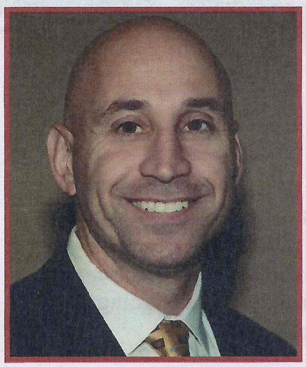

PREPARING FOR A 401(K) AUDIT

BY MARK SHORE

We are all familiar with the prospect of getting our personal tax returns audited by the government. In fact, the possibility of an audit is a great motivator to help us all keep accurate records and follow the rules. But what happens if your 401(k) plan gets audited? How can plan sponsors adequately prepare?

Maintaining your plan records, documents, and notes in an organized manner will assist in both keeping you out of an audit and helping you to make an audit go smoothly if you are examined. Your records should include, among other things, Minutes or Resolution documenting actions taken by the plan sponsor, the Plan Documents (including all amendments), recent Form 5500 filings (at least seven years) and Summary Annual Report (SAR), Summary Plan Description (SPD) with any modifications, payroll and contribution records, fiduciary and fidelity bonds, and nondiscrimination testing results.

Document, Document, Document

One of the key items a plan sponsor can have in place to help ensure their plan is operated in a compliant manner is a list of written procedures. Documenting how your plan is operated not only provides those performing the duties with a basis for their actions, but can also provide proof to an auditor that the plan has been operating correctly. Examples of such important procedures includes how newly eligible participants are enrolled in the plan or how contributions are calculated and remitted.

In general, it is a good idea to maintain a checklist[1] to assist with plan compliance. You can start by answering the following questions:

1. Has your plan document been updated within the past few years?

2. Are your plan's operations based on the terms of the plan document?

3. Is the plan's definition of compensation for all deferrals and allocations used correctly?

4. Were employer matching contributions made to all appropriate employees under the terms of the plan?

5. Has the plan satisfied the 401(k) nondiscrimination tests (ADP and ACP)?

6. Were all eligible employees identified and given the opportunity to make an elective deferral election?

7. Are elective deferrals limited to the amounts under IRC §402(g) for the calendar year?

8. Have you timely deposited employee elective deferrals?

9. Do participant loans conform to the requirements of the plan document and IRC §72(p)?

10. Were hardship distributions made properly?

If Your Plan Is Selected for an Audit

Usually, an agent will notify you indicating your plan has been chosen for examination. A written notice will follow, which will include a list of items to be provided to the auditor for review. You should immediately reach out to your service provider and/or CPA to determine the support that can be given to you. Do an assessment of the requested documents to see whether they are in your possession, which will help you determine how much prep time you will need before scheduling the actual appointment. Don't be afraid to ask for a reasonable extension if you need more time—it's better than presenting incomplete documentation. Try to have assistance at the audit from your service provider, CPA or attorney.

Finding a Mistake

If you discover a mistake with respect to your 401(k) plan prior to any audit, you may use the IRS's Employee Plans Compliance Resolution System (EPCRS) to fix the issue and hopefully avoid the consequences of possible higher sanctions and plan disqualification. There are three components of the EPCRS: Self Correction Program, Voluntary Correction Program and Audit Closing Agreement Program.

The Self Correction Program allows a plan sponsor to correct certain *operational* plan deficiencies without submit-

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[1] IRS Publication 4531 (Rev. 11-2008)

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Who Is the Auditor?

Most private sector retirement plans are covered by the Employee Retirement Income Security Act (ERISA). Among other things, ERISA specifies protections for participants and beneficiaries, as well as dictates the fiduciary responsibilities of plan sponsors. Both the Employee Benefit Security Administration (EBSA) of the Department of Labor (DOL) and Internal Revenue Service (IRS) periodically perform audits of these pension plans in order to enforce the provisions and protections provided under ERISA and the Internal Revenue Code.

ting to the IRS. As a general rule, the plan sponsor has two years from the end of the plan year in which the Operational Failures occurred to correct them, unless they are reasonably deemed Insignificant Operational Failures. There is no fee for this option as there is no submission, but the plan sponsor must keep complete documentation of the correction in their files.

The Voluntary Correction Program permits a plan sponsor to pay a fee to the IRS and receive approval for the correction of plan failures prior to an audit. This includes any documentation failures. The plan sponsor must submit an application identifying the failure(s), show proof of the corrective action taken using the General Correction Principles, and pay the filing fee. The fee is generally based on the number of plan participants per the Form 5500. The IRS then issues a Compliance Statement detailing the identified failures and approval of the correction.

The Audit Closing Agreement Program requires a plan sponsor to pay a sanction and to correct identified plan failures while the plan is under audit or review. The plan sponsor must correct and provide proof for all identified plan deficiencies or failures prior to entering into the Closing Agreement. The sanction is typically much greater than the fee paid under the Voluntary Correction Program.

The DOL EBSA division also has corrective programs that may be applicable for certain circumstances, such as late contributions and loan repayments, as well as late submission of Form 5500. You should never ignore a mistake once it is found. It won't go away by itself and it is always better to find it and fix it yourself before the audit letter arrives.

Can I Avoid a 401(k) Audit?

Just like with your own personal tax returns, some audits are based on a random selection. However, 401(k) audits can also be initiated based on specific complaints lodged by participants or information submitted on Form 5500. So, while there is no way to guarantee your plan will not be audited, the best approach plan sponsors can take is to administer their plans on an ongoing basis as if they were already preparing to be audited.

Mark Shore is the President of Atlas Consulting Services, LLC.
Mark acknowledges Transamerica Retirement Services for their assistance and for information contributed to this article.

This article was originally published in the Fall/Winter 2010 edition of the New Jersey Association of Legal Administrators' *Jer-Z-Journal* and is reprinted with permission.