

# Have You Checked Your Plan's Definition of Compensation Lately?

By: Lyndsey Barnett on May 24, 2018 on [graydon.law](http://graydon.law)

Each summer as clients are going through the external audit for the Form 5500 for their 401(k) plans, we seem to receive the same call from clients. The call goes something like this: "Our auditors just discovered an error in the operation of our plan. They say that our plan document includes bonuses in the definition of compensation, but we have never allowed employees to defer on bonuses. Are they correct? What do we need to do to fix the error?"

This error is all too common among employer retirement plans. It happens for a variety of reasons. Sometimes it happens due to a change in a payroll system, payroll vendor or coding in the payroll system. Many times, the document once contained the exclusion but when the plan switched document providers the exclusion was dropped. This reason is the most common that we see and the easiest to ensure that it doesn't happen again.

While many plan sponsors rely on the expertise of the vendors and assume they will properly carry over the terms of the plan, many times there are errors in carrying over provisions when a plan changes providers or is restated. It is the plan sponsor's responsibility to ensure that the document states what they want it to state before they sign the document making it the legal document governing the terms of the plan. It is imperative that a plan sponsor thoroughly review a plan document before executing it or even better ask counsel to review it to ensure everything was carried over correctly. While it sometimes feels like you are saving money by not having counsel review your new document, we are trained to review these for consistency and, more often than not, we find errors when reviewing draft documents that could save a client thousands of dollars in error correction if discovered later on audit. Skipping a review on the front end is a prime example of the phrase "a penny wise and a pound foolish."

If it has been awhile since you have compared your payroll files to the definition of compensation in your plan document, we recommend that you do an internal audit of payroll now. Don't assume that you know your plan's definition of compensation, but check the actual document. The earlier that any mistakes are detected the less the error will cost you. Because if a plan has been improperly excluding a type of compensation from plan compensation, the employer must contribute the missed contributions to the plan, plus

earnings, which can get expensive. The IRS does not permit self-correction by retroactive amendment even when the error was a scrivener's error or unintentional. The only way to retroactively change the definition of compensation is to submit an application through the IRS's Voluntary Correction Program, which is itself expensive and is a tough, uphill battle to get approval for such a retroactive change.