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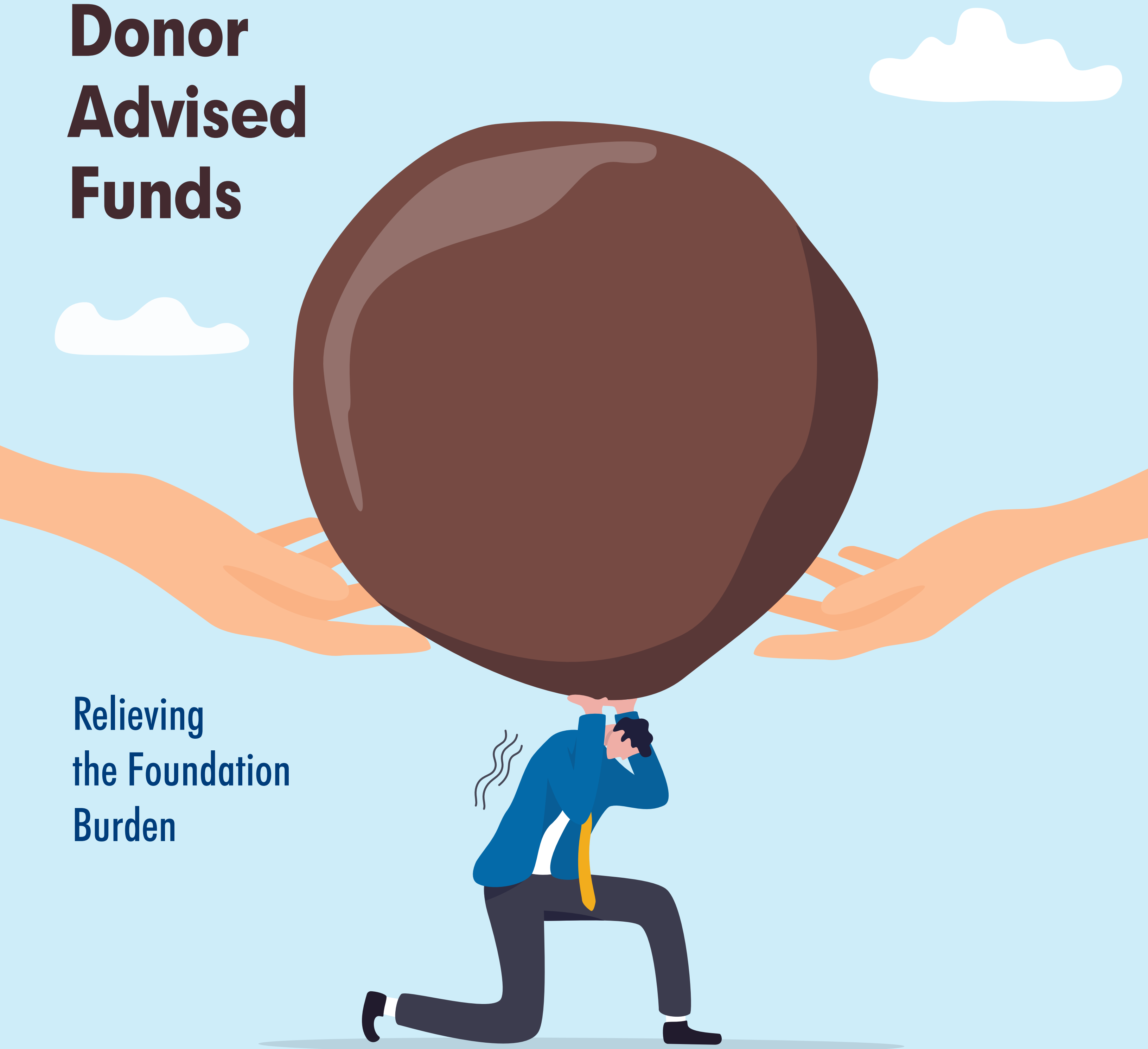
Donor Advised Funds



Relieving the Foundation Burden

Best Practices for a Self-Audit of Retirement Plans

by
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Some banks hold retirement plan assets as a trust company or custodian and in some cases, as a bundled service provider that also acts as a third party administrator tasked with assisting the plan sponsor in following the plan document and its rules.

The House with No Rules - Once upon a long time ago, I fell asleep on the couch, as I often do. My astute baby girl speed-dialed my husband to report that she was in a house with no rules, because I had fallen asleep. Also, she said there was no need for him to hurry home, because he should bring pizza with crust, cheese, sauce, and nothing else. She had it under control. She knew the rules and knew how to follow them. Oversight was not necessary.

The Honor System - After the change in the participant counting rules, roughly 20,000 plans no longer need an audit of their financial statements. However, with the increasing prevalence of automatic enrollment, and the new long-term, part-time employee rules, many small plans are scheduled to grow quickly, and become large plans that will need audits. New small plans, growing small plans, merging small plans, all the small plans live in the house with no rules. The rules still apply, but there is no independent auditor in charge of verification: the honor system!

Self-Audits or Agreed-Upon Procedures - The honor system comes with an important responsibility. For small plans that have no audit oversight, it behooves plan sponsors to trust, but verify that their plan officials are operating the plan in accordance with its terms. In addition to maintaining sound internal control policies and procedures, plan sponsors can add a layer of verification through a self-audit or an agreed-upon-procedures engagement performed by an independent accountant or specialized professional.

Don't Just Trust, Verify - Generally, tax-exempt retirement plan trusts set up under sections 401(a) of the Internal Revenue Code are not subject to income tax on their earnings as long as they comply with the specific rules for qualification. Plan sponsors and their service providers, such as the third-party administrator are responsible for operating the plan in accordance with its terms to preserve the plan's qualified status. Banks often act as the custody agent, trust company, and in bundled arrangements, banks can also be the third-party administrator for retirement plans. Operating the plan in accordance with its terms is no small task. Large plans are subject to an independent audit requirement, but small plans can benefit from additional oversight either from an internal audit process or agreed-upon procedures performed by a third-party specialist, to ensure that internal controls related to the plan are properly designed and that they are working. Despite their exemption from an audit requirement, small plans can collaborate with their service providers to verify their compliance.

Following is a menu of contribution-related procedures that plan sponsors could consider when designing a self-audit program and/or requesting an agreed-upon procedures engagement.

Contribution Testing - Timeliness and Completeness of Contributions: Verify that accurate contributions to the plan are remitted timely to comply with DOL rules and regulations

- **To Test Completeness:** Obtain a complete list of paycheck dates and a complete list of deferral deposits to the plan by date. The total deferral deposits should agree to the total deferrals reported on the Form W-3. Any discrepancies represent funds withheld from a participant's pay that were not deposited or amounts allocated to a participant that were not withheld from payroll. Discrepancies for each person should be identified and resolved in accordance with the Internal Revenue Service's correction program, the Employee Plan Employee Compliance Resolution System.
- **To Test Timeliness:** Compute the number of days between each paycheck date and the date in which related deferral withholdings were deposited. After establishing a pattern that shows how soon the deferral withholdings can be segregated, identify and report as delinquent contributions any deferral withholdings that were not deposited as soon as they could be segregated from the employer's assets.

Why it matters:The DOL considers delays in the remittance of deferral deposits as a prohibited short-term loan from the participant to the plan sponsor. Prohibited transactions are subject to reporting and disclosure rules and to an excise tax.

Demographic Data - Verify the accuracy of employee SSN, date of birth, and date of hire using source documents.

- Obtain and review source documents, such as a Form I-9 or other personnel records to verify that the demographic information on the census used for plan administration is accurate.

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Why it matters: Date of hire affects eligibility to participate in the plan and the vesting computation. Date of birth affects eligibility to participate in the plan, to obtain an in-service distribution, and to obtain a required minimum distribution.

Eligibility: Entry Date - Determine whether all newly participating employees contributing to the plan during the year are eligible to participate based on plan provisions. For plans with automatic enrollment provision, also determine whether contributions began in a timely manner.

• First, identify the population of participants with pre-tax, Roth, or after-tax contributions who have an eligibility or entry date during the plan year under audit.
• Second, determine whether each participant was eligible to contribute on the first contribution date based on the plan provisions. For auto-enrollment plans, compute the number of days between the calculated entry date and the date of the first deferral withholding on the pay-by-pay payroll report to determine whether each participant was auto-enrolled in a timely manner.

Why it matters: Failure to follow the plan document is a disqualification error. Excess contributions or improper exclusions must be corrected in accordance with the Internal Revenue Service's correction program, the Employee Plan Compliance Resolution System (EPCRS).

Eligibility: Opt-out Verification - For a sample of employees that became eligible to participate during the year but did not participate, verify the employee was given the opportunity to participate.

• Opt-out forms are the best practice for eligible employees who are not participating. Alternatively, obtain sign-up sheets for enrollment meetings or evidence that enrollment packages were mailed.

Why it matters: Failure to follow the plan document is a qualification error. Improper exclusion of an eligible employee must be corrected, most often with an employer-funded Qualified Nonelective Contribution (QNEC) for the missed deferral opportunity plus the missed employer match.

Eligible Compensation for Deferrals - Participant 401(k) or 403(b) Deferral Elections Were Followed: Verify that payroll deferrals are calculated based on the plan's definition of compensation. On a sample basis, determine whether employee deferrals are properly withheld and remitted to the plan in accordance with the employee's election.

• Request a pay-by-pay report by participant, including gross earnings and every type of pay that comprises gross earnings, as well as 401(k) withholdings for each pay period.
• Verify the completeness of the pay-by-pay report by comparing control totals to payroll tax filings, or the Form W-3.
• Review the plan document to obtain the definition of eligible compensation for the plan being audited.
• Obtain a schedule of participant deferral elections in place for the whole year and deferral election changes.
• Apply the participant's deferral election to eligible compensation for that participant based on the relevant plan provisions and the deferral election date. Compare the computation to the amount withheld and allocated to the participant's account.
• Obtain deferral elections for a sample of participants and recompute the deferrals that should have been withheld from eligible pay during the audit year. Compare the recomputed amount to the amount withheld from the participant's pay.

Why it matters:Use of the incorrect definition of compensation is the most common finding in both IRS audits and Independent Qualified Public Accountants' (IQPA) financial statement audits.

If the test uncovers an error, the plan sponsor must identify all the participants affected by the error and complete a correction that is compliant with the Internal Revenue Service's correction program, the Employee Plan Compliance Resolution System (EPCRS).

Employer Match and True-up Contributions - On a sample basis, determine whether employer match contributions and true-up contributions, if applicable, are properly calculated and remitted to the plan in accordance with plan provisions.

• Using YTD eligible compensation from the pay-by-pay report for selected participants and the match formula stipulated in the plan provisions, calculate expected employer match and compare the computation to actual employer contribution amounts remitted to the plan.
• Determine whether the plan provisions include a true-up provision and verify that the match true-up was deposited for a sample of participants who did not contribute deferrals evenly throughout the year.

Why it matters:Failure to follow the plan document is a qualification error. If the test uncovers an error, the plan sponsor must identify all the participants affected by the error and complete a correction that is compliant with the Internal Revenue Service's correction program, the Employee Plan Compliance Resolution System (EPCRS).

Profit Sharing and Nonelective Employer Contributions - On a sample basis, determine whether profit sharing and nonelective employer contributions are calculated in accordance with plan provisions, and using accurate eligible compensation.

• Allocation of Assets and Contributions to Participant Accounts Obtain a schedule of participant account balances.
• Reconcile the beginning and ending balances to the Schedule of Net Assets on the Form 5500.
• Reconcile the 401(k) or 403(b) contribution amount to the Form W-3 or the master payroll report.
• Reconcile the match contributions to the payroll report or

match computation tested above.

- Once the completeness of contributions allocated to participants in total has been established, on a sample basis, trace the deferral allocation to a participant's account to the respective Forms W-2.
- After adjusting for timing differences related to receivables and other accruals, identify and resolve any discrepancies between the participant account balance report and the plan's financial statements, including beginning assets, contributions, distributions, and ending assets.

Distribution Procedures - Perform the following procedures related to benefit payments:

Completeness of Distributions

- Obtain a Form 1099-R report listing all distributions and withdrawals by participant.
- Reconcile its totals to the trial balance, financial statements, and/or Form 5500, as applicable.

Accuracy of Distribution Processing

For selected participants on the schedule previously obtained, test the benefit payment as follows:

a. Determine that income taxes have been withheld if the distribution was not rolled over.
b. Trace the distribution amount to the individual participant's account.
c. Verify that payroll stopped for participants who took a terminating distribution.
d. If in-service distributions are allowed at a specified age, such as 59 1/2, verify the relevant participants' ages.
e. Verify that the benefit payment was determined in accordance with the plan's provisions. For example, based on the participant data tested (such as evidence of age, years or hours of service, earnings, vested percentage and related forfeiture amount, or other relevant bases), test or recompute the benefit amount and check the recipients' eligibility to receive the benefits.
f. Determine that payments to participants or their beneficiaries do not exceed the balance in their participant's account, net of any participant loans. In addition, if the participant is withdrawing from the plan, verify that the participant's account is zero at the end of the year, and that a termination date is entered on the census.

Hardship Withdrawals - For hardship withdrawals:

a. Review the financial need indicated in the withdrawal request and any related supporting documents, as applicable, and consider whether it meets the plan provisions and tax requirements for a hardship withdrawal.
b. Determine that the amount withdrawn does not exceed the amount available in the contribution sources as defined by the plan.
c. Determine, based on the plan document and Reg. 1.401(k)-1(d)(3)(iii), that all requirements were met to take the hardship withdrawal.

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Rollover Distributions - If the payment is a rollover distribution, that is, a transfer to another qualified plan or to an individual retirement account, verify that the plan allows rollover distributions, that the rollover was made according to the provisions of the plan and that no tax was withheld.

Mandatory Cashouts - Determine that mandatory cash-out provisions have been observed.

Corrective Distributions - Verify that corrective distributions were processed pursuant to the discrimination testing results, as applicable.

Required Minimum Distributions - Verify that Required Minimum Distribution rules are being processed in accordance with plan provisions and SECURE 2.0 rules.

Forfeitures - For each participant forfeiture recalculated for the distributions tested, trace the participant's forfeited amount to the record of total forfeitures for the period. Trace the total to documents supporting either the reallocation to remaining participants or to offset administrative expenses or employer contributions in accordance with plan provisions. Ensure that forfeitures are being used timely, as noted in the plan provisions.

Participant Loan Procedures - Perform the following procedures for participant loans:

Completeness of Loan Balances - Obtain or prepare a schedule of participant loans, including the beginning balances, transactions during the year, ending balances, and income earned during the year.

a. Trace or reconcile beginning loan balances to the prior year Form 5500 ending balance and the current year Form 5500 beginning balance

b. Trace or reconcile beginning and ending loan balances, transactions during the year, and income earned during the year to the working trial balance or the custodian statement, as applicable, and the Form 5500.

c. Determine that any amounts reported by the custodian agree with the payroll records.

Compliance with Plan Loan Provisions and IRS Rules - Consider whether participant loans comply with ERISA, tax, and plan requirements by assessing whether the following requirements are met:

a. The plan document must authorize loans to participants on a reasonably equivalent basis that does not discriminate in favor of highly compensated employees.

b. The loans must bear a reasonable rate of interest.

c. The loans must be adequately secured.

d. The term of the loans must comply with the plan's loan policy and must not exceed five years (unless for the purchase of a principal residence).

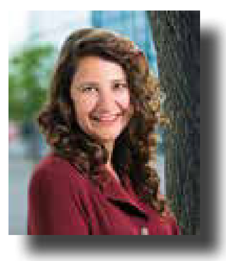
e. Spousal consent was obtained, if required by the plan document.

f. The loans are properly segregated from other investments within individual participant accounts.

Examine the agreement supporting the loan and compare descriptions and terms to the information on the schedule of participant loans.

Notice Distributions - Verify that notices were distributed: As applicable, ensure that all required notices, including but not limited to the Safe Harbor, Qualified Default Investment Alternative (QDIA), and Plan Expense notices were timely provided to participants.

IRS Audits and DOL Investigations - Under the honor system created through the audit waiver for small plans, the IRS and the DOL choose to trust, but also when to verify. Failure to follow the plan provisions is a qualification error, and nobody wants to get disqualified. Plan officials should always play by the rules, even in the house with no rules, by having processes and procedures designed to operate the plan in accordance with its terms. However, in the absence of an audit requirement, it behooves every small plan sponsor to trust, but verify, to stay qualified.



Maria leads a team of specialized retirement plan auditors and the retirement plan audit practice group at BLS. She spearheads the firm's employee benefit audit blog – The Art of the Qualified Plan Audit and speaks at local and national educational conferences, including the AICPA/DOL National Employee Benefit Plan conference and the American Society of Pension Professionals and Actuaries conferences.