

IRS 403(b) PLAN AUDITS



INTRODUCTION

The final 403(b) regulations have essentially eliminated the ability for a plan sponsor to limit involvement in matters of plan administration. This manual contains some helpful tips from the IRS for preparing for an efficient plan audit.

IRS officials are auditing more and more 403(b) plans, so compliance with the new regulations is very important. A standardized process of documenting policies and procedures for your 403(b) plan will certainly prove useful in the event of a plan audit, or simply as a method of archiving important plan history for your potential successors.

WEA Member Benefits' Plan Administration Consultants can help you with questions you may have about this topic. Call 1-800-279-4030.

Continue to scroll through this document for tips on how to prepare for an efficient audit, a compliance checklist, IRS questions to review, and plan maintenance reminders.

Additional IRS resources for plan audits are available on the IRS Web site at www.irs.gov/ep.

Tips to Prepare for an Efficient Audit

When your plan is selected for an audit, the initial contact letter from the IRS will include a list of items the IRS agent will want to examine. The IRS will indicate the requested items be available and organized for the agent's visit. **Remember to contact all approved vendors and/or your third party administrator immediately upon receipt of the audit notice.** Preparations can be made to provide all reports and information to you in a timely manner prior to the date of the audit.

HAVE DOCUMENTS READILY AVAILABLE

Plan and Trust Documents, Adoption Agreements, Amendments, Summary Plan Descriptions, etc. (including all the prior version of these documents, if applicable)

An audit review verifies that your plan document contains all terms and provisions necessary to satisfy requirements for tax qualification and that all required amendments have been timely and properly adopted. This will require a review of the complete executed version of your plan document, including amendments, as well as your plan's trust documents (if applicable). The IRS may also require a review and verification that prior versions of your documents were timely and properly adopted. An agent will advise you as to the documents that may be needed and why they are needed.

An agent may also ask that some or all of these documents be provided prior to the initial audit appointment. This will allow the agent to familiarize himself/herself with your plan and to request clarifying information if needed. It will also reduce the amount of time the agent will need to spend at your site and provide you or your representative with an opportunity to respond to any questions raised in their initial review of the documents.

REQUESTED RECORDS EFFICIENTLY ORGANIZED

It is important that all records are present, available, and separately identifiable at the audit site in advance of the audit. The requested information should be organized in a manner that will allow for quick and easy review. **Do not wait for the agent to arrive to begin locating or pulling records that have been requested unless agreed to by the agent and you (or your representative).** When you receive your audit appointment letter, an Information Document Request (IDR) will be attached. It will be helpful to have the records labeled or tabbed to coincide with the IDR. This will ensure the audit process is more efficient and may lessen the time an agent needs to spend doing the audit or any required follow up appointments.

AGREEMENTS WITH SERVICE PROVIDERS

If you have outside service providers performing administration of your plan or trust, have available any agreements or other documentation explaining what services they provide.

HAVE APPROPRIATE PEOPLE AVAILABLE

During the audit, it is very important to have available (either in person or on the telephone) the people that are best able to explain what is actually being done and answer questions on the administrative processes as opposed to what was written. These people may include: attorney, accountant, representative with power of attorney, trustee, record keeper, payroll processor, or plan sponsor personnel.

BE PREPARED TO EXPLAIN THE TERMS OF THE PLAN

Individuals assigned plan responsibilities by the plan sponsor, plan administrator and/or plan trustees should have a good understanding of relevant terms of the plan document. This understanding includes knowledge of what the plan provides for and where to locate relevant sections within the plan document. When plan representatives have a working knowledge of the provisions of the plan, the audit typically is more efficient. Understanding the terms of the plan also leads to better plan administration. Demonstration of a good understanding of the plan increases the credibility of those involved with the plan and helps the agent determine the reliability of the internal controls being applied to plan operations.

BE PREPARED TO EXPLAIN THE OPERATION OF THE PLAN

In addition to knowing the terms of the plan, those involved with administering the plan need to be aware of the paperwork and decisions needed to properly operate the plan. Such individuals must ensure proper documentation of plan operations is maintained and be readily able to describe various procedures, including:

- Preparing and maintaining updates/amendments of the plan document;
- Notifying employees of plan eligibility;
- Providing and accounting for deferral election forms;
- Providing and securing proper election and consent forms before making distributions;
- Communicating loan or hardship distribution procedures and documentation requirements to plan participants (if applicable)

This list is not all inclusive, but is intended to highlight major areas of plan operations that require additional documentation beyond the plan document.

BE PREPARED TO EXPLAIN INTERNAL ADMINISTRATIVE PROCESSES

Evaluation of internal controls is a major part of all audits. Internal controls are the actual checks and balances in place to ensure that all of the procedures are being properly applied. For example, the coordination and review of “compensation” is needed by the individuals to ensure the correct compensation, per the written plan document, is used when calculating contributions. This is just one example of the need for and being able to explain the internal controls and procedures.

BE PREPARED TO IDENTIFY PLAN ERRORS

It is always best to bring any known errors (corrected or not) to the attention of the audit agent before he/she asks. During the opening interview the agent will ask about any plan errors, so be honest. A few questions that might be asked are:

- What errors have you found in the operation of the plan?
- How did you correct the errors?
- What documentation do you have related to identifying and correcting the errors?

If operational errors are detected during the audit, the agent will determine whether the errors are significant. If an error is not significant, the agent may allow you to correct it without sanction. For other errors, the agent will discuss correction alternatives.

UTILIZE SELF-AUDIT AS A VERIFICATION TOOL

Periodic internal auditing of plan operations and administration may enable you to enjoy a high level of confidence about compliance with plan requirements. Internal audits provide a means for detecting compliance deficiencies early and for prompt implementation of corrective procedures. Self-audits lead to better plan administration by educating the responsible parties about the basic features and functions of the plan. Self-auditing will establish internal controls and other practices and procedures to prevent deficiencies, strengthen the goals of compliance, and lead to prompt correction of errors in the plan administration process. Performing self-audits is important even if the plan is never examined.

If your plan is selected for examination, a practice of regular self-auditing may be valuable. It will make preparation for the audit easier because much or all of the needed documentation and information will have been collected and maintained in the process, including an inventory of any corrections that have been made. Self-auditing may demonstrate that the plan is operated with concern for compliance and may contribute to an IRS agent's decision to limit the examination.

HAVE YOU HAD YOUR RETIREMENT PLAN CHECK-UP THIS YEAR?

A retirement plan needs regular care to keep it operating properly. Your plan's care should include a regular review of its basic operations. How often you perform a plan check-up may depend on the size and complexity of the plan.

As a matter of best practice, we are including a couple sample checklists in this section that may be used in the self-audit process as guides to a more compliant plan.

Compliance Checklist

Plan Documents

- The Plan has a 403(b) compliance file containing all plan related documents and correspondence.
- The Plan has provided all approved vendors with copies of their plan documents.
- The Plan Sponsor will provide approved vendors with plan amendments on an ongoing basis including any changes in contributory vendors.

Universal Availability

- Our 403(b) plan is available to any employee who is not a member of an excludable group.
- Any exclusion of employees is consistently applied.
- The District annually provides *all* eligible employees with a notice of the availability of our 403(b) plan (Universal Availability Notice).

Contributions

- The Plan remits employee deferrals as soon as administratively possible and not later than 15 business days following the month paid to employee.
- Employees are not offered an option to receive post-employment non-elective contributions in cash.
- Employee post-severance contributions are deposited by the later of 2 ½ months following termination of employment or the end of the year in which the employee retires.
- Employees are asked to provide the District with a copy of their contribution limit calculation when they are contributing in excess of the base limit (\$18,000 in 2016, and as indexed in succeeding years) *and* will not turn age 50 by the end of the tax year.

Information Sharing

- The payroll office notifies vendors in a timely manner when a participant has severed employment or retired.
- Contributory vendors notify employer in a timely manner of hardship distributions and the consequent six-month suspension of employee's right to make elective deferrals.

Reporting

- The Plan requires approved vendors to provide periodic reports of new enrollments, employee contributions, exchanges/transfers/rollovers, loans, hardship and all other withdrawals, as well as investment performance.
- The Plan requires approved vendors to certify hardship distributions and to notify the district to suspend contributions of that employee (if applicable).
- Vendors monitor contributions and notify the Plan Sponsor if there is a potential for excess contributions.

Distributions

- The District requires its 403(b) vendors to verify aggregate loan amount limits by coordinating loan limits with other vendors (if applicable).
- Approved vendors report if employees do not make loan repayments when due.
- The District requires its vendors to process exchanges and transfers according to its plan documents and the new IRS regulations.
- Approved vendors are assigned the responsibility of reviewing and processing Qualified Domestic Relations Orders (QDROs).

Review IRS Compliance For Your 403(b) Plan

These 10 questions are posed by the IRS to help you determine whether your plan is in compliance. **If you answer “no” to any of these questions, you may have a mistake in the operation of your 403(b) plan.** However, answering “yes” to each question may not mean your plan is 100% compliant. This checklist is not a complete description of all plan requirements and should not be used as a substitute for a complete plan review.

Question	Yes or No	Important Consideration
Does your organization qualify as a public educational institution or as a charitable organization exempt from tax under IRC 501(c)(3)?	Yes <input type="radio"/> No <input type="radio"/>	Only public educational institutions described in IRC 170(b)(1)(A)(ii) or 501(c)(3) organizations may establish a 403(b) plan.
Are ALL employees who normally work 20 hours or more per week (Universal Availability rule) given the opportunity to make a salary deferral?	Yes <input type="radio"/> No <input type="radio"/>	Failure to meet this rule is often due to excluding part-time employees who would otherwise be eligible to participate.
Are elective deferrals, including any designated Roth contributions, limited to the amounts under IRC 402(g) in a calendar year?	Yes <input type="radio"/> No <input type="radio"/>	Failure to limit deferrals to the 402(g) limit may result in additional taxes and penalties to the employee and employer.
Are the total employer and employee contributions limited so as not to exceed the IRC 415(c) limits?	Yes <input type="radio"/> No <input type="radio"/>	Total employee and employer contributions cannot exceed the lesser of a stated amount annually or 100% of includible compensation.
If the IRC 402(g) “15 years of service catch-up” contributions are being made, does the employee have the required 15 years of full-time service with the same employer?	Yes <input type="radio"/> No <input type="radio"/>	Even if this requirement is met, a calculation must still be made to determine the level of entitlement.
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 <input type="radio"/> No <input type="radio"/>	If your plan permits, participants age 50+ may defer an additional \$5,500 to the 403(b) plan annually.
Does the 403(b) annuity contract or custodial account: contain the non-transferability provisions (annuity contract only); state the limits under IRC 402(g); and contain the direct rollover provisions of IRC 401(a)(31)?	Yes <input type="radio"/> No <input type="radio"/>	Certain provisions are required for annuity contracts or custodial accounts.
If your plan offers a 5-year post severance provision, are amounts contributed through a non-elective method?	Yes <input type="radio"/> No <input type="radio"/>	Amounts contributed to a 403(b) plan that an employee had an option of receiving in cash are considered elective deferrals and are not eligible for the 5-year provision.
Are you (as the employer) and your vendor enforcing participant loan repayments and limiting aggregate loan amounts as required under IRC 72(p)?	Yes <input type="radio"/> No <input type="radio"/>	If not, defaulted loans or loans in violation of IRC 72(p) may be deemed taxable distributions and reported as income to the participant.
Are you and your vendor(s) requiring documentation that hardship distributions meet the definitions and requirements for hardship found in the IRC 401(k) regulations?	Yes <input type="radio"/> No <input type="radio"/>	The employer should certify, based on the facts, that the participant has an immediate and heavy financial need.

Plan Maintenance Reminders

These tips can help keep your plan running smoothly:

- **Watch for law changes** – Keep your plan up to date with the law. Ask your benefits professional “when and what” to change in your plan. Your retirement plan provider may offer auditing and plan review services.
- **Review your plan** – It’s cheaper to fix plan errors when they are small and have not continued over a long period of time. Consider regular check-ups and self-audits.
- **Watch for common mistakes** – Some of the most common are:
 1. not following the terms of the plan;
 2. not covering the proper employees;
 3. not giving the employees the required information;
 4. not depositing employee deferrals and/or employer contributions timely; and
 5. not limiting employee deferrals and employer contributions to the proper limits.
- **Monitor the people who work with your plan** – Make sure the correct data is getting to those who operate your plan, especially employment and compensation records. Monitor the plan investments. Make sure any fees are appropriate. Ensure plan contributions and distributions are made properly and timely.

This sample document is provided by the WEA Tax Sheltered Annuity Trust program to assist you with the administration of your 403(b) program. This document is not intended to constitute legal or tax advice. Please contact your legal or tax professional for more detailed information.