Note - Any federal tax advice contained in this transcript is intended to apply to the specific situation described and should not be considered official guidance independent of the presentation. The tax advice and statements contained herein should not be relied upon for retirement planning purposes without first consulting a tax or retirement planning professional. This transcript has been edited for technical accuracy and may differ slightly from the audio recording of the "The Importance of Good Internal Controls." This information is current as of August 8, 2013. Since changes may have occurred, no guarantees are made concerning the technical accuracy after that date.

Eddie: At this time I would like to formally begin today's call and introduce John Schmidt.

John: Thank you very much Eddie and hello everybody. My name is John Schmidt and I'm from the IRS Employee Plans, Customer Education and Outreach office. I'd like to welcome you to the Importance of Good Internal Controls phone forum. Thank you all for joining us today.

Today, we'll be hearing from Monika Templeman, Director of Employee Plans Examinations and Janice Gore Employee Plans, Area Manager. Before we start, I'd like to point out a couple of administrative type things. If you'd registered for this forum, we will be mailing you a certificate of completion in about a week as long as you attend the entire live forum. Enrolled agents, enrolled retirement plan agents, and enrolled actuaries are entitled to continuing education credit for this session.

Other types of tax professional should consult their licensing organization to see if today's session qualifies to CE credit. Most importantly as with all our presentations, the comments expressed you our speakers should not be construed as formal guidance from the IRS. We had many retirement resources available to you. For example, if we'll take a look at slide two of your handout, you'll find a link to our retirement plans website. You can also get there by going to the main irs.gov page and clicking on the information for dropdown box in the upper right hand corner of the screen and selecting retirement plans.

While you're visiting our website you might also want to subscribe to one or both of our free electronic newsletters. To subscribe, select the newsletters in the left hand navigation bar to subscribe and then select retirement news for employers, our newsletter for employer sponsoring retirement plans, or the employees plan news, our newsletter for retirement plan professionals. So without further adieu, I'd like to turn this presentation over to our speakers starting with Monika Templeman.

Monika: Thank you John and it's a great pleasure to be with all you today for a phone forum that focuses on a very important topic that has a huge impact on your ability to find fix and avoid mistakes that could actually threaten your retirement plan. This topic is the need for good internal controls to keep retirement plans in compliance and also drastically reduce the cost of fixing any plan errors.

Today Janice Gore and I will share with you why we're convinced that effective internal controls are essential to prevent mistakes that could actually jeopardize the tax-favored status of a plan. We're going to introduce some innovative tools to help plan sponsors and their advisors strengthen internal controls.

During retirement plan examinations and voluntary compliance correction submissions, employee plan specialists often discover insufficient internal controls that are not in place and/or poorly administered. The expression and ounce of prevention is worth a pound of cure is definitely applicable to keeping retirement plans qualified. There are many examples in life as well where if you take preventative measures, it really pays off. For example, you may want to get a yearly medical check to ensure you stay healthy to detect problems early so that they are easier to treat or prevent them all together.

The same analogy is true for your retirement plan. Strong internal controls provide reasonable assurance to plan will remain in compliance throughout its life. When a company establishes as a retirement plan, some employers actually think that the plan may run on its own and that tends to be far from the truth. You really have to review your retirement plan at least once a year to ensure its operating in accordance with the plan's terms and law because mistakes found quickly are so much easier to fix. That's just what we're going to be discussing today as we go over the importance of internal controls, the mistakes that we see and how to prevent them.

On slide two, and John eluded to this already, we will talk about our retirement plan's website at www.irs.gov/retirement. Not only do we have the wonderful free newsletters electronic that you can subscribe to, but we have many excellent tools that we'll cover toward the end of this presentation. I'd like to step back a moment to stress that the primary objective of the employee plan's function is to implement and maintain outreach, guidance, voluntary compliance, and enforcement programs that have a positive impact on the retirement system to protect plan participants.

Currently, EP examination has approximately 550 employees and approximately 400 are revenue agents, those folks who actually go in the field to ensure that retirement plans are in compliance . The entire IRS Employee Plans function has slightly under a thousand employees. Last fiscal year, in the Federal government, the year, as you may know, begins in October and ends in September, we closed over 10,000 retirement examinations and over 4,500 employee plans compliance checks. We'll explain the difference later, but compliance checks are not an audit and don't prevent the use of our voluntary compliance programs under the Employee Plans Compliance Resolution System (better known as EPCRS)..

In EP, we're very transparent and we not only have great tools and information on our website, but also it's very easy to see what we're looking for because our Internal Revenue Manual (IRM), particularly chapters 71 and 72, tell you anything you might want to know about the audit process and really gives you a good understanding of what we're doing.

With that, let's go to slide three and start [inaudible 00:05:58] focusing on the importance of good internal controls to keep plans in compliance. Good internal controls are important to help a plan sponsor eliminate and reduce operational errors. Having effective internal controls also facilitates the use of our very cost-effective self-correction program under our employee plans compliance resolution system- Revenue Procedure 2013-12, better known as EPCRS.

If you briefly look at the relationship between internal controls and self-correction under EPCRS, you'll further see the importance. Having effective practices and procedures in place to prevent compliance problems is a basic requirement to be eligible to use the IRS Self-Correction Program (SCP)under the employee plans compliance resolution system to fix operational errors. In order to use the self-correction program, a plan sponsor or administrator must have practices and procedures, either formal or informal that are reasonably designed to promote and facilitate overall compliance with the Code. So let me give you an example of sufficient controls. The plan administers a qualified plan that may be top-heavy under 416 and includes in its operating manual specific annual step to determine whether the plan is top-heavy, and if so, ensure that the minimum contribution requirements of top-heavy rules are satisfied. Please note, that a plan document alone does not constitute evidence of established procedures that are necessary for a plan sponsor to use the self-correction program. Formal or informal established procedures must have been in place, and must be routinely followed.

To be eligible for SCP, an operational failure should have occurred because of an oversight or mistake in applying established practices and procedures or because the procedures weren't sufficient to prevent the mistake. That is something that's inherent in using the EPCRS self-correction program. Remember, self-correction cannot be used to correct document failures, but we do have a voluntary compliance program (VCP) which is a very reasonable, non-draconian program.

On slide four, one of the important factors to consider is that internal control help keep an audit focused (if your plan or your client's plan is selected for audit) and can significantly reduce the time and burden of an audit. I'd like to take a moment to explain how good internal controls can affect you if your plan is selected for an EP examination. Not only can good internal controls reduce the length of the audit by and shortening the turnaround time for responding to information requests, but combined with clear communication to avoid any kind of misunderstandings, they can help resolve issues in a much more copasetic manner.

It's important to be aware that hiring a service provider, or third-party administrator, to assist in plan administration does not shift the burden for maintaining strong internal controls because an employer is still responsible for ensuring that internal controls are not put on the backburner. Keep in mind that third-party administrators process information received from the plan and depending on the service level agreement, donor always y monitor the plan for compliance.

In addition, a yearly checkup, which I alluded to in the beginning, needs to confirm whether or not good internal controls in place and there also needs be a good communication system with whoever is administering the plan to make sure that any changes to the plan or the summary plan description (SPD), or amendments having been timely communicated. Good internal controls can make a big difference in the audit sanction as well, if there is a problem found with the plan, because if you proactively address problems, that will serve as a mitigating circumstance and could even allow you to use self-correction during an audit, depending how far you got in the self-correction process.

Now, let’s take a quick look at slide five where we’ll talk about internal controls with respect to the employee plan audit process. EP agents use a focused audit approach for most examinations. “Focused audit” means that we zero in on three to five issues that are typical in a certain type of plan based on audit and voluntary compliance and other data. In other words, compliance problems that we’ve seen in specific market segments. By market segment I mean plan type and industry type. If there are good internal controls in place and the plan is well run, the audit stays focused. If the internal controls aren’t there and the plan seems to have many other issues, the scope of the audit could be expanded. The Internal control interview really help the examiner to determine whether the plan is well run and whether there are serious compliance risks that would give rise to expanding the audit, or whether the plan has sufficient internal controls and the audit can actually be done very expeditiously. A primary example of the result of insufficient internal controls is inaccurate or incomplete information/ data (such as inaccurate census data, hiring, termination, employee age, amount of service, or compensation) being provided to third party administrators, This is a major cause of compliance errors because the calculations for contributions and benefits are based on incorrect data.

Problems can also arise from decentralized payroll systems without internal controls to ensure that plan provisions are properly applied with respect to a parent plan and any subsidiaries, to determine eligibility, or highly compensated status, or what constitutes plan compensation. Let’s say that inaccurate data results in incorrect coverage or allocations; then you could have qualification issues. Another example of problems we are finding during plan audits is data on the Form 5500 filed for a given year that fails to conform to the actual books and records (for example, does not conform to payroll or plan census data).

It’s important to remember that the strength of internal controls, as I mentioned earlier, usually plays a part in the overall amount of any sanction, if applicable, under an audit closing agreement. There’s also very good news for plan sponsors who find and substantially fix via self correct, an operational failure, even a significant failure, as long as the correction was at least 65% completed prior to the audit. Under these circumstances, the Service will allow the error to be self corrected without a sanction, even though the plan is under examination,. if the plan sponsor can substantiate what they did to correct the error prior to being audited.

Let's take a quick look at slide six . I want to explain that the EP agent auditing the plan will make every effort to ensure internal controls are running smoothly when the audit concludes because we're passionate about working with you to keep qualified plans qualified. As I just mentioned, self-correction is a possibility for minor issues or if you're 65% complete with the process even if it's significant issue, even in an audit situation. Again, we want to work together to keep plans in compliance. Janice, the next slide belongs to you.

Janice: First slide seven we're looking at. We're often asked what are good internal controls and what are insufficient internal controls? This slide shows an examples of weaknesses in internal controls found during audits. If the data provided to those who administer the plan operation and test for compliance is inaccurate, it can really cause multiple errors especially if the information is used for different purposes. For example incorrect compensation might be used for a nondiscrimination testing, for allocations of contributions and for other compliance testing that uses compensation for calculations.

Incorrect hours of service, dates of hire and dates of termination can also cause problems with eligibility, proper testing, and accurate allocations. We do find often on audit that the 5500 information does not match up with the actual record for the plan year. As Monika mentioned, if payroll systems are decentralized it can cause inconsistencies in identifying highly compensated employees from payroll records and other errors. The next slide, go back to you Monika.

Monika: Thank you Janice. We get frequent questions about "what are good internal controls?" and "what is the service looking when determining the sufficiency of the plan's internal controls?"So let me give you some examples. Segregation of duties, for example between payroll, human resources, and other business environments is crucial. It's really important that there is that segregation that would include accounts payable, general ledger. An effective and accurate IT system is important because of system designed to catch errors. Errors will happen but if they're caught quickly and fixed quickly, they're usually inexpensive and easy to correct.

Plan books and records should be maintained by knowledgeable and responsible personnel, with a real understanding of the business so they can tell whether things are copasetic and if the books and records are accurate. There needs to be a good method to ensure the transfer of knowledge and responsibilities if one record keeper leaves and another takes over to ensure that errors can be identified and mistakes are not overlooked. With respect to the Form 5500 that Janice just talked about, the flip side is that good internal control means that the Forms 5500 are accurately filed and reconcile to the plans books and records and don't have any watch outs. Again, that is why it is so important to have good internal control. Now let's talk about our 401(k) questionnaire. Janice, back to you for slide nine.

Janice: The location of the original questionnaire that we sent out and the released final report is shown on this slide. You can go to www.irs.gov and then select 401(k) plans then 401(k) questionnaire final report and then there'll be a selection for next steps and web resources and that will bring you to the items shown on this slide. Some have used this questionnaire as an internal control tool to help them with their annual self-audits. Monika?

Monika: On slide 10, we have some really good news for you. We added new internal control questions to the Questionnaire and repackaged it completely to make a self-audit tool for you to use. We incorporated some of your suggestions as well and those of our TE/GE Advisory Committee (known as the ACT)to really be able to provide an innovative tool to better help plan sponsors and their advisors with internal controls. The usefulness of this questionnaire as an internal control tool should be greatly enhanced, packaged in this user friendly format . Another great thing about this tool is that it is designed to be downloaded and used by plan sponsors and their advisors to do their own internal self-audits, which should include and verifying internal control sufficiency.

By using this tool to proactively ensure plan compliance, not only will you be able to find fixed and avoid operational mistakes, but you'll be able to fix them without IRS intervention or involvement. We even included definitions to make it a very user-friendly product and we are definitely … interested in your feedback when we launch the Questionnaire Self Audit Tool (or QSAT) as a tool to help strengthen internal controls. Janice back to you.

Janice: Although the tool isn't available yet, it should be released this year so stay tuned and we'll have some publicity in our newsletters. On slide 11, there were questions added as Monika said to this tool. They're actually typical questions that an examiner would ask during an audit to determine the strength of the internal controls of the plan in operation. Responses to the questions asked during the initial interview are really important to demonstrate knowledge about the operation of the plan and separation of duties, or checks and balances. This could lead the examiner to gain in some insight into how well the plan is operated and whether there might be a need to expand the scope of the audit beyond our pre-identified focus.

We're going to tell you about how you can use the QSAT tool to avoid common errors and Monika and I will go over some of those common errors.

On slide 12 this is a list of the most common plan errors and we'll discuss the common causes of these errors, what the QSAT internal control questions would be that are relevant to these issues and some tips on how to strengthen the controls to avoid them. We'll look at non-amender, late amender errors, failure to follow the plan's terms, eligibility, problems with loans, nondiscrimination testing, 402(g) limits, depositing deferrals timely and hardships. Monika, back to you.

Monika: issues. Just in case if you didn't catch it, we're calling the new self-audit tool the QSAT because it's a questionnaire self-audit tool. We hope the name is catchy and easy to your member. Now let's go to slide 13 and start looking at non-amender and late amender issues
Failure to timely amend plans for changes in the law is a huge problem in all types of plans. We're seeing a lot of non-amender, late amender issues during EP examinations. We're seeing that some representatives and employers are unable to locate necessary documentation to prove a plan with timely amended. Remember, a plan has to be signed, dated, and kept up for all law changes. We're seeing working copies that were never executed and there's no proof that the plan was ever adopted. The new EPCRS revenue procedure 2013-12, specifies you can't use working copies and if a plan is under audit you would need to show proof that an amendment was timely approved and adopted.

There are ways to prove things up. For example, you could have copies of Board of Director resolutions and plan minutes. You may have some compelling evidence to prove that an amendment was timely adopted. Short of that, you're going to have a major problem if you don't have the proof because unexecuted copies of plans and plan amendments are definitely problematic and if the plan is under examination, a closing agreement would be needed to keep the plan qualified.. If you find such a problem exists prior to an audit notification, you can go through the voluntary compliance program (VCP) to preserve the plan's qualified status.. Remember, you cannot correct document failures through self-correction.

Many plan sponsors believe that if they signed up for a prototype or mass submitter document service, they'll be automatically in compliance with timely amendment rules. This is usually true, but there should be a caveat that it is the plan sponsor's responsibility to ensure that all required plan amendments are timely adopted. So it's important for the plan sponsor to have regular annual contact with the company who sold the plan to make sure they're getting timely amendments.

Another factor that can lead to compliance problems is when the adoption agreement provides variables and sometimes the wrong boxes are checked, causing a plan to fail to comply with its terms (since the … it plan sponsor thinks the plan has different terms than the ones in the document). So as you can see, we encounter many plan document problems and the most prevalent issues are non-amender or late amender issues. Janice, slide 14.

Janice: On slide 14, these are the questions on our internal control tool. Who's responsible for making timely amendments for changes in the law? If there's been a merger or acquisition and plans are merged, who verifies that the language of the resulting plan is correct? As an example we have a similar situation like this on an audit in Great Lakes. A large corporation acquires another company. They were both sponsoring very similar 401(k) plans. They merge the plans several years prior to our examination.

Most of the plan language in the surviving plan was the same with one exception. The plan was always intended to include commissions in the definition of compensation for deferrals, but the surviving plan was not carefully reviewed to make sure this provision was still in the plan. The surviving plan language excluded commissions from the definition for deferral purposes so the plan in operation was not following the terms of a document.

Retroactive amendment was allowed - but a closing agreement and a sanction were required. Carefully reading the plan document and making sure that those who provide compensation information to those who administer the plan are reviewing these definitions annually - could have avoided this error and the closing agreement.

On slide 15, some tips to avoid this error. Make sure that the information provided to the plan administrator is according to the definitions and plan provisions. Don't assume that if you operate the plan the same as the prior year, it will be correct. Compare the summary plan description with the plan document. The participants expect the summary plan description to correctly reflect the plan document provisions. Use some reminder system or tickler file and reach out to the company who sold the plan to make sure it's up-to-date. Monika, slide 16.

Monika: Thank you Janice. Slide 16 is about the fixing non-amender or late amender errors. As I mentioned earlier, you can't use self-correction for document failure errors, the way you can for operational failures. Fortunately, the Voluntary Compliance Program is available as long as the plan is not under audit (and has not received a notice of a pending Plaudit). Later, we'll tell you that if you have employee plan compliance check which is not an audit, the voluntary compliance program is available throughout the compliance check process, but any notification of an audit closes the VCP door. The fix is to either adopt the required amendments to bring a plan into compliance with all current law changes or to adopt a pre-approved or master and prototype plan from an M&P sponsor, or volume submitter plan practitioner.

Keep in mind when you make a retroactive amendment … that amendment dates need to be retroactive as Janice alluded to in the prior slide. On slide 17, we're going to start with the next topic which is failure to follow the terms of the plan. This is very often a problem when plan definitions and plan operation are inconsistent. This frequently occurs with definitions of compensation or matching contributions, but can occur in other areas as well.

Let's use definition of compensation as example here because it's the most common error that we see in this category. An important aspect of operating a plan is determining proper compensation. The plan may use different definitions of compensation for different purposes. For example deferrals may be based on a definition that includes or excludes certain types of compensation such as bonuses, overtime, car allowances, or as Janice talked about, commission.

For 401(k) testing, if the ADP test uses a definition that includes all taxable wages, you may not have that in your other definition. The plan document determines what compensation amounts are available for elective deferrals. Based on audit findings and/or voluntary compliance submissions, some of the most common situations in which plan sponsors don't follow the terms of the plan, include problems with using different definitions of compensation for different purposes. Where feasible, it's great to simplify and use only one definition. We're not saying this will work for most plans, but it would help eliminate many errors. In all circumstances, it is extremely important to communicate to those who do the testing and administration for the plan, the proper definition for the proper purpose.

Another area where failure to follow the terms of the plan can cause errors is plan loans.. For example, some plans do not provide for loans but are giving them anyway. This error can be fixed by retroactive amendment, but it definitely would have to be fixed; otherwise the plan sponsor is not following the terms of the plan. Smaller plans sometimes provide better/more generous benefits for employees than the plans allows and the employer will say they are doing more than the plan allows so it should not be a problem. Although the good intentions are very commendable , the plan sponsor needs to amend the plan, otherwise the plan could have a qualification issue for not being operated in accordance with the terms of the plan.

Another issue we're seeing is following a prior restatement of the plan instead of the current one. Again, all of these things could be very problematic. So now we have some internal control questions we would like to share to help you ensure plan compliance. Janice, slide 18.

Janice: These are the questions on the slide that will be included on our QSAT tool. Just reading these questions annually can cause you to look at the plan document and discuss the process for communicating this information to those who use it for plan administration. Make sure that all those who need to know - understand the plan's definitions of comp including when there are multiple definitions for different purposes. Monika, Slide 19

Monika: On Slide 19, to prevent problems resulting from a failure to follow terms of plan, we are providing some tips f to ensure good internal controls. It's important to know the plan document's definitions and all changes and compare them to the operational procedures. Does the plan language say and reflect what you're actually doing in operation? It is crucial to know what third-party administrators agreed to provide. Are they relying on the employer for all the information? Are things getting covered? Is accurate data being used for testing purposes? If possible, as I mentioned earlier, simplify the definition of compensation and use the same definition for multiple purposes. If that's not possible, make sure you have a very good communication plan. Janice, slide 20.

Janice: To avoid matching contribution errors, another failure caused by not following the plan terms, again a review of the plan document is really important. This is a common error in Great Lakes and I believe in other areas. This error can be tied to the plans definition of compensation for matching contribution purposes. Also, if matching contributions are made on a payroll basis, make sure to check the plan language. If the plan defines compensations for the match as plan year compensation, there may be a need to "true-up" at the end of the year so that the participants receive the correct match according to the terms of the plan.

On to slide 21, to fix the errors caused by not following the terms of the plan for contributions based on incorrect compensation, if the deferral contribution was more than allowed by the plan terms, you can distribute the excess plus earnings. If a profit sharing allocation was more than allowed, you can forfeit and reallocate including earnings or place the amount in account to use for future profit sharing allocations. If you do not contribute enough, you need to make a corrective contribution again including earnings. You can self-correct this error if you find it. If it's found on audit, it may need to be corrected with a closing agreement depending on the significance. Monika, slide 22.

Monika: Thank you. On slide 22, we'll look at employee eligibility errors. Excluding eligible employees, or including ineligible ones, is problematic and can cause compliance problems for the plan. Misunderstanding a plan's eligibility requirements and entry dates, having different requirements for different contributions, or operating the same as the prior year when the plan is restated, are all prevalent errors. Another issue that we encounter are plans operated based on a summary plan description (SPD) that wasn't updated and not actually following the terms of the plan. For example, not considering part-time employees and not including employees who elect not to make deferrals.

If an employer has leased employees, contract employees, contract labor or has shared ownership of other enterprises, determining eligible employees can be a much more complicated process. There are several errors we are seeing during the examination of these types of plans that involve excluding eligible employees. For example, including all employees eligible to make elective deferrals, even if they chose not to make one for that year is something that's not always being done as required.

Problems also stem from incorrectly assuming that the plan does not cover a group of employees, (let's say assuming that it does not cover part-time employees) but the plan language actually covers that group of employees.. Merger or acquisition issues can also be problematic because certain employees may not be taken into account and the census data may be inaccurate. These are just some of the watch outs. Again, it is a very good idea to perform annual self audits to find and fix mistakes and prevent compliance problems.

Now, let's take a look at slide 23. The QSAT, the Questionnaire Self-Audit Tool, will have the following internal control questions:

- Who determines when an employee is eligible to participate in the plan?
- What steps does this person take to determine if the employee is eligible to participate?
- What steps are taken to notify the employees that they are eligible to participate in the plan?
- How does the plan track the amount of service an employee has completed?

Janice will now cover slide 24.

Janice: Additional questions on the tool regarding eligibility will include: Who maintains the personal records and how are they kept accurate? How was the employee information needed for plan purposes shared with those who administer the plan? Who's responsible for making sure the information that's shared is accurate? These questions might prompt the plan sponsor to analyze the internal controls of the information shared for plan operation.

Slide 25. To avoid the mistakes in eligibility, review personnel records for accuracy so that information shared for plan purposes will be valid. If information is missing for example a salary deferral election for a 401(k) plan, take steps to secure that information and conduct self-audits to compare a plan terms with the operation.

On to slide 26. To fix the mistakes for eligibility errors, revenue procedure 2013-12 provides correction methods in Appendices A and B. For a 401(k) eligibility error the employer makes a qualified non-elective contribution that equals the missed deferral opportunity. The missed deferral opportunity is defined in the Rev Proc as 50% of the missed deferral. You determine the missed deferral by multiplying the actual deferral percentage for the year of the exclusion, for the employees group, (meaning highly compensated or non-highly compensated group) by the compensation for that year. This is also reduced so that doesn't exceed any other plan limit such as 402(g).

The QNEC or qualified non-elective contribution for correction of the match is the total amount the employee would have received as a match, had the employee made a deferral. These correction methods are explained in more detail in the revenue procedure and include and eligibility errors for other types of the plans. Monika?

Monika: On slide 27, we're going to focus on some loan common issues. Loans are again a prevalent problem we're seeing in the field on EP examinations and also on VCP submissions that are coming into our Voluntary Compliance Program. If any of you have reviewed our recently published 401(k) Questionnaire Final Report, you are aware that we are quite concerned about an apparent increase in defaulted loans. Some of the other prevalent problems that we're seeing with respect to loans are:

- Loans in excess of the 50,000 maximum allowed. Remember, the amount of a loan cannot exceed to less or of 50% of the participant's vested account balance or $50,000. Generally, participants cannot correct to preserve loan exemptions, but there are some exceptions under EPCRS so do take a look at revenue procedure 2013-12

- loans made an excess of 72(p) limits, loans where there are terms of the loan do not match the plan provision.
- As I mentioned earlier, we're seeing plans that don't allow for loans that are getting loans.
- We are also seeing plans where the plan language specifies certain loan term loans that the plan does not follow in operation. Let's say the plan permits a maximum of five-year loans but they're offering 10-year loans, or specifies no more than three outstanding

loans, but they allow five outstanding loans. These examples would equate to qualification issues for failure to follow the terms of the plan.

We are also encountering plans that in operation allow loans, but the plan document does not allow loans. Fortunately, this error can be corrected by retroactive amendment Remember, it is important to check the terms of the plan when looking for potential errors involving plan loans.

Now we will move on to slide 28. Janice back to you.

Janice: These are some of the questions that would help with internal controls for loans. Go through the process that's in place for requesting a loan and make sure all of the rules are followed including any restrictions for loans that the plan language provides. If applications for loans are electronic, make sure that participants understand the rules. The system, if possible, could be setup to provide information specific to the plan rules, such as maximum number of outstanding loans allowed, the maximum loan amount available at the time of the loan request. Applications for loan should be reviewed by someone for internal controls. Slide 29, Monika.

Monika: Here are some basic tips to avoid problems with loans. Again, it is very important to have practices and procedures in place because good internal controls prevent compliance problems. If you develop loan procedures, you can ensure

- Five year plan limits
- Reasonable interest rate
- Meet dollar limit of IRC 72(p)
- Repayments are being made according to plan terms
- Repayments at least quarterly to make sure that the loan isn't being defaulted and
- Good monitoring to ensure that the rules are being adhered to and the plan is following its terms.

On slide 30, fixing loan errors, we highlight the fact that generally, plan participants cannot correct to preserve loan exemption and Self Correction (SCP) is generally NOT an option for loan errors (see Rev Proc 2013-12 for the few exceptions under EPCRS). If a plan loan is a prohibited transaction, then basically you have to fix it by filing a Form 5330 and paying the required excise tax.

Now Janice will tell you about ADP/ACP testing on slide 31.

Janice: Another common error is the mistakes made in applying the non-discrimination testing for 401(k) plans. There are a lot of things that can cause errors in testing as you can see on this slide. Not using the correct definition of compensation again comes into play for this error. During an audit, if we identify that incorrect compensation was used, the plan sponsor or representative will need to re-run the test with the correct data. This can be very time consuming since we would also need to verify that the error didn't occur in other years.

If internal controls were in place to ensure that correct data was provided to those who conducted the testing, it could save a lot of time and resources. We'd do sometimes find that when we ask for the correct data to be used for the test, the test will still pass non-discrimination. This is a time-consuming use of resources for a mistake that actually did not have a negative impact. If the test failed on retest depending on the impact of the error, if it occurred in more than one year or how significant, it could also be costly to correct. Depending on the significance of the mistake, if found on audit, it might also involve the closing agreement and a sanction. These are all good reasons to set up good internal controls to minimize this error.

On slide 32, some of the questions on the QSAT tool are shown on this slide. If this tool were used annually, especially if there have been changes to personnel who gather the plan information and provide it to those who administer the plans operation and conduct compliance testing, many potential errors could be avoided. Also, any misunderstanding of the plan provisions and definitions, if made clear up front, would go a long way toward ensuring the plan operational errors are minimized or avoided. Monika, slide 33.

Monika: Thank you very much. On slide 33, we have a few internal control tips. Keep in mind that you have the option to establish or amend to a Safe Harbor plan. If ADP/ACP testing is required, it's very important to establish internal controls to ensure compliance and eliminate communication gaps. The plan administrator and the employer need to be in communication to make sure internal controls and the data used for testing is accurate. Technical issues often lead to invert errors in ADP/ACP testing, we've seen quite a few of those during EP examinations. For example:

- Improperly classifying highly compensated employees (HCEs) and non-highly compensated employees NHCEs
- Including all employees <u>eligible</u> to make elective deferrals, even if they chose not to make one in that year
- Including controlled group information
- Definition of compensation errors can negatively affect ADP/ACP testing.
- Family aggregation rules**.** We're seeing a lot of issues with family aggregation rules. They may affect the treatment of stock-owned directly or indirectly by family members. The law treats any individual whose spouse, child, grandparents, or parents or someone who's a five percent owner or together with that individual would own more than five percent of a company's stock as a five percent owner. As a five percent owner, each of these individuals is a highly compensated employee for the plan year. It's important to identify the family ownership insurance of all company stock and to make sure that information is given to the third-party administrator, advisor, or person performing the non-discrimination testing. You may base your ADP and ACP percentages for non-highly compensated on either the current or prior in contribution. The election to use current or prior year data is contained in the plan document itself, but under limits its circumstances sometimes elections can be changed. Again, the key is communicating with whoever is preparing the testing to make sure correct data is being used.

Now let's look at slide 34 to discuss fixing ADP/ACP errors Some ADP/ACP failures can be corrected under the Employee Plans Compliance Resolution System, Rev Proc 2013-12. Based on the facts and circumstances, , you may be able to use self-correction, voluntary compliance, or if the plans under audit, then the only option may be Audit CAP. To avoid testing errors, provide complete information to the plan administrator. As I previously mentioned, inaccurate data and misclassifying employees is often the genesis of ADP/ACP failures.

Now let's focus on correction by looking at the two possible corrections methods. The first method is to make qualified non-elective contributions for the NHCEs to the extent necessary to pass the tests. A QNEC is an employer contribution that is always 100% vested. You must make QNECs for all eligible NHCEs (if the contribution does not cause the IRC section 415 limit to be exceeded). The 415 limit is a limit on annual additions that may be credited to a participant's account in a given year. Annual additions consist of employer contributions, forfeitures and employee contributions. These contributions must be the same percentage for each participant. There is also a second alternative permitted correction method (referred to as the one-to-one method) under Revenue Procedure 2013-12. Under this method, excess contributions (adjusted for earnings) are assigned and distributed to the HCEs. Any amounts forfeited because of matching contributions are to be used according to the plan document provisions relating to forfeiture. That same dollar amount (in other words, the excess contribution, adjusted for earnings) is contributed in the form of a QNEC to the plan and allocated pro rata, based on compensation, to all eligible NHCEs. Janice, back to you.

Janice: Another common error we find is failure to limit the elective deferrals to the 402(g) limits. This can be a costly error. IRC 401(a)(30) provides that the plan is not qualified unless the amount of elective deferrals for each participant under all plans of the same employer do not exceed the limitation provided in IRC 402(g). Unless a participant is eligible for catch up contributions, the excess plus earnings over the 402(g) limit needs to be withdrawn by April 15th of the year following the year the excess occurred. If they're not timely returned, they're subject to additional tax, so they are taxed in the year contributed to the plan and in the year distributed so they're taxed twice. It's also important to remember that the 402(g) limits are the maximum limits, however there may be other limits defined in the plan document.
Note the 402(g) limit for 2013 is 17,500.

We're going on to slide 36. Some of the internal control questions on the QSAT for this is to make sure procedures are in place to ensure that these limits aren't exceeded and make sure there are checks and balances to alert the plan administrator. An example on an audit held quite awhile ago in Great Lakes, the plan sponsors plan included a separate limit on elective deferrals. The payroll system was programmed to limit the deferrals to the 402(g) limit for the year, but it did not consider the plan limits which for some employees was less than the 402(g) limit.

This resulted in a failure to follow the plan's terms. Correction was required. We allowed a retroactive amendment under a closing agreement to allow deferrals up to the 402(g) limit and all non-discrimination testing was passed. With the closing agreement, there was also a sanction so this could have been avoided with strong internal controls.

On to slide 37, to avoid this mistake, procedure should be in place including checks and balances to alert the plan administrator if the 402(g) limits are exceeded so that corrective action can be taken timely to avoid double taxation. Read the plan to make sure there are not additional limits defined in the plan document. Monika slide 38.

Monika: Slide 38 explains how to fix the error by distributing the excess deferrals to employees. You have to correct by April 15th following the close of the year, because as Janice previously mentioned, timely correction is very important to avoid being taxed twice.. Otherwise you have that 10% additional tax under 72t. If not timely, you can use EPCRS to correct, but 72(t) tax cannot be waived under EPCRS.

On slide 39, I will introduce another common issue, namely, timely deposit of elective deferrals. Many plan sponsors tend to think of timely remittance of elective deferrals as a Department of Labor, EBSA issue, and I am frequently asked to explain IRS jurisdiction With respect to timely remittance of elective deferrals. I would first like to clarify that failure to make timely deposits may constitute both an operational mistake giving rise to plan qualification issues if the plan specifies a specific date by which the employer must deposit elective deferrals and/or you could have a prohibited transaction. IRS, Employee Plans has a memorandum of understanding with Department of Labor that covers coordination and referrals that include these issues. Also, keep in mind that IRS is responsible for form 5330 collecting excise tax for prohibited transactions.

During EP audits we often encounter misunderstandings about the timing requirement. The Department of Labor rule requires that employers make the payment to the plan on the earliest date that the employer can segregate the amount from the employer’s general assets with a maximum deadline of the 15th business day of the following month. For plans with less than 100 participants, there is a seven-day Safe Harbor rule for contributions, but there is no Safe Harbor rule for plans over 100 participants. Keep in mind that if the plan contains specific language about the timing, as I just mentioned, let’s say weekly by payroll, you could have a qualification problem if you’re not following the terms of the plan. The error can be corrected under EPCRS, but the bottom line is that it is important to ensure timely deposits of elective deferrals to avoid problems that are of concern to both IRS and DOL.

On slide 40, we again share some QSAT internal control questions:

- How and when employee deferrals are admitted to the trust?
- Who verifies deferrals allocated to participant accounts are correct?

Back to Janice for slide 41.

Janice: To avoid those errors, make sure you coordinate with the payroll provider to clearly communicate the timing of the deposit of deferrals. If there's any change in personnel, make sure they understand the importance of timely payment of deferrals into the trust.

Slide 42, to fix this error, identify the late deposits and make the payment to the trust including any lost earnings. Discuss the importance of timely deposits with those responsible and establish procedures that will prevent late deposits and remember that prohibited transactions are not eligible for correction under EPCRS. Monika, slide 43.

Monika: Now let's look at hardship distributions. Hardship distribution failures could in many cases be avoided simply by following the provisions in the plan document. Also, it is very important to keep documentation to substantiate the reason for the hardship. We find many errors regarding the application of the hardship rules. There should be procedures to follow to review hardship applications. Many plans are allowing participants to apply for a hardship electronically and the participant may not understand the rules. The hardship distribution should only be made on account of an immediate and heavy financial need and should only be for the amount necessary to satisfy that need. It will NOT be treated as necessary to satisfy an immediate & heavy financial need if:

- It is in excess of the amount needed to relieve the financial need of an employee
- if the need can be satisfied from other resources reasonably available to the participant

Records should be kept of information used to determine eligibility for a hardship. If a participant does something electronically, the plan sponsor is still responsible for maintaining records to show it was properly done. Plan sponsors need to keep in mind the need to follow the terms of the plan in operation. Accordingly, hardship distributions need to conform to the definition of hardship stated in the plan which could be more restrictive than the definition under the Internal Revenue Code.

We often find hardship distributions to participants where the plan allows for loans and the participant does not have an outstanding loan. The financial need could have been satisfied by a loan rather than a hardship. We also find hardship distributions from plans where the plan document does not allow for hardship distributions. Fortunately, this can be corrected by a retroactive amendment to allow hardship distributions – SCP). We have seen an increase in problems related to hardship distributions which could have be avoided or quickly discovered and corrected if the plan had good internal controls. Janice, slide 44 . Janice, slide 44.

Janice: These are the internal control questions that the QSAT will ask and they mostly are about making sure that hardships are only for the amount necessary to satisfy the immediate need. On audit, we find a lot of hardships for much more than what is provided by the participant to show the need. If the plan allows loans was a loan considered for this financial need? Make sure to maintain records and documents used to determine if the rules for a hardship distribution were followed because this will be requested during an examination. Monika, slide 45.

Monika: On slide 45, we provide a few tips for avoiding hardship distribution the errors. The most important thing is to follow the plan language and have established practices and procedures in place to ensure that in operation the plan conforms to its written terms. . We're seeing requests for hardship distributions from multiple employees that appear identical. Each situation should have its own individual circumstances to justify the hardship. We also encounter situations during an audit where only highly compensated employees made hardship requests. - Rank and file-employees must also be notified that this feature is available and it cannot be exclusively for the highly compensated employees.

Janice, back to you.

Janice: For fixing the error, as Monika mentioned, the revenue procedure allows for a retroactive amendment under self-correction which means no sanction to allow hardship distributions for a plan that made hardship distributions even though the plan language didn't provide for hardships. Remember, hardship distributions are taxable and may also be subject to the 10% early distribution penalty if the participant is not 59 and a half. Monika?

Monika: On slide 47, we have a very important tip for you. It's simple but it's very integral to keeping your plan in compliance. The tip is: Read the plan, know its terms, and make sure you're following them.

On slide 48, we again highlight our website that has some really good information that will help keep plans and compliance. The website address, that John Schmidt shared at the beginning of this phone forum, is www.irs.gov/retirement. Visit our website to learn important employee plans information, including the latest information about 403(b) pre-approved plans.

On the next slide (slide 49), we begin a short tour of our internal control tools available for your use on our website at **www.irs.gov/retirement** . Be sure to check out the links to find some wonderful, free electronic tools that will help to strengthen a plan's internal controls. Our web-based tools are user-friendly and include Checklists about common errors found in particular types of plans (such as 401(k) plans; IRA based plans; or 403(b) plans). Anytime you have a no answer it's really important that you delve a little deeper to see if you have a compliance problem. We also have excellent Fix-It Guides that help plan sponsors and their advisors find, fix, and avoid common plan mistakes. The Fix-It Guides correspond to our EPCRS Revenue Procedure 2012-12 and our new 401(k) Questionnaire Self Audit Tool (the QSAT) that will be available shortly.

On slide 50, I'd like to bring to your attention a very important feature on **www.irs.gov/Retirement-Plans/EP-Compliance-Trends and Tips** -- where we share trends-and-tips listed by plan type.

We even have a specific page to share information about our large case Employee Plan Team Audits (better known as EPTA). EPTA plans are plans with more than 2,500 participants and these large plans cover about 60% of the plan participant universe and 70% of total plan assets. Large 403(b) Plans (that are utilized by public and private schools and other charitable organizations), 457 plans and large Multiemployer Plans, known as MAP, are also included in the EPTA Program. We continue to optimize our EPTA program and have expanded our focus to include International issues.

We also have tips on our website on how to prepare for an effective and efficient audit. In fact, the genesis of that particular tool was a brainstorming session many years ago with practitioners. The current iteration on the web is in the form of an Audit Efficiency Guide that provides valuable information about the EP audit process, including good communication tips on how to work together to make the audit process less burdensome and to ensure that the plan has effective internal controls. 0.

Let's go slide 51 where Janice and I are going to share with you some of the most popular voluntary compliance submissions. These errors are not too different from the types of issues that we encounter during EP audits that could result in an audit closing agreements We already discussed common loan errors, 401(k) testing issues, compensation errors, 415 errors, and non-amenders, however there are two unique issues on this slide that we will would like to highlight. I'm going to tell you a little bit about PPA 1101, and excise tax and Janice will discuss scrivener's error.. Under PPA 1101 EP Examinations is encountering a couple of issues in defined benefit plans that we are coordinating with the Voluntary Compliance function in EP Rulings and Agreements. These include Internal Revenue Code 736 issues, such as prohibited payments during a period of benefit restrictions. A common correction is to recover the payment, but if unable to do so, the plan sponsor must contribute the amount that was paid in error.

We are also seeing benefit accruals that should be frozen due to a late or not issued AFTAP even though the plan was well-funded. If the EPTAP is late or not issued, the presumption is the plan is probably funded less than 60% and certain restrictions would kick in. Regardless of the true funding of the plan, the correction is to amend the plan to allow for the restriction of the accruals and to have the plan make contributions as if the current EPTAP drop below 80%

We are also finding some issues with 1101 and excise tax. Under the voluntary compliance program, certain excise taxes can be waived as part of the voluntary compliance statement if the correction causes those excise taxes and this is explained in the latest EPCRS Revenue Procedure 2013-12. Janice do you want touch briefly on scrivener error?

Janice: Right and we just wanted to mention that although we don't recognize scrivener's errors, incorrect language in the plan can cause a failure of following the plans' term so this can be a problem. Onto 52.

Monika: On Slide 52 I want to very briefly highlight our very successful EPTA large case program pilot last fiscal year that analyzed internal controls. to make sure that the plan systems are functioning properly to find and allow the plan sponsor to fix errors. Using a system's analysis audit approach helps to strengthen the plans internal controls to keep it running smoothly. Janice will discuss the updates to the EPTA Internal Revenue Manual (IRM).

Janice: The EPTA IRM was revised to include internal controls. The Great Lakes EPTA manager played a major role in updating the internal revenue manual to include an analysis of internal controls in the systems that are used for plan operation, for example payroll and human resources.

On slide 53, the EPTA trends-and-tips and also internal control questions that are normally included by an agent to understand internal controls and systems procedures for an EPTA exam can be found on the IRS website by typing in the website shown above or you could just copy and paste the top line into your browser. Now Monika will cover slide 54.

Monika: On Slide 54, we feature our examination guidelines that can be found at http://www.irs.gov/Retirement-Plans/EP-Examination-Guidelines In the interest of transparency, we share guidelines that our EP agents use which can help you with your own internal control audits. Janice, slide 55.

Janice: This slide you can also type or copy and paste the address shown on this slide to review many of the internal control tips discussed today and also related IRS and DOL publications.

Monika: On slide 56, you'll see that we have a link **www.irs.gov/Retirement-Plans/EP-Examination-Projects---Learn,-Educate,-Self-Correct-and-Enforce-(LESE)-Projects** that will take you to our learn educate self-correct and enforce or what we call LESE projects. These are small projects randomly selected to look at potential issues and determine how to address them. When we find that non-compliance stems from confusion about the rules, we work with plan sponsors to help educate them and we provide additional expand outreach and guidance. When we encounter deliberate non-compliance we usually expand our enforcement efforts which could include more widespread examinations.

On slide 57, you'll see information about our Employee Plans Compliance Unit (EPCU) projects at **http://www.irs.gov/Retirement-Plans/Employee-Plans-Compliance-Unit-(EPCU)---Completed-Projects---Projects-With-Summary-Reports**. As I previously mentioned, an EPCU Compliance Check is not an audit or an investigation under IRC section 7605(b and does not directly relate to determining a tax liability for any particular period. The purpose of a compliance check is to verify information on a return filing. The contact is usually in the form of a letter and does not involve a visitation from a revenue agents to inspect the books and records to verify compliance. While a letter from the IRS may "feel" like and audit, an important difference is the availability of Voluntary Correction, including self-correction where feasible, or filing a VCP submission, throughout the entire Compliance Check unless it becomes an audit (usually because the plan sponsor fails to respond to the request for information).As you probably ate aware, a plan sponsor is prohibited from filing a VCP upon any receipt of a Notice of Audit (written or oral). Now Janice will cover Slide 58.

Janice: This is our most popular internal control item on the web. It's the Fix-It Guide mentioned previously. What you see at the top of the slide is how you find the link to the guides on our landing page. The Fix-It Guide provides the user a way to find, fix, and avoid the most common errors in SEPs, SIMPLEs, SARSEPs , and 401(k) plans and with the new revenue procedure, we added a new 401(b) Fix-It Guide.

Eddie: Monika and Janice just a quick reminder we are at the top of the hour here.

Monika: We just have a few more minutes and we'll conclude. Thank you.

Janice: Slide 59, this is another internal tool and it's "Have You Had Your Retirement Plan Check-Up This year?" This explains the need for regular review of your retirement plan. It provides checklists for five different types of plans - the same type of plans that have fix-it guides. Each checklist has the top ten errors, (six for SEP plans) The plan sponsor can read each question and answer yes or no. Any no answer could indicate a mistake and should be reviewed. This is not a form that's filed or sent to the IRS. Monika, back to you.

Monika: On slide 60, you have what I refer to as "the EPCRS Menu" and a picture is worth a thousand words (maybe more if you consider inflation). This slide illustrates the benefits of our Self-Correction Program (SCP) and Voluntary Compliance Program (VCP)under EPCRS to keep a plan qualified.

On slide 61, we have the link to correcting plan information **www.irs.gov/Retirement-Plans/Correcting-Plan-Errors** **where you can find the latest** information about our EPCRS programs (Self-Correction, Voluntary Compliance, and Audit CAP), including how to find, fix, and avoid errors and what's is new under EPCRS Rev Proc - 2013-12

On slide 62, you have the link to the newsletters at www.irs.gov/Retirement-plans/Newsletters that John Schmidt mentioned at the onset of this phone forum.\, The two free, electronic newsletters that I want to bring your attention are Retirement Plan News for employers and business owners and Employee Plans News, which is a publication for retirement plan practitioners. t I really suggest subscribing to both. since they're free, they're electronic, and they have hot information right off the presses on important information to help keep a plan in compliance.

The final slide, (slide 63), is a very important reminder that Janice and I would like you to take to heart. It is crucial to have good internal controls to keep a retirement plan running smoothly. Good internal controls help to keep qualified plans qualified so employees can received the benefits promised under the plan and actually enjoy the fruits of their labor when they retire.

We really want to thank you for joining us today for our phone forum on the importance of good internal controls. We also want to remind you to stay tuned for future phone forums on other EP hot topics. Again, thanks for being with us today and have a great day. Eddie back to you.

Eddie: Thank you Monika, thank you Janice and thank you to all of our participants for joining us today. This concludes our conference and you may now disconnect.