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A Guide to a 401(k) Audit

As a plan sponsor you may be required to engage a CPA firm to perform an audit of your 401(k) plan. This guide has been prepared to assist plan sponsors in preparing for the annual audit of their 401(k) plan. The early completion of the key items outlined in this guide will minimize the time required to audit the plan and help keep the cost of the audit to a minimum. Generally, audited financial statements are required to be filed with Form 5500 for plans with 100 or more participants as of the beginning of the plan year. The Form 5500 is due by the seventh month following the plan year end. An additional 2 ½ month automatic extension is available by filing IRS Form 5568. You are encouraged to plan early to avoid the potential of a late filing for which the IRS penalties are quite steep. If this is the first year your organization is required to have an audit, the process can seem overwhelming. The guide provided below can help make the process less intimidating.

The following is a guide to a 401(k) audit (assuming your plan qualifies for a limited-scope audit):

1. Provide your CPA with the most current versions of the plan document, plan amendments, summary plan description, IRS determination letters, prior Form 5500 and an independent auditor's report. If you use an outside third party administrator or an investment provider, have them provide you these documents, if you don't already have them. You will need to request an "audit package" which includes the trust and participant accounting. This audit package will need to be forwarded to your auditor or the auditor will need to be given access to an online account to access the information.

2. If your plan assets are held by a trust company (bank or non-bank) or an insurance company, you may be eligible to have your plan elect the "limited-scope exemption". This exemption does not eliminate the requirement for an audit; however, it reduces the "scope" and will typically reduce the cost of the audit. The trust company or insurance

company must provide a certification as to the completeness and accuracy of the investments and related investment transactions it holds on behalf of your plan. Request an "annual audit package" from the trust company or insurance company and provide it to your CPA as soon as possible.

3. If your plan assets are not held by any of the institutions mentioned above in item 2, have your investment provider prepare account statements for the entire plan year and provide them to your CPA as soon as possible.

4. If your plan holds investments in limited partnerships, real estate or other investments, or if your plan is an ESOP for which published market values as of the plan year end are not readily available, obtain an independent appraisal of such investments as of the plan year end and provide copies to your CPA.

5. Provide your CPA with the annual census report for the year being audited. It is recommended that you prepare your census to include ineligible participants as well as eligible. Most third party administrators and investment providers have systems that will allow you to provide them this data in an electronic format. Make sure that the census data is reconciled with your annual payroll data to avoid any inadvertent errors. This area tends to be the most troublesome in terms of errors.

6. Provide your CPA with the annual administration performed by your outside recordkeeper. This normally includes participant allocation reports, discrimination and coverage tests, Form 5500, etc. If your plan is a 401(k) plan, make sure your recordkeeper performs the discrimination tests and returns any excess contributions within 2 ½ months after your plan year end, otherwise a 10% penalty will apply.

7. If your plan permits participant loans, reconcile all loans at plan year end and provide your CPA with a year end loan summary. Most recordkeepers provide this service.

8. If your plan financial statements are prepared on the accrual basis of accounting, provide your CPA with a list of any employee and employer contributions for the plan year not deposited as of the end of the plan year. Employee contributions (i.e. 401(k) deferrals) and

participant loan payments are required to be deposited on the earliest date on which such contributions can reasonable be segregated from the employer's general assets. Employer contributions are generally required to be deposited by the due date (including extensions) of the plan sponsor's income tax returns.

9. Once all this information is provided, your auditor will schedule a field work date with you to come out to your location to meet with the personnel who are responsible for the plan. The auditor will need to gain a better understanding of how the plan accounting works, the internal controls over the plan, and any fraud risk.

10. Once this information is obtained, your auditor will pick a sample of employees, distributions and loans, and request that you provide employee files and supporting documents for the distributions and loans.

11. When the fieldwork is done and the financial statements are completed, you will be provided with a draft of the financial statements and a draft of a report of any control deficiencies found during the audit. You will also receive a management representation letter with notations on any adjustments made to the plan accounting records. This letter will need to be signed and returned to the auditor.

12. Once the management representation letter is returned, and you have approved the financial statement draft, the auditor will provide you with a final financial statement.

13. The financial statements will need to be filed with your Form 5500.

If you would like more information on any of the topics discussed in this article, please contact Paul McGovern at **pmcgovern@downeycocpa.com**.