THE WHITE PAPER

Your Guide to Life Planning

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Could Your Plan's Internal Controls Be Stronger?

When it comes to operating a retirement plan, there are a lot of moving parts. A strong system of internal controls can help keep a plan operating smoothly and in compliance with the law. Here are some commonly asked questions about internal controls.

What are internal controls? The IRS describes internal controls as policies and procedures designed to detect and prevent errors in a retirement plan.

How are internal controls beneficial? They can help a plan sponsor avoid mistakes that could jeopardize the plan's tax-favored status. If an insignificant operational error is discovered, the sponsor may be able to correct it using the IRS's Self-Correction Program (part of the Employee Plans Compliance Resolution System) without contacting the IRS or paying any fees.

However, the self-correction option is available only if the plan has established practices and procedures that are reasonably designed to promote and facilitate compliance with the law.

When the IRS selects a plan for audit, the agent conducting the audit begins by evaluating the effectiveness of the plan's internal controls. Whether the agent performs a focused or expanded audit is determined by the strength of the plan's internal controls.

Should a plan have procedures for reviewing the plan document? It should. A regular review of the plan document allows the sponsor to determine whether the plan needs updating. According to the IRS, during audits, employers often can't find documentation to prove that their plans were amended for current law. When this happens, the matter must be resolved using an audit closing agreement with the IRS. It is much less expensive to file for correction of a plan document failure using the IRS's Voluntary Correction Program, but this program is not available to plans under audit. Reviewing the plan document annually can reveal if any amendments are needed.

What internal controls should a plan have with respect to plan operations? The appropriate practices and procedures will depend on the organization sponsoring the plan, the plan type, and the plan's particular features. Knowing and following the terms of the plan is critical. Two items the IRS recommends looking at are whether employee loans and distributions were made according to plan rules and whether eligible employees were included in the plan in a timely manner.

If a third party administrator performs annual testing for the plan, it's important to keep the lines of communication open regarding all employees eligible to make elective deferrals, including employees who terminated during the year. The plan sponsor should have procedures in place to ensure that the proper payroll information is provided and used in the testing calculations. Certain information regarding family relationships, officer status, and companies under common control may need to be provided to ensure that the testing can be completed properly.

What are some examples of internal control procedures? The IRS lists several on its website:

- Comparing salary deferral election forms with the actual amounts deducted from employees' paychecks
- Verifying the types of compensation used for allocations, deferrals, and testing
- Checking that plan service providers received accurate compensation and ownership records
- Monitoring annual contribution and compensation limits
- Confirming that years of service were accurately determined for purposes of eligibility and vesting
- Verifying marital status and spousal consent for plan distributions
- Ensuring that participants received required minimum distributions

Having strong internal controls around employee eligibility, plan contributions, plan distributions, plan testing, and plan administration is key to avoiding costly penalties and potential plan disqualification. Plan sponsors should consider the benefits of being proactive by conducting a compliance self-audit each year.

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