

Responsibilities of a Plan Sponsor

What plan sponsors should do to protect themselves when administering a plan ...

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Fiduciary Liability Management
Technical Compliance Management
Audit/Financial Statements Impact



Fiduciary Liability Management

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Why Worry About Fiduciary Liability Management?

- ◆ 150 to 300 new lawsuits per calendar quarter
- ◆ Personal liability of fiduciaries (parties being sued)
 - Plan sponsor
 - Administrative and investment committees and their individual members
 - Compensation committees and board members on the committees, individually
 - Members of the Board who appoint committee members

Why Worry About Fiduciary Liability Management? (continued)

Costs of defense

- Consultants
- Lawyers
- Accountants
- HR personnel time
- Executives' time
- Labor relations

Who is a Plan Fiduciary?

ERISA defines a retirement plan fiduciary as anyone who does any of the following:

- Exercises control or authority over the management of the plan or the plan's assets;
- Provides investment advice for a fee; or
- Has discretionary authority over the plan's administration

The plan sponsor is the ultimate plan fiduciary as they can name other fiduciaries

Who is a Plan Fiduciary? (cont'd)

Many fiduciaries are named within the plan or policies of the plan.

- Trustee(s)
- Investment managers
- Plan administrator – (not TPA) may be an individual or employer

Who is NOT a Plan Fiduciary?

Professional service providers if they offer:

- Legal services
- Accounting or auditing services
- Recordkeeping
- Third party administration
- Actuarial services

But...if these services are provided while exercising discretion in conjunction with these services, then they are a fiduciary.

ERISA Fiduciary Responsibilities – General Rule

ERISA 404 (a)

- Imposes a “prudent man standard of care” for qualified plan fiduciaries.
- Subsection (1) of 404(a):
 - “a fiduciary shall discharge his duties with respect to a plan solely in the interest of the participants and beneficiaries and –
 - (A) for the exclusive purpose of:
 - (i) providing benefits to participants and their beneficiaries; and
 - (ii) defraying reasonable expenses of administering the plan;

ERISA Fiduciary Responsibilities – General Rule (continued)

- (B) with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims;
- (C) by diversifying the investments of the plan so as to minimize the risk of large losses, unless under the circumstances it is clearly prudent not to do so; and..."

Steps to Fulfill ERISA 404(a) Plan Operations Responsibilities

- ◆ Designate responsible parties to carry out administrative responsibilities
- ◆ Establish administrative guidelines and document administrative decisions
- ◆ Establish procedures and criteria to select and monitor plan service providers
- ◆ Avoid conflicts of interest

Steps to Fulfill ERISA 404(a) Plan Investments Responsibilities

- ◆ Prepare written Investment Policy Statement (IPS)
- ◆ Use “Prudent Experts” to make specific investment decisions
- ◆ Diversify assets across risk/return spectrum
- ◆ Monitor activity of money managers
- ◆ Monitor and control expenses
- ◆ Document investment decisions

IPS Typical Components

- ◆ Plan's purpose
- ◆ Purpose of IPS
- ◆ Roles and responsibilities
- ◆ Investment guidelines
- ◆ Manager/fund selection process
- ◆ Fund array — core & non-core
- ◆ Default fund
- ◆ Investment monitoring and reporting
- ◆ Benchmarks and peer groups

Investment Dilemmas Facing Fiduciaries

- ◆ Does a broader array of investment choices reduce fiduciary liability exposure?
 - More asset classes
 - Multiple options same asset class
 - Monitoring burden

- ◆ Can a plan sponsor rely on a provider's due diligence?
 - Does sponsor understand process followed?
 - Does IPS cover selection and monitoring criteria?

Investment Dilemmas Facing Fiduciaries (continued)

- ◆ What is the best Qualified Default Investment Alternative (QDIA)?
 - Asset allocated fund based on plan demographics
 - Target date funds

- ◆ Is the broker or vendor a fiduciary?
 - Unlikely to be named as a fiduciary
 - Unlikely to accept fiduciary status in writing
 - Likely to deny having fiduciary liability in contracts and service agreements
 - Comes down to authority and services provided

MOST Common ERISA 404(a) Issues

- ◆ Plan sponsor understanding that it (not the vendor or broker) is responsible for investment manager selection and monitoring
- ◆ Plan sponsor understanding that it (not the investment vendor, recordkeeper or TPA) is responsible for making sure that the administrative functions are carried out correctly
- ◆ Documenting the periodic monitoring of plan asset performance and administrative activities
- ◆ Documenting decisions and actions taken

ERISA Section 404(c)

- ◆ Exception to General Rule under 404(a)
- ◆ Very few participant-directed retirement plans are in full compliance with ERISA Section 404(c)
- ◆ If a plan is not in compliance, plan sponsors and plan fiduciaries may be personally responsible for the investment results attributable to participant-directed investment decisions

Most Common 404(c) Gaps

- ◆ Naming fiduciaries to:
 - Provide investment information
 - Receive and carry out participant investment directions
- ◆ Designating “core” investment options
- ◆ Having a process to select and monitor investment classes for participant investment allocations
- ◆ Complying with QDIA requirements, including required notices to participants

Most Common 404(c) Gaps (continued)

- ◆ Providing required investment information
 - Risk/reward attributes
 - Investment holdings of the funds
- ◆ Disclosing trading restrictions
- ◆ Delivering prospectuses
- ◆ Disclosing expenses charged against participant accounts

Do 401(k) Products Qualify as “404(c) Plans”?

- ◆ “Our materials all comply with 404(c)...”
- ◆ “We provide support for 404(c)...”
- ◆ “We help your plan comply with 404(c)...”
- ◆ “Here is your 404(c) Compliance Handbook...”
- ◆ “Don’t worry about 404(c)...”
- ◆ “No one can comply with 404(c)...”

Technical Compliance Management

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Why Worry about Plan Technical Compliance Management?

- ◆ IRS and DOL audits
- ◆ IRS and DOL penalties
- ◆ Make-up contributions with interest
- ◆ Additional contributions
- ◆ Employee goodwill
- ◆ Interruption to business
- ◆ Redirection of valuable business resources

Plan Sponsor Technical Compliance Responsibilities

- ◆ Plan design
- ◆ Documents
- ◆ Education & communication
- ◆ Payroll feeds
- ◆ Data integrity
- ◆ Reporting & disclosure
- ◆ Coordination between HR, payroll, tax, finance, legal, vendors, brokers, auditors, etc.

Most Common DOL Audit Issues

- ◆ Timely payment of contributions
- ◆ Proper plan expenses
 - Reasonableness of charges to participant accounts
 - Permitted plan expenses
- ◆ Exclusion of eligible employees
- ◆ Timely SPD, SMM and Notice distribution

Most Common IRS Audit Issues

- ◆ Signed plan documents
- ◆ Plan adoption by all companies
- ◆ Current plan law change amendments after GUST
- ◆ Timely EGTRRA restatements

Most Common IRS Audit Issues (continued)

Compensation definition for contributions and testing

- ◆ Exclusions for deferrals
- ◆ Payroll buckets/coordination between payroll & HR, any changes in types of compensation paid
- ◆ Ensure that company's payroll (in-house or service provider) has coded wages properly to match plan's provisions
- ◆ Ensure when payroll conversions/upgrades occur that coding is still proper
- ◆ Ensure that dollar limits on compensation are correct in the system and updated every year for new limits
- ◆ Watch for any compensation paid outside of payroll
- ◆ If errors are found, must make participants whole (could be costly and time consuming)

Most Common IRS Audit Issues (continued)

- ◆ Eligibility and vesting determination, including:
 - Hiring contractors/leased employees
 - Part time employees
 - Transfers/rehire issues
 - Forfeiture determination

Most Common IRS Audit Issues (continued)

- ◆ Contribution determination
 - True-ups
 - Manual checks
 - Review amounts just under an even percentage

- ◆ Discrimination testing
 - For ADP/ACP test failures, consider:
 - ◆ HCE designations
 - ◆ Aggregating tests
 - ◆ Excluding under 1 year and 6 months entry and age 21 eligibility
 - ◆ Dividing into QSLOBs
 - ◆ Safe harbor contributions
 - ◆ Auto enrollment
 - 410(b)/401(a)(4) every third year

Self Correction Opportunities

- ◆ Employee Plans Compliance Resolution System “EPCRS”
 - Sponsor makes best efforts to retroactively correct any operational error using the correction principles set forth in Rev Proc 2008-50
 - Self-correction window without incurring large government correction fees
- ◆ Voluntary Fiduciary Correction Program “VFCP”
 - Avoids potential civil actions and civil penalties if steps are taken to correct identified violations under the VFCP guidelines



Impact on Audit and Financial Statements

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Employee Benefit Plan Assurance Services

Noncompliance Issues... Stuff Happens

Auditors biggest concern?

Audit impact

Financial statement impact

Oversight of the Plan??

- ◆ No meetings to review plan investment results
- ◆ No meetings to discuss plan investment options
- ◆ No meetings to discuss plan provisions/law changes

Who is monitoring the Plan??

Audit impact = letter to management and those charged with governance

Those Charged With Governance (BOD) Duties

- ◆ Adopts/terminates plans
- ◆ Appoints members and establishes duties of the retirement plan committee
 - Reasons to have a retirement plan committee
 - ◆ Members have a combination of disciplines and add different perspectives to the decision making process
 - ◆ Members have a shared history from prior committee decisions and actions
 - ◆ Members' collective opinion creates carefully determined decisions
- ◆ Appoints plan administrator and establishes duties of the administrator
- ◆ Reviews committee and administrator performance

Retirement Plan Committee Duties

- ◆ Establishes and monitors investment policies and guidelines
- ◆ Selects and monitors investment managers
- ◆ Selects and monitors service providers
- ◆ Monitors overall plan compliance
- ◆ Sets policy for plan expenses
- ◆ Appoints/evaluates/terminates trustee(s)
- ◆ Provides periodic report to BOD

Administrator Duties

- ◆ Establishes plan administrative policies and procedures
- ◆ Monitors plan qualification and other regulatory compliance matters
- ◆ Monitors plan contribution deposits for timeliness and accuracy
- ◆ Monitors plan expenses
- ◆ Ensures proper plan reporting and disclosure
- ◆ Maintains ERISA 404(c) plan compliance
- ◆ Oversees proper and timely employee plan communications
- ◆ Provides periodic report to BOD/Planning Committee

Need Proper Oversight of the Plan

- ◆ Have regular meetings
 - To review plan investment results
 - To discuss plan investment options
 - To discuss plan provisions/law changes

- ◆ Document those meetings
 - Who attended
 - Date of meeting
 - What was discussed

- ◆ Prepare or review financial statements with GAAP disclosure checklist

Audit/Financial Statement Impact

Noncompliance issues

Audit/Financial Statement Impact

- ◆ Untimely remittance of employee contributions
 - Be consistent
 - Document reasons for not being consistent
 - Have controls in place

Audit impact = letter to those charged with governance of the plan

Financial statement impact = prohibited transaction disclosure, DOL supplemental schedule, and reported on Form 5500

Audit/Financial Statement Impact

- ◆ Failure to timely amend the plan for recent law changes
 - Number 1 reason for plans to ask the IRS for relief
 - Loss of tax exempt status is ultimate concern, but probably remote

Audit impact = representation letter and communication to those charged with governance

Financial statement impact = footnote disclosure (tax status footnote)

Audit/Financial Statement Impact

- ◆ Discrimination testing – not completed or failed
 - Operational defect
 - Problems with testing?
 - How will they be remedied?
 - ◆ Return contributions to participants?
 - ◆ Employer to make contributions into the plan?

Audit impact = representation letter, back up for corrections made to pass testing and letter to management and those charged with governance

Financial statement impact = possible payable or receivable, footnote disclosure (tax status and accounting policies if payable or receivable)

Audit/Financial Statement Impact

◆ Wrong definition of compensation

- Operational defect
- Proper compensation definition is critical for accurately calculating participant deferrals, employer contributions, benefit accruals, and discrimination tests
- KNOW definition of compensation
 - ◆ Full year or from entry date?
 - ◆ Bonuses
 - ◆ Vacation pay
 - ◆ Overtime
 - ◆ Commissions

Audit impact = representation letter and letter to management and those charged with governance

Financial statement impact = possible payable or receivable, footnote disclosure (tax status and accounting policies footnotes)

Audit/Financial Statement Impact

- ◆ Failure to follow plan's eligibility provisions
 - Operational defect
 - Wrong entry dates (missed entry date or allowed too early)
 - Failure to admit eligible employees into the plan
 - Admitting ineligible employees into the plan
 - Acquired a group of employees in an acquisition

Audit impact = representation letter and letter to management and those charged with governance

Financial statement impact = possible receivable, footnote disclosure (tax status and accounting policies footnote)

Audit/Financial Statement Impact

◆ Distributions

- Improper vesting
 - ◆ Rehires
 - ◆ Incorrect vesting schedule
 - ◆ Improper data

◆ Participant Loans

- Not in compliance with plan provisions
 - ◆ Exceeds statutory limit
 - ◆ Exceeds repayment period
 - ◆ Failure to obtain spousal consent

Audit impact = representation letter and letter to management and those charged with governance

Financial statement impact = footnote disclosure

In Summary – Audit Impact

- ◆ Evidence of work performed and conclusions reached
- ◆ Revised representation letter
 - To acknowledge discrepancy and intent to address
 - To modify language regarding plan being in compliance
- ◆ Required communications to plan management and those charged with governance of the plan

In Summary - Financial Statement Impact

◆ Can auditor release the report?

It depends...

- Possible receivable or payable
 - ◆ Can an accrual be estimated?
 - ◆ Could the impact to the financial statements be material?
- Is the plan sponsor willing and trying to correct?
- Will plan sponsor sign representation letter?
- Is the violation properly disclosed in the footnotes?



SFAS 157

Fair Value Measurements

New for This Year – SFAS 157

Effective for fiscal years beginning after
November 15, 2007

- that means 12/31/08 year ends!

◆ Redefines fair value of investments

- Shifts to exit price (from entry price) – the price that would be received to sell the asset in an orderly transaction between market participants at the measurement date

How SFAS 157 Effects Benefit Plans

- ◆ Expands disclosures about fair value
 - Fair value measurements and techniques for each type of investments
 - Investments listed by level hierarchy (with \$ amts)
 - ◆ Level 1 – Quoted market prices
 - ◆ Level 2 – Observable inputs (based on similar assets in an active market)
 - ◆ Level 3 – Unobservable inputs (based on reporting entity's own assumptions)
 - Level 3 needs roll forward from beginning of year to end of year

SFAS 157 – Plan Sponsor's Responsibility

- ◆ Plan sponsor must take ownership
 - Establish a process for fair value
 - Select appropriate valuation measurements
 - Identify and support assumptions used
 - Prepare a valuation
 - Ensure presentation and disclosures are in accordance with FAS 157

SFAS 157 – Issues

◆ Reality

- Plan sponsors may not have expertise
- External party can assist with mechanics
- Valuation can be delegated (but not abdicated)
- Management must have sufficient understanding to challenge valuation:
 - ◆ Underlying investments
 - ◆ Strategies
 - ◆ Significant assumptions
- Need information from 3rd parties to fully understand pricing
- May result in SAS 114/112 communications

SFAS 157 - Issues

- ◆ Implementation issues:
 - Understanding valuation techniques and pricing services
 - Just where do prices come from?
 - Plan sponsors and auditors are not investment experts
 - Need to rely heavily on service providers (trustees) to determine how investments are priced
 - Determining what level they fall into

SFAS 157 - Issues

- ◆ Start gathering FAS 157 information NOW
 - Request FAS 157 information from trustee or investment managers now
 - Guidance/AICPA EBP AQC publications available:
 - ◆ *Getting Started: Applying New Accounting Rules for Measuring and Reporting Fair Value of Plan Investments*
 - ◆ *New Accounting Rules for Valuing and Reporting Investments in Plan Financial Statements*
 - ◆ *Assessing the Fair Values of Your Plan Investments*
 - E-mail catrina.blackwell@mossadams.com if you would like the above publications e-mailed to you.

NEXT STEPS

Corporate Governance

- ◆ Documented procedures and clear delegation of responsibilities from Board of Directors to:
 - Establish a plan administrator and investment committee, and to
 - Require periodic reports to Board of Directors
- ◆ Documented initial and periodic reviews of written Investment Policy and vendors' investment line-up
- ◆ Identification and determination of reasonableness of fees
- ◆ Documented ERISA 404(c) compliance including adequacy of participant communications
- ◆ Plan administrative compliance
- ◆ Preparation for the audit

ANY QUESTIONS?