PLAN SPONSOR

Digest

Wealth Management

Issue 4, 2024

Your Challenge, Our Solutions™

Plan audits: what plan sponsors need to know

The term "audit" can trigger anxiety in many different contexts. For example, taxpayers can be subject to random IRS audits, and the thought of examiners combing through tax records can create considerable stress, even for those with stellar compliance. In this article, we will focus on routine audits that retirement plan administrators must submit with their Form 5500 annual report. This annual audit requirement can make plan sponsors nervous, but understanding the process may lessen the concern and may help improve plan compliance.

Why does the DOL require regular plan audits?

The Employee Retirement Income Security Act (ERISA) requires plan sponsors to maintain retirement plans for the exclusive benefit of plan participants and beneficiaries. One way that the Department of Labor (DOL) meets this rule is to require plan administrators to submit an annual report detailing various aspects of plan operations, including financial data. One provision in Form 5500 requires certain plans to include an audit that complies with DOL standards. This audit, conducted by a qualified independent public accountant, is intended to:

- Protect qualified plan participants
- Ensure compliance with generally accepted accounting practices
- Encourage adherence to ERISA, the Internal Revenue Code and regulations
- Uncover plan defects in order to remedy them

Which plans are subject to the audit requirements?

Generally, both defined benefit plans and defined contribution plans (including 401(k) plans) must submit an annual audit if the plan has 100 or more participants with a plan balance at the start of the plan year. Some exceptions apply, such as when a small plan (under 100 participants) for the previous year exceeds 100 participants for the current year but does not exceed 120 participants. In addition, some small plans must submit an audit report if the plan holds more than 5% of its assets in certain nonqualifying assets, such as assets that are not held by regulated entities (e.g., banks, insurance companies).

Plan sponsors with small plans that are not required to conduct a plan audit may still derive considerable benefit from doing this, especially as the plan participant count nears the 100-participant threshold. Not only could an earlier-than-required audit reveal compliance concerns, but it could provide enough time to address possible problems before a required audit points out these concerns to the DOL.

What does a plan audit entail?

Depending on the assets held in the plan and various other factors, plan audits can range

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in complexity. The following text from ERISA Sec. 103 gives a good idea of the information needed.

“The administrator of an employee benefit plan shall engage, on behalf of all plan participants, an independent qualified public accountant, who shall conduct such an examination of any financial statements of the plan, and of other books and records of the plan, as the accountant may deem necessary to enable the accountant to form an opinion as to whether the financial statements and schedules required to be included in the annual reports ... are presented fairly in conformity with generally accepted accounting principles.”

The independent qualified public accountant (IQPA) has significant latitude to determine what is needed from the plan sponsor to present an informed opinion about the accuracy of the Form 5500 data and the financial controls employed by the plan. The IQPA renders an opinion based on a review of all the plan sponsor’s relevant financial records and reconciles these findings with the information presented in the Form 5500. On Form 5500, the IQPA will provide one of four possible opinions.

- **Unmodified opinion** — The IQPA concludes that the plan’s financial statements are presented fairly in all material respects.
- **Qualified opinion** — The IQPA concludes that misstatements are material but not pervasive, or the IQPA cannot obtain enough appropriate audit evidence on which to base an opinion.
- **Disclaimer opinion** — The IQPA cannot obtain enough evidence on which to base an opinion and concludes that the possible affects of undetected misstatements, if any, could be material and pervasive.
- **Adverse opinion** — The IQPA has obtained sufficient audit evidence and concludes that misstatements are both material and pervasive.

Clearly, plan sponsors will seek an “unmodified opinion.” Any other type of opinion may raise a red flag with the DOL. Plan sponsors will want to work with their auditor to address any concerns before submitting the audit with Form 5500.

Getting the most value from a plan audit

Plan sponsors who are required to submit an annual audit should hire a qualified independent public accountant with experience conducting such plan audits. This cost may be significant. But here are three approaches that may help plan sponsors wring the most value from the process.

1. Consider using plan forfeitures to pay for the audit. As a requirement for plan qualification, the audit cost is a legitimate plan expense. Plan sponsors should seek competent counsel to determine whether they should use forfeitures in this way.
2. Cooperate fully with the IQPA. Audit information that conflicts with financial statements can often be fixed before filing Form 5500. Missing or inaccurate information could lead to a less-than-favorable audit opinion.
3. Use the audit to improve your plan. Candid conversations and disclosures can lead to a more compliant plan. The best IQPAs will not merely report their findings in the form of an opinion, but they will use this information to equip plan sponsors to run the best plan possible.

For larger plans that meet the 100-participant threshold, the annual audit requirement may seem like a burden. As plan sponsors respond to auditors’ recommendations by making changes to their plan administration, the result will be less burden—and better plan compliance.

Documenting plan changes will make amendments easier later

The SECURE 2.0 Act of 2022 contained nearly 100 retirement plan provisions. Some of these may apply to only a small portion of plans and may not affect your plan at all. Some provisions are mandatory, such as the requirement to provide eligibility to certain long-term, part-time employees or to automatically enroll employees (for plans established after December 28, 2022). Other SECURE 2.0 provisions are optional. Plan sponsors have flexibility when deciding whether—and when—to implement many of these options. For example, plans may contain provisions that allow student loan repayments to be considered deferrals (for matching contribution purposes), that permit certain distributions (e.g., for emergencies or domestic abuse), or that give participants the option of treating employer contributions as Roth contributions.

Retirement plans must be amended to reflect the applicable provisions of the SECURE 2.0 Act (and other legislation). IRS Notice 2024-2 has extended the amendment deadline from the original date stated in SECURE 2.0. Now, most plans will have until December 31, 2026, union plans have until December 31, 2028, and governmental plans have until December 31, 2029. But while plans may not need to be amended for some time, in the interim they must be operated properly to reflect any plan changes that have been adopted. Simply put, if a plan sponsor adopts an optional SECURE 2.0 provision, the plan must be administered according to the requirements of that provision even though the plan has not been formally amended to reflect this decision.

To make the amendment process easier when the time comes, plan sponsors should carefully track which provisions they adopt and when. Documenting these decisions will save time and effort; rather than trying to reconstruct which provisions were adopted, and the adoption date, the plan sponsor can simply refer to a notation in the plan file.

Example: SECURE 2.0 allowed plans to permit distributions for terminal illness for eligible distributions made after December 29, 2022. Although the plan sponsor wanted to include this provision in the plan, the retirement plan committee decided to combine the terminal illness provision with several other new SECURE 2.0 provisions, to be effective for distributions on or after January 1, 2024.

By clearly documenting this decision, the committee will not have to struggle to remember the timetable that applies to the provisions included in the amendment in 2026 (or later).

Properly amending your plan is an important component of keeping your retirement plan in compliance with IRS and DOL rules, as well as operating your plan properly in the time between required amendments. By carefully documenting decisions about adopting optional provisions, plan sponsors will make their lives much easier when it comes time to formally amend their plans.

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24-20-03079_20181 (10/24)