



JENNINGS LAW FIRM

memorandum

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Qualified retirement plans covering fewer than 100 participants are generally exempt from the requirement to engage an independent certified public accountant to perform an annual audit of the plan's financial statements and Form 5500. This rule is sometimes called the Small Plan Audit Waiver. However, in situations where more than 5% of the plan's assets are not invested in "qualifying plan assets," an audit is required unless certain requirements are satisfied. The most important requirement is that there is an ERISA bond covering the entire value of the non-qualifying assets.

We are attaching to this memorandum the Labor Department's Questions & Answers summarizing the Dept's view. For those who wish to read the actual regulation, the citation is DOL Reg. 2520.104-46.

Some important Q&As are presented below.

Q. What is the general rule regarding obtaining an ERISA bond?

A. Each person who handles any assets of a qualified retirement plan must be bonded. The bond amount must be at least 10% of the plan's assets (but no less than \$1,000) and no more than \$500,000. Each person handling plan assets can be separately bonded or a single bond may be obtained, provided it covers each person handling plan assets. This requires, among other things, constant monitoring by the employer on who is handling plan assets and that each such person is actually named in the bond.

A person does not have to be a fiduciary to be subject to bonding. An employee, who processes distributions for an employer and can direct the plan to make distributions, must be bonded even if that person is not considered a fiduciary.

Q. What if all of the plan's assets are qualifying assets but there is no ERISA bond?

A. Failure to have an ERISA bond does not result in an audit being required if all of the plan's assets are qualifying assets. Additionally, even if the plan holds non-qualifying assets, the Small Plan Audit Waiver is still available provided the amount of the ERISA bond is at least equal to the value of the non-qualified assets (and other requirements are satisfied, as explained in the attached Labor Dept's Q&As).

Example: The value of the plan's assets is \$1 million, which includes \$50,000 of non-qualified assets. The normal ERISA bonding rules require the plan to have an ERISA bond of at least 10% of the value of plan assets, or \$100,000. If the plan has its minimum bonding coverage, no further bonding is required. Thus, in most cases, until the value of the non-qualifying assets exceeds 10% of the value of all plan assets, the normal bonding coverage will be sufficient.

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memorandum

Page 2

Q. What if a plan has no ERISA bond and it holds non-qualifying assets with a value of 5% or less of all plan assets?

A. As long as the value of the non-qualifying assets does not exceed 5% of all plan assets, failure to obtain any ERISA bonding will not result in an annual audit being required.

Q. What are “qualifying plan assets?”

A. The attached Labor Dept Q&As define qualifying plan assets and here are some examples of what are and are not qualifying plan assets:

- Mutual funds and assets held in brokerage accounts qualify. Mutual funds offered by insurance companies in variable annuity contracts qualify.
- A checking or savings account owned by the plan qualifies.
- Employer stock generally qualifies.
- Participant loans qualify.
- Amounts due from the employer or employee (such as unremitted 401(k) contributions) qualify.
- Gold and real estate generally are not qualifying. However, gold coins held in an account with a regulated financial institution in the plan’s name should qualify. Gold coins held in a safety deposit box (even if the box is in the name of the plan) will likely not qualify.

Q. When must the value of the plan’s assets be determined for this purpose?

A. The value of a plan’s assets that are invested in qualifying or non-qualifying assets is determined on the last day of the preceding year. This is going to be very problematic since non-publicly traded assets cannot often be immediately valued. And even in cases where the value of a non-qualifying asset is readily determinable, the number of assets may not be readily determinable.

Example: The trustee of a plan is buying and selling gold coins throughout a plan year. Even though the value of a gold coin may be readily available on a daily basis, it may take time for the trustee to inventory the plan’s gold holdings until well after the last day of each plan year.

Example: The trustee of a plan invests in rare coins or stamps for which there is no daily price available. In fact, there may be no meaningful value unless the coins or stamps are actually placed for auction.

The obvious solution in these cases is to purchase sufficient bonding so that there can be no question about whether the entire value of the non-qualifying assets is covered.

memorandum

Page 3

Q. What are the consequences of failing to obtain sufficient ERISA bonding if the plan's investment in non-qualifying assets exceeds 5%?

- A. The plan is deemed to have filed an incomplete Form 5500, which means the plan has filed no return. The regular late-filing penalties apply. However even if the plan qualifies for the Labor Dept's DFVCP program, the plan cannot file an amended Form 5500 until the audit is conducted. If the plan is deemed to have filed no Form 5500, the statute of limitations never begins to run. This means if the plan is later audited by the Labor Dept (or IRS), the auditor can go back unlimited plan years.

Example: The value of the plan's assets is \$1 million, which includes \$150,000 of non-qualified assets. The plan holds an ERISA bond for more than \$150,000 but not all employees who handle plan assets are covered under that bond. In that case, it is likely an audit is required.

* * * * *

There are many retirement plans that have not obtained their ERISA bond. In those cases where the plan is investing in non-qualifying assets, the employer sponsoring the plan faces significant expense if an audit is required, particularly for several prior years. Most 401(k) plans of our clients are invested solely in qualifying assets (like mutual funds), so this special audit rule should not present any new risks. However we are also seeing employers who are investing in non-qualifying assets that are perceived to present a hedge against normal market fluctuations. Thus employers must make an immediate review of their plan's investments to determine whether there is sufficient ERISA bonding and that all persons handling assets are covered under the bond.

If you have any questions about your plan, please contact Lee T. Jennings at our office.

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Frequently Asked Questions On The Small Pension Plan Audit Waiver Regulation

What is the Small Pension Plan Audit Waiver Regulation?

The Department of Labor's regulation at 29 CFR 2520.104-46 establishes conditions for small employee benefit plans (generally those with fewer than 100 participants) to be exempt from the general requirement under Title I of the Employee Retirement Income Security Act (ERISA) that plans be audited each year by an independent qualified public accountant (IQPA) as part of the plan's annual report (Form 5500).

The Department amended the regulation in October 2000 to impose additional conditions for small pension plans to be exempt from the annual audit requirement. The purpose of the new conditions is to increase the security of assets in small pension plans by improving disclosure of information to participants and beneficiaries and, in certain instances, requiring enhanced fidelity bonds for persons who handle plan funds. The amendments went into effect beginning in 2001.

The Employee Benefits Security Administration (EBSA) has received a variety of questions on how to determine whether a small plan has met the conditions for the audit waiver. The purpose of this document is to answer frequently asked questions about the audit waiver requirements under the amended regulation. Questions concerning this guidance may be directed to the EFAST Help Line at 1.866.463.3278. The EFAST Help Line is available Monday through Friday from 8:00 am to 8:00 pm, Eastern Time.

 [Back To Top](#)

[Eligible Pension Plans](#)

[What pension plans are eligible for an audit waiver under the Small Pension Plan Security Amendments?](#)

Pension plans with fewer than 100 participants at the beginning of the plan year are eligible if they meet the conditions for an audit waiver under 29 CFR 2520.104-46.

 [Back To Top](#)

[Can a plan that utilizes the "80 to 120 Participant Rule" to file as a small plan claim the audit waiver?](#)

Yes. All Schedule I filers that meet the conditions of the audit waiver are eligible. If the plan meets the conditions of the "80 to 120 Participant Rule," it may file as a small plan and attach Schedule I instead of Schedule H to its Form 5500. Under the 80 to 120 Participant Rule, if the number of participants covered under the plan as of the beginning of the plan year is between 80 and 120, and a small plan annual report was filed for the prior year, the plan administrator may elect to continue to file as a small plan.

 [Back To Top](#)

[Does the plan have to tell participants, beneficiaries and the Department of Labor if it is claiming the audit waiver? If so, how?](#)

Yes. The plan administrator must disclose that it is claiming the waiver by checking "yes" on Line 4k of Schedule I of the Form 5500 filed for the plan.

 [Back To Top](#)

[Does a small pension plan that does not meet the audit waiver conditions need to](#)

[file Schedule H instead of Schedule I?](#)

No. Small pension plans that cannot claim the audit waiver may still file Schedule I, but must attach the report of an IQPA to their Form 5500. They also do not need to include schedules of assets held for investment, a schedule of reportable transactions, the Schedule C or Schedule G.



[If a small plan elects to file as a large plan pursuant to the 80 to 120 Participant Rule, can it still claim the small pension plan audit waiver?](#)

No. Only plans filing as small plans can rely on the small pension plan audit waiver.



[If the plan previously did not have to include an audit with its annual report filing because it met another ERISA exception to the audit requirement, does it now have to meet the conditions under 29 CFR 2520.104-46?](#)

No. If a plan meets another exception to the IQPA audit requirement, for example, if it is a small pension that is not required to complete Schedule I (such as a plan using a Code section 403(b) annuity arrangement that is exempt from the audit requirement under 29 CFR 2520.104-44) it does not have to meet the audit waiver requirements in 29 CFR 2520.104-46.



[General Conditions For Audit Waiver](#)

[What are the requirements for the audit waiver?](#)

In addition to being a small pension plan filing the Schedule I, there are three basic requirements for a small pension plan to be eligible for the audit waiver:

First, as of the last day of the preceding plan year at least 95% of a small pension plan's assets must be "qualifying plan assets" or, if less than 95% are qualifying plan assets, then any person who handles assets of a plan that do not constitute "qualifying plan assets" must be bonded in an amount that at least equal to the value of the "non-qualifying plan assets" he or she handles.

Second, the plan must include certain information (described below) in the Summary Annual Report (SAR) furnished to participants and beneficiaries in addition to the information ordinarily required.

Third, in response to a request from any participant or beneficiary, the plan administrator must furnish without charge copies of statements the plan receives from the regulated financial institutions holding or issuing the plan's "qualifying plan assets" and evidence of any required fidelity bond.



[What are qualifying plan assets?](#)

"Qualifying plan assets" are:

- Any asset held by certain regulated financial institutions (see the next question);
- Shares issued by an investment company registered under the Investment Company Act of 1940 (e.g. mutual fund shares);
- Investment and annuity contracts issued by any insurance company qualified to do business under the laws of a state;
- In the case of an individual account plan, any assets in the individual account of a participant or beneficiary over which the participant or beneficiary has the opportunity to exercise control and with respect to which the participant or

beneficiary is furnished, at least annually, a statement from a regulated financial institution describing the plan assets held or issued by the institution and the amount of such assets;

- Qualifying employer securities, as defined in ERISA section 407(d)(5); and
- Participant loans meeting the requirements of ERISA section 408(b)(1), whether or not they have been deemed distributed.

 [Back To Top](#)

Which financial institutions are “regulated financial institutions” for purposes of the audit waiver conditions?

Only the following institutions are “regulated financial institutions” for purposes of the audit waiver conditions:

- Banks or similar financial institutions, including trust companies, savings and loan associations, domestic building and loan associations, and credit unions.
- Insurance companies qualified to do business under the laws of a state;
- Organizations registered as broker-dealers under the Securities Exchange Act of 1934;
- Investment companies registered under the Investment Company Act of 1940; or
- Any other organization authorized to act as a trustee for individual retirement accounts under Internal Revenue Code section 408.

 [Back To Top](#)

If more than five percent of the plan’s assets are non-qualifying, does that mean that the plan must be audited?

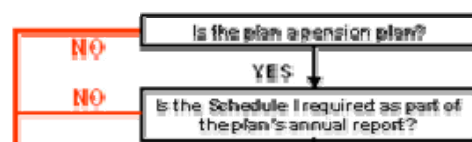
Not necessarily. If the plan obtains bonding in accordance with the provisions of the regulation and otherwise meets the waiver requirements, it can still claim the audit waiver.

 [Back To Top](#)

What are the basic decisions that must be made to determine whether a small pension plan may claim the audit waiver?

Administrators can use the following diagram to help decide whether they meet the conditions for being eligible for the audit waiver.

Small Pension Plan Audit Waiver (SPPAW) Summary





Qualifying Plan Assets

How do I calculate the percentage of “qualifying plan assets” for my plan?

All plan assets that must be reported on the Form 5500 Schedule I line 1a, column (b) for the end of the prior plan year must be included in the calculation of “qualifying” and “non-qualifying” plan assets. The calculation must be made as soon as the information regarding the plan’s assets at the close of the preceding plan year practically can be ascertained. This generally will be much sooner than the due date for filing the Form 5500 for that preceding plan year.



How is the percentage of “qualifying plan assets” determined for initial plan years?

In the initial plan year, the plan administrator may rely on estimates. The administrator should follow a similar method to the one described in 29 CFR 2580.412-15 for estimating the amount required for the ERISA section 412 fidelity bond for an initial plan year. For example, if a plan will be investing exclusively in assets that meet the definition of “qualifying plan assets,” for example, insurance contracts and mutual fund shares, bonding in addition to that required under section 412 would not be necessary to meet the first condition for claiming the audit waiver.



When a new plan is initially funded through the transfer of assets from a predecessor plan, how is the percentage of “qualifying plan assets” determined for the initial plan year?

You should make the determination by treating the new plan as not having a preceding reporting year and use the assets actually transferred from the predecessor plan to determine whether the new plan meets the 95% percentage condition for “qualifying plan assets.”



Does the type of account the plan has with a “regulated financial institution” matter in determining whether assets are “qualifying plan assets”?

Generally, the account must be a trust or custodial account. For example, plan assets held in bank custodial, common or collective trust or separate trust accounts are qualifying plan assets. In addition, securities held by a broker-dealer for the plan in an omnibus account are qualifying plan assets. Checking and savings accounts that create a debtor-creditor relationship between the plan and the bank are also “qualifying plan assets” for purposes of the audit waiver conditions.



If I put plan assets in a bank safe deposit box, can I treat those assets as “qualifying plan assets”?

No. Plan assets put in a safe deposit box with a bank are not qualifying plan assets.



the individual account statements from the regulated financial institutions are mailed by affiliates of the regulated financial institutions, other unaffiliated service providers, or the plan administrator?

Yes. The account statements must be statements of the regulated financial institution, but the institution's regular distribution systems may be used to transmit the statements to participants and beneficiaries. For example, a statement prepared by the regulated financial institution, on the institution's letterhead including contact information that a participant could use to confirm the accuracy of the information in the statement with the regulated financial institution could be given to the plan administrator for distribution to the plan participants and beneficiaries. However, a statement prepared by the plan administrator, even if based on data from the regulated financial institution, would not meet the audit waiver condition.

 [Back To Top](#)

Fidelity Bonding For Non-Qualifying Assets

What type of fidelity bond is needed to meet the audit waiver conditions if more than five percent of its assets are non-qualifying assets?

Persons that handle non-qualifying assets must be covered by a fidelity bond or bonds that meet the requirements of section 412 of ERISA, except that the bond amount must be at least equal to 100% of the value the non-qualifying plan assets the person handles. Persons handling non-qualifying plan assets can rely on normal rules and exemptions under section 412 in complying with the audit waiver's enhanced bonding requirement. For example, if the only non-qualifying assets that a person handles are not required to be covered under a standard ERISA section 412 bond (e.g., employer and employee contribution receivables described in 29 CFR 2580.412-5) that person would not need to be covered under an enhanced bond for a plan to be eligible for the audit waiver.

 [Back To Top](#)

If the plan has more than 5% of its assets in non-qualifying plan assets, does the enhanced bond have to cover all the non-qualifying assets or only those in excess of the 5% threshold?

All the non-qualifying assets, not just a selection that represent the excess over 5%, are subject to the enhanced bond requirement.

 [Back To Top](#)

Can the plan satisfy the audit waiver bonding requirement by having persons who handle the non-qualifying plan assets get their own bond?

Yes. The person handling the non-qualifying plan assets can obtain his or her own bond. Also, a company providing services to the plan can obtain a bond covering itself and its employees that handle non-qualifying plan assets. The bond has to meet the requirements under section 412, such as the requirements that the plan be named as an insured, that the bond not include a deductible or similar feature, and that the bonding company be on the U.S. Department of the Treasury's Circular 570 list of approved surety companies. [<http://www.fms.treas.gov/c570/c570.html>]

 [Back To Top](#)

Can the plan's section 412 fidelity bond be used to satisfy the bonding requirements for an audit waiver?

Section 412 of ERISA provides that persons that handle plan funds or other property generally must be covered by a fidelity bond in an amount no less than 10 percent of the amount of funds the person handles, and that in no case shall such bond be less than \$1,000 nor is it required to be more than

\$500,000. In some cases, 100% of the value of non-qualifying plan assets may be less than 10% of the value of all of the plan funds a person handles. Under those circumstances, the section 412 bond covering the person will satisfy the audit waiver condition because the amount of the bond will be at least equal to 100% of the non-qualifying plan assets handled by that individual.

For example, a person may handle a total of \$1 million in plan funds, but only \$50,000 are non-qualifying plan assets. In that case, the ERISA section 412 bond covering the person should be equal to or greater than \$100,000, which would be more than the value of the non-qualifying assets the person handles. For that person, the ERISA section 412 bond would also satisfy the audit waiver enhanced bonding requirement.

Even where the amount of an existing section 412 bond is insufficient to meet the audit waiver requirement, plan administrators may want to consider increasing the coverage under the section 412 bond rather than getting a new fidelity bond.



Summary Annual Report Disclosures

What information must be included in the summary annual report for the plan to be eligible for the audit waiver?

The plan administrator must include the following additional information in the Summary Annual Report (SAR) furnished to participants and beneficiaries to be eligible for the small pension plan audit waiver:

- Except as noted in [the following question](#) below, the name of each regulated financial institution holding or issuing "qualifying plan assets" and the amount of such assets reported by the institution as of the end of the plan year;
- The name(s) of the surety company issuing enhanced fidelity bonding, if the plan has more than five percent of its assets in "non-qualifying plan assets;"
- A notice indicating that participants and beneficiaries may, upon request and without charge, examine or receive from the plan copies of evidence of the required bond and copies of statements from the regulated financial institutions describing the "qualifying plan assets;" and
- A disclosure stating that participants and beneficiaries should contact the Department of Labor's Employee Benefits Security Administration (EBSA) Regional Office if they are unable to examine or obtain copies of the regulated financial institution statements or evidence of the required bond.



Do the enhanced Summary Annual Report (SAR) disclosure requirements apply to all "qualifying plan assets?"

No. The enhanced SAR disclosure is not required for the following qualifying plan assets:

- Qualifying employer securities as defined in section 407(d)(5) of ERISA and the regulations issued thereunder;
- Participant loans meeting ERISA section 408(b)(1) and the regulations issued thereunder; and,
- In the case of an individual account plan, any assets in the individual account of a participant or beneficiary over which the participant or beneficiary has the opportunity to exercise control provided the participant or beneficiary is furnished, at least annually, a statement from an eligible regulated financial institution describing the assets held or issued by the institution and the amount of such assets.

Do the enhanced Summary Annual Report (SAR) disclosure requirements apply even if 95% of the plan's assets are "qualifying plan assets?"

Yes. Even if 95% of the plan's assets are qualifying plan assets, to be eligible for the audit waiver, the

SAR must include the required information on the regulated financial institutions holding or issuing the plan's qualifying plan assets.



[Is there model language for the enhanced Summary Annual Report \(SAR\) requirements?](#)

The regulations do not require that model language be used for the required enhanced SAR disclosures. Rather, as long as the SAR includes the required information, it will satisfy the audit waiver condition. The Department did not issue model SAR disclosure text as part of the regulation because there are various ways that plans can satisfy the audit waiver conditions. Nonetheless, the following example may assist administrators in composing SAR disclosures for their plans that would satisfy the regulation. Plan administrators will need to modify the example to omit bonding or other information that is not applicable to their plan.

The following is language for a model notice:

The U.S. Department of Labor's regulations require that an independent qualified public accountant audit the plan's financial statements unless certain conditions are met for the audit requirement to be waived. This plan met the audit waiver conditions for **(insert year)** and therefore has not had an audit performed. Instead, the following information is provided to assist you in verifying that the assets reported in the Form 5500 were actually held by the plan.

At the end of the **(insert year)** plan year, the plan had (include separate entries for each regulated financial institution holding or issuing qualifying plan assets):

[set forth amounts and names of institutions as applicable]

[(insert \$ amount) in assets held by (insert name of bank)],

[(insert \$ amount) in securities held by (insert name of registered broker-dealer)],

[(insert \$ amount) in shares issued by (insert name of registered investment company)],

[(insert \$ amount) in investment or annuity contract issued by (insert name of insurance company)]

The plan receives year-end statements from these regulated financial institutions that confirm the above information. **[Insert as applicable** - The remainder of the plan's assets were (1) qualifying employer securities, (2) loans to participants, (3) held in individual participant accounts with investments directed by participants and beneficiaries and with account statements from regulated financial institutions furnished to the participant or beneficiary at least annually, or (4) other assets covered by a fidelity bond at least equal to the value of the assets and issued by an approved surety company.]

Plan participants and beneficiaries have a right, on request and free of charge, to get copies of the financial institution year-end statements and evidence of the fidelity bond. If you want to examine or get copies of the financial institution year-end statements or evidence of the fidelity bond, please contact **[insert mailing address and any other available way to request copies such as e-mail and phone number]**.

If you are unable to obtain or examine copies of the regulated financial institution statements or evidence of the fidelity bond, you may contact the regional office of the U.S. Department of Labor's Employee Benefits Security Administration (EBSA) for assistance by calling toll-free 1.866.444.EBSA (3272). A listing of EBSA regional offices can be found at www.dol.gov/ebsa. General information regarding the audit waiver conditions applicable to the plan can be found on the U.S. Department of Labor web site at www.dol.gov/ebsa under the heading "Frequently Asked Questions."