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Benefits Issues in M&A Transactions

A Practical Guide to Benefits Due Diligence for Potential Investors

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About This Report



If your company has recently made, or is considering an acquisition, there are many important issues to address regarding the benefits programs you are also acquiring. Acquiring a new company usually brings a host of challenges in the form of existing benefit programs.

This report will offer practical guidelines with the right questions to ask, in advance, and how to resolve many potentially thorny issues around qualified plans, health and welfare benefits, nonqualified plans, and other executive compensation arrangements.

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Today's Discussion



- Identification of Plans
- Review Retirement Plans
- Review Health and Welfare Plans
- Review Nonqualified Plans and Executive Compensation Arrangements
- Summary

Identification of Plans



Identify all current and pending:

- ◆ Qualified Retirement plans
- ◆ Health and welfare programs
- ◆ Nonqualified plans and executive compensation arrangements

Identification of Plans



Obtain copies of:

- ◆ All plan documentation
- ◆ Administrative procedures
- ◆ Committee meeting minutes
- ◆ Investment Policy Statement
- ◆ Insurance contracts
- ◆ Employee communication materials
- ◆ Employment contracts
- ◆ Copies of proxy/private placement memorandums

Review Retirement Plans



❑ Tax qualification of plans:

- ◆ Current IRS determination letter
- ◆ Prepare schedule of administrative procedures
- ◆ Review plan operations to ensure they match plan terms
- ◆ Compliance with current legislation/regulations
- ◆ Review distributions, loans, withdrawals, and hardship withdrawals
 - Correct IRS reporting on Form 1099-R
 - Proper withholding
 - Compliance with rollover rules

Review Retirement Plans



Tax qualification of plans: *(cont.)*

- ◆ Review testing
 - Non-discrimination testing
 - 415 limitation testing

Reporting and disclosure

Review Retirement Plans



❑ **Fiduciary Compliance:**

- ◆ Identify trustees, plan administrator, investment managers, administrative committee, investment committee, loan committee, etc.
- ◆ Confirm that individuals who handle plan monies are bonded.
- ◆ Review any fiduciary liability policies.
- ◆ Ensure that plan investments are held in the trust name.
- ◆ Review committee meeting minutes and Investment Policy Statement.
 - Proper due diligence for investment selection
 - Monitoring of investment performance

Review Retirement Plans



Fiduciary Compliance: *(cont.)*

- ◆ Procedures in place to identify any parties in interest to the plan(s) and prohibited transactions.
- ◆ Timely deposit of employee contributions/participant loan payments.
- ◆ Confirm that no pending lawsuits or DOL investigations.

Review Retirement Plans



Funding obligations (Defined Benefit Plans only):

- ◆ Review actuarial reports for funded status of defined benefit pension plans.
- ◆ Review FAS 87/88 actuarial reports.
- ◆ Review PBGC filings and confirm that all PBGC premiums have been paid timely.
- ◆ Confirm that there are no due and unpaid contributions.
- ◆ For union plans, information on potential withdrawal liability.

Review Retirement Plans



Service provider contracts and liabilities:

- ◆ Services that are being provided
- ◆ Look for any overlap or gaps in services
- ◆ Any unpaid fees to service providers

Review Health and Welfare Plans



Tax Issues:

- ◆ Cafeteria plan issues
- ◆ Confirm that applicable nondiscrimination testing has been done
- ◆ Review Form 5500's to determine
 - Required filings have been made
 - Audits have been conducted when necessary
- ◆ Tax Deductions for VEBA Funding (if self insured) are within Code limits

Review Health and Welfare Plans



Tax Issues: *(cont.)*

- ◆ Confirm that plan documents are up to date with:
 - COBRA
 - HIPAA
 - USERRA
 - Family Medical Leave Act
 - Newborn's and Mother's Health Protection Act
 - Americans with Disabilities Act
 - Age Discrimination in Employment Act

Review Health and Welfare Plans



❑ **ERISA fiduciary issues:**

- ◆ Compliance with reporting and disclosure rules
- ◆ Confirm no apparent fiduciary breaches
- ◆ No MEWA issues

❑ **Funding and Review:**

- ◆ Review
 - Insurance contracts
 - Service provider contracts, and
 - Funding of benefits

Review Health and Welfare Plans



Funding and Review: *(cont.)*

- ◆ Identify any change in control provisions for need to obtain third party consents.
- ◆ Review accounting policies for the plans.

Review Health and Welfare Plans



Self insured plans:

- ◆ Examine timeliness of deposit of employee contributions to trust or expenditure of plan assets.
- ◆ Evaluate incurred but not reported claims for accuracy of reporting.
- ◆ Review any operational claim audits for consistent issues identified by TPA.
- ◆ Review results of any dependent eligibility audits.
- ◆ Evaluate payment of claims for accuracy and assess whether there is any latent liability for improperly denied claims.

Review Health and Welfare Plans



Retiree health obligations:

- ◆ Review FAS 106 Reports.
- ◆ Evaluate ongoing liability to retirees.
- ◆ Identify whether plan permits amendment or termination at employer's option.

Review Nonqualified Plans and Executive Compensation Arrangements



❑ Ascertain which executive compensation arrangements are defined as “deferred compensation” under §409A. Potential 409A plans include:

- ◆ Nonqualified Deferral Plans (elective or non-elective)
- ◆ SERPs
- ◆ Employment agreement with deferral feature
- ◆ Severance plans
- ◆ Multi-year bonus arrangements
- ◆ Stock-based plans (options and SARs) issued below market value
- ◆ Restricted stock units
- ◆ Phantom stock plans
- ◆ Anything that “smells” like a deferral...

Review Nonqualified Plans and Executive Compensation Arrangements



❑ 409A Issues:

- ◆ Require 409A representations and warranties, but “buyer beware”...
- ◆ Differentiate between “grandfathered” and 409A amounts.
- ◆ Carefully review any amendments that were written after 10/3/2004, which could create a material modification and remove grandfathered treatment.
- ◆ Verify 409A qualification (good faith compliance) of all non-grandfathered amounts.
 - Deferral elections
 - Distribution elections
 - Changes if form or timing of distributions
 - Prohibition of distribution “acceleration”

Review Nonqualified Plans and Executive Compensation Arrangements



❑ **409A Issues:** *(cont.)*

- ◆ Ascertain any potential tax-withholding obligations, gross-up payments or other indemnity rights if plan has not met qualification requirements.
- ◆ Take a close look at severance plans and employment agreements. For 409A plans, distributions to “key employees” of public companies must be delayed by six months.
- ◆ “Same Desk” rule: Following a change of control, an employee who maintains the same job for the new employer has likely experienced a “separation from service”.
- ◆ Evaluate stock option and SAR plans to ensure pricing at “Fair Market Value”.
- ◆ Discounted stock options not 100% vested on 12/31/2004.

Review Nonqualified Plans and Executive Compensation Arrangements



❑ **Additional Executive Compensation Issues:**

- ◆ Review employment contracts for special arrangements.
- ◆ Evaluate the impact of the transaction on stock based programs, e.g. vesting.
- ◆ Confirm that SEC requirements have been met for stock-based programs including Rule 16b-3.
- ◆ Confirm that top hat plans have:
 - Met DOL filing requirements
 - Cover only a select group of management of highly compensated employees

Review Nonqualified Plans and Executive Compensation Arrangements



❑ **Additional Executive Compensation Issues:** *(cont.)*

- ◆ Review company's financial statement to determine whether executive compensation arrangements are properly accounted for under FAS 87 and FAS 88.
- ◆ Evaluate change of control provisions
 - Are golden parachute liabilities triggered by transaction?
 - Evaluate excise tax to employee(s).
 - Evaluate possible loss of deduction to employer (162m).
 - Review total compensation package for compliance with tax deductibility provisions of the IRC.
 - Does a "Springing Rabbi Trust" create the necessity to fund deferred compensation liabilities?

Summary



- Identification of Plans
- Review Retirement Plans
- Review Health and Welfare Plans
- Review Nonqualified Plans and Executive Compensation Arrangements
- Look for opportunities to simplify your life!



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