



Legal Alert: IRS Employee Plans Team Audits

10/30/2009

The Internal Revenue Service (IRS) maintains a program known as the Employee Plans Team Audit (EPTA) program, under which random audits are used to discover, and remedy, common plan problems and mistakes, and to assist retirement plan sponsors and administrators in identifying those issues. Recently, the IRS updated its list of "common plan mistakes" that have been found during EPTA audits, as well as a sample of a questionnaire used by EPTA auditors to test the system of internal controls utilized by a plan. The EPTA Program is designed to deal with large retirement plans, i.e., those covering at least 2,500 participants, but having an insight into the EPTA procedures enables administrators of plans of all sizes to avoid most common errors in plan administration. The EPTA materials can also be utilized to develop and conduct self-audits and to correct any mistakes thereby identified.

The IRS has offered tips on how to identify – and avoid – the mistakes that are most frequently found by EPTA auditors.

Common Errors

Probably the most common problem that is identified by EPTA audits is a failure to adopt timely amendments in order to comply with changes in the law. These failures can result in significant penalties, up to and including plan disqualification, if they are discovered during an audit. In order to avoid such a document failure, the IRS recommends an annual review of all plan documents.

Some commonly-found errors that occur with respect to all plan types include:

- Failure to follow the plan's terms regarding such matters as plan eligibility, definitions of compensation, vesting requirements, and contribution and benefit limitations;
- Failure to make required minimum distributions to individuals for whom they apply (i.e., participants over age 70-1/2, and certain beneficiaries);
- Failure to properly process distributions and file proper information returns;
- Generally failing to maintain adequate records and systems of internal controls.

Specifically in 401(k) plans, the IRS has discovered frequent failures to:

- follow the plan's automatic enrollment procedures;
- remedy ADP and ACP test failures (nondiscrimination testing); and
- correctly compute employer matching contributions.

In the case of defined benefit pension plans, the most common mistakes included using inaccurate participant demographic data in computing benefits, distributing benefits at the wrong times, and failing to follow the rules governing suspension of benefits.

Internal Controls Questionnaire and Document List

The IRS provided questions that could be used to make sure that a plan administrator's procedures and internal controls are adequate. The questions were grouped in four general categories, each one directed at a particular area affecting plan compliance: payroll issues; human resources administration; plan administration and plan operational failures.

- **Payroll issues:** The primary issue is the accurate transmission of employee payroll data to the appropriate plan recordkeeper. Other issues are: proper handling of "nonstandard" payroll items (such as bonuses and non-cash items), methods of correcting payroll errors, communicating the results of a correction to the plan administrator and maintaining a record of the correction.

- **Human resources administration:** Coordination of employees' hirings and terminations with plan administrator; proper handling of transferred, rehired and leased employees; and making sure that new hires in HR or Benefits are up-to-speed concerning plan practices and procedures so that they might properly communicate those practices and procedures to other employees.

- **Plan administration:** Allocation of responsibilities, and communications, between the employer and the plan's recordkeeper or other service providers; determining who is responsible for ensuring timely amendment of the plan; ensuring that the custodian of trust assets maintains trust data, communicates that data to the plan's trustee and deals with errors; and the plan's procedures for identifying and disclosing certain reportable transactions and events.

- **Plan operational failures:** Determining how plan personnel can identify operational failures; properly correcting failures; implementing new procedures so that failures do not recur. (These issues are among those that are taken into account in assessing penalties for operational failures.)

The IRS also provided a comprehensive listing of documents that will normally need to be made available in an EPTA audit, for defined contribution plans, defined benefit plans, and both. The particular documents that are requested, however, will depend upon the particular issues that are being reviewed.

The Bottom Line:

This information should not only alert plan sponsors as to what to expect in the event of an EPTA audit, but also can serve as guidelines for checking plan compliance and internal control procedures. Plan sponsors should conduct periodic self-audits, perhaps as frequently as annually, so that any

plan errors may be discovered and may be self-corrected pursuant to IRS correction procedures, without requiring IRS approval. Ford & Harrison's Employee Benefits Group can assist you in performing a self-audit, or in taking any action that may be indicated as a result thereof.

If you have any questions regarding this Alert, you can contact the author, Jeffrey Ashendorf, at 212-453-5926, jashendorf@fordharrison.com, or any other member of Ford & Harrison's Employee Benefits practice group.