

Dol Revises Small Plan Audit Exemption Rules

The U.S. Department of Labor finalized new regulations that tighten the rules regarding the audit exemption for small employee benefit plans. A small plan is generally one that covers less than 100 participants. **Plans that only cover a sole proprietor, partners in a partnership, a 100% owner of a business, and their respective spouses, continue to be exempt from the audit requirement.**

This letter provides a brief overview of the changes and describes their potential impact. Your individual circumstances will determine what action, if any, is recommended or required. Please call your Schloss & Co. Retirement Plan Consultant if you have any questions.

- **When are the new rules effective?** The new requirements for the audit exemption are effective for plan years beginning after April 17, 2001.
- **What is an "Audit Exemption"?** Small plans were previously exempt from the requirement to have an independent accountant do a certified audit of plan assets each year. All other plans (generally those with 100 or more participants) were required to have the annual audit performed.
- **What changes were made?** The exemption remains available to small plans that have at least 95% of plan investments in "qualifying plan assets" at the start of each plan year. Plans that are below the 95% threshold must meet additional bonding requirements.

In order to maintain the audit exemption, ALL small plans must also satisfy expanded disclosure requirements (see next page).

- **What are "qualifying plan assets"?** Assets held by a bank or similar financial institution, insurance company, broker-dealer or regulated entity; mutual funds; participant loans; qualifying employer securities; self-directed individual account plans that offer participant control of their investments and provide, at least annually, a statement describing the investments at the regulated financial institution.
- **What are "non-qualifying plan assets"?** Assets that are not held by a regulated entity. Examples could include limited partnerships, real estate, mortgages, artwork, collectibles and securities of "closely-held" companies.

<p>ALERT: Securities (stocks, bonds, etc.) that are registered in the name of the plan/trust and held in the plan trustee's possession (as opposed to being held by a broker-dealer in "street name") are considered non-qualifying plan assets.</p>

In Order To Maintain The Audit Exemption:

i. **What additional bonding conditions apply to small plans with less than 95% of investments in "qualifying plan assets"?**

A Fidelity Bond covering at least 100% of the value of non-qualifying assets must cover all individuals that handle such assets. The Fidelity Bond already required by ERISA (10% of plan assets, maximum bond \$500,000) may suffice, IF:

- It covers at least 100% of the value of non-qualifying assets without regard to the \$500,000 maximum;
- It covers all individuals who "handle" plan assets; AND its amount is fixed at the start of each plan year.

ii. **What additional information can a participant request?**

The Summary Annual Report (SAR) required to be distributed annually to all plan participants must include the following additional information:

- the identity of each regulated financial institution holding qualifying plan assets and the value of such assets held at year end;
- the name of the surety company issuing the bond;
- notice to participants of their right to request without charge, to examine or receive copies of statements from the regulated financial institutions and evidence of the surety bond; and
- notice to participants to contact the U.S. Department of Labor if they do not receive the above information.

iii. **What additional information can a participant request?**

A participant can request to see or receive copies, at no charge, of each financial institution statement and evidence of the Fidelity Bond.

• **What should be done now?**

Sponsors of small plans (under 100 participants) should review their plan investments to determine whether or not at least 95% are "qualifying plan investments". If not, options include:

- i. Consult with your accountant to determine the scope and expense of performing the certified audit.
- ii. Increase the Fidelity Bond, if necessary, to meet the new threshold requirements. This may be the easiest approach, although due care should be taken to ensure the accuracy of the value of "non-qualifying plan assets" and the coverage of all individuals handling such assets.
- iii. Reduce the level of non-qualifying plan assets to 5% or less of total plan assets. This would require selling or transferring control of assets that may not be highly liquid.

ALERT: The determination of the 95% threshold is fixed at the start of the plan year, based on the asset values at the end of the prior year. Any of the above actions must be taken before that date. For example, a plan year (6/1/2001 - 5/31/2002) will reflect asset values as of 5/31/2001.

CALENDAR PLAN YEARS HAVE A BIT OF BREATHING ROOM, AS THEIR THRESHOLD WILL BE DETERMINED AS OF DECEMBER 31, 2001 FOR THE PLAN YEAR BEGINNING JANUARY 1, 2002.