

Benefit Plan Audits: New Tips from the IRS

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The Internal Revenue Service has published an updated list of common plan mistakes found during IRS employee plans team audits (EPTAs) and an internal controls questionnaire used by EPA auditors.

Although the EPA program focuses on retirement plans with at least 2,500 participants, the published materials give all plan administrators valuable insights into the IRS' audit process and what the IRS believes plan sponsors can do to avoid common errors in plan administration.

Plan sponsors should use these tools to assess their plans' compliance and to correct mistakes.

Compliance Trends and Tips

The IRS web page [EPTA Program—Compliance Trends and Tips](#) provides an extensive description of the mistakes found most frequently by the EPA auditors. The site offers advice on how to avoid these errors.

Common errors. One of the most common problems identified by EPA team members is the plan sponsor's failure to adopt timely amendments to comply with changes in the law. The failure to adopt timely amendments could result in significant penalties (possibly even plan disqualification) if uncovered during an audit. To avoid such failures, the IRS suggests that plan sponsors conduct an annual review of the plan document.

Other common errors found in all plan types include failures to:

- Follow the plan document's terms on plan eligibility, eligible compensation, vesting, and contribution and benefit limitations.
- Make required minimum distributions for participants over age 70.5.
- Process and report distributions properly.
- Maintain adequate plan records and internal controls.

In addition, the IRS has found that 401(k) plans often fail to correct nondiscrimination testing (*actual deferral percentage/actual contribution percentage*) failures, do not apply matching contribution formulas correctly, and fail to follow the plan's automatic enrollment procedures.

Common defined benefit pension plan mistakes:

- Using inaccurate data in benefit calculations.
- Failing to follow the suspension-of-benefits rules.
- Commencing benefit payments at the wrong time.

Suggested procedures to minimize errors. EPA auditors suggest ways to avoid

making these common mistakes. For example, to avoid mistakes related to eligible compensation, the IRS suggests using a straightforward definition of eligible compensation and using the same definition for multiple purposes within the plan and across plans.

A 401(k) plan's failure to follow automatic enrollment procedures can best be avoided by documenting and communicating automatic increases properly in salary deferrals and ensuring that the plan document contains language addressing participant rehires in the context of automatic arrangements.

To address suspension-of-benefits issues, defined benefit plan sponsors should ensure that the plan document includes a suspension-of-benefits provision and should work with the plan's administrator to confirm that the suspension-of-benefits notice is accurate and being provided when necessary.

Internal Controls Questionnaire and Document List

The IRS web page [EPTA Program—Internal Control Questionnaire](#) provides sample questions used to check a plan administrator's procedures and internal controls. The questionnaire contains four sets of questions each directed at various points of plan compliance: human resources, payroll, plan administration and operational failures.

- Regarding **human resources**, EPTA auditors inquire about:
 - ✓ the coordination of employees' hiring and termination with the delivery of benefits.
 - ✓ how transferred, rehired and leased employees are handled.
 - ✓ how plan practices and procedures are communicated to new benefits or HR personnel when turnover occurs.
- Regarding **payroll**, EPTA examiners focus on the controls in place for the accurate transmission of employee payroll data to the plan record keeper. The IRS reviews whether certain pay is run through nonstandard payroll (such as bonuses and executive pay), how payroll errors are corrected, how the correction is communicated to the plan administrator and whether record of the correction is maintained.
- Regarding **plan administration**, EPTA examiners review how responsibilities are allocated and how communications and data are maintained between the plan sponsor and the plan's record keeper or other service providers. Examiners will consider items such as who is responsible for determining that timely amendments are executed for the plan.

In addition, EPTA auditors review how the custodian of trust assets maintains trust data, communicates that data to the plan's trustee and deals with errors. They review how certain reportable transactions and events are identified and disclosed.

- Regarding **operational plan failures**, EPTA examiners will ask a series of procedural questions. For example, examiners will want to know:
 - ✓ what procedures are in place to identify operational failures.
 - ✓ how identified failures have been corrected.
 - ✓ what procedures have been implemented so that failures do not occur again.

The IRS will be particularly interested in a plan sponsor's answers to these questions when determining whether sanctions are appropriate and, if so, the severity of these sanctions.

Finally, the IRS provides an [EPTA Program—Taxpayer Documentation Guide](#), with a

comprehensive list of documents that need to be made available during an EPTA audit. This resource includes guides specific to defined contribution plans and to defined benefit retirement plans, as well as a combined guide for both plan types.

Depending on the specific issues under review, an auditor might require that the plan sponsor make available such diverse materials as:

- Documentation confirming the correction of a plan's past operational failures.
- The amount and date of distributions to individual participants (including bank records documenting distributions).
- The amounts and types of plan expenses and other disbursements.

Next Steps for Plan Sponsors

The EPTA materials not only alert plan sponsors of what to expect in an IRS audit but also are valuable resources to check plan compliance and internal control procedures. These are important tools that plan administrators may use to conduct self-audits of plan compliance. Plan sponsors should conduct periodic self-audits, as frequently as annually. These self-audits can permit the plan to self-correct errors without requiring IRS approval and to prepare for eventual IRS audits.

The questionnaire specifically asks about the self-audit procedures in place, and the IRS might consider evidence of self-audit procedures in negotiating any penalties for errors found in a formal audit.

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