What 401(k) Plan Sponsors Should Do When They're Selected For An Audit

By Ary Rosenbaum, Esq.

When I started my own law practice almost 10 years ago, I was very frank in my comments on LinkedIn about the need for plan sponsors to understand their fiduciary responsibility and keep their 401(k) plans in order to minimize their fiduciary liability. This consultant to brokers who had a penchant for getting into squabbles in the discussions in LinkedIn groups accused me of several other forward-thinking 401(k) experts that we were selling fear. This consultant claimed that small to medium-sized plans never got sued and I retorted that litigation is the least of a 401(k) plan sponsor's worries, that the greater fear was an audit from the Internal Revenue Service (IRS) and/or the Department of Labor (DOL). Based on some audits I've gone through, I'd prefer litigation. This article is a wakeup call for 401(k) plan sponsors that their biggest worry concerning their fiduciary responsibility is an audit from the IRS and/or the DOL.

Why do plans get audited?

The reason why the IRS and DOL conduct audits is to ensure that plan sponsors voluntarily comply with the law and regulations that govern retirement plans. One of their ways to make sure that plan sponsors are on their best behavior is through the audit process. Lots of errors in administration and lots of plan sponsor abuses have been detected through a government audit. Hundreds of millions in fines and recovery of participant assets have been procured through DOL audits, so they also happen to be a big revenue producer for the government, which also includes IRS penalties. The problem with what I call the audit game is that most audits are random, which again, is the best tool for the IRS and DOL to ensure compliance. Sometimes, audits are targeted because of errors detected by Form 5500. For example, a 401(k) plan that reports on their Form 5500 that they don't have a required ERISA bond or that they made late deferral deposits are likelier to hear from the government about an audit than those that don't have such problems. Another reason for audits (it happens on the DOL side) is because of a participant complaint. I've had to handle these types of audits because participants may complain to the DOL that they might not have received the benefit they were entitled or if the plan sponsor is unresponsive. So while there are many reasons for an audit and a plan sponsor can certainly avoid being a red flag for them by avoiding issues that might require that unfortunate response on Form 5500 as well as properly handling participants requests. However, no matter what, a plan sponsor can't change the audits that are just random.

What to do when a plan sponsor gets an audit request

Plan audit requests from the IRS or the DOL will be sent through the mail. The audit request (really an order) advises the plan sponsor on what information they need, as well as the year or years being audited. Plan sponsors usually don't have to worry about something that happened 20 years ago because there is a statute of limitations on auditing Form 5500, which is three years from the due date (including extensions). After reviewing what materials that the IRS or DOL are requesting as part of the audit, I think the first thing a 401(k) plan sponsor should do is contact an ERISA attorney. Sure, I am one (and I don't play one on TV), but I think 401(k) plan sponsors come up with this crazy idea that they can handle an audit on their own and they simply can't. Too many plan sponsors think they can handle an audit on their own, I re-

member one 401(k) plan sponsor who didn't want my services because they didn't want the audit to be an "adversarial" process. By its nature, an audit is an adversarial process in the sense that the job of a government auditor if to check everything that a plan sponsor does. The biggest reason that a 401(k) plan sponsor shouldn't handle a plan audit alone is that they are the most ill-equipped in dealing with their 401(k) plan because they don't have the background for it. In addition, unlike attorneys, plan sponsors usually cause trouble for themselves by giving answers that are more expansive than the questions asked, i.e, they volunteer information that they shouldn't be volunteering. While many 401(k) plan sponsors often rely on their third party administrator (TPA) to help represent themselves in an audit, I think that's a mistake because based on what an auditor may find, the TPA and the 401(k) plan sponsor may have adversarial interests especially if compliance errors committed by the TPA are discovered on the government audit. I know company excluded, ERISA attorneys can cost a lot of shekels, but I think the value in hiring one outweighs the costs because they have the background to properly represent a 401(k) plan sponsor in an audit.

Finding the errors before the government does

The problem with compliance errors is that they're usually only detected in two scenarios: there is a change of TPA or there is an IRS/DOL audit. The problem with errors detected on a plan audit is that the plan sponsor can't use a voluntary compliance program to fix these errors. Any errors detected by the IRS or DOL could result in substantial penalties. I hate surprises, that's why I knew what gender my children would be and I would recommend that a 401(k) plan sponsor go through a plan review before the audit so there will be no surprises. It makes sense to hire an independent reviewer because a TPA isn't likely to discover one of their previous errors. Errors detected before the audit can be corrected and they can be corrected cheaper if the error can be fixed through the self-correction process. A plan sponsor is in a better position of strength if they identify their errors and try to correct them before the government does.

Identify the areas where the IRS and/or DOL may target

When dealing with plan audits, the IRS and DOL have a blueprint on what areas they will review as part of their audit. The IRS actually has audit technical guides online so their agents could identify the areas that they need to focus on. In addition, the DOL does announce areas that they will focus on. For the IRS, they are looking at the nuts and bolts of plan administration because their area of concern is qualification of the 401(k) plan under the Internal Revenue Code. So, the IRS agent is going to look at compliance testing, they are going to focus on eligibility, and they're going to look at vesting. The IRS will also look at plan loans and make sure that repayments are made timely. They're going to look at distributions and they're also going to pay attention to the plan document to make sure it's up to date an actually being followed. These are just some of the areas that the IRS will focus on. The DOL audits will always have a different spin because their concern isn't about plan qualification, their concern is about participant rights. Right now, the biggest focus for the DOL for the past few years have been the late deposit of salary deferrals. The DOL wants salary deferrals to be deposited as soon as possible, essentially before the next payroll, as quickly as 3 days for most plan sponsors. The DOL is also now interested in the fiduciary process such as whether the plan sponsor has an investment policy statement and wanting to identify how plan providers were selected. Another new area of concern for the DOL is missing participants and how they are handled especially in terms of locating them as well as the processes in place to deal with their account balances. If a 401(k) plan sponsor uses an automatic rollover provider, the DOL is going to be concerned about the fees as well as how that rollover provider was selected. Since the DOL is concerned about participant rights, a certain focus will be on all required notices and disclosures that have to be provided to plan participants. Don't be surprised now if the DOL starts asking about proprietary funds that a plan sponsor may be using that are managed by their plan provider. Whether it's an IRS or DOL audit, I think it;'s extremely important to identify potential areas of concern because things that come to those who wait were left there by those who came there first. Better to know what the auditor might be focusing on so that errors and issues can be resolved on the plan sponsor's clock, rather than the auditor's clock.

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