Is It Possible to Avoid an Audit for the First (Short) Year of Our Plan?

Facts

Our company has about 200 employees, and we launched a new 401(k) plan on October of last year. We were eager for all of our existing employees to get excited about this new benefit, so we waived the waiting period to join so that everyone would be eligible on day one. The good news is that it worked, and we had a lot of our employees sign up for the plan. The bad news is that no one warned us ahead of time (and that our current TPA just told us) that we must have the plan audited for that three-month period because we have more than 100 employees eligible when we launched the plan. Adding insult to injury, we have to rush to get it done in time to file our first Form 5500 by October 15th! Yikes!

Question

This is definitely a surprise (not the good kind) and a large, unplanned expense that is likely to be larger given the rushed nature. Isn't there anything we can do to avoid the audit requirement for this first "year," especially since we are only talking about a three-month period from October 1 – December 31?

Answer

There always seems to be an exception to the rules, and exceptions to those exceptions, except for when you need it most, right? Well, today might be your lucky day…maybe.

While there is no "free pass", there is a rule that allows you to postpone your initial short-year audit until next year.

In general, if a plan has more than 100 participants on the first day of the year, the company sponsoring the plan must engage an Independent Qualified Public Accountant (IQPA) to audit the plan's financial statements each year. The IQPA prepares a report that you must attach to your Form 5500 when you file it with the Department of Labor. However, there is a rule that allows you to postpone the audit if there is a short plan year of seven months or fewer. You don't skip the audit, rather you attach the short plan year audit to the following full-year Form 5500 along with the audit for that full year. In other words, you attach both audit reports to the same 5500.

Let's apply those rules to your situation. You noted that you had approximately 200 employees and that you waived the eligibility requirements on plan startup. Since there were more than 100 eligible on the first day of the plan, you are a large plan filer subject to the IQPA requirement. Assuming your plan normally runs on a calendar year, the first "year" of your plan is only three months and runs from October 1, 2018 through December 31, 2018. Since three months is definitely less than seven months, you qualify to postpone the audit of that initial short plan year. Simply check the box on Schedule H to the Form 5500 to indicate you are taking advantage of that special rule and file your 2018 Form 5500 without an audit attached.

Fast forward to this time next year. The IQPA you engage should audit the three months from 2018 as well as all of 2019 and prepare his/her report covering that entire period. When you file the 2019 Form 5500 (by October 15, 2020), attach the report(s) covering the entire 15-month period.

Oh, happy day, right? Yes; just be sure that when you engage an IQPA for the 2019 plan year you share with them the need to audit both the 2018 short plan year and the full 2019 plan year.

Also, be sure to expect a higher cost this first round as they will likely charge more since it will consist of two plan years.

Now, the maybe. When a company starts a new plan at a time other than the beginning of a year, it is common to split the effective date. The overall plan effective date is set to the first day of the year – January 1, 2018 using your plan as an example. However, the effective date for the employee deferral part of the plan is set to the date when the plan is actually rolled out to employees – October 1, 2018, again, using your plan as an example. This is done so that none of the IRS compensation and contribution limits are pro-rated for that initial year. In this type of situation, the first plan year is actually the full twelve months even though the plan is not actually launched until later in the year. That means postponing the audit for that initial year would not be an option.

If you have other questions surrounding your Form 5500 or other plan-related government reporting, give us a call!

Related Resources

- Form 5500 FAQs