



Illinois Municipal Retirement Fund

2211 York Road Suite 500 Oak Brook IL 60523-2337

Service Representatives 1-800-ASK-IMRF

www.imrf.org

GENERAL MEMORANDUM

Number: 562

Date: October 23, 2007

To: All Authorized Agents

Subject: Results of recent employer audits

Executive Summary

IMRF recently began a program of Employer Audits. During the audits, we perform procedures designed to determine compliance with statutory reporting requirements. Employers are selected at random. Initial Employer Audits revealed the following exceptions:

- Employees meeting the hourly standard are not enrolled
- Employees incorrectly classified as Independent Contractors
- Section 125 (Cafeteria Plan) contributions reported to IMRF, but the appropriate resolution is not on file
- Pension plan box not checked on Form W-2 for IMRF-eligible elected officials
- Inability to reconcile total payroll to IMRF-reportable payroll

Noncompliance is a serious matter that can affect a member's future. In addition to following up with these employers to ensure they are in compliance with all statutory reporting requirements, we are also sharing these results with all employers so they can review their own procedures for possible similar exceptions.

If future Employer Audits reveal continuing statutory reporting exceptions, IMRF will consider taking further action to secure compliance with the Illinois Pension Code.

IMRF is conducting a program of Employer Audits to ensure that employers comply with IMRF statutes, policies and procedures. Noncompliance is a serious matter that can affect a member's future.

Employers are selected at random. During the Audit, we perform certain procedures designed to determine the employer's compliance with statutory reporting requirements relating to employee enrollment, earnings, and service.

When exceptions are found, we follow up with the employers to ensure they are in compliance with federal tax laws and the Illinois Pension Code.

To date, Employer Audits have revealed the following:

1. Employees meeting the hourly standard are not enrolled

One park district had 77 employees working more than the hourly standard, but who were not enrolled. We discovered one county with 26 employees who should have been enrolled. This exception to the Illinois Pension Code was also found at cities, townships, and a school district.

When an eligible employee is not enrolled promptly, that employee does not receive all the benefits he or she is legally entitled to. Instead, at a later date, the employee must purchase the omitted service by paying the member contributions which would have been made plus interest due to the delay in reporting.

If you do not know your employer's hourly standard, log in to your Employer Access account and display your employer's resolutions. You can also call an IMRF Member Services Representative at 1-800-ASK-IMRF (1-800-275-4673).

If you are unsure if an employee should be enrolled, refer to the Authorized Agent checklist, "Should this employee be enrolled in IMRF?" available in the employer publications area of www.imrf.org or request a copy from an IMRF Member Services Representative. You can also call an IMRF Member Services Representative for assistance.

2. Employees incorrectly classified as independent contractors

This exception was found at cities, a county and a school district. Several management positions were improperly identified as independent contractors.

An employer cannot simply designate a person as an independent contractor. If the employer retains control over when and how a person works, that person remains an employee, even though the employer may enter into a contract which states that the person is an independent contractor. The actual working arrangements control, not the name given or the provisions of a written agreement.

The most important tests of whether a person is an employee or an independent contractor are:

- Is the person under your work direction and control as to the time and manner of work performance?
- Is the person performing services which are a key aspect of your business?
- Can the person realize a profit or a loss, have unreimbursed expenses, hire his or her assistants, or make his or her services available to the public?

Employers who attempt to avoid IMRF contributions by designating certain employees as independent contractors or consultants, without changing the working conditions to give the employees the necessary independence of independent contractors, are subject to assessment for retroactive contributions.

If you are unsure if a person should be classified as an employee or an independent contractor, refer to Paragraph 3.10 A. Independent Contractors in the *Manual for Authorized Agents* for a list of guidelines.

3. Section 125 (Cafeteria Plan) contributions being reported as IMRF earnings, but no resolution on file

Cafeteria plans may be established under Section 125 of the Internal Revenue Code. If the cafeteria plan has a cash option, those cash payments are always IMRF earnings and must be reported to IMRF.

However, other compensation paid under a cafeteria plan is not reportable to IMRF unless the employer's governing body adopts the appropriate resolution, IMRF Form 6.72, "Resolution to Include Compensation Paid Under an IRC Section 125 Plan as IMRF Earnings."

By not having the appropriate resolution on file, your unit of government is incorrectly reporting non-reportable compensation to IMRF.

To read more about reporting other compensation paid under a cafeteria plan, refer to Paragraph 6.60 F. To Include Compensation Paid Under an Internal Revenue Code Section 125 Plan as IMRF Earnings in the *Manual For Authorized Agents*.

4. Retirement Plan box on form W-2: Wage and Tax Statement (box 13 for 2007) not checked for elected officials who are eligible for IMRF but elected to not participate

Employers check box 13 for their employees who participate in IMRF, i.e., who according to the Internal Revenue Service (IRS) are "active participants" in a defined benefit plan.

However, the IRS includes in its definition of "active participants" those employees who are *eligible to participate* in a defined benefit plan.

Therefore, if an elected official holds a position that qualifies for IMRF but he or she elects to not participate, the Retirement Plan box on form W-2 (box 13 for 2007) should be checked.

By not checking this box, you indicate that the elected official is not covered by an employer-provided retirement plan. This could result in the elected official taking a deduction on his or her individual income tax return for a retirement plan contribution which he or she may not be eligible for, and correspondingly, subjecting the elected official to federal and state income tax penalties.

For more information, refer to paragraph 9.10G, IRS Form W-2 for Employees, in the *Manual For Authorized Agents* or download Publication 590, Individual Retirement Arrangements, from the IRS website at www.irs.gov.

5. Inability to reconcile total payroll to IMRF-reportable payroll

The Illinois Pension Code requires that if an employee works in a position eligible for IMRF, that employee must be enrolled in IMRF. In addition, the Illinois Pension Code provides that the IMRF Board of Trustees defines what constitutes IMRF wages and subsequently, what wages are to be reported to IMRF and used in the calculation of IMRF benefits.

IMRF wages includes compensation, fees, and other emoluments paid for official duties. (Certain types of non-cash compensation is not reportable to IMRF. For a complete explanation of IMRF earnings, refer to Section 3 in the *Manual for Authorized Agents*.)

When an employer's total monthly payroll is reduced by subtracting wages for employees not eligible for IMRF and for wages not subject to IMRF contributions, the balance should equal the monthly wages reported to IMRF.

As a result of this procedure, some employers had IMRF-reported wages that were higher than they should have been. In one case, the employer reported wages that are not subject to IMRF contributions, e.g., car or clothing allowance.

In other instances, IMRF-reported wages were lower than they should have been. This could be the result of an employer not enrolling or reporting an employee eligible for IMRF or not reporting wages that are subject to IMRF contributions.

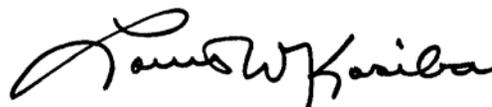
The amount of an IMRF benefit payment is based—partially—on a member's reported wages. By reporting wages that are not reportable to IMRF, or by not reporting wages that are subject to IMRF contributions, a member could receive either more or less in benefit payments than he or she is entitled to.

IMRF's Employer Audit program will continue in 2007 and beyond. We believe this program provides added assurance that employers are in compliance with statutory requirements and that members receive all the service credit and benefits they are entitled to under the Illinois Pension Code. We also believe it is beneficial in uncovering common problems that can be brought to the attention of all employers to assist them in complying with the requirements of the IMRF program.

If future Employer Audits reveal continuing statutory reporting exceptions, IMRF will consider taking further action to secure compliance with the Illinois Pension Code.

If you have any questions regarding this program, contact IMRF Internal Auditor Douglas Samz at 630-706-4214.

Sincerely,



Louis W. Kosiba
Executive Director