

Form 5500 Employee Benefit Plan Audits

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This practice note discusses the auditor's role in examining financial statements made part of the Form 5500 annual report of an employee benefit plan subject to the Employee Retirement Income Security Act (ERISA). The auditor, who must qualify as an Independent Qualified Public Accountant (IQPA), must form an opinion whether the plan's financial statements and their accompanying notes are fairly presented in conformity with generally acceptable accounting principles (GAAP). The practice note discusses the impact of the AICPA's new auditing standard, [Statement on Auditing Standards \(SAS\) No. 136](#), "Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA," on the financial statement review process, as effective for audits of plan years that end on or after December 15, 2020.

The practice note is organized to discuss the following topics:

- General Form 5500 Filing Information
- The IQPA Financial Statement Audit
- Audit Requirement Waived for Plans Filing Simplified Annual Report
- Content and Format of the Audit Report
- Audited Financial Statements Precedents

For a further discussion about Form 5500 filings and their disclosures, see Employee Benefits Law § 10.03, paragraph

[4]. Also see [AICPA, Employee benefit plans – financial statement audits](#).

General Form 5500 Filing Information

Form 5500 is the annual financial report for all ERISA employee benefit plans (employee pension benefit plans and welfare benefit plans alike). ERISA § 102(a)(1)(A) (29 U.S.C. § 1023(a)(1)(A)). The report is required to include:

- A financial statement and IQPA opinion (unless an exception applies) –and–
- An actuarial statement and opinion (by an enrolled actuary for a defined benefit plan)

ERISA § 102(a)(1)(B) (29 U.S.C. § 1023(a)(1)(B)).

To reduce the filing burden on plan administrators and employers, the Internal Revenue Service (IRS), U.S. Department of Labor (DOL), and Pension Benefit Guaranty Corporation (PBGC) have created an electronic filing system that satisfies the reporting requirements under ERISA and the I.R.C., to prepare and file an annual Form 5500. ERISA §§ 104, 4065 (29 U.S.C. §§ 1024, 1365); I.R.C. § 6058. Unless a filing exception applies, each year's Form 5500 must be filed electronically with the Employee Benefits Security Administration (EBSA) using EBSA's computerized ERISA Filing Acceptance System (EFAST2). Further information about the electronic filing system is available at www.efast.dol.gov.

Form 5500 filings should be postmarked on or before the last day of the seventh month following the end of the plan year (i.e., July 31 for a calendar year plan). ERISA § 104(a)(1) (29 U.S.C. § 1024(a)(1)).

Plan administrators, who are responsible for filing Form 5500, can request a 2½ month filing extension using IRS Form 5558. Corporate plan sponsors can rely on their corporate income tax Form 1120 extension (using IRS Form 7004) to extend the Form 5500 original filing deadline, but that extension (to September 15 for a calendar year plan year) falls a month short of the October 15 deadline permitted by filing Form 5558. Other employer plan sponsors can also use the extension form for their related Federal income tax filing to rely on as a Form 5500 extension up to the applicable due date of their Federal income tax return (such as September 15 for partnerships filing Form 1065 or October 15 for self-employed individuals and employers filing Form 1040). Extensions based on the sponsors' Federal income tax due date are applicable only if the plan year and the employer's tax year are the same.

In light of the novel coronavirus (COVID-19) pandemic, the IRS has granted filing due date extension relief for plans having original or extended deadlines falling between April 15 and July 15, 2020, allowing them to file or request an extension by July 15, 2020. I.R.S. Notice 2020-23.

For employee pension benefit plans (retirement plans, whether defined benefit or defined contribution plans), the Form 5500 identifies general plan and participant information, and information concerning the plan's:

- Financial condition
- Assets (and liabilities)
- Investments
- Operations
- Coverage
- Source(s) of funding –and–
- Changes made in the plan during the year

29 C.F.R. § 2520.103-1. Plans with fewer than 100 participants at the beginning of the plan year may complete and file Form 5500-SF. That annual report is significantly shorter and less complicated than the full Form 5500. Overall, the Form 5500 is a useful compliance and research tool for the DOL, IRS, and PBGC.

Form 5500 reporting, which includes filing schedules that provide additional plan information not contained in the body of the Form 5500, will vary depending on whether the Form 5500 is being filed for a "large plan," a "small plan," and/or a Direct Filing Entity (DFE, as discussed below in "Special Filings for Direct Filing Entities (DFEs)"), and on the particular type of plan (i.e., pension benefit plan or welfare benefit plan) or DFE involved (e.g., common/

collective trust, pooled separate account, master trust investment account, 103-12 IE, or group insurance arrangement).

Small Plans and Large Plans

Generally, an annual return/report filed for a pension benefit plan or a welfare benefit plan that covered fewer than 100 participants at the beginning of the plan year is a "small plan" and can use a Form 5500-SF for its annual report. For plan years beginning after December 31, 2020, multiple employer plans (plans described in ERISA § 210(a) (29 U.S.C. § 1060(a)) covering 1,000 or fewer participants plan-wide, where no employer has more than 100 participants, are likewise eligible for simplified reporting. ERISA § 104(a)(2)(A) (29 U.S.C. § 1024(a)(2)(A)); Further Consolidated Appropriations Act, 2020. Pub. L. No. 116-94, Div. O § 101(d)).

A plan covering 100 or more participants as of the beginning of the plan year being reported qualifies as a "large plan" and must use the full Form 5500, unless an exception applies. Common exceptions for employee welfare benefit plans are that the plan is unfunded or fully insured. For purposes of counting participants, ERISA Section 3(7) defines "participant" as "any employee or former employee of an employer, or any member or former member of an employee organization, who is or may become eligible to receive a benefit of any type from an employee benefit plan." ERISA § 3(1) (29 U.S.C. § 1002(7)). Whether the plan is small or large, and the method of counting participants, will be relevant later in this discussion in determining whether the plan is exempt from the audit requirement (i.e., because it is a small plan). See Audit Requirement Waived for Plans Filing Simplified Annual Report below.

Form 5500 Main Form and Schedules

Form 5500 consists of a short main form that requests basic plan identifying information and includes a checklist guiding filers to more detailed schedules that must accompany the filing. Filers complete only those schedules that apply to the filer's specific type of plan, as follows:

- **Schedule A.** Schedule A (Insurance Information) is used by large and small plans and certain Direct Filing Entities (DFEs) if any benefits of the plan are provided by an insurance company, insurance service, or like entity. These would also include insurance contracts with insurance companies such as guaranteed investment contracts (GICS) and annuity contracts. A separate Schedule A must be filed for each insurance contract, but Schedule A information may be reported on an insurance contract or policy-year basis.

- **Schedule C.** Schedule C (Service Provider Information) reports information on service providers for large plans and certain DFEs. This schedule generally reports persons who have rendered services to or had transactions with the plan during the reportable year if the person received, directly or indirectly, \$5,000 or more of reportable compensation with respect to services rendered.
 - o You will need to attach Form 5500, Schedule C to an ERISA plan's annual report when filing Form 5500 (unless specifically excluded such as health and welfare plans meeting the conditions of the limited exception at 29 C.F.R. § 2520.104-44 or [Department of Labor \(DOL\) Technical Release 1992-01](#)). Schedule C contains information on each person who rendered services to the plan, or had transactions with the plan, and who received \$5,000 or more in total direct or indirect compensation in connection with those services rendered to the plan, or the person's position with the plan during the plan year. Form 5500, Schedule C, Line 2, Element (b) will contain Code 10 to identify that the service provider rendered accounting services to the plan. This includes auditing the plan.
- **Schedule D.** Schedule D (DFE/Participating Plan Information) reports information on participation in certain pooled investment/insurance arrangements, such as master trust investment accounts (MTIAs), common or collective trusts (CCTs), pooled separate accounts (PSAs), 103-12 investment entities (103-12IEs) and group insurance arrangements (GIAs).
- **Schedule E.** Schedule E (ESOP Annual Information) reports information on ESOP plans.
- **Schedule G.** Schedule G (Financial Transaction Schedules) reports information on nonexempt transactions and loans, leases and fixed income investments in default/uncollectable for large plans and certain DFEs.
- **Schedule H.** Schedule H (Financial Information for Large Plans and DFEs) consists of financial statements and related information for large plans and DFEs. The schedule streamlines large plan financial questions on the Form 5500 and consolidates them into a separate schedule. The Schedule H must be attached to a Form 5500 filed for a pension benefit plan or a welfare benefit plan that covered 100 or more participants as of the beginning of the plan year and a Form 5500 filed for an MTIA, CCT, PSA, 103-12 IE, or GIA. This schedule includes an asset and liability statement (Part I), an income and expense statement (Part II), type of opinion issued and identifying information of the Independent Qualified Public Accountant (IQPA) (Part III) and requires the attachment of the IQPA's report, and a series of compliance questions (regarding any delinquent contributions, prohibited transactions, or if there is fidelity bond coverage and in what amounts) (Part IV).
- **Schedule I.** Schedule I (Financial Information for Small Plans) consists of financial statements and related information for small plans that are not eligible to file Form 5500-SF.
- **Schedule MB.** This schedule is required for multiemployer defined benefit plans or defined contribution plans that currently amortize a waiver of the minimum funding requirements. The schedule must be filed by the plan administrator of any multiemployer defined benefit plan that is subject to the minimum funding standards under I.R.C. §§ 412 and 431, and Part 3 of Title I of ERISA. The schedule must be prepared and signed by the plan's enrolled actuary.
- **Schedule R.** Schedule R (Retirement Plan Information) reports information on pension plans including plan distributions, funding requirements, nondiscrimination coverage, and the adoption of amendments in a defined benefit plan or pension plan otherwise subject to the funding rules of I.R.C. § 412 or ERISA § 302 (29 U.S.C. § 1082). The parts of the Schedule R that must be completed depend on whether the plan is subject to the minimum funding standards of Code Section 412 or ERISA Section 302.
- **Schedule SB.** This must be filed by the plan administrator of a single-employer defined benefit plan that is subject to the minimum funding standards under I.R.C. § 412 and Part 3 of Title I of ERISA. This schedule must be completed and signed by the plan's enrolled actuary.

Employee Benefits Law § 10.03.

Special Filings for Direct Filing Entities (DFEs)

Some plans participate in certain trusts, accounts, and other investment arrangements that may individually have to file Form 5500 as DFEs. See 29 C.F.R. § 2520.103-9. These trusts, accounts, and arrangements include:

- Master trust investment accounts (MTIAs)
- Common or collective trusts (CCTs)
- Pooled separate accounts (PSAs)
- 103-12 investment entities (103-12IEs) –and–
- Group insurance arrangements (GIAs)

A plan whose assets are held in one of these vehicles is relieved from including in its annual report certain

information about the current value of its interest in the DFE, provided the plan administrator provides the DFE with the applicable plan number and plan sponsor's federal employer identification number (EIN), which it must then use in filing its own Form 5500 report. See 29 C.F.R. § 2520.103-9(a), (b). By filing as a DFE, the plan need only report the investment as a single line item on its balance sheet (Form 5500 Schedule H), rather than complete separate line items for its proportion of each underlying investment in the fund.

The IQPA Financial Statement Audit

Form 5500 annual reports, with limited exception, will include financial statements for the plan year to which the Form 5500 annual report relates. Financial statements are often presented for two years: the most-recent plan year to which the Form 5500 relates and, for reference, a comparative financial statement column for the next prior plan year. For the relevant years, the financial statements must set forth the plan's:

- Assets and liabilities for the current and prior plan year ("Statements of Net Assets Available for Benefits") – and–
- Income and expenses, including changes in net assets for at least the current plan year and many times the prior plan year as well ("Statement[s] of Changes in Net Assets Available for Benefits")

ERISA § 103(b) (29 U.S.C. § 1023(b)). The information set forth in the financial statements will vary based on whether the plan is:

- An employee welfare benefit plan under ERISA § 103(b) (1) (29 U.S.C. § 1023(b)(1)) –or–
- An employee pension benefit plan under ERISA § 103(b) (2) (29 U.S.C. § 1023(b)(2))

With limited exceptions for plans that are principally insured, or are small plans, as discussed below, plan administrators are required to engage an IQPA to audit the plan's financial statements. ERISA § 103(a)(3) (29 U.S.C. § 1023(a)(3)). These financial statements appear as a schedule to the Form 5500 (Schedule H) and, as audited, are required to be attached, with accompanying notes and the IQPA's audit report, to the Form 5500 filing.

ERISA defines an IQPA as:

- A person who is a certified public accountant, certified by a regulatory authority of a state

- A person who is a licensed public accountant licensed by a regulatory authority of a state –or–
- A person certified by the Secretary as a qualified public accountant in accordance with regulations published by the secretary for a person who practices in states where there is no certification or licensing procedure for accountants

ERISA § 103(a)(3)(D) (29 U.S.C. § 1023(a)(3)(D)).

Paying for the IQPA

The IQPA's audit fee can be paid by the plan, from plan assets, or the plan sponsor can pay the fee directly from its general assets. If paid by the plan, Form 5500 must disclose the cost of the audit as an expense incurred by the plan. Also, [Schedule C](#), which discloses service provider information and is attached to Form 5500, should identify the IQPA, but only if the plan paid the IQPA's fee (and the plan was not reimbursed by the plan sponsor or other employer sponsoring the plan). As the IQPA is a service provider to the plan, even where the plan sponsor pays the IQPA's fee, plan fiduciaries are tasked with exercising due care in selecting the IQPA. See [Dep't of Labor, Selecting an Auditor for Your Employee Benefit Plan](#) and [AICPA, EBP Audit Quality Center Resource for Auditor Selection](#).

IQPA Examination

Only administrators of an ERISA employee benefit plan covering at least 100 eligible participants are required to engage an IQPA to examine the plan's financial statements, and other books and records of the plan. ERISA § 103(a) (1)(B)(ii), (3)(A) (29 U.S.C. § 1023(a)(1)(B)(ii), (3)(A)). The audit exception for plans with fewer than 100 participants is discussed further below in Audit Requirement Waived for Plans Filing Simplified Annual Report. Plans that are substantially insured enjoy a similar exemption from the audit requirement, as discussed below in "Insured Plan Audit Exception" also in Audit Requirement Waived for Plans Filing Simplified Annual Report.

The purpose of the IQPA audit is for the IQPA to form an opinion as to whether the financial statements, including their footnote disclosures and related schedules, are fairly presented in conformity with generally accepted accounting principles (GAAP). It's the duty of the plan administrator to allow the IQPA retained on behalf of the plan to inspect whatever books and records of the plan are necessary for performing such audit. ERISA § 104(b)(5)(D) (29 U.S.C. § 1024(b)(5)(D)).

Audit, Not Prepare

The IQPA's role is to audit, but not to prepare, the plan's financial statements, footnote disclosures, and the books

and records of the plan. Thus, the plan administrator should arrange that the plan's financial statements are indeed prepared, and the plan's books and records are maintained, by someone other than the IQPA. This may be:

- The plan administrator
- A recordkeeper
- The sponsor's accounting department –or–
- In some cases, by a separate CPA firm or outside accountant

It's not unusual that the last bullet applies, so that one CPA firm will prepare the plan's financial statements and another (independent) CPA firm will audit them, as the IQPA. The IQPA will need to remain independent of the preparation process. Based on the results of its independent audit, the IQPA can make recommendations for changes to the plan's financial statements and disclosures or propose adjustments to the plan's books and records or make recommendations about the plan's operation.

Audit Goals and Audit Opinion

To accomplish these objectives, the IQPA plans and performs the audit to obtain reasonable assurance that its audit identifies material misstatements in the plan financial statements for the year audited (and typically for the prior plan year), whether caused by error or fraud. The IQPA assesses the reliability, fairness, and appropriateness of the plan's financial information as reported by plan management. To do this, the auditor will:

- **Test.** Conduct tests of the amounts and disclosures in the plan's financial statements and required supplemental schedules. This may require reference to discrimination testing that was performed by the plan administrator, third-party administrator or other professional plan consultant, and sampling of required qualification tests (like I.R.C. § 415(c) annual additions for a defined contribution plan), to determine if the plan, on a sample basis, exceeded statutory limits and that deposits (particularly deposits of employee contributions) were timely made.
- **Review accounting principles.** Assess the accounting principles used and significant accounting estimates made by management. –and–
- **Evaluate to form an opinion.** Evaluate the overall financial statement presentation to form an opinion on whether the financial statements as a whole are free of material misstatement.

If any of those changes or adjustments are deemed by the IQPA to be material in nature, something to the extent that it would affect a user's judgement, the plan must make the

changes or adjustments to obtain an unmodified, sometimes referred to as a "clean," opinion, needed to properly file the plan's Form 5500. If the plan chooses not to or cannot make any of the material changes or adjustments proposed by the IQPA, the audit report likely will be:

- A qualified report ("except for")
- A disclaimer ("unable to form an opinion") –or–
- An adverse report ("does not present fairly")

In such cases, the Form 5500 filing will be rejected by the DOL. This topic is discussed below in "Consequence of Accountant's Opinion containing any Material Qualification, a Disclaimer or Adverse Opinion" in Content and Format of the Audit Report.

Preparing for the Audit

The plan, via the plan administrator or plan sponsor, should provide the IQPA with the financial statements to be audited, access to the books and records and other supporting financial and compliance information, and any other information requested by the IQPA to perform the audit. The IQPA will request several plan-related documents or records in advance of actively conducting the audit. These include, typically:

- The plan document, with all amendments
- The plan's current summary plan description (SPD)
- Custodial statements of the plan's assets
- A draft of the Form 5500 to be filed
- The names and roles of plan service providers –and–
- The plan's latest determination letter (or opinion letter, for a master or prototype plan)

Management Representation and Legal Letter

The financial reporting process may involve many parties, including the plan sponsor's financial accounting and human resources departments, a third-party administrator, investment trustees and custodians, an actuary, ERISA legal counsel, and the independent auditor. Plan management may hire service organizations to perform recordkeeping and reporting functions. However, the ultimate responsibility for accurate financial reporting rests with plan management. Therefore, at some time during the audit process, the IQPA will ask the plan administrator or sponsor to represent in writing that it acknowledges its responsibility for the fair presentation of the plan's financial statements. This representation is simply referred to as management's representation, although it may be signed by an entity other than the sponsoring employer. In it, the responsible party makes certain representations concerning:

- The information provided to the IQPA in the course of the audit
- The compliance of the plan with applicable laws and regulations –and–
- Other operational and financial representations regarding the plan

In making these representations, the responsible party implicitly or explicitly makes assertions regarding the recognition, measurement, presentation, and disclosure of the various elements of the financial statements and related disclosures. See [ERISA Advisory Council, Beyond Plan Audit Compliance: Improving the Financial Statement Audit Process \(June 25, 2019\)](#), p. 5. The form of the management representation has been changed for audits performed after December 31, 2020. See 2019 AICPA Guidance (SAS No. 136) in Content and Format of the Audit Report below, for a further discussion. In addition, the IQPA will also request a legal letter from the plan’s ERISA attorney and/or the plan sponsor’s counsel to complete the audit process. The legal letter will request the opinion of the plan’s tax counsel, as to whether the plan is currently designed and operated to comply with the qualification requirements of the IRC and in accordance with ERISA and will request information on any settled or pending claims or litigation affecting the plan and plan assets.

Conducting the Audit

As indicated above, the overall objectives of the plan auditor under its professional standards are to:

- Obtain reasonable assurance about whether the plan’s financial statements as a whole are free from material misstatement, whether due to fraud or error
- To assess the accounting principles used and significant accounting estimates made by management –and–
- Evaluate the overall financial statement presentation, inclusive of the footnotes and disclosures, to form an opinion on whether the financial statements, inclusive of the footnotes and disclosures, as a whole are free of material misstatement

To accomplish these objectives, the auditor plans and performs the audit to obtain reasonable assurance that it has detected material misstatements, whether caused by error or fraud. The auditor assesses the reliability, fairness, and appropriateness of the plan’s financial information, as reported by plan management. The auditor will perform tests that review certain types of payroll and human resources information, checking the plan’s compliance with:

- Plan provisions
- Participant eligibility

- Participant notices and elections
- The establishment and adherence to internal controls
- Plan operational procedures –and–
- The plan’s compliance with applicable laws and regulations

The IQPA performs the review on a sampling basis and it is not intended as a substitute for an internal audit. However, if deficiencies are identified, it can be used as a springboard for such.

The IQPA may also request the plan administrator’s or its staff’s assistance in performing certain confirmation procedures directly with eligible and current participants. This part of the audit may include tests assuring that “in-pay status” participants and beneficiaries are receiving payments of benefits to which they are entitled, checking the eligibility of participants, or that deposits of employee contributions meet the requirements of 29 C.F.R. § 2510.3-102. Depending upon the type of plan the audit may include access to participants’ personal information and records. In the audit of a health and welfare plan, that review may include access to protected health information (PHI, pursuant to HIPAA). In such case the plan (as a covered entity) should have the IQPA execute a HIPAA business associate agreement (BAA) to access that PHI in the course of the audit. For information regarding the need to have a BAA in place, see [HIPAA Privacy, Security, Breach Notification, and Other Administrative Simplification Rules](#).

Issues That May Lead to a Qualified Report or an Adverse Opinion

The IQPA’s evaluation of plan transactions or the plan’s financial condition may lead to its issuing a qualified or adverse opinion regarding the plan’s financial statements. These conditions usually relate to:

- Material or chronic errors or irregularities (e.g., in payments or deposits of employee or employer contributions)
- Illegal acts, including fraud or embezzlement
- Plan qualification errors or even breaches of ERISA fiduciary duties
- Material internal control deficiencies
- Any impairment of assets or taxes due based on plan disqualification or unrelated business taxable income (UBTI)
- Plan parties in interest or disqualified persons having engaged in nonexempt prohibited transactions under I.R.C. § 4975 or ERISA § 406 (29 U.S.C. § 1106)

Auditors do not merely reconcile financial statements. They also review internal controls to determine whether the controls adequately safeguard assets for plan participants. A simple example of one possible internal control that can be easily understood by lay persons would be a requirement to have two disinterested individuals approve all checks issued by the plan. Hence, material irregularities can cause grave concerns that the plan financials are materially incorrect. See [EBSA, Advisory Council Report on Employee Benefit Plan Auditing and Financial Reporting Models](#).

Footnotes and Other Disclosures

The IQPA must review the plan's financial statement disclosures and footnotes to ensure that they, too, conform to GAAP. Financial statements will necessarily include footnotes and disclosures. These will report information, in narrative, sometimes supplemented with charts, on:

- The plan provisions
- Benefits and eligibility
- Investments and other plan assets
- Plan liabilities (if applicable such as in a defined benefit pension or self-funded health and welfare plan) –and–
- Certain specific additional disclosures as required

Additional disclosures may include information on the plan's funded status and minimum funding requirements (for defined benefit pension plans), any subsequent events after the current plan reporting year, such as material amendments or terminations or mergers. The disclosures may also provide contingent information, such as the plan having filed, where applicable, under the IRS' Employee Plan Compliance Resolution System (EPCRS), the DOL's Voluntary Compliance Fiduciary Program (VCFP), or similar compliance programs, while acceptance is pending. Similar disclosure is required if the plan is under audit by either the DOL, IRS, or the PBGC.

Footnote disclosures, additionally, should indicate the plan's tax status, including information on plan amendments and the plan's compliance with applicable IRC requirements and changes. The latter will become more important in IQPA's audits for future years, as the recent changes in the IRS' determination letter process will mean that many plans will no longer be able to request (or produce for the IQPA) an updated determination letter. See Revenue Procedure 2019-20 and [Determination Letter Application Procedures](#). The IQPA may have to perform additional work and make additional inquiries of the plan administrator and plan management that the plan has been properly updated and amended to maintain its compliance with IRC qualification requirements.

The Complete IQPA Opinion

Remember that the financial statements themselves, including their footnotes and disclosures, are the plan's, and the IQPA is providing the opinion letter on the fairness of those statements and disclosures in conformity with GAAP. The opinion is then attached to the annual report that is filed (electronically) with EBSA on Form 5500. For defined benefit plans, the Form 5500, with the audited financials, must then be displayed within 90 days of filing on the plan sponsor's or plan administrator's intranet website. ERISA § 104(b)(5) (29 U.S.C. § 1024(b)(5)).

Management Letter

Even if the IQPA does not identify material weaknesses and/or significant deficiencies in internal control that would require a qualified opinion or written communication with management or those charged with governance, it may wish to communicate deficiencies in internal control or other issues or recommendations for improvement to processes discovered during the audit. Such comments generally are included in a "management letter." Management letters generally document the deficiency in internal control or other issue and include a recommendation for remedying the situation.

Terminating the IQPA Relationship

If the plan terminates the IQPA's services, either for the current or prior plan year, you'll need to attach to Form 5500 on Part III of Schedule C, an explanation of why this decision was made. Similarly, where applicable, you'll report any termination of the plan's enrolled actuary, also on Schedule C, Part III, for the year of termination.

For example, if the accountant performing the audit is terminated in the 2019 plan year after completing the audit for the 2018 plan year, you'd report the termination on the Form 5500 for the 2019 plan year (reported in the year of termination, not in the year audited) and include a statement providing the reasons for the termination. The statement must describe any material disputes, or matters of disagreement, concerning the termination, even if the dispute or disagreement was resolved before the IQPA's termination. While sometimes the reason is simply that a request for proposal lead to another IQPA being selected, the DOL may look at a termination as relating to the IQPA being rejected for being too robust in its review. Preparing the explanation may be a sensitive task.

The plan administrator is required to provide the terminated IQPA with a copy of the explanation for the termination, as attached to the annual Form 5500, and notify the IQPA that it can file a comment with the DOL about the explanation.

Audit Requirement Waived for Plans Filing Simplified Annual Report

Plans covering fewer than 100 participants at the beginning of the plan year are exempted from the plan audit requirement for that plan year. So are new plans or merged plans with a short plan year and ERISA plans (typically group health, life, and other insured benefits) for which plan benefits are substantially provided (and funded) through insurance.

Small Plan Audit Exception

This exemption is available to small plans that are eligible for simplified annual report filing under ERISA § 104(a)(2) (29 U.S.C. § 1024(a)(2)) (i.e., using a Form 5500-SF). 29 C.F.R. § 2520.104-41. The DOL is permitted (and does) waive ERISA requirements that the plan engage an IQPA where it is eligible to file a simplified annual report. ERISA § 104(a)(2)(A) (29 U.S.C. § 1024(a)(2)(A)); 29 C.F.R. § 2520.104-46(c)(1) and (3). Importantly, the regulation states that the administrator is not required to engage an IQPA to conduct an examination of the financial statements of the plan, provided that:

- The plan covers fewer than 100 participants at the beginning of the plan year
- The plan assets meet the waiver definition of “qualifying plan assets” or the plan meets additional bonding requirements –and–
- The plan provides additional disclosure information regarding the plan assets and the waiver in the plan’s summary annual report (SAR)

See *Summary Annual Report Disclosure*, below, for a further discussion.

Safe Harbor in Determining Eligibility for Simplified Reporting

While it is relatively easy to count participants (active, retired, and terminated vesteds) as of the first day of the plan year, regulations identify a safe harbor allowing the plan audit waiver to continue to a subsequent year where the plan has 100 or more participants in that year. 29 C.F.R. § 2520.104-46. The rule accommodates fluctuations in the participant account year-to-year by setting forth an “80-120” participant count rule (the “80-120 Rule”). The 80-120 Rule thus permits a plan with 100 or more participants, but less than 120 participants, at the beginning of the plan year, to file a simplified annual report, for which

an audit is waived, where the plan filed a simplified annual report for the prior year.

As a planning opportunity, given the cost of an audit, some plan sponsors consider splitting the plan into two where a plan is approaching the 100-participant-limit. For example, a law firm sponsoring a 401(k) plan that currently covers 94 participants may decide to split the plan into two plans, one covering attorneys and one covering non-attorneys. Thus, each plan will cover fewer than 100 participants for the foreseeable future and the plans can avoid the annual audit expense.

To avoid the risk of a possible fiduciary breach when considering this approach, plans and their fiduciaries should document the business purpose(s) and objectives of creating an additional plan(s) and that the action is not solely for audit fee cost savings.

For a further discussion on the plan audit waiver, see [DOL, Frequently Asked Questions on the Small Pension Plan Audit Regulation](#).

Determining Who Is a Participant in Applying the Small Plan Audit Exception

If the plan covers fewer than 100 participants at the beginning of the plan year, the plan is not required to include a report of an IQPA with the annual report. All employees who are eligible to participate, regardless of whether they choose to be participant in the plan, should be counted. Determining the employees who are eligible to participate in the plan requires counting all eligible employees according to the plan document. The proper total participant count also includes:

- Those previously separated from service with a vested account balance or benefit –and–
- Those retired participants and beneficiaries receiving benefits or having a vested account balance

Example. A law firm sponsoring a 401(k) plan may allow employees to participate in the plan after they complete one year of service and attain age 21. In determining whether the plan covers fewer than 100 participants at the beginning of the plan year, employees who are younger than age 21 or who have not completed one year of service will not be counted toward that total. The number of participants also includes former employees who still have an account balance (or accrued benefit) in the plan.

Summary Annual Report Disclosure

The audit waiver regulation contains a model notice that plan administrators can use when preparing a summary

annual report (SAR). The special language informs participants and beneficiaries that the plan has met the conditions for the waiver of the audit requirement and therefore that no audit was performed on the plan for the plan year. 29 C.F.R. § 2520.104-46(e). Since a SAR's use is limited to defined contribution plans and non-PBGC-insured defined benefit plans, most defined benefit plans, being subject instead to preparing and delivering to participants and the PBGC an annual funding notice under ERISA § 101(f) (29 U.S.C. § 1021(f)), need not report on the annual funding notice the fact that the plan was not subject to the examination of its financial statements. Indeed, small plans of 100 or fewer are permitted to provide their annual funding notice as part of the Form 5500. ERISA § 104(f)(3)(B) (29 U.S.C. § 1021(f)(3)(B)).

For a sample SAR disclosure that the plan qualified for the audit waiver, based on a DOL model notice, see the last optional clause in [Summary Annual Report \(Defined Contribution Plan\)](#).

Audit Exception for Short Plan Year

The regulation provides that the plan administrator is not required to include the report of an IQPA in the annual report for the first of two consecutive plan years if one of the years is a short plan year of seven or fewer months in duration during which:

- The plan was established or commences operations
- The plan is merged or consolidated with another plan or plans
- The plan is terminated –or–
- The annual date on which the plan year begins is changed

29 C.F.R. § 2520.104-50(b).

Even though the plan administrator is not required to include the report of an IQPA for the first of two consecutive plan years, one of which is a short plan year, the plan administrator must still file an annual report (Form 5500) with the DOL that includes:

- Financial statements and required accompanying schedules
- An explanation of why one of the two plan years is of seven or fewer months' duration –and–
- A statement that the annual report for the immediately following plan year will include a report of an IQPA regarding the financial statements and accompanying schedules for each of the two plan years

29 C.F.R. § 2520.104-50(b).

Insured Plan Audit Exception

Welfare plans, like health plans, commonly provide employee benefits, such as medical, dental, life insurance, and disability benefits. Employee welfare benefit plans under ERISA § 3(1) (29 U.S.C. § 1002(1)) are subject to the annual Form 5500 reporting and filing requirements just as are ERISA employee pension benefit plans under ERISA § 3(2) (29 U.S.C. § 1002(2)). However, many ERISA welfare plans avoid the Form 5500 if they meet one of the exceptions under the law. One exception is for small, insured plans, which are also exempted from filing a Form 5500. 29 C.F.R. § 2520.104-43. The other exception eliminates the audit requirement for a large insured plan.

Funded versus Insured Plans

An unfunded plan is one in which the employer pays the benefits from general (corporate) assets. A “funded” plan is one where funds are set aside in a custodial account or trust fund (like a welfare benefit plan funded through a VEBA under I.R.C. § 501(c)(9)) for the exclusive benefit of plan participants. The small plan audit exception does not apply to a funded plan. In other words, all funded welfare plans must file a Form 5500 and have audited financial statements, regardless of the number of plan participants. However, benefits (and funding) under most ERISA employee welfare benefit plans are insured, not funded. Most are either fully insured or partially insured using a stop-loss insurance policy. For these plans the DOL has two exceptions:

- **Unfunded and small insured welfare plans.** If a welfare plan covers fewer than 100 participants at the beginning of a plan year and is unfunded and/or insured (meeting the filing exemption under 29 C.F.R. § 2520.104-21), the plan sponsor is not required to file a Form 5500 (or consequently, to engage an IQPA to audit the plan's financial statements). 29 C.F.R. § 2520.104-23.
- **Large insured welfare benefit plans.** Likewise, a large plan, the benefits of which are provided (1) solely from the general assets of the employer, (2) exclusively through insurance contracts or policies issued by an insurance company or similar organization, or (3) from the general assets of the employer or from insurance, provided any required participant contributions are quickly forwarded to the insurer (whether or not funneling them through a cafeteria plan operating under I.R.C. § 125), then:
 - The plan will be exempt from completing certain items of the Form 5500. –and–

- o The plan need not engage an IQPA to audit the financial statements of the plan. 29 C.F.R. § 2520.104-44.
 - This is different than the Audit Scope Limitation When Relying on Statements Certified as Accurate by a Bank, Similar Institution, or Insurance Carrier (before December 15, 2020 “Limited Scope Audits”) discussed below in Content and Format of the Audit Report.

Content and Format of the Audit Report

The obligation of the IQPA is to audit the plan’s financial statements that are part of the annual report submission. The annual report must include financial statements for the plan that contain the following information:

- A statement of assets and liabilities (referred to as “statement of net assets available for benefits” in the IQPA’s report, aka, a balance sheet) –and–
- A statement of changes in net assets available for benefits (referred to as “income and expense statement” on Form 5500, Schedule C), which includes details of revenues and expenses and other changes aggregated by general source and application –and–
- For health and welfare benefit plans, additional statements of benefit obligations and the corresponding statement(s) of changes in benefit obligations, if not alternatively presented in the footnote disclosures
- For defined benefit pension plans, additional statements of accumulated plan benefits and the corresponding statement(s) of changes of accumulated plan benefits, if not alternatively presented in the footnote disclosures.

ERISA § 103(b)(1), (2) (29 U.S.C. § 1023(b)(1), (2)). As indicated above, there are differences in the annual report for an “employee welfare benefit plan” and an “employee pension benefit plan.” See ERISA § 103(b)(1), (2), (3) (29 U.S.C. § 1023(b)(1), (2), (3)). Those differences are evident when following the Form 5500 instructions. However, the differences also make the IQPA’s audit more challenging, and more expensive, for an employee pension benefit plan (defined benefit and defined contribution plans, alike) than for most employee welfare benefit plans.

Notes to the Financial Statements

As discussed above in The IQPA Financial Statement Audit “Footnotes and Other Disclosures,” plan financial statements are typically annotated to set forth a narrative. In these

notes to the financial statements, the IQPA is required to consider the plan’s disclosures of the following:

- Any significant changes in the plan made during the period and the impact of such changes on benefits
- The plan’s funding policy, including any changes in such policies during the year and (for a defined benefit plan) the policy as regards prior service costs
- Any significant changes in plan benefits made during the period
- Material lease commitments, other commitments, and contingent liabilities
- Agreements and transactions with persons known to be parties in interest
- The payment priorities upon plan termination (for a defined benefit plan subject to PBGC insurance)
- Information concerning whether a tax ruling or determination letter has been obtained –and–
- Any other matters necessary to fully and fairly present the financial statements of such plan

ERISA § 103(b)(2) (29 U.S.C. § 1023(b)(2)).

Audit Scope Limitation When Relying on Statements Certified as Accurate by a Bank, Similar Institution, or Insurance Carrier (Before December 15, 2020 “Limited Scope Audits”)

ERISA allows the IQPA not to express an opinion as to any statements prepared by a bank or similar institution or insurance carrier regarding assets on the plan’s financial statement which:

- Are held in a common or collective trust –or–
- Are insured

ERISA § 103(b)(3)(G) (29 U.S.C. § 1023(b)(3)(G)). This exception applies where, as is customary, the bank or insurance carrier is regulated and supervised and is subject to periodic examination by a state or federal agency. ERISA § 103(a)(3)(C), 103(b)(3)(G) (29 U.S.C. § 1023(a)(3)(C), 1023(b)(3)(G)); 29 C.F.R. § 2520.103-8. The exception applies, most frequently, to ERISA defined contribution plans that are fully or partially insured and is mostly utilized by defined contribution plans.

As a result of SAS No. 136, the AICPA will now refer to this as an ERISA-permitted audit scope limitation (formerly referred to as a “limited scope audit” but see the discussion below for more details on changes under SAS No. 136). The AICPA states that this limitation on the scope of the

audit is available only when the qualified institution certifies both the accuracy and completeness of the investment information submitted to the plan administrator. If the certifications address only the accuracy of the investment information, or only the completeness of the investment information, the AICPA believes that they are not adequate to allow management to limit the scope of the audit. While many of these certifications typically meet both requirements, it is incumbent upon the IQPA to identify that, and if both are not present, the IQPA would have to advise the plan that the limited scope audit exception is unavailable, requiring a full scope audit.

This limitation on the scope of the audit does not apply to areas such as:

- Participant data
- Participant account balances and related earnings allocations
- Contributions
- Benefit payments
- Participant loans, unless specified included in the certification –or–
- Other information regardless of whether such information is included in the certified statement or information

Thus, the IQPA still will be required to perform auditing procedures in those areas above as required for a full scope audit. Further, this limitation does not change the auditor's responsibility to evaluate whether the form and content of the financial statement disclosures related to the information prepared and certified by a qualified institution follow the applicable financial reporting framework. After SAS No. 136 is effective, for periods ending on or after December 15, 2020, an audit performed pursuant to ERISA Section 103(a)(3)(C) will no longer be referred to as a limited scope audit for the primary reason that SAS 136 includes new performance and reporting requirements for these occasions. Going forward, it will be referred to as an "ERISA Section 103(a)(3)(C) audit." The SAS clarifies what is expected of the IQPA in this circumstance. It includes:

- Specific procedures when performing an ERISA Section 103(a)(3)(C) audit –and–
- Using a new report design intended to provide more transparency about the scope and nature of the audit and describes procedures to be performed on the certified investment information

2019 AICPA Guidance (SAS No. 136)

The American Institute of Certified Public Accountants (AICPA), through its Auditing Standards Board (ASB), voted in December 2018 to issue a new auditing standard, [Statement on Auditing Standards \(SAS\) No. 136](#), "Forming an Opinion and Reporting on Financial Statements of Employee Benefit Plans Subject to ERISA." (SAS No. 136). SAS No. 136 addresses:

- Engagement acceptance
- Audit risk assessment and response
- Communications with those charged with governance
- Procedures for an ERISA Section 103(a)(3)(C) audit (currently referred to as a limited scope audit) –and–
- Considerations relating to the Form 5500

For example, SAS No. 160 requires the "engagement letter" between the plan sponsor and the IQPA to set forth certain audit requirements, such as:

- Providing the IQPA with copies of the current plan document
- Providing the IQPA with a copy of the draft Form 5500 for the plan for review and to reconcile inconsistencies –and–
- Discussing with the IQPA any reportable findings, including identifying any prohibited transactions that have not been properly reported in the supplemental schedules
- At the conclusion of the audit, providing written management representations, particularly agreeing that administering the plan is management's responsibility. While obtaining management's representation is already commonplace, often accomplished at the beginning of the engagement, it is now a requirement under the SAS.

The SAS is effective no earlier than for audits of plan financial statements for periods ending on or after December 15, 2020. This means audits of financial statements appended to 2020 Form 5500 plan years (filings made in 2021 for December 31, 2020 and afterwards plan year-ends), must comply with SAS 136's requirements. See [AICPA, Learning About the New Employee Benefit Plan Auditing Standard – Questions and Answers](#).

AICPA SAS 136 Change to IQPA Report for ERISA Section 103(a)(3)(C) Audits

SAS No. 136, when effective, will change the substance and format of the IQPA's opinion report, for limited scope

audits under ERISA Section 103(a)(3)(C) to be hereafter known as “ERISA Section 103(a)(3)(C) Audits.” The SAS also sets forth a new audit report format. The SAS includes new performance and reporting requirements for these audits which, formerly, lead to the IQPA providing a “disclaimed” opinion. Instead, SAS No. 136 requires the IQPA to issue a two-part opinion that must state that:

- The information on the financial statements not covered by the bank or insurer’s certification is fairly presented. –and–
- The investment information contained in the financial statements reconciles with or is derived from information in the bank’s or insurer’s certification.

The new rules are intended to fortify the certification so that it is a fair substitute for the IQPA’s excluding those assets and internal controls related to them, from the purview of its audit.

Consequence of Accountant’s Opinion Containing Any Material Qualification, a Disclaimer, or Adverse Opinion

The IQPA’s providing an unmodified opinion assures plan participants that, in the IQPA’s opinion, the plan’s financial statements fairly present the financial condition of the plan in accordance with GAAP and that the plan is generally operated in accordance with its terms. Issuing a qualified audit report, a disclaimer opinion, or an adverse opinion, puts the DOL, IRS, and plan participants on notice that the plan may be somehow at risk. This can be grievous for the plan, the plan sponsor, and consequently, the plan or sponsor’s counsel. The DOL may, in fact, reject the annual filing if there is any material qualification or irregularity that the IQPA or enrolled actuary identifies in the opinion attached to the annual report. ERISA § 104(a)(4) (29 U.S.C. § 1024(a)(4)).

Typically, as plan or sponsor’s counsel, you’ll work with the IQPA to avoid issuance of a qualified opinion, and certainly one that is adverse or disclaims an opinion.

Correcting an Annual Report Rejected by the Secretary for Any Material Qualification

In cases where the DOL rejects the plan’s annual report because the filing is incomplete or the IQPA’s opinion contains any material qualification, ERISA allows the plan administrator 45 days (from the date of the DOL’s notice to the plan administrator) to revise the annual report. ERISA § 104(a)(5) (29 U.S.C. § 1024(a)(5)).

Consequences of Failing to Correct an Annual Report Rejected by the Secretary

If the plan administrator does not file a revised annual report within 45 days, the DOL can take the following actions at the plan’s expense if it deems it in the best interest of the participants:

- Retain its own IQPA to perform an audit of the plan’s financial statements
- Retain an enrolled actuary to prepare an actuarial statement
- Bring a civil action for such legal or equitable relief as may be appropriate to enforce the applicable ERISA provisions –or–
- Take any other action authorized by ERISA

ERISA § 104(a)(5) (29 U.S.C. § 1024(a)(5)).

ERISA § 104(b)(5)(D) (29 U.S.C. § 1024(b)(5)(D)) authorizes the secretary (i.e., the DOL) to bring an action against the plan in any court of competent jurisdiction to recover the expense of such audit or report if the plan fails to pay those expenses.

In addition, the DOL, through the EBSA, reviews the IQPA audit workpapers of selected plans as part of an ongoing quality review program designed to ensure the quality of ERISA audits. If the EBSA believes a substandard audit has been performed, it may reject the plan’s Form 5500 filing.

Civil Penalty for Failing to Attach Audit Report to Form 5500 or for Rejected Filing Due to Poor Quality of the IQPA’s Report

At times the audit report is incomplete at the time the Form 5500 filing is due. With paper filings (pre-EFAST2) it wasn’t uncommon that the Form 5500 was filed without the audited financials, which report would be provided within a reasonable time thereafter. Electronic filing complicates this tactic although some file a blank page as the audited financials with a message that the report will follow. The DOL can assess a penalty on plan sponsors (not to be paid from plan assets) for the late filing. As of January 15, 2019, the DOL can assess penalties of up to \$2,194 per day (with no statutory maximum but generally limited by DOL to a maximum of \$50,000) for failing to file any annual Form 5500 report, or filing an annual Form 5500 report where the IQPA report is missing or deemed to be deficient ERISA § 502(c)(2) (29 U.S.C. § 1132(c)(2)). This penalty reflects an increase under the Federal Civil

Penalties Inflation Adjustment Act Improvements Act of 2015, Pub. L. No. 114-74, § 701, which increased civil monetary penalties above their prior increases for inflation. See 81 Fed. Reg. 43,430, 43,441 (July 1, 2016). In addition, the IRS may apply its penalty for late filing of a 5500-series return of \$25 per day, up to a maximum of \$15,000.

For more information on Transactions Search, click [here](#).

For a tutorial in using Transactions Search, see [Transactions Search for Employee Benefits & Executive Compensation Attorneys: How-to Video](#).

Audited Financial Statements Precedents

Click [here](#) to see recent examples of audited financial statements and footnote disclosures for defined contribution plans in Transactions Search powered by Intelligize®. This includes audited financial statements for (1) the [Nordstrom 401\(k\) Plan](#) and (2) the [Snap-on Incorporated 401\(k\) Savings Plan](#), each for their plan years ended December 31, 2018. Transactions Search enables Practical Guidance users to leverage Intelligize data and technology to find precedent documents and market intelligence. Transactions Search is included in your Practical Guidance subscription. You can customize this search to your needs by adding filters or modifying the search criteria.

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José M. Jara's practice focuses on ERISA and employment litigation and counseling and includes representing clients under investigation by the Department of Labor ("DOL") and Employee Benefits Security Administration ("EBSA"), and defending clients from lawsuits filed by the DOL's Office of the Solicitor regarding civil and/or criminal violations of ERISA. José has defended plan fiduciaries and boards of directors against ERISA litigation alleging breach of fiduciary duty in connection with imprudent investments, excessive fees, and delinquent employee contributions. In addition, he provides guidance to plan sponsors and fiduciaries on meeting their fiduciary responsibilities, plan fees and expenses, and ERISA's prohibited transaction provisions.

José's experience extends to advising his clients in a myriad of labor and employment issues such as: sexual harassment and discrimination charges, retaliation, wrongful termination, restrictive covenants, and traditional labor (grievances, arbitrations, and collective bargaining). José also defends companies against DOL wage and hour investigations. Lastly, he provides interactive harassment training, conducts internal investigations, and drafts employment and severance agreements.

Notably, José began his career as a Federal Investigator with the DOL and was a former complex claims director at a major insurance company.

José is an avid speaker and writer on ERISA and employment law topics. Recent seminars and webinars include: "DOL and IRS Health and Welfare Plan Audits"; "Disability Claims & Procedures"; "Protecting Fiduciaries: Insurance, ERISA Bonding, and More"; "Changes to Valuation of Stock Cases: ESOP Challenges & Enforcement Activity"; "#MeToo in the Workplace and Beyond"; and "Meet the Enforcers from the EEOC, NYS Division of Human Rights, and NYC Commission on Human Rights – A Sexual Harassment Seminar."

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