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Plan Sponsor Basics Webinar Series

Preparing for and Managing Plan Audits

Webinar 3 of 5

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Overview of Presentation Topics

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

Common Types of Audits

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

Preparing for Audit

- Best preparation is BEFORE notification is received
- Consider a self-review of plan operations/administration and documentation
 - Review resources made publicly available (e.g., IRS website)
 - Undergo a “mock” audit
 - *Considerations regarding “attorney-client privilege”*
- Gather documentation, signatures, resolutions, etc.
 - Consider gathering and “cleaning up” any plan documentation issues (i.e., health and welfare wrap plan)

Preparing for Audit (cont'd)

- Document any self-correction steps taken
- Document procedures and processes
- Review internal controls (new focus of IRS examination)
- Review plan governance (fiduciary)
 - Understand fiduciary roles and responsibilities
 - Evaluate fiduciary vs. settlor functions
 - Establish charters, procedures, etc.
 - Consider initial and ongoing fiduciary training
- Consider scrubbing data in advance of PBGC audit

Preparing for an IRS Audit

- IRS Resources

- 401(k) Plan Checklist, located at <http://www.irs.gov/pub/irs-tege/pub4531.pdf>
- 403(b) Plan Checklist, located at <http://www.irs.gov/pub/irs-tege/pub4546.pdf>
- 401(k) Plan Questionnaire, located at http://www.irs.gov/pub/irs-tege/epcu_401k_questionnaire.pdf
- Internal Control Questionnaire, located at [http://www.irs.gov/Retirement-Plans/EP-Team-Audit-\(EPTA\)-Program---Internal-Control-Questionnaire](http://www.irs.gov/Retirement-Plans/EP-Team-Audit-(EPTA)-Program---Internal-Control-Questionnaire)
- Understanding the Employee Plans Audit Process, located at <http://www.irs.gov/pub/irs-pdf/p1ep.pdf>

IRS Review of Internal Controls

- The IRS will review and assess the internal controls of an organization in order to limit actual audit time by determining potential problem areas and the scope of the audit
 - IRS will make a determination through interviews of personnel and review of answers to targeted questions
 - It will review and assess internal communication between management and day-to-day administrators
- Focus on controls is an efficient way to determine areas that may need to be reviewed more closely
- Solid internal controls can also help to reduce any Audit CAP sanction that would otherwise be imposed for errors found by the IRS

IRS Review of Internal Controls

- IRS will review internal and external factors that could adversely affect plan operation and administration, such as:
 - Personnel turnover
 - New systems/technology
 - Rapid expansion of the organization and/or acquisitions
 - New areas on which the IRS or DOL is focusing on audit
- IRS will evaluate specific internal control activities, including reconciliations, monitoring, authorizations, etc.

Preparing for an IRS Audit (cont'd)

- Common Audit Topics 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)

- Common Audit Topics 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 an IRS Audit (cont'd)

- Common Audit Topics for 403(b) Plans
 - Eligibility of organization to sponsor 403(b) plan
 - Adoption of document by December 31, 2009
 - All employees given opportunity to defer (universal availability)
 - Proper eligibility for 15 years of service contribution
 - Loans
 - Hardship withdrawals

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)

- Common Audit Topics for 401(k) Plans
 - Timing of deferral of contributions/loan repayments
 - *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
- DOL focus on plan fees
- Common Audit Topics 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 an 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
 - Mandatory audit for plans with >300 participants; plans with 300 or fewer participants may be subject to random audit
 - PBGC may also audit if there is a reason to believe there is a problem (e.g., complaint by plan participant)

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 audit 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 properly given distributions as part of the termination
 - Review insurance contracts and certificates to ensure that they are accurate
 - PBGC can refer plan to IRS or DOL for audit if significant issues occur
 - Review calculations for a sample of participants

Managing Annual Internal Audits

- Review and understand “management representation letter” terms and provisions
 - Negotiate the terms, as necessary
- Provide information consistent with the management representation letter
- Discuss audit findings and issues
- Evaluate and correct, if necessary, any issues identified, with special attention to any issues included in the audited financial records



Questions?

Presenters

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