

When will your 401(k) or other Retirement Plan Require an Annual Third Party CPA Audit?

Starting with the 1999 Form 5500 filing season, the Department of Labor substantially changed the filing format of Form 5500 as well as how Form 5500 will be processed. This change requires an Annual by a qualified Third Party CPA firm when certain conditions are met, primarily when total eligible participants reach 100 and the plan is deemed a “large” plan. This requirement significantly increases the annual costs of administration because of the fees charged for increased preparation by the TPA (Innovative Pension) and fees charged by auditing CPA firm.

Definition of a Large Plan

A Large Plan is a pension (profit sharing, 401(k), money purchase, etc.) plan that includes over 100 eligible participants at the beginning of the Plan year. A participant is defined as follows:

- Active participants - those individuals currently employed with the plan sponsor and who are covered under the plan and are receiving credited service. An active participant would include those employees who have elected to participate in the Plan as well as those who are eligible to participate but are excluded or, in the case of a 401(k) plan, have elected not to defer.
- Retired or separated participants - those individuals who are no longer employed by the employer but who are receiving benefits or are entitled to receive benefits under the Plan. A common example would be a former employee who maintains an account balance in the Plan.
- Deceased participants - those individuals who are deceased and have one or more beneficiaries receiving or entitled to receive benefits.

If the Plan qualifies as a Large Plan, it must file Schedule H to form 5500 and have the Plan audited by a qualified independent public accountant. If the Plan has under 100 participants at the beginning of the Plan year, it will file Schedule I Small Plan with its 5500 and forego the required audit. If the Plan is a new Plan, then you must determine the number of participants as of the first day participants were eligible to participate in the Plan.

Exceptions to the Audit Requirement

Short Plan Year

If the Plan would qualify as a large Plan and its Plan year is seven months or less, the Plan sponsor may elect to defer the audit requirement to the following Plan year. In the subsequent year, if the Plan qualifies as a small Plan, the Plan sponsor will nevertheless be required to have the Plan audited for the short Plan year.

The 80 to 120 Participant Rule

If the number of participants reported in Part II, line 6, of Form 5500 is between 80 and 120 and a Form 5500 was filed in the prior year, the filer may elect to complete the current year's Form 5500 in the same category (large or small Plan) as was filed in the previous year. For example, if the number of participants at the beginning of the Plan year is 110, and a Form 5500 was filed in the previous year as a small Plan (Schedule I was filed instead of Schedule H), the filer may elect to continue to file Schedule I and forego the audit requirement. However, if the participant count is 121, then regardless of what category of Plan was filed in the previous year, the current year's form 5500 must include Schedule H and the Plan must be audited.

Since the audit requirement is solely dependent on the number of participants, an accurate participant count is critical. A Plan sponsor has the option of distributing participant account balances for inactive participants providing their vested account balance is \$5,000 or less. Accordingly, if your participant count is such that you may be required to have the Plan audited, you may consider distributing inactive account balances under \$5,000 to the participants prior to the end of the Plan year.

Preparing for your 401(k) or other Retirement Plan Annual Third Party CPA Audit

Starting the audit too early and/or without the proper documents generally results in rescheduling, audit delays, and unnecessary costs. We recommend that the following be available at the start of the engagement:

- Plan document, adoption agreement and all amendments
- IRS determination letter
- SAS 70 report
- Summary plan description
- List of all parties in interest.
- Plan sponsor financial statements
- Discrimination tests
- Form 5500 with all supporting schedules
- Participant trial balance for the Plan year.
- Distribution forms for distributions during the Plan year
- Loan documents for all participant loans
- A schedule of deposits to the Plan on a pay period basic
- Forms W-2 or other annual payroll registers and reports
- Form 1099 for distributions
- Certification report for the Plan custodian

How do you tell if you have over 100 eligible participants? Check your 401(k) Form 5500 as filed. If the total number of eligible participants at year-end are over 100, you need an independent CPA audit for this year. If you start at less than 80 you do not need an audit until you have 120 participants.

The following table is a general pricing guideline for the audit of a typical 401(k) plan

Plan Size (eligible participants)	Independent CPA fee (estimated)	Big 5 CPA firm fee (estimated)
100 - 249	\$6,500	\$10,000+
250 - 499	\$7,500	\$12,500+
500 - 749	\$8,500	\$15,000+
750 - 1,500	\$9,500	\$20,000+
1,500+	\$10,500+	\$25,000+