How to Prepare for a 401(k) Audit

If the term ?audit? makes you uncomfortable, anxious, or even scared, you are not alone. Last year, the Department of Labor (DOL) closed 1,122 civil investigations with 754 (67%), resulting in fees, repayments, or corrective actions.[1] The agency collected over $3.12 billion in direct payments to plans, participants, and beneficiaries. This represents a whopping 300% increase in just five years.[2]

From this perspective, you might think there is no chance that you?re walking out of an audit unscathed. However, the outlook is a little less bleak when you realize that in the US, there are nearly

722,000 retirement plans and only 1,122 escalated to an investigation.

So instead of viewing the DOL as the boogey monster or fearing a 401(k) audit, let?s take a look at the utility behind audits, identify red flags and establish best practices to help demystify the process.

What is a 401(k) Audit?

Retirement plan audits are normal; in fact, they happen all the time. Generally speaking, a plan audit is the review of a company?s retirement plan with the primary objective of ensuring that it meets guidelines and regulations set by the DOL and IRS. For large companies with over 100 participants, audits are an annual occurrence, but small plans can also be under scrutiny if a red flag is raised.

What are Audit Red Flags?

The following red flags can prompt the DOL to take a closer look at your retirement plan.

Employee Complaints

Individual complaints from employees are a frequent source of DOL investigations. From a total of 171,863 inquiries from workers, 357 resulted in the opening of new investigations and more than half of all monetary recoveries relate to benefits of terminated vested participants of defined benefit plans.[3] The simple lesson here is that plan sponsors must establish clear protocols for how participants can communicate questions or complaints about their benefits to the plan sponsor before filing complaints with the DOL. Quick and effective responses are critical.

DOL Enforcement Priorities

Examinations may also relate to enforcement priorities launched by the DOL. As of this publication, the agency ?continues to focus its enforcement resources on areas that have the greatest impact on the protection of plan assets and participants' benefits.?[4] Just like the old story about why a robber goes to a bank, this translates to the DOL likely focusing more on large plans because that?s where the money is.

Delinquent Contributions

Delinquent contributions are pursued as part of an ongoing national priority. These are easy pickings for the DOL and a clear violation of the most basic fiduciary standards. No employer should deduct contributions from employees? wages and fail to contribute those deferrals to the plans without fear of significant and swiftly administered reprisals.

Plan sponsors are encouraged to review their Form 5500 and other records to spot trouble points, such as:

- Missed contributions
- Assets not held in trust
- Paying unreasonable compensation to service providers (conduct regular fee benchmarking to avoid this)
- Paying expenses from the plan that are actually expenses of the employer (known as ?settlor expenses?. These costs include consulting services regarding plan design or plan termination.)

Other areas of interest include lost or missing participants, and, of course, the DOL often accepts referrals from other agencies such as the IRS.

A Knock at the Door

If you happen to receive a notice from the DOL about an audit or an investigation, your response should be the same:

- Take a deep breath.
- Put your team together and choose a qualified primary contact person.
- Strongly consider engaging ERISA counsel. Expert help may avoid missteps and provide an intermediary for difficult conversations.
- Consider requesting an extension of time to respond. Many initial deadlines can be short for complex exams. Extensions, if reasonable, are routinely granted.
- Review all documents prior to production. Be ready to report any issues found.
- Deliver documents in neat and organized fashion.
- Prepare employees for interviews. Treat it like a deposition. Caution them to take their time, thoughtfully consider their responses and ask for clarification of any questions they do not understand.
- Always be truthful and respectful.

What Documents are Typically Requested?

The sheer volume of documents requested may at first seem overwhelming, but the requests will be for documents you should have readily available in your files. They include:

- Plan document, Investment Policy Statement, plan records of fees/expenses
- Form 5500, Summary Plan Description (SPD), Summary Material Modification (SMM), participant fee disclosures and benefit statements
- Service provider contracts and fee disclosures

- Participant claims and benefits data
- Bonding and fiduciary liability insurance
- Fiduciary committee charters, committee meeting minutes and other records
- Organizational documents about your company and organizational charts
- More recently, cybersecurity practices

Stay Prepared

Whether you are subject to a routine audit or a red flag prompts an investigation, it is important to remember that fiduciary vigilance is key. The best preparation is to follow sound operational procedures every day and don?t fall behind.

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[1]Department of Labor. "Fact Sheet. EBSA Restores Over $3.1 Billion to Employee Benefit Plans, Participants and Beneficiaries." 2020.

[2]Ibid.

[3]Ibid.

[4]Employee Benefits Security Administration. ?Enforcement.? DOL.gov. Accessed 2021.

This information was developed as a general guide to educate plan sponsors and is not intended as authoritative guidance or tax/legal advice. Each plan has unique requirements, and you should consult your attorney or tax advisor for guidance on your specific situation.