ALERT

Employee Benefits

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GOOD NEWS FOR SMALL EMPLOYERS: CHANGES TO PLAN AUDIT REQUIREMENT COUNTING METHODS

Revisions to the Form 5500 released earlier this year are about to make life a little easier for many small employers that sponsor defined contribution plans. Specifically, the revised form reflects a change to the methodology small employers must use to count participants for purposes of Form 5500 reporting and – most critically – the need for a plan audit.

Before diving into this important policy change, let's review the current rules. Defined contribution plans that are considered "large" plans are subject to an annual Independent Qualified Public Accountant (IQPA) audit requirement. Under the current rule, a plan is considered to be "large" if the number of employees who are eligible for the plan at the start of the plan year is 100 or greater, regardless of whether those eligible employees have account balances. If, on the other hand, this number adds up to less than 100, the plan is deemed to be "small" and qualifies for an audit waiver.

On February 24, 2023, the DOL, IRS, Treasury, and Pension Benefit Guaranty Corporation (PBGC) released final forms and instructions for the Form 5500 and Form 5500-SF that change the method for counting participants. As relevant here, the new forms dictate that, for purposes of calculating whether a plan meets the 100-participant audit threshold, plan sponsors need only count *participants with account balances* at the beginning of a plan year, rather than all *eligible employees*.

Consider, for example, the hypothetical company ABC, Inc., which sponsors the ABC, Inc. 401(k) Plan. In 2023, ABC, Inc. has 150 total employees. Of the 150 employees, 125 are eligible to participate in the plan, but only 85 had account balances at the beginning of

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the 2023 plan year. Under the current rules, ABC, Inc. would be subject to the annual IQPA audit requirement. However, under the new rules, ABC, Inc. qualifies for an audit waiver (although it is still required to file a Form 5500).

This new rule, which is effective for plan years beginning on or after January 1, 2023, arrived in the wake of the new SECURE 2.0 rules expanding plan participation requirements for long-term, part-time employees. The new long-term, part-time rules, which take effect in 2024, will increase the number of participants who are eligible to participate in a plan and, under the current participant-counting rules, subject more plans to annual audit requirements.[1] However, the changes to participant counting methods will have the opposite effect. The changes are estimated to significantly reduce the number of employers subject to an IQPA audit. According to the government's estimates, small plans may save $7,500 or more on audit expenses.

For more information on the new participant counting method, or any other employee benefits topic, please do not hesitate to contact one of the following attorneys on our Employee Benefits team at (316) 267-2000.

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[1] For more information on SECURE 2.0, see our January 9, 2023 alert.