

# HOW TO SURVIVE AN IRS EMPLOYEE BENEFIT PLAN AUDIT

Thompson & Knight

ATTORNEYS AND COUNSELORS



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**Fort Worth Chapter**

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# HOW DOES THE AUDIT PROCESS BEGIN?

- **The audit process typically begins when the IRS sends a letter to the plan sponsor advising the sponsor of the plan that is being reviewed.**
- **The letter will advise the sponsor that the IRS will visit the company on a certain date to review plan documentation.**
- **The letter will typically request a multitude of documents and provide a date by which to respond.**

# **WHEN SHOULD YOU CONTACT LEGAL COUNSEL? – RIGHT AWAY!**

- **Can negotiate an extension of the response time**
- **Can assist in assembling documentation**
- **Will review documentation for red flags**
- **Unlike communications with a broker or an accountant, communications with legal counsel have the benefit of attorney-client privilege**

# TYPES OF IRS AUDITS

- **Full Scope Examination**
- **Focused Examination**
- **Office/Correspondence Examination (OCEP)**
- **EP Team Audit (EPTA) Program**

# HOW IS A PLAN SELECTED FOR AN IRS AUDIT?

- **Form 5500**
- **Referrals from other government agencies**
- **Withdrawn VCP requests**
- **Information from the media**
- **Form 5330**
- **Form 5310**
- **LESE – Learn, Educate, Self Correct, and Enforce**
- **Emerging issues**

# PREPARING FOR THE AUDIT

- **Determine who will interface with the examiner**
- **Determine where the examiner will be located in your office**
- **Organize documentation**

# TYPICAL AUDIT PROCESS

- **Initial interview**
- **Information review**
- **Request for additional information**
- **Closing interview**
- **Review process**
- **Closing letter**
- **Appeal rights**

# REVIEW OF INTERNAL CONTROLS

- The initial interview will often ask questions about the plan sponsor's internal controls.
- Internal controls are the methods that the employer has in place to minimize the risk of mistakes in plan administration.
- The IRS website provides sample internal control questions that EP Agents could ask during their interview and examination: [http://www.irs.gov/Retirement-Plans/EP-Team-Audit-\(EPTA\)-Program---Internal-Control-Questionnaire](http://www.irs.gov/Retirement-Plans/EP-Team-Audit-(EPTA)-Program---Internal-Control-Questionnaire)
- If the IRS agents find that the plan sponsor has checks and balances that are likely to prevent errors and catch errors, the IRS will consider limiting the focus of the audit.



# COMMON DOCUMENT REQUESTS

- **Plan and trust documents**
- **Summary plan description**
- **Determination/opinion letter**
- **Employee census**
- **Form 5500**
- **Safe harbor notices**
- **Committee minutes**
- **Testing results**
- **Business tax returns**
- **Controlled group / ownership information**
- **Payroll data**
- **Fidelity bond**
- **Asset statements**
- **Plan loan information**
- **Distribution information**

# COMMON AREAS OF REVIEW

- Eligibility, participation & coverage
- Vesting
- Discrimination
- Top heavy requirements
- Funding and deductions
- Distributions
- Contribution and benefit limitations
- Funding and deductions
- Controlled group
- Trust activities
- Returns and reports
- Plan and trust documents

# COMMON ISSUES WITH PLAN DOCUMENTS

- **Plan documents incomplete or not on site**
  - **Often an issue with prototype plans when the prototype providers have only provided the “adoption agreement”**
  - **In connection with a corporate transaction, complete copies of plan documents not provided in due diligence and cannot be located afterwards**
- **Plan documents not properly amended for applicable law**
- **Best practice is for official plan documents to be retained for the life of a plan, so that the plan sponsor has a record of the terms of the plan from its inception**

# COMMON OPERATIONAL ERRORS

- **Failure to follow plan document's definition of compensation in administering the plan**
- **Excluding eligible employees from participation**
- **Inclusion of ineligible employees**
- **Failure to follow terms of plan document and loan policy in administering loans**
- **Improper hardship distributions**
- **Improper in-service withdrawals**
- **Failure to make required minimum distributions**

# RESOLVING QUALIFICATION ISSUES

- **What are the consequences of failure to resolve issues?**
- **Typically, IRS will propose alternatives to preserve tax qualification of the Plan. The general rule is that plan participants must be put in the same position they would have been in if no error had occurred. All years involved must be corrected.**
- **EP Compliance Resolution System (“EPCRS”)**
  - **Self-Correction Program (“SCP”)**
  - **Audit Closing Agreement Program (“Audit CAP”)**

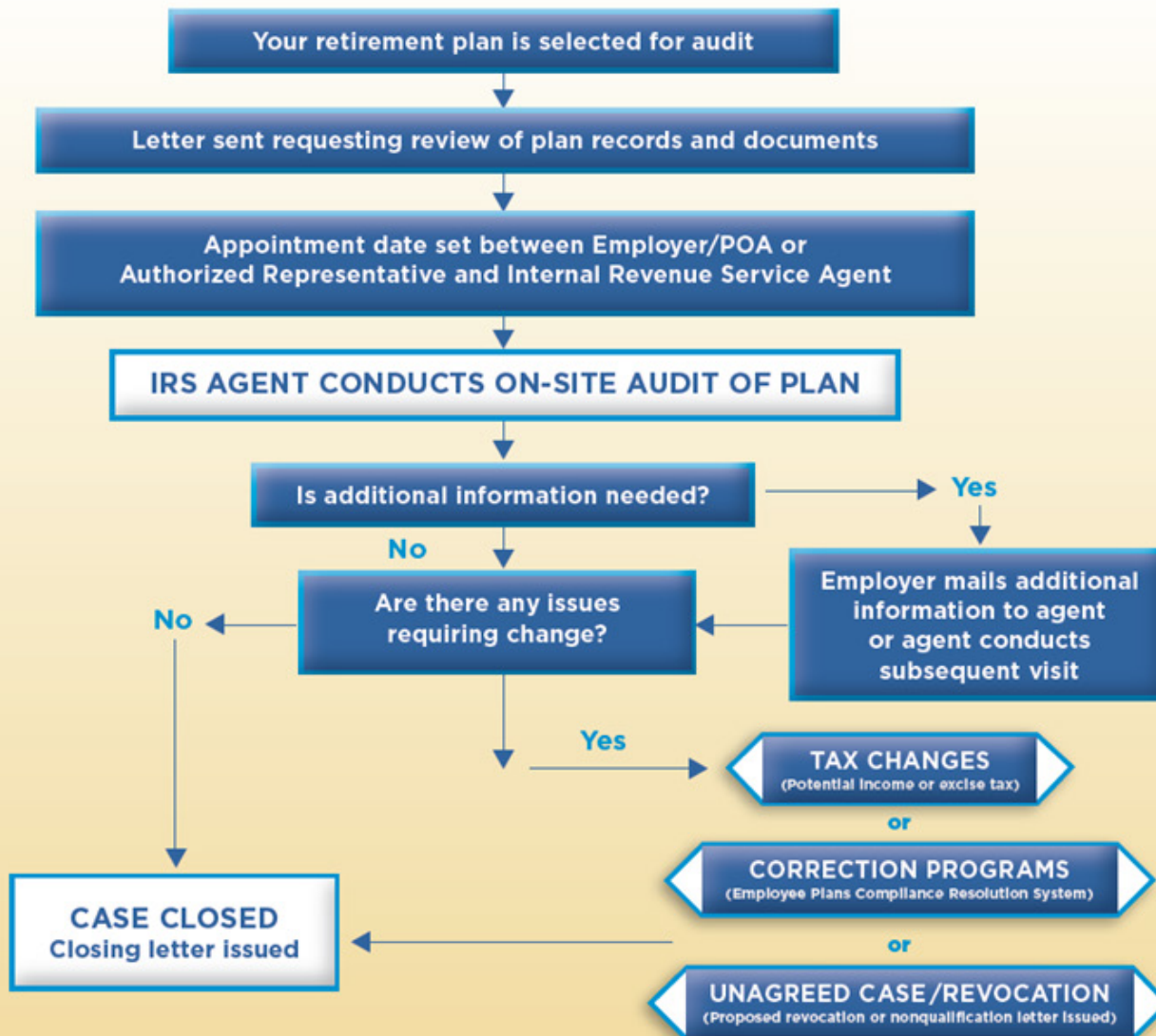
# BEST PRACTICES TO MINIMIZE AUDIT RISK

- **Emphasize internal controls**
- **Self audit**
- **Engage employee benefit counsel to assist you in keeping plan in legal compliance and in correcting errors in a timely manner**

# OTHER TYPES OF AUDITS

- **Department of Labor audits**
- **PBGC audits**
- **Nonqualified deferred compensation plans**

# Employee Plan Examination Process





# THANK YOU



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