation is often not treated with the attention it deserves. This is a mistake that could lead to unwanted and unnecessary government inquiry about the plan.

Employer plan sponsors should not blindly rely on the Form 5500's preparation by service providers that may have little incentive to provide customized treatment relative to the filing. The Form 5500 preparation deserves greater attention.

The Department of Labor and Internal Revenue Service comment that they use Form 5500 to identify plans and issues worthy of investigation or inquiry. These inquiries may lead to the discovery of fiduciary breaches and qualification failures. This makes perfect sense. Both of these agencies are increasingly vocal about their focus on fiduciary processes and internal controls, respectively. As an example of recent DOL enforcement efforts, please see the attached DOL Fact Sheet.

Fiduciary processes involve the engagement by plan fiduciaries in a process aimed at fulfilling their fiduciary duties to the plan and its participants. Similarly, as stated by the IRS, internal controls are "business processes designed to detect and prevent mistakes in your retirement plan." Erroneously completed Form 5500s may have a tendency to identify fiduciary breaches and/or a lack of internal controls.

Accordingly, the annual Form 5500 should be carefully reviewed and understood by the employer (and revised, if necessary and appropriate). It is the employer who is making the statements on the Form 5500, not the service provider that generated the Form 5500 for signature. As part of that review, another party should be involved in reviewing the Form 5500, the schedules and attachments, and the audit report.

Some of the issues that may unnecessarily raise red flags and prompt attention from the government include:

- Inconsistent and/or incorrect use of plan names and employer names. There is no excuse for this, and it merely demonstrates that someone may be “asleep at the wheel” relative to more important issues.
- Conflicting figures and information as between the Form 5500 and the audit report.
- Misreporting of a plan problem; for example, reporting on Schedule H that there were late deposits, when actually the issue was not a late deposit issue, but a failure to implement a participant election (also a problem that should be properly addressed under the IRS’ correction program, but there is no need to report it on the Form 5500).
- Schedule C 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. This issue might signal a “partial termination.” Often times, the counts are simply wrong due to the inattention of the preparer; this is easily remedied.
- Incorrect codes on Line 8 regarding the plan characteristics. These are very easily identifiable and fixable, but a very common error nonetheless. The IRS reports that it uses these codes as the basis for identifying plans to examine relative to several projects.
- Lacking schedules or separate statements. 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. Similarly, the separate statement that is required to accompany a “yes” answer on Schedule C, Line 2(h) is often missed.
- Misreporting the existence of a fidelity bond, reporting that there is no fidelity bond (which is required and thus will flag a problem), and/or reporting the incorrect fidelity bond coverage amount.
- Reporting (or overlooking the reporting of) a prohibited transaction as the result of noncompliance with the new 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, 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 may often be 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). In cases where an "Other" entry is required because there is nowhere else to put it, the plan sponsor should understand what is represented by that entry so that it is ready to respond to an inquiry.

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

Another aspect regarding Form 5500 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 accomplished. 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. 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.

Please contact John C. Hughes (john@erisalawgroup.com) or Jeffery Mandell (jeff@erisalawgroup.com) at 208-342-5522 or 866-ERISALAW if you wish to discuss your plan specifics.

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