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WIPFLI DENTAL Perspective

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Investors' Biggest Risk? This Information May Surprise You

By Nate Wenner, CFP®, CPA, PFS, CIMA, Wipfli Hewins

In this issue:

Talk Is UP About Investment Risk

Whenever the economy seems to be turning down, conversations about the volatility in the stock market and concerns about investments seem to heat up. While concern about past performance and fears about the future may trigger vigorous discussions, what makes the most sense in understanding the full picture of risk?

Knowing Where You Are

To understand your investment risk and reward status, you need data. Can you answer:

- ❑ What was the annual rate of return on your investment portfolio last year?
- ❑ How is your portfolio allocated across asset classes?
- ❑ What were the total costs you incurred for your investment activities in 2007? This includes the cost of mutual fund expenses and any brokerage costs or sales "loads" (commissions) paid indirectly when not using an advisor who is completely "fee only."
- ❑ How do these investments fit in with your total financial picture and long-term financial-independence plan, including your dental practice's long-range strategic business plan?

Without complete data, it's hard to know how well you are really doing and how much risk you may be taking. Creating and projecting your personal financial statements, a normal first step in a financial planning engagement, can begin the process of seeing how you stack up over the long-term. Exploratory conversations with a CFP (Certified Financial Planner)® professional - a designation earned through completion of a rigorous process of education, examination, experience, and ethics - can take that process to the next step.

Seeing Your Investment Risk in Context

Understanding investment risk starts with understanding your own portfolio. Placing your investments in a broader context helps paint a bigger picture. A long-term study from Dalbar Inc., the nation's leading financial-services research firm, offers keen insights into practical relationships between risk and return. Examining real investor returns from 1984 through 2005, the study clearly illustrates the benefit of a disciplined process, clearly defined investment strategies, access to resources, and the importance of understanding all investment costs:

- ❑ The S&P 500 stock market Index had an annualized return of 13.0%, while the average equity fund investor realized an annual return of only 3.5%!
- ❑ While the LB Aggregate Bond Index during this period had an annualized return of 11.2%, the average fixed-income mutual investor realized an annualized return of only 3.8%!

Do you know what your actual dollar-weighted returns were? Did you benefit from access to resources and disciplined strategies?

The Risk in Relationships

The relationship you have with a financial professional is clearly a partnership that needs to be based on trust. Many professionals believe the most compelling reason to work with a financial advisor is the assumption they will help you manage your financial results better than you would on your own.

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- Strategic planning
- Comprehensive practice exam
- Benchmarking and performance monitoring services
- Fee schedule review
- Dental team assessment
- Practice transitions

Small Business Plan Design

By Bob Buss, Wipfli LLP

A common concern of profitable small-business owners is how to minimize taxes and increase the cash flow of the business. Given its flexibility and use as a potential savings vehicle for the owners and employees of the business, the very popular 401(k) retirement plan is a consideration. But what about the business owner who wants, as is typically the case, to contribute even more money on a pretax basis to the 401(k) plan on his or her own behalf? A possible solution to this owner's concerns is a safe harbor 401(k) cross-tested profit-sharing plan.

A basic characteristic of dental practices is that they tend to have one or more highly paid owner-employees who are supported by a number of staff employees, often at widely varying income levels. The owners, who now have a business that is successful enough for them to be able to think about putting money away for their own retirement, have three objectives. What are those objectives? They include the desires to keep things simple, to allocate significant income to themselves, and to have complete flexibility.

One of the significant problems facing many 401(k) plans is that, in order for the owners to be able to defer income under the 401(k) feature, the nonowner employees must defer income into the plan. To circumvent this issue, Congress, realizing that there is a lack of retirement savings, created a safe harbor provision.

Though there is more than one safe harbor option, the one used in this article is the three percent nonelective contribution. The employer agrees, in advance, that it is willing to contribute three percent of pay for all eligible employees for the following plan year. This is an election that is made each year in advance for the next year. Specifically, a notice must be given to the employees no later than 30 days prior to the beginning of the new plan year, informing them that the employer is committing to this three percent safe harbor contribution for the next plan year. Two other conditions that apply to this safe harbor contribution are that the three percent safe harbor contribution is fully vested, and there are no service conditions to receive the contribution.

The benefits derived from the safe harbor election include the ability for the owners to defer as much income as they want (up to the $15,500, or $20,500 if age 50 or greater maximum in 2008) to the 401(k) and the ability to use the three percent safe harbor contribution in our cross-testing calculations. If the employer just wants to put in the three percent for employees (because they are having a difficult year, or that is what they want to do generally and such a design will meet their objectives for owner contributions), then the owners will be able to get the maximum 401(k) deferral, plus the three percent safe harbor contribution on their own income. However, if the owner is willing and able to make a greater contribution on his or her behalf, up to $30,500 in 2008, a cross-tested allocation may be the answer.

Cross-testing is the term used to describe a technique in which an allocation is converted to a projected benefit at retirement. Then the projected retirement benefits for all participants in the plan are tested to ensure that the plan does not discriminate in favor of the owners. If all of the projected benefits at retirement are a uniform percentage of compensation for all participants, the plan is not discriminatory.

What is the advantage of a cross-tested plan?

The advantage of cross-testing a plan is that it permits substantially larger contributions to be made for older participants than for younger participants. This is because the older employee has fewer years than a younger employee for the contribution to accumulate before the employee reaches retirement age.

In some situations, the employer may be able to make a 20-percent contribution for the owners and only a 5-percent contribution for all other employees.

Following is a chart comparing different allocation methods for a hypothetical employer, based on 2008 limits. These two allocations satisfy the nondiscrimination rules, but each achieves a different purpose. There are numerous other alternatives that may be viable, and ultimately the employer must work with a qualified plan consultant to determine which plan design best fits the employer's needs.

Compensation of Cross-Tested Plan Contributions and 10% of Profit-Sharing Plan

	Age	Salary	P/S Allocation	% of Salary	Cross Tested Allocation	% of Salary
Owner/Emplyee	55	$230,000	$23,000	10%	$46,000	20%
Emplyee A	35	$50,000	$5,000	10%	$2,500	5%
Employee B	30	$45,000	$4,500	10%	$2,250	5%
Employee C	54	$38,000	$3,800	10%	$1,900	5%
Employee D	27	$28,000	$2,800	10%	$1,400	5%
Employee E	24	$26,000	$2,600	10%	$1,300	5%
Total		**$417,000**	**$41,700**		**$55,350**	
Owner's % Share			**55%**		**83%**	

To summarize, depending primarily on the ages and compensation of` the owners versus the other employees, the cross-tested plan may offer unique advantages. Plan contributions are discretionary, the plan is flexible, and the plan will permit the employer to go beyond the standard 401(k) plan design and skew benefits in favor of the owners without any additional employee contribution. ■

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Terminating Problem Employees

By Julia Johnson, Wipfli LLP

The employment relationship between employers and employees has traditionally been governed by the "employment-at-will" rule. Subject to certain statutory restrictions, employers have had the right to terminate an employee at any time, with or without notice, for any reason or for no reason at all. However, over the past many years significant changes have eroded the traditional employment-at-will rule have occured. The passage of sweeping legislation (federal and state of Wisconsin) has restricted employers from discharging employees for reasons such as race, color, sex, religion, national origin, ancestry, age, disability, sexual orientation, marital status, arrest record, membership in a military reserve unit, use or nonuse of lawful products, or any other characteristic protected by law.

Employers should carefully review their reasons for dismissing an employee to avoid a claim of discriminatory termination. If the employee is a member of a protected class, the employer must clearly document that the employee was discharged for reasons unrelated to the employee's status as a protected-class member. Failure to document the legitimate, nondiscriminatory basis for an employee's termination could expose an employer to a wrongful-discharge claim.

Disciplining and terminating problem employees is never an easy task. The process is fraught with pitfalls: inadequate communications, poor documentation, and employee-defense strategies. Documentation of unsatisfactory performance is of critical importance when looking to terminate or discipline an employee.

The termination process needs to be a well-planned, well-executed event to reduce exposure to potential liability. By doing your homework and taking an active role, versus a reactive one, you can often circumvent challenges to the termination decision.

The following checklist will assist you as you address performance issues with your problem employees that may culminate in termination:

- Document declining performance
  - Date and time
  - Location
  - Description of event
  - Others involved
  - Action taken
  - Communication to the employee
- Prepare an performance improvement plan
  - Identify objectives and develop an agenda
  - Review and organize documentation
  - Involve the employee
  - Verify that the employee has proper training
  - Anticipate employee reaction
- Confront employee
  - Schedule date and time
  - Select an appropriate location
  - Set the tone
  - Review documentation
  - Indicate areas for improvement
  - Involve the employee
  - Explain the consequences
  - Establish a method to monitor ongoing performance
- Continue to evaluate performance
  - Continue to document
  - Monitor performance and communicate with the employee
  - If improved performance, provide positive feedback
  - If performance remains substandard, repeat the process, following normal disciplinary procedures, thus preparing for termination

When termination becomes necessary, the interview should be honest, private, and humane. It is strongly recommended when at least two company representatives who are familiar with the employee's work record and the reasons for dismissal are present during the termination interview. Reasons for the discharge, including the employee's prior corrective action record and details of the discharge interview, should be completely documented and placed in the employee's personnel file after termination.

Our experienced human resource consultants can help you set up a program to proactively address employee performance issues, as well as assist with handling difficult situations as they occur. ■

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Consider the following assessment tools:

- ❑ Get details about professional competence, skill, and expertise. Trusted advisors provide documentation of their credentials, ethics, business practices, compensation, and services. Ask for it.
- ❑ Check out credentials. The Financial Industry Regulatory Authority (FINRA) lists 80+ "professional" designations (http://apps.finra.org/datadirectory/1/prodesignations.aspx) and summarizes the experience, education, and examination requirements (if any) for each. Some credentials may be of minimal value.
- ❑ Demand transparency of fees and other charges. Those professionals who are acknowledged fiduciaries are typically compensated like other professionals you depend on for specialized knowledge - CPAs and attorneys - and not by product sales.

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Fiduciaries are required to put your financial interests first, and "fee only" advisors typically charge hourly or flat fees for planning and a percentage of assets under management for investment management services. Insist on an apples-to-apples comparison when assessing "fee only" advisors versus "fee based" services or others partly or wholly paid for with commissions (which may be hidden and may also include other implicit fees and costs) from product sales.

The Real Measure of Relationship Risk: Trust

Several years ago, Charles Greene and David Maister wrote a business best-seller called *The Trusted Advisor*. Greene, whose work has been published in *Harvard Business Review*, *Directorship Magazine*, *CPA Journal*, and *American Lawyer*, created a formula that certainly has helped me focus on what matters for my clients. According to Greene:

$$\text{TRUST} = \frac{\text{Credibility} + \text{Reliability} + \text{Transparency}}{\text{Self-Orientation}}$$

Understanding your own portfolio and how it relates to your goals, using contextual data like the Dalbar study, and getting the facts about advisor relationships to help assess credibility, reliability, and transparency – are all important. Greene would argue the real risk assessment of any professional relationship is orientation -- the higher the advisor's focus on "what's in it for me," the lower trust should be.

In Summary

When considering investment risk, it is important to look at markets, specific investments, advisor expertise, all explicit and implicit costs and fees, and perhaps most important of all, the trustworthiness of the professional with whom you are working. As Oliver Wendell Holmes said, "Put not your trust in money, but put your money in trust." ■

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