IRS and DOL Audit Issues for Retirement Plans: How Plan Sponsors Can Improve Internal Controls

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Today’s eLunch Presenters

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Top IRS Audit and DOL Audit Issues for Retirement Plans: Background

• You: Plan Sponsor, Plan Fiduciary, Plan Administrator
• Purpose: Identify top government audit risks for your plan
• Goal: You can focus your limited time on what really matters

• Background:
  • Every year 1,000’s of EB plan audits are conducted by:
    • The Internal Revenue Service (IRS)
    • Department of Labor (DOL)
  • Winston & Strawn’s experience – over many years
• Auditors’ focus:
  • Internal controls employers maintain for their employee benefit plans
Top IRS Audit and DOL Audit Issues for Retirement Plans: Background

Your Challenges

• Myriad IRS and DOL compliance requirements for retirement plans
• Employers need help:
  • prioritizing their efforts
  • establishing and maintaining essential internal controls
Top IRS Audit and DOL Audit Issues for Retirement Plans: Background

• How Did We Develop Our “High-Priority” List?

We:

• assembled IRS and DOL data requests in audit letters from recent years
• catalogued each request by:
  • topic
  • frequency of recurrence
• reviewed issues the agencies themselves have identified in
  • seminars
  • speeches
  • on their websites
• compiled the results
• created a “high priority” list employers should prioritize
General Comments

• Best Practices:
  • Documented practices and procedures that:
    • prevent errors
    • quickly flag errors before they result in large financial consequences
  • Evidence of:
    • actual checks and balances
    • specific and tangible internal controls
    • retention of records or proof that internal controls have been implemented (example – copies retained of required notices, proof of mailing)
General Comments

• Failures discovered on audit usually result in fines or excise taxes (such as on prohibited transactions)
  • In 2017, the DOL’s Employee Benefits Security Administration agency collected $1.1 billion from audits, voluntary fiduciary corrections, and complaint resolutions
  • Plan disqualification is remote, but possible in extreme cases
• Voluntary correction options are available but only before plan is subject to audit. Once plan administrator is notified of audit, voluntary correction is no longer an option.
Issue # 1 – Top DOL Audit Issue 2017-18

• Treatment of Missing Participants and Beneficiaries. Failure to track and locate terminated, vested participants and their beneficiaries.
  • Increased focus on procedures in place for follow-up when an employer faces challenges locating missing or unresponsive participants and beneficiaries
  • IRS issued recommendations, DOL for terminated plans, but more guidance is needed on active plans. DOL has indicated plans to issue more soon
  • Action Steps: Review procedures for locating participants. Make sure you or your TPA has a procedure, and is following it. Consider annual sweeps, working with a third-party search service, annual death sweeps. Document efforts to locate participants and maintain records to allow for reinstatement of benefits if the participant is later located. Dovetail small lump sum ($5,000) cashout procedure, uncashed checks, returned mail procedures with missing participants’ procedures.
Issue #2 - DOL and IRS Issue

**Minimum Required Distributions.** Failure to make age 70-1/2 minimum required distributions (“MRD”s) timely and properly.

- Correspondence to participants suggesting distributions be “requested” is NOT sufficient – checks must be distributed with no participant consent required
- After participant’s death, failure to properly and timely distribute to beneficiaries
- Proof that the employer searched for missing participants
- Make sure any 5% owners are tracked

**Action Steps:**

- Develop an age 70-1/2 MRD policy (or check your TPA’s policy – are they following it?)
- Identify all terminated employees age 70-1/2 or older, deceased participants
- Consider letters to active participants nearing ages 60, 65, 69
- Beef up language in SPD on need to take at 70-1/2
Issue #3 – Mainly IRS Issue

• **Definition of Compensation.** Failure to follow plan’s definition of eligible compensation.
  
  • The definition of compensation in retirement plans – many purposes, different definitions:
    • Critical for determining DC allocation or DB benefit
    • Testing (ADP/ACP; Top-heavy status)
    • Pay over 401(a)(17) limit ($275,000 in 2018)
    • 415 limits
  
  • IRS suggests **annual** self-audit of payroll codes, check-in with service providers
  
  • Problem for large corporation with numerous payrolls
  
  • Very easy issue to spot for IRS agents – “shooting fish in a barrel”
  
  • Are you **sure** you want to use W-2 definition? (e.g. stock option income)

• **Action Steps: Review payroll codes annually.**
  
  • **compare to plan document definition of eligible compensation**
  
  • **non-safe-harbor definition? Need to do annual/3-year testing of compensation**
Issue #4 – DOL and IRS issue

• **Loans.** Failures on plan loans
  • Failure to maintain a loan policy (your TPA should have one)
  • Failure to give complete loan paperwork to participants, including:
    • loan agreement
    • promissory note
  • Failure to obtain required documentation from participants (e.g., proof of need for longer residential purchase loan – records must be kept for entire period loan is outstanding – up to 15 years)
  • Failure to properly administer loans for employees on leave, including military leave.
  • Failure to timely default unpaid loans
• **Action Steps:**
  • *Review loan policy*
  • *Maintain file of loan applications until expiration of loan term*
  • *Review loan paperwork for representative sampling of employees with loans, including defaulted loans*
Issue #5 – Top DOL Audit Issue 2014-16

- **Late Payroll Deposits.** Late deposit of participant contributions to 401(k)/defined contribution plans.
  - DOL will look at all your payrolls, when contributions were made, what was the fastest you were able to get contributions to the trust, then use that as your maximum deadline
  - DOL has informally indicated that it thinks 3 (or 4) days should be the maximum, despite 7-day safe harbor for small plans (fewer than 100 participants). Often the maximum is as low as 1-2 days.

- **Action Steps:**
  - *Review your payroll records and determine when is a reasonable time to make contributions to the trust, particularly when changes are made to payroll systems or providers*
  - *Work with payroll and your recordkeeper to make sure that those deposits are made within that timeframe*
Issue #6 – DOL Issue

• **ERISA fidelity bond.** Missing or inadequate ERISA fidelity/fiduciary bond/fiduciary insurance policy:
  - Failure to keep copy of certificate
  - Failure to comply with ERISA bonding requirements – ERISA bond must:
    - contain no deductible
    - name plan as insured
    - be in an amount equal to a minimum of 10% funds in the plan (with a maximum of $500,000, or $1 million if plan contains employer securities)
    - include a discovery period of at least one year after the termination or cancellation of the bond
    - cover all individuals who handle plan assets
  - **Action Steps:**
    - *Make sure you have a copy of your ERISA fidelity bond and fiduciary insurance policy*
    - *Review policy to ensure compliance with ERISA/DOL requirements*
Issue #7 – DOL and IRS Issue

• **Employee Eligibility.** Failure to follow plan's eligibility or enrollment rules.
  • Improper exclusion of part-time employees or a merged-in group of employees
  • Failure to adhere to service crediting rules (hours, elapsed time)
  • Rehire failures – failure to re-enroll rehired participants without delay
  • Auto enrollment failures:
    • Failure to automatically enroll timely
    • Failure to provide automatic enrollment notice
  • Failure to provide complete enrollment package materials – examples should be retained for demonstration of compliance on audit
  • Controlled group employee errors (for example, standardized prototype plans may cover ALL employees of all controlled group members – is that too broad?)

• **Action Steps:**
  • *Periodically pull representative sample of employees (new hires, transfers, rehires, part-time) and review eligibility procedures*
  • *Maintain file of enrollment packets*
Issue #8 – DOL and IRS Issue

• **Vesting.** Vesting errors:
  • Failure to provide for 100% vesting at normal retirement age
  • Failure to properly account for vesting for employees with breaks in service, inter-company transfers, acquisitions
  • Failure to calculate and vest employees affected by partial terminations
  • Failure to timely sweep forfeitures from terminated participant accounts

• **Action Steps:**
  • Pull representative sample of employees, especially those with breaks-in-service, inter-company transfers, or acquired employees, and review that vesting was calculated appropriately
  • Review plan document rules on when forfeitures are removed from participant accounts or accrued benefits
Issue #9 – Mainly IRS Issue

• **In-Service Distributions.** Failure to follow plan’s in-service distribution rules.
  • Distributions made for impermissible reasons under the plan, or made too early
  • Failure to follow hardship withdrawal procedures, e.g.:
    • 6-month suspension of future deferrals (changing 1/1/19)
    • failure to look for signs that hardship procedures are being abused, e.g.:
      • too many requests from 1 group or division
      • requests from multiple employees that look identical
      • only highly compensated employees are taking withdrawals
  • Failure to permit “special” in-service distributions as a result of protected benefit from a merged-in plan
• **Action Steps:**
  • **Pull representative sample of employees receiving in-service distributions or hardship withdrawals**
  • **Review reason for withdrawal**
  • **Check transferred employees – coded on payroll as “terminated”?**
Issue #10 – Mainly IRS

• **Distribution Paperwork.** Failure to provide correct distribution paperwork to employees.
  • Failure to provide correct options (installments, annuities, lump sums) in paperwork
  • Spousal consents – some plans require spouses to consent to ALL distributions. Does your paperwork match your plan rules?
  • Cashing out $1,001-$5,000 lump sums without participant consent but failing to roll over to auto-rollover IRA:
    • Failure to negotiate and keep appropriate contract paperwork with auto-rollover IRA vendor (specific DOL fiduciary guidelines on contracting with auto rollover vendors)
    • Failure to make timely *de minimis* cashout sweeps

• **Action Steps:**
  • Review distribution paperwork and compare to plan document rules
  • Pull representative sample of employees receiving small lump sum cash-outs and check for proper consent, or auto-rollover to IRA
  • Review frequency of cash-out sweeps and compare to plan document rules
Issue #11 – DOL Issue

• **Blackout Notices.** Failure to provide blackout notices for individual account plan participants undergoing investment fund change for participant directed individual account plans.

• **Action Steps:**
  - Monitor all investment fund changes and ensure that blackout notices, if required, are properly provided and contain the proper information for participants
  - Keep copies of notices provided to participants
Issue #12 – IRS Issue

• **Updating the Plan Document.** Failure to amend plan document for tax law changes.
  • IRS suggests annual review of plan document
  • "Discretionary" amendments must be adopted by end of plan year in which audit is effective. “Interim” amendments may be adopted by employer’s due date for filing tax return (including extensions), if later
  • Prototype or other preapproved plan? Keep signed copies and sign and date all amendments
  • Merged-in plan? Be sure to amend to update before merger to avoid tainting surviving plan
  • Be sure that plan document and SPD match. If plan is amended, don’t forget to update the SPD

• **Action Steps:**
  • Review plan amendments and SPDs with your legal advisors
  • Maintain copies of all legal plan amendments, particularly for merged-in plans
Issue #13 – DOL Issue

- **Investment Policy.** Failure to adopt or adhere to Investment Policy/Guidelines
  
  - **Action Steps:**
    
    - Review your plan’s Investment Policy annually with your investment advisors and plan committee members
    
    - Always refer to the Investment Policy when discussing any changes to plan investments
    
    - Keep records in Committee minutes
Issue #14 – DOL Issue

• Committee Minutes
  • Failure to keep minutes of plan committee meetings
  • Incomplete minutes that raise additional questions that are not answered in those minutes or following meeting’s minutes

• Action Steps:
  • Keep regular minutes of all plan administration or investment committee meetings
  • Retain in permanent files
  • Review minutes to avoid unanswered questions, conflicts of interest, etc.
  • Review prior meeting’s minutes before each meeting to make sure any tasks documented in prior minutes are completed or addressed
Issue #15 – IRS Issue

• ADP/ACP Test
  • Failure to pass ADP/ACP test in 401(k)/(m) plan
    • Often due to incorrect compensation or ineligible employees
  • Failure to provide required ADP/ACP safe harbor notice

• Action Steps:
  • Review with plan administrator to ensure that testing has been timely done
  • Plan passes
  • Correct compensation and employee population was used in testing (easy for IRS auditor to find errors)
Issue #16 – IRS Issue

• Top-Heavy Testing.
  • Failure to test or provide top-heavy benefit under 416, if applicable
  • Typically more of a problem for smaller plan populations with preponderance of long-service, highly compensated participants
  • However unlikely it may be that the plan will not pass top-heavy testing, nevertheless all plans are required to demonstrate passing

• Action Steps:
  • Review with plan administrator to ensure that testing has been timely done and passed
Issue #17 – IRS Issue

• 410(b) Testing
  • Failure to perform 410(b) testing (benefiting 70% of non-highly compensated employees)
  • Especially problematic for:
    • Partially-frozen plan
    • Multiple plans in single controlled group

• Action Steps:
  • Review with plan administrator or legal counsel to ensure that testing has been timely done and passed
Issue #17 – IRS Issue

• **QDROs.** Failure to maintain or adhere to QDRO procedures
  
  • **Action Steps:**
    
    • Review with plan administrator or legal counsel to ensure that QDRO procedures are maintained and are being followed
    
    • Give all parties copy of plan’s QDRO procedures (including attorneys)
    
    • **Joinder in California**
    
    • Develop “model” QDRO for plan – much easier
Issue #18 – IRS and DOL Issue

• Suspension of Benefits
  • Failure to follow suspension of benefits (SOB) rules in defined benefit pension plans upon attainment of normal retirement age
  • Failure to give SOB notice to post-normal retirement age active employees
  • Failure to appropriately calculate actuarial increases (post-NRA different from post-age 70-1/2)

• Action Steps:
  • Identify all active employees who are close to retirement age and ensure that SOB letters were sent
  • Check with plan’s actuaries to ensure appropriate actuarial increases are made for all participants regardless of SOB letters
Issue #19 – DOL Issue

• **Float.** Failure to review “float” received by trustee or custodian (see DOL guidance 2002-3).
  - Float must be transparent in TPA agreement:
    - must be considered when weighing alternatives
    - should be compared to other service providers
    - must be reasonable
  - **Action Steps:**
    - Review all new or updated agreements with trustee or custodian to make sure compensation, including float) is spelled out and understood
    - Consult legal counsel for complete review
Issue #20 – DOL Issue

• Consultants and Investment Managers
  • Failure to adhere to DOL recommendations regarding hiring plan consultants or investment managers:
    • Does the consultant/advisor have a conflict of interest?
      • does advisor get bonus based on business placed with particular firm?
      • does advisor have preferred vendors because they get additional compensation?
      • does advisor have a policy on receiving gifts from vendors doing business with?
  • Fiduciary
    • is the advisor a fiduciary? If so, must say in writing. ERISA 3(21) or 3(38) advisor?
    • adequate insurance coverage
    • fees reasonable
    • shop every 3-5 years

• Action Steps:
  • Review agreements with plan consultants and investment advisors to ensure they contain appropriate disclosures
Issue #21 – DOL Issue

• Target Date Funds

• DOL issued guidance (February 2013) for plan sponsors on reviewing their plan’s Target Date Funds. DOL indicated that:
  • Fiduciaries must engage in a process to obtain information to evaluate their TDF
  • Fiduciaries must understand the differences among TDFs
  • Fiduciaries must document their selection and review process and how they reached their decisions on the TDF selected

• Action Steps:
  • Prepare (or have counsel/advisors prepare) TDF checklist
  • Periodically review TDF checklists, document review in Committee minutes
  • Make sure all Committee members understand the “glidepath” of your TDF
Issue #22 – DOL Issue

• Revenue Sharing/12b-1 fees
  • Are there extra funds in your plan’s “ERISA account”? What are you doing with those extra funds?
  • In 2013 DOL released Advisory Opinion 2013-03A regarding whether revenue sharing payments constitute “plan assets” under ERISA.

• Action Steps:
  • Review of your revenue sharing arrangement
  • Make sure you structure revenue sharing arrangement appropriately
  • Make sure you use revenue sharing funds properly
  • Consider alternatives to revenue sharing
  • If a fund has significant revenue sharing, good idea to document other reasons why it is a good fund (great returns, etc.)
Top IRS Audit and DOL Audit Issues for Retirement Plans – Cont’d

• In summary, we have found the 22 issues we’ve discussed today to be the most significant issues employers should focus on to ensure they have proper internal controls over administration of their retirement plans.
  • Based on our review of recent IRS and DOL audits
  • Based on issues employers can and should prioritize

• If you need assistance with these issues, Winston attorneys have broad experience in conducting self-audits, both comprehensive and targeted (e.g., focused on only a select number of issues)

• QUESTIONS?
Thank You.

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