Be Prepared – Conduct an Annual Self-Audit

An annual self-audit is an effective means of keeping a qualified plan in compliance and it offers other benefits as well. Although not all inclusive, the Q&A that follows provides an overview of:

- Key areas to cover with a self-audit
- Correction options if errors are discovered
- Tips for surviving an IRS audit

Also, to assist you with maintaining compliance and correcting plan errors the Internal Revenue Service (IRS) provides a number of tools on their Website at https://www.irs.gov/retirement-plans/retirement-plan-operation-and-maintenance and https://www.irs.gov/retirement-plans/expanded-self-correction-program-epcrs-rev-proc-2019-19.

1. Why perform an annual self-audit?

The qualified plan rules are numerous and complex and it is the responsibility of the employer and the plan fiduciary to ensure the plan complies with those rules. By performing an annual self-audit of your plan you will always be prepared should your plan be selected by the Internal Revenue Service (IRS) for audit. In addition to being prepared for an IRS audit the self-audit will:

- Help you prepare for the Form 5500 annual independent audit requirement for large plans
- Uncover operational errors so you can correct them timely, before the plan is under audit
- Provide an opportunity to enhance or change existing internal procedures as needed
- Offer a means of training new benefits staff or a refresher for existing staff

2. What should a self-audit cover?

The following areas should be included in a self-audit as these are generally the areas the IRS would audit:

- Plan document
- Plan qualification
- Plan assets
- Tax issues
- Reporting requirements

3. How can I ensure the plan document is up to date and in compliance?

The plan document file should include the items listed below. Any information regarding legislatively required amendments or restatements should be provided to you by your plan document provider. If any of the information listed here is missing you should contact your document vendor to discuss it.

- A copy of the latest document adopted by the employer
- Proof that all required amendments and restatements were timely adopted
- Proof that any discretionary amendments were timely adopted
- An IRS Opinion Letter for a prototype plan, an IRS Advisory Letter for a Volume Submitter plan or a Determination Letter for an individually drafted plan
- Up-to-date Summary Plan Description (SPD), and at least a Summary of Material Modifications (SMM) covering each amendment to the plan since the last restatement
- Written loan guidelines if the plan permits participant loans
- Trust agreement if it is a separate document

4. Is the plan meeting the IRS qualification requirements?

To determine if the plan is meeting the IRS qualification requirement the audit should cover at least these key areas:

- ADP/ACP Testing
  - Was the correct compensation data used?
  - Were the correct participants included?
  - Were Highly Compensated Employees (HCEs) properly identified?
- Top Heavy Testing
  - Were Key Employees properly identified?
  - Was the correct determination date used?
- Coverage Testing
  - Were excludable employees properly identified?
  - Were benefiting employees properly identified?
  - Were HCEs properly identified?
- Annual Limits (e.g., 401(k) annual deferral limit, annual catch-up contribution limit, 415 annual additions limit, compensation limit)
  - Were each of the annual limits for the year imposed?
- Distribution and loan procedures
  - Are the proper forms and notices being used?
  - Are any restrictions being monitored (e.g., number of loans/distributions permitted)?
  - Was spousal consent obtained if required?
  - Does the vesting schedule meet the minimum regulatory requirements of 100 percent after 3 years of service or 6 year graded at 20% per year starting in the 2nd year?
- Eligibility requirements
  - Covered participants must become eligible no later than age 21 and completing 1,000 hours of service in a 12 consecutive month period. Ensure your document and plan operation meets this requirement.

5. Is the plan operating in compliance with its provisions?

Some of the key provisions to audit are:

- Are the plan eligibility requirements for age, service and entry date being applied correctly?
- Are employer allocations and match contributions being determined in accordance with the plan formula and eligibility provisions?
- Were elective deferrals implemented in accordance with each participant's election (e.g., effective date and amount)?
- Were distributions and loans approved and paid in accordance with the plan provisions?
- Was required hardship withdrawal and participant loan documentation retained?
- Is vesting being calculated in accordance with the schedule in the plan?

6. Are plan assets being handled properly?

Some key areas to audit are:

- Determine if employee contributions have been timely remitted (i.e., as soon as they can reasonably be segregated from corporate assets but no later than the 15th business day of the following month OR if this is a plan with less than 100 lives, the plan may remit within 7 business days even if remittance could have been made sooner).
- Review the Form 5500 and related schedules to ensure all data is accurate, and be prepared to explain any items that may generate questions during an IRS audit (e.g., low participation, large losses, large administrative expenses, etc.).
- Ensure there is proof that the investments are held by a trust or in an insurance contract.
- Documentation of any expenses paid with plan assets.
- In a participant directed plan ensure that contributions were invested in accordance with participant selections.

7. Has all reporting been done in an accurate and timely manner?

Some key areas to audit are:

- Was Form 5500 completed accurately and timely?
- Was Form 1099-R provided accurately and timely for distributions?
- Was Form 945 filed to report withholding from participant distributions?
- Was Form 5310A timely filed as required for certain plan mergers and transfers?

8. Have tax related issues been handled properly?

Review the items listed below to determine if all requirements have been met consistently.

- Loans that are deemed to be distributions are taxed in the year of default
- 20% is withheld on all eligible rollover distributions
- Deduction limits on the employer's tax return are not exceeded

9. Have all required disclosures been timely provided to participants?

All defined contribution plans must provide participant account statements at least quarterly, upon request for a distribution generally the notice of Right to Defer and notice of rollover rights must be provided, the Summary Annual Report must be provided after the Form 5500 is completed and participants must receive an annual fee disclosure notice including plan-related and investment related information as well as a quarterly statement of any administrative fees actually charged to participant accounts in the prior quarter. In addition, if applicable the following notices must be distributed timely:

- For Safe Harbor ADP/ACP plans the initial annual participant notice
- For automatic enrollment plans the initial and annual participant notices
- For plans using a Qualified Default Investment Alternative the initial and annual notices
- For plans holding employer stock the one-time diversification notice
- Blackout notice if participants will be restricted from requesting distributions, loans or diversifying assets credited to their accounts for a period of more than three consecutive business days.

10. What should be done if an operational or qualification failure is discovered during the self-audit?

Generally, the failure should be corrected as soon as practicable after it is discovered. The IRS provides a program for correcting these failures called the Employee Plans Compliance Resolution System (EPCRS). EPCRS was designed to provide a means for employers to correct errors that are discovered during the normal course of operating the plan. The latest version of the program is described in IRS Revenue Procedure 2019-19 and is updated by the IRS periodically. To access it copy and paste the following link into your browser https://www.irs.gov/retirement-plans/expanded-self-correction-program-epcrs-rev-proc-2019-19. EPCRS includes three correction programs based on the type of failure to be corrected. If you discover a plan failure we suggest you contact your service provider and your plan attorney to discuss the correction options. A more detailed overview of EPCRS can be found on the Voya 401(k) InfoCenter web page (http://foremployers.voya.com/articles/401k-infocenter) under Plan Tips, Tools, and Calculators>Tools.

11. What is the best way to proceed when a plan is selected for an IRS audit?

The IRS will contact the employer to set a date for the audit and to advise the employer of the documents or other information they want to review. The IRS will want to conduct the audit in the place where the majority of plan records are kept and where the key plan representatives are located, which is usually the employer's office. Some tips for employers for preparing for the audit include:

- Determine who will be the key plan representative to work with the IRS auditor, before the audit date
- Adhere to the response times established between the IRS and the employer
- Gather the information requested by the IRS in advance of the audit date
- Be prepared to provide any related information the IRS may request after the initial review
- Cross check for consistency (e.g., does the participant count on the 5500 actually reflect the number of participants at the start of the plan year)
- Give the IRS copies of requested documents, not the originals
- Create an audit file to keep the original of each document provided to the IRS as well as copies of any correspondence, emails and documentation of telephone conversations
- Have appropriate service providers on call in the event they are needed to provide additional information or input (e.g., trustee, record keeper, accountant, attorney, etc.)
- If you are missing some information or know something is incorrect be forthright and tell the IRS representative about it
- Identify any known errors and show proof of correction
- Be prepared to provide information about related employers
- Be prepared to explain the terms of the plan, the plan operation and internal administrative processes