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Plan sponsor Q&A

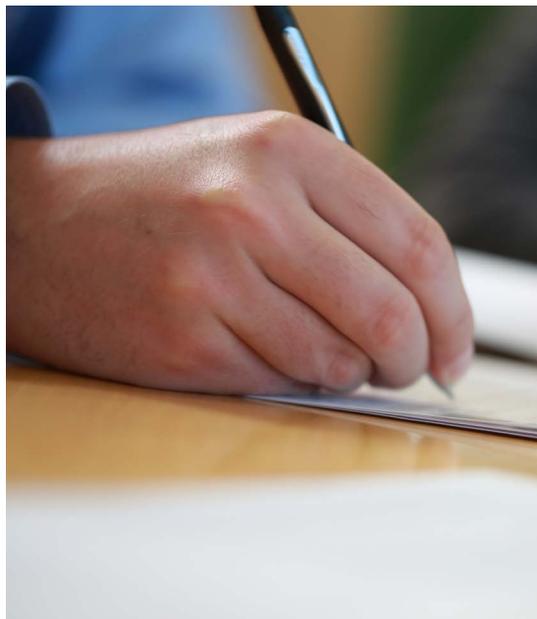
HELPFUL TIPS TO

PREPARE FOR A

RETIREMENT PLAN AUDIT



Knowing when and how to arrange for an audit of a plan's financial statements is an important responsibility for plan sponsors. While the rules governing audits may appear straightforward, there are important exceptions that can impact filings — for example, the so-called “80-120 Rule.”



# INTRODUCTION AND OVERVIEW



A well-informed plan sponsor is also better able to recognize the positive implications of an audit.

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Though some sponsors see audits simply as a necessary expense, a good auditor can be a useful resource in helping to keep the plan “IRS ready” (i.e., compliant with plan provisions and applicable tax qualification requirements).

**The following Q&A offers a useful road map to help determine:**

- Whether an audit is required
- Whether it can be limited in scope, and what that means for the plan
- How to select an auditor with the proper expertise

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### Q. When is an audit of the retirement plan financial statements required?

- A. Large qualified retirement plan Form 5500 filings must include financial statements that have been audited by an Independent Qualified Public Accountant. However, some large plans may be eligible for a limited-scope audit rather than a full-scope audit. Smaller plans can seek to have the requirement waived if they meet certain criteria.

### Q. What is a large plan?

- A. A plan with 100 participants or more as of the first day of the plan year, with participants defined as:

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- 1 Any individual who is eligible to participate in the plan, regardless of whether they choose to contribute a deferral, or...

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  - 2 Retired or terminated participants who still have an account balance in a defined contribution plan, or who are either receiving benefits or are entitled to future benefits under a pension plan, and their beneficiaries, as applicable.

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Participant counts should not include any individual to whom an insurance company has made an irrevocable commitment to pay all the benefits to which an individual is entitled under the plan.

### Q. What is the 80-120 Rule?

- A. The 80-120 Rule provides that so long as the number of plan participants on the first day of the plan year is between 80 and 120, the plan sponsor may elect to file the same type of Form 5500 it filed in the previous year. This is not a one-time election. So long as a plan that has previously filed as a small plan continues to have between 80 and 120 participants on the first day of the plan year, the plan sponsor can continue to elect to file as a small plan. Please note that the 80-120 election is not available for plans in their initial year, since those plans did not file a Form 5500 in the previous year. A new plan with 100 participants on the day of inception must attach audited financial statements to its large plan filing.

### Q. Under what conditions can small plans waive the requirement for a plan audit?

- A. Small retirement plans with fewer than 100 participants at the beginning of the plan year can claim a waiver from the audit requirement if they meet the conditions of DOL Regulation 29 CFR 2520.104-46\*:
- As of the last day of the preceding plan year, at least 95% of a small retirement plan's assets must be "qualifying plan assets" or, if less than 95% are qualifying plan assets, then any person who handles assets of a plan that do not constitute "qualifying plan assets" must be bonded in an amount at least equal to the value of the "nonqualifying plan assets"
  - The plan must include additional information in the Summary Annual Report (SAR) furnished to participants and beneficiaries in addition to the information ordinarily required, including:
    - the name of each regulated financial institution holding qualifying plan assets and their amounts as of the end of the plan year
    - the name of the surety company issuing the enhanced fidelity bond, if the plan has more than 5% of its assets in nonqualifying plan assets
    - a notice indicating that participants may, upon request and without charge, examine or receive copies of evidence of the required bond and copies of statements from the regulated financial institutions describing the qualifying plan assets
    - a disclosure stating that participants and beneficiaries should contact the Department of Labor's Employee Benefits Security Administration (EBSA) Regional Office if they are unable to examine or obtain copies of the regulated financial institution statements or evidence of the required bond
  - In response to a request from any participant or beneficiary, the plan administrator must furnish, without charge, copies of statements the plan receives from the regulated financial institutions holding or issuing the plan's "qualifying plan assets" and evidence of any required fidelity bond

\* As summarized in the Frequently Asked Questions posted on the Employee Benefits Security Administration website ([http://www.dol.gov/ebsa/faqs/faq\\_auditwaiver.html](http://www.dol.gov/ebsa/faqs/faq_auditwaiver.html)).

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## Q. What is the definition of qualifying plan assets?

- A. For purposes of determining whether a small plan is eligible for the audit waiver, a qualifying plan asset is defined as:
- Any asset held by certain regulated financial institutions, such as:
    - Banks, trust companies, savings and loan associations, credit unions, etc.
    - Insurance companies qualified to do business under the laws of a state
    - Broker-dealers registered under the Securities Exchange Act of 1934
    - Investment companies registered under the Investment Company Act of 1940
    - IRA institutional trustees under Internal Revenue Code Section 408
  - Shares issued by an investment company registered under the Investment Company Act of 1940 (e.g., mutual fund shares);
  - Investment (such as pooled separate accounts) and annuity contracts issued by any insurance company qualified to do business under the laws of a state;
  - In the case of an individual account plan, any assets in the individual account of a participant or beneficiary over which the participant or beneficiary has the opportunity to exercise control and with respect to which the participant or beneficiary is furnished, at least annually, a statement from a regulated financial institution describing the plan assets held or issued by the institution and the amount of such assets;
  - Qualifying employer securities, as defined in ERISA section 407(d)(5); and
  - Participant loans meeting the requirements of ERISA section 408(b)(1), whether or not they have been deemed distributed.

## Q. What are the filing requirements for 403(b) and other non-ERISA retirement plans?

- A. Non-ERISA plans (see below) do not file a Form 5500. To determine whether they are a large plan or a small plan, ERISA 403(b) plans have the option to exclude pre-2009 contracts that meet certain criteria from the participant count as follows:

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- 1 The contract or account was issued to a current or former employee before January 1, 2009
  - 2 The employer ceased to have any obligation to make contributions (including salary reduction contributions), and in fact ceased making contributions to the contract or account before January 1, 2009
  - 3 All rights and benefits under the contract or account are legally enforceable against the insurer or custodian by the individual owner of the contract or account without any involvement by the employer
  - 4 The individual owner of the contract is fully vested in the contract or account
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## Q. What types of plans are defined as non-ERISA?

- A. Non-ERISA plans include:
- Deferral-only, tax-deferred annuity plans in which the employer has limited involvement as described in Field Assistance Bulletin (FAB) 2010-01, found at: <http://www.dol.gov/ebsa/regs/fab2010-1.html>
  - Federal, state, or local government plans, including plans of international organizations
  - Certain church or church association plans
  - Plans maintained solely to comply with state workers' compensation, unemployment compensation or disability insurance laws
  - Plans maintained outside the United States primarily for non-resident aliens
  - Unfunded excess benefit plans maintained solely to provide benefits or contributions in excess of those allowable for tax-qualified plans

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## Q. What is a limited-scope audit?

- A. Limited-scope audits exclude investment values from the scope of the audit if the assets are held at a regulated financial institution such as a bank, insurance, or trust company that certifies that the value of the assets is complete and accurate pursuant to Department of Labor Reg. 29 CFR 2520.103-5.

Although the audit opinion states that the auditor is unable to express an opinion on the financial statements as a whole (due to the significance of the investment values excluded from the scope of the audit), it also indicates that the information included in the financial statements and supplemental schedules, other than the information certified by the regulated financial institution, was audited in accordance with auditing standards generally accepted in the U.S. and, in the auditor's opinion, is presented in compliance with the Department of Labor's Rules and Regulations for Reporting and Disclosure under the Employee Retirement Income Security Act of 1974.

This means that all of the following significant audit areas dealing with certain plan operations undergo the same audit procedures that would take place in a full-scope audit:

- Eligibility
- Employee contributions
- Employer contributions
- Loan processing
- Distributions (hardship, terminating, in-service, corrective, and deemed distributions)
- Participant data
- Allocation to participant accounts

## Q. When are limited-scope audits worthwhile?

- A. I believe that a key reason 65% of plan sponsors engage auditors to perform limited-scope audits is because they see value in the verification of their plan operations' compliance with the plan provisions, a process separate and distinct from the verification of investment values.

There can be misconceptions about the extent of the audit procedures involved in a limited-scope audit. It's not uncommon for both plan sponsors and service providers to be dismayed by an "audit information request letter" that is substantially the same as what they would receive under a full audit. As a result, they must produce backup documentation including:

- Original-source payroll-by-payroll detail for selected participants
- Demographic information to substantiate the census data
- Records to prove eligibility for contributions and distributions,
- Loan documents and repayment detail
- Numerous reconciliations to prove the completeness and accuracy of contributions allocated to participants

Sadly, many service providers tell their clients that their audit fee should be negligible because the plan qualifies for a limited-scope audit. However, limited-scope audit fees are lower based on the amount of time it would have taken to test the completeness and accuracy of investment values and investment earnings at the financial statement level ONLY.

Depending on the complexity of the investment products involved and their balances, the time saved can vary from 3 hours to 24 hours. In many cases, there is not a substantial difference in price between a full-scope audit and a limited-scope audit.

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## Q. Why is hiring a qualified auditor important?

A. On many occasions, DOL officials\*\* have stated that many auditors lack the specialized knowledge required to audit retirement plans, and that 4,000 of the nearly 10,000 firms that perform employee plan audits only have one retirement plan audit client. Many substandard plan audits are performed by auditors who received inadequate compensation and who did not spend enough time completing all the required audit procedures. To prevent deficient audits, the DOL has plan auditors on its radar and its agents frequently review audit workpapers as part of its enforcement initiative to monitor the quality of ERISA audits. The DOL has the right to assess penalties of up to \$1,100 per day, without limit, on plan sponsors for deficient filings, including filings that attached an incomplete, inadequate, or untimely audit report.

Plan sponsors have a fiduciary responsibility to engage a plan auditor that is qualified to perform retirement plan audit services, and the decision often requires engaging a different firm than the one that performs other accounting and tax services for the employer.

Before selecting a retirement plan auditor, plan fiduciaries should consult the DOL and AICPA websites and use the tools provided to ensure the selection of an auditor with enough expertise in the industry to perform a quality audit. Auditing retirement plans well requires a major investment in continuing education to ensure that the audit procedures comply with all the industry-specific standards and that the audit team is abreast of the ever-changing regulatory environment.

## Q. How can I find a qualified retirement plan auditor?

A. Selecting a plan auditor is an important fiduciary responsibility. To that end, the Employee Benefit Plan Audit Quality Center (“the Center”) has prepared a document titled “Obtaining Quality Employee Benefit Plan Audit Services: The Request for Proposal and Auditor Evaluation Process” to assist plan sponsors and other stakeholders in the proposal and evaluation process to obtain quality audit services for employee benefit plans. It addresses each step of the proposal process, contains a checklist of items that should be considered in preparing the RFP, discusses the proposal evaluation and auditor selection process, and provides information about how to find an auditor, including guidelines for the preparation of a Request for Proposal, which can be found at [http://www.aicpa.org/InterestAreas/EmployeeBenefitPlanAuditQuality/Resources/PlanSponsorResourceCenter/DownloadableDocuments/Plan\\_Sponsor\\_Guidelines\\_preparing\\_RFP.pdf](http://www.aicpa.org/InterestAreas/EmployeeBenefitPlanAuditQuality/Resources/PlanSponsorResourceCenter/DownloadableDocuments/Plan_Sponsor_Guidelines_preparing_RFP.pdf)

The DOL’s EBSA has developed a booklet titled “Selecting an Auditor for Your Employee Benefit Plan” to assist plan administrators in their selection of an auditor, which can be found at <http://www.dol.gov/ebsa/publications/selectinganauditor.html>

The American Institute of Certified Public Accountants (AICPA) Employee Benefit Plan Audit Quality Center (EBPAQC) has compiled tools and resources for plan sponsors, administrators, and trustees. The Plan Sponsor Resource Center can be accessed through the following link: <http://www.aicpa.org/InterestAreas/EmployeeBenefitPlanAuditQuality/Resources/PlanSponsorResourceCenter/>

All CPA firms that are members of the Center are listed by name and by state. By joining the Center, member firms show their commitment to providing quality audit services to their clients by adhering to membership requirements such as additional training, quality control, and self-monitoring. Center members also agree to make publicly available the results of their external peer review of their audit practice, which must include external review of employee benefit plan audits.

\*\*Including Phyllis Borzi, the Assistant Secretary of Labor, Ian Dingwall, the DOL’s Chief Accountant, and Marcus Aaron, Senior Auditor in the EBSA Division of Accounting Services in the Office of the Chief Accountant.

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## Q. Is your auditor helping you become IRS audit-ready?

A. Although the auditor is not meant to be a guarantor of the plan's tax qualified status or that the plan operations are completely error-free, plan sponsors should retain auditors that can help them address common errors found during IRS examinations. To help determine an auditor's potential value, consider the following questions:

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- 1 Does your auditor request executed copies of amendments and updates to the plan document to reflect recent law changes?

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  - 2 Does your auditor verify that your plan operations are consistent with your plan provisions for all significant audit areas?

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  - 3 Does your auditor work with your payroll department to ensure they understand the importance of using the correct definition of compensation as defined by the plan?

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  - 4 Does your auditor test the timeliness of deferral deposits and assist with the correction of any late deposits?

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  - 5 Does your auditor verify that the census information submitted to the TPA for the discrimination tests is complete and accurate, to validate the results of all relevant tests and limits, including: ADP, ACP, 402(g), 401(a)(17), 415, 416, 404, 401(a)(4), and any other discrimination or limits tests that would be meaningless if incorrect or incomplete census information was used?

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  - 6 Does your auditor test whether eligible employees were erroneously excluded from the plan, both for employee and employer contribution purposes?

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- 7 Does your auditor test whether participant loans are administered in accordance with the plan provisions and IRC Section 72(p)?

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- 8 Does your plan auditor test that distributions, including hardship distributions and loan offsets, were made only to participants who had met the eligibility requirements for a distribution?

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- 9 Is your auditor available for assistance with operational questions throughout the year, working hand-in-hand with your third-party administrator to guide your plan officials through the day-to-day compliance challenges, with the goal of preventing errors before they happen, rather than detecting them after it is too late?

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All items on the list above appear on the 401(k) Plan Fix-It Guide found on the IRS website at [http://www.irs.gov/Retirement-Plans/401\(k\)-Plan-Fix-It-Guide](http://www.irs.gov/Retirement-Plans/401(k)-Plan-Fix-It-Guide). They represent common errors that the IRS agents find during their examinations. To a good auditor, they should represent an opportunity to add value, by tipping the scales from "detection to prevention." Of course, a plan sponsor should make sure that there is a common understanding with the auditor concerning the scope of the auditor's review and services and that this common understanding is clearly reflected in the auditor's engagement letter. This is particularly the case with respect to certain plan qualification matters, such as discrimination testing, and other fiduciary obligations, such as assessing the reasonableness of investor fees, that do not directly impact a plan's financial statements. Such plan qualification matters might be viewed as being outside the scope of an auditor's financial statement review in the absence of a clear statement that such matters are in fact covered by the review.

# CONCLUSION



## Retirement plan audits can add value

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Unfortunately, many employers consider their retirement plan audit a costly necessary evil that adds little or no value to their plan operations.

However, the auditor can be a great resource to the plan sponsor by providing an emphasis on certain plan operations as the first building block of complete and accurate financial statements. In fact, an auditor that understands the industry and the plan sponsor's goals can help to streamline plan processes to tip the scales from detection of errors to prevention of errors. Best of all, a good retirement plan auditor will incorporate value-added procedures that can help employers be IRS-ready, and result in added peace of mind.

# PREPARING FOR A PLAN AUDIT

## Sample checklist of materials needed for a plan audit

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### General plan information

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- 1 Executed copies of the latest plan document, adoption agreement, plan amendments, and the most recent IRS determination letter or opinion letter, as applicable.
  - 2 Copy of the summary plan description (SPD) and any summary of material modification (SMM).
  - 3 Sample of enrollment packages, loan applications, distribution forms provided to employees, and a description of the approval process for each of the relevant plan transactions.
  - 4 Listing of members of the board of directors/trustees, audit committee and plan officials responsible for plan operations, oversight and governance.
  - 5 Minutes from board/committee meetings, if applicable.
  - 6 Proof of ERISA fidelity bond.
  - 7 Contact information for all service providers and parties of interest.
  - 8 Executed copies of agreements with service providers including current rate schedules, if applicable.
  - 9 Login and password to access online reports from third-party administrators and custodians.
  - 10 Census of all employees during the year, broken down by eligibility status, and including date of birth, date of hire, date of eligibility to each plan feature, date of termination for retirees and terminated employees who still have balances in the plan. Please identify employees who were eligible to participate in the plan during the year but elected not to participate.
  - 11 For each participant listed in the census, gross wages, a column for each exclusion from the definition of eligible compensation by participant, a column for pre-eligibility compensation for every relevant plan feature, and a reconciliation of total gross wages by employee on the census to the total payroll report and the W-3.
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### Plan internal controls

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- 1 Copy of SSAE #16/SOC 1 or 2 report on controls at service providers, along with documentation of the plan's specific "user controls" necessary, as identified therein. If the SOC 1 report does not cover the full plan year, a gap letter indicating whether the controls at the organization have changed.
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### Financial reporting information

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- 1 Year-end reporting packages from third-party administrator and investment statements.
  - 2 For limited-scope audits, a copy of the certification from a regulated financial institution such as a bank or insurance company, in accordance with 29 CFR 2520.103-5.
  - 3 Draft Form 5500 as soon as it is available.
  - 4 Discrimination testing for the plan including ADP, ACP, top heavy, Section 415, Section 404, any 401(a)(4) testing, as applicable.
  - 5 A report showing asset balances and plan transactions after the year-end audit through the date of the audit report.
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## Cash and investments

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- 1 Copy of investment policy statement.
  - 2 Schedule of assets held for investment and schedule of reportable transactions, if applicable, in a format compliant with the Form 5500 instructions.
  - 3 Reconciliation of the aggregate of the participant account balances to assets per the trust statements, with explanations for any variances.
  - 4 If loans are allowed by the plan, a list of loan balances as of the beginning of the year, loan repayments, interest rate, issue date should be listed to identify new loans, balances outstanding at year end.
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## Contributions, rollovers and forfeitures

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- 1 Reconciliation of total participant contributions per the W-3 to total plan contributions deposited per the plan's investment custodian.
  - 2 A listing of payroll dates and the corresponding dates in which the deferrals for each payroll period were deposited.
  - 3 Payroll-by-payroll detail (gross wages, enough information to recompute plan wages, and the related deferral per payroll) for a list of selected participants. Please include all amounts paid to a participant, even if they are excluded from the definition of compensation for the plan.
  - 4 Contribution receivable detail by participant (employee and employer) as of plan year end (if any).
  - 5 Employer matching and/or profit sharing contribution computation by participant, if any, deposit support (contribution authorization and wire transfer support).
  - 6 Detail of rollovers into the plan.
  - 7 Forfeiture statement for the year showing the amount of forfeitures created and utilized during the plan year and the beginning and ending balances of the forfeiture account.
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## Benefits payable and expenses

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- 1 Listing of all distributions by type (e.g., hardship, termination, death, QDRO), made during the plan year (the listing should tie in total to total distributions per the trust statements).
  - 2 1099-R report.
  - 3 Distribution application forms for selected audit sample.
  - 4 List of and explanation of deemed distributions, if any.
  - 5 Documentation of the client and recordkeeper procedures for distributing terminated participant balances under \$5,000 or \$1,000, if applicable, and of their procedures for investigating long-outstanding benefit checks, if any.
  - 6 Detail of any administrative expenses paid by the plan or reimbursed by the sponsor (e.g., accounting fees, investment fees, legal fees, appraisal fees, trustee fees).
  - 7 408(b)(2) and 404(a)(5) statements and evidence of their distribution.
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## For selected participants

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- 1 For a selection of participants, we will test demographics and obtain backup for all transactions in the selected participants' account balances.
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## Compliance testing documentation

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- 1 Copy of the year-end compliance testing required by the Internal Revenue Code including documentation of any action required by the testing results. Reconciliation of deferral and match totals used for the testing to the payroll and other source documents.
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### About the author

Maria has more than 20 years of public accounting experience, including two years spent with an international accounting firm in Washington, D.C. As the Director in charge of retirement plan services at Belfint, Lyons & Shuman, the largest locally owned CPA firm in Delaware, she is responsible for planning, supervising and reviewing audits of single and multi-employer benefit plans. She also provides independent retirement plan design consultations to clients. As a result of Maria's close working relationships with local ERISA attorneys, she is frequently asked to perform the final audit of terminated benefit plan financial statements for national companies undergoing bankruptcy proceedings in Delaware.

Maria has the following professional affiliations: American Institute of Certified Public Accountants, Delaware Society of Certified Public Accountants, American Society of Pension Professionals and Actuaries, International Foundation of Employee Benefit Plans (IFEBP), ASPPA Benefits Council of Greater Philadelphia - Board Member and Treasurer, Wilmington Tax Group - 2008 President and 2007 Treasurer, and PrimeGlobal Employee Benefit Group Member. She also received Academic Achievement in the Retirement Plan section of the Certified Employee Benefit Specialist curriculum sponsored by the IFEBP and the Wharton School of Business.

Maria graduated Cum Laude from Georgetown University with Bachelor of Science Degrees in Accounting and International Management.

If you have any questions on this white paper or would like more information, please contact Maria Hurd directly at 302-573-3918.

\* As of September 30, 2013.

**All investments involve risk, including loss of principal.**

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