

Are You Really Paying For the Right Performance

by Pat Byrnes

Imagine two scenarios:

In Scenario 1, James, a sales rep for your company, exceeds his annual sales goal by 50%. As part of your pay-for-performance program, he receives a bonus equal to \$40,000, or approximately 45% of his annual salary.

In Scenario 2, David, another sales rep for your company, exceeds his annual sales goal by 10%. David's bonus is \$5,000, or approximately 6% of his annual salary.

Sounds great, right? The person generating the better results reaps higher rewards—a typical pay-for-performance scenario. However, consider the possibility that James, while selling at a high level, is a prima donna who tends to sell volumes of low-margin business. David, on the other hand, sells to fewer clients, but they tend to buy higher-margin products and services. He also tends to be team-oriented, assisting with the integration of new clients into your company's operations.

Is your system rewarding the right person?

The answer to this question depends upon a number of factors, including your culture. Some businesses are willing to tolerate dysfunctional behavior if it results in exceptional performance. Others, though, are realizing that pay-for-performance programs which focus solely on short-term operational results tend to undermine long-term organizational development. Effective incentive programs should balance the right performance with the right behaviors.

Most would agree that the "right" people aren't simply high-performers—they're high-performers who behave in accordance with accepted norms. If your culture seeks to foster the development of prima donnas, James is your man and you should reward him handsomely. If, however, you are building an organization that recognizes interdependence and values accountability and cooperation, David is the person who you want to incentivize.

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HIPAA Compliance Deadline Looming

by Wayne Miller, Reish Luftman McDaniel & Reicher

If your company offers health insurance or a cafeteria plan, you must comply with the medical information protection laws contained in the Health Insurance Portability and Accountability Act (HIPAA), a sleeping giant about to wake up and roar. The compliance deadline is rapidly approaching. Although many see HIPAA as a health care industry issue, company plans are also covered. The plan itself typically exists on paper only. So you and your third party administrator (TPA) will need to take the steps to comply with HIPAA on behalf of the plan.

As detailed below, compliance will involve extensive planning, new forms and agreements, changes in procedures, and staff education. The compliance process will take many months. Immediate action is required now, since there is an opportunity to extend the deadline for one part of the HIPAA rules. However, a compliance plan must be filed immediately to take advantage of this delay.

HIPAA imposes three categories of federal standards applicable to employee protected health information or PHI. Privacy requirements dictate how PHI may be used or disclosed. HIPAA also has standards for securing PHI from unwanted access. Finally, HIPAA transactions and code set standards establish uniform specifications for electronic claims payment.

Companies should designate a HIPAA task force to assume the compliance effort. Members of the team will likely include representatives from HR, IT and the TPA as well as HIPAA experts.

Suppose your company sponsors an employee cafeteria plan with a flexible spending account for medical expenses. You have a third party administrator for the plan, but your HR staff also assists in running the plan. What will the HIPAA task force need to do?

Determine PHI Records

The team must clearly identify the universe of documents that make up each employee's PHI. HIPAA defines this term very broadly. PHI will include employee claim forms; receipts from all health care providers; plan reimbursement statements; and any correspondence regarding plan claims. All of these documents are subject to HIPAA privacy protection.

Enable Employee Access

The privacy rules require employee access to their PHI. For example, your staff can: review and get copies of the PHI maintained by the plan; review the plan's privacy procedures; request changes or restrict access to PHI; and review a log of unusual disclosures of PHI such as to the IRS. The law imposes strict response times to inquiries. The team will need to establish procedures to enable employee access, and assign staff and resources to timely respond to employee PHI requests.

Forms: Plan Documents

The team will oversee the adoption of new forms required by HIPAA. These forms will need to be customized for your plan. Foremost among these will be a notice of privacy practices. This notice will state in great detail how the company uses PHI. The notice format must meet HIPAA standards. The HIPAA team will adopt authorization, consent and other

forms in accordance with strict HIPAA requirements. The plan documents will also be amended to describe how PHI will be used for legal functions, such as paying claims, and how inappropriate use is avoided.

Policies and Procedures

The team should review and amend existing policies and procedures regarding PHI handling. The P&P's will describe how employees receive the privacy notice, and are made aware of the how they access their PHI. Also, the P&P's will describe how plan matters are segregated from other HR and company operations.

Contracts

The team will need to reach a new or amended agreement with the TPA and others, to comply with the HIPAA "business associate" rule. This law provides that a TPA who will handle PHI in the course of adjudicating claims, must enter a written contract which details the TPA's efforts to comply with HIPAA requirements. Similar contracts may be needed with IT or other vendors who have access to PHI.

TCS Standards: Security Rules

HIPAA establishes a single standard format for communicating health care claims electronically, called "transactions and code set" standards (TCS). All electronic claims will be required to be in the standard format. If your plan accepts or pays employee claims electronically, or expects to do so, the TCS rules will apply. Plans can delay compliance with these rules, however. To get this extension, the team will need to file a detailed plan *immediately* that describes how compliance will be achieved. The team may need to consult with a HIPAA expert to prepare

Four Important Reasons to Complete the Annual Retirement Plan Questionnaire

by Glenda McAfee, Consulting Administrator

Each year, when you receive your data request package containing, among other things, the Annual Retirement Plan Questionnaire you might ask yourself, “Why should I complete this again this year?” There are several answers to that question and all relate to various issues regarding your plans’ qualified status and the annual filing required for each retirement plan.

1. Issues Related to Ownership

Every year a determination must be made regarding which employees are considered “Highly Compensated” and which are considered “Non-Highly Compensated.” ACI also must determine which employees are considered “Key” and which are considered “Non-Key” employees. This is necessary to ensure that your plan is operating in a non-discriminatory manner. In addition, certain owners of one company may have ownership in other companies as well. If the common ownership in the vari-

ous entities is large enough, they may be considered a Controlled Group for purposes of the minimum coverage requirements for qualified plans. The same may be true for service organizations that have a service or ownership relationship and are determined to be Affiliated Service Groups.

2. Issues Related to Annual Activities

The Department of Labor requires that 401(k) deferrals and loan payments be deposited to the trust as soon as they can reasonably be segregated from the assets of the corporation. If deposits have not been completed in a timely manner, your response to that section of the questionnaire allows for implementation of the necessary corrections.

3. Issues Related To Bonding

Title I of ERISA requires that all employee benefit plans that are required to file an annual report, IRS Form 5500 for example, must engage an Independent Qualified Public Accountant to

write an opinion and include it with the annual 5500 form. Historically, there has been an exemption for plans with fewer than 100 participants. Effective for plan years beginning after April 17, 2001, there are new rules that must be satisfied in order to maintain the exemption. Plans holding assets that are considered non-qualifying plan assets are required to provide the required accountant’s opinion or obtain a larger fiduciary bond to cover the non-qualifying assets. Providing the requested information regarding your plan’s current level of bonding will help us determine whether it is adequate to meet the current requirements and advise you if it is not, so that additional coverage can be obtained.

4. Issues Relating to IRS Form 5500 Reporting

Almost all of the information requested on the questionnaire is incorporated into the Form 5500 filing and can change from year to year including but not limited to those listed above. It’s important that the most current information be made available to avoid confusion and reporting errors.

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this plan. The team will also need to review HIPAA security rules, which dictate how PHI is stored and discarded.

Education

HIPAA carries steep penalties for noncompliance. Companies will need to fully educate and train staff who will implement the HIPAA rules. The team will need to put in place a formal compliance program, which may include disciplinary action against employees who violate PHI privacy rules.

In short, there is much to do and precious little time to do it. If your company gears up quickly, you can still meet the compliance deadline, with the assistance of TPAs and HIPAA experts. At the very least, form the HIPAA team and obtain the TCS extension to start progress quickly towards your compliance goal.

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Waiver of IRS User Fees

by Craig Handa, Consulting Actuary

A plan sponsor is required to pay a user fee to the IRS if the sponsor is seeking an advance determination as to the qualified status of its retirement plan. The IRS will issue a favorable determination letter if the terms of the retirement plan conform to the requirements of the Internal Revenue Code and regulations thereunder.

Most plan sponsors are currently restating their retirement plans to comply with six Acts enacted by Congress starting in 1994 collectively known as "GUST." Part of the restatement process is requesting a determination letter. The IRS charges a user fee for your request ranging from \$125 to \$1,250 depending on the type of request, whether a master and prototype plan or a volume submitter plan is involved, and whether the request is for an opinion on the coverage test or the nondiscrimination test.

The GUST restatement does not include provisions of the Economic Growth and Tax Relief Reconciliation Act (EGTRRA) enacted in 2001. There are a few required amendments from EGTRRA that will need to be adopted by the end of the plan year beginning in 2002.

There was one provision of EGTRRA that provided relief to plan sponsors who are requesting determination letters for the GUST restatements. Under EGTRRA, an *eligible employer* is not required to pay an IRS user fee for a determination letter request if the request is made after December 31, 2001 but before the later of: 1) The last day of the fifth plan year that the plan is in existence; or 2) the end of any remedial amendment period beginning within the first

five years of the plan.

An *eligible employer* is defined as: 1) Having no more than 100 employees who received at least \$5,000 of compensation for the preceding calendar year; and 2) Having at least one employee who was a non-highly compensated employee in the preceding plan year and who must have participated (benefited) in the preceding plan year. If the determination letter request is filed in the first plan year, then at least one employee who is a non-highly compensated employee must participate (benefit) in the plan for the first plan year.

We are currently in the GUST remedial amendment period, which started on December 8, 1994 according to the IRS. Therefore, a GUST determination letter request for a plan that was in existence (has an effective date) on or after December 9, 1989 will qualify for the waiver of the IRS user fee for an eligible employer.

There are some technicalities to this provision that will exempt certain plan sponsors from the waiver:

In determining if there are no more than 100 employees in the preceding calendar year, controlled groups and affiliated service groups are treated as a single employer.

Zero-percent money purchase pension plans and frozen plans generally will not qualify for the exemption because these two types of plans do not satisfy the condition that at least one non-highly compensated employee benefited in the preceding plan year.

Profit sharing plans (without a 401(k) feature) that did not have a profit shar-

ing or forfeiture allocation in the preceding plan year will not qualify for the exemption because no non-highly compensated employees benefited.

Leased employees will need to be counted because they are treated as employed by the employer.

This provision was included to encourage employers to start sponsoring retirement plans for their employees and for employers who currently sponsor retirement plans to seek the opinion of the IRS on the qualified status of their plans to ensure compliance with current pension laws.

ACI Client Education and Seminar Schedules

The following seminars are held at ACI's office in Torrance. You may RSVP by contacting Lace Opperman at (310) 316-1334, ext. 120, or by email at lace.opperman@acibenefits.com.

EGTRRA & BEYOND: A Seminar on Current Events in Retirement Plan Design & Compliance

Tues. July 16 10 - 11:30 AM
Wed. Aug. 7 10 - 11:30 AM
Thurs. Sep. 5 9:30 - 11 AM
Tues. Sep. 24 2:30 - 4 PM

401(k) BASIC TRAINING: An Introduction to 401(k) Plan Operation

Wed. July 7 9:00 - 12:00 PM

Right Performance

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To begin developing an effective compensation program, you might want to define your corporate values in behavioral terms. “Excellence,” “Respect,” and “Integrity” are among the most common corporate values. The problem is, by themselves, their meaning is pretty vague. The author of these values took the first step to developing them. The second step is creating a concise definition of each value to which everyone in the organization can relate. Is “Excellence” defined as “Zero Defects” or “100% Customer Satisfaction”? Is “Integrity” defined as “Always keeping the customer’s best interests in mind” or “Always talking straight”? These kinds of definitions begin to help employees understand how to behave—and that’s the first step to developing a high-performance culture. The next step, (and by far the hardest), is integrating these behaviors in the business—learning to walk the talk every day.

Your corporate vision, strategic plan, and business plan can provide you with the operational statistics for the “performance” portion of your incentive program. Eventually, you’ll want to determine the proper weighting for performance measures and behavioral measures. Not everyone weighs them evenly. People with frequent customer contact often have a heavier weighting on behavioral measures, while employees more focused on internal operations tend to be more heavily weighted towards performance measures.

Undoubtedly, your plan will evolve as your business evolves. By looking at both the behaviors that lead to great performance, and the performance itself, you’ll have a plan that truly rewards the right people.

What You May Not Know About Catch-Up Contributions

by Laura Mitchell, Consulting Actuary

While dealing with your retirement plan, you probably have heard the term “top-heavy.” You may have an understanding of what top-heavy means or you may just know that it is something you want to avoid because it results in increased contributions to staff members. This article is intended as a refresher on top-heavy and how 401(k) plan catch-up contributions affect top-heavy status.

What is a top-heavy plan?

Top-heavy is a measure of the portion of the plan’s assets (or benefits, in the case of a defined benefit plan) that are attributable to “key” employees. If key employees have at least 60% of the plan’s assets in their accounts, or 60% of the benefits in a defined benefit plan are attributable to them, the plan is top-heavy. A top-heavy plan requires minimum benefits (sometimes up to 5% of pay) that need to be given to non-key employees.

What is a catch-up contribution?

A catch-up contribution is an extra salary deferral to a 401(k) plan for participants who are at least age 50 and who are at the plan’s deferral limit or a statutory limit. For 2002, plans that are amended to allow for catch-up contributions can permit participants to save an extra \$1,000 on a tax-deferred basis. The catch-up amount increases annually in \$1,000 increments to \$5,000 in 2006. These catch-up contributions do not impact non-discrimination testing, but they do have an impact on top-heavy determination.

Catch-up Contributions’ Impact on Top-Heavy Status

When determining whether a plan is top-heavy in 2003, the catch-up contributions for 2002 will be included. Realistically, this impact is likely to be pretty minimal, since we are only talking about \$1,000. But, there are two things to keep in mind: First, the annual catch-up amount increases to \$5,000 quite quickly, plus the earnings on the contribution are also counted towards determining top-heavy status. Second, catch-up contributions are more likely to be made by key employees than non-key employees. While this may not seem obvious, remember, participants must be at least 50 and be deferring at the plan’s limit or exceeding the statutory limit in order to make a catch-up contribution. If the plan limit is the statutory limit (\$11,000 in 2002), participants must already be deferring \$11,000 before they can make catch-up contributions. Non-key employees may have a difficult time deferring \$11,000, and therefore making the additional \$1,000.

So what does this mean to you? If your plan is already top-heavy, the catch-up contribution has no impact. If your top-heavy test has been producing a ratio above 55%, it means if you allow catch-up contributions, your plan may become top-heavy sooner than expected. So, when determining whether to permit catch-up contributions, take into consideration your plan’s current top-heavy status.

California Finally Conforms!

by *Laura Mitchell, Consulting Actuary*

As you may have read in our broadcast fax in May, California finally adopted most of the provisions of the Federal tax law known as EGTRRA. Among other provisions, EGTRRA increases the compensation and benefit limits for defined contribution and defined benefit plans and allows participants who are at least 50 to make additional 401(k) contributions, known as catch-up contributions.

It should be noted that California did not adopt all of the provisions of EGTRRA. The most notable exceptions relate to the "Saver's Tax Credit," a provision that would provide a tax credit to low- and middle-income savers, and tax credits related to new plan start-up costs. Participants will still be able to take advantage of the Saver's Tax Credit on a Federal level, but not on a State level. Plan sponsors will still be able to get a "New Plan" tax credit of up to \$500 on a Federal level, but not on a State level.

Before California conformed, based on strict interpretation of California law, there was a risk that if an employer adopted the provisions of EGTRRA, the plan could have been disqualified on the State level. At the very least, employers would have had different deduction levels for State and

Federal purposes and increased costs associated with calculating those different deduction levels. Because of these complications, many employers postponed adopting the EGTRRA provisions for their plans. Now that California has conformed, employers are free to take advantage of the increased deduction opportunities EGTRRA provides.

Several States still have not conformed to EGTRRA. Which States have conformed changes daily. If you have employees outside of California, please contact us to determine how your plan is affected.

New Mortality Table for Defined Benefit Pension Plans

by *Craig Handa, Consulting Actuary*

The IRS has revised the prescribed mortality table used to determine a participant's lump sum distribution amount or the maximum annual benefit that a participant may receive from a defined benefit pension plan. The new mortality table may or may not increase the amount of benefits that a participant can receive from a plan. The use of the new mortality table is required no later than December 31, 2002.

ACI In the News

PUBLISHED ARTICLES

The **Los Angeles Business Journal** published an article by Pat Byrnes and Steve Speer titled "*An Employee Retention Strategy for All Economies.*" The article was featured in the March 25, 2002 issue of the Los Angeles Business Journal. Contact Lace Opperman at (310) 316-1334, ext. 120, or email at lace.opperman@acibenefits.com to obtain a copy of the article.

SPEECHES

Pat Byrnes, a past President of the **American Society of Pension Actuaries (ASPA)**, spoke in the ASPA 401(k) Sales Summit Conference on March 1st at the Paradise Valley Resort in Scottsdale, Arizona. The topic of his speech was, "*Beyond 401(k): Cross-Selling Opportunities in Non-Qualified Plans.*"

On April 9th, Pat presented "*New Strategies for Compensation: Culture-based Compensation Programs*" at the **Western Pension Benefit Conference's Spring Seminar** in Los Angeles. His presentation focused on the concept that high-performance businesses align their compensation programs with the cultures they want to create.

Pat also spoke at the **National Institute of Pension Administrators 20th Annual Conference** in Scottsdale, Arizona, on April 28th. The subject of his presentation was, "*Vendor or Consultant? A Consultant's Perspective.*"

On June 26th, Pat moderated a seminar focusing on "*Recruiting, Rewarding, and Retaining the Right People*" held at **Reish Luftman McDaniel & Reicher** offices in Los Angeles. The seminar was sponsored by the **CalCPA LA Chapter**.

PROFESSIONAL DEVELOPMENT PRESENTATIONS

On May 6th, Jeff Wallace and Laura Mitchell spoke at the **Pasadena CPA Discussion Group**. The topic was, "*Common Operational Errors in Retirement Plans.*"

Each year, ACI prepares a number of presentations related to employee benefits and compensation issues. Many of the presentations are eligible for continuing education credit and have been presented at various professional conferences. For a complete list of ACI's 2002 Presentation Topics, contact Lace Opperman.