

Strafford

Presenting a live 110-minute teleconference with interactive Q&A

401(k) Plan Audit Preparation Strategies

Navigating IRS and DOL Standards, Taking Corrective Actions and Minimizing Risks of Penalties

WEDNESDAY, JANUARY 18, 2012

1pm Eastern | 12pm Central | 11am Mountain | 10am Pacific

Today's faculty features:

Rance Buss, Partner, McConnell & Jones, Houston

Ilene Ferenczy, Managing Member, Law Offices of Ilene H. Ferenczy, Atlanta

Russ Dempsey, VP and Chief Legal Officer, United Retirement Plan Consultants, Dublin, Ohio

For this program, attendees must listen to the audio over the telephone.

Please refer to the instructions emailed to the registrant for the dial-in information. Attendees can still view the presentation slides online. If you have any questions, please contact Customer Service at 1-800-926-7926 ext. 10.

Conference Materials

If you have not printed the conference materials for this program, please complete the following steps:

- Click on the + sign next to “Conference Materials” in the middle of the left-hand column on your screen.
- Click on the tab labeled “Handouts” that appears, and there you will see a PDF of the slides for today's program.
- Double click on the PDF and a separate page will open.
- Print the slides by clicking on the printer icon.

Continuing Education Credits

FOR LIVE EVENT ONLY

Attendees must listen to the audio over the telephone. Attendees can still view the presentation slides online but there is no online audio for this program.

Attendees must stay on the line for at least 100 minutes in order to qualify for a full 2 credits of CPE. Attendance is monitored as required by NASBA.

Please refer to the instructions emailed to the registrant for additional information. If you have any questions, please contact **Customer Service** at 1-800-926-7926 ext. 10.

Tips for Optimal Quality

Sound Quality

For this program, you must listen via the telephone by dialing **1-866-873-1442** and entering your PIN when prompted. There will be no sound over the web connection.

If you dialed in and have any difficulties during the call, press *0 for assistance. You may also send us a chat or e-mail sound@straffordpub.com immediately so we can address the problem.

Viewing Quality

To maximize your screen, press the F11 key on your keyboard. To exit full screen, press the F11 key again.

401(k) Plan Audit Preparation Strategies Seminar

Jan. 18, 2012

Russ Dempsey, United Retirement Plan
Consultants
russ.dempsey@unitedretirement.com

Ilene Ferenczy, Law Offices of Ilene H.
Ferenczy, LLC
ilene@ihflaw.com

Rance Buss, McConnell & Jones
rbuss@mjlm.com

Today's Program

Introduction And Keys To Success
[Russ Dempsey]

Slide 7 - Slide 17

Dealing With IRS Audits
[Ilene Ferenczy and Russ Dempsey]

Slide 18 - Slide 40

Dealing With U.S. Department Of Labor Audits
[Rance Buss and Russ Dempsey]

Slide 41 - Slide 54

Russ Dempsey, United Retirement Plan Consultants

INTRODUCTION AND KEYS TO SUCCESS

The Department Of Labor: Areas Of Responsibility

- I. Exclusive benefit rule
- II. Prudence of plan fiduciaries
- III. Conflicts of interest
- IV. Investments
- V. Benefits in accordance with the law and plan
- VI. Disclosure to government and participants
- VII. Audits and investigations

The Internal Revenue Service: Areas Of Responsibility

- I. Income tax exemption
- II. Retirement plans covered by the IRC
 - A. Pension, 401(k), profit-sharing, etc.
- III. Plan document and determination letters
- IV. Operation of plan
- V. Disclosure to government and participants
- VI. Audits and investigations

DOL Audits: Top Triggers

I. Participant complaints

- A. Deposits not made timely to trust
- B. Failure to make distributions timely

II. Form 5500

- A. Desk reviews of 5500s
- B. Late-filers and non-filers
- C. EFAST2 analysis

III. Referrals from other governmental agencies

IV. Random audits

IRS Audits: Top Triggers

- I. Large number of separated participants not 100% vested
- II. High percentage of assets classified as “other”
- III. Significant distributions on income statements
- IV. Top-heavy Sect. 401(k) plans
- V. Top-heavy plans for self-employed individuals

Key To Success Is Preparation

- I. Educate yourself and plan sponsors
 - A. Know roles and duties
 - B. Fiduciaries/responsible persons
- II. Document everything
 - A. Procedural prudence
 - 1. Document key policies and processes
 - 2. Document decisions and results of monitoring efforts
- III. Organize for easy retrieval
 - A. Relevant documents should be strategically stored for quick access.

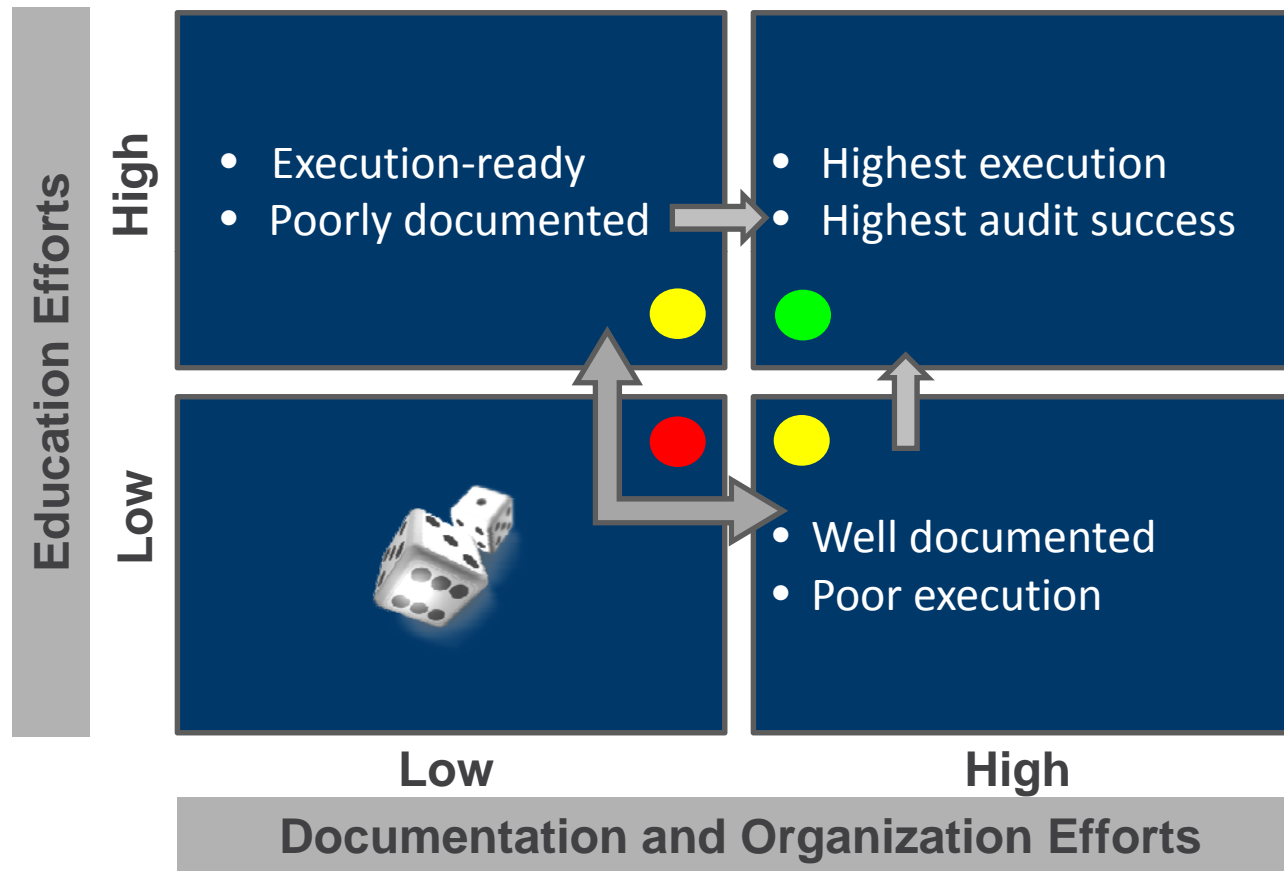
The Business Case For Compliance



The Business Case For Compliance (Cont.)



The Business Case For Compliance (Cont.)



Managing DOL And IRS Audits: Preparation Is THE Key

- I. Why we don't prepare
 - A. Time
 - B. Experience
 - C. Know-how

Managing DOL And IRS Audits: Preparation Is THE Key (Cont.)

- I. 8 keys to preparation*
 - A. Understand objectives
 - B. Learn from others
 - C. Understand options
 - D. Define interests
 - E. Set strategy
 - F. Plan your plan
 - G. Pick your team
 - H. Write it down

** Adapted from Ronald M. Shapiro's
"How To Win Before You Begin"*

Ilene Ferenczy, Law Offices of Ilene H. Ferenczy, LLC
Russ Dempsey, United Retirement Plan Consultants

DEALING WITH IRS AUDITS

Preparing For The Audit



Preparation In Advance: Not In Response To An Audit

- I. Documents
 - A. Plan, amendments, SPD
- II. Responsible individuals
 - A. Plan sponsor, trustee, consultants
- III. Operation and administration
 - A. Forms, records, test results, error correction

Documentation

- I. Plan document
 - A. Amendments
 - B. Opinion/determination letter
 - C. Summary plan description
- II. Operational documents
 - A. Test results and corrective actions
 - B. Transactions (loans and distributions)
 - C. Administrative forms (enrollment, deferrals, consents)

Responsibilities

- I. Identify responsible parties
 - A. Trustees
 - B. Administrative staff
 - C. Service providers
- II. Know duties
 - A. To participants
 - B. Operation of plan
 - C. Compliance with Internal Revenue Code

Preparation

- I. Form of presenting information
 - A. How may a reviewer like to receive the information?
 - B. When does a reviewer like to receive the information?

- II. From the practitioner's/client's perspectives

Location Of Audit

- I. IRS position on handling audits at the TPA's office?
 - A. Reports "from the field" that IRS reviewers in some areas
 - 1. Not to have audits outside the client's office
 - 2. Resistant to handling audits in service provider's office
 - B. What must be demonstrated to the IRS to make an audit at the TPA's office appropriate?

During The Audit



Previously Discovered Failures

How do we handle:

- I. If there has been a VCP for the year at issue?
- II. If there has been a self-correction that meets the EPCRS rules for the year at issue?
- III. If there has been a self-correction that did not meet the EPCRS rules for the year at issue?

Previously Discovered Failures (Cont.)

What if the decision was made not to correct the failure?

- I. Are some uncorrected failures more problematic than others?
- II. Is the IRS harder on a taxpayer that discovered an error and chose not to correct, than it is on taxpayers that never realized that an error had occurred?

Failures Discovered On Eve Of Audit

What should a taxpayer/practitioner do if an error is discovered on the eve of an audit?

- I. From the IRS' viewpoint, is this the same as if they discovered the error in the audit?
- II. Is there value in pointing it out to the auditor vs. allowing it to be discovered?
 - A. In other words, do we get "credit" for being forthcoming?
 - B. If so, how does that credit manifest itself?

Failures Discovered On Eve Of Audit (Cont.)

- I. Remember: Self-correction is possible even under audit, if the failure is insignificant.
 - A. Significant errors: Self-correction period ends when audit notice is received
 - B. But: Is “credit” given if an error is in process of correction by the time the audit takes place?
- II. Moral: Make any valid argument that the failure was insignificant

Failures Discovered On Audit

- I. Not eligible for any of the EPCRS corrections other than audit CAP, unless insignificant

- II. Question No. : Why did the IRS find this and you did not?

Failures Discovered On Audit (Cont.)

Three options

- I. Acknowledge error and cooperate with IRS in correcting the error and entering into CAP program

- II. Make argument that the error did not, in fact, occur - i.e., the IRS reviewer is misunderstanding the data

- III. Make argument that the action that the IRS is averring is a disqualifying failure is not, in fact, impermissible

Failures Discovered On Audit (Cont.)

Strategies

- I. Should any responses be given on the day of the audit?
 - A. Is it a better strategy to get all questions in writing, take time to get all the facts/strategies, and then to respond; or
 - B. To try to respond “off the cuff” to as many questions as possible?
 1. What if impressions at the time of the audit turn out to be incorrect, and you want to change directions later? Is the client’s position “prejudiced” by having taken a position on the day of the audit?

Failures Discovered On Audit (Cont.)

Strategies (Cont.)

- II. Should the demeanor of the parties during this process be adversarial?
 - A. What is the IRS reviewer's goal?
 1. To "nab" the taxpayer and collect the maximum tax or sanction?
 2. To ensure plan compliance in a corrective manner and to move forward?
 3. Both?
 - B. Is an audit in which no tax or sanction is collected considered a "failure" for the reviewer?
 - C. Can you really catch more flies with honey than with vinegar?

How Does The CAP Process Work?

Three elements

I. Correction

- A. There may be several alternatives in how to correct the failure.

II. Sanction

- A. What is the MPA?
- B. Why is it needed?
- C. If you concede that the MPA is large (say \$100,000 or more), is there any real reason to calculate it?

III. CAP agreement document

Resolving Problems



“Mean” Auditors

What should a taxpayer or representative do if the auditor is hostile or rude?

“Incorrect” Auditors

What should a taxpayer or representative do if the auditor is taking a position that is:

- I. Against IRS policy (e.g., in relation to place of audit)?

- II. Incorrect on the law?

Going Up Chain Of Command

- I. When is it appropriate for a practitioner to ask to speak to the auditor's supervisor?

- II. When is it appropriate to contact the D.C. office?

When There Is No Meeting Of Minds

- I. What is the procedure when the parties cannot come to an agreement?

- II. What is the procedure for requesting an appeal of an audit finding?

What Not To Do

What should a taxpayer or practitioner NEVER do in an audit situation?

Rance Buss, McConnell & Jones

Russ Dempsey, United Retirement Plan Consultants

DEALING WITH U.S. DEPARTMENT OF LABOR AUDITS

DOL Audits

- I. Similarities to IRS Audit
 - A. Demeanor toward investigator
 - B. Location of audit issue
 - C. Volume of documents requested
- II. Differences
 - A. Higher probability of criminal/civil penalties
 - B. Most DOL investigators are lawyers

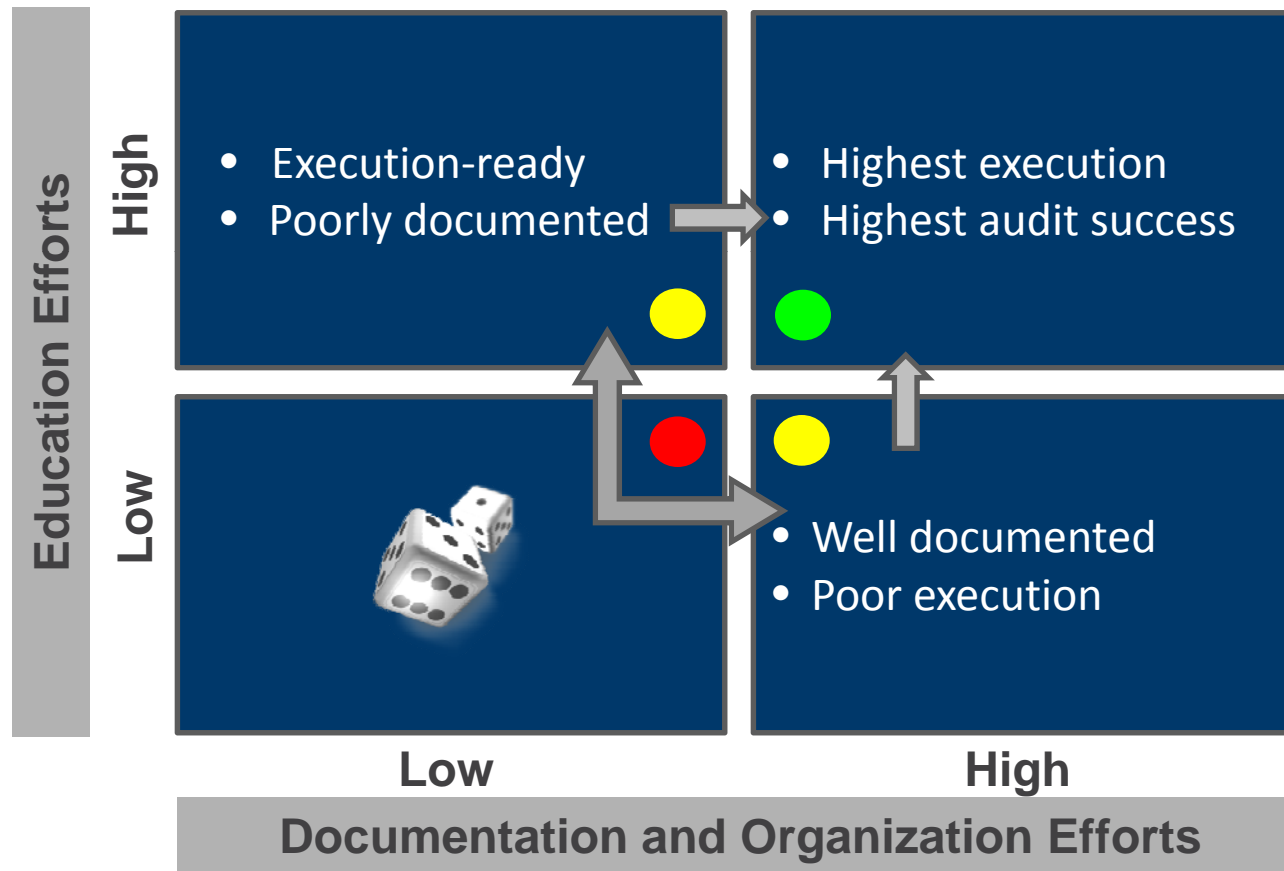
DOL Audits: So, What Happens?

75% of all DOL
retirement plan audits
result in at least one
violation!



Source: "Surviving a DOL Audit"
Aiken & Aiken
<http://aikenandaiken.com/blog/benefits-lawyers/41>

Best Position For Success



DOL Document Request

Not 1 page...

ATTACHMENT "A"



PLEASE HAVE THE FOLLOWING ITEMS AVAILABLE FOR REVIEW AND RETENTION

Note: Unless otherwise specified, the documents to be provided should include those covering the entire period under review — January 1, 2007, through to the present date.

1. Plan document, Adoption Agreement, Trust Agreement, and all amendments
(Note: Please include copies of the signed signature pages for each of the documents.)
2. Any written policy statements, guidelines, or other documents governing or concerning the operation or administration of the Plan (e.g., Plan Investment Policy, Participant Loan Policy, etc.)
3. Summary Plan Description, and all modifications
4. Most recent IRS Determination Letter
5. Fidelity bond (current and complete copy), if any, including the declarations page and any riders/endorsements identifying the Plan as a named insured and specifying the amount of coverage, the period covered, and the name of the surety company
6. Fiduciary liability insurance policy current and complete copy, if any
7. List of Plan managers, trustees, and members of any administrative committees, along with owners of the Plan sponsor, including titles, responsibilities, and contact information
8. List of service providers (including titles and responsibilities), together with applicable contracts, agreements, management letters, and fee schedules, and points of contact information
9. Annual reports (Forms 5500 or 5500-C/R) with signed signature pages, together with all attachments, including (if applicable) the accountant's opinions, financial statements, notes to the financial statements, and management letters
10. Summary Annual Reports
11. Most recent Annual Reports (Forms 5500 or 5500-C/R) for all other sponsored plans (health, pension, benefits, etc.)
12. Most recent internal balance sheet (statement of assets and liabilities) for the Plan, including descriptions of all assets held and their locations; e.g., name of investment company, financial institution, etc., where trust assets are deposited. There should be no category marked "other" where assets are aggregated.
13. Promissory Notes and security agreements between Plan and third parties from January 1, 2007 to present.

DOL Document Request (Cont.)

Not 2 pages...

14. Most recent Plan valuation, including a listing of participants with social security numbers, annual account allocations, and account balances (i.e., something that has the current Plan balance and number of participants)
15. Schedules of Plan receipts and disbursements, including supporting documentation (account statements, check registers, canceled checks, deposit slips, wire transfer confirmations, etc.)
16. Samples of participant statements provided to participants through the last Plan year provided for individual account plans with and without participant directed investments. Please include a sample if a participant statement has been provided to a beneficiary, as well. For defined benefit plans, please provide samples from the last year provided.
17. Plan's correspondence file (no copies required at this time; for review only)
18. Minutes of any Plan Trust or Plan Committee meetings (no copies required at this time; for review only)
19. Notices to participants regarding any blackout periods, if any.
20. If the company that sponsors the Plan has filed bankruptcy, please provide copies of the original bankruptcy filing, which would include, but is not limited to, the voluntary petition, all initial filing documents (schedules and statement of affairs), any additional initial filing documents which may have been required by the U. S. Trustee and any copies of interim statements and operating reports, a current list of creditors with respect to the bankruptcy, and the Plan of Reorganization
21. If there are employee contributions to the Plan, documents that show employee contributions due and made to the Plan for each pay date for the period indicated; January 1, 2006 through the present. These documents should include:
 - A. A payroll summary or register showing **an** employee contributions (payroll deductions, loan repayments, etc.) to the Plan delineated by each pay period.
 - B. Evidence of receipt of these monies by the Plan's trust. For example, acceptable evidence would be trust deposit statements and canceled checks with corresponding bank statements. Note: If monies deposited include employer contributions, please indicate the amounts for each period.

The purpose of this is to be able to correlate deducted amounts to deposited amounts. Often it is easiest to expedite the review process if a spreadsheet of the amounts is provided along with the backup documents.
22. If employee contributions to the Plan have been 30 days or more in arrears at any time since the Plan's inception, please provide a schedule or documentation of the delinquent contributions and actions undertaken to correct this situation.
23. Summary of Plan investments with corresponding annual rates of return for each investment for the period indicated, delineated by Plan year, and separated by quarter. (Note: The Fund Custodian can usually accomplish and provide this item easily.)
24. Signature cards from bank accounts from which employee deductions are sent.

DOL Document Request (Cont.)

Not 3 pages...

25. Sample of documentation for loans secured by the vested interest of individual Plan participants. (including application forms, promissory note, amortization schedule, withholding authorization if applicable).
26. For all investments that are not strictly mutual funds, all supporting documents pertaining to Plan investments held or acquired (including but not limited to the following), including information pertaining to the investment decision-making process such as feasibility studies and investment advisor reports:
 - a. Bank statements, including certificates of deposit
 - b. Stock certificates, brokerage account transaction statements, mutual fund statements (and prospectuses) with the most recent financial report, or other indicia of ownership for Plan investments
 - c. Insurance contracts and statements showing current values of contract
 - d. Asset appraisals
 - e. For all loans, other than loans secured by the vested interest of individual Plan participants:
 - i. Promissory note
 - ii. Loan application, agreement (including modifications), guarantees, extensions, etc. (include all supporting documentation)
 - iii. Loan underwriting file (including credit reports)
 - iv. Documents evidencing the details of the loan transaction, including whether the borrower is a business or entity other than an individual, documents identifying the type of entity and its owners, officers and directors (where applicable), the borrower's relationship to the Plan or any parties in interest thereof (if applicable)
 - v. Loan amortization / repayment schedule
 - vi. Identification of collateral, if any, together with all applicable recorded documents (security agreements, deeds of trust, UCC-1 filings, etc.)
 - f. For all property, including land, buildings, equipment, motor vehicles, coins, etc. held by the Plan during any portion of the period under review:
 - i. Description of property, including location with street address where applicable
 - ii. Acquisition date and details of acquisition, including identity of seller and the seller's relationship to the Plan, the terms of purchase, appraisal and title policy, grant deed or other indicia of ownership, if applicable
 - iii. Value at acquisition and current market value, including any reports, studies, analyses, or appraisals performed or obtained during the period under review relating to the value of the property or to the use (or prospective use) of the property
 - iv. Information on debt financing, including identity of lender, amount financed, interest rate, payment terms and current balance (or date paid in full)
 - v. An explanation of the use made of property, if any, and by whom
 - vi. Sources and amounts of income for any income-producing property, including leases or other applicable documents evidencing the selection process for obtaining tenants
 - vii. Documents evidencing the details of the disposition of the property, including the date, amount and terms of sale / transfer (value received, financing, etc.), fees or commissions paid in connection with the sale / transfer of the property , and

DOL Audit Document Request (Cont.)

documents identifying the purchaser and the purchaser's relationship to the Plan or any parties in interest thereof (if applicable)

4 pages...

- g. For any partnership or limited partnership investment:
 - i. Partnership Agreement and offering circular
 - ii. Most recent Schedule K-1 (Form 1065) and current market value
 - iii. Most recent partnership financial statement

You have to be ***prepared in advance*** to respond successfully.

Preparation: Education

- I. Identify parties-in-interest
 - A. Fiduciary
 - B. Employee of plan
 - C. Service providers
 - D. Employer
 - E. Substantial owner
 - F. Directors and officers

Preparation: Education (Cont.)

I. Fiduciary - 3(21)

- A. Exercises discretionary or other management authority or control over plan assets
- B. Offers investment advice for a fee
- C. Has discretionary authority or responsibility in administration of the plan

II. Fiduciary - 3(38)

- A. Investment manager fiduciary
- B. Has discretionary authority/control over plan assets

Preparation: Know Duties Of All Involved

I. Fiduciary duties

- A. Act for the exclusive benefit of participants
- B. Prudence: Act with care, skill, prudence and diligence of a prudent individual
- C. Diversify investments to minimize risk of loss
- D. Operate plan consistently with plan document

II. Three categories of prohibited transactions

- A. Between plan and party-in-interest
- B. Between plan and fiduciary
- C. Transfer of property to a plan by a party-in-interest

Documentation

I. Procedural prudence: Compliance with new fee disclosure regulations

The DOL's new three-stage plan to assist (and make regulatory) sponsors/participants with decision-making

- 1 Service provider fee disclosures to plan sponsors to assist in assessing reasonableness of compensation and potential conflicts of interest (Reg. 408(b)(2), effective April 1, 2012)
- 2 Disclosures by plans of certain plan fee and investment-related information to participants (Reg. 404(a), effective May 31, 2012)
- 3 Disclosures to public and government on 5500 Schedule C, including direct/indirect compensation

Documentation (Cont.)

I. Procedural prudence: Compliance with new fee disclosure regulations (Cont.)

What do plan sponsors do with all this information? What will the DOL auditor want to see?

- I. Evaluate all contracts to determine if they meet the new requirements
- II. Assess the reasonableness of their plan fees/services
- III. Detect whether any potential conflicts of interest affect the quality of those services
- IV. Monitor investment alternatives and service providers once selected, to determine whether they continue to be appropriate choices and their fees continue to be reasonable

Conclusion

- I. Educate yourself and plan sponsors
 - A. Know roles and duties
 - B. Identify and educate fiduciaries
- II. Document everything
 - A. Procedural prudence
 - 1. Document key policies and processes
 - 2. Document decisions and results of monitoring efforts
- III. Organize for easy retrieval
 - A. Relevant documents should be strategically stored for quick access