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EBP COMMENTATOR

THE NEWSLETTER OF THE BDO EMPLOYEE BENEFIT PLAN AUDIT PRACTICE

CAUTION WHEN CORRECTING LATE DEPOSITS

We see it quite frequently during plan audits – employee elective deferrals and loan repayments to a plan are deposited to the plan's trust later than the time period allowed by the Department of Labor (DOL). Collectively, we refer to these as "late deposits." DOL rules require that the plan sponsor deposit employee deferrals and loan repayments to the trust as soon as the sponsor is able, but no later than the 15th business day of the following month. This so-called "15 business day rule" is not a safe harbor. Small plans with fewer than 100 participants do have a safe harbor of seven business days, but the safe harbor is not available to large plans (e.g., plans that require an audit).

It is the plan sponsor's policies, procedures and internal controls that dictate the amount of time it should take to segregate the employee elective deferrals and loan repayments. A good way to determine whether deposits were made timely is to periodically evaluate all of the remittances that were made to the plan (or should have been made to the plan). For each remittance that would ordinarily have been made, the plan sponsor should determine the earliest date that the assets could have been segregated from the general assets of the plan sponsor (which may be as soon as the payroll withholding date) and compare that date to the actual deposit date. If any deposits exceed the time period the plan sponsor determined to be reasonable, the remittance is considered late and is considered a prohibited transaction. This is an area our clients frequently consult with us about. Once the sponsor has made a general determination of timeliness, the sponsor should consider formalizing this as the plan's remittance policy. As with all policies, this policy should be adhered to once set.

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LATE DEPOSITS

The plan sponsor is not automatically eligible to use the DOL online calculator to determine the lost earnings on late deposits.

Correction of the late deposits includes several steps. The plan sponsor must make each affected plan participant whole by making an additional contribution to the plan that reimburses the participants' accounts for the lost earnings on the late deposits that were not invested in a timely manner. Such late deposits need to be reported on the Form 5500, *Annual Return/Report of Employee Benefit Plan,* and included in a supplemental schedule attached to the audited financial statements. Additionally, for non-403(b) plans, a Form 5330, *Return of Excise Taxes Related to Employee Benefit Plans*, must be filed by the plan sponsor to pay an excise tax equal to 15 percent on the amount of the lost earnings restored to the plan (e.g., the plan correction). There are two different methods for correcting the late deposits: DOL Voluntary Fiduciary Compliance Program (VFCP) or self-correction.

▶VFCP OPTION

The VFCP is a program that allows a plan sponsor to report and correct late deposits to the DOL. In exchange, the plan sponsor obtains a "no action" letter from the DOL, which states that the DOL will not recommend the plan be audited for this issue.

What are the advantages to using VFCP? The DOL online calculator is used to determine the lost earnings needed to make plan participants' accounts whole. The interest rates in the DOL online calculator are set at the Internal Revenue Service (IRS) interest rates for underpayment (generally around 3-6 percent), which, depending on market conditions, may be less than the actual earnings for the plan and therefore more favorable to the plan sponsor. Other advantages of VFCP include 1) no required filing of Form 5330 if the excise tax is less than $100 and 2) waiver of excise taxes over $100 provided notice is given to the participants.

Why would VFCP not be preferable? Many plan sponsors decide to forgo the VFCP procedures because payment of the excise tax can be less costly than the time incurred to prepare the VFCP-required paperwork and due to the participant notification requirements.

▶SELF-CORRECTION OPTION

Use of VFCP is not required – in fact, most late deposits are corrected without going through VFCP. Rather, a plan sponsor may elect to self-correct by remitting a corrective contribution to the plan to make participants' accounts whole. The downside to self-correction is that the restoration to the plan must be the greater of the plan's actual rate of return or the IRS underpayment rate that is used in the DOL online calculator. The plan sponsor is not automatically eligible to use the DOL online calculator to determine the lost earnings on late deposits. Depending on the plan's actual rate of return for the years involved in the correction, the required corrective contribution to the plan may be considerably larger than the correction under VFCP automatically based on the DOL online calculator. The use of unreasonable rates of interest has recently been identified by the IRS as a recurring error in plan corrections.

▶REPORTING OF LATE DEPOSITS

As noted above, late deposits are reported on the Form 5500 (and disclosed in the audited plan financial statements and supplemental schedules). The late deposits must continue to be disclosed every year, including the year in which they are fully corrected. Keep in mind that a late deposit is not considered fully corrected until the plan sponsor files a Form 5330 or obtains a waiver through VFCP. If there are amounts reported that are not ultimately corrected, this may be a red flag to the DOL.

Plan sponsors should monitor the timeliness of deposits throughout the year and ensure any corrections are made appropriately. They should also ensure appropriate policies, procedures and internal controls are implemented to avoid recurrences.

PBGC PUBLISHES FINAL RULE IMPACTING LARGE PLAN FLAT-RATE PREMIUM DUE DATES

The Pension Benefit Guaranty Corporation (PBGC) published a final rule on Jan. 3, 2014, that moves the due date for the flat-rate premiums for large plans to coincide with the due dates for variable-rate premiums for single-employer plans. This final rule moves the flat-rate premium due date from Feb. 28, 2014 to Oct. 15, 2014. For more details, see http://www.pbgc.gov/prac/pg/other/guidance/final-rules.html.

KEY UPCOMING 2014 FILING DEADLINES

Form 11-K: For plans subject to filing Form 11-K with the Securities and Exchange Commission (SEC), the filing is due 180 days after the plan's year-end. The deadline would generally be Monday, June 30, 2014, for calendar year-end plans.

Form 5500: The filing deadline is seven months after the plan year end, which would generally be Thursday, July 31, 2014, for calendar year-end plans. Form 5558 should be filed by the original Form 5500 due date in order to extend the Form 5500 filing by 2½ months (assuming a calendar year-end, the extended due date would be Wednesday, Oct. 15, 2014).

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ADDRESSING SOC 1 REPORT CARVE-OUTS

In our [Summer 2013](#) edition of the *EBP Commentator*, we provided a brief overview of SSAE 16 (Statement on Standards for Attestation Engagements No. 16) and, in particular, SOC 1 reports. This article continues that discussion by focusing on how to address the carve-outs of subservice organizations in a SOC 1 report. SOC 1 reports cover key controls at the organizations that provide various services to the plan (e.g., payroll providers, recordkeepers, custodians, etc.). These reports should be obtained and reviewed by the plan sponsor so they understand the systems in place at the service organization, including key controls that address financial statement assertions. The reports are also generally used by the auditor for performing the plan audit. We have found carve-outs of subservice organizations within the SOC 1 report (and how best to address them) to be a common hurdle in using the SOC 1 report effectively.

Subservice organizations are third-party entities that provide services to the service organization providing services to the plan. Some typical examples of carved out processes are IT general controls, pricing services and certain investment related services. Subservice organizations are required, under SSAE 16, to either report their controls in the SOC 1 report using the inclusive method or exclude them from the SOC 1 report using the carve-out method.

The inclusive method includes controls surrounding any key aspects of the subservice organization's system in the service organization's SOC 1 report. Under the carve-out method, controls for the subservice organization are excluded from the service organization's SOC 1 report and are referred to as carve-outs.

The plan sponsor would ordinarily obtain and review the service organization's SOC 1 reports and review and consider any complementary user entity controls (e.g., controls the plan sponsor is expected to have in place). This review would ordinarily be documented and address whether the complementary user entity controls are in place and operating effectively for the plan. The plan sponsor should also identify any carve-outs. Generally, carve-outs will be noted in the independent service auditor's report on the SOC 1 report. Sometimes, the carve-outs are located within the body of the report, often under the company information, overview and/or scope of report sections.

As a general rule, carve-outs are significant if they directly impact the plan and its data. For instance, consider whether there is another data processing center that has access to the plan's data or makes updates directly to the plan's records or a subservice organization that provides investment related services. This review and conclusion regarding the significance of carve-outs should be documented. If there are significant carve-outs, consider obtaining the subservice organization SOC 1 reports related to the carve-outs. These reports would be reviewed in a similar manner to the service organization's SOC 1 reports.

Under the carve-out method, controls for the subservice organization are excluded from the service organization's SOC 1 report and are referred to as carve-outs.

What if a carve-out SOC 1 report is not available? Possible alternative procedures that the plan sponsor may want to consider include, but are not limited to, the following:

- Perform a review of the current procedures in place at the plan sponsor to address the specific carve-out and document that the controls are properly covered. However, in most instances, this will likely not cover outsourced controls adequately.
- Contact either the service organization or the subservice organization directly, discuss the controls and procedures in place, document those discussions and obtain any supporting documentation to confirm such controls and procedures are in place. This discussion would ordinarily focus only on key processes and controls that impact the sponsor's plan.
- Request that the plan auditor work with the service organizations to perform the necessary steps to address and document these controls.
- Request that the subservice organizations have SOC 1 reports prepared.

Since reviews of SOC 1 reports are part of the audit planning process, the plan sponsor should consider obtaining the relevant SOC 1 reports and performing the reviews now. The time to review these reports can be lengthy, but it is the plan sponsor's responsibility to understand how the controls impact the plan's operations and controls. If the sponsor is proactive with this review, it generally results in a more efficient audit.

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