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Surviving a Retirement Plan Audit: Techniques and Tips for Efficient and Successful Audit Response and Outcomes

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Introduction: The Complex Environment

Internal Revenue Code

- Governs:
 - Employer contribution deductibility
 - Employee pre-tax contributions
 - Tax treatment of gains and losses
 - Tax treatment of distributions
 - Excise taxes for prohibited transactions

Also for some types of plans—
insurance laws

ERISA

- Governs:
 - Fiduciary obligations of sponsors, administrators, and vendors to plans
 - Trust requirements
 - Funding requirements
 - Rights of Participants
 - Party in Interest transactions

Also, for retirement plans, securities
laws



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Types of Plan Audits & Goals of Each



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Internal Audits and Due Diligence

The first step in every agency audit is to determine whether the corporation sponsoring and administering the plan has internal controls in place for plan administration.

IRS Newsletter: **Employee Plans News**, Issue 2012-3 (Nov. 14, 2012); Advisory Committee on Tax Exempt and Government Entities (ACT): **Report of Recommendations** (June 6, 2012).

The presence or absence of internal controls is reflected by:

- Processes and procedures for organizing and retaining plan documents
- Communications between Human Resources personnel and third-party administrators and plan asset custodians
- Procedures to assure payroll/elective deferral contributions are administered in accordance with plan documents
- Whether operational failures were promptly identified, corrected and made subject to new procedures to prevent recurrence
- The existence of protocols for communications by and between corporate board of directors, officers, plan committees, etc.
- Supervision and periodic examination of plan vendors

IRS Webpage: EP Team **Audit** (EPTA) Program - **Internal Control** Questionnaire



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Internal Audits and Periodic Due Diligence Help Demonstrate Internal Controls Are in Place

The IRS provides guidance for self-audits at:

<https://www.irs.gov/retirement-plans/policies-procedures-and-internal-controls-self-audit>

The DOL provides training on fiduciary duties and compliance at:

<https://www.dol.gov/agencies/ebsa/employers-and-advisers/plan-administration-and-compliance/fiduciary-responsibilities/fiduciary-education-campaign>



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Self-Audit Procedures (Every Two Years)

- Review vendor agreements, paying particular attention to the ability to gather documents if audited; performance guarantees; language limiting fiduciary status; and required notices for termination
- Review plan eligibility rules and sample a group of new employees to determine whether they are permitted to enroll in the plan and enter the plan according to plan terms
- Sample payroll records and assure proper definition of “compensation” is applied to elections to make deferral contributions, and that limitations on compensation and contributions that are applicable to the plan year are properly applied
- Review plan loans, hardship distributions and required minimum distributions to determine whether plan provisions are followed
- Review coverage and discrimination testing, assuring that related entities are included in testing of plan



External or Agency Audits

- **Independent audit**—General rule: Plans that cover 100 or more participants in a plan year must file audit report prepared by an independent qualified public accountant (subject to 80-120 rule). The purpose is to permit control and oversight of plan assets by IRS and DOL, and prevent diminution of plan assets.
- **Internal Revenue Service**—Goal is to help assure compliance with tax qualification rules
 - Form 5500
 - Prohibited transaction
 - Plan audit as part of general corporate audit
 - Whistleblower driven audit
- **DOL Investigation**—Goal is to help assure compliance with fiduciary, disclosure and funding rules
 - General
 - Focused or limited scope
 - Response to complaints



Merger and Acquisition Due Diligence

Types of transactions:

- Stock purchase/sale
- Asset purchase/sale
- True merger

Note: Termination of a seller's plan must occur PRIOR to the closing of the transaction in a stock purchase or true merger if the surviving entity/buyer wish the plan to be terminated and plan assets distributed.



Due Diligence Is Necessary on Issues of:

- Credit for prior service for eligibility and vesting
- Anti-cut back rules
- Surviving employer may have to correct seller's plan if not operationally compliant
- Controlled and affiliated service group issues
- Loans – deemed distributed or capable of being “rolled over”
- Responsibility to file final Form 5500



Independent & Fiduciary Audits: When Needed or Necessary



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IQPA Opines That Financial Information on Schedule H of Form 5500 Are Fairly Presented and Conform to GAAP

- Plans with 80 or so participants and that file Schedule I in one plan year may rely on small plan audit waiver for the following plan year if they have less than 120 participants and satisfy the small plan audit waiver (SPAW) requirements
- Disclosure requirements for SPAW (to be included in the summary annual report):
 - ID of all institutions holding qualified plan assets and the amount of same, including plan loans
 - Name of surety company issuing fidelity bond, unless 95% or more are “qualifying assets”
 - Statement that participants may receive information from companies holding plan assets and of fidelity bond without charge
 - Contact information for EBSA
 - Increased fidelity bond requirement in some instances (example: when plan holds employer securities)



“Independence” and “Qualified” as to the IQPA

- “Independence” means the IQPA is not the auditor of the sponsor or the auditor or CPA of any vendor to the plan, such as the third-party administrator
- “Qualified” means
 - The person is a certified public accountant under state law
 - The person is a licensed public accountant under state law
 - The person is certified by the DOL as a qualified public accountant if the accountant practices in a State where there is no certification process
- ERISA § 103(a)(3)(D)



Contents of IQPA Report

- The report must be signed manually, dated, identify city and state where issued, and contain description of financials reviewed
- Contain a representation that generally accepted auditing procedures were used, and a description of the reasons for any variance
- The IQPA's opinion on the financial statements and a description of any reasons an opinion cannot issue or exceptions from generally accepted auditing procedures

29 CFR § 2520.103-1(b)(5)



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Penalties for Non-Compliance

- ERISA § 502(c)(2) permits the DOL to assess a penalty against a plan administrator for failing to file, or properly file, a employee benefit plan annual report (Form 5500)
 - Penalty may be up to \$2,194 per day-calculated from due date of Form 5500; Labor Reg. § 2575.2(b)
 - The penalty is subject to a “reasonable cause” defense
 - Process is that a voluntary compliance letter will issue giving the plan administrator 30 days to correct non-compliance and will contain the DOL’s proposed penalty amount

EBSA Enforcement Manual, Administrative Procedures, Civil Penalties, § 3.



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Common Operational & Fiduciary Errors



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Top 10 Operational Failures

1. Failure to apply plan's definition of "compensation" to participant elections to make deferrals
2. Failure to determine when employees are eligible to enroll and their plan entry dates
3. Failure to apply limits on compensation, deferrals, annual additions
4. Failure to properly apply vesting credit, particularly in merger and acquisition transactions



Top 10 Operational Failures (Cont'd)

5. Failure to identify components of pay subject to deferral elections (bonuses, post-separation compensation, deferred compensation, etc.)
6. Failure to offer participation to independent contractors (misclassification of independent contractors)
7. Failure to recognize controlled groups of corporations
8. Miscalculation of profit-sharing contributions, particularly if discretionary
9. Failure to deem distributed loans in default
10. Failure to conduct due diligence as to loans in merger and acquisition transactions



Top 10 Fiduciary Failures

1. Late filing of Form 5500
2. Late or missing deposits of elective deferral contributions
3. Participant loan administration failures (too many, late payments, incorrect amounts, etc.)
4. Failure to follow plan document terms
 - Compensation
 - Vesting credit
 - Required minimum distributions



Top 10 Fiduciary Failures (Cont'd)

5. Failure to make required disclosures, particularly SARs
6. Failure to recognize plan requires IQPA report in growing plan
7. Failure to monitor and disclose plan expenses
8. Failure to adopt investment policy and monitor investments
9. Failure to administer plan solely for the benefit of plan participants
10. Prohibited transactions/party in interest transactions



Internal Controls & Correction of Plan Errors



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Three Correction Programs

- Form 5500 filing errors: Delinquent Filer Voluntary Correction Program (DFVCP)
- Fiduciary errors: Voluntary Fiduciary Correction Program (VFCP)
- Tax qualification errors: Employee Plan Compliance Resolution System (EPCRS) Rev. Proc. 2019-19
 - Self correction (SEP)
 - Voluntary Correction Program (VCP)
 - Audit Cap



DFVCP

- Plan administrators are eligible, unless they have received a notice of non-compliance from EBSA
- Two-part process:
 - Electronic filing of delinquent Form(s) 5500
 - Calculation and payment of penalty amounts (plan sponsor/administrator must pay)
 - Penalty is \$10 per day--
 - Cap for small plan is \$750, unless multiple years involved, then \$1,500
 - Cap for large plan is \$2,000, unless multiple years involved, then \$4,000



VFCP

- Eligible parties are plan sponsors, administrators, and parties in interest
- Procedure and application description is located in Federal Register, April 19, 2006
- 19 categories of transactions may be corrected via VFCP
- Application and supporting documentation submitted to DOL
- Restitution must be paid to plan, including missed earnings (VFCP Calculator)



EPCRS

- Eligibility and process rules are contained in Rev. Proc. 2019-19
- SEP may be used for insignificant errors or significant errors discovered and corrected before the last day of the second plan year in which the error occurred
- VCP may be used, so long as plan sponsor has not received IRS audit letter – fee for VCP is based upon plan assets and number of participants, and is capped at \$3,500
- Audit Cap is used when operational errors are discovered on audit. A sanction is usually imposed to correct operational errors discovered or revealed during audit
- No correction program is available for diversion or misuse of plan assets or tax avoidance transactions

Note: There is NO statute of limitations on operational errors



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More About EPCRS

- SEP
 - Plan must have favorable determination letter
 - Plan must have processes and procedures for operational controls
 - Correction includes developing procedures so failure is not repeated
 - SEP is now available for correction of loan failures



More About EPCRS

- VCP
 - Submission is made electronically via www.pay.gov
 - Supplemental supporting material sent via fax to IRS, with tracking number
 - IRS may open or broaden investigation into issues submitted
 - Taxpayer may request a conference with the IRS prior to issue resolution
 - Result is a compliance statement (limited to issues addressed in vcp), upon which both the taxpayer and IRS may rely



DOL & IRS Audits: Management of Agency Investigations



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Process of Audit (Tax) or Investigation (Fiduciary) (See Appendix)

1. Opening letter (Howdy letter)
2. Request for documents and, often, an opening conference
3. Production and review of documents
4. Additional requests for documents and information
5. Subpoenas or summons to third parties
6. Interviews of plan administrators
7. Proposed adjustments or notice of non-compliance
8. Closing statement or Agent report on return (may be unagreed)
9. Appeal or court litigation



Important Information

- For plan sponsor/administrators, fiduciary obligations make cooperation in an audit or investigation both necessary and, from a management standpoint, desirable
- DOL and IRS may share information obtained in an audit or investigation
- DOL and IRS may refer matter for further investigation and enforcement
- Statute of limitations is usually 3 years for IRS audit; 6 years for IRS (in some cases); and for DOL investigation
- There is no statute of limitations for tax purposes on matters that have never been disclosed on tax return or report



Audit & Investigation Tips

Retain counsel for representation – do not wait until you discover that you are in trouble.

- READ the audit/investigation cover letter. The notice contains:
 - Information regarding the type of audit or investigation
 - The plan years included
 - The contact information for the auditor or investigator (the Auditor)
 - Time period for response to document or information request; and then
 - Contact the Auditor via phone to—
 - Introduce who will be the primary contacts for counsel and plan administrator
 - Ask whether the audit or investigation is a general scope, limited scope, or targeted based upon a complaint (some Auditors will tell you this)
 - Propose that you produce documents first, prior to any on-site interviews, etc.



Audit & Investigation Tips (Cont'd)

- Ask the Auditor for additional time to respond. The Auditor will always give you 30 days, and you can propose a segregated production to obtain more time. This will allow you to:
 - Gather and review your documentation
 - Conduct interviews of employees involved in plan administration
 - Conduct your own due diligence
 - Identify operational errors before the IRS or DOL does



Audit & Investigation Tips (Cont'd)

- Bring any operational or fiduciary errors you discover to the attention of the Auditor (no, really!!)
- Request correction of any errors within the audit or investigation
- Ask to submit a request for waiver or reduction of any proposed penalty in writing
- Offer to put into place additional plan controls that may be verified to prevent future errors in administration in exchange for a penalty or sanction reduction



Other Discussion Points & Questions



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