Preparing for an employee benefit plan audit

Once taxes are filed, it’s employee benefit plan audit season. Each year, the rules and regulations governing EBP compliance grow more complex. With more DOL regulations, it’s more important than ever to have your EBP audit compliant with all applicable requirements.

Offering a 401(k) plan or profit sharing plan is a tremendous benefit for employees. As a plan sponsor, you know that a benefit of this type does come with additional administrative responsibilities in order to operate the plan properly. You also have a fiduciary responsibility to ensure that the plan is compliant with the Department of Labor, IRS, and other regulators. And for those plan sponsors that have at least 100 employees eligible to participate in a plan, than that plan is required to have an audit performed by an independent, qualified CPA firm. An audit will provide reliable and accurate information for all plan participants.

There are many things a plan sponsor can do throughout the entire audit process to help ensure a positive experience.

Organizations need to determine which of their plans require an audit. These plans could be:

- Defined contribution plans
- Defined benefit plans
- Health and welfare plans
- Employee Stock Ownership Plans (ESOP)
- 403(b) Plans
- 401(k) Plans

Being prepared before an employee benefit plan audit can help make the process fast and efficient, which helps to keep costs down. Whether your employee benefit plan is about to be audited for the first time or you are looking to improve upon the audit process from the prior year, consider these tips to prepare for an audit of your plan and maximize efficiencies.

**Planning**

You should be able to discuss key policies and procedures that impact the operation of the plan, any changes to the polices and plan documents, and any compliance issues. Understanding these items early on allows the audit team to identify and focus on any risks that could affect your plan. Ensure the audit team is aware of key plan resources. To have a successful plan, you must have a solid understanding of the plan and good communication with the person responsible for the overall audit process, including overseeing preparation of the plan’s financial statements and Form 5500, Annual Return/Report of Employee Benefit Plan.

Having a single point of contact for the audit team can help with a smooth and efficient process. This is generally the person who has primary responsibility for the administration of the plan.
Know the plan’s investments and arrangement in which they are held. This can help determine the type of scope required. In addition, the type and complexity of investments determines the extent of audit procedures and financial statement disclosures required. This planning stage is the time to gather required disclosure information about the plan’s investments from the plan’s custodian or investment advisers. This is especially important if the plan invests in alternative or hard-to-value investments.

It is important to provide easy access to any requested documents, along with a draft of the plan’s financial statements. Generally, the auditor’s request list will include updated plan documents or amendments, an employee census report, the annual auditor package from your TPA, activity-level internal control narratives, spreadsheet templates to summarize plan activity, and confirmation templates. The confirmation process can be done via email or paper requests, and tend to be most effective when sent early in the audit process.

**Fieldwork**

Be available to meet with the audit team to discuss key plan processes and controls at the activity level and plan level, as well as the plan’s information technology controls. You should be able to discuss any financial statement line items and footnote disclosures that need updating in the working draft of the plan’s financial statements. Involving the plan’s TPA in discussions with the audit team regarding the plan’s investments helps with communication.

Have the documents the audit team will need for tests of participant and plan-level data. Key testing areas include contributions, participant data, eligibility, an election not to participate, allocations to participant accounts, participant loans, benefit payments, and any other plan transactions during the year. Also, be ready with data regarding the plan’s nondiscrimination testing, forfeitures applied, and any prohibited transactions such as late remittance of participant contributions to the plan. In the case of a full-scope audit, investment valuation and transaction testing will also be performed. Prior to leaving the field, the audit team should provide a complete list of items required and establish a timeline for completion.

**Wrap-up**

Again, be available for any final questions on adjusting journal entries and passed journal entries to the financial statements. Along with finalizing the financial statements, final audit communications will be presented, which includes a management representation letter and any letters that discuss the audit process and any findings during the course of the audit. Lastly, the draft Form 5500 will be reviewed to ensure it agrees to the draft audited financial statements, prior to issuance of the audit report.

**80/120 Rule**

This allows plans with 80 to 120 participants, as of the first day of the plan year, to file the Form 5500 in the same category as the prior year’s Form 5500 filing. The number of participants dictates the plan size. Employees become includable as “participants” on the date that the employee becomes eligible to participate - regardless of if they participate.

You may need an audit if the number of eligible plan participants has changed since your last filing. Eligible participants include:

- Active – currently employed by plan sponsor (could be participating or not participating)
- Retired or separated – not employed by the plan sponsor, but has assets in the plan
- Deceased – have passed away, but their beneficiaries have assets in the plan or are receiving/entitled to receive benefits
This table illustrates some possible situations:

<table>
<thead>
<tr>
<th>Number of eligible participants on first day of plan year</th>
<th>Financial schedule filed with prior year Form 5500</th>
<th>Options for current year Form 5500</th>
<th>Audit required?</th>
</tr>
</thead>
<tbody>
<tr>
<td>&lt;80</td>
<td>Doesn't matter</td>
<td>Smal Plan - Schedule I</td>
<td>No</td>
</tr>
<tr>
<td>80-99</td>
<td>Small Plan - Schedule I</td>
<td>Small Plan - Schedule I</td>
<td>No</td>
</tr>
<tr>
<td>100-119</td>
<td>Large Plan - Schedule H</td>
<td>Either Schedule H or I</td>
<td>Optional*</td>
</tr>
<tr>
<td>&gt;120</td>
<td>Doesn't matter</td>
<td>Large Plan - Schedule H</td>
<td>Yes</td>
</tr>
</tbody>
</table>

*Audits are always required if you elect to file as a large plan using Schedule H.
File Schedule I to avoid the audit requirement in these circumstances.

There are always exceptions to audit requirements. For example, if you have a large plan and the plan year is seven months or less, the you may elect to defer the audit requirement to the following plan year (a short-plan year). Another exception is the 80-120 participant rule, which allows a plan that filed a Form 5500 as a “small plan” last year to file its current Form 5500 in the “small plan” category again this year. This also allows a plan to forego the audit requirement if it now has up to 120 participants at the beginning of the current plan year, which otherwise would meet the 100 participant threshold and require a large plan filing and annual audit.

If your organization is in need of an audit, you might need either a DOL limited-scope audit or a full-scope audit. If your plan trustee can provide certified trust statements regarding the value of the investments, then a DOL limited-scope audit will suffice. While this type of audit doesn’t go as deep as the full-scope audit, the auditor must still assess and document internal controls and risks of non-investment activity, including participant eligibility, employee and employer contributions, benefit payments, and plan administrative expenses.

If your plan needs an audit, don’t worry. An experienced CPA can guide you through the process. Be sure to look for:

- A dedicated team of CPAs specializing in employee benefit plan audits
- A strong technical knowledge of GAAP, GAAS, ERISA and DOL requirements
- Significant and up-to-date knowledge of regulatory requirements
- An ability to effectively communicate with your third-party plan administrator

**Remember**

Penalties can be steep. Failure to properly file can result in fines of up to $50,000 for each plan year. That means companies would be wise to pay attention to both the July 31 deadline and the extension deadline of Oct. 15.

*Don’t face this process alone. Consult with an adviser to assure you are in compliance.*