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The Importance of Good Internal Controls

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Retirement Plan Resources

- Retirement Plans Website – www.irs.gov/retirement
- Newsletters – from the Retirement Plans website, select “Newsletters” in the left-hand navigation bar, choose “subscribe” and then select “Retirement News for Employers,” our newsletter for employers sponsoring retirement plans and “Employee Plans News,” our newsletter for retirement plans professionals.



Importance of Good Internal Controls

- Can eliminate or reduce errors in plan operation
- Plan sponsor can quickly identify errors to correct via Self Correction with minimal cost
- Impacts Audit Closing Agreement Program (Audit CAP) sanction negotiations



Importance of Good Internal Controls

- Can keep the audit “focused”
- Can significantly reduce the time for conducting an examination
- Can shorten turnaround time on request for further information during examination
- Can promote clear communication between IRS and employer/representative



Good Internal Controls Affect an Employee Plan Audit

- The EP agent will evaluate the effectiveness of the plan's internal controls to determine to perform
 - A focused audit (just look at 3-5 issues) or
 - Expand the scope of the examination
- Good internal controls are a key factor in keeping an audit “focused”
- The internal control interview helps the examiner determines whether the plan is
 - Well run or
 - Whether there are serious compliance risks that would give rise to expanding the scope of the audit



Good Internal Controls Affect an Employee Plan Audit

- The EP agent will make every effort to ensure your internal control systems are running smoothly when the audit concludes
- NOTE! If a self correction action is more than 65% complete, even if the error is significant, it can be self corrected during the audit



Examples of Insufficient Internal Controls Discovered During EP Audits

- Third party reports frequently have inaccurate data
 - Dates of hire and termination
 - Employee age and service
 - Compensation, etc.
- Decentralized payroll systems without internal controls
 - Each subsidiary determines eligibility, HCE status, or what constitutes plan “compensation,” result in incorrect coverage and allocations
- Data used for Form 5500 fails to conform to actual records (i.e., payroll data)



Good Internal Control Examples

- Segregation of Duties
 - Ex.: Payroll, Human Resources
- Established Systems
 - Important to check that systems accurately verify the data and processes to ensure plan compliance
- Good IT System
- Knowledgeable & Responsible Personnel
- Form 5500 returns accurately filed & reconciled



Questionnaire – Current Location

401(k) Compliance Check Questionnaire Final Report - Next Steps and Web Resources



We'll use the Questionnaire's findings to:

- enhance our 401(k) plan administration compliance tools,
- produce outreach materials,
- improve voluntary compliance programs,
- assess the need for additional guidance, and
- define upcoming projects and enforcement activities.



401(k) plan sponsors can use the [Questionnaire](#), along with these findings, to strengthen internal controls over plan operations.

Web Resources

[401\(k\) Plans](#)

[401\(k\) Plan Overview](#)



Coming Soon – New & Improved Tool!

- ***Good News!*** We added new internal control questions and repackaged the 401(k) Questionnaire as the **QSAT** (Questionnaire Self Audit Tool)
- Scheduled to be released in 2013
- The QSAT will help plan sponsors to find, fix and avoid costly mistakes



QSAT Tool

How to Use the QSAT
(with Internal Control
Questions) to avoid
Common Plan Errors



Common Plan Errors

- Non-amender/Late amender
- Failure to follow the terms of the plan
 - Definition of “Compensation”
 - Matching contributions
- Omitting eligible employees
- Loan issues
- Nondiscrimination testing (ADP/ACP)
- IRC 402(g) limits
- Timely deposit of employee elective deferrals
- Hardship Distributions



Non-Amender/Late Amender

Failure to timely amend the plan for changes in the law

Documents to maintain:

- Original plan document
- All subsequent amendments or restatements
- All adoption agreements
- Any opinion letter or advisory letter issued by the IRS
- Any determination letter issued by the IRS
- Board of Director's resolutions and minutes related to the plan



QSAT - Internal Control Questions

- Who is responsible for making timely amendments to the plan for changes in the law?
- If there has been a merger or acquisition, and plans are merged, who verifies that the language of the resulting plan is correct as intended?



Non-Amender/Late Amender Internal Control Tips

- Use a “tickler file” or similar system
- Annual review of plan document
 - Does Summary Plan Description match plan?
- Maintain contact with company who sold the plan



Fixing Non-Amender/Late Amender Errors

You can fix the mistake under the EPCRS –
Revenue Procedure 2013-12

- Self Correction (SCP) - **NO**
- Voluntary Compliance program (VCP) - **YES**
- The Fix:
 - Adopt amendment(s) for missed law changes
OR
 - Adopt a pre-approved plan from an M&P sponsor or volume submitter practitioner



Failure to Follow Plan Terms

Plan definition vs. plan operation not consistent

- Failing to communicate plan changes to those involved in plan administration
- Definition of “Compensation” for all purposes
- Matching contributions



QSAT - Internal Control Questions

- What is your plan's definition of compensation?
- Are there multiple definitions included in the plan?
- Who determines the participants compensation amount for plan purposes from the payroll records?
- Who verifies that participants' compensation used for all plan purposes is according to the definitions in the plan document?



Failure to Follow Plan Terms

Internal Control Tips

Avoiding Definition of Compensation Errors

- Know plan document definition and all changes
 - Compare to operational procedures
- Know what third-party administrators agreed to provide (Are they relying on the employer for all information?)
- If possible, simplify the plan's definition of compensation and use the same definition for multiple purposes



Failure to Follow Plan Terms

Internal Control Tips

Avoiding Matching Contribution Errors

- Review plan document annually to verify the plan terms are being followed and that the plan is
 - Properly counting hours of service
 - Correctly identifying plan entry dates
 - Using correct “Compensation” definition
 - Payroll periods vs. plan terms
 - Annual amounts and percentages
 - Compare to operational procedures
 - Timing of the match



Fixing Failure to Follow the Terms of the Plan Errors

EPCRS Revenue Procedure 2013-12

- Fixing Definition of Compensation Errors
 - Over contribution
 - Elective deferrals
 - Distribution of excess amount + earnings
 - Profit-sharing allocation
 - Forfeit and reallocate w/ earnings or
 - Place in unallocated account for future use
 - Under contribution
 - Corrective contribution w/ earnings



Employee Eligibility

Excluding eligible employees / Including ineligible employees caused by:

- Misunderstanding plan's "eligibility" and "entry dates" definitions
- Different requirements for different contributions
- Operating the same as the prior year – without reviewing the plan document for changes
- Not considering part-time employees
- Not including employees who elect not to make deferrals



QSAT - Internal Control Questions

- Who determines when an employee is eligible to participate in the plan?
- What steps does this person take to determine if an employee is eligible to participate in the plan?
- What steps are taken to notify an employee they are eligible to participate in the plan?
- How does the plan track the amount of service an employee has completed?



QSAT - Internal Control Questions

- Who is responsible for maintaining personnel records?
- What actions are taken to make sure the personnel records are accurate?
- How is information from personnel records shared with the plan administrator?
- Who is responsible for sharing personnel information with the plan administrator and ensuring this information is accurate?



Employee Eligibility Internal Control Tips

Avoiding the mistake

- Conduct annual self audit and compare operation vs. plan terms
 - Date of hire
 - Date of birth
 - Hours of service
 - Entry date
 - Salary deferral elections
- Review plan document
- Inspect payroll records
- Inspect W-2 forms



Fixing Employee Eligibility Errors

Fixing the mistake

- Qualified Non-Elective Contributions (QNEC) equal to Missed Deferral Opportunity
 - 50% of employee's missed deferral



Loan Issues

- Loans in excess of the \$50,000 maximum allowed
- Treatment of outstanding loan balances when participant terminates employment and account balance is distributed
- Plans that limit number of loans to a participant and violate the plan provisions by providing more than the limit.
- Loan terms longer than 5 years – and loan found not to be for purchase of primary residence.
- Plans that allow loans – but the plan document does not allow loans
 - (Can be corrected by retroactive amendment – **SCP**)



QSAT - Internal Control Questions

- Who verifies the plan's loan provisions?
- How does a participant request a loan from the plan?
- How are loan applications reviewed and approved?
- Who reviews and approves requests for loans?
- Who determines a participant's maximum loan amount?
- How is the loan delivered from the trust to the participant?



Loans: Internal Control Tips

Avoiding the error

- Develop loan procedures and systems to ensure
 - Five year plan limits
 - Reasonable interest rate
 - Meet dollar limit of IRC 72(p)
 - Repayments being made
 - According to plan terms
 - Repayments at least quarterly



Fixing Loan Errors

Fixing the error

- Self Correction (SCP) - **NO**
 - Generally, participant cannot correct to preserve loan exemption
 - Some exceptions exist under EPCRS
 - See EPCRS Revenue Procedure 2013-12



Nondiscrimination testing (ADP/ACP)

401(k) testing and/or contribution errors

Causes include:

- Not properly identifying Highly Compensated Employees
- Excluding those who elect not to defer salary from the test
- Not using the correct “compensation” definition
- Not using the testing method defined by the plan document (current or prior year)



QSAT - Internal Control Questions

- Who verifies that correct data was used to complete the annual testing?
- Who determines which participants are highly compensated employees?
- Who verifies deferrals allocated to participants' accounts are correct?
- Who determines whether participants compensation for deferral purposes are correct?
- How are matching and nonelective contribution amounts determined?
- Who ensures that each participant receives the correct matching and/or nonelective contribution?



Nondiscrimination Testing Internal Control Tips

Avoiding the mistake

- Establish/Amend plan to safe harbor plan
- Eliminate communication gaps
 - Employer
 - Plan administrator
- Verify the accuracy of:
 - Classification of Employees (Highly and non-highly compensated)
 - Family aggregation
 - Definition of compensation



Fixing Nondiscrimination Testing Errors

Fixing the mistake

- Rerun tests if original data incorrect
- Two methods
 - Qualified non-elective contributions
 - One-to-One method
- Correction
 - Within 12 months following plan year end – OK
 - Otherwise, correct using EPCRS 2013-12



IRC 402(g) Limits

Failure to limit elective deferrals to IRC 402(g) limits

- This can be a costly error
- If not timely returned – will be taxed twice
- Plan document may have define limits below the maximum under 402(g)
- **Note: IRS 402(g) limits for 2013 - \$17,500**



QSAT - Internal Control Questions

- Are procedures in place to ensure that participants will not exceed the 402(g) limit?
- Are there checks and balances to alert the plan administrator if the limits of 402(g) (or plan limits) are exceeded so that corrective action can be taken timely?



402(g) Limit

Internal Control Tips

Avoiding the mistake

- Sufficient payroll information
- Checks and balances
- Procedures to follow if contribution limits are exceeded
- During annual self audit compare
 - Participant's elective contributions
 - § 402(g) limit for the year
- Analyze employee records
 - Age 50 catch-up



Fixing Excess Elective Deferral Errors

Fixing the mistake

- Distribute excess deferral to employee
 - Correct by April 15 following close of year
 - Otherwise 10% additional tax (IRC 72(t))
 - If not timely, can use EPCRS to correct
 - IRC 72(t) tax cannot be waived



Timely Deposit of Deferrals

Failure to timely deposit elective deferrals caused by:

- Misunderstandings about DOL rules regarding the timing requirements
- For plans with less than 100 participants, there is a 7 business day safe harbor rule for contributions
- If the plan contains specific language stating when the deposits will be made for example weekly with payroll, the terms of the plan must be followed



QSAT - Internal Control Questions

- How and when are employee deferrals remitted to the trust?
- Who verifies deferrals allocated to participants' accounts are correct?



Timely Deposit of Deferrals - Internal Control Tips

Avoiding the error

- Establish a consistent procedure for deposits
- Coordinate with payroll provider
- Change in personnel?
 - Ensure they have full understanding of deposit timing



Fixing Timely Deposit of Deferrals Errors

Fixing the operational error

- Determine and make late deposits
 - Calculate/Include lost earnings
- Review procedures and correct deficiencies
- Remember, prohibit transaction issues cannot be corrected through EPCRS



Hardship Distributions

Failure to follow the Plan's terms regarding hardship distributions

- Failure to follow the rules for hardship distributions
- No procedures in place to review hardship applications
- Allowing participants to apply for a hardship electronically without understanding the rules



QSAT - Internal Control Questions

- Are distributions only made on account of an immediate and heavy financial need and only for the amount necessary to satisfy that need?
- Is the amount in excess of the amount needed to relieve the financial need of an employee?
- Can the need be satisfied from other resources reasonably available to the participant?
- Are records kept of all information used to determine eligibility for a hardship?



Hardship Distributions - Internal Control Tips

Avoiding the error

- Know the plan language and make sure it conforms to plan operation
- Establish procedures
- Watch for abuses/ineffective management
 - Identical requests from multiple employees
 - Only highly-compensated employees make requests
 - Have rank-and-file been notified of this plan feature?



Fixing Hardship Distribution Errors

Fixing the error

- Plan document does not allow for hardships
 - Retroactive amendment
- Hardships do not meet plan terms or IRC rules
 - Possible repayment to plan

Note: Hardship distributions may be subject to the 10% early distribution tax on distributions made prior to reaching age 59 ½.



Important Tip to Avoid Operational Plan Errors



Read the Plan



www.irs.gov/retirement



Subscriptions | Language | Information For...

Search

Advanced

Filing

Payments

Refunds

Credits & Deductions

News & Events

Forms & Pubs

Help & Resources

for Tax Pros

Retirement Plans



Benefits Practitioner

Plan Participant, Employee

Plan Sponsor

Tax Information for Retirement Plans



403(b) Pre-Approved Plans

Resources for filing an application for an opinion or advisory letter for a pre-approved 403(b) plan.



www.irs.gov/retirement

**Internal Control Tools
Available On The Web For
Your Use**



www.irs.gov/Retirement-Plans/EP-Compliance-Trends-and-Tips

Trends and tips listed by

- Plan type
 - Large case examinations
- Issue
- Voluntary compliance issues

Also, tips on how to prepare for an efficient audit



Voluntary Compliance Program (VCP) Popular Submissions

Correlate to errors found on examination

- Improper loans
- PPA 1101 and excise taxes
- Scriveners errors
- 401(k) testing and/or contribution errors
- Compensation errors
- 415 language
- Non-amenders



Employee Plans Team Audit (EPTA - Large Case) Pilot

- In FY 2012 EPTA successfully piloted a systematic approach to more effectively identify compliance risks & determine “Focused Issues”
- The EPTA Pilot methodology included:
 - Comprehensive “pre-audit analysis” and
 - Detailed evaluation of “Internal Controls” related to the various payroll/ personnel systems and business environments that effect the administration of all qualified plans sponsored by a taxpayer.
- In FY 2013, the EPTA IRM was revised to include an internal controls/systems analysis audit approach to determine risk



[www.irs.gov/Retirement-Plans/EP-Team-Audit-\(EPTA\)-Program](http://www.irs.gov/Retirement-Plans/EP-Team-Audit-(EPTA)-Program)

Internal Control Tools

- Trends and Tips
- Internal Controls Questionnaire



www.irs.gov/Retirement-Plans/EP-Examination-Guidelines

- Provides guidance to EP agents
- Assists examiner in performing audit of certain issues, including
 - Top heavy
 - IRC 403(b)
 - Prohibited transactions
- Cannot be cited as authority



www.irs.gov/Retirement-Plans/Plan-Sponsor/A-Plan-Sponsor's-Responsibilities

- Internal Control Tips
 - Many discussed today
- Related IRS and DOL publications



[www.irs.gov/Retirement-Plans/EP-Examination-Projects---Learn,-Educate,-Self-Correct-and-Enforce-\(LESE\)-Projects](http://www.irs.gov/Retirement-Plans/EP-Examination-Projects---Learn,-Educate,-Self-Correct-and-Enforce-(LESE)-Projects)

- Learn
 - Small sample projects
- Educate
 - Publish examination results
- Self-correct
 - You perform self-audit and correct if needed
- Enforce
 - Expand examinations



[www.irs.gov/Retirement-Plans/Employee-Plans-Compliance-Unit-\(EPCU\)---Completed-Projects---Projects-With-Summary-Reports](http://www.irs.gov/Retirement-Plans/Employee-Plans-Compliance-Unit-(EPCU)---Completed-Projects---Projects-With-Summary-Reports)

- Employee Plans Compliance Unit (EPCU)
 - Develops compliance projects
 - Perform data analysis
 - **Not** an audit
 - Completed projects posted
 - Can use during self-audit



www.irs.gov/Retirement-Plans/Plan-Sponsor/Fix-It-Guides---Common-Problems,-Real-Solutions

Video Explanations

SEP Plan Fix-It Guide Common Problems, Real Solutions

Potential Mistake	Find the Mistake	Fix the Mistake	Avoid the Mistake
1) You have not updated your SEP plan document for current law (More) (Video)	Determine if your Form 5305-SEP is the current revision (December 2004) (More)	Adopt revised Form 5305-SEP (More)	Maintain regular contact with the company that sold you the plan (More)
2) The plan excluded employees of related businesses from participating (More)	Identify any companies that you own or with which you have a financial relationship (More)	Apply reasonable correction method that would place affected employees in the position they would have been in if there were no operational plan mistakes (More)	Determine if you own any other businesses (More)

This Checklist is *not* a complete description of all plan requirements, and should *not* be used as a substitute for a complete plan review.

For Business Owner's Use

(DO NOT SEND THIS WORKSHEET TO THE IRS)

It is important to review the requirements for operating your 403(b) retirement plan annually. This checklist is a "quick tool" to help you keep your plan in compliance with many important tax rules. See IRS Publication 571, *Tax Sheltered Annuity Plans (403(b) Plans) for Employees of Public Schools and Certain Tax-Exempt Organizations* at www.irs.gov/ep. Underlined text below shows a link to expanded explanations and resources, also at www.irs.gov/ep.

1. Does your organization qualify as a public educational institution or as a charitable organization exempt from tax under IRC 501(c)(3)?

Yes No

Only public educational institutions described in IRC 170(b)(1)(A)(ii), or 501(c)(3) organizations may establish a 403(b) plan.

6. If your program permits age 50+ catch-up contributions, were each of your employees age 50 and over informed of their rights to make catch-up deferrals?

Yes No

If your plan permits, participants age 50+ may defer an additional \$5,000 to the 403(b) plan for 2006.

7. Does the 403(b) annuity contract Yes No

ATTENTION:
PLAN
SPONSORS!

**EMPLOYEE PLANS
COMPLIANCE RESOLUTION
SYSTEM**

The EPCRS Menu

What's Your Choice?

The impact of
non-compliance left unchecked
can be costly.

Preventive Maintenance –
Fix Mistakes Immediately!!

	Audit CAP	Voluntary Correction	Self- Correction
Cost of Correction			
IRS Fees			\$0
Time Involved			
Result			



www.irs.gov/Retirement-Plans/Correcting-Plan-Errors

Information on

- All EPCRS programs
 - SCP, VCP, Audit CAP
- How to find, fix, and avoid errors
- What's new in EPCRS and the website



www.irs.gov/Retirement-Plans/Newsletters

- Two free newsletters
 - Retirement News for Employers
 - For employers and business owners
 - Employee Plans News
 - For retirement plan practitioners

Internal Controls



**It is crucial to have
good internal
controls!!**

Thank
you