Benefit Insights

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A non-technical review of qualified retirement plan legislative and administrative issues **October 2012**

How to Survive a Visit from the IRS or DOL

There are few things that will give a person that sinking feeling in the pit of their stomach like opening the mailbox and seeing an envelope with the words "Internal Revenue Service" (or Department of Labor) in the return address. It is similar to seeing that police car as you drive down the highway; you might not even be speeding, but you immediately slow down and wonder how you will look in stripes.

The IRS and DOL both have jurisdiction over qualified retirement plans, and between the two agencies, they generally audit more than 20,000 plans each year. And, if recent speeches and articles are any indication, both agencies will be visiting even more plan sponsors in the months ahead.

While no article is likely to take away that initial panic, there are certain steps you can take to make sure the reality of a visit from your friendly neighborhood auditor is not nearly as bad as the anticipation. In fact, with the right preparation, an IRS or DOL audit of your retirement plan can be a non-event.

What Are They Looking for, Anyway?

When facing an audit, it is common to wonder what the Feds are hoping to find. The answer depends on which Feds are doing the auditing.

Department of Labor

Among other things, the DOL is charged with the enforcement of ERISA, which includes all of the rules requiring plan fiduciaries to act prudently and in the best interest of participants and beneficiaries. It is no coincidence, then, that in conducting audits, the DOL's primary focus is to ensure that participants and beneficiaries are receiving all the benefits to which they are entitled and that fiduciaries are not jeopardizing the plan's ability to provide those benefits. Specific areas of review might include verifying the plan has an investment policy statement (and that it is being followed) and confirming that employee salary deferrals and loan payments are deposited on a timely basis.

Internal Revenue Service

Believe it or not, the division of the IRS that is responsible for qualified retirement plans is one of the few divisions not charged with raising revenue. That means they do not set out to find reasons to penalize plan sponsors. Quite the contrary. Their goal is to preserve the tax benefits associated with retirement plans by making sure sponsors are operating their plans in accordance with regulations, plan documents, etc. Essentially, the IRS understands that retirement plans represent significant tax benefits to sponsors and participants, and they want to be sure that those claiming the tax benefits are playing by the rules.

Why Me?

It is a common misconception that if the government comes knocking, there was a complaint, evidence of wrong-doing or something else that must have initiated the visit. While both IRS and DOL take participant complaints very seriously and sometimes do initiate investigations because of them, many plan audits are semi-random in nature.

The selection process is not quite as random as putting a bunch of Forms 5500 in a spinning barrel and pulling out the winning entries; rather, the agencies identify certain issues or characteristics and then query the Form 5500 database to find plans that fit those criteria. Then, they randomly sample that population to determine which plans they will audit.

As an example, several years ago, the IRS was concerned about plan investments in real estate, so they were able to narrow their focus to the affected plans by reviewing Form 5500 data.

The DOL has an ongoing, national enforcement project related to the timely deposit of employee contributions. One way they may target plans is to review Form 5500 to determine if receivables related to salary deferrals are disproportionately high based on the total employee contributions for the year.

What Should You Do When You Receive an Audit Notice?

This next statement might win the obvious award, but if you are the proud recipient of an audit notice, do not ignore it. The notices generally include a proposed schedule for the audit as well as a laundry list of document requests and the contact information for the examiner. Auditors are generally pretty reasonable people who understand scheduling challenges. If you have a conflict or do not believe you can gather all of the requested information in time, they are usually willing to reschedule within reason as long as they have some lead-time.

However, before you contact the auditor, your first call should be to the provider who assists you with plan compliance matters such as your TPA. If you have worked with that service provider for a few years, they probably have much of the information the auditor requests. Given the volume of documents involved, the TPA will likely need some time to compile all of the information, and they will welcome as much advance notice as you can provide.

At that point, it is also useful to work with your providers to conduct a pre-audit. This process involves reviewing plan records and operations for the years the auditor will be examining. Retirement plans are complex beasts, and despite best efforts, mistakes do happen. To the extent you are able to identify mistakes and take corrective action before the audit begins, the more likely you are to minimize any penalties that might otherwise be assessed. Certain types of mistakes can be completely self-corrected even when a plan is under examination.

What Should You Do on the Big Day?

It is common for auditors to want to stop by your place of business as part of their examination. Sometimes, they simply want to confirm that there aren't hundreds of employees working on your factory floor despite the fact that your Form 5500 says you only have 20 participants. Other times, they will conduct a significant portion of their document review over several days in your office. Either way, it is advisable to coordinate the length of the visit in advance.

Be Organized

One of the most important things you can do to expedite the review process is to have all of the requested documents neatly organized. Often times, the document request lists items in the same or similar order that the auditor will review them. Consider using sticky notes, labels or tabs to arrange everything in that same order to facilitate a more streamlined review. In short, make it easy for the auditor to find the requested information quickly so that he or she can move on to the next item on the list.

Be Helpful

While the rule of thumb is not to provide extraneous information that has not been requested, it is important to be cooperative and helpful. For example, if the auditor asks to see information about a specific participant, try to identify the exact page rather than handing the auditor a 300-page report and wishing him or her good luck.

Be Judicious

While it is certainly advisable to extend some common courtesy, keep in mind that an auditor is still an auditor with an obligation to take action if he or she identifies errors. As a result, it is a good idea to exercise discretion in determining the internal personnel that work with the auditor. An accounting clerk who is not familiar with rules related to 401(k) plans may not think it is a big deal to mention a payroll error that caused several late deferral deposits, but an auditor will certainly think it is.

Be Confident…but Respectful

The IRS and DOL agents that audit plans have varying degrees of experience and knowledge. Not every agent is going to be well-versed in the myriad rules and regulations that govern retirement plans. There are instances in which an auditor may challenge something that is perfectly legitimate.

Consider this example. There was an agent reviewing a 401(k) plan that used the so-called otherwise excludable rule to disregard certain short-service employees from its nondiscrimination testing. The auditor was not familiar with that rule and challenged the test results even though they were correct. In that circumstance, it was necessary to confidently point the agent to the Code section that authorized the testing method; however, it was equally necessary to do it in a helpful, non-confrontational manner rather than disparaging his or her lack of knowledge of that rule.

Be Willing to Ask for Help

Anyone who does not have experience working with an auditor should think twice about representing him or herself. Not only is it prudent to seek counsel from plan service providers before the audit, it is wise to seek their assistance throughout the audit.

What Can You Do before You Get an Audit Notice?

As the saying goes, an ounce of prevention is worth a pound of cure, and that is especially true with retirement plan maintenance. Conducting self-audits at regular intervals can highlight oversights or procedures that may need to be updated and allows you to address your findings without the pressure of an upcoming audit.

The IRS and DOL publish information about their enforcement initiatives on their websites:

www.irs.gov/Retirement-Plans/Examinations-and-Enforcement-1
www.dol.gov/ebsa/erisa_enforcement.html

The websites also include a wealth of information about steps you can take to identify and correct mistakes before the government comes knocking. Resources include plan compliance checklists that focus on the most common compliance errors.

Both agencies also maintain in-depth voluntary correction programs.

The IRS has recently highlighted the importance of internal controls and has started reviewing them as part of their examination process. In a nutshell, internal controls are processes and procedures put in place to make sure errors do not occur in the first place.

If there is a checklist showing that during that last payroll conversion, someone matched codes on the payroll system to the plan document's definition of compensation, there is a higher likelihood that the correct compensation was used to calculate that matching contribution. With that solid internal control identified, there is less of a need to spend time reviewing each compensation record on a participant-by-participant basis.

Conclusion

Audits are never fun. They require time and resources and no matter how diligent your compliance efforts, leave you sitting on pins and needles. However, retirement plan audits do not have to cause weeping and gnashing of teeth.

With some professional advice from your service providers and some organization, cooperation and courtesy in dealing with the agent, the audit can be like a routine teeth cleaning rather than a root canal.

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