An INHAM Audit Will Keep You Out Of Sticky Compliance Issues

A corporation's own pension plan managed by the corporation's in-house managers needs an independent audit in order to take advantage of the prohibited transaction relief provided by the INHAM class exemption. If the plan does not get a timely audit, the plan's counterparties can owe lots of money.

<u>Which plans need audits?</u>

Many large companies have the in-house management expertise to provide discretionary investment management services to plans of an affiliate (referred to as "in-house plans"). The INHAM exemption provides broad relief from the prohibited transaction provisions of the Employee Retirement Income Security Act ("ERISA") for the company's in-house staff to act as a discretionary investment manager ("INHAM") for plans maintained by affiliates of the INHAM, provided that the INHAM adopts written policies and procedures that are designed to assure compliance with the conditions of the exemption and an independent auditor conducts an annual exemption audit.

<u>Why?</u>

Companies whose plans are managed by in-house managers cannot engage in otherwise beneficial transactions on behalf of plans with related parties in the absence of an administrative exemption. DOL's Prohibited Transaction Exemption ("PTE") 96-23 permits related parties to engage in transactions with a plan if, among other conditions, the plan assets are managed by an INHAM. That is, using its fiduciary authority to cause an affiliate's plan to engage in prohibited transactions is not permitted unless the in-house manager meets the requirements and restrictions imposed in PTE 96-23. This PTE was subsequently amended on April 1, 2011 to clarify the requirements for an exemption audit.

An INHAM audit is different than the typical audit done for financial statement purposes. The purpose of an INHAM audit is to demonstrate that the plan's in-house manager complied with PTE 96-23. It is an independent review to ensure that the INHAM complied with its adopted policies and procedures and the objective conditions described in the PTE. Consequently, the DOL requires that the auditor be an expert in ERISA fiduciary matters. Specifically, the PTE requires "an independent auditor, who has appropriate technical training or experience and proficiency with ERISA's fiduciary responsibility provisions…"[1]

[1] See PTE 84-14, Part V(c)

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What is involved in this audit?

The purpose of the audit, as specified in PTE 96-23, is to determine whether the INHAM is in compliance (i) with the INHAM's written policies and procedures and (ii) with the objective requirements of the exemption.

This will be accomplished by:

1. A review of the written policies and procedures adopted by the INHAM;
2. A test of a representative sample of the plan's transactions during the audit period to determine if the INHAM is in compliance with its policies and procedures and the objective requirements of the exemption; and
3. To the extent that an individual transaction does not comply with the INHAM's policies and procedures or the objective conditions of the exemption, the auditor will identify which policy or procedure or exemption condition was not satisfied. The auditor will also describe the actions, if any, taken by the INHAM to remedy the non-compliant transaction.

The independent auditor will summarize its conclusions in a written report for the plan. In the event the auditor identifies prohibited transactions, the INHAM is required to take appropriate action to address the adverse finding. The failure of the INHAM to address the prohibited transactions identified in the written report would raise issues under the fiduciary responsibility provisions of ERISA § 404.

When is the audit due?

The audit must be completed within six months following the end of the plan year. For calendar year plans, the audit is due by June 30.

Failure to get a timely audit

If a plan does not receive a timely INHAM audit, the INHAM will be considered out of compliance with the INHAM exemption and taxes would be owed under IRC 4975(a) for any prohibited transactions entered into by the INHAM on behalf of the plan.

IRC 4975(a) imposes an excise tax on each prohibited transaction. The amount of the tax is 15% of the amount of the prohibited transaction for each year that the transaction is outstanding.

Who do I contact to get an INHAM audit?

Fiduciary Counselors is a privately-held firm that primarily acts as an independent fiduciary for employee benefit plans. With our extensive knowledge of ERISA and the associated fiduciary responsibilities established by the DOL along with our expertise and experience in financial and investment matters, Fiduciary Counselors is well qualified to provide INHAM audits as well as solutions to a broad range of fiduciary and investment issues.

In addition to our unique fiduciary expertise, our qualifications are enhanced with the services of Mr. Ivan Strasfeld as a senior advisor. Mr. Strasfeld formerly served as the Director of the Office of Exemption Determinations at the DOL's Employee Benefits Security Administration.

Please contact Laura Rosenberg, Senior Vice President, Finance, at Laura.Rosenberg@FiduciaryCounselors.com or (202) 558-5135, or Ivan Strasfeld, Senior Advisor, at Ivan.Strasfeld@FiduciaryCounselors.com.