

# 401k Annual Audits: Anticipating Serious and Costly Errors, Evaluating Alternative Solutions

TUESDAY, APRIL 11, 2017, 1:00-2:50 pm Eastern

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# 401k Annual Audits

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April 11, 2017

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# 401(k) Annual Audits

April 11, 2017

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- Employee Retirement Income Security Act of 1974 (ERISA)
  - Title I: Protection of Employee Benefit Rights
    - Enforced by the Department of Labor (DOL)
  - Title II: Amendments to the Internal Revenue Code (IRC)
    - Enforced by the Internal Revenue Service (IRS)
- Form 5500 Annual Report
  - Published by the DOL
  - Used by the DOL and the IRS
  - Filed by all employee benefit plans

## ■ DOL Enforcement

- Reporting and disclosure
- Fiduciary standards
- Voluntary Fiduciary Correction Program
- Delinquent Filer Voluntary Compliance Program

## ■ IRS Enforcement

- Plan qualification – formal and operational compliance
- Employee Plans Compliance Resolution System (EPCRS)
  - Self Correction, Voluntary Compliance Program, and Audit CAP

- General procedure for IRS and DOL audits
  - Selection for audit
  - Initial contact by the IRS or the DOL
  - Document request
  - Site visit
  - Additional requests
  - Discussion of issues
  - Correction of failures
  - Completion of audit



- Electronic filing required annually using DOL EFAST2 system
  - Exceptions for certain government and church plans, and one participant plans that have assets of \$250,000 or less as of the close of the plan year
  - Designed to satisfy annual reporting requirements under ERISA and the Internal Revenue Code
  - Requirement to file is for the plan administrator, *not* the plan sponsor
- Single Form 5500 is filed for a single employer plan even if there are multiple related employers participating
- Participating employers in a multiple employer plan must be listed on a separate attachment that includes an estimate of each participating employer's contributions during the year
- Employers must keep records of information used to prepare the Form 5500 for at least six years after the Form 5500 is filed
- Draft Form 5500-SUP released by IRS

- **Form 5500-SF:** 401(k) plans with fewer than 100 participants may be able to file the Form 5500-SF
  - 80-120 Rule: If a plan files as a small plan in one year, and has at least 80, but not more than 120, participants at the beginning of the following plan year, the plan can file as a small plan for that following plan year
  - The plan must also (i) be eligible for the small plan audit waiver, (ii) hold no employer securities, and (iii) have 100% of its assets in investments that have a readily ascertainable fair market value
- **Form 5500-EZ:** One participant plans with assets in excess of \$250,000 as of the close of the plan year must file the Form 5500-EZ

- Due date is generally seven months after the end of the plan year or short plan year (July 31 for calendar year plans)
  - Two and one-half month extension available by filing the Form 5558 with the IRS (extension until October 15<sup>th</sup> for calendar year plans)
  - Automatic extension to due date for plan sponsor's tax return in certain circumstances (but not later than nine and one-half months following the end of the plan year)

- Part I: Annual Report Identification Information
  - Plan year, type of plan, type of filing, extensions
- Part II: Basic Plan Information
  - Plan name, number, effective date, plan sponsor information, preparer information, plan administrator information, number of participants
- Electronic signature using EFAST2
- Proposed changes effective 2019

- Schedule A (insurance information)
- Schedule C (service provider information)
  - Required for plans with 100 or more participants, generally for service providers paid \$5000 or more
  - Not required for plans with fewer than 100 participants
- Schedule D (DFE/Participating Plan Information)
  - Information on participation in pooled investment or insurance arrangements
- Schedule G (financial transaction information)
  - Not required for plans with fewer than 100 participants

- Schedule H (financial statement and related information, including auditor's report)
  - Not required for plans with fewer than 100 participants
- Schedule I (financial statement and related information for small plans)
- Schedule R (retirement plan information, including distributions)



- EFAST2 system challenges
  - DOL will take into account good faith attempts to file correctly
- Failure to file Form 5500 or late filing
  - Delinquent Filer Voluntary Correction (DFVC) program available
- Incomplete filing
  - Plan administrator can file a revised Form 5500 within 45 days of the DOL's notice of rejection
- Failure to maintain proper records
  - Informal comments indicate plans should keep an actual signed copy of the Form 5500, even though submitted using an electronic signature



## ■ Civil Penalties

- Separate penalties can be assessed by the DOL and IRS
  - DOL penalty of up to \$1,100 per day but \$2,097 after Jan. 13, 2017 for violations after Nov. 2, 2015 (reduced penalties under the Late-Filer and Non-Filer Enforcement Programs)
  - IRS penalty of \$25 per day (capped at \$15,000)
- Penalty for failure to file a Form 5500
  - Rejected Form 5500s are treated as not filed

## ■ Criminal Penalties

- Under ERISA, up to \$100,000 and ten years in prison (maximum fine of \$500,000 if the entity is not an individual) for “willful” violation
- Federal criminal penalties (e.g. for knowingly making a false statement or concealing information)

- Form 8955-SSA (Annual Registration Statement Identifying Separated Participants With Deferred Vested Benefits)
  - Same deadline and extension rules as Form 5500
  - Filed with the IRS
  - Formerly the Form SSA
- Form 8822-B (Change of Address or Responsible Party – Business)
  - Due within 60 days of the change in address or identity of a plan’s “responsible party”

- Participant complaints
- Form 5500 review
- At-risk employers vulnerable to selection for audit
- Specific DOL reasons for certain audits (e.g. looking into plan administration at certain industries)
- Random selection

- Typical Document Request includes:
  - Plan Document and SPD
  - Fidelity Bond and Fidelity Insurance Policy
  - Form 5500s for the past three years, and Summary Annual Report for the previous year
  - Trust agreement and trustee statements for the past three years
  - Service provider agreements
  - Meeting minutes
  - Asset records and payroll/contribution records

- IRS generally requests various documents and information related to 401(k) plans
  - Plan and trust governing documents
  - Amendments (including proof of adoption)
  - IRS determination letter - reliance
  - Summary plan descriptions
  - Payroll records and tax forms
  - Documents relating to contributions
  - Corporate minutes relating to plan

- Plan, trust and amendments must comply with the law in form
  - Plan and trust documents
  - Amendments
  - IRS determination letter
    - Determination letter program eliminated for individually designed plans
- Sample IRS audit request
  - Copies of the plan and trust documents, including the original plan and trust documents, all amendments, adoption agreements and restatements thereto, from the inception of the plan to the present
  - Copies of all determination and/or opinion letters that the plan has received from its inception to present

- Plan must be operated in accordance with its terms and applicable law
  - Most issues in an IRS audit focus on operational compliance with the terms of the plan document
- Common issues reviewed during an IRS audit
  - Eligibility and Vesting
  - Timing of Salary Deferrals
  - Compensation Definitions
  - ADP/ACP Testing
  - Distributions and Hardship Withdrawals

- Properly apply eligibility requirements and vesting standards
  - Allow employees to participate and make elective deferrals
  - Vest benefits in accordance with plan terms and IRC requirements
- Sample IRS audit request
  - Copy of employee census reports and/or valuation reports, which should include date of birth, date of hire, date of termination, and total hours worked during the year, as to each employee
  - Copy of payroll records used to decide employees' eligibility and vesting (e.g., time cards, personnel records, employment contracts)
  - Copies of Forms 940, 941, W-2





- Timely deposit salary deferrals
- Sample IRS audit request
  - Copies of payroll records
  - Copies of all cancelled checks (front and back), wire transfers or other documentation substantiating all contributions made to the plan for the year(s) under examination
  - Provide a reconciliation showing when the pay period ended, when employees were paid, when the deposits were made and, if possible, when the deposits were received by the custodian

- Different compensation definitions used for various purposes
  - Deferrals and other contributions
  - Testing – 415, nondiscrimination, top heavy
- Sample IRS audit request
  - Identify plan provisions that define compensation and provide an explanation of how compensation is determined for plan purposes
  - Sample calculations for applying compensation definitions for various purposes under the plan

- Compliance with actual deferral percentage (ADP) and actual contribution percentage (ACP) tests
  - Properly include/exclude eligible employees
  - Correctly classify highly compensated employees
  - Compensation definition
  - Corrective measures taken, if any
  - Safe harbor requirements, if applicable
    - Safe harbor notice to participants

- Sample IRS audit request

- Copy of ADP and ACP tests, including a list of all highly compensated employees and all eligible employees and an explanation of how the figures on the tests correspond to the compensation and deferrals listed on Form W-2
- Sample calculations demonstrating how correction was made, if any corrective measures taken to satisfy ADP and ACP testing
- Samples of safe harbor notices sent to participants

- Administer distributions and hardship withdrawals in accordance with plan terms
- Sample IRS audit request
  - List of all participants who received a distribution and their dates of hire and termination, as well as proof of payment/rollover, all notices provided to terminated participants
  - Sample calculations showing the benefits paid to participants, including the compensation that was used, years of service, etc.
  - Copies of hardship withdrawal files
  - Copies of Forms 1099R (statement of recipients of total distributions)

- Threatened sanction
  - Loss of tax-qualified status
- Audit CAP
  - Enter into a settlement agreement with IRS resolving compliance failure
  - Negotiate settlement to tailor penalty to the compliance failure
  - Correct compliance failure as stipulated in closing agreement
  - Improve internal controls prospectively
  - Pay fine to IRS and excise taxes, if any
- End of IRS audit

- Selection and Contact by IRS or DOL
  - Timely respond to notifications from IRS or DOL
  - Review location of plan files in anticipation of document request
- Document Requests
  - Respond within required time frames/request extensions
  - Keep plan records updated and accessible
- Site Visit
  - Agent performs audit onsite



- **Additional Requests**

- DOL or IRS may request additional information based on documentation provided and/or site visit

- **Discussion of Issues**

- Opportunity to discuss identified issues with agent

- **Correction of Failures**

- Allows the plan to correct failures identified through audit

- **Audit Completion**

Thank You