

Benefits Compensation[®] DIGEST

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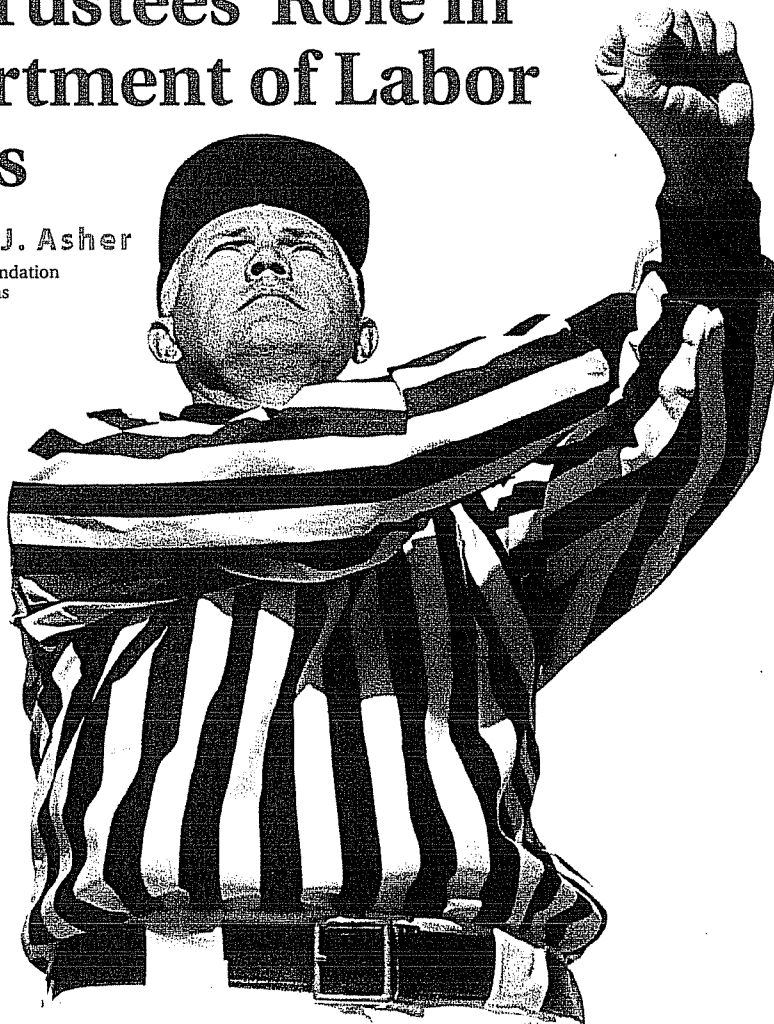
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The Trustees' Role in Department of Labor Audits

by Michael J. Asher

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News Summaries

An audit by the Department of Labor (DOL) is viewed as many things, but seldom treated as a golden opportunity for trustees to demonstrate the caliber of plan operations and compliance with fiduciary standards. This article provides a guide for trustees' participation in the audit process by reviewing the purpose and power of the DOL, and explaining how trustees can take an active role at the audit's inception. It discusses how trustees should direct the production of documents and interaction with the investigator, how they can prepare for the DOL interview and how they can effectively "tell the story" of their prudence during the interview.

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The Trustees' Role in Department of Labor Audits

Continued from page 1

The Purpose and Power of the DOL

The Department of Labor, through the Employee Benefit Security Administration (EBSA), is responsible for enforcement of ERISA fiduciary standards. The secretary of labor has the power to require production of plan records and interview trustees and key plan professionals. The remedies for violations range from monetary restitution, injunctive relief, removal of trustees, or other "equitable relief." Further, the DOL has "sharing agreements" with other agencies, such as the IRS, Office of Labor Management Standards and Department of Justice in the event violations of other laws are uncovered.

The DOL is proud of its mission and not shy about publicizing its achievements in the press or on its Web site at www.dol.gov. Enforcement results for 2007 include:

- 3,236 civil investigations closed; 75% resulted in corrected violations
- \$1.5 billion in assets restored to plans
- 115 criminal indictments; 75 cases closed with convictions.

The need for DOL enforcement is apparent. However, there are several factors inherent in the process that can make trustees subject to possible violations, despite their best intentions and efforts of competent advisors:

- **Complexity**—The ERISA statute and its regulations is one of the most complex, largest and growing bodies of law. Further, the discretion exercised by courts in interpretation of this law has led to conflicting judicial decisions as well as frequent departure from DOL interpretive bulletins and advisory opinions.
- **Fiduciary Standard**—Conduct is measured against the highest standard known to law: the care and skill of a fiduciary, which demands both procedural and substantive prudence.
- **Hindsight**—Legally, trustee actions are judged based on facts that existed at the time action was taken, not in hindsight: Reality is that hindsight is often unavoidable. It inevitably influences DOL findings.

Appreciation of these factors creates a healthy respect for the DOL and its mis-

sion. It also puts trustees in the proper mindset to begin the process of persuasion at the audit's inception.

Commencement of Audit

Upon receipt of the DOL's letter announcing the plan has been scheduled for an investigation, coupled with a "list of documents required for examination," the trustees should convene with legal counsel and take the following action:

- Discuss the anticipated progress of the audit.
- Review the fiduciary insurance policy for its notice provisions. Some policies require notice upon commencement of the audit, while others do not require notice until findings are issued.
- Assign duties for compiling documents and recordkeeping.
- Assign legal counsel as the primary contact with the DOL. Upon receipt of the audit letter, legal counsel should reply in writing that all communication should be directed through its office. This keeps the document production orderly and centralizes communication.
- Identify transactions with unsuccessful outcomes or that may be questioned for procedure or events that have later transpired.

Recordkeeping—Production and Management

It is critical to manage the production and maintenance of plan records to achieve an orderly, professional presentation to the DOL (its enforcement manual directs the auditor to report disorderly or incomplete records). It's also important to keep track of documents reviewed and/or provided to the DOL.

A designated room should be cleared for the DOL representative. The documents should be set forth in the order requested. The plan manager and/or legal counsel should review the records for completeness and removal of extraneous information.

The DOL will request copies of certain records. These should be submitted with a cover letter itemizing the requested information and a duplicate copy should be filed separately.

Continued on next page

PENSIONS— ADDITIONAL Resources

More Information

For related article summaries, see www.ifebp.org/DOLaudits.

[!] Got a specific benefits question? Need some help answering it? Call (888) 334-3327, option 5, and get a prompt e-mail or fax back.

Conferences and Seminars

Trustees and Administrators Institutes

June 5-7
Carlsbad, California

For more information, view www.ifebp.org/trusteesadministrators.

Fraud Prevention Institute

September 17-18
Atlantic City, New Jersey

For more information, view www.ifebp.org/fraudinstitute.

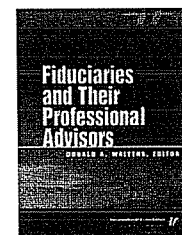
E-Learning Course

PPA-DOL Interpretations of Participant Investment Advice Rules

For more information, view www.ifebp.org/elearning.

Book

Fiduciaries and Their Professional Advisors



Donald A. Walters, editor. (International Foundation). 203 pages. Item #6382. \$59 (I.F. Members \$44). For more book details, see www.ifebp.org/books.asp?6382.

To order, call (888) 334-3327, option 4.

Trustee Roster

Meeting Date	Trustees/Date Appointed					
May 2002	Adams (7/99)	Brown (6/00)	Colver (6/97)	Denning (9/01)	Eagle (1/89)	Frank (5/75)
December 2003	Adams	Brown	Colver	Denning	Eagle	Gowan (10/02)
May 2004	Adams	Brown	Colver	Harlow (2/4/03)	Eagle	Gowan
July 2004	Adams	Brown	Inge (6/30/03)	Harlow	Eagle	Gowan
October 2005	Adams	Brown	Inge	Harlow	Jones (9/20/05)	Gowan

The initial document production and sundry interaction with the DOL should not be taken lightly. It's the first opportunity for trustees to advertise their professionalism, and provides needed momentum for the more dramatic and sometimes feared stage of the DOL audit: the trustee interview.

The Trustees' Role in the Interview Process

The DOL's enforcement manual includes the following as objectives of trustee interviews:

- To verify the accuracy of the plan's books, records and reports filed with the DOL
- To secure explanations for both recorded and unrecorded transactions and events
- To secure admissions regarding violations from potential defendants
- To obtain evidentiary information regarding specific transactions and/or actions of individuals dealing with the plan(s)
- To assess the desirability of the interviewee being used as a witness at trial.

Thus, the DOL uses the interview to obtain evidence. Trustees must be prepared to give accurate and complete evidence which establishes their active involvement as fiduciaries, knowledge of plan operations and the prudence of significant transactions undertaken during their tenure. While there may be an enormous volume of events occurring over several years, they can be effectively summarized by the following means: *trustee roster, timetable of events, plan operation*

checklist and a memorandum of significant events.

Trustee Roster

Trustees should know when their tenure began and the board composition during their tenure. Table I is especially helpful if the audit extends over a number of years where trustees have come and gone.

Chronology of Significant Events

Trustees should direct counsel and the plan manager to compile a chronology of significant events and fund performance during the period being audited. All meeting dates, attendance and noteworthy items should be included. This will refresh the trustee on important transactions and provide context for various events. See Table II.

Review of Basic Plan Operations

The next step is to refresh memories regarding basic plan operations, the financial status of the plan at various intervals, and the identity of plan employees and service providers. Much of the information is so fundamental that the trustee rarely needs to address it. However, the DOL often inquires about these matters since they form the basis for plan operations. Common inquiries include:

- What constitutes a quorum?
- What is the difference between the trust and plan document?
- What is a summary annual report?
- When is the annual actuarial valuation submitted each year? Do you know

why it is generally submitted at this time?

- What is the difference between bonding and insurance?
- What are the limits of your fiduciary insurance? How much is the premium?
- If self-administered, what are the terms and compensation of the administrative manager and his employees?
- How are bills paid?
- Can you identify the vendors on the Schedule of Bills?
- Approximately how many employers contribute to the fund and how much is the monthly/annual contribution?
- How are investment managers selected?
- What function does your custodian perform?
- What are your directions to investment managers on trading?
- Approximately how much do you pay in investment fees annually?
- What is your investment policy allocation?
- What does Section 404 of ERISA provide?
- Do you know what a "party in interest" is?

Answers to these questions and related inquiries can be summarized in the sample plan operation checklist below.

Plan Operation Checklist Trust Agreement

The trust agreement creates the trust, executed by settlors, and sets forth purpose and powers/limitations.

- Appointment of trustees
- Chairman and secretary—election

Timetable of Significant Events

Meeting Date	Present	Description
8/22/02	Adams, Brown, Colver, Denning, Eagle, Frank	<ul style="list-style-type: none"> Trustee meeting Money manager interviews for small cap Terminate X and hire Y—Deadlock Legal Report—DOL says no further action needed
8/29/02	Adams, Brown	<ul style="list-style-type: none"> Benefits meeting—eligibility bank lowered to 12 months
9/10/02	Adams, Brown, Colver, Denning, Eagle, Frank	<ul style="list-style-type: none"> Special board meeting Money manager interviews Options for legal recourse discussed against service provider
9/20/02	Adams, Brown, Denning, Eagle	<ul style="list-style-type: none"> Trustee meeting Terminate X and hire Y Actuary appears—85% funded; additional .05 required to maintain benefits Arbitration proceedings on deadlock
10/10/02	Colver, Denning	<ul style="list-style-type: none"> Delinquency meeting—strike notice to A,B,C, Inc. Collection policy revised—surety bonds required of all contributions per CBA

- Quorum
- How meetings are called
- Trustee compensation, reimbursement of expenses

Plan Document

The plan document sets forth benefits available, eligibility and payment.

Summary Plan Description (SPD)

This is the summary of the plan document distributed to participants every five years.

Summary of Material Modifications

This is the summary of significant plan changes sent to participants on an annual basis.

IRS Form 5500

The Form 5500 is an annual report submitted to the IRS not later than seven months after the end of the plan year. It sets forth details on plan administration and financing. It attaches various schedules, including Schedule B (actuarial report signed by actuary), Schedule C (service provider information regarding identity and fees), Schedule H (financial information; and also includes copy of audited financial statement prepared by plan's certified public accountant).

Summary Annual Report (SAR)

The SAR summarizes Form 5500 and is sent to participants no later than nine months after close of the plan year.

Annual Funding Notice

This summarizes the funding status of the defined benefit plan.

Trustee Meetings

- What is the frequency of board meetings?
- What is the authority of committees vis-à-vis the board of trustees?
- Committee meetings
- Benefits
- Investment
- Delinquency

Minutes

How are the minutes taken, reviewed and approved?

Travel Policy and Trustee Reimbursement

What is the process for approving trustee expenses? Is there a limit on conferences?

Insurance and Bonding

What are the limits of insurance and amount of premiums? Who pays waiver of recourse? ERISA requires up to \$500,000

fidelity bond for anyone who handles plan assets.

Administrative Office

- If self-employed, know the general operating expenses, amount of staff and their duties, general terms and conditions of employment. If third-party administrator, be familiar with the general terms of contract such as compensation, duties and termination.
- Authorization to instruct bank, check-writing authority and internal controls.
- Know the general schedule of office expenses—should be contained in financial statements and copied into checklist. See Table III.

Payment of Bills

Be familiar with schedule of bills paid. Have a sample of at least one schedule of bills from each year being audited. Be able to identify the vendors listed and their duties. See Table IV.

Service Providers and Schedule of Bills

Know the appropriate annual fee for service providers and services they provide (the Schedule C of Form 5500 sets forth all service providers, employees

Continued on next page

Schedule of Office Expenses for 12-Month Period Ended April 30, 2007

Table III

	Month Ended	Year to Date
Salaries and Wages	\$28,074.11	\$375,783.31
Telephone	1,464.00	13,901.68
Equipment Rental	393.18	49,914.00
Office Supplies	416.89	12,384.71
Employer Payroll Taxes	4,118.06	13,287.97
Fringe Benefits	20,574.91	33,429.76
Insurance Expense	531.40	5,458.90
Misc. Supplies	381.00	17,433.28
Computer Services	1,521.50	132,959.00
Research Services	200.00	2,600.00
Meeting Expenses	0.00	629.50
Automobile	56.09	1,246.23
Property Taxes	3,942.09	34,814.81
Depreciation Expenses	2,045.18	59,137.77
Building Expenses	\$63,718.41	\$752,980.92

Local Pension Fund Schedule of Bills October 2006

Table IV

Vendor	Check Number	Date	Description	Amount
Trustee	18134	10/2/06	Conference Expense— Advance IFEBEC 2006	\$1,200.00
Fed. Reserve Bank	EFT933	10/4/06	Retiree Federal Taxes— October 2006	300,396.00
AT&T	18136	10/5/06	Telephone— 8/22/06-9/21/06	550.47
Office	18137	10/5/06	Office Supplies 9/28/06	212.94
Consumer Energy	18138	10/12/06	Utilities—Monthly Merlin Telephone Maintenance	567.40
Flame	18139	10/12/06	Building— Quarterly Heat Maintenance	472.60
Administrator	18140	10/19/06	Vehicle Expense for Administrator	157.40
Money Mgr.	18141	10/19/06	Money Mgr. Fees—Quarterly Investment Advisor Fee July-Sept. 2006	85,000.00
Waste Removal	18142	10/19/06	Building—Monthly Waste Removal Service	168.95
Deli	18143	10/26/06	Miscellaneous— Lunch for Benefits Meeting	52.75
Landscape	18144	10/26/06	Building—Lawn Service	1,878.00
State of Michigan	18145	10/26/06	State Taxes Withheld	17,733.45
Law Firm	18146	10/26/06	Legal Services— Professional 9/1/06-9/30/06	15,437.50
Auditor	18147	10/26/06	Payroll Audit Fees	8,744.34

**Pension Trust Fund—Form 5500 Schedule C
Service Provider and Trustee Information
Fiscal Year Ending April 30, 2007**

Table V

Employer ID Number	Official Plan Position	Relationship	Gross Salary/ Allowance Paid by Plan	Fees Paid by Plan
38-555550	Staff	Employee	\$40,000	None
38-555551	Administrator	Employee	\$90,000	None
38-555552	Actuary	Provider	None	\$40,000
38-555553	Legal Services	Provider	None	\$120,000
38-555554	Investment Manager	Provider	None	\$200,000
38-555555	Payroll Auditor	Provider	None	\$60,000
38-555556	Computer Services	Provider	None	\$30,000
38-555557	Investment Consultant	Provider	None	\$80,000
38-555558	Custodian	Provider	None	\$60,000

Investment Summary

Table VI

Manager	Mandate	Market Value	Percent Invested	Liquidity	Percent of Fees	Amount
1	Equity	\$50,000,000	50%	Immediate	.4%	\$200,000
2	Equity-Int'l.	\$10,000,000	10%	Immediate	.7%	\$70,000
3	Fixed	\$20,000,000	20%	Immediate	.20%	\$40,000
4	Real Estate	\$10,000,000	10%	Quarterly	1%	\$50,000
5	Hedge Fund	\$10,000,000	10%	Quarterly	1%	\$50,000
TOTAL		\$100,000,000	100%			\$410,000

Investment Policy Allocation—60/30/10
 Investment Actuarial Assumption—7.5%
 Trading-Commission Recapture
 Custodian—\$50,000
 Securities Lending—70/30
 Basis Points—1% = 100 bps

paid by the plan, their official positions and annual compensation), summarized in Table V.

Allocation of Common Costs

If fiduciary insurance covers more than one fund, such as pension and health, how are those funds allocated?

Contributions

Trustees should be familiar with the amount of contributions coming into the plan, methods of collection and any significant failures to contribute/collect. What is the approximate number of

contributory employers (fund office maintains list) and approximate amount of contributions per month? What is the procedure for collection, reconciliation?

Trustees must make systematic and diligent efforts to pursue delinquent contributions in order to avoid prohibited transaction.

Topics to understand include collection meetings, delinquency notices, strike notices, liquidated damages, surety bonds/cash bonds and construction liens.

Investments can be summarized in a chart similar to Table VI.

Be familiar with the following topics as applicable:

- Investment consultant—advises on asset allocation and prudent hiring/monitoring of investment managers
- Investment managers—delegation to registered investment advisor who becomes fiduciary over investments
- Investment policy statement
- Commission recapture
- Custodian/securities lending

Continued on next page

- Actuarial investment assumption (by law actuary sets all assumptions)
- Proxy voting
- Best price/best execution
- Asset level over last several years
- "Alternative investments"
- Class actions

Knowledge of Basic Legal Principles and Watchwords

- ERISA—Employee Retirement Income Security Act of 1974. Federal law passed by Congress that governs all areas of employee benefits
- ERISA §404—defines fiduciary duties of prudence, exclusive benefit rule, diversification and plan document
- Prudence—the care and skill of a person familiar with such matters in a similar enterprise
- Exclusive benefit rule—all acts in the sole interest of participants to the exclusion of other aims
- Party in interest—person or entity that has a specific relationship to the plan such as bargaining parties, service providers, relatives of the above
- ERISA §406 prohibited transactions—prohibits self-dealing and transactions between the plan and parties in interest, subject to several exemptions if proper procedures are followed (i.e., collection of delinquent contributions, payment to service providers, leasing of office space).

Significant Transactions

A synopsis should be prepared of all significant transactions. For instance, unsuccessful investments and service provider underperformance should be summarized. Trustee decisions are measured at the time they are made with all the attendant circumstances and pressures, not the luxury of 20/20 hindsight. Command of these facts will remind the trustee of his or her mindset at the time the decision was made—This needs to be communicated to the investigator.

Conduct of the Interview—Mechanics and Dynamics

Trustees must be prepared for both the mechanics and dynamics of the interview.

Mechanics: Location, Preamble, Question and Answer, Lawyer's Role

The prospect of the interview itself is

unsettling. Trustees should know what to expect in terms of the overall process so they are not unduly surprised and won't overreact to comments which have no real significance.

- Request to have the interview at a familiar location, such as the plan or general counsel's office. The DOL may request it occur at its local division, but is often receptive to a different location.
- Trustees should understand the lawyer's very limited role at the interview. The DOL's enforcement manual states: "If the attorney seeks to take charge and control the scope and progress of the investigation, the interview will be courteously discontinued."
- The trustees should be told the investigator will present his federal badge/identification and read the following statement which can be intimidating upon first blush:

"I am Ronald Brown from the Employee Benefit Security Administration, a division of the U.S. Department of Labor, and am conducting an official investigation of the Smith Company's Pension Plan pursuant to authority granted in the Employee Retirement Income Security Act of 1974, as amended. We are requesting your voluntary cooperation and information obtained during this official investigation may be referred to the U.S. Department of Justice or other appropriate federal agencies for review. Do you understand?"

- The trustees can expect the first 20 minutes to be spent on personal background, beginning with name, birthdate, even Social Security number, and various positions held up through the date of the interview.

- The interview, depending on the trustee's tenure or complexity of events, can be expected to last anywhere from one to three hours or more. It may extend more than one day.
- Investigator will know the trustee's vote, correspondence or position taken on various matters.

Dynamics

Trustees should not approach the interview as an inquisition, but an opportunity to substantiate that their actions conform to fiduciary standards. Trustees should

- Use the question and answer format to educate and inform the investigator.
- Explain their analysis and judgment amidst the pressures and uncertainties that existed at the time of decision, not in the luxury of perfect hindsight.
- Expound on the due diligence of transactions that had less than optimum results.
- Promote plan successes, specifically in light of obstacles that existed at the time.

Conclusion

Prudence does not always speak for itself. That is why trustees must provide active leadership throughout the audit process. When it is time to be interviewed, the DOL should be already impressed with the quality of plan operations and the trustees will be prepared to address the many matters that have transpired during their tenure. The groundwork will be laid for a perfect setting to tell the story of their prudence. B&C

For information on ordering reprints of this article, call (888) 334-3327, option 4.



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