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Employee Benefit Plan Audit Series #1 | Incorrect Employee Deferrals - and How to Correct Them

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Jessica Doremus: This is Barnes Dennig Ask the Experts. I'm Jessica Doremus, and we have Dan Holthaus here to talk about the incorrect employee deferrals and how corrections can be made. Thanks for joining us today, Dan. One of the most common errors that we see in plans is incorrect employee deferrals. What are some of the reasons why employee deferrals might not be correct?

Dan Holthaus: Yeah, so Jessica, this is a very common issue as we know. It's one of the big things in employee benefit plans is the amount of money that's coming into the plan for employee deferrals. And there're a few different things that could go wrong. The first thing is that the plan could have an auto enrollment feature, and the plan sponsor might not be administering that auto enrollment feature properly. That could affect just a couple participants or could affect a large population of participants. So we'll be looking at that.

The second area is the incorrect definition of compensation. So the basis of employee deferrals is the employee's compensation, and that's defined by the plan document. And if that is not being calculated properly, then there's no way that the employee deferrals would also be correct. A lot of times we'll see that where an employee benefit plan will either include or exclude bonuses. And if that's not factored in properly in the setup of payroll, there might be an error. And the third area, which is probably the most common, is the incorrect deferral percentage. So if a participant elects a certain percentage, they might change it during the year, but bottom line, somewhere along the line, the processes and the administration of the plan, they don't actually defer what they intend to defer, so their withholding is incorrect.

Jessica Doremus: So let's just say a plan has a one, two, or maybe all those types of errors. How would a plan sponsor go about correcting those?

Dan Holthaus: That's great because that's the first question they're going to ask us when we find one of these errors. So essentially what we're going to try to do is the plan sponsor is going to want to make the participant whole, so put them in the position that they would've been had the error not happened. Now, there's a big caveat with this because when you first say that the plan sponsor immediately thinks, "Oh my gosh, I'm going to have to make all these large contributions for what was lost on the deferrals." But that's really not the case.

The first way that we are going to look at this is generally they are going to have to make up 50% of the lost employee deferrals. Now, we're not going to get into all of the rules with this because they can be very complex and they can be very specific to certain situations, but there are some safe harbors to allow them to reduce that 50% down to 25%, and potentially even down to 0% depending on the length of the error. So if there's a very short error where it might've only been going on for a month, there's a possibility that if you meet requirements, it's 0% on what they have to correct on the deferral piece.

The second piece is any type of employer contributions. So if there's a match or a profit sharing, they're going to have to correct a hundred percent of that because that money the participant would've received out of the employer's contribution. And the third area, and this is for all instances, is any lost earnings on both the employee deferral piece and in the employer match piece. So at a high level, there's three different things we're going to look at. We're going to go with the employee deferral, could be 50%, could be 25%, could be 0%. There's an employer portion, whether that's the match or the profit sharing, and then any earnings that they lost out on both of those amounts.

Jessica Doremus: So how do you calculate those missed earnings?

Dan Holthaus: Sure. So there's a very simple way and there's a much more complex way. So the simple way the Department of Labor has a lost earnings calculator on their website, you can easily find that if you Google search that. You put in the amount that's lost, when it was lost, when it was recuperated, and then it will calculate the earnings for you. That is generally only to be used in smaller errors. If it's a much larger error, bigger magnitude, you may be required to go back and look at actual earnings during the period lost and calculate it based on actual plan earnings. We generally would recommend you talk to an ERISA attorney whether or not you need to use the DOL calculator or do some more complex calculations.

Jessica Doremus: Okay. Thanks for filling us in on that information, Dan. Thank you for joining us today on Barnes Denning Ask the Experts.