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The Equivocal Economy

by Patrick J. O'Keefe, Director of Economic Research

Adolescents often rely on "yeah-but" equivocations to explain the complexities of reality. (For example: "Yeah-but I wouldn't have been late if I wasn't stopped for speeding.")

In light of the erratic behavior of the economy since the end of the "Great Recession" we should name the rebound the *"Yeah-But Recovery"* ("YBR") as in: "Yeah-but it's not as bad as it was," and "Yeah-but it's not as good as it should be."

Federal Reserve Chair Ben Bernanke best summarized the implications of the YBR when he testified that "the economic outlook remains unusually uncertain."

This has been a YBR from the start. Its beginning wasn't announced until 15 months after the event by the National Bureau of Economic Research ("NBER"), in what was tantamount to a yeah-but release (cf., http://www.nber.org/cycles/sept2010.html).

In making its determinations, the NBER examines a range of "measures that refer to the total economy," including Gross Domestic Product ("GDP"), data on incomes and wholesale/retail sales, and indicators of output. Its determinations are not based on a "fixed formula;" but are, instead, an informed judgment of when the shift from contraction to growth *(or vice versa)* occurred.

So now, some 30 months after the recession "officially" ended, has the economy yet **recovered**, based on the NBER's criteria? That is: has it returned to pre-recession levels?

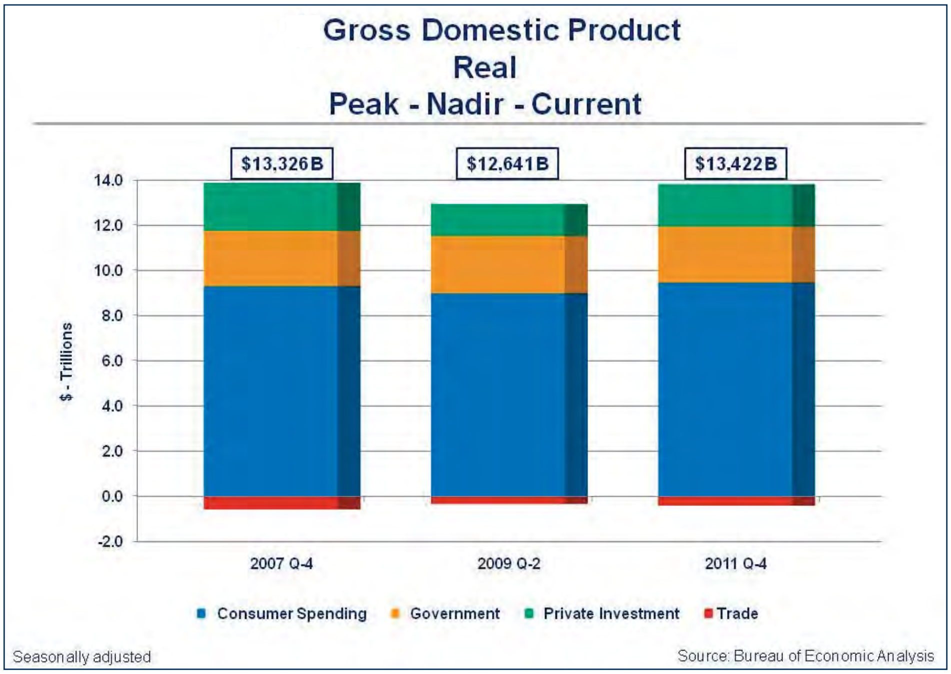
The answer is a resoundingly equivocal: "Yeah-but...."

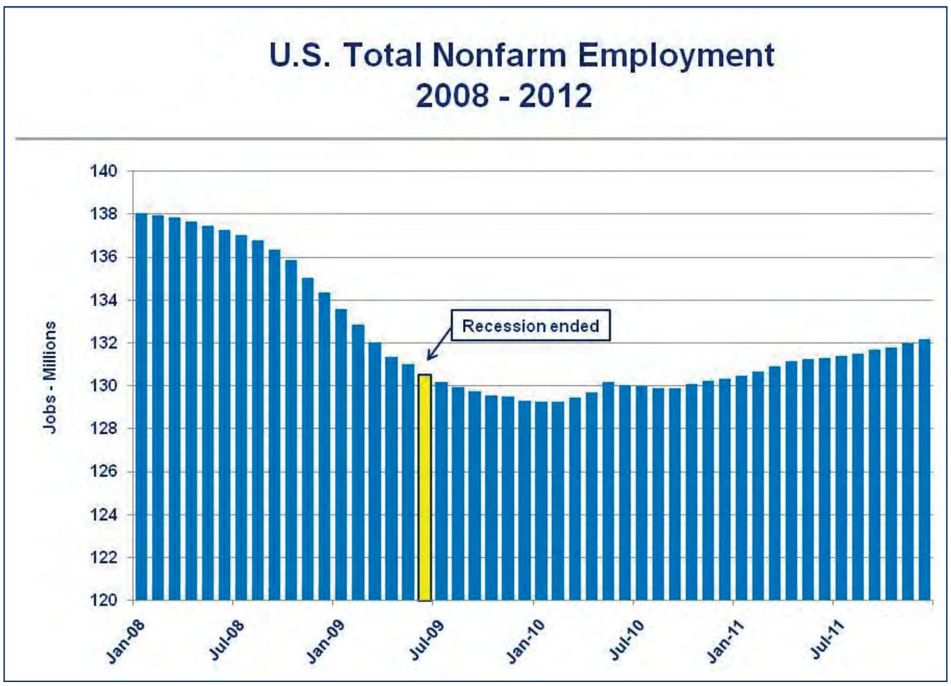
On the broadest measure of activity, real GDP (i.e., total output adjusted for inflation), the economy ended 2011 just above where it stood at the end of 2007. So if GDP were the only measure of the economy's health, we would declare its recovery to be complete... if only by a cat's whisker.

Yeah-but on other key indicators the economy either: remains below pre-recession levels (e.g., employment conditions and industrial production; or, like retail sales, has surpassed them only because of inflation).

Yeah-but aren't after-tax incomes, even when adjusted for inflation almost $1 trillion more than prior to the downturn? Yeah-but not because more workers are earning more, but largely because income transfers are up and taxes down.

Indeed, wage and salary disbursements (i.e., dollars in paychecks) were only 57.4% of after-tax incomes in 2011, essentially unchanged from 2010's record low (57.3%).





When adjusted for inflation, however, disbursements are 4.2% below where they were in December 2007. That is to say: working households' purchasing power has yet to recover.

The yeah-but character of the recovery has contributed to its sluggish pace and stutter-step progress. Early on, it restrained household confidence; and then, mid-2011, caused it to falter.

Since then, however, the consumer's outlook has improved robustly as job growth began to accelerate. During the six months through January, confidence rose more than in any other six-month period since March 1991. Yet, despite that, it remains weak.

Similarly, after sliding downward for much of 2011, business confidence rose smartly in the final quarter. The outlook is for activity to improve at least through the summer.

Which brings us to the outlook for the remainder of the year, beginning with the question: does heightened confidence among businesses and households imply that the economy is shifting from a yeah-but to a no-but recovery?

The answer is: Yeah-but, equivocally.

One reason for equivocation is that U.S. exports will slow due to the financial turmoil and recession in the Eurozone and slower growth in emerging economies. Another is the drag arising from fiscal consolidation domestically.

Yeah-but what about consumer spending, which comprises about 70% of GDP? Won't rising employment translate into more spending by households?

Yeah-but over the past year consumer spending has increased more rapidly than after-tax incomes, while savings have declined. And households have become much more judicious in their use of credit: keeping credit-card balances low, while borrowing for cars and student loans. Consumer spending will grow, but only in line with nominal after-tax incomes.

And despite the improvements in employment, incomes, and sentiment, there is little prospect of a rebound in housing activity. Instead, given that homeowner equity is less than one-half its 2007 peak, housing will continue to constrain consumer spending.

Yeah-but with corporate profits at record levels and businesses feeling optimistic, won't they invest more?

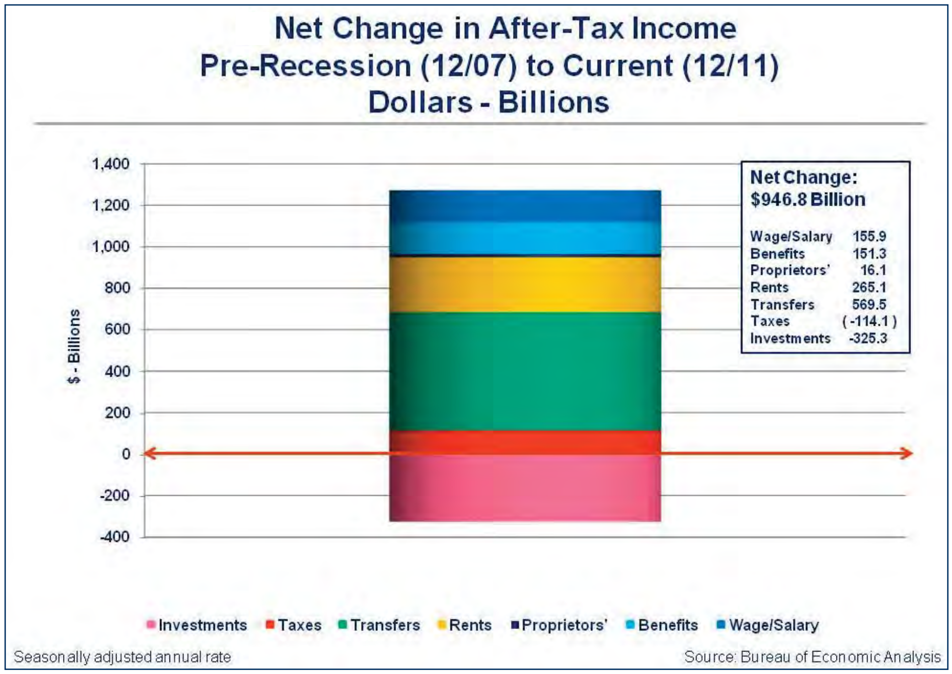
Yeah-but a considerable share of those profits were earned outside of the U.S. and would be subject to additional taxes before they could be spent or invested domestically. Nevertheless, some increase is expected in business investments in plant, equipment, software, and inventory, which have been a mainstay of the recovery. But in absolute dollars, the boost will be limited.

Outlook

The view here has long been—and remains—that the economy would recover only slowly from the 2007-2008 recession and the coincident meltdowns in the financial and housing sectors.

Over the past few months, several indicators—most notably those relating to labor markets—have seen a modest increase in momentum. That is certainly positive and looks likely to continue into the second half of the year.

Yeah-but, what lies beyond the fourth quarter, when national elections occur and the temporary fixes that pass for Federal fiscal policy expire? There we stand with Mr. Bernanke: "the economic outlook remains unusually uncertain." But, we do so equivocally. ■



To view all of the charts associated with this article, click here.

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Hedging Your Bets Against the Whistleblower Trifecta

Today, in light of potential rewards and proffered protection, the motivation to report fraud to the Department of Justice ("DOJ") or the Securities and Exchange Commission ("SEC") is greatly increased. The passage of the Dodd-Frank Wall Street Reform and Consumer Protection Act and the 2010 debut of the SEC's Office of the Whistleblower have greatly increased the incentive for a whistleblower to come forth with information about corporate wrong-doings.

As a result, companies must evaluate their anti-fraud and anti-bribery/corruption policies and processes to further insulate themselves against events that could lead to a DOJ/SEC investigation and significant fines and costs.

Recently, executives from LeClairRyan, an entrepreneurial law firm, and J.H. Cohn LLP, one of the leading audit, tax, and consulting firms in the United States, gathered to discuss the impact of increased regulation, the renewed focus on regulations surrounding bribery and corruption, and the resulting increase in claims, and what companies can do to prevent as well as handle allegations of fraud, bribery, or other corporate wrongdoings.

J.H. Cohn and LeClairRyan have produced an overview of the issues discussed, available at www.jhcohn.com. Following is an excerpt from that document:

Whistleblower actions are nothing new, but with the advent of new regulations and increased enforcement by the DOJ and SEC pertaining to the Foreign Corrupt Practices Act of 1977 ("FCPA"), along with similar regulations in many foreign countries, whistleblower motivation, claims, and awards have risen substantially. In fact, in just the first few weeks of the SEC's whistle-blower program almost 400 tips were received by the SEC. Clearly, as these claims are just starting to go through the Office of the Whistleblower, 2012 will likely be known as "the year of the whistleblower."

In fact, rewards now have the potential to range between 10 percent and 30 percent of monetary sanctions collected as a result of regulatory action, and an "open-door policy" means that all with cause are welcome to blow the whistle on perceived wrongdoing, anonymously, with the added bonus of protection against retaliation. Awards to whistleblowers in the millions of dollars are becoming much more prevalent.

A "bounty hunter" mentality is setting in and companies must aggressively assess their internal policies and compliance programs to have any chance of successfully navigating these potentially troubled waters.

The Role of the Foreign Corrupt Practices Act in Detracting Criminal Activity

Triggers for whistleblower actions may include securities fraud, healthcare/Medicare fraud, or significant internal control deficiencies but consensus is that the FCPA has been a major driver for reform.

The FCPA, which is jointly enforced by the SEC and the DOJ, prohibits U.S. companies and citizens, foreign companies listed on a U.S. stock exchange, or any person acting while in the U.S. from corruptly paying or offering to pay, directly or indirectly, money or anything of value to a foreign official to obtain or retain business (commonly referred to as the Antibribery Provisions). The FCPA also requires issuers with securities traded on a U.S. exchange to (1) file periodic reports with the SEC, (2) keep books and records that accurately reflect business transactions, and (3) maintain effective internal controls. This rule was made to help ensure that transactions are executed according to management's general or specific authorization and that they are recorded to permit the preparation of financial statements in conformity with generally accepted accounting principles, and to maintain accountability for assets.

The repercussions for noncompliance are harsh and may include such disciplinary action as fines, prison,

civil penalties, and debarment from contracting with the U.S. government. And it's not the alleged wrongdoers who would be responsible for the accused actions, said William A. Despo, a LeClairRyan shareholder and leader of the Firm's Financial Services Litigation and Regulation team.

"It is possible for a parent company to be held responsible for the conduct of its subsidiaries under SEC rules even if it had no knowledge or suspicion of FCPA violations," said Despo. Today, greater resources are being dedicated to FCPA compliance than ever before. The DOJ has reported that it prosecuted more FCPA cases in 2008 and 2009 than in the preceding 20 years combined. Improved information-sharing arrangements and prosecution by foreign regulators, both via treaties and informal arrangements, have gone far in cracking down on FCPA violations, as have industry-wide probes, the prosecution of individuals, and the potential for reward. Further, stiffer corporate and civil penalties and a more stringent focus on non-traditional bribes and payments made through intermediaries, such as agents or consultants, have detracted from any remaining allure that an FCPA violation may hold, regardless of perceived short-term gains.

"It now goes beyond cash exchanges," said Anthony Zecca, CPA, managing partner of Cohn Consulting Group, a division of J.H. Cohn LLP. "Now, the DOJ and SEC are looking at travel and entertainment, charitable donations, family perks—essentially anything of value—and there is no materiality factor."

Carlos Ortiz, a shareholder at LeClair-Ryan added, "The new provisions are a game changer. There is so much money on the table, it is too much to ignore. There is now a global army of lawyers and forensic accountants working for the DOJ and SEC who are actively investigating allegations, pursuing higher fines, and sharing information across borders, making it almost impossible for perpetrators to escape."

The FCPA compliance program, for its strengths, continues to evolve and is subject to its own potential downsides. Though considered a "gold standard" compliance program on paper, deficiencies exist in numerous areas, including the dedication of resources to ensuring the control objects are being met and resources charged with ensuring the program is implemented and fully functioning throughout the company. Further, third-party risk mitigation and education remains an ongoing problem, as do varying interpretations of FCPA by international bodies. The UK Bribery Act, for example, has a much broader definition than does the FCPA, which in turn requires additional compliance research to be conducted by an entity prior to engagement in foreign activities.

"In certain countries, corporate officers say that bribery is a natural course of getting business done but leadership has to enforce an international anti-fraud corporate culture," said Cohn Consulting Group's Zecca. "Management needs to take a stand and simply not do business in countries where that is the modus operandi, because that is no longer a excuse or defense against violations of the FCPA." In many ways, he added, the only good defense is a very strong, documented, and carefully executed compliance program, which demonstrates that a company took reasonable steps to prevent the FCPA violation.

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"Hedging Your Bets Against the Whistleblower Trifecta" goes on to discuss the False Claims Act, fraud and the role of ethics in its existence, fraud prevention, and steps to take when fraud occurs. ■

Click here to download the complete report.

U.S. Citizens, Residents Remain Taxable on Worldwide Income Regardless of Stateside Presence

by Gary Lubowiecki, CPA

One of the most common misconceptions about the international aspects of U.S. individual income taxation is that income earned or received by an individual outside of the U.S. is not taxable for U.S. income tax purposes.

To the contrary, the U.S. stands alone among industrialized countries in taxing its citizens and residents on their worldwide income even if they are not present in their home country. The fact that the income may have been physically paid outside of the U.S. and never remitted into the U.S. makes no difference.

For example, a U.S. employer may send a U.S. citizen or permanent resident to work in a foreign country either on a temporary or permanent basis on an assignment either directly for the U.S. employer or for a foreign affiliate of the U.S. employer. Employers and employees are often surprised to learn that, as a U.S. citizen or resident alien, the employee remains subject to U.S. income tax on his worldwide income. They often are incorrectly under the impression that the income cannot be taxable for U.S. income tax purposes because the income was paid outside of the U.S. by a foreign affiliate, or that foreign income tax was paid on the income, or that the income was never brought into the U.S. These circumstances, however, do not change the fact that the income is taxable for U.S. income tax purposes and must be declared on an annual U.S. income tax return. While there are special rules allowing U.S. citizens working abroad to elect to exclude part or all of their compensation income from their gross income, that income must still be declared on an annual U.S. income tax return. For 2011, an eligible individual may elect to exclude up to $92,900 of foreign earned income from gross income, but the individual must still timely claim the exclusion on his return.

In addition to complying with all U.S. income tax rules, the employer must also be careful to comply with any foreign reporting and withholding requirements both on an individual and employer basis. Similarly, the fact that an employee may be paid from the U.S. does not automatically mean that the employee's compensation is not subject to foreign income or social taxes in the foreign country. Also, the corporate tax ramifications of employing an individual in a foreign country must be carefully reviewed.

Another common fact pattern is a teacher or entry-level employee working abroad. Sometimes such an individual assumes that he is simply not taxable for U.S. income tax purposes because he is living and working outside of the U.S. Alternatively, the individual may be aware of the foreign earned income exclusion and simply assume that he is not required to file a U.S. income tax return because his compensation is well below the maximum amount of the exclusion. As noted above, the foreign earned income exclusion is not automatic. The income must be declared and the exclusion claimed on a timely basis.

A third common situation is an individual who receives an inheritance from a foreign estate or receives income from a foreign trust. For example, a nonresident alien may die abroad leaving non U.S. situs property, such as an investment portfolio in foreign securities or a foreign rental property, to a U.S. citizen. The gross income that the property generates is taxable for U.S. income tax purposes. The fact that the income from the property may be in a foreign currency, or that the rental of the property results in a loss, does not change the fact that the income must be reported on a timely filed U.S. income tax return.

Another common misconception regarding the international aspects of U.S. individual income taxation is that the income of non-U.S. citizens or residents is automatically not taxable for U.S. income tax purposes if it is paid or received outside of the U.S.

Also, an individual may be the owner of a foreign trust or the recipient of income from a foreign trust. The income from the foreign trust must be reported on the individual's U.S. income tax return. In addition, there are information returns which must be filed regarding the ownership and/or receipt of income from foreign trusts and the failure to file the required information returns on a timely basis may result in the assessment of Draconian penalties. Even if an individual has no income from foreign sources, he or she may still be required to file Form 90-22.1, Report of Foreign Bank and Financial Accounts, if there is a financial interest in or signature authority over a foreign bank or financial account(s) which exceeded $10,000 in the aggregate at any time during the year. Form 8938, Statement of Specified Foreign Financial Assets, is brand new and generally must be filed by an individual living in the U.S. who has an interest in certain foreign financial assets which exceeded $50,000 on the last day of the tax year or $75,000 at any time during the tax year. The filing thresholds are increased to $100,000 and $150,000 for married taxpayers filing joint returns. There are also larger thresholds for individuals living outside of the U.S.

There are also individuals who deliberately fail to report their foreign source income on their returns. For example, U.S. persons hiding assets in Swiss bank accounts have received a great deal of publicity over the past few years. In any case where income has not been reported, legal counsel should be retained by the individual; in turn, qualified tax advisors, such as those at J.H. Cohn, can then be retained by legal counsel under what is known as a *Kovel* arrangement. Those accounting services are retained by legal counsel that allows any communications between the contracted tax advisors and the client to be protected under the attorney-client privilege.

Another common misconception regarding the international aspects of U.S. individual income taxation is that the income of non-U.S. citizens or residents is automatically not taxable for U.S. income tax purposes if it is paid or received outside of the U.S.

In certain limited situations, nonresident aliens are exempt from U.S. income tax on certain types of income. For example, a nonresident alien is not subject to U.S. income tax on interest income from U.S. bank deposits. Generally, the starting point to determine what income is subject to U.S. income tax by a nonresident alien is the premise that all U.S. source income is taxable for U.S. income tax purposes. The U.S. generally sources compensation income based upon where the services have been performed, not where the compensation is paid. Thus, a foreign national coming to the U.S. and working in the U.S. even for one day may be required to file a U.S. individual income tax return and pay U.S. income tax even though his salary is paid in foreign currency outside of the U.S. Non-U.S. employers are often surprised to learn

U.S. citizens and permanent residents are taxable on their worldwide income even if that income is paid outside of the U.S. and not brought into the U.S. Unless exempt by treaty, nonresident aliens are generally subject to U.S. income tax on U.S. source income even if that income is paid outside of the U.S.

that the place of payment is not outcome determinative and that even though the employee has remained on a foreign payroll the employee is subject to U.S. income tax. A non-U.S. employer may also incorrectly assume that because there is an income tax treaty between the home country and the U.S., the compensation income earned by the employee in the U.S. is exempt from U.S. income tax. While the U.S. has negotiated income tax treaties with many of its trading partners, the fact that the employee comes from a country with which the U.S. has an income tax treaty does not automatically mean that the employee is not subject to U.S. income tax. While treaties may be similar, each is unique and must be separately applied to the particular set of facts. In very general terms, treaties provide for an exemption from U.S. income tax for compensation paid to a nonresident alien by or on behalf of a non-U.S. employer where the employee is physically present in the U.S. for less than 183 days and the compensation income is not charged back to a permanent establishment held by the employer in the U.S. While it may initially appear that an employee may qualify for treaty relief, the provisions of the applicable treaty must be applied to the facts. For example, the individual must generally be an employee of the foreign company, not the U.S. company, to qualify for treaty relief. Also, the employee cannot be physically present in the U.S. for more than 183 days. Some treaties apply the 183-day-rule on a taxable (calendar) year basis while other treaties apply the 183-day-rule to any period of 12 consecutive months. Even if it is determined that an income tax treaty applies to a given situation, it is important to remember that the treaty may not always apply for state income tax purposes. For example, New Jersey does not generally recognize income tax treaties for purposes of the New Jersey gross income tax.

Non-U.S. employers must also comply with all U.S. reporting and withholding rules if they pay U.S. source compensation to an employee even if that compensation is paid outside of the U.S. The corporate tax ramifications of employing individuals in the United States must also be carefully reviewed.

In summary, U.S. citizens and permanent residents are taxable on their worldwide income even if that income is paid outside of the U.S. and not brought into the U.S. Unless exempt by treaty, nonresident aliens are generally subject to U.S. income tax on U.S. source income even if that income is paid outside of the U.S. ■

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Healthcare Reform: What to Expect in 2012

by Jill Bergman, CEBS and Kevin Quinn

After passage of the Affordable Care Act ("ACA" or "the Act") in March 2010, employers and plan sponsors scrambled to understand the implementation timeline and swiftly turned their attention to the initial mandates contained in the Act. Fully insured and self-funded plans have extended coverage to young adult dependents up to age 26, removed lifetime limits on essential benefits, began to cover required preventive services with no member cost sharing, and wrestled with the concept of grandfathered plans and what benefit that status might offer.

While the initial ACA frenzy has calmed (somewhat), healthcare reform continues to proceed, but not without a few diversions along the way. Some portions of the law have already been repealed, such as the enhanced 1099 reporting requirement. In this article, we will highlight what plan sponsors can expect in 2012 and summarize what ACA issues the Supreme Court may decide on this term.

W-2 Reporting Requirements

Employers will need to report the cost of healthcare coverage for each participating employee on employees' 2012 W-2 statements. Interim guidance eased the overall compliance burden and granted exemptions to smaller employers (those who issued less than 250 W-2 statements in 2011) and employers who contribute to a multiemployer plan.

In general, only annual medical plan costs will need to be reported on the W-2 statement (Box 12, Code DD) as the interim rules allow employers to disregard amounts contributed to stand-alone dental and vision plans and health reimbursement arrangements ("HRA"). Amounts contributed to health savings accounts ("HSA"), accident or disability insurance, or salary reduction elections to a healthcare flexible spending account (unless optional employer flex credits are offered) are also excluded from the determination.

The Uniform Summary of Benefits and Coverage ("SBC")

Beginning September 23, 2012, all fully insured and self-funded plans will be required to provide summaries of benefit plan information along with a glossary of common insurance and medical terms in a format and manner prescribed by law and implementing regulations. The SBCs must include specified coverage information as well as two examples illustrating how the plan may cover the costs for "having a baby" and "managing Type II diabetes." The SBCs generally must be distributed with group plan enrollment materials as stand-alone documents, or may be included with the Summary Plan descriptions if prominently featured. The SBCs must be no longer than four double-sided pages, use 12-point font, and precisely replicate all symbols, formatting, bolding, shading, and page breaks as described in the SBC Instruction Guide.

Employers to Help Fund the Patient-Centered Outcomes Research Fund

The Patient-Centered Outcomes Research Fund was established to evaluate outcomes and the effectiveness of healthcare services in order to identify and recommend the best course of action to treat and prevent disease. The ACA imposes a fee on self-funded and fully insured plans to help support this effort. For plan or policy years that end after September 30, 2012 (stated another way—plan or policy years that begin after October 1, 2011), the fee is equal to the product of $1 multiplied by the average number of lives covered under the plan. The annual fee, which will increase to $2 (also multiplied by the average number of lives covered under the plan) the following year, can be increased in the future and is scheduled to end in September 2019.

Wellness Reporting

By March 2012 the Department of Health and Human Services ("HHS") must develop wellness reporting requirements for insurers and group health plan sponsors. Insurers will be required to report on such activities as case management, care coordination, chronic disease management, preventing hospital readmissions, and improving patient safety. Employers may need to provide details regarding efforts to implement wellness and health promotion activities in the workplace. Plan sponsors will provide annual reports to HHS and to plan participants at open enrollment. HHS has the authority to impose penalties for noncompliance.

Medical Loss Ratio Rules

Beginning with the 2011 calendar year, insurance carriers in the small group market must spend at least 80 percent (85 percent in the large group market) of the premiums they collect on medical services (such as claim payments) and on activities that improve healthcare quality. Carriers will report the aggregate Medical Loss Ratio ("MLR") results by state with respect to the policies they issue separately in the large group, small group, and individual markets. Carriers that fail to meet these targets must issue a rebate to plan sponsors by August 1 of the following calendar year.

Beginning with the 2011 calendar year, insurance carriers in the small group market must spend at least 80 percent (85 percent in the large group market) of the premiums they collect on medical services (such as claim payments) and on activities that improve healthcare quality.

In general, employer-sponsored plans may need to treat the portion of the rebate attributable to employee contributions as plan assets subject to ERISA fiduciary provisions, unless plan documents state otherwise, the employer paid the full cost of coverage, or the plan is not subject to ERISA. The plan sponsor needs to ensure that the rebate is used to benefit covered employees such as reducing employee contributions, providing benefit enhancements, or paying individual rebates.

Coverage of Additional Preventive Services for Women

Non-grandfathered, fully insured, and self-funded plans will be required to cover the following women's preventive services as of the first plan year that begins on or after August 1, 2012, with no member cost sharing (deductible, copayment, or coinsurance payments) as follows:

- Annual well-woman visits for preventive care services that are age and developmentally appropriate;

- Gestational diabetes screening for women 24 – 28 weeks pregnant and women at high risk for developing gestational diabetes;
- Family planning services, including Food and Drug Administration-approved contraceptives, sterilization procedures, and education and counseling services;[1]
- High-risk human papillomavirus DNA testing every three years for women age 30 and older, regardless of Pap smear test results;
- Annual HIV and sexually transmitted disease screenings;
- Breastfeeding support and counseling services as well as lactation supplies and devices; and
- Domestic violence screening and counseling.

CLASS Dismissed

The long-term care Community Living Assistance Services and Supports ("CLASS") program included in the ACA will not proceed at this time due to concerns about the program's financial soundness. CLASS was intended to provide a minimum $50 lifetime daily benefit to individuals having difficulty with activities of daily living such as eating, bathing, and dressing. Enrollees would be required to pay premiums for at least five years before becoming eligible to receive benefits.

The Road to the Supreme Court

Since it was signed into law, numerous challenges to the ACA have been brought by individuals, states, and a variety of business groups. One of the central issues the Court will decide is whether Congress has the authority under the Constitution's commerce clause to require all Americans to buy health insurance or pay a penalty (individual mandate). Opponents argue that Congress cannot regulate inactivity (such as a decision not to purchase health insurance) as commerce. Lower court rulings have been mixed on this issue.

The Supreme Court is expected to rule on the issues by the end of June 2012. The timing will no doubt play a role in the 2012 elections and presidential race.

The United States Supreme Court has agreed to hear an unprecedented six hours of oral arguments on March 26 – March 28, 2012. The Supreme Court will review four key ACA issues as follows:

- **Anti-Injunction Act** — A lower court ruled that the constitutionality of the individual mandate cannot be considered until after the mandate takes effect in 2014 and tax liabilities are imposed (April 2015), as no individual has yet been harmed by the individual mandate.
- **Individual mandate** — Does Congress have the power to require individuals to purchase a product (i.e., insurance) in the private marketplace or be subject to a penalty?
- **Severability** — The Court must decide if the remainder of the ACA will be allowed to stand should the Court declare the individual mandate to be unconstitutional. Many believe that if the individual mandate is struck down, the entire law will be compromised as premiums (or tax penalties) must be collected from everyone in order to spread the risk and costs among the entire population. Others suggest many facets of the law are not intertwined with the individual mandate (such as extending coverage to adult children up to age 26) and that alternative options are possible if the individual mandate is struck down.
- **Medicaid** — The states argue that the ACA's expansion of Medicaid should be struck down on the ground that it unconstitutionally "coerces" state governments to expand the program in order to continue to receive Federal funding for the Medicaid program. Lower courts have allowed this provision to stand.

The Supreme Court is expected to rule on the issues by the end of June 2012. The timing will no doubt play a role in the 2012 elections and presidential race.

More information about the various ACA provisions can be found on the DOL website, located at www.dol.gov/ebsa/healthreform/. ■

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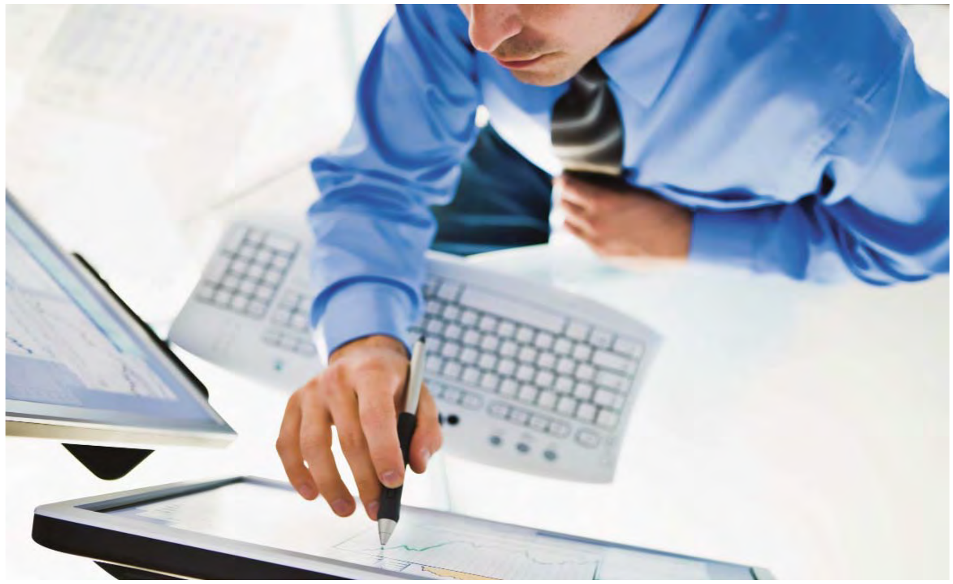
**Cohn Benefits Consultants is a joint-venture between J.H. Cohn LLP and Chernoff Diamond, Co., LLC.*

[1] *This provision (with modification) is delayed until August 1, 2013 for certain religious institutions.*

A Primer: 401(k) Plan Investments and Fiduciary Responsibilities

by Michael M. Eisenberg, Esq.

Two of the most important and challenging aspects of an employer's fiduciary duties are (i) the selection of suitable 401(k) investment options and (ii) providing participants with appropriate tools and guidance to facilitate the intelligent investment of their account balances. For many participants, 401(k) and profit sharing plan account balances represent not only their retirement savings but also a substantial portion of their overall assets and sometimes even an emergency fund that may be accessed through loans and, in extreme cases, hardship withdrawals.



While participants generally understand that participating in a 401(k) plan is a smart thing to do, they frequently do not have the knowledge and/or experience to properly invest their account balances. Surveys consistently point to the fact that plan participants need and want guidance in this regard. Similarly, while most employers want to help, they are sensitive to the time, required expertise, and liability associated with such an undertaking.

The solution and challenge: Selecting 401(k)/profit sharing plan service providers that have the expertise, experience, and resources to (i) advise on (and monitor) the proper selection of investment options and (ii) deliver effective guidance and tools to enable participants to make prudent investment decisions.

Selecting 401(k) Plan Service Providers

Arguably, the most important decision a plan sponsor makes is which service provider(s) to hire. The right service provider delivers the advice and administrative support necessary to make a plan function effectively and efficiently. This in turn produces better results that serve to attract and retain employees while minimizing administrative burdens and fiduciary liabilities.

So, what should a plan sponsor consider in order to make an informed decision when selecting service providers? There are a number of factors that should be evaluated, including the (i) scope and quality of advisory services, (ii) depth and breadth of investment options, (iii) administrative systems and support services, (iv) educational and investment guidance for plan participants, and (v) fees.

The last factor noted above (service provider fees) represents the biggest potential source of misinformation in retirement plan management. Historically, retirement plan "vendors" have been able to avoid the full disclosure of direct and indirect fees received from the employer and/or other sources such as mutual funds. Indeed, payments by mutual funds to service providers are a common source of indirect revenue. This so-called "revenue sharing" often results in significantly greater than reported fees/expenses, with significant adverse impact on net investment performance and benefit accruals.

In recognition of this and other issues, the Department of Labor ("DOL") is requiring greater fee and expense disclosure. However, the disclosure requirements have yet to be fully implemented and generally apply only to larger company plans, leaving many plan sponsors to take it upon themselves to request and evaluate the appropriate information. Clearly, plan sponsors should require service providers to disclose all sources (direct or indirect) and amounts of revenue.

When designing and implementing a retirement plan, employers need to ask and answer many questions. For example: What type of 401(k) plan is right? What is the smartest plan structure? Should the plan sponsor elect safe harbor? Does it make good business and employee benefit sense to integrate the 401(k) with a profit sharing or other form of qualified retirement plan? Should the plan sponsor consider implementing a supplemental plan to make highly compensated employees whole? What administrative support do we need? Do we need to provide retirement planning and investment guidance to participants? If so, how should we do it? What categories of investments are appropriate? How many alternatives are enough and not too much? Selecting an independent, experienced, expert advisor is therefore critical to the overarching objectives of optimizing plan results on the most efficient basis possible.

The availability of a wide range of suitable and excellent investment options is similarly important. Since investment options must be reviewed and perhaps changed from time to time, it is important that a broad range of appropriate mutual funds be available at all times. In addition, to assist plan participants in selecting appropriate investment options, it is helpful if the service provider makes available one or two special types of composite investment options: target date funds, which consist of a combination of equity, bond, and money market funds, and which will be invested more conservatively as time passes and the participant reaches his or her "target retirement date;" and structured portfolios, which also consist of equity, bond, and money market funds but which do not become more conservatively invested over time. Instead, such portfolios allow participants to invest based upon their respective risk tolerance.

Can plan sponsors get help in selecting 401(k) plan service providers? The short answer is yes, and the best place to start is often your accountant. Accounting firms generally know or work with employee benefits experts who can guide you through the complex retirement plan regulatory landscape. Some firms provide independent fiduciary and compliance reviews, while others can help solicit Requests for Proposals from investment advisors and/or plan administration firms, and aid in other aspects of conducting a vendor search.

Can plan sponsors get help in selecting 401(k) plan service providers? The short answer is yes, and the best place to start is often your accountant.

Selecting Plan Investment Options

An important aspect of an employer's fiduciary duty is determining the investment options available under the plan. What are the factors a plan sponsor should consider when determining how the investment lineup should be chosen for a participant-directed retirement plan such as a 401(k) plan? Ideally, a qualified retirement plan investment advisor should be employed.

An important aspect of an employer's fiduciary duty is determining the investment options available under the plan.

An advisor should enable the plan sponsor to put a formal written Investment Policy Statement ("IPS") in place. The IPS should:

- Detail the methodology that will be used in both selecting and monitoring the plan's investment lineup;
- Detail the steps that will be taken when the selection and monitoring criteria trigger changes to the fund lineup;
- List the criteria for benchmarking the relevant noted factors; and
- Incorporate fees and costs, and governance and management of investments, into the process.

Should a participant-directed retirement plan incorporate index mutual funds (or "Exchange Traded Funds," which act similarly to index funds) or actively managed funds? Ever since Burton Malkiel wrote his classic book "A Random Walk Down Wall Street" in 1973 and Vanguard introduced the first index mutual fund in 1976, there has been much debate about active versus passive management.

According to research published by Morningstar, only one-third of active funds beat their respective investment category index over a (recent) three-year period. Other studies have shown that, while active funds have often failed to beat their benchmarks, they do provide added value when a disciplined approach is adopted over longer periods. The selection of a qualified advisor, employing a strong, disciplined approach, can help plan sponsors navigate the selection process. Many knowledgeable advisors will employ a combination of actively and passively managed funds in 401(k) lineups. Investment management fees will clearly be a factor in making this determination. Index funds charge dramatically lower fees, while active managers must achieve sufficiently high returns in order to compensate for the higher fees they charge.

Providing Investment Advice to Participants

In addition to selecting best-in-class investment lineups, plan sponsors are increasingly seeking to provide help to participants in selecting from among those investment options. Many have simplified the decision-making process by making target date funds and/or structured portfolios available. In addition, some plan sponsors have gone further to make available to plan participants the services of qualified investment advisors.

Under recent final regulations issued by the DOL, plan sponsors and their service providers are permitted to provide such investment advice to plan participants using either a "certified computer model" or a "level fee arrangement." The computer model must be developed by a fiduciary advisor based on certain objective criteria and be subject to an annual audit, while the level fee arrangement must essentially guarantee that the fiduciary advisor's advice will not affect his or her fees (or those paid to his or her employer). In order to minimize potential fiduciary liabilities, plan sponsors who wish to make such advice available to their participants should make sure that their service providers are competent registered investment advisors who fully understand the rules. ■

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Numerous Opportunities for Aggressive Trust and Estate Planning Strategies Available in 2012

by Ira Herman, CPA

The start of the new year marked the half-way point in the two-year period during which the Bush-era tax cuts are extended and significant gift and estate planning opportunities are available. Because of this, we believe individuals should consider aggressively planning or readdressing various trust and estate issues before the end of 2012.

Increased Exclusions: Estate tax exclusion amounts are $5,120,000 per individual and $10,240,000 per married couple for 2012, and the top tax rate for estates in excess of the exclusion amount is 35 percent. Also, since the gift tax has been reunified with the estate tax, an individual's exclusion may be used for gifts during life or for assets passing upon death. Lifetime gifts over the exclusion threshold will be taxed at 35 percent. Further, there is still a $5,120,000 million generation-skipping tax exemption for 2012.

As of January 1, 2013, the gift tax and estate exclusion is scheduled to return to $1 million with a tax rate of 55 percent. This means an effective $4 million reduction on the opportunity to transfer wealth on a tax-free basis.

Portability: New portability rules allow a surviving spouse's estate to use any unused Federal estate and gift tax exemption. For example, if a husband dies survived by his wife and his estate only needed to use $3.5 million of his exemption, his wife can combine the unused portion of $1.5 million with her $5 million exemption, thereby passing an additional $6.5 million estate tax free. (It is important to note that a timely election must be filed upon death of the first spouse.)

Other Key Points to Consider

- **Every will, revocable trust, and power of attorney should be reviewed** for formula clauses and percentage allocations, among other things that may no longer work as expected.
- **State transfer taxes must be carefully considered** as they have a significant impact on costs and payments.
- **Portability should be considered in prenuptial agreements.** Many prenuptial agreements include formula clauses that were never addressed in 2009 or early 2010 to deal with repeal. These too should be reviewed to ascertain whether the $5,120,000 exclusion undermines their intent.
- Should you **continue rolling Grantor Retained Annuity Trusts** or just make outright gifts?
- Can you **eliminate or lessen guarantees on trust obligations** by adding additional gifts to the trust using the new $5,120,000 exclusion?

- What role should **discounted gifts** play in your estate planning strategy?
- Is it worthwhile to **freeze assets now** to remove future appreciation from an estate?
- There can be a great benefit to **setting up a lifetime spousal bypass trust** or a lifetime Qualified Terminable Interest Property Trust.
- Is it time to **gift higher cash value policies** to an irrevocable life insurance trust, something that could not have been done in the past due to the lower gift tax exemption?

The extensions of the Bush-era tax cuts and the current exclusion amounts may not last forever, but present an ideal opportunity to work with your J.H. Cohn advisor to ensure that your estate is set up to maximize the current opportunities. ■

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A Five-Step Life Insurance Analysis

by Laurence F. Ziff

Although most individuals probably review their financial goals and investments on a regular basis, far fewer examine their life insurance coverage to determine if it is still meeting their needs. A thorough review of your life insurance should be conducted annually, and as you work on tax planning paperwork this time of year, now may be an ideal time to take a fresh look. (Life insurance should also be reviewed after a major life event, such as marriage, birth of a child, retirement, career change, or the launch of a new business venture.)

To be certain your time is well spent, follow these steps for a life insurance analysis:

1. **Find an agent who will provide thorough service.** It is no secret that agents make the bulk of their commission when you initially buy insurance coverage. However, this should not prevent the agent from providing outstanding service throughout the life of the policy. Insist that you discuss any changes in your personal or financial situation and review changes in the insurance industry. If the agent doesn't sit down with you, find an insurance professional who will.

2. **Review the nuts and bolts of your current coverage.** An "in-force" illustration is available from your life insurance carrier. This illustration will show exactly how the policy has performed up until now, and can project future costs and cash values based on current assumptions. Universal life policies, a type of permanent life insurance, include both guaranteed values and values based on current assumptions. These assumptions can change since they are based on mortality charges, interest rates, carrier experience, carrier expenses, and on the carrier's investment portfolio performance. In-force ledgers with "reasonable" future assumptions should be retrieved and reviewed during the evaluation process.

3. **Assess the need behind the life insurance.** Does the need for which you bought the coverage still exist? Life insurance is not about dying. It is about dying at the wrong time, when you are still an integral part of your business or when your kids are still in college. Life insurance can outlive these risks. A policy review can also uncover new risks that require protection and determine the appropriate amount of coverage.

4. **Be informed about any changes to the life insurance industry.** Life insurance companies and policies have changed drastically in the last 20 years. Mortality tables have changed, secondary death benefit guarantees have emerged, and mutual companies have demutualized. In other words, the environment has evolved and there may be a product that outperforms your existing coverage or provides a benefit that was not available before. Work with your agent to get an update on the industry overall—not just your carrier. Also, in today's market, be sure to understand the viability of the insurance company.

5. **Evaluate the fair market value of your policy.** The cash value of your policy is not the only way to assess what your policy is worth. Capital sources all over the world are purchasing existing policies from policyholders for more than the cash value of the policy—this process is called a life settlement. Over 50 percent of the time, the insured sells his existing coverage and takes the proceeds to buy new life insurance, saving thousands of dollars in premium. Just as you would update your computer when the latest technology becomes available, we recommend that you follow the same reasoning with your life insurance policies. Like new technology, a new life insurance policy can be better suited for today's environment and your current needs.

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The Evolving Role of the CFO

by Charles M. Smith, CPA, CPC, SPHR

A recent survey cited 81 percent of CFO respondents interviewed said they believe it's more difficult to be a company leader today than it was five years ago.[1] The "Great Recession" has caused a general flattening of the organizational chart with middle management layers compressed. At the same time, executives are facing additional pressures as they attempt to keep service levels high and position their companies for growth.[1] (See shaded box below, "In Leadership, Difficulty.") In addition, through J.H. Cohn's Job Benchmark process, which uses and interprets validated assessments in many search engagements, we are increasingly seeing job descriptions that require the individual to be "all things to all people."

In Leadership, Difficulty

CFOs were asked, "Do you think it's more or less challenging to be a company leader in today's business environment versus five years ago?"[1]

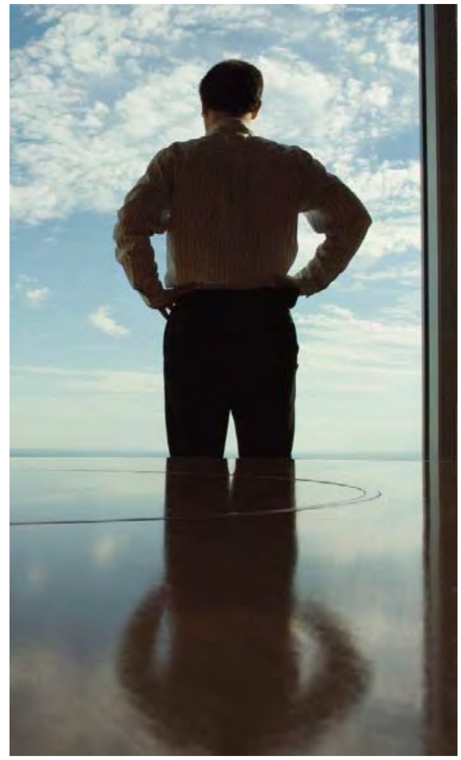
- Significantly more challenging – 31%
- Somewhat more challenging – 50%
- No change – 14%
- Somewhat less challenging – 3%
- Much less challenging – 1%
- Don't know – 1%

Over the past five years, J.H. Cohn has helped clients fill C-suite roles (including CEOs, CFOs, and other operational positions) through our search and organizational development services, and in doing so, we have observed several trends worth noting. Many people we hire have moved up within their organizations: controllers have become CFOs, CFOs have become COOs, COOs have become general managers, and general managers have become presidents (specific examples are cited later in this article). A handful of our client company owners have stepped out of day-to-day roles, having grown to trust their C-Suite members, allowing these owners time to pursue other life interests while retaining ownership in their companies. Clearly, CFOs created, and took, opportunities where the trend warranted an evolution of the role into that of a true business partner. The progression trend is increasingly common and clear, and many CFOs have found this path to be the norm when plotting future career moves.

But how learned is the progression, and how much of it is instinctual based on behavior type?

Through the years, our organizational development research has led to the creation of many job benchmarks, which provide an objective picture of what the job requires for the incumbent or new hire to be successful. The process allows us to have a debate on job requirements for an open position *before the selection process commences*. More than a job description, which describes functional duties, the job benchmark is critical to understanding today's more complex roles and to ensuring success in recruiting, hiring, and/or retaining top talent. Our clients understand the value of matching candidates to the job benchmark and the significant organizational value and cost savings that result when the right person is in the role.

A part of many search/selection engagements for our clients is to identify the goals of the organization and the role itself. We hire for the current need as well as the anticipated future need. Thus, with growth and evolution of the organization together with nurturing



and job enrichment, the incumbent is able to grow with the job. While the focus of this article is on the evolution of the corporate CFO role, the same role evolution occurs for virtually every position involving management or leadership.

The behavioral component of our validated assessment suite measures observable natural and adapted behaviors as well as behaviors required by the job along four factors:

- How one responds to problems and challenges (the need to direct);
- How one influences others to their point of view (the need to interact);
- How one responds to the pace of the environment (the need to serve); and
- How one responds to rules and procedures set by others (the need for procedure).

Lately, more and more job benchmarks include all four behavioral factors as requirements for the job, essentially asking the candidate or incumbent to essentially be "Superman" or "Superwoman," and making it more challenging than ever before to find a fit. Our own experience in selection for our clients and in our job benchmarking

[1]"Survey: Executives face greater job demands today than five years ago," www.accountingweb.com, December 20, 2010

work confirms the trend: recent CFO job benchmarks look for leadership qualities such as a sense of urgency, versatility, and competitiveness.[2] For example, we have seen CFOs take on human resources and information technology responsibilities as well as operations, administration, customer service and, yes, even sales. One of our own Firm's senior partners recently retired from the Firm and is now executive vice president and COO of a nationally prominent non-profit entity.

In another example, we recently worked with a CFO who directly and indirectly supervises 5,000 individuals, including those in large operational and revenue-generating areas. We also recently recommended to another client, a national distributor, that its CFO take charge of execution of strategic company initiatives.

To further emphasize this trend, in the article "The Rise of the Operational CFO," Chris Langhoff, a finance executive recruiter with New York-based Russell Reynolds Associates, said, "We have more and more clients that say they want a great CFO, but also someone who can continue to grow and be a candidate to run a division, be a chief operating officer, or a CEO."[3]

Over the past several years, CFO Research Services, the sponsored research arm of CFO Publishing, has documented the expansion of the role of the CFO from a traditional oversight function to that of performance manager. CFO Research Services' study confirms that most finance executives now view themselves comfortably in this broader role, and in particular consider operational improvement as part of the finance mandate. Their mission, as one finance executive said in the study, is to "forge relationships with operating managers to provide them the data they need—not what finance thinks they need."[4]

More than a job description, which describes functional duties, the job benchmark is critical to understanding today's more complex roles and to ensuring success in recruiting, hiring, and/or retaining top talent.

In this survey of 168 respondents, 59 percent said they were consistently involved with improving operating performance, 37 percent said they were opportunistically involved, and only four percent said they were infrequently or never involved.

In a CFO.com article, Tom Kolder, president of recruiting firm Crist|Kolder, said, "Over time, it's become more critical for organizations to have financial input on business decision making. They need to have a finance leader who is more than just a scorekeeper; who is a key partner to the CEO. But as CFOs take on more intensive business activities like operations or strategy, they become more culpable if things go wrong. You're no longer in a support function; you're on the front lines, accountable for the good and bad."[5]

New Roles

The portion of CFOs surveyed who said that in the previous 18 months they had assumed additional responsibilities:[6]

- Information technology – 43%
- Strategy/business development – 41%
- Human resources – 39%
- Operations/production – 38%
- Risk – 37%
- Customer service – 37%
- Procurement – 35%
- Marketing/sales – 33%
- Research/development – 30%
- Supply-chain management – 25%
- Legal – 24%
- Sustainability – 23%

The state of the economy also plays a role in the need for an operational CFO. In "The Rise of the Operational CFO," Steve Harvill, an executive training consultant, said, "if you're a CEO, can you imagine having your talented CFO *not* involved in setting direction? Of course not."[3]

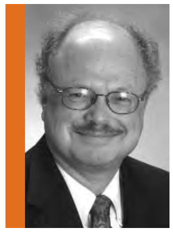
For years, companies managed finance during long periods of upward growth. Now, in a time of slower growth, finance chiefs must think more creatively about how to create shareholder/stakeholder value, says Jeff Kotzen, a senior partner with Boston Consulting Group in New York, who was quoted in The Wall Street Journal, saying: "This requires a sharper focus on driving profitable growth through cost reduction, pricing and managing capital structure, among other things. The attention being paid to financial health and strength of the business is greater than I've seen in 20 years."[6]

Greater and greater reliance is being placed on executives in business today—CFOs included. Now, more than ever, it is essential to use a robust set of validated assessment tools to understand what is required of these roles. The Job Benchmark process identifies incumbents' areas of fit and development. It helps both the search/selection and coaching

[2] J.H. Cohn LLP Client Job Benchmark data from TriMetrix™ Job Insights Surveys – actual client engagements, 2007 – 2011
[3] "The Rise of the Operational CFO," by Tim Beyers, Inside Edge (AmericanExpress.com, October 5, 2010)
[4] "The CFO's Role in Achieving Operational Excellence" (prepared by CFO Research Services in collaboration with Accenture, April 2009)
[5] "Who needs a COO," by Marshall Krantz, CFO.com (CFO Publishing Corporation, August 1, 2008)
[6] "Finance Chiefs Expand Roles" by Dana Mattioli, WSJ.com (The Wall Street Journal, January 31, 2011, quoting source: Accenture survey of 1,054 finance executives; multiple responses were allowed)

tasks to ensure the incumbent is operating at his or her highest and best use and ensures the right people are in the right places, maximizing fit with today's complex job requirements.

The process of Job Benchmarking, using and interpreting validated assessments, is best done when guided by an experienced professional who can help ensure you are hiring and coaching for today and tomorrow. ■



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Charley is also an example of the trend discussed in this article. He serves as chairman of the board of Capital Workforce Partners, a not-for-profit whose mission is to match people with jobs and provide training toward job readiness, and is the past co-chair and founder of its Governance Committee. He is also a past chair of the Finance and Audit Committee. In those roles, he continues to influence and preside over significant organizational changes.

Financial Managers Learning Forum: A Resource for CFOs and Financial Executives

The J.H. Cohn Financial Managers Learning Forum ("FMLF") provides CPE-accredited courses on practical and timely business issues for CFOs and senior financial executives. FMLF sessions also provide attendees opportunities to exchange ideas with their peers and receive thorough, insightful updates from J.H. Cohn's experienced and knowledgeable audit, tax, and advisory professionals.

Today, FMLF membership includes more than 2,500 financial managers from mid-sized companies, multinational corporations, financial institutions, and not-for-profit organizations. Each session is complimentary to clients and friends of the Firm and qualifies for an anticipated three CPE credits.

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138 Pehle Avenue,
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Crowne Plaza,
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Jamesburg, NJ

New York:

Yale Club
50 Vanderbilt Avenue,
New York, NY

Coming soon:
Additional New York region locations

Connecticut:

Marriott Hartford
Rocky Hill,
100 Capital Boulevard,
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California:

Skirball Cultural
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