

EBP pitfalls and quality importance

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In May 2015, the Department of Labor (DOL) issued a report “Assessing the Quality of Employee Benefit Plan Audits,” which contained the results of its inspection of 400 employee benefit plan audits. The results of the study were eye-opening, with an average audit deficiency rate of 39 percent. These overwhelming results set in motion efforts by regulators and public accounting institutions, like the AICPA, to improve the quality of employee benefit plan audits. This report has had a significant impact on the employee benefit plan audit industry, but the ultimate impact of the study falls on plan sponsors.

What does this mean for law firm plan sponsors? Certainly it highlights the importance of selecting a quality auditor. One of the main findings from the report was a direct relationship between the quality of the audit and the number of employee benefit plan audits performed by the audit firm. For example, CPA firms that audited only one or two employee benefit plans had an average deficiency rate of 75.8 percent, while firms that audited 100 or more had the lowest deficiency rate at 12 percent. Plan sponsors have a fiduciary responsibility to the plan participants, and a quality audit from a firm with experience and specialization goes a long way in meeting that fiduciary responsibility. Plan sponsors should review their auditors and determine if they meet the criteria for providing a quality audit:

- > **Experience level:** How many plan audits is your current provider conducting annually?
- > **Quality:** What is your current provider’s training regimen and requirements?
- > **Industry involvement:** How involved in the employee benefit plan audit industry is your provider?

Not only can an audit failure be costly — DOL penalties can range up to \$1,100 per day, in addition to the cost of re-performing the audit by a different auditor — but quality audits are helpful in assessing whether your employee benefit plan is operating as designed and in accordance with applicable regulations. If your audit is deficient, the last thing you want to do is deal with an operational error on top of that. Therefore, the quality study also highlights the need to be aware and mindful of potential pitfalls lurking within the operation of your employee benefit plan.

Benefit plans have many regulations to navigate, which requires complex plan design features and required processes that create an operating environment where errors are bound to happen if adequate controls are not in place. A well-designed and implemented internal control environment over the plan’s processes and procedures remains your best defense and can effectively reduce the risk of error. Even so, certain aspects of plan design, operational processes and related regulations tend to result in a higher likelihood of errors. Law firms often sponsor multiple employee benefit plans covering different segments of employees and partners in the firm, which can add to this complexity. The following are some common compliance pitfalls and errors to consider when evaluating your plan’s processes and procedures:

- > **Compensation.** The use of incorrect or incomplete compensation to calculate contributions continues to be one of the most frequent errors found by plan auditors. For example, it is common for plans that define compensation as W-2 wages to accidentally exclude non-cash compensation from contribution calculations, such as taxable group term life insurance premiums or short-term disability premiums. If such an error remains undiscovered for many years and is only discovered under DOL examination, it can result in significant correction amounts and penalties. Other factors can further complicate the application of proper plan compensation, including the existence of multiple plans, multiple compensation pay codes within the payroll system, off-cycle pay or bonus runs, manual corrections and different definitions of compensation for different classifications of participants. A plan may define compensation as W-2 wages for employees and Schedule K-1 income for partners, for example, requiring careful consideration based on participant classification. Careful review of your desired definition of compensation and its implementation is important for all plans.

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- > **Investments held in self-directed brokerage accounts.** Brokerage accounts are a popular option in law firm plans, especially for partners. Some plans permit participants to maintain their self-directed account with a broker of their choice, which can lead to inefficiencies or other problems. Certain brokerage accounts may not meet the requirements for a limited scope audit, resulting in higher audit costs for the plan sponsor. Additionally, companies should consider establishing restrictions on the investment choices within a brokerage account, to avoid the plan holding investments which aren't traded on an active market and are thus hard to value. Hard-to-value investments are receiving increased scrutiny from the DOL due to the higher levels of retirement risk involved with them.
- > **Late remittance of employee contributions.** Late remittances of amounts withheld from employees remains number one on the DOL watch list for areas of noncompliance. Late remittances are deemed to be a loan from the plan to the plan sponsor, which is considered a prohibited transaction under ERISA. Contributions must be remitted as soon as those assets can be segregated from general company assets. A rule of thumb is to remit the contributions within the same time period that you remit payroll income tax withholding to the federal government.
- > **Auto-enrollment/eligibility errors.** Auto-enrollment of employees when they become eligible is a popular way of increasing plan participation rates. However, this feature also means a mechanism must be in place to ensure this happens as employees do not have to take any action on their part. The frequency of missed auto-enrollments has been high enough that the IRS has eased some of the penalties and made it easier to correct auto-enrollment errors.
- > **Over-reliance on third party administrators.** Most plan sponsors today outsource the daily administration of their plans' investments, benefit payments, loans and recordkeeping to a third party service provider (TPA), among other functions. Often times the TPA may also serve as a trustee and co-fiduciary. This arrangement can lead to complacency; the plan sponsor always bears the fiduciary responsibility for the plan and must monitor and oversee the functions outsourced to the TPA. Be careful not to over-rely on the TPA without establishing adequate controls to monitor compliance yourself.
- > **Plan fee and expense benchmarking.** Regulations requiring disclosure of plan fees were implemented in 2012 to increase the transparency of fees and expenses charged to the plan and its participants. Plans with unreasonably high expense ratios may be at an increased risk for litigation from plan participants and beneficiaries. Periodic benchmarking of the plan's fees and investment rate of return against retirement plans of comparable size within the legal industry is a recommended practice to ensure adequate execution by the plan sponsor of its fiduciary responsibilities. Several recent lawsuits underscore this risk.

Employee benefit plan sponsors face a daunting task of ensuring compliance with the multitude of regulatory and legal requirements currently in place. A well designed and implemented control environment with detailed and documented processes and procedures for employees to follow is a necessity. Being alert and aware of potential pitfalls and stumbling blocks will aid you with knowledge to help your plan run smoothly. Fortunately, there are also a lot of resources and third party vendors available to aid plan sponsors with this, including your employee benefit plan auditor. Hiring an auditor with a high level of experience performing these audits, as well as deep experience auditing plans similar to your own within the legal industry, will go a long way in ensuring you meet your fiduciary responsibilities.

About the author

Benjamin Wilhelm, CPA, is a partner in the firm's professional services practice and is located in the Tysons, VA office. He has been with the firm for more than 15 years, performing assurance, advisory and compliance services for a wide range of industries and practice areas, with a primary focus on employee benefit plans, professional service organizations and not-for-profit entities.