

# THE SHERIDAN ROAD MAP

## The Best Route to Financial Success



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Welcome to the Sheridan Road Map! Your source of monthly insight into the financial world. Sheridan Road provides a one stop financial solution for middle-market companies, their executives and employees. We are the premier provider of Corporate Advisory, Corporate Retirement Advisory, and Wealth Management Services, by providing holistic and independent advice to our corporate and individual clients. The Sheridan Road Map will provide insight into both historical and topical issues, a calendar of upcoming events, industry news and analysis, and a "Friends of Sheridan Road" section which often spotlights a new company that may be of service to our clients. "Let us help you navigate your Financial Road!" Visit us at [www.sheridanroad.com](http://www.sheridanroad.com).

## WHAT ABOUT LARUE?

Much has been written about the Supreme Court's recent decision in the *LaRue* case. Some commentators have concluded that it will unleash a tidal wave of litigation against plan fiduciaries, while others have reached the opposite conclusion. I tend to agree with the latter group. My belief is that there will not be a tidal wave of litigation . . . because there is not a tidal wave of fiduciary breaches.

However, that does not mean that there are not serious fiduciary issues and reasons for concern. Those concerns can be dealt with in a litigation free environment. In other words, the *LaRue* case should heighten fiduciary compliance, not litigation.

The *LaRue* decision is a "friend" for competent advisers whose practices are focused on 401(k) plans. That is because the use of a competent, non-conflicted adviser is material evidence that fiduciaries have engaged in a prudent process.

The first lesson from *LaRue* is that fiduciaries should work with advisers who are competent and focused on 401(k) plans. As a part of that, fiduciaries should have regular meetings with their adviser. The adviser should provide the fiduciary (for example, the plan committee) with reports and information to review prior to the meeting and then should go over those reports and answer questions posed by the fiduciaries. The reports should cover all aspects of plan operation, including investments, participant investing practices, participation, deferral rates and, yes, fees and expenses—including the fees that are paid, both directly and indirectly, to the adviser.

If the fiduciaries are attentive to that process, then the use of an adviser and the review of the reports are substantial evidence of both substantive and procedural prudence. The fiduciaries' job is to review and understand the information, ask questions of the adviser, and reach and implement reasoned decisions.

There is another significant lesson from *LaRue*, though. That is that fiduciaries should not allow plans to enter into agreements with providers that imprudently give away valuable participant rights. For example, if a provider makes a mistake in implementing a participant-directed investment, will the provider agree to be financially responsible for that mistake? Or, does the recordkeeping agreement

effectively give away the protection that the participant should have. There is no approach that is right in all circumstances. Instead, the fiduciaries need to evaluate all of the provisions in the agreements that limit the liability of the service providers. Then, they need to determine whether it is reasonable and prudent to accept provisions that limit the liability of the service provider (and thereby give up the right of the plan to protect itself and the participants).

An adviser who is focused on 401(k) plans can help plan sponsors evaluate those agreements and provide fiduciaries with information about whether the agreements provisions are standard in the industry or unduly restrictive. Of course, they should also be reviewed by attorneys.

To my mind, those are the important lessons from *LaRue*. There may be others, but these are important ones.

**The *LaRue* case  
should heighten  
fiduciary compliance,  
not litigation.**

## COURTING DISASTER

### Confusion over 401(k) plan fees is triggering lawsuits and congressional inquiries. What can plan sponsors do to head off trouble?

Last summer, when a federal judge dismissed a suit brought by employees of John Deere & Co. alleging that they were charged unreasonable and poorly disclosed fees in their 401(k) plans, companies may have been tempted to breathe a sigh of relief. Companies are becoming acutely aware of a fiduciary responsibility that few seem suitably prepared to address.

In March, the Department of Labor (DoL) lent its weight to the employees' side of the case, filing a brief in support of their claim as they pursue an appeal. It's the latest salvo in the battle over 401(k) fees, namely how to accurately assess and communicate them to employees.

Over the years, as more providers have gotten into the defined-contribution business, their fees and behind-the-scenes revenue-sharing arrangements have become so complex that plan-expense comparisons are virtually unattainable. If plan sponsors can't ascertain the true cost of their defined-contribution plans, they certainly can't explain fees to plan participants, who pick up many of these expenses. The upshot has been litigation against more than a dozen plan sponsors and intense scrutiny of 401(k) fees by Congress and the DoL. The latter is in the midst of receiving public comment on proposed guidelines to make fees more reasonable and transparent.

Rather than wait for the DoL to issue new regulations, some companies have called in retirement advisory firms to analyze and benchmark the hodgepodge of fees that they and their employees pay for the services rendered by 401(k) providers.

Many plan sponsors doubt the suitability of fees. According to a study released in March by Chatham Partners, while 79% of plan sponsors believe understanding their 401(k) plans' overall costs is important, only 58% feel confident they do. 34% said they found it difficult to compare one plan's fees with another's, and only 38% say their provider discloses its revenue-sharing arrangements with partner firms.

Were these respondents able to obtain full disclosure of what they're really paying for, they would find wide disparity. According to data compiled by HR Investment Consultants, for a plan covering 500 participants with average account balances of \$50,000, the shared fees paid by plan sponsors and participants ranged from \$211 to \$822 with an average of \$599.

Wariness makes sense given the lineup of companies alleged to be in violation of the Employee Retirement Income Security Act of 1974 (ERISA). Companies ranging from Boeing to RadioShack are embroiled in litigation filed by employees over the reasonableness and disclosure of the 401(k)-related fees they have paid.

None of the cases have been settled, although a lawsuit filed by employees of

Deere & Co. against Fidelity Investments, the company's trustee and record-keeper for its \$2.5 billion 401(k) plan, was dismissed last July. (But, in March, the DoL became involved and asked the judges to reconsider.) Nevertheless, increased due diligence seems in order, given sponsors' fiduciary obligations to protect the interests of employees.

When defined-contribution plans came on the scene in 1978, after Congress amended an Internal Revenue Code to permit them, plan fees were easy to interpret. The original providers were third-party administrators (TPAs), like Hewitt, that charged a single fee to employers for the administrative services associated with the three or four investment options presented. On top of that, the plan sponsor might pay an investment manager to handle the portfolio.

Once the mutual-fund companies realized they had the technology in place to handle the record-keeping themselves, they gave the TPAs stiff competition.

The major drawback for plan participants was that investment options were limited to the mutual-fund company's proprietary products. Realizing this, the TPAs brokered a truce with the fund companies. The TPAs then included the companies' funds in the menu of investments they provided, linking the parties' technology so participants could execute trades. They also provided free record-keeping and other administrative services to sponsors. In the background, the partners shared revenue.

TPAs now had leverage over the mutual-fund companies because they could offer an array of mutual-fund families. The mutual-fund companies became lesser players, a situation they remedied by creating revenue-sharing arrangements with one another by permitting trades out of one fund family into another, while providing their own recordkeeping services or hiring the TPAs to do it for them.

On the upside it permitted plan participants to significantly diversify assets across several funds and fund classes. The down side was the complicated side deals that obscured the plan costs. Not that the bundled fee isn't listed in the prospectus. But the components of this fee (administrative expenses; trustee, audit, and legal costs; consulting expenses; statement fees; trading costs; potential performance bonuses; and the actual fund or investment fees) are unclear. There needs to be complete disclosure. The DoL is looking into revising the laws to make the revenue sharing arrangements more transparent.

To get the best deal, get an analysis of what you are paying versus what others are charging. Having an outside advisory firm perform the analysis may be the best solution.



## WHAT AUDITORS HAVE TO SAY ABOUT CFOs

- 1. What best describes the type of audit firm you work for?**
  - 27% Big 4 (Deloitte, E&Y, KPMG, PWC)
  - 38% Regional firm
  - 28% Local or single-office firm
  - 7% Mid-tier (Grant Thornton, BDO Seidman, others)
- 2. Which initiative is currently most important to your firm?**
  - 75% Getting more new clients
  - 68% Getting more work from current clients
  - 60% Hiring new staff
  - 33% Strengthening international reach
  - 5% Merging with another firm
- 3. What are the most important ways you feel you add value to your public clients' companies?**
  - 50% Depth of industry knowledge
  - 23% Reassurance about financial controls
  - 15% Information about new accounting rules
  - 6% International presence
  - 4% Insight into emerging risks
  - 1% Access to info about other companies for benchmarking
- 4. Compared to 3 yrs ago, how has your client relationships changed?**
  - 62% It has gotten better
  - 7% It has gotten worse
  - 31% No change
- 5. What creates the most stress for you on a day-to-day basis?**
  - 54% Long hours
  - 53% Clients not prepared
  - 36% Clients difficult to work with
  - 33% Fee pressure from clients
  - 22% Pressure from firm to generate more revenue
  - 14% Fear of lawsuits
  - 14% Fair-value issues (non-real-estate-related assets)
  - 13% Threat of a PCAOB audit
  - 9% Valuation of real estate-related assets
  - 5% Preparing for IFRS
- 6. What is the biggest mistake clients make that reduces the efficiency of audits?**
  - 46% Not having work papers prepared
  - 17% Not involving auditor early enough in major accounting decisions
  - 16% Poor client attitude, lack of cooperation
  - 13% Starting the audit process too late
  - 7% Not having enough staff
  - 1% Not having a designated point person
- 7. How have your audit processes changed as a result of Auditing Standard No. 5?**
  - 46% Some changes, review fewer controls & transactions
  - 16% No change
  - 12% Major changes, review far fewer controls & transactions
  - 26% Not applicable
- 8. What issues are most likely to add to audit costs in the next year?**
  - 34% Fair-value issues (FAS 157, FAS 159, etc)
  - 28% Short supply of audit staff
  - 16% Section 404 (for nonaccelerated filers)
  - 12% New format for financial statements
  - 9% IFRS
  - 1% XBRL

Source: March 2008 survey of 95 auditors by CFO magazine conducted through the CPA societies of MA, TX, CA, NY and through Grant Thornton

## WHAT CFOs HAVE TO SAY ABOUT AUDITORS

- 1. What best describes your audit firm?**
  - 59% Big 4 (Deloitte, E&Y, KPMG, PWC)
  - 24% Regional firm
  - 13% Mid-tier (Grant Thornton, BDO Seidman, others)
  - 4% Other
- 2. How satisfied are you with your auditor?**
  - 42% Very satisfied
  - 44% Somewhat satisfied
  - 14% Not satisfied
- 3. If you are not satisfied, why not?**
  - 49% Too expensive
  - 46% Too concerned about its own liability
  - 42% Not enough guidance provided
  - 38% Audits are too detailed
  - 37% Too much turnover on its team
  - 35% Not able to resolve questions at the local office level
  - 30% Requires too much time from company's finance team
  - 19% Other
- 4. How does your auditor add value to your company?**
  - 31% Information about new accounting rules
  - 22% Depth of industry knowledge
  - 21% Reassurance about financial controls
  - 7% Insight into emerging risks
  - 6% International presence
  - 3% Access to other companies for benchmarking
  - 10% Doesn't add value
- 5. How did your audit costs change from 2007 to 2008?**
  - 82% Increased
  - 10% Stayed the same
  - 6% Decreased
  - 3% Don't know
- 6. How do you expect your audit costs to change from 2008 to 2009?**
  - 73% Increased
  - 16% Stayed the same
  - 6% Decreased
  - 4% Don't know
- 7. What issues might add to your company's audit costs next year?**
  - 37% Fair-value issues (FAS 157, FAS 159, etc.)
  - 20% Short supply of audit staff
  - 20% New format for financial statements
  - 12% International financial reporting standards
  - 10% Section 404 (for nonaccelerated filers)
  - 2% XBRL
- 8. Have you seen any changes in your audit as a result of AS<sub>5</sub>?**
  - 64% No change
  - 31% Some changes, auditors review fewer controls
  - 2% Major changes, auditors review far fewer controls
  - 4% Other changes
- 9. Do you meet with auditors ahead of the audit?**
  - 70% Always
  - 21% Sometimes
  - 9% No
- 10. Do you prepare your audit work papers before the audit?**
  - 54% Always
  - 37% Sometimes
  - 10% No

Source: March 2008 survey, CFO magazine of 205 finance executives  
Answers will not add up to 100% because rounding or multiple responses were allowed.

## A NEW TOP COP FOR CORPORATE FINANCE?

### Treasury Secretary Paulson mulls over an idea for a new and improved replacement for the SEC.

Tucked away among the five new regulators called for in U.S. Treasury Secretary Henry Paulson's blue-sky blueprint for reforming the financial-services industry is an authority of special interest to CFOs: a corporate finance regulator.

Under the long-range provisions of the U.S. Treasury's Blueprint for Financial Regulatory Reform, announced by Paulson in March, corporate-finance executives in most industry sectors would deal with a regulator very similar to the Securities and Exchange Commission that CFOs deal with today. In the regulatory structure Paulson envisions over the long term, a corporate finance regulator

*"The Fed would have the authority to go wherever in the system it thinks it needs to go for a deeper look to preserve stability."*

would hold sway over "the SEC's current responsibilities over corporate disclosures, corporate governance, accounting and auditing oversight, and other similar issues."

But that regulator would be less than simply a rebranded SEC. Paulson proposes splitting off the SEC's current functions as a regulator of secondary securities markets, broker dealers, exchanges, and the like. In an "intermediate-term recommendation," he suggests those functions be merged with those of the Commodity Futures Trading Commission.

The Fed would also see its role revised, but in the other direction: it would reign at the top of Paulson's hierarchy, as a market stability regulator. Besides the Fed's familiar roles of installing monetary policy and supplying liquidity to banks, the Treasury Secretary wants it to take on "a different, yet critically important regulatory role with broad powers focusing on the overall financial system.... The Fed would have the authority to go wherever in the system it thinks it needs to go for a deeper look to preserve stability."

Whether any of this comes to pass remains to be seen, of course, and given that this is an election year, there's no telling exactly how lawmakers will act to address the current economic situation.

David M. Katz • CFO Magazine, May 2008

## CAUSES FOR CONCERN

### CFOs continue to worry about consumer spending and the labor market.

TOP EXTERNAL CONCERNS	AVERAGE IMPORTANCE SCORE
1. Consumer demand	1.35
2. Credit markets/interest rates	0.88
3. Housing-market fallout	0.69
4. Cost of fuel	0.66
5. Cost of nonfuel commodities	0.55
6. Upcoming change in U.S. Administration	0.48
7. Other	0.41
8. Financial regulation	0.30
8. Devaluation of the U.S. dollar	0.30
9. Environmental regulation	0.14
10. Int'l political instability	0.11

### TOP INTERNAL, COMPANY-SPECIFIC CONCERNS

1. Cost and availability of nonfinance labor	1.35
2. Ability to forecast results	1.29
3. Cost of health care	1.20
4. Supply-chain risk	0.76
5. Other	0.42
6. Data security	0.39
7. Cost and availability of labor in accounting/finance	0.30
8. Auditing costs	0.12

Source: Duke University/CFO Global Business Outlook Survey

Methodology: Respondents were asked to rank their top three concerns. The average importance score reflects the weighted average that resulted for each concern. Based on 475 respondents in the United States.

Kate O'Sullivan • CFO Magazine, May 2008



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