



Action Items

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Pension Protection Act of 2006 (PPA06)

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The PPA, signed into law by President Bush on August 17th, implements the most significant changes to US Pension Laws since 1974.

The PPA (a 907 page document) includes permanent extension of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) retirement savings provisions. It also overhauls pension funding rules and includes reforms affecting hybrid plans, defined contribution plans and nonqualified deferred compensation.

In this article, we have highlighted the provisions of this bill for the types of plans administered by ACI.

Cash Balance and other Hybrid Plans

PPA has significant impact on Hybrid Plans such as cash balance plans.

Most importantly, cash balance plans are deemed not age discriminatory after June 29, 2005 as long as:

- A. They use a vesting schedule that provides 3 year cliff vesting or better in 2008;
- B. The interest crediting rate does not exceed the "market rate"; or
- C. A participant's accrued benefit is not less than the accrued benefit of any similarly situated younger employee.

"Similarly situated" means that the participants are identical in every respect (e.g., period of service, compensation, position, date of hire, work history), except age.

The definition of accrued benefit has been changed and can be tested on the basis of an annuity payable at normal retirement age, a hypothetical account balance (e.g., cash balance plan), or the current value of the accumulated percentage of the employee's final average pay.

The 3 year cliff vesting is effective for plan years beginning after December 31, 2007 for plans that were in effect before June 29 2005 and is effective immediately for plans that were in effect after June 29, 2005. In addition, conversions from traditional

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defined benefit plans to cash balance plans can occur as long as there is no wear-away of the accrued benefit provided by the traditional defined benefit plan.

For plans that provide for subsidized early retirement benefits, these subsidies also need to be preserved for the accrued benefits.

Additionally, PPA eliminates the “whipsaw” problem by allowing the lump sum distribution from a hybrid plan to be equal to the hypothetical account balance (e.g., cash balance plan) or the accumulated percentage of final average pay. This is effective for distributions made after the date of enactment.

Sponsors of cash balance plans should also review the section on defined benefit plans as these rules impact cash balance plans as well.

Defined Benefit Plans

If you sponsor a defined benefit plan there are big changes in store, however, if your plan is well funded, these changes may not have a large impact.

Minimum Funding:

Historically actuaries have had latitude in determining assumptions used to calculate the contribution levels. However, effective for plan years beginning after December 31, 2007, PPA mandates:

- A. The interest rates
- B. Mortality tables
- C. Funding method
- D. Valuation dates (beginning of the plan year for plans with more than 100 participants)

That must be used for determining the minimum and maximum contribution.

In addition it changes the way the minimum required contribution is calculated. For most well funded plans, we do not anticipate these changes will have a significant impact.

For plans that are less than 92% funded for the plan year beginning on or after January 1, 2008, the unfunded liability will be amortized over 7 years. The 92% phases up to 100% in 2008. The liability will be determined using a new mortality table and interest rates based on corporate bond yield curve. (This could be the full yield curve or a segmented yield curve with break points at years 5 and 20). At this time the yield curve and mortality tables have not been published, so we are unable to determine the exact impact of these changes. For 2006 and 2007, the rules remain the same as for 2005, including the extension of the Pension Funding Equity Act (PFEA) interest rates used to determine the current liability.

Beginning in 2008 there are additional rules for plans with more than 500 participants that are 80% funded. Additional calculations are needed to determine if the plan is “at-risk”. These tests involve determining the liability including the assumption that employees within ten years of retirement will retire at the earliest possible time, and that employees are assumed to elect the

most valuable payment option. An additional loading factor will apply to plans that are in at-risk status for at least two of the last four years. This rule is phased in using 65% in 2008, 70% in 2009, 75% in 2010 and 80% for 2011, and thereafter.

When looking at the funding levels described above, assets must be reduced by any credit balances (resulting from contributions in excess of the minimum required contribution). These credit balances will be split into credit balance before 2008 and after 2008. Pre-2008 credit balances can be waived to improve the funded status. In addition if the plan was using an asset smoothing method, changes in the smoothing method may be required so the smoothing period does not exceed 24 months and the smoothed value of assets is not more than 110% or less than 90% of the current value of assets.

The due date for required minimum contributions has not changed and is still 8½ months after the close of the plan year. However contributions made after the valuation date for the plan year will need to be adjusted for interest if made. Quarterly contributions are required if liabilities exceed assets in the prior year.

Maximum Deductible Contributions:

For the 2006 and 2007 plan years, the maximum Defined Benefit deduction is increased to 150% of current liability. Beginning in 2008, the maximum deductible contribution will be similar to the calculation for 2006 and 2007, but the terms are redefined to 150% of target liability less assets.

For plans with 100 or fewer participants, any benefit increases for highly compensated employees attributable to plan amendments adopted within the past two years cannot be taken into account. If the plan is covered by the PBGC, the actuary may also project increases in the compensation dollar amount under IRC §401(a)(17).

Combined Deduction Limits for Defined Benefit and Defined Contribution Plans:

The combined limits for 2006 and 2007 have been changed and allow a plan sponsor to deduct up to 150% of current liability in the defined benefit plus a 6% of eligible compensation contribution in the defined contribution plan [other than 401(k) contributions].

Defined Contribution Plans that exceed 6% of participant compensation will be subject to the existing 25% of compensation limit for contributions to all plans. Elective deferrals will continue to be disregarded from the deduction limits in 2008 (no limits if PBGC).

PBGC Covered Plans:

PPA makes no changes to the PBGC flat rate premium. The Deficit Reduction Act of 2005 already increased the per-participant flat-rate premium to \$30 for single-employer plans and to \$8 for multiemployer plans. The rules for the variable rate premium will continue for 2006 and 2007 and then be amended to reflect the segmented yield curve beginning in 2008. In addition, for employers with 25 or fewer employees, the per-participant variable rate is not more than \$5 multiplied by the number of plan participants in the plan at the beginning of the preceding year. Unfortunately, the full funding limitation exemp-

tion has been repealed.

Lump Sums:

There are items in PPA that effect the calculation of lump sums.

The first affects participants who have benefits at the benefit limits in defined benefit plans. PPA adopts the PFEA rule with a twist: the interest rate to be used is the greater of: (1) 5.5%; (2) the rate that will provide a benefit of not more than 105% of the benefit that will be provided if the IRC §417(e)(3) rate were used; or (3) the plan's rate. This means that participants who are at the benefit limit may have reduced lump sums.

Since this provision is effective January 1, 2006. There is the possibility that a plan has already paid out benefits during 2006 before the enactment of this change. Current law reverted back to the use of the greater of the 417(e)(3) rate or the plan rate to calculate the maximum lump sum. If the lump sum paid out were greater than what the new limitation provides, relief is needed so that the plan is deemed to satisfy IRC §415. If the plan paid less, the plan should have the option of: (1) paying the greater amount or (2) limiting the effective date of the higher limitation to distributions made after the enactment date (or some later transition date perhaps). Considering the recent low 30-year Treasury rates, the 5.5% rate will probably apply for most 2006 distributions made before the enactment of this legislation; so it is very possible some plans paid a greater amount based on the 30-year Treasury rate.

The second issue impacting lump sums is the interest rate used to calculate them changes effective in 2008. PPA replaces the 30-year Treasury rates with the segmented yield curve with a phase-in of 20% a year from 2008-2012 (current rules remain in effect for 2006 and 2007).

What You Need to Know About PPA06 as the Sponsor of a Defined Contribution Plan

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While PPA has a large impact on funding defined benefit plans, its primary impact on defined contribution plans centers around automatic enrollment. The Act defines three types of automatic enrollment arrangements, Automatic Contribution Arrangements (ACA), Qualified Automatic Contribution Arrangements (QACA), and Eligible Automatic Contribution Arrangements (EACA). These arrangements all have similar features but different requirements and advantages

Automatic Contribution Arrangements:

Effective August 17, 2006 PPA preempts state laws that interfere with the automatic enrollment process, thus allowing automatic enrollment. The 2½ month correction period for the ADP/ACP test still applies.

Eligible Automatic Contribution Arrangements (EACA):

This arrangement is effective in 2008. If an employee does not make an election, the participant is automatically enrolled at a uniform percentage and contributions are invested in accordance with the Department of Labor safe harbor rules. A notice explaining participant's rights is required before the start of each plan year. It allows for a 6 month correction period for the ADP/ACP test without an excise tax and allows automatically enrolled employees to retroactively cash out up to 90 days after the automatic enrollment begins.

The Qualified Automatic Contribution Arrangement:

This arrangement is effective for plan years beginning in 2008. This arrangement will be eligible for safe harbor treatment under the ADP/ACP tests, and will be deemed to meet top heavy requirements, if the automatic enrollment percentage initially is between 3% and 10%, but no less than 4% in the second year of participation, no less than 5% in the third year of participation, and no less than 6% in any subsequent year of participation and a match of at least 100% of the first 1% of pay plus 50% of the next 5% of pay, or at least a 3% non-elective contribution is provided. The arrangement does not have to apply to employees already participating (or who have elected not to participate). The automatic enrollment rate applies until a participant makes an affirmative election. Vesting on contributions will have to be 100% after no more than two years, rather than the immediate vesting rule for other safe harbor 401(k) plans. An annual notice explaining the automatic enrollment procedure and the default investment, if one exists is required.

In addition to the automatic enrollment arrangements, PPA has a lot of miscellaneous provisions that impact defined contribution plans.

Accelerated vesting under DC plans:

PPA imposes the top heavy vesting rules on all DC plan contributions (not just on matching contributions, as was done under EGTRRA), effective for contributions made in plan years beginning in **2007 or later** (for employees who have at least one hour of service after the effective date).

Hardships:

PPA requires the Treasury Department to issue regulations that permit hardship withdrawals for hardships or unforeseeable emergencies of a person who is the participant's beneficiary under the plan, even if that beneficiary is not the participant's spouse or dependent.

Missing participants under terminated plans:

The PBGC's missing participant program is extended to multi-employer plans and to plans not covered by the PBGC (including terminated defined benefit plans maintained by professional corporations with 25 or fewer plan participants and terminated defined contribution plans).

Blackout notices:

PPA adds an exception to the notice requirement for one-participant plans (including plans that cover the spouse of the owner), and plans that cover only partners in a partnership (or

only partners and their spouses). This is effective as if it were originally part of Sarbanes-Oxley.

Mapping investment options:

PPA Act will provide fiduciary relief under ERISA §404(c) during a blackout period if certain conditions, as prescribed by the DOL, are satisfied. Rules will be provided with respect to the mapping of investments to both new and existing investment options in the case of a change in investments under a participant-directed plan under which participant control is deemed to be retained. This is effective for plan years beginning after December 31, 2007.

Benefits statements:

Benefits statements will be required quarterly for participant-directed defined contribution plans, annually for defined contribution plans that are not participant directed, and every three years for defined benefit plans. The DOL must issue model benefit statements that will satisfy this requirement. The Act allows statements to be delivered by electronic means. It remains to be seen how this will impact the DOL's current regulations on electronic communications. This is effective in post-2006 plan years.

Diversification of employer securities investments:

A DC plan will have to permit employees to diversify out of investments in employer securities if the securities are publicly traded. This will not apply to ESOPs that contain no elective deferrals, employee contributions and matching contributions, and will not apply to one-participant plans. A plan can require up to three years of service before diversification rights apply to employer matching and non-elective contributions. This is effective in 2007, except that, for existing plans, the diversification requirement will be phased in over a three-year period with respect to the portion of the participant's account that will be subject to the diversification election. Participants will have to receive 30 days advance notice of the diversification right (\$100-per-failure penalty).

Distribution notice and consent rules:

Effective for plan years beginning in 2007, the 90-day distribution notice period will be expanded to 180 days.

PPA06 for Fiduciaries and Investment Advisers

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The PPA also updates regulations that affect those with fiduciary responsibility for plans including Plan Sponsors and their investment advisers. The law creates a complex mechanism to allow a fiduciary adviser to avoid committing a prohibited transaction when providing fiduciary advice to plan participants.

What is a Fiduciary Adviser?

A fiduciary adviser may be:

- A Registered Investment Adviser under the Investment Advisers Act of 1940;
- A bank or similar financial institution, but only if provided through a trust department subject to periodic examination and review by Federal or State banking authorities;
- An insurance company;
- A person registered as a broker or dealer under the 1934 Securities Act;
- An affiliate of a person described in (a) through (d); or,
- An employee, agent, or Registered Representative of a person described in (a) through (g).
- A person who develops the computer model (see below) also may qualify as a fiduciary adviser

Investment Advice

The PPA contains a prohibited transaction exemption for participant level advice provided by a "fiduciary adviser" under an "eligible investment advice arrangement." An eligible investment advice arrangement must either:

- Provide that the fees received by the fiduciary adviser do not vary on the basis of which investment options are chosen; or
- Use a **computer model** under an investment advice program meeting certain conditions.

An independent fiduciary will have to approve the arrangement. There will need to be disclosures to participants regarding the fiduciary adviser's fee arrangement, the adviser's relationship with the development of the computer model, certain performance statistics and other prescribed information. In addition, the plan sponsor is deemed to have met its fiduciary duties under Part 4 of Title I of ERISA if the conditions of the exemption are met.

Investment advisers for IRAs will not be eligible to use the computer model exception, only the fee arrangement exception for an eligible investment advice arrangement. The DOL and the Treasury, however, will conduct a feasibility study to determine if a computer model exists that could allow IRAs to use that exception. If it is determined that the requisite computer model does not exist, the DOL must issue a class exemption for IRAs that will allow for investment advice to be rendered along the lines of the computer model exemption.

The plan sponsor (fiduciary) has not breached its duty under an eligible investment advice arrangement, if:

- The advice is pursuant to an arrangement between the employer fiduciary and the financial adviser
- The fiduciary adviser is required to comply with eligible investment advice arrangement
- The fiduciary adviser acknowledges status as a fiduciary to the plan
- The employer still has the duty to prudently select and monitor the fiduciary adviser (Computer model is yet to be defined by the DOL)

Continued on page 5, "Fiduciaries and Advisers"

Default Investments in Individual Account Plans

A default investment is used when a participant, who is given a choice of investment arrangements, does not execute a choice. This comes up most frequently in 401(k) plans that automatically enroll eligible employees into a plan.

A fiduciary safe harbor is granted to the plan fiduciaries regardless of whether the plan complies with ERISA §404(c), i.e. a participant who loses money in a “qualified default investment account” (QDIA) also loses the right to sue in Federal Court.

The DOL published proposed default account regulations pursuant to the PPA on September 27, 2006. The proposed rules require:

- That the QDIA must be an age-based or target-date fund, or a balanced fund which could include a risk-based lifestyle fund, or a managed account
- The funds must be diversified to minimize the risk of large losses
- There must be no penalty or restriction if a participant wants to move his or her account to a different fund or funds
- Funds must be managed by a fiduciary under ERISA§38 (38) or an investment company under the Investment Company Act of 1940
- The QDIA not contain stock of the employer unless they were selected by a registered investment advisory company or similar structure
- Participants must be offered a broad range of investment alternatives (not dissimilar to the ERISA§404(c) requirement) and must be provided notices that meet the following criteria:
 - Notice must be delivered not later than 30 days before the first defaulted investment that explains:
 - The participant’s right to select his or her own investments and
 - The participant will have a reasonable time to make a decision before the default investment is triggered
 - That there will be no penalty or restriction to move to another choice;
 - A description QDIA which includes the risk and reward characteristics, and
 - How the participant can obtain information of the other investment alternatives

Blackout Periods

If a plan is replacing investment alternatives the vendor has to shut down the participants’ ability to access their account during what is known as a blackout period. The PPA provides fiduciary relief under ERISA§404(c) during a blackout period if certain conditions, as prescribed by the DOL, are satisfied. Effective for plan years after 12/31/07 – PPA Section 621

- Fiduciaries will not be protected by ERISA§404(c) during blackout periods, however;
- Fiduciaries will not be liable for losses during the blackout period if he or she satisfies the requirements of ERISA in implementing the blackout period;
 - Which includes an expanded Sarbanes-Oxley Notice requirement;
 - Protection ends with the close of the blackout period;
 - DOL has until 8/17/07 to write regulations

Mapping of Investments

When a plan changes investment vendors or, through normal investment due diligence causes an investment alternative to be changed, the old investment is often “mapped” into an investment of similar characteristics. Some fiduciary relief is now being granted for plan years beginning after 12/31/07.

- If the plan was ERISA§404(c) compliant before the beginning of a blackout period, a participant will be treated as having exercised control over the funds to which the departing funds are mapped.
- Available if:
 - The participant had selected investment(s) prior to the beginning of the blackout period, and
 - New options are reasonably similar in risk characteristics and rate of return projections
- Notice to participants must be provided 30 to 60 days before the change in investments and must include:
 - Analysis of existing and new options, and a statement that:
 - Mapping will occur unless the participant provides instruction to select different options and that
 - Participant’s account before the beginning of the blackout period was based on choices that the participant had made



Final 401(k) Regulations

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Final 401(k) & (m) Regulations (referred to as the "Final 401(k) Regulations") were published by the Treasury on December 29, 2004. These regulations finalized proposed regulations that were issued in July of 2003. The Final 401(k) Regulations affect every 401(k) plan as well as any other qualified retirement plan that provides for matching contributions and/or after-tax employee contributions.

The IRS **requires** that plans affected by the Final 401(k) Regulations adopt a "good-faith" amendment to reflect these regulations and for most plans, the amendment must be adopted by the last day of the plan year beginning in 2006 (or December 31, 2006 for calendar year plans).

Generally, the "good-faith" amendment will:

- Clarify that pre-funding of deferrals is prohibited;
- Restrict the employer's ability to use "bottom-up" QNEC's and "targeted" matching contributions;
- Provide for optional true-up for any safe harbor match contributed more frequently than annually;
- Require inclusion of GAP earnings on corrective distributions;
- Provide that the match ratio for all participants be equal;
- Expand the "needs" requirement for hardship to include funeral expenses for parents, and damage repairs to the employee's principal residence; and
- Clarify an employee's ability to defer compensation paid after a severance from employment.

If you have a 401(k) plan, or if you have a plan that provides for matching contributions and/or after-tax employee contributions, and if ACI has document responsibility for your plan, you should have received an amendment package from us.

The package included an adopting resolution and, if applicable, a Summary of Material Modifications. This "good-faith" amendment package is intended to bring your plan into compliance with the Final 401(k) Regulations only. It is not intended to make any changes that are desired or required as a result of the Pension Protection Act which was signed into law on August 17, 2006.

If you have any questions concerning this amendment please don't hesitate to call your ACI plan administrator.

2007 Retirement Plan Limits

On October 14, the Internal Revenue Service announced the cost-of-living adjustments that will be applied to the dollar limits in all tax-qualified retirement plans in 2007. The limits apply to calendar year plans, and plans that have been amended for EGTRRA. If your plan has not been amended, or you have an off-calendar plan year end, contact your plan administrator to see if there are any changes to your plan.

Defined Benefit Plan Limits:

The limitation on the annual benefit under a defined benefit plan increases from \$175,000 to \$180,000.

Defined Contribution Plan:

Individual Contributions: The limitation on contributions made on behalf of an individual to a defined contribution plan increases from \$44,000 to \$45,000. Individuals will still be limited to contributions of 100% of compensation or \$45,000, whichever is less.

401(k) Deferrals: This dollar limitation on employee deferrals into 401(k) plan increases from \$15,000 to \$15,500.

Catch-Up Contributions: For individuals age 50 and over, the catch-up contribution limit will remain unchanged at \$5,000.

Annual Compensation Limits

The maximum annual compensation that may be recognized by a plan will increase from \$220,000 to \$225,000.

Key Employees

The dollar limitation for determining whether an employee is "Key" for officers in a top-heavy plan will increase from \$140,000 to \$145,000.

Highly Compensated Employees

The dollar limitation on compensation used to determine which employees are considered highly compensated will remain unchanged at \$100,000. Thus, employees who earn in excess of \$100,000 in the plan year beginning in 2007 will be considered highly compensated for the plan year beginning in 2008.



On The Same Page

by Mark H. Fowler, CMC, CPA
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Business failure can occur when two or more stakeholders, who must work together because of operational or financial arrangements, view a situation differently. Call it “philosophical discontinuity.” Disagreements and undercurrents of dissension can chip away at a company’s foundation for years until one day management discovers that the business has been irrevocably altered.

When families, friends and associates decide to build a business together they often focus only on the positive. They agree on everything from the company’s long-term vision to its operational basics, and quickly sweep away any philosophical disagreements. They grant concessions to make the new enterprise work. By doing so, however, they are really setting up the business for difficulties and possible failure.

Once operations begin, the parties form their own ideas about the company’s direction. The singular vision, one held by everyone, diverges into two, three or even more mind-sets.

Sometimes team members discuss their ideas and reach consensus. Often they don’t. But even if they communicate on smaller issues, they frequently fail to confront the major questions of how to run the company.

It’s easy to agree on what the company should manufacture or what services it should provide. But how this is done is the important question and an area in which differences in style, experience, education, culture and mind-set quickly emerge.

You see this in professional firms. Their purpose is to support and service clients and make them happy. However, one partner might do this by giving great advice, but not adequately charging for it, while another partner is focused on the value of advice and is not afraid to bill for it.

This philosophical gap can lead to arguments about billings and collections, profitability, staffing and partner distribution. If it continues, crisis rules.

Such a philosophical misalignment can lead to poor staff relations, high turnover, low productivity and culture riddled with growth and profitability challenges. The result could range from the firm splitting to the failing.

Symptoms of Philosophical Discontinuity

Companies that are struggling philosophically often experience the following:

- Projects don’t get done, promises aren’t kept and issues aren’t resolved. When people feel forced into something they often won’t give their best effort or worse. What’s worse, there may be times when they find way to undermine the efforts of others and ensure that projects fail.
- No new products or services are forthcoming. When people are unclear about corporate direction, creativity diminishes.
- Employee turnover is high. Employees sense the un-

derlying struggles at the managerial level and are confused about goals and priorities. The work environment is usually under-productive, stressful and employees are seeking new horizons.

Here are some real-life examples of when philosophical discontinuity sets in- the resulting consequences:

Parent Company vs. Division

A 75-year-old manufacturing company with \$15 million in annual sales merges with the regional distributor that sold its products. From an operational standpoint, the transition went well. Offices were combined and redundancies in services and costs were eliminated. A new management team and a corporate plan were assembled, with the parent company’s senior executives overseeing the distributorship.

Before long, the new managers had their own ideas about the company’s direction. Instead of restricting their product lines to those of the manufacturer, they wanted to sell other related products. Although senior management agreed with the diversification plan, they were still deeply committed to their main product lines.

Everyone at both companies liked each other and worked well together, but the end result was a constant, low-level struggle that prevented the distributor from succeeding. It soon started to lose money and market share.

Product lines eroded and the manufacturer saw profits diminish because it directed too much energy to the distributorship and not enough to product development.

Finally, the distributorship was sold and the manufacturer built a new product line.

The struggles lasted for four years, and the manufacturer spent more than \$1 million in personnel recruitment, legal and professional costs to establish the new company.

All this effort put its market development several years behind.

Owners vs. Managers

In another case, a personal service firm with \$3 million in annual sales was stagnating. Owned by two entrepreneurs, the firm had two managers who had been with the business for about four years.

This 15-year-old firm with 17 employees and three locations had a strong reputation and nearly a market monopoly.

In one year, sales dropped from \$3 million to \$2.25 million. While attempting to develop new niches to replace its maturing market dominance, two philosophies emerged.

Second-tier managers wanted to reach new markets and expand firm capabilities. The owners wanted to focus on the existing customer base, believing that by resolving the challenges of existing customers they would develop new niches.

For two or three years, these approaches operated concurrently and the company went nowhere. Sales dropped to \$1.7 million and prospects for the future were dismal. Something had to happen.

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During a management retreat, both approaches were discussed and team members decided to proceed with the owners' philosophy and develop new products for existing customers.

Historically, this had been the firm's success area and appeared to be the most appropriate decision. Still, one manager left the firm. The other stayed and agreed to commit to the new direction. Within two years, sales grew to \$3.5 million.

Partners Go Their Separate Ways

A 20-year-old CPA firm with annual fees of \$1.7 million and two offices wanted to expand its client base. However, the firm's partners were unclear about what services were required and on which industries they needed to focus. The firm's marketing approach was clouded and the partners disagreed about how to effectively maintain two offices.

The firm's partners were constantly at odds and never developed an expansion program. After struggling for five years, they finally split the offices and divided the client base. None of the newly created firms became particularly successful. The partners spent so much energy on the struggle that they didn't have adequate resources or focus for their new endeavors.

Avoiding the Crisis

To keep philosophical discontinuity at a minimum, all of the players in a business, CPAs, attorneys, bankers, board members and strategic advisers, need to be vigilant.

Key points to remember include:

- Philosophical continuity increases business' chance for success. When philosophical discontinuity emerges, management must seek solutions. While the most desirable solution is to address areas of conflict and maintain a focused vision, sometimes businesses must resort to selling divisions, merging, retiring senior management or other major shake-ups.
- Major philosophical issues cannot be negotiated away or smoothed over. Unlike normal daily challenges, which are settled fairly easily, philosophical issues impact a company's very underpinnings. Differences must be fully analyzed and resolved or they will continue to undermine the business' success. Painful changes, such as terminations and partner buyouts, are sometimes required to settle differences. For that reason, people often ignore problems and sweep them under the rug. But refusal to deal with differences only prolongs the agony and results in even more painful changes later.
- To succeed, it is essential that a company define, discuss and use its philosophical leanings just like other assets. Too often, a company's philosophical tendencies are so hidden that management may not even know what they are.
- Philosophical issues must be documented to avoid verbal battles. Sometimes just writing down the different perceptions of an issue and discussing those differences helps crystallize the situation, as well as solutions.

- Perception rules over fact. Fundamental belief systems can alter anyone's perception of reality. Before any change can occur, everyone's belief system must be fully understood and appreciated.

Also, watch for these areas where disagreements and philosophical discontinuity can creep in:

- How to get work done - planning vs. waiting until the last minute;
- How to motivate employees - the carrot or the stick;
- Communication styles- telling vs. dialoguing and listening;
- Management style-delegation vs. "I have all the answers";
- Future vision for the business - growth vs. status quo; and
- Pricing- value vs. low ball.

You must discuss each of these areas and agree upon an approach to be successful. While your decisions can change, as every company must alter itself from time to time, you always must obtain consensus.

The Adviser's Role

An adviser can help owners, managers and supervisors resolve philosophical discontinuity. Advisers normally know a great deal about their clients' habits, history and decision-making processes. This information is essential to helping clients recognize that belief systems are critical to their well-being.

Advisers may encounter clients who simply write off challenges and managerial differences and fail to promote change. If you can help identify and inventory the company's different belief systems, you can help resolve the situation.

Mark Fowler specializes in transitioning companies from challenges to achievement with a focus on enhancing revenues and profits. For 25 years, he has been assisting companies move from problem to solution. A certified management consultant, he is a member of the Institute of Management Consultants (IMC) as well as a member of the AICPA, and California CPA Society.

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Reminders

Data Request Package

For those clients who have calendar year plans you will be receiving a data request package from us shortly. This is the time of year when we ask for census information, the company questionnaire and information regarding your desired contribution. If you provide us with trust information each year we will ask for that as well. Remember that the sooner you return this to your administrator, the more flexibility you will have in terms of ADP/ACP test correction options if required, contribution planning and so forth. We recommend that as soon as you have verified the accuracy of your census for W-2 purposes, you should send the completed data request package to us.

1099's

For those clients who do not have a daily valued arrangement with a recordkeeper or a corporate trustee, you will be required to provide 1099's to participants or former participants for all distributions that have been made during the 2005 calendar year. In order for ACI to prepare the 1099's on your behalf, we will need to have information regarding each distribution, including: name and social security number of the person receiving the distribution, their address, whether the distribution was taken as cash or rolled to an IRA or another qualified plan and the amount of Federal and State Withholding, if withheld. These 1099's and accompanying forms will be sent to you in January. The 1099's must be given to the applicable participants no later than January 31, 2007. If you have not returned the completed "ACI Copy" of any distribution packages, please do so now along with a copy of the distribution checks.

ADP/ACP Testing

Calendar year 401(k) plans need to pass an ADP (actual deferral percentage) test each year in order to prove that the amount of deferrals being made for the non Highly Compensated participants will support the deferrals being made for the Highly Compensated participants. An ACP (actual contribution percentage) test is also required for plans that have an Employer Match. Safe Harbor plans do not need to be tested; they have some communication and vesting requirements associated with them, but if you have had trouble passing the tests in prior years you may wish to explore the feasibility of Safe Harbor for 2007 and later.

If your ADP or ACP test fails, and you make the decision to refund contributions to certain Highly Compensated participants, note that refunds made prior to March 15, 2007 will be taxable to those participants as ordinary income for **2006**. If you make the refunds after March 15, 2007 they will be taxable to those participants as ordinary income for **2007**, however there will be a 10% penalty incurred by the plan sponsor.

It is imperative that you provide the completed data request package to us as soon as feasible in order to have some flexibility with your correction options in the event that the test(s) fail.

Partnership Elections

The 401(k) regulations require that a partner **must** make an election to defer prior to the close of the partner's taxable year (usually December 31). This election can be either a percentage of income or a dollar amount. A deferral election is also required if an LLC (Limited Liability Company) is electing to be taxed as a partnership. Your ACI plan administrator should be sending partnership elections to you; please execute them by the end of the year. If you have changed your business form and have not communicated that to your administrator, please contact them and ask them to provide the election forms.

Los Angeles Benefits Conference (LABC)

The 2007 **Los Angeles Benefits Conference (LABC)** will be held on January 25-27 at the Hilton Los Angeles/Universal City in Universal City, CA. There will be a pre-conference program on January 24.

The LABC is co-sponsored by the Internal Revenue Service, ASPPA, NIPA and WP&BC. This conference offers a high level of education, knowledgeable speakers and the latest information on pension issues. It's the perfect opportunity to meet and discuss employee benefits issues with colleagues and top IRS and DOL government agency representatives. Come hear all the latest from PPA06.

ACI's President, Pat Byrnes, is a founding co-chair of the Conference. He is part of the LABC executive committee as a senior advisor. The LABC is an ideal forum to hear the latest information on pension plans, benefits regulations, litigation, enforcement and compliance. Prominent speakers from the IRS and DOL will be available to discuss employee benefit issues with conference attendees.

Continuing Education credit are as follows:

- ASSPA members is 15 credit hours (4.5 additional credits for conversations with the IRS and DOL)
- NIPA members will receive 1 credit hour per 50 minutes, or a total of 16 hours for the entire conference
- Attorneys in California: ASPPA is a State Bar of California MCLE approved provider.
- Accountants: ASPPA is registered with the National Association of State Boards of Accountancy (NASBA) as a sponsor of continuing professional education on the National Registry of CPE Sponsors. State boards of accountancy have final authority on the acceptance of individual courses for CPE credit.
- CFP: Program sessions have been designed to comply with the CFP Board of Standards for continuing education credits.
- Enrolled Actuaries: This conference is designed to offer Enrolled Actuaries Core and Non-core JBEA credit hours. The final decision as to applicable credit rests solely with the Joint Board for the Enrollment of Actuaries

Reservations must be made by January 3, 2007. For more information regarding the conference, log onto the ASPPA web site at www.asppa.org/labac.htm.

ACI Client Education Seminars

BASIC TRAINING SEMINARS:

Understanding Annual Plan Administration

An Introduction to 401(k) Plan Operation

The *Introduction to 401(k) Plan Operation* is an educational presentation that covers items such as non discrimination testing, employee deferrals and employer contributions, loans and distributions and payroll issues.

Understanding Annual Plan Administration was added last year to help members of your staff understand the process of plan administration in general. This seminar will cover issues such as employee communication, distribution requirements, tax reporting (945, DE6, DE7 & 1096), year-end data packages, setting up timeline and expectations and changes in company structure.

The seminars will briefly cover how your plan is affected by the Pension Protection Act of 2006 (PPA06).

The seminars are open to anyone who would like a better understanding of their plan(s). The seminars will be held at our Torrance location. There is a \$25 fee for each seminar. **This fee is waived for all ACI clients.** SEATING IS EXTREMELY LIMITED.

You can contact Lace Greene, Marketing Manager, to reserve a seat at lace.greene@acibenefits.com or (310) 212-2600, ext. 204. \$25 fee must be received prior to seminar date in order to confirm your reservation.

Our seminars are getting bigger! Due to popular demand, we have added more seminar dates for 2007.

Below is the 2007 schedule:

Plan Administration

Tuesday	February 6	8:00 AM to 12:00 PM
Wednesday	February 21	8:00 AM to 12:00 PM
Tuesday	May 8	8:00 AM to 12:00 PM
Wednesday	May 23	8:00 AM to 12:00 PM
Tuesday	August 7	8:00 AM to 12:00 PM
Wednesday	August 22	8:00 AM to 12:00 PM
Tuesday	November 6	8:00 AM to 12:00 PM
Wednesday	November 7	8:00 AM to 12:00 PM

401(k) Basic Training

Tuesday	February 6	1:30 PM to 4:30 PM
Wednesday	February 21	1:30 PM to 4:30 PM
Tuesday	May 8	1:30 PM to 4:30 PM
Wednesday	May 23	1:30 PM to 4:30 PM
Tuesday	August 7	1:30 PM to 4:30 PM
Wednesday	August 22	1:30 PM to 4:30 PM
Tuesday	November 6	1:30 PM to 4:30 PM
Wednesday	November 7	1:30 PM to 4:30 PM

The following seminars will be scheduled for 2007. Invitations will be sent once the dates are finalized:

DEFINED BENEFIT PLANS:

How they fit in your business?

How does the PPA-2006 affect them?

Seminar is tentatively scheduled in June and then again in September.

MINIMIZING FIDUCIARY LIABILITY IN 401(K) PLANS:

It's not an event, it's a process.

Seminar is tentatively scheduled in July.

PENSION PROTECTION ACT OF 2006:

Seminar is tentatively scheduled in June.

THE RIGHT RETIREMENT PLAN:

In light of the Pension Protection Act of 2006.

Seminar is tentatively scheduled in July and then again in October.

Have an Idea for an Article?

Action Items is provided to our clients and their advisors with articles that address relevant, timely issues. If you have a particular topic that you would like us to address, a question you would like answered, or if you would like to submit an article for publication, please let us know. We welcome your feedback and input.

If you have any comments or suggestions regarding *Action Items*, please contact our marketing manager, lace.greene@acibenefits.com.



*Actuarial Consultants, Inc.
wishes you all
peace and joy in the New Year.*

Circular 230 Disclosure: In accordance with recently issued Treasury Regulations, which became applicable to all tax practitioners as of June 20, 2005, please note that the advice given herein (including any attachments) is not intended or written to be used and cannot be used by any taxpayer for the purpose of (1) avoiding tax penalties under the Internal Revenue Code, or (2) promoting, marketing or recommending to another party any matters addressed herein.