

Does My Retirement Plan Need an Audit (and What the Heck is the “80/120” Rule)?

The end of July is creeping closer for calendar year plans and usually arrives sooner than expected for 401(k) plan sponsors. The IRS Form 5500 filing deadline can surprise employee benefit plan administrators when their TPA contacts them with news that their retirement plan has grown in size and now requires a plan audit. As an employer, it's important to be familiar with the plan audit requirements before it's time to file your Form 5500. You need to be prepared well in advance of the filing deadline if an audit is required.

When Does My Plan Need An Audit?

The simple answer is when you are a “large” plan, as defined by the IRS. However, a closer look at the IRS Form 5500 filing instructions shows that it is not a straightforward determination. Since every qualified retirement plan must file the Form 5500 (or 5500-SF), you have to determine annually whether you are a “large” plan or “small” plan for filing purposes. The good news is that you can determine “large” plan status on the first day of your plan year, and you don't have to wait until after the plan year-end when your 5500 is being prepared.

The “large” vs. “small” plan determination for 5500 filing status is made by looking at the number of participants on the first day of the plan year. In a Plan's initial year of existence, the cutoff point for determining if your plan is considered to be a large plan is if there are 100 eligible participants. It's important to note that employees are considered to be participants if they have satisfied the plan's eligibility requirements, regardless of whether or not they actively contribute to the plan. Additionally, a terminated employee who still maintains an account balance in the plan is also considered to be a participant.

After determining your participant count, plans with less than 100 eligible participants are considered a small plan and will file a Form 5500-SF (short form). A large plan (those with over 100 or more participants) will file the Form 5500 and also be required to complete Schedule H and other supporting schedules.

The Exception: The 80/120 Rule

Now that you know, in general, a count of 100 or more eligible participants is the cutoff separating large plans from small plans, there is an exception. The “80/120 rule” allows a plan to continue to be considered a small plan and avoid the audit requirement that is made of large plans.

Under the 80/120 rule, a plan may continue to file as a small plan filer (and thereby avoid the requirement for an audit) as long as there are between 80 and 120 participants at the beginning of the plan year. This is especially important for plans in which the participant count may tend to hover around the 100 participant threshold.

For example, a plan has 90 eligible participants as of January 1, 2014 and files its IRS Form 5500-SF as a small plan for 2014. Then, on January 1, 2015, the count of eligible participants has increased to 110. Utilizing the 80/120 rule, the plan can continue to file the form 5500-SF as a small plan and not be subject to the requirement for an audit. If the count of eligible participants had exceeded 120, then the plan would be considered a large plan for filing purposes and an audit would be required.

Following this example, if the number of eligible participants continues to fall within the 80/120 rule, the plan would be eligible to con-

tinue filing as a small plan filer in each following year, as long as they never reach the 120 eligible participant threshold. A plan classified as a large plan will remain as such, until the participant count goes below 100 eligible participants. Only then will the plan be able to file using small plan status and not be required to submit an audit.

Be Aware and Be Prepared

Plans sponsors can find making the determination of large plan versus small plan status confusing. It's important to take the time to understand the requirements for a 401(k) plan audit and prepare well in advance of the July 31st filing deadline for calendar year plans (the deadline is the end of the seventh month after the end of the plan year). At Kushner & Company, our team of experts is ready to help you with your plan status and avoid any confusion. If you have questions about your 5500 filing status, please call our offices. Our retirement team is ready to assist you.

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