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Plan Sponsor Basics

Webinar 4 of 6

Preparing For and Managing Plan Audits

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Overview of Presentation Topics

- Common Types of Audits
- Preparing for Audit
- Preparing for an IRS Audit
- Preparing for a DOL Audit
- Compliance Issues
- Audit Notification
- Managing the Audit Process
- Responding to Information Requests
- Resolving Open Audit Issues

Common Types of Audits

- Department of Labor (DOL)
 - Fiduciary audit
 - Health and welfare plan audit
- IRS Qualified Plan Audit
 - Single plan audit
 - Group audit
- PBGC Terminated Defined Benefit Plan Audit

Preparing for Audit

- Best preparation is BEFORE notification is received
- Consider a self-review of plan operational and documentation
 - Undergo a “mock” audit
 - *Considerations regarding “attorney-client privilege”*
- Gather documentation, signatures, resolutions, etc.
 - Consider “cleaning up” plan documentation issues (i.e., wrap plan)

Preparing for Audit (cont'd)

- Document any self-correction
- Document procedures and processes
- Review plan governance (fiduciary)
 - Understand fiduciary roles and responsibilities
 - Establish charters, procedures, etc.
 - Consider initial and ongoing fiduciary training

Preparing for an IRS Audit

- IRS Resources

- 401(k) Plan Checklist, located at

- <http://www.irs.gov/pub/irs-tege/pub4531.pdf>

- 401(k) Plan Questionnaire, located at

- http://www.irs.gov/pub/irs-tege/epcu_401k_questionnaire.pdf

- Understanding the Employee Plans Audit Process, located

- at <http://www.irs.gov/pub/irs-pdf/p1ep.pdf>

Preparing for an IRS Audit (cont'd)

- Areas Commonly Audited for 401(k) Plans
 - Compensation
 - *Deferral compensation, HCE compensation, testing compensation*
 - Loan administration
 - Withdrawals
 - Forfeitures
 - Eligibility, service, and vesting
 - Required minimum distributions

Preparing for an IRS Audit (cont'd)

- Areas Commonly Audited for Defined Benefit Plans
 - Compensation
 - Eligibility, service, and vesting
 - Distributions
 - *Eligibility for normal and early retirement*
 - *Late retirement, including suspension of benefits notices or actuarial increase*
 - *Retroactive annuity starting date*
 - Required minimum distributions

Preparing for a DOL Audit

- DOL Resources

- Meeting Your Fiduciary Responsibilities, located at <http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html>
- Reporting and Disclosure Guide for Employee Benefit Plans, located at <http://www.dol.gov/ebsa/pdf/rdguide.pdf>
- Understanding Retirement Plan Fees and Expenses, located at <http://www.dol.gov/ebsa/publications/undrstndgrtrmmt.html>

Preparing for a DOL Audit (cont'd)

- Areas Commonly Audited for 401(k) Plans
 - Timing of deferral of contributions
 - *Requirement is that contributions be deposited to the trust as soon as it is reasonably possible to segregate them from the company's assets, but no later than the 15th business day of the month following the payday*
 - *If employers can reasonably make the deposits sooner, they need to do so*
 - Review of plan governance
 - *Will request fiduciary documentation, including charter, procedures, meeting minutes, etc.*

Preparing for a DOL Audit (cont'd)

- List of fiduciaries and service providers
 - *Important to clearly understand and differentiate between “settlor” and “fiduciary” duties*
- Copy of trust agreement and service provider agreements
- Recent focus on plan fees
- Areas Commonly Audited for Health and Welfare Plans
 - Plan documentation
 - Required notices
 - ACA

Compliance Issues

- Issues discovered during self-audit or normal plan operation of retirement plans
 - Correct under the Employee Plans Compliance Resolution System (EPCRS)
 - *Many errors can be self-corrected*
 - Document correction
 - *Consider filing with the IRS to correct significant issues that cannot be self-corrected*
 - The IRS cannot generally audit a plan while VCP is pending – unless it is anonymous VCP

Audit Notification

- IRS Notification
 - Notification via letter or telephone
 - Typically lists “initial” documents and discussion of a kick-off meeting
 - Precluded from correcting failures following notification, unless such failures were “substantially complete” at the time of notification

Audit Notification (cont'd)

- *A failure is “substantially complete” if the plan sponsor had (i) identified the failure, (ii) formulated a correction method, and (iii) initiated correction in a manner that demonstrates a commitment to completing correction of the failure as expeditiously as practicable, and within 120 days after the notification of audit the plan sponsor completes correction.*
- *The IRS also considers correction of an error to be “substantially complete” if 65% of the affected participants are corrected at the time of audit notification and the plan sponsor finishes the correction relatively quickly after audit notification.*

Audit Notification (cont'd)

- DOL Notification
 - Notification typically via letter
 - Letter will provide a certain number of days to provide documentation
 - Often involves a meeting with a DOL agent during the process

Audit Notification (cont'd)

- PBGC Notification
 - Following plan termination, notification via letter
 - Letter will provide a certain number of days to provide documentation

Managing the Audit Process

- Decide single point of contact for auditor
- Determine how in-person meetings will be handled
- Consider how counsel will be involved
 - IRS audits may require submitting an IRS Form 2848 at the beginning of the process if counsel is to be involved at all
- Different considerations for on-site auditors vs. paper/telephone audits

Managing the Audit Process (cont'd)

- Require governmental agencies to make requests in writing
- Prepare responses carefully and honestly
 - See later discussion
- Expect the process to take a long time
 - May be 1-2 years
- For IRS audits, discuss correction of any compliance issues discovered *before* undergoing any corrections
 - Audit Cap process

Responding to Information Requests

- Respond carefully and honestly
 - Answer the question asked and “own” the response
 - Consider implications of responses and prepare for follow-up questions
 - Know the “right” answer and the answer being given
- Consider disclosing “known” issues, if any
- Perform an advance self-audit for purpose of responding to documentation requests
- Don’t be afraid to ask for additional time when necessary

Resolving Open Audit Issues

- Discuss compliance issues and correction methods with auditor in *advance* of making corrections
- To the extent possible, obtain any agreement to correction methods in writing from the agent
- For IRS audits of retirement plans, review EPCRS program for acceptable retirement plan corrections
 - Corrections will be made through “Audit Cap”
 - Agent may not require that all matters go through Audit Cap and be subject to sanction; however, all compliance failures should be corrected

Resolving Open Audit Issues (cont'd)

- For an IRS audit, the agent will issue a Closing Agreement for any issues that are subject to sanction
- The sanction is generally determined by calculating the Maximum Payment Amount (MPA)
 - Under Audit Cap, a plan sponsor is generally required to pay a penalty equal to a negotiated percentage of the MPA, in lieu of disqualification
 - The MPA is a proxy for the tax the IRS could collect upon plan disqualification, which in turn is the sum for open taxable years, of the following:

Resolving Open Audit Issues (cont'd)

- *Income tax resulting from inclusion of income on amounts deferred;*
 - *The tax on the trust;*
 - *The loss of employer deductions for contributions made to the plan; and*
 - *Any other tax that results from a qualification failure but for the correction under EPCRS*
- Taxes assessed for “open tax years” (normally three tax years based on the statute of limitations)

Resolving Open Audit Issues (cont'd)

- For DOL audits, the auditor could:
 - Issue a sanction for statutory breaches (failure to file IRS Form 5500, failure to create a summary plan description, etc.)
 - Discover and require correction of fiduciary breaches
 - Discover and require correction of prohibited transactions
- Settlement with the DOL may also result in a 20% civil penalty
 - Consider self-correction and disclosure for purposes of avoiding 20% penalty

Resolving Open Audit Issues (cont'd)

- For PBGC audits (following plan termination), the PBGC will:
 - Ensure that all notices were provided properly
 - Ensure that participants were made whole as part of the termination
 - Refer plan to IRS or DOL for audit if significant issues occur



Questions?

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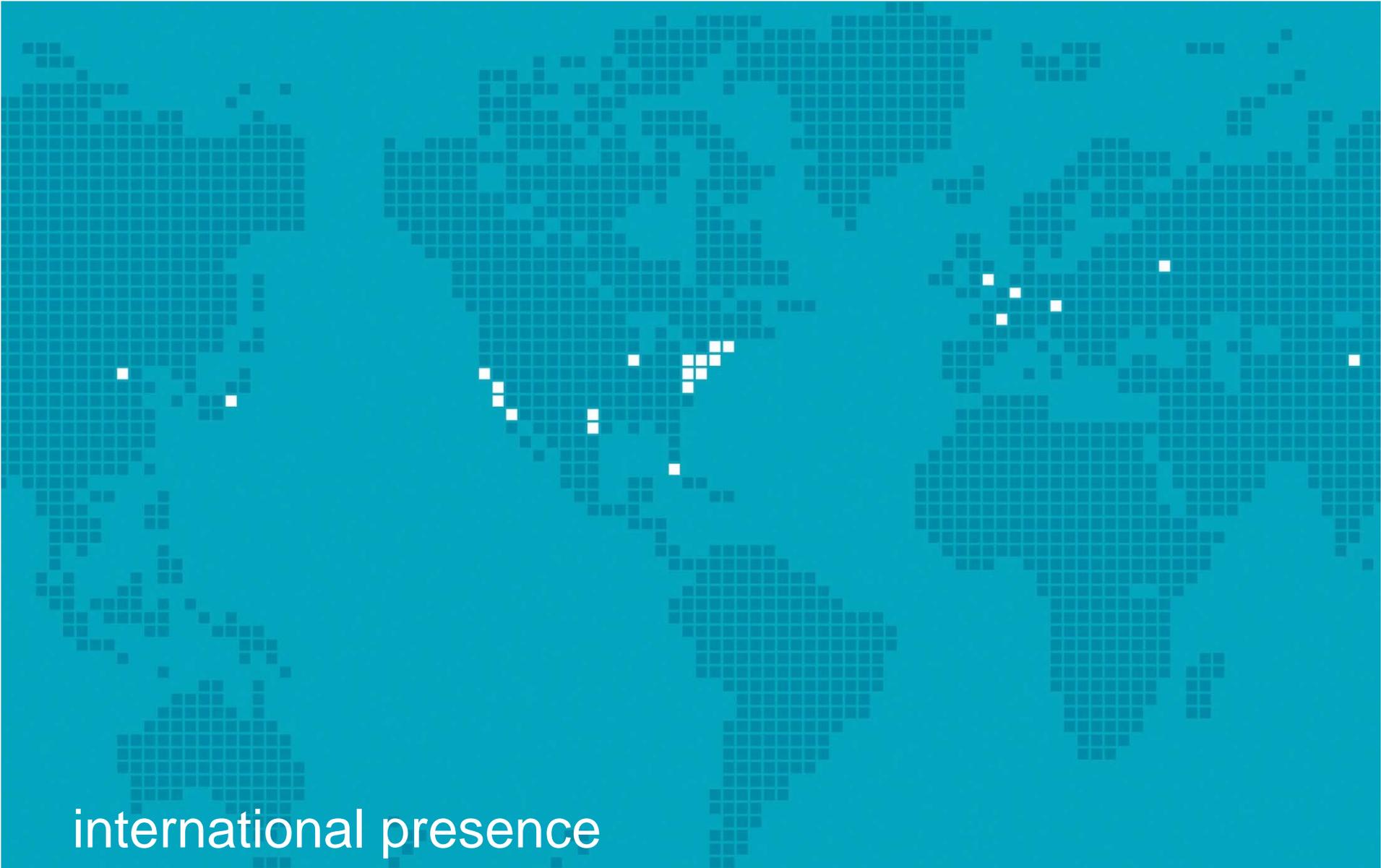
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