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THE NEWSLETTER OF THE BDO EMPLOYEE BENEFIT PLAN AUDIT PRACTICE

EBP COMMENTATOR

TRENDING EBP TOPICS

ARE YOU TRYING TO WADE THROUGH RECENT EBP REGULATORY CHANGES?

In this edition, we discuss considerations to keep in mind as plan administrators are preparing for the upcoming 404(a)(5) disclosures to participants. As the definition of a plan fiduciary continues to evolve, we provide a status update on proposed changes to the definition. Also discussed is how a recently-enacted transportation bill could affect your company's costs for funding a defined benefit plan. In our compliance corner, we highlight an IRS proposed regulation and provide useful reminders about plan corrections. And finally, we emphasize the risk of plan fraud and provide some practical suggestions for evaluating the risk in your plan.

▶ Read more on page 2

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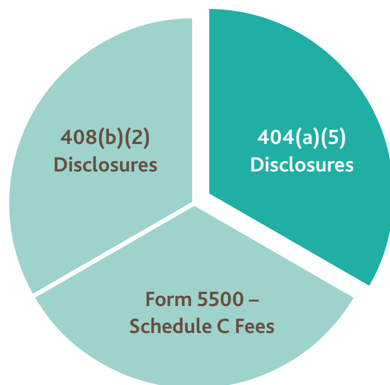
UPCOMING 404(a)(5) DISCLOSURES



Plan administrators are busy this summer preparing for the upcoming 404(a)(5) participant fee disclosures, which must be implemented by Aug. 30, 2012. This is the last of a trio of sweeping, fee-related disclosures implemented over the past three years. 404(a)(5) provides for a two-pronged disclosure of participant-related expenses at the plan level and investment-related expenses.

The previous disclosures in the trio were: a) the Form 5500 Schedule C disclosures that were implemented for the 2009 plan year and were intended to provide enhanced reporting of the indirect compensation paid in connection with services and information provided to plan sponsors; and b) the 408(b)(2) disclosures, which were effective in July 2012 and were intended to educate plan sponsors on the full fees paid by the plan. For more on these earlier disclosures, refer to our fall 2011 edition and winter 2012 special edition of the *EBP Commentator*.

While service providers will likely handle the majority of the 404(a)(5) prep work, plan sponsors do have certain responsibilities, some of which are discussed below.

Plan sponsors need to understand whether the plan fees are reasonable (but not necessarily lowest) and how the fees compare with peer plans. It is the responsibility of the plan fiduciary to ensure that the plan fees are appropriate. Benchmarking plan fees is a tool to consider. However, a Request For Information ("RFI") or Request For Proposal ("RFP") may be as effective as a benchmarking project, since there can be variables unique to a plan and/or a market that cannot be easily factored into a benchmarking database analysis.

One important consideration, before jumping into a new fee arrangement or switching service providers, is the non-monetary costs associated with the changes. A cheaper fee structure may not provide a similar level of quality and support to sponsors and participants.

Perform appropriate due diligence before engaging a new service provider. Even if fees are lower, evaluate the evidence that the potential service provider is reputable and reliable. Choosing a new provider based solely on cost potentially places the plan sponsor at risk if the service provider should prove unreliable or inept. If the fee quote is "too good to be true," it is the plan sponsor's fiduciary duty to find out why. That being said, there are excellent low-cost providers in the market. Be sure the selection can be justified based on the provider's abilities and reputation, not just cost.

Plan sponsors bear the ultimate responsibility for a poor outcome since the fiduciary duty cannot be delegated. For example, maintenance of accurate books and records is needed to enable the plan to undergo an Employee Retirement Income Security Act (ERISA) required financial statement audit. If a provider fails to maintain adequate records and impairs the plan's ability to stay in regulatory compliance, there may be a fiduciary breach by the plan sponsor.

Once the plan sponsor is comfortable with the reasonableness of the fees, the next step is anticipating the participant's concerns and questions. Be available (and well-prepared) for participant questions, which may focus on explanations for certain fees or benchmarking the plan fees to other plans.

Spend time with the service provider to understand the required disclosures. While providing too little information can be a problem, too much information may be confusing to the participant. Do the disclosures make sense to you and, most importantly, will they make sense to the participants? Ask the service provider to provide clarification, if needed.

If the plan's fees are higher than the peer plans', be prepared for an onslaught of questions. Do you have valid justifications and can you easily explain them? What value or unique features does this plan offer when compared with other plans? Consider how you can best communicate these factors to the participants.

Participants may need some remedial education to understand the costs and fees paid from their plan accounts. As plan sponsor, you probably know and understand the plan participants better than any third-party provider. What do you think is the best way to provide this education? Discuss the education options with your advisors. One possible solution may be to hold participant investment education sessions.

We also suggest plan sponsors monitor updated guidance on implementation of the new disclosures, since the regulatory expectations of sponsors are evolving. One example is the Department of Labor's (DOL's) recent Field Assistance Bulletin (FAB) 2012-02 and revised FAB 2012-02R on Fee Disclosure Guidance. FAB 2012-02 intended to provide

THE BOTTOM LINE ON 404(a)(5) DISCLOSURES:

- Understand whether plan fees are reasonable and take action to reduce costs, as appropriate
- Be prepared for participant questions
- Work with service providers to provide clear disclosures and sufficient education to participants
- Monitor the evolving regulatory guidance

Read more on page 3

▶CONTINUED FROM PAGE 2

UPCOMING 404(a)(5) DISCLOSURES

working guidance on the 408(b)(2) regulation requirements but created controversy due to DOL comments in Question 30 that indicated certain participant disclosures would be needed for brokerage windows (e.g., accounts that permit participants to direct trading within a brokerage offering through a plan) and similar options such as self-directed brokerage accounts. The comments indicated that a relatively low threshold would be imposed such that many plan sponsors might be required to comply with such disclosures.

Due to feedback and concerns, the DOL issued a revised FAB that rescinded the guidance in Question 30 and replaced it with Question 39. While removing the objectionable requirements, the DOL makes it clear in Question 39 that it questions the "prudence and loyalty" of fiduciaries who attempt to circumvent the participant investment disclosures and also indicates that it is the fiduciary's duty to consider "the nature and quality of services" that participants receive through the brokerage window and similar arrangements.

In summary, careful preparation for the upcoming 404(a)(5) disclosures is key.

THE MOVING AHEAD FOR PROGRESS IN THE 21ST CENTURY ACT (MAP-21)

The Moving Ahead for Progress in the 21st Century Act, otherwise known as MAP-21, was signed into law in July 2012. While MAP-21 is primarily a transportation bill, it includes certain provisions that impact defined benefit plans. These provisions include rate stabilization, higher Pension Benefit Guaranty Corporation (PBGC) premiums, and excess asset transfers.

▶ Under the Pension Protection Act of 2006, plan sponsors may elect to calculate future pension obligations using either the yield curve of corporate investment-grade bonds or on three segment rates. The yield curve of the corporate investment-grade bonds is calculated based on rates reported for the preceding month by the Treasury Department. The use of the three segment rates stabilizes the interest rates by allowing plan sponsors to use an average yield curve from the preceding 24-month period. However, due to the recession and lower interest rates, the minimum contribution requirements have increased for defined benefit plans, with many plan sponsors struggling to fund the minimum contribution requirements. As a result, many plans are underfunded and labeled "at risk."

MAP-21 has no impact on plans that use the yield curve calculation. Plan sponsors are allowed to switch to the segment rate method without IRS approval, but there is a time limit to do so. The Act changes the interest rate assumptions by taking the average of interest rates over the most recent 25-year period rather than the average of interest rates over the last 24-month period. Since interest rates over the past 25 years have been historically higher, plan sponsors benefit from using higher interest rate assumptions. Higher rate assumptions reduce the minimum funding requirements and improve funding attainment percentages. The segment rate does need to be within a specified range of the 25-year average. MAP-21 specifies the range by outlining the applicable minimum percentage (floor) and the maximum percentage allowable (cap) for future calendar years, beginning in 2012. The floor and the cap both expand in future years, thereby reducing the minimum interest rate. However, the use of the 25-year average is expected to continue to help defined benefit plans in a low interest rate environment.

The Internal Revenue Service (IRS) released Notice 2012-55 in August 2012. Notice 2012-55 provides guidance on the segmented interest rates which were enacted as part of MAP-21. Additional implementation guidance is expected at a later date from the IRS and the Treasury Department.

The revised rules for the segment rates do not change other plan calculations, such as the interest rate calculation for lump-sum distributions, IRS Code Section 415 benefit limits, IRS Code Section 404 deductible contribution limits, PBGC variable rate premiums or reporting under Section 4010 of ERISA.

Plan sponsors may adopt MAP-21 segment rates beginning with plan years starting on or after January 1, 2012, or January 1, 2013, with some transition rules for plan sponsors that adopt in 2012. The required annual funding notice must disclose to participants that the plan is using the stabilized rates. The DOL is in the process of updating the model annual notice on its website, but the release date has not yet been announced.

▶ Under Map-21, plan sponsors should expect higher PBGC premiums for both single-employer and multiemployer plans. Flat-rate premiums are expected to increase in 2013 and 2014 and will be adjusted for inflation thereafter. Variable-rate premiums are also expected to increase for underfunded plans, but the Act does establish a maximum limit, which will be adjusted for inflation beginning in 2014.

▶ Under IRS Code Section 420(b), overfunded plans (e.g., those with assets greater than 125 percent of the funding target and target normal cost) may transfer excess assets to a retiree medical account on an annual basis. MAP-21 extends the provision that was due to expire in 2013 to 2021. Additionally, MAP-21 now allows the excess assets to be used to fund retiree group term life insurance, but limits the per-retiree life insurance amount.

As noted, MAP-21 has significant potential impact to defined benefit plans. We suggest early consultation with the plan's actuary to enable the plan sponsor to evaluate and take advantage of the available options.

The IRS released Notice 2012-55 in August 2012. Notice 2012-55 provides guidance on the segmented interest rates which were enacted as part of MAP-21.

EVOLVING DEFINITION OF PLAN FIDUCIARY

IN ATTEMPTS TO SHORE UP THE SECURITY OF BENEFIT PLANS, THE DOL HAS SOUGHT TO CHANGE THE DEFINITION OF PLAN FIDUCIARY BY EXPANDING THE POOL OF THOSE WHO WOULD BE HELD TO FIDUCIARY STANDARDS.

In 2011, the DOL's Employee Benefits Security Administration (EBSA) held hearings on a proposed new definition of fiduciary. EBSA Assistant Secretary Phyllis Borzi summed up the historical definition of a fiduciary by noting that ERISA provides for a statutory test in which "a person is a fiduciary if he or she renders advice for a fee or other compensation, direct or indirect, with respect to any monies or other property of the plan." Borzi went on to note that a later-adopted five-part test for a fiduciary limited the application of the definition. This resulted in an exemption for those who might otherwise be held to fiduciary standards. Borzi concluded her opening remarks by noting that the evolving complexity of plans has increased reliance on advisors and, in turn, there is an increased need for a clearer definition of fiduciary since "the security of American retirement plans depends on its fiduciaries."

The resulting DOL proposal would have significantly expanded the definition of plan fiduciary, but came under significant criticism and was eventually withdrawn in late 2011 with promises that a reproposal would be forthcoming in 2012. At the time the proposal was withdrawn, there was some question as to whether the new proposal would be finalized before the 2012 elections. Now that it is the second half of 2012 and the presidential election is looming, it appears that such a delay may be the case.

Possible reasons for delay include DOL's need to analyze costs of compliance with such a proposal and to coordinate the definition of fiduciary with other regulatory agencies (including the Securities and Exchange Commission). The DOL has indicated that it intends to cooperate with other agencies on coordination of the definition, but it will not necessarily delay the proposal.

There have been few indications from the DOL as to what the reproposed definition will resemble. However, in a recent ERISA Advisory Council Meeting, Borzi indicated that additional clarification of prohibited transaction class exemptions could be expected. This additional clarification of exemptions is likely due to concerns about the unintended consequences of an expanded definition. Essentially, concerns were raised that investor education, resources and products available to plans and plan participants would be limited if the plan fiduciary designation was expanded too far and vendors left the marketplace rather than accept the associated responsibilities and risks of a designation as a plan fiduciary.

For now, it is a waiting game to see what the reproposed definition will bring. Stay tuned!

COMPLIANCE CORNER

IRS ELIMINATES SIGNATURE REQUIREMENT ON FORM 5558 FOR EXTENDING FORM 8955-SSA

On June 21, 2012, the IRS proposed regulations to amend the rules related to filing Form 5558 – *Application for Extension of Time to File Certain Employee Plan Returns*. Under the proposed regulations, plan administrators can obtain an automatic 2½-month extension of time to file the Form 8955-SSA by submitting a Form 5558. The proposed regulations also provide that a signature is not required for this type of extension.

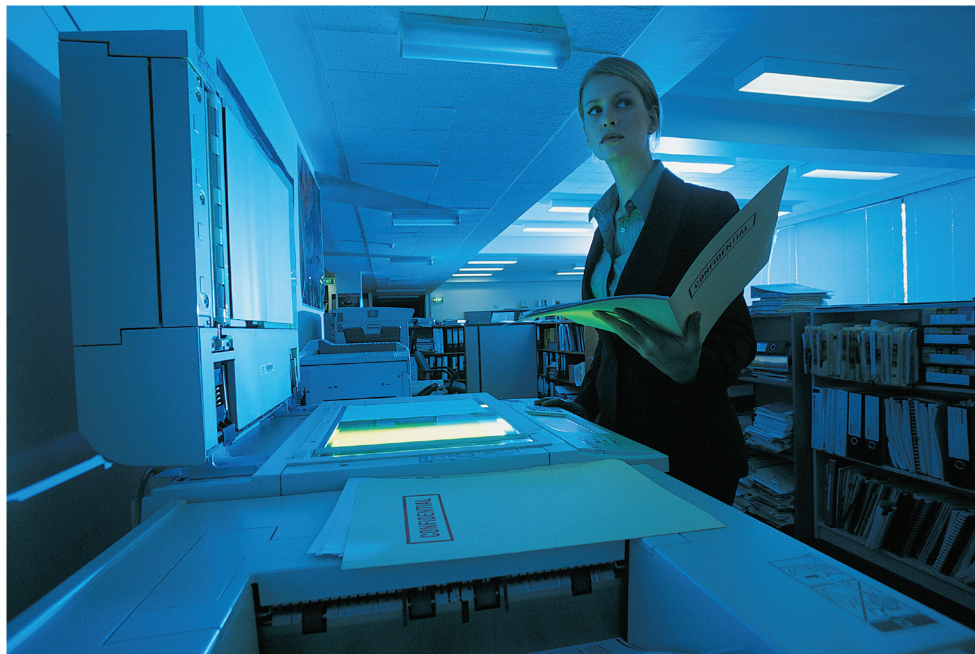
The regulations are proposed to be effective on or after June 21, 2012 and taxpayers may rely on the proposed regulations pending the issuance of final regulations.

CORRECTING DELINQUENT CONTRIBUTIONS AND LOAN PAYMENTS

Failures to deposit participant contributions and loan repayments on a timely basis are considered Prohibited Transactions by the DOL. If the plan has delinquent participant contributions and/or loan payments, be sure to fully correct them by calculating and depositing lost earnings to participant accounts (there is a calculator on the DOL website that can be used for determining the lost earnings). In addition, most plans that have delinquent contributions or loan payments must file a Form 5330 to pay an excise tax equal to 15 percent of the lost earnings.

Plan sponsors can also submit the corrections under the DOL Voluntary Fiduciary Correction Program (VFCP). While use of the VFCP is optional, an approved submission will receive a "Letter of No Action" from the DOL. The no-action letter states that the DOL will not assess a penalty or initiate a civil investigation for any transactions described in the no-action letter.

EVALUATING THE RISK OF FRAUD IN THE BENEFIT PLAN



Members of management often wear multiple hats: CFO, controller, HR director and often, plan administrator. By juggling so many responsibilities, management may overlook the company benefit plan, especially if it appears to be operating smoothly and on "auto-pilot." This may be especially true when it comes to monitoring for fraud. Benefit plans aren't typically thought of as high risk and, therefore, may not be a key area of concern for management. However, the DOL doesn't think employee benefit plans should be ignored when it comes to possible fraud. Because there is so much money in benefit plans (and, potentially, at risk), the DOL has made fraud prevention in benefit plans a key focus of the Department's EBSA. We suggest that management take a closer look at plan fraud risks as part of its duty as plan sponsor to monitor the plan.

One way to monitor for fraud is to periodically evaluate the plan's fraud risks. A tool commonly used by auditors to perform this periodic evaluation is a brainstorming session. During a brainstorming session on plan fraud risk, members of management can discuss key fraud-related questions: **How, What, Where, When**, and **Why** can fraud occur? By coming up with possible scenarios where fraud may be likely to exist or occur with the plan, management can better focus its resources on preventing or detecting such fraud.

Especially important to a successful fraud brainstorming session is a willingness to re-evaluate long-held assumptions about plan fraud risks. This allows management to better evaluate the *current* risk environment, since changes in company personnel, policies and procedures can weaken plan internal controls, thereby making the plan more vulnerable to fraud.

Fraud can be evaluated from both a plan and plan participant perspective during a brainstorming session. Here are some examples of plan and participant-related fraud concerns:

▶FROM A PLAN PERSPECTIVE

- Be alert to personal issues with plan personnel that may heighten the risk of rationalizing or committing fraud (e.g., a spouse's job loss or mounting bills).
- Has the company's ability to provide adequate segregation of duties for the plan been hampered by recent job cutbacks? Management can still find creative solutions to minimize fraud risk. For instance, consider using a rotating group of management to review and approve plan transactions. This avoids putting the burden on one person (and also mitigates further fraud risk).
- Consider that fraud risks don't just exist "in-house" — the plan may be vulnerable to fraud committed by someone *outside* the company.
  - Consider recent cases of fraud perpetrated against plans by third-party administrators (TPA) and service providers. In two recent examples, a TPA pled guilty to theft in a diversion of plan insurance premiums, and a plan investment advisor was sentenced to prison for mail fraud and embezzlement in a misrepresentation of plan asset investments. Outside fiduciaries and service providers require as much scrutiny as personnel inside the company.
  - Don't forget plan investments. Investments are getting more attention from regulators due to the fraud risks attributed to the complex nature of certain investments, which can confound investors' abilities to understand how investments function. In other words, hard-to-understand investments may pose greater fraud risks.

▶FROM A PLAN PARTICIPANT PERSPECTIVE

- Is there a risk that the company or a plan fiduciary may misuse or divert employee contributions to the plan?
- Are the employee contributions to the plan being remitted on a timely basis (as soon as administratively possible after being withheld from participants' payroll)? The

▶ Read more on page 6

CONTINUED FROM PAGE 5

EVALUATING THE RISK OF FRAUD IN THE BENEFIT PLAN

DOL has made it clear that it considers late remittances to be an improper use of plan assets by the sponsor. From a brainstorming perspective, chronic late remittances may indicate that someone within the company is trying to use the withheld monies for the company's benefit for as long as possible.

- Is management aware of recurring questions from participants that aren't fully or clearly addressed?

On its website, the DOL's EBSA has listed ten warning signs of possible fraud for which participants should watch. Late remittances and inaccuracies with account balances are some of the possible fraud warning signs cited. We suggest this list as a potential resource for a fraud brainstorming session.

http://www.dol.gov/ebsa/Publications/10warningsigns.html

In addition to evaluating fraud risk from a plan or participant perspective, we also suggest consideration of certain areas where benefit plan fraud has been found to occur. The American Institute of Certified Public Accountants' (AICPA's) Employee Benefit Plan Audit Quality Center categorizes these areas as follows: distributions, expenses/forfeitures, participant notes receivable (loans), eligibility, contributions, investments and other (miscellaneous). Management could use each of these areas as potential discussion points during a brainstorming session.

We also suggest using recent DOL enforcement cases as a source of real-life fraud examples for discussion. The following link is to the DOL's ERISA-related Criminal Enforcement News Releases:

http://www.dol.gov/ebsa/newsroom/criminal/main.html

What should management do with the results of a fraud brainstorming session? The greatest take-away may simply be that management has identified the specific areas where fraud potential exists in the plan. In other words, where should management be looking for fraud and monitoring? Hopefully, there are only a few areas where management finds controls need to be enhanced or where fraud monitoring is needed. The most important thing is management's commitment to follow through and implement the needed changes. If it isn't feasible to implement certain changes, greater oversight and scrutiny by management may be the solution. Regardless, we suggest that management continue to monitor carefully.

THE BOTTOM LINE ON FRAUD RISK IN THE COMPANY BENEFIT PLAN:

- Ask **How, What, Where, When,** and **Why** fraud could occur
- Be willing to question everything and everyone
- Consider fraud risk from both the plan and participant perspectives
- Commit to follow-through on needed changes
- Continue to monitor

BDO EBP PRACTICE

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In addition, BDO has a National Employee Benefit Plan Audit Group that meets regularly to develop training and guidance and discuss updates in the industry and auditing practices. Our professionals are regular presenters at local, state and national seminars. BDO's professionals continue to be extensively involved as Chair of the American Institute of Certified Public Accountants (AICPA) National Conferences on Employee Benefit Plans. Many of our professionals serve in leadership roles in the accounting profession as senior advisors and are active members of several governing boards and CPA societies. For example, our professionals currently serve on various AICPA committees, such as the AICPA Employee Benefit Plan Audit Quality Center Executive Committee and the AICPA's Joint 403(b) Plan Audit Task Force (we are proud to have representation at the Chair level for these committees). BDO's EBP professionals have also served on the Employee Benefit Plan Expert Panel in the past.

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