BE PREPARED: A 401(K) AUDIT RESOURCE MANUAL FOR 2015

401(k) plans are the most widely used retirement plan in the US and the number of employees who depend on their 401(k) plans for their long-term financial needs continues to increase. Because of this, the Internal Revenue Service (IRS) and the U.S. Department of Labor continue to focus on 401(k) plan compliance as a top priority.

Federal law requires that "large" 401(k) plans undergo an annual audit from an independent Certified Public Accounting (CPA) firm. The purpose of this audit is to protect the interests of all parties involved by ensuring that the plan's financial reporting is accurate and that the plan is operating in compliance with all plan documents and all regulations set forth by the IRS and Department of Labor.

After completing a 401(k) audit, the CPA firm will issue audited financial statements for the plan, along with the auditor's opinion, required supplemental schedules, and footnote disclosures (including any perceived missteps in plan management or execution). These documents will be attached to the audited organization's tax forms. The IRS can then choose whether or not to take further action.

The requirements and process for receiving a 401(k) audit can be complex, but that complexity should not impede companies from following through on this important federal obligation. We have designed this e-book for business owners, human resource specialists, and anyone responsible for scheduling their company's 401(k) audit. The answers contained in this e-book will help you:

- Understand your business's obligations regarding an annual 401(k) audit.
- Prepare for your audit.
- Choose an accounting firm to perform your audit efficiently, effectively, and in the most cost-effective way possible.

Summit CPA Group

CONTENTS

PART I

DOES MY BUSINESS REQUIRE A 401(K) AUDIT?

WHAT ARE THE GENERAL REQUIREMENTS FOR A 401(K) AUDIT?

An external audit is required for any 401(k) plan that:

- Has more than 100 eligible participants or more on the first day of the plan year (or 120 if it has never been required to undergo an external audit before—more on that later). And,
- Has assets that are held in trust (by law, all 401(k) plans are required to have their assets held in trust).

WHAT IS AN "ELIGIBLE PARTICIPANT"? IS THAT THE SAME AS AN EMPLOYEE?

No. An eligible participant is anyone who is eligible to participate in the 401(k) plan in any way. This includes:

- Active employees who are eligible to participate in the plan and are participating in the plan.
- Active employees who are eligible to participate in the plan but have chosen not to.
- Terminated, resigned, or retired employees who still have a balance on their account on the first day of the plan year.
- Beneficiaries of deceased employees who are receiving, or are entitled to receive, benefits from the plan.

ONLY PLANS DEEMED AS "LARGE" ARE REQUIRED TO BE AUDITED. WHAT DEFINES A LARGE PLAN?

Technically, any 401(k) plan with more than 100 eligible participants is considered a large plan; however, due to what is known as the "80-120 participant rule" or the "80-120 participant exception," any plan that was filed in the previous year as a "small" plan and still has fewer than 120 participants can continue to file as a "small plan" and avoid the external audit requirement.

But if the number of eligible plan participants reaches 121 by the first day of a plan year, it is no longer subject to the "80-120 participant rule" and must be filed as a large plan. An external 401(k) audit would be required in this situation.

WHAT OTHER EXCEPTIONS ARE THERE TO THE AUDIT REQUIREMENT?

In addition to the "80-120 participant rule," there is the "short plan year" exception. If a company's 401(k) plan would qualify as "large" and its plan year is seven months or shorter, the plan sponsor may elect to defer the audit requirement to the following plan year. But in the subsequent year, even if the plan qualifies as "small," it will nevertheless be required to have the plan audited for the short plan year.

CAN I AVOID A 401(K) AUDIT BY MAKING CHANGES TO MY BUSINESS?

If you're in charge of the 401(k) plan at a growing company, you may be interested in reducing the number of eligible participants in order to avoid the 401(k) audit required for "large" plans.

It may be helpful to remember that if you're close to the magic number of 121 eligible participants, and your company is growing, reducing the number of eligible participants may only be a short-term fix. You may want to start planning for your 401(k) audit now. Some companies even hire an outside accounting firm to perform a plan audit before it is required, in order to get a better handle on the compliance and reporting issues before these issues are to be disclosed to the IRS.

However, there are steps a company can take to reduce the number of eligible participants in its plan. These steps encourage 401(k) plan best practices, as they provide for more plan transparency and reduce the "clutter" of plan participants who would be counted as eligible participants simply because they haven't cleared the small balance in their account.

Companies interested in reducing the number of eligible participants in their plan should consider the following:

- **Eligibility requirements.** If your company experiences a high level of employee turnover, it may be wise to extend the period of employment required before an employee is eligible to participate in the plan. Remember, an employee with any balance in his or her account on the first day of the year must be counted as an eligible participant. A revolving door of short-term employees who sign up for the plan and remain in the plan with a balance will add to your total of eligible participants.
- **Department of Labor provisions for automatic distributions.** If your company already has former employees adding to the "eligible participants" total with small account balances consider putting the Department of Labor's provisions for automatic distributions to use. These provisions allow companies to use automatic distributions for accounts with balances lower than $1,000.
- **Exit interviews.** Upon their departure, communicate about payment options with vested employees who are being terminated, are resigning, or are retiring.
- **Stay in touch.** Continue to communicate with former employees who have a balance in their account about payment options.
- **Lump sum distributions.** Ensure that your plan documents allow for lump sum distributions, so that separated employees who wish to withdraw their funds can do so in a timely fashion.

WHAT RECENT CHANGES HAVE BEEN MADE TO THE 401(K) AUDIT REGULATIONS?

The 2015 401(k) audit requirements have changed very little since 2014, with one exception: an increased Cost-of-Living Adjustment, or COLA. This change will increase the dollar limit on defined contributions and benefits of many 401(k) plans, as the changes in the cost-of-living index will trigger the adjustment of plan limits.

PART II

HOW CAN I PREPARE FOR A 401(K) AUDIT?

WHAT DOCUMENTS MUST I FILE TO GET STARTED?

To start the 401(k) audit process, you can electronically file your plan's Form 5500. If you are filing as a "large" plan on your Form 5500 and are required to hire a CPA firm to perform an audit, their additional audit reports will be attached electronically to your Form 5500. In 2010, the IRS began requiring that all financial reports from a 401(k) audit be electronically attached to the plan's electronically filed Form 5500. Paper filings are no longer permitted.

WHAT DOCUMENTS WILL I NEED TO SHOW THE AUDITOR?

Required documents will likely include:

- Executed plan documents (including executed amendments)
- Current year census
- Copy of Form 5500 filed in previous year
- Participant statement and trust reports
- Plan sponsor financial statements
- Form W2s or other annual payroll registers
- Loan documents for all participant loans
- Certification report from the plan custodian
- Discrimination tests
- Summary plan description
- IRS determination letter or opinion letter
- A schedule of deposits to the plan on a pay period basis
- List of all parties in interest
- Form 1099 for distributions

WHAT IS THE IMPORTANCE OF "FIDUCIARY RESPONSIBILITY"?

Every plan must have at least one plan fiduciary named in their documents. Many plan fiduciaries may not realize the full scope of their role, or even that they are a plan fiduciary. Considering the liability that being a fiduciary involves (a fiduciary can be held personally liable if their conduct is unlawful or unethical), it's paramount that each plan fiduciary is aware of their responsibilities and role in plan management.

Fiduciary status is based on the functions performed for the plan, not just a person's title. Each plan must have at least one fiduciary. By definition, a plan fiduciary is anyone who:

- Exercises any discretionary authority or control over plan management, assets, or administration.
- Renders, or has any authority or responsibility to render, investment advice for a fee.

Because they have been chosen to act on behalf of plan participants, fiduciaries are expected to uphold certain ethical and conduct standards. According to the Department of Labor, the responsibilities of fiduciaries include:

- Acting solely in the interest of plan participants and their beneficiaries and with the exclusive purpose of providing benefits to them.
- Carrying out their duties prudently.
- Following the plan documents (unless inconsistent with the Employee Retirement Income Security Act [ERISA]).
- Diversifying plan investments.
- Paying only reasonable plan expenses.

A great resource for those seeking more information on fiduciary responsibility is the "Meeting Your Fiduciary Responsibilities" page on the Department of Labor's website: http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html.

WHAT IS THE IMPORTANCE OF OPERATIONAL COMPLIANCE?

Every 401(k) plan was set up with plan documents outlining how the plan "works," with guidelines on plan policies like enrollment procedures, employee eligibility guidelines, and rules pertaining to participant deferral deposits. When checking for operational compliance, you're looking to make sure that the plan is running as it was promised to in the plan document.

The Summary Plan Description (SPD) is perhaps the most straightforward of plan documents. Every plan's SPD should be clear enough to be easily understood by plan participants, yet comprehensive enough to convey all of the rules, regulations, and guidelines of the plan. According to the IRS, every SPD should include the following:

- When and how employees become eligible to participate in the 401(k) plan.
- The contributions to the plan.
- How long it takes to become vested.

- When employees are eligible to receive their benefits.
- How to file a claim for those benefits.
- Basic rights and responsibilities participants have under the Federal retirement law, the Employee Retirement Income Security Act (ERISA).
- An explanation of administrative expenses that will be paid by the plan.
- If you're managing a 401(k) plan and checking its operational compliance, your first step may be to carefully examine the SPD and other plan documents (including the Summary of Material Modifications and amendments) and compare them with how the plan is actually being carried out. If the plan isn't operating within the scope of the plan documents, there's likely a compliance issue that will have to be addressed during your 401(k) plan audit.

Common Operational Compliance Issues:

- **Plan eligibility provisions.** Are non-eligible employees being allowed to participate in the plan? Are eligible employees aware they can participate?
- **Plan definition of compensation.** Refer to the plan's definition of participant compensation, and compare it to your payroll records.
- **Late deferral payments.** Is there a good policy in place for avoiding late deferral payments? Is that policy being followed?
- **Loan restrictions.** Read the plan document's restrictions on participant loans, and check if any outstanding loans are in non-compliance.
- **Hardship withdrawals.** Ensure all hardship withdrawals are approved and well documented. Make sure all hardship withdrawals follow the requirements specified in your plan document.
- **Failure to recognize the plan is subject to audit.** Ensure you have an audit conducted when it is required based upon participant levels.
- **Errors in establishing participant elections.** Verify the set up of initial participant contribution elections and investment options is correct.
- **Monitoring Service Providers.** You cannot outsource your fiduciary responsibility. Monitor the work of your service providers such as your Third Party Administrator to ensure their procedures are adequate and meet your plan requirements.

The IRS has released a 401(k) plan checklist that is quite helpful for identifying and fixing compliance issues: http://www.irs.gov/pub/irs-tege/pub4531.pdf.

WHAT CAN I DO TO MAKE THE AUDIT GO AS SMOOTHLY AS POSSIBLE?

- ***A*lways use best practices when managing your company's 401(k) plan, regardless of its size.** Whether or not you are facing a required audit, handling your plan with great attention to detail and regulations will put you—and all participants—in the best position possible moving forward. Do your research and ensure that all of your plan's policies adhere to federal guidelines and are being followed. Don't wait until your CPA firm's first visit to start gathering the needed documents and getting your financials in order. Last-minute preparation will just add unnecessary stress
- **Keep all plan paperwork organized, current, and accessible.** The process of getting your documents in order (often the most time-consuming aspect of a 401(k) audit) is made much easier when you have proactively kept all plan documents organized and current.
- **Form a strong 401(k) administrative committee.** Having a knowledgeable and proactive group at the center of your 401(k) management can make all the difference in the outcome of your audit. Create your 401(k) administrative committee with executive level company officers from offices that include human resources, finance, and legal departments.

PART III

HOW DO I FIND A 401(K) AUDITOR?

WHAT ARE THE GOVERNMENT'S REQUIREMENTS FOR A 401(K) AUDITOR?

The auditor must be licensed or certified as a public accountant by a state regulatory authority. The auditor should also be independent, and have no financial interests in the plan or the plan administrator.

HOW SHOULD I FIND AN AUDITOR?

Today, companies have a great deal of choice when selecting an accounting firm to hire for their audit. Modern technology has allowed accounting firms to service companies across the country, regardless of their physical location. While you can still pick at random from the phone book, being able to research CPA firms online allows you to choose one that has the experience, pricing, and procedures that you're looking for.

DOES IT MAKE A DIFFERENCE WHICH AUDITOR I USE?

Yes. An incomplete or inadequate audit report can result in large penalties against the plan administrator, so choosing a reliable and experienced auditor is extremely important.

WHAT SHOULD I LOOK FOR IN AN AUDITOR?

- **401(k) audit expertise.** 401(k) audits require unique and specific tests and procedures. If your auditor isn't experienced with 401(k) plans, he or she may miss a required test or document- resulting in penalties for your company. Choosing a CPA firm that specializes in 401(k) audits ensures that your audit will be completed fully, in a professional and timely manner.
- **Experience working with plan administrators.** A CPA firm with experience in 401(k) plans will be able to guide you through the complex audit process, helping you to do your part effectively for your company's plan.
- **Straightforward pricing.** Too often, an "estimate" becomes a "starting point." Hidden fees and excessive billed hours can turn your audit into a costly endeavor. Hiring a company that offers simple, flat-fee pricing will guarantee that there's no surprises on your final bill.
- **Non-intrusive procedures.** With the technology available today, there's no need to have a group of auditors sitting in a closed room in your offices day in and day out. Audits can now easily be performed off-site, allowing your company to carry on with daily tasks without disruption.

LEARN MORE ABOUT A 401(K) AUDIT FROM SUMMIT CPA

The Summit CPA Group specializes in performing 401(k) audits. We have years of experience helping businesses fulfill their obligations with the Internal Revenue Service (IRS) and the U.S. Department of Labor. We offer competitive flat-fee pricing and perform all of our audits remotely, from our office, reducing interruptions to your business.

To help businesses understand what's involved in a 401(k) audit, we have documented the exact process we follow in a free step-by-step guide. This guide includes information on:

- Each step Summit CPA takes during a 401(k) audit.
- Why each step is important.
- How to take the next step toward scheduling a Summit CPA 401k audit.

You can download a step-by-step guide for your business by clicking on the image below or visiting http://offers.summitcpa.net/summitcpa-401k-audit-brochure-step-by-step.

THE GUIDE TO SUMMIT CPA'S 401K AUDIT

At SummitCPA, we have had years of experience performing 401k Audits. We've gotten it down to a science. Are you considering working with SummitCPA for your 401k Audit? If so, here is what you can expect out of an engagement with us.

1 REVIEW YOUR COMPANY'S FORM 5500
Why it is important? Use this document to determine the number of eligible participants in the plan. This will allow you to determine the cost of the 401K Audit based on eligible participants located on Form 5500.
What to expect? You will find a simple and easy to read pricing matrix with no hidden costs.

2 QUESTIONNAIRE
Why is it important? This document provides us with important contact information related to the plan.
What to expect? Less than 20 quick questions relating to contact information for all parties in interest such as the TPA, Trustee, Company Contact, etc. It also includes general questions related to the plan.

3 ENGAGEMENT LETTER
Why is it important? This document provides in writing a mutual understanding of services performed as well as the representations and responsibilities of management for the agreed upon price.
What to expect? A two page document detailing what services we will performed, management responsibilities, cost of the service, and an estimated completion date. In addition, you will receive a copy of our most recent peer review and supplemental information regarding the plan sponsor's fiduciary responsibilities to the plan.

4 REQUEST FOR PLAN CENSUS
Why is it important? The Census contains key details of employee information.
What to expect? A list of sample employees that we will need to test for compliance. Specifically, items such as I-9s, W-4s, plan enrollment forms, etc.

5 REQUEST FOR AUDIT PACKAGE
Why is it important? The Audit Package contains key information such individual participant statements, discriminatory testing, SOC report, and the trust report.
What to expect? The TPA can send us the Audit Package directly. From there only minimal follow-up questions to the plan sponsor.

6 INTERVIEWS AND WALKTHROUGHS
Why is it important? The auditor is required gain an understanding of the internal controls, subsequently test controls, and gain a better overall understanding of the plan, its process and people involved in the plan.
What to expect? 2 to 4 one-hour pre-scheduled meetings with the Plan Sponsor, Office Manager, and/or Human Resource Director.

7 PRELIMINARY AUDIT REPORT ISSUED
Why is it important? The Plan Sponsor will have the opportunity to review the Audit report before the report is finalized.
What to expect? The full audit report, financial statements, and disclosures.

8 FINAL REPORT AUDIT REPORT ISSUED
Why is it important? The Audit Report is required to finalize the submission of Form 5500.
What to expect? An electronic copy issued via our secured client portal as well as a bounded copy mailed to the Plan Sponsor.

NEXT STEPS
Are you looking to take the next steps with SummitCPA? Click here to get in touch with one of the members of our team.

Summit CPA Group | 888.393.9650 | www.summitcpa.net