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Schmidt: Thank you very much, Colin, and hello everyone. As Colin said, I'm John Schmidt. I'm the acting director of IRS Employee Plans Customer Education Outreach and I'd like to thank you for joining us today and welcome you to our phone forum entitled, "How to Prepare for an IRS Employee Plans Audit. Today we'll be hearing from Monica Templeman, the director of Employee Plans Examinations; Tom Petit, Employee Plans area manager, and Alfred Sanchez, Employee Plans team audit group manager.

Before you start, I'd like to point out a couple of things. We will mail a certification of completion to everyone registered for today's forum who attends the entire presentation. Enrolled agents, retirement plan agents, and actuaries can receive continuing education credit for this session. Other tax professionals should consult their licensing organization to see if today's session qualifies for continuing education credit.

As with all of our presentations, the comments expressed by our speakers should not be construed as formal IRS guidance. We have many retirement plan resources for you so I ask you to please take a look at Slide 2 of your handout where we've highlighted information on Employee Plans audits under Examinations and Enforcements on our website, which is www.irs.gov/retirement. Another way to get to our page from irs.gov is to click on the 'Information For' drop-down box in the upper right corner of the screen, then select 'Retirement Plans'.

If you now take a look at Slide 3, you'll notice a picture of how you can subscribe to our free electronic newsletters. To subscribe, select 'Newsletters' in the left navigation bar, choose 'Subscribe' and then select 'Retirement News for Employers', our unique newsletter for employers who sponsor retirement plans, and the Employee Plans news, our newsletter for retirement plan professionals.

Thank you for your patience with me and now I'd like to turn the microphone over to Monika Templeman.

Monika: Thank you, John, and it's a pleasure to be with all of you today. I'm excited to tell you about the EP audit program and offer tips and trends, ways to prepare for an IRS audit, and tips to help keep your plans in compliance. I'd like you to take a look at Slide 4, about Retirement Plan Statistics, to set the stage for what the retirement plan universe looks like.

There are over a million plans, not counting 403(b) and 457 plans and IRAs, and they cover approximately 90 million participants. We have approximately 19.5 trillion, that's trillion with a T, that are invested in these retirement plans, and that's more than a third of all US households' financial assets. So it's a very vast universe. Now more than ever, it is really crucial to ensure that plans are operating in accordance with their terms and providing appropriate benefits to plan participants.

When our examination presence diminishes, the opportunity for non-compliance increases, and current economic factors that have been plaguing us for the last few years, have made people more susceptible to promoter schemes. That's why it's so very important to maintain an active and vigorous examination program that protects and preserves our retirement system. I feel it's equally important to ensure the right balance between service and enforcement, so my goal is to develop and deliver compliance programs that strike that balance, with an emphasis on good customer service.

The primary objective of the Employee Plans function is to implement and maintain outreach, guidance, voluntary compliance, and enforcement programs to have a positive impact on our retirement systems and protect plan participants. Our mission is to provide Employee Plans customers top quality service by helping them to understand and comply with applicable tax laws and to protect the public interest by applying the tax laws with integrity and fairness to all.

Employee Plans activities cover qualification of pension annuity and profit sharing and stock bonus plans, individual retirement arrangements, simplified employee plans, saving incentive match plans for employees, 403(b) tax sheltered annuities, and IRC 457 plans and related trusts, and the tax treatment of participants and their beneficiaries, deductions for employer contributions, and administrative procedures with respect to such plans. I'd like to emphasize the fact that Employee Plans examinations, the function that I'm responsible for, works closely with Employee Plans Rulings and Agreements and Employee Plans Customer Education and Outreach (CE&O), in what I call a holistic approach to preserve and enhance the private retirement system in America.

Accordingly, there are aspects of outreach and voluntary compliance and enforcement components in each of our key priorities. EP examinations has approximately 550 employees, and of those employees, about 400 are revenue agents who can go into the field and actually examine retirement plans. The entire Employee Plans division has just under a thousand employees. Last fiscal year (our year, as you may know, begins in October and ends in September) we closed over 10,000 EP examination cases and over 4,500 Employee Plans Compliance Unit (EPCU) Compliance Checks.

Transparency is very important in the way we do business and is very evident in the user-friendly, free publications and newsletters that John described, and in the way we openly share information on our website. If you haven't checked it out, it is absolutely fabulous with lots of free tools, and we encourage you to look at the Internal Revenue Manual, Chapter 71 and

Chapter 72 in particular, which give you almost everything you'd want to know about the audit process.

Today, Tom, Fred and I will share with you an overview, not only of the EP audit process, but will also highlight tips to help keep your plans in compliance, and if your plan is selected for an audit, ways to make that process smooth and efficient, and much less burdensome for everyone concerned.

If you turn to Slide 5, I'd like to highlight a question that I get at every outreach event, pertaining to potential EP audit triggers. The question is "What are the kinds of responses on a Form 5500 that are more likely to increase the chances of an audit?" Generally, the answer is "any kind of inconsistencies or blanks reported on Form 5500".

For instance, if the participant section of Form 5500 indicates a sharp reduction in participants, we may see the potential of a partial termination issue. Another example would be a large amount in other assets that's reported on the form; also significant distributions on income statements. Top-heavy plans are something that may catch our interest, especially with 401(k)s and if you've seen the recent 401(k) questionnaire report that's been posted in March of 2013, there are some areas of concern including loans and top-heavy and 401(k) plans, and 401(k) plans with self-employed individuals, that could be areas of more concern.

One tip that I'd like to give you is that if you have anomalies on your 5500, major differences from the prior year, you may want to consider adding an attachment to the 5500 that explains the reasons for the year-to-year anomaly between the two returns on the attachment. In addition to adding the attachment, if the return shows some text in the area where the anomaly exists, you should add a note indicating 'see attached explanation' on the 5500 itself. We also suggest adding something to the end of the year accountant letter. You may want to highlight it to make it more noticeable because anomalies do tend to be triggers for greater scrutiny.

Now I'll turn it over to Fred.

Fred: Thank you, Monika. I'm on to Slide #6. This is a diagram which shows the overall Employee Plans examination process from the time your plan is selected for audit, the various steps we go through to contact you, to conduct the audit for the plan at your sites, to resolving issues and to the completion of the examination. The several slides that follow will go into more detail on each one of these items that are in this diagram.

With that, I will turn it over to Tom.

Tom: Thank you, Fred. On Slide 7, which is the resource examination guide, we have great resources available on the web as Monika and John had mentioned, and this is one of them, the EP Examination Guide. We'll be using some of this material in our presentation today and I encourage you to visit the site and use these resources in the future.

Under the [irs.gov](https://www.irs.gov/retirement) retirement page, you'll find a link for, among other things, examinations and enforcements. If you click on that link it opens up a page with several items of interest including the EP Examination Process Guide and it is this we will look at more today. This guide was prepared in response to a customer satisfaction survey to help our customers through the examination process. There are 11 sections in that guide and we'll go through a few of them today.

Monika?

Monika: Thanks, Tom. And first, just a word about that EP Examination Process Guide. The initial version of it, and I had the honor of working on the predecessor version, was a product that was engendered through the private sector and public sector partnering to look at the components of an effective and efficient audit. We actually brainstormed those components. Today, as Tom previously said, in response to customer satisfaction surveys, the Guide has evolved into an excellent electronic tool that we try to keep up to date to give you insight into the audit process. We'll be referring to it throughout the presentation.

On Slide 8, examination selection methodology, we let you know how plans are chosen for audit. That's a question we get consistently. We continue to improve case selection methodologies to identify areas of non-compliance and develop examination projects that address those areas. With a universe, as I previously mentioned, of over a million plans, we need to leverage our resources to maximize our enforcement presence to facilitate compliance, and look at the areas where we have a known non-compliance or emerging non-compliance, so that we can help plans to maintain their qualified status. We use random selection methods even though we specifically look at set criteria with respect to compliance issues. Let's start with risk -based compliance project exams. Currently, we're focusing on 39 market segments. When I refer to a market segment, I mean a plan type and industry type.

Risk areas are determined based on data from a baseline study of 79 market segments and several years of audit data. In the 401(k) market segment (looking at compliance in 401(k) plans), we're finding some common issues that are across various industries. These issues include ADP/ACP discrimination testing errors; timely employee elective deferrals; and non-amender/late-amender issues. I would like to point out that non-amender/late amender problems are prevalent, not only 401K(k) plans, but in all plan types. We'll be talking about specific common issues later and we're also going to address some of the questions that came in specifically for this phone forum.

Now, let's look at LESE examinations. LESE is an acronym for Learn, Educate, Self-correct, and Enforce. These are small and quick projects. We select plans, using random selection, but we refer consider it to be judgment sampling because we're not doing a statistical sampling.

The LESE concept started in 2007, and helps us to look at issues that could be of significance, because they're emerging , have received high media coverage, or haven't been looked at for a while and appear to be emerging in particular geographic areas. We usually open an LESE project with approximately 50 examinations with one or more similar characteristics that could be problematic. For example, our 401(k) potentially top heavy LESE project was recently completed, and we found many typical types of issues addressed in most 401 (k) plans. The results also are posted on our website in a summary report for internal and external users to be able to take a look at what we found.,. Based on the results of an LESE projects, we decide what to do next. If confusion is resulting in non-compliance, more guidance or more outreach might be the best approach. If non compliance is deliberate, we may need more widespread enforcement, or a combination of enforcement and outreach. Some examples of ongoing or recent LESE projects are:

- Loans from small plans: We selected 100i plans with ten or fewer participants, and over \$100,000 in participant loans. The most common issues were taxable distributions and prohibited transactions.
- The joint venture partnership project: This LESE project focused on defined contribution plans with ending assets over a \$100,000 in partnerships or joint ventures. The most common issue was valuation of assets.
- Another example would be a 4979 excise tax project that involved agents checking Forms 5330for accuracy, as well as ensuring that ADP /ACP tests were properly calculated, and the excess was correctly determined and timely distributed. About 45% of the plans that we sampled had some of these types of problems.

Plans could be audited as a result of a referral, either internal, for example from another operating division such as (LB&I) Large Business International, or (SBSE) Small Business Self-Employed, or from other agency, such as Department of Labor or the Pension Benefits Guarantee Corporation (PBGC). A referral is a situation where a specific plan is being looked at for a possible compliance problem. These referrals also come from external stakeholders, including plan participants.

Tom is going to cover the selection criteria for our large-case program and promoter investigations.

Tom: Thank you. Our large-case program which we call the Employee Plans Team Audit is a specialized program we have in EP Exam and we'll talk about that more in detail later. But they have their own unique selection criteria. Not only do they interface with the risk-based compliance that Monika mentioned, with market segments and industry and plan types, but they use some other criteria to help select those cases, including working in conjunction with Large Business and International, LB&I, that is in IRS. We sometimes work concurrently with them on their examinations and we'll examine the qualified plan of that taxpayer.

We also do stand-alone audits where we just audit the plans without coordinated or joint audits with LB&I. So there's an entire set of selection criteria that's used with EPTA cases, including, for instance, the things listed here. Lately we've been very much involved with international issues along with other parts of the IRS, so some of our audits in the Employee Plans Team Audit arena have been with taxpayers that have international aspects to their operations.

The promoter investigation abusive transactions are another selection criteria we use. Those are done in conjunction specifically with SBSE, Small Business Self-Employed, which coordinates the promoter investigations within the IRS. We get involved with those when they involve a qualified plan with that type of promoter scheme. Also, abusive transactions is another project that we get involved with, particularly abusive transactions that are in the qualified plan arena. So those types of things will be areas where we would have projects or audits using the selection criteria for those examinations.

Monika?

Monika: Yes. On slide nine, the question we get most often is, "why us"? As I mentioned emphasized on the previous slide, we utilize random selection, including for our Employee Plan's Compliance Unit (or EPCU) compliance checks. The primary way we approach audit selections is by random sampling based on set criteria.

This last fiscal year, we also were predominantly looking at 401(k) plans because they the most prevalent type of plans. We've also had an increase in our defined benefits audits and in our IRA-based examinations. About 30% of the cases that we look at don't have issues at all and we're able to go in and out very quickly, and about 34% were closed with self-correction because the plan's sponsor was proactively able to find and fix issues so the errors did not result in a sanction. Most of the cases where there are issues are resolved through an Audit Closing Agreement. Our big passion is to keep qualified plans qualified as legitimate retirement vehicles, and work with the retirement plan community to keep their plans as genuine retirement vehicles for people to reap the benefits of their work when they retire.

To address the question, "why us"? I want to again clarify that, with the exception of a referral or a promoter investigation that Tom just highlighted, we choose plans for audit or compliance checks by looking at random sampling based on set criteria. For example, if we are concerned about an increase in partial terminations in a particular market segment. Hypothetically, let's say 401 (k) plans, we may select a random sample of 401(k) plans that indicate in the participant section of Form 5500, a sharp reduction in participants. If this was a risk-based project, we would use a statistically valid sample so we could project the results into the entire 401(k) universe. If, instead, this was a Learn, Educate, Self-correct, and Enforce – (LESE) type project, the random sample would be a small one (that may not be statistically valid) in order to test whether an issue really is a problem. The next step would be according to what we found and may involved increased enforcement activity, but the sampling/ selection methodology would still be random.

Sometimes EP also participates in joint audits with other IRS functions, such as Large Business International (LB&I) or Small Business Self-Employed (SBSE). Occasionally, EP participates in joint audits with another agency, such as EBSA (the employee benefits function in Department of Labor) through a formal request. . But the majority of our audit work is done by looking at criteria that could be problematic and then randomly sampling to test out whether or not there were problems in that market segment. Now, I'll turn it over to Tom to talk about the initial contact.

Tom: Yes. Once your plan is selected for an audit, you'd be contacted by an IRS/EP agent in some fashion. Typically or oftentimes it's first by phone just to alert you to the fact that your return has been selected, and that would be followed up with an appointment letter soon thereafter.

If you look at Slide 10, you'll notice that it refers to Section 3 of the Exam Process Guide, and there is a whole section on the initiation of an examination. What's included there is not only a sample of our initial contact letter, but there's also samples of the lists of documents that we may ask for on a typical audit and there's a whole list in there for different types of plans, like 401(k) plan, profit sharing plan, defined benefit plan. There's a laundry list of the different types of information document requests, we call them, IDRs, that you would be expected to see on that particular audit. It also contains, Section 3, a telephone checklist that our agents may use or something like it when they hold that telephone conference with the taxpayer with the client sponsor. It goes through the types of question that the agent would be asking to initiate that audit to find out a little bit more background about the plan, about the taxpayer, the business, the place of the business, and those types of things. If you look at Section 3, you will find all of that information there that kind of alerts you about what you could expect in that initial examination.

Slide 11 continues and includes the letter sent on the audit, includes a detailed list of the items required to have available for the agents to review. As I said, this is called the information document request, or IDR. These are very important to us and we try to only ask for relevant documents that we'll need for your particular audit. We'll talk more on that in a few minutes, but that does give the plan sponsor an overview of the types of information we're going to be expecting to review once we get out there.

Some of the items that will be part of this examination we may ask for before we go out there. The agent may request some of the items for review prior to the initial appointment, prior to actually showing up on the place of business. Typically we like to get a plan document for one thing, so it takes some time to review that, so we like to have that done before we go out so we have a good understanding of what exactly the plan is.

Monica, Slide 12?

Monika: Yes. On Slide 12, let's look at preparing for the audit. It's very important to inform the managers and employees who will assist with the audit to make sure you have the right people

available who have knowledge of the business and the systems, such as payroll and HR, and internal controls that are in place to prevent and catch errors. If a plan is selected for audit by the IRS, the EP agent conducting the retirement plan examination will evaluate the effectiveness of the plan's internal controls to determine whether to perform a focused audit (just look at 3-5 issues) as Tom just mentioned, or expand the scope of the examination. In other words, good internal controls are a key factor in keeping an audit "focused". The internal control interview helps the examiner determine whether the plan is well run and whether there are serious compliance risks that would give rise to expanding the scope of the audit. Okay, so Tom, what about Banks and vendors?

Tom: Yes, you can see from the slide, those other people involved with your plan operations typically include banks, vendors, third-party plan administrators. We really look to the plan sponsor to contact those other people and make them aware that records may be requested that they have, so we will not be requesting them directly from those third parties, but we will be expecting the plan sponsor to obtain those types of records from those other people that may be involved with your plan administration.

Fred?

Fred: This is Slide #13 and it continues preparing for the audit. What you can do to make the audit go as smooth and efficiently as possible is to prepare for it. To that end, you should have your plan document, amendments and the most recent determination letter available for the agent to review. It is also helpful to have a hard copy of the various tests performed for the year-end examination. These would include any coverage, non-discrimination, ADP-ACT tests, etc. The agent will most likely have some questions regarding plan operations and processes, so you should be prepared to answer these questions or have someone available who can answer them. Addressing these items up front can help facilitate the pace of the examination. These questions and concerns usually involve plan provisions, assessment of internal controls, and any errors that were corrected prior to the inception of the audit or are in the process of being corrected.

Tom, you have the next slide.

Tom: Yes, Slide 14, which continues with the Section 3 initiation of an examination in the Exam Process Guide. As I mentioned, Section 3 has a sample of an initial audit letter and the attachments. It also has a copy of the Pub 1-EP which is a publication that Employee Plans produces which walks you through the exam process. It also has an explanation of our focused exam process.

It started several years ago when we began this focused exam process which moves from a comprehensive review of all plan operations to a limited review where we concentrate on those important activities or operations relevant to this particular type of plan or industry. It allows us and the agent to focus our audit efforts to better evaluate overall plan compliance

and we hope it makes it a more efficient audit. It takes us less time to complete than doing a full scope, what we call a full scope review, of all plan operations.

Our initial IDR, as I mentioned before, will be tailored to just those items which are included in that focus examination.

Monika?

Monika: On slide 15, you'll see the exam process guide focusing on initiation of the examination, with a reference to the place and time for conducting an audit. I published an article in the Retirement News for Employers, one of the newsletters John spoke about during the opening, that focused on the frequently asked question, "Why do we have a strong preference to conduct the audit at the taxpayer's place of business?" The answer is, to ensure the Employee Plan agent's time is efficiently used by having access to source documents where they are stored, and also have a chance to evaluate internal controls. It's also important to evaluate certain issues, such as controlled groups and possible eligibility and coverage. If we receive a request for an exception to having the EP examination at the taxpayer's place of business, we may grant it if it's due to a genuine business reason (for example, no office space for the agent) and if the source documents are with the plan adviser, not at the place of business. If we agree to conduct the audit at a practitioner's office, the agent will still request to walk through the business and check it out for the reasons I just specified.

Tom, would you like to elaborate?

Tom: Monika, I think you've covered it. We should probably go on to the next slide.

Monika: No problem. The next slide is again sharing tips for a smooth and efficient audit and I wanted to basically stress here the importance of open, honest communication. If an item or items being requested don't seem to be the best approach and/or if there's an easier, less burdensome way to deliver that information, by all means talk to the auditor. Good communication and quick responses significantly reduce the length of an audit and are in everyone's best interest.

On Slide 17, again we'll continue with tips for a smooth audit. There's an erroneous reference to ERPAs on that slide, but the basic concept is correct; allocate enough time for an opening interview between the EP agent and the practitioner. Again, make sure all plan documents and requested records are readily available. Keep in mind, the opening interview helps the examiner determine whether the plan is well run. Form 5500 filings should be available and should reconcile to the books and records. . Efficiently organize all materials so that the IRS agent doesn't have to hunt and search through boxes to find what is relevant. Efficiently organizing the requested materials makes the audit much smoother and also shows that things are well-run and well-organized. The opposite is true when boxes just dumped in a room for us to sort through.

On slide 18, although Fred touched on some of this, I want to emphasize that it's important to have test results(such as ADP/ACP; coverage testing; top heavy)and be able to explain the terms of the plan and the operations of the business. This again is why it's so important to have the right people available to talk to during the audit.

On slide 19, I want to take this opportunity to again stress the importance of good internal controls, as I've been doing all along. During the audit, be prepared to talk about practices and procedures and good internal controls, because that could make all the difference in being eligible for self-correction. Self-correction is a possibility during an examination for insignificant errors , or even to complete correction on a significant error. If the correction was 65% corrected prior to the audit (or notification of an audit), then, we'll let you self-correct even though, we've already started the examination. If the mistake is less than 65% corrected, the proactive actions to correct could be a significant mitigating factor in determining an Audit Closing Agreement sanction. Having good internal controls can also significantly reduce the time for conducting an examination. It's important to have honest communication about what you found during internal self audits and what you're in the process of correcting in order to develop trust and credibility. Good internal controls can also help to promote clearer communication between the IRS agent and the plan sponsor and their representative.

"What are some examples of good internal controls?" is a frequent question I would like to address. In a nutshell, good internal controls include:

- Segregation of duties within the plan sponsor's various functions, such as payroll, accounts payable, general ledger, human resources, etcetera.
- Systems such as the ones I just mentioned in the plan's operation, that need to be established to verify consistency of data and processes with the plan's provisions. Remember, it's important to check that these systems accurately verify data and have processes to ensure compliance and catch mistakes.
- The plan's books and records, need to be maintained by knowledgeable and responsible personnel, and
- Books and Records need to reconcile to the Form 5500 which also needs to be filed timely and completely.

If things are outsourced, don't shift the responsibility to a third party. It's very important that the plan sponsor know that they're still responsible for having a well-run plan and strong internal control. With that, Fred will cover the next slide.

Fred: Thank you, Monika. Let's go on to Slide 20. One of the questions than an auditor will ask up front is the status of any operational errors uncovered during the years under exam and letter of ECP was submitted. Typically these errors fall into one of three pools.

The first pool is errors for which a VCP application was submitted and ruled on. This really doesn't affect the audit other than it's good to know up front so the agent doesn't come across it and try to fix something that's already been fixed.

The second pool are errors that were found and were resolved under VCP prior to initiation of the audit. So long as the errors fit under the VCP guidelines of EPCRS Rev. Proc. 2012-13, they're not really considered as part of the audit. But it's nice to know this up front so that the agent again doesn't come across it and spend any significant time looking at them.

The third pool of errors are errors that were found before the initiation of the audit or are still in the process of correcting after contact for the audit. Our basic rule of thumb which I believe is referenced in Rev. Proc. 2012-13 is that correction is at least 65% complete, we will allow you to finish correcting and will not consider it as an issue for potential closing agreements. If it is less than 65%, the agent will consider it an equity which works in your favor.

I'm moving on to Slide #21. Slide 21 deals with a document that was prepared, put together a few years ago and it's called the Audit Efficiency guide. It is basically a PDF file which sets forth some of the protocol to be followed by both the agent and the taxpayer, and has things like the date of the audit, time of the audit, the way records will be provided, whether they're going to be in hard copy or whether they're going to be electronic formats, mutual response times and follow-ups and things of that nature. It's a tool for our agency. It's not mandatory that they use it, but it's highly encouraged and if you go to this website which is, I believe you go back to Slide #2, you can find the link there for this guide and you can print it and you can sit down with the agent and you can go over that when they do their initial visit with you guys.

With that, I'm going to turn the pulpit to Tom for Slide #22.

Tom: Thank you, Fred. Slide 22 deals with the Section 4 of the Exam Process Guide, communications during exam. Monika mentioned the importance of communication between the agent and the client sponsor or practitioner, POA, during the audit process from initiation to closure. This section provides some general explanations of what you can expect during that type of audit and includes the types of letters that may be used by the agent during the exam process. There's a list of letters for all types of scenarios that we use and many of them are included in that Section 4.

Also in Section 4 are samples of IDRs that were also shown in Section 3, but you'll find them again in Section 4, which has IDRs that you can expect to see for all different types of plans and audits.

Fred?

Fred: Thank you, Tom. I'm going to cover a little bit of our EPTA Program, our large-case examination program. I am the EPTA group manager for Gulf states and while we audit the same issues as in general program eligibility coverage, etc., the way we go about it is very

different due much in part to the size and complexity of some of these large cases. What we'll go through in the next few slides is to highlight some of the differences with some of the things that are the same, some that are different. I'm going to turn it over to Tom. He's going to talk a little bit more about the criteria for picking an EPTA case.

Tom: Thanks, Fred. As I mentioned before there is a separate criteria we use for selecting cases for our team audits. Actually if you look in the IRM it's there. It shows you, it's in the IRM, I'll give it to you its 4.71.16.3. The threshold is a plan or plans with a minimum in the aggregate of 2,500 participants. On a regular basis the selection committee made up of the EPTA managers and the area managers gets together and cases are selected for exam.

Not every case selected is examined but it's a pool from which we draw on. Some factors that go into determining whether a case is selected include but aren't limited to referrals, both internal and external, media reports, plans that have experienced mergers and acquisitions, if there is significant decrease in trust assets, or significant investment in what's called tier 3 assets, which are private equity hard to value assets, voluntary compliance withdrawal requests could get looked at and this list is not all inclusive, so Fred?

Fred: One of the things that is different from a general program audit is the pre-audit analysis. The agent will do quite a work up front pre-planning the examination before it even makes contact with the tax payer. The agent will typically do research on the internet and through our internal systems such as our IDRS information document and retrieval system and TEDS, which is our tax exempt determination system to see what's out there.

Whether there's any other IRS functions doing any kind of audits in the operations of the tax payer. We use plans that tend to be large and complex and we would typically bring in an actuary, especially if it's when there's defined benefit plan, that's one of the plans we're then be looking at. We also bring in our attorneys to help us as well

Another thing we do up front in the first portion in the initial portion of the pre-audit is we do a very thorough assessment of internal controls. One of the initiatives within the enforcement functions of the IRS' assessment in internal controls and in employee planned exams, we have begun a more thorough job in this area.

We will look at the key people involved in internal processes and procedures as well as gauge how well the various functions such as payroll, benefits and HR communicate with each other. The benefit of this assessment is twofold, first it helps us to consolidate the areas we want to look at and it points us to potential areas of non-compliance and (2) it's significantly shortens the audit timeline, so it's favorable for both the tax payer and for the service, and this really is important in this time of limited resources.

Also, we do focus the examinations as well. Once the agent completes the pre-audit analysis and goes through, he will go through and pick the issues, the monetary issues he's going to look

which are always going to be client qualification form and distributions, and he'll pick up some other issues as well to look at up front. This list of the ten we expanded as the audit progresses if there is a reason to do so. I'm going on to the next slide, Analysis of records.

When examining large plans our optic program the number of records and population is usually high so the only real way to examine them is by securing these records in some type of electronic format. These records are typically requested upfront. You work with a computer audit specialist. That's a specialty within LB&I to put them in a format that we can use, typically Excel or Access. Some of our agents have very good computer skills and design and run their own queries to stratify links and sample data. We also work with RCAS in the more complicated ones that we run.

Once we have these records we do not go back to the tax payer until we see some discrepancy that needs to be addressed or we have some samples that we want the tax payer to provide support and data on. Now since the computer records are in electronic format it makes for a more efficient audit, and it is a lot less cumbersome on the tax payer as well.

We're on to slide number 27, Information document requests. The information that we request on an EPTA audit is done through a sequence of IDRs.

Typically the first round of IDRs is for basic information such as plan documents, returns, disposal agreements etc. Usually these are easily filled requests that are sometimes sent out with the opening letters so that they may be available for the auditor's first visit with the tax payer.

During the opening conference with the tax payer we discuss how the IDRs will be issued and we give a timeframe for responding to them. The IDRs are specific and only relate to one plan per request. The IDRs are issued over a period of time so as not to overwhelm the person or persons filling them. We will typically issue them in draft form and discuss with the tax payer prior to forming the issue.

Certain IDRs can take a little longer to fill such as those coming from service providers, and you typically work with the tax payer are any extensions needed. Once we get the IDR we review it for completeness. If it is not complete we do not issue another IDR but rather some type of correspondence such as a letter or a memo to communicate to the tax payer why the IDRS response is efficient. The response date is kept and the tax payer is encouraged to submit the missing data as soon as possible.

I'm going on to slide number 28, Co-ordination with large business and international. On many of our large audits we will be on site at the same time as the LB&I. We have different functions but we work well together. We work hard to co-ordinate our efforts with the LB&I team and will typically follow LBNI protocol on IDRs and notice the pros adjustments. We will also assist the LBNI team in evaluating both foreign and domestic pension expenses. One of the concerns

the tax payer has with this sometimes is they think we're going to be part of the LBNI team, which goes from one cycle to the next.

That is typically not true. We typically do not have the resources to work from one cycle to the next so we will pick up where we determine there are issues that go into the future years. We log it for one cycle. We'll try to work with the tax payer to get the permits and compliance and then typically we close up and move on to something else. That is not to say that we will not, that we will never go back. There are certain times when another audit is justified, but that is the exception and not the rule.

Another initiative that the service is under is the increased emphasis in the international arena. With this in mind we have to train our agents in a number of different foreign issues on compliance including eligibility, coverage, foreign equality and foreign pension expenses. We work collaboratively with our LBNI counterparts embedding these issues.

I am going on to slide number 29. These audits tend to be large and complex, with issues that you sometimes don't see until you work large cases. These include cross-testing, subsidized early retirement [inaudible 00:07:54], cash balance conversions, legacy benefits, minimum distributions etc. It's not uncommon to bring in specialists to assist in these issues. As a matter of course we'll bring in an actuary refer and any reference that we are examining or if there's an issue on a VC plan that they can assist on.

We will bring in our field counselor attorneys when an issue comes up with regards to planned language or we encounter something unique. Some examples that I can cite from my own experiences are full day farce, spin-offs, IOC, or transfer of assets, lost participants in early retirement windows.

We also bring in LBNI specialists to assist on this issue time to time. They can be general engineers, financial product specialists, economists and international examiners. We typically bring these people in to assist on things such as hard to value assets, real estate holdings, private equity and foreign pension expenses. With that, I am going to turn over to Monika for slide number 30.

Monika: Yes, thank you. On slide 30 again we this slide refers to the section in the Audit Efficiency Guide where either the employer mails additional information, or the agent conducts a subsequent visit. Again, I want to stress the importance of honest, open communication and the ability to suggest alternative and/or less burdensome ways to provide additional requested information. I am also going to take this opportunity to address a question that I frequently get about whether it is okay to discuss a case with the agent's group manager or even higher up the line, if needed? The answer is an unequivocal yes. If you have an issue, or a problem that can't be resolved and you feel the need to elevate it, by all means feel free to do so. Hopefully, most things can be resolved working with the auditor, but if you need to get the group manager involved or even move it further up the management chain, we encourage you to do this to be

able to resolve issues. One of our customer service initiatives is to make sure that the group manager's name and phone number are on our letters so that you have that information available.

I would like to now turn your attention to the next slide which Tom is going to cover on concluding the audit process, resolution of issues, and Appeals

Tom: Thank you Monika. On slide 31 you'll see the flowchart portion that talks about are there any issues requiring a change. If there are not any issues then the next step is to close the case, and I'll need to point out that the agent should notify the plan's sponsor that the case will be closed and there are no changes required.

Discussing the findings on the audit, there may be items to bring to your attention, that don't impact compliance today but they could be watch-outs for the future, things they should be mindful of because they could lead to compliance problems in the future. Those types of things should be discussed with the plan sponsor and they actually may show up on the closing letter.

If there are issues that require a change this could take three parts, one is tax changes such as excise tax or income taxes, there could be items that could be corrected or will be corrected under one of our correction programs or it could end up an unagreed case and we'll talk about those more in a few minutes, Monika?

Monika: Thank you Tom. Slide 32 has the EPCRS (Employee Plans Compliance Resolution System) menu that Tom was referring to is resolve compliance issues. Here, a picture is worth a thousand words, or perhaps ten thousand, considering inflation. This slide illustrates the advantage of conducting a regular self audit to make sure the plan is in compliance in both form and operation, so that the Self Correction Program (SCP)s available, where feasible. As you can see, SCP has no fees or sanctions to the IRS and no reporting requirements to the IRS. The cost of correction if you find things quickly is far less. This is definitely an incentive to correct proactively and sooner rather than later. Also keep in mind that the Voluntary Compliance Program (VCP) is a very reasonable program and r document failures cannot be corrected through self correction. VCP is a wonderful alternative, and worst case scenario, if issues are found on examination. In most cases, they can be resolved through an Audit Closing Agreement (Audit CAP) which is still a copasetic win-win situation, and a much better alternative to plan disqualification. An Audit CAP preserves a plan's qualified status and is non-Draconian. The closing agreement program is excellent, but the menu really speaks for itself why it is important to be proactive.

On the next slides, slide 33 and 34, I want to highlight very quickly the impact of the new Employee Plan's Compliance Resolution System (EPCRS) Revenue Procedure 2013-12 and the fact that you should check it out on the website. We have an excellent link at www.irs.gov/retirement click on the correcting plan errors and it tells you what's new and under EPCRS including highlights of what is new under Rev Proc 2013-12 which now allows

403(b) plan sponsors to correct 403(b) documents failures. The biggest visible change for practitioners is that we now require filing forms, Form 8950, Application for "Voluntary Correction Program" and Form 8951, "Compliance Fee for Application for Voluntary Correction Program" which mirror our determination letter filing forms. This is one example of our closer coordination of our determination letter and voluntary compliance sister functions.

On slide 35 I want to focus on the impact of the IRS letter forwarding program no longer being available (as of August 31, 2012 for plan sponsors to use to locate participants and beneficiaries to whom additional benefits under the plan are due. Any requests for locator services received by the Service on or after August 31st were not processed. There was some limited extension of relief under Rev Proc 2013-13, but that ended May 30th. Keep in mind, it's the plan sponsor's responsibility to take action to find all current and former participants and beneficiaries who are owed an additional benefit under the plan. If they can't be located at the last known address, then it is important not only to send a certified letter, but if that's unsuccessful, to use an additional search method. Although you can no longer use the IRS letter forwarding program, you could still use the Social Security Administration Employer Reporting Service Letter Program; a commercial locator service; a credit reporting agency; or Internet search tools. In some cases it might be prudent to use a combination thereof.

The other frequently asked question is what about self correction program under the new Rev Proc 2013-12? Keep in mind that the predecessor Rev Proc 2008-50 and Rev Proc 2013-12 have the same self correction provisions for 401(a) and now 403(b) plans. If a significant operational error that qualifies for SCP is at least 65% corrected as Fred previously discussed, you could even use SCP for a plan under examination. The flip side is true that you still cannot use self correction to correct document failures for any type of plan.

The next slide is one in which Fred, Tom, and I'll now turn it over to Fred.

Now let's get to slide 36, where Tom, Fred and I are going to discuss common examination errors. We will be also answering some of the pre-submitted for this phone forum as part of our presentation and we'll use most of the remaining time to do that. Fred, I'm going to turn it to you.

Fred: Thank you Monika. Prior to this phone call and we did get some questions in, which we're going to try to incorporate within these topics that we have covered. I will be covering non-amenders and roll-overs. Tom will come in after me and he'll tell you the definition of compensation, including ineligible employees and excluding eligible employees and then Monica will come back in and cover recurring loans and hardship distributions.

Employee plans examinations and focused audit mandate and one of the mandatory issues that agents are required to address is plan qualification inform.

As such one of the first requests for information that an auditor will issue is on examination, is for a copy of the most recent letter of determination along with copies of all planned amendments, planned documents etc. Our auditors will address the timeliness, the accurateness of these amendments.

Sometimes we do come across issues that are considered true non-amenders or late amenders, where we will require that a retro act amendment be adopted and effective back to date that it should have been enforced in accordance with the requirements EPCSR 2012-13.

There will be a closure agreement along with a reasonable monetary sanction. This is a requirement under the Rev Proc. On a sidebar if you find this yourself you can submit a VCP application. You can't submit a VCP. It's much cheaper than if it's found on audit.

This kind of error cannot be corrected through self-correction. It has to come in on a VCP application. Sometimes we come across situations where there are missing or unsigned amendments. This could be due to a number of different factors including a wrong submitter, sponsor's no longer in business, or a date that you no longer have a business relationship with, or just misplacing the documents and that kind of thing.

What you want to do, is you want to make your case based on the facts and circumstances of the particular case in question. If you know that you did adopting end but cannot come up with a signed copy of it, what you want to do is you want to submit copies of board of director minutes, which might reference these amendments, copies of correspondence between the tax payer and the service provider that mention these amendments and things of that nature.

What you want to do, is you want to make your case to the auditor that you didn't timely document the amendments in question and provide as much supporting documentation as possible. We also got some questions regarding roll-overs. With respect to eligible roll-overs, the planned sponsor of the plan we to make certain that the roll-over is shared and make certain that it is ineligible before bringing it in to the trust.

Our position is that a participant cannot self-certify that it is that same permanent qualified retirement plan. There needs to be some kind of documentation to substantiate that it is a eligible roll-over and that can be in the form of a letter from the prior plant sponsor noting that the name of the plan and that it did have a note of pre-determination letter. It can also be in the form of a notice of as the same type of information. With that I'm going to turn it over to Tom, he's going cover compensation.

Tom: Thank you Fred. Compensation continues to be another common examination issue area that we find time and time again. The definition of compensation is one of the most important definitions in the plan because it's used to determine such things as allocation, accrual, deferrals, and it is used for various testing purposes such as ADP/ACP , non-discrimination

testing. You can have different definitions of compensation for different purposes, so this makes it a likely place where errors can occur.

You should make certain the correct definition is used for its intended purpose and you should make sure that in your payroll and benefits departments, the processes are correctly set up to capture the various fields that go into compensation. Some plans have very complex definitions in compensation. There're all types of parts of what makes up compensation, especially if you get into the larger plans. Making sure that the data that is used by your HR department correctly picks up all those things that make up compensation as determined in the plan documents for whatever purpose under the plan is correct.

That is time and again an issue that we find very common, common errors in plans. Another one, at times we'll come across situations in which eligible employees are not participating in the plan. When this occurs we require that these individuals be brought into the plan and that correction be given to accounts, including all benefits, earnings they would otherwise have been entitled to had they been in the plan at the inception of when they should have been.

Again at times we come across situations where the plan includes people that should not be in the plan. An example of this would be a non-resident alien who was included in the plan specifically excludes them. We run into this from time to time on some of our larger cases also. The remedy is to take them out of the plan and reimburse the plan for any amounts which could not be recovered from the individual due to distributions or paying out of benefits. Monika are you going to take loans?

Monika: Yes and I also want to again let everyone know that a lot of the questions that were pre-submitted are being incorporated in our discussion of common issues, including loan issues. In June 2011, the Wall Street Journal reported that 30% of all retirement plans have a loan outstanding which is the highest level in history. It's not surprising that we continue to see an increase in participant loan issues, including in our recently published 401(k) Questionnaire Final Report, where data analysis indicated a potential major issue with defaulted loans. Two common issues we are seeing during plan audits are exceeding the code limit and the defaulting of the plan loan. Loans in excess of the \$50,000 maximum allowed are common error. We see that there is a problem with understanding that rule. Keep in mind that the amount of the loan cannot exceed the lesser of 50% of the plan's vested participant account balance or the \$50,000. We are also seeing issues with the treatment of outstanding loan balances when participants terminate employment and account balances are distributed. We find plan documents that actually specify a limited number of loans, let's say no more than three outstanding loans, but the agent finds that they violated this provision. Maybe they're giving five outstanding loans. Other problems include loan terms longer than five years and the loan is not for the purchase of a primary residence, problematic payroll practices (usually a failure to withhold loan payments), mergers and acquisitions that result in payroll errors, and too often, we see plans that provide loans for the participants but the plan document does not allow for loans in the plan language. Unfortunately, the plan sponsors may not be reading their

plan. Now the good news is that plan sponsors can correct this error and provide loans by retroactive amendment under the Employee Plans Compliance Resolution System. They need to do so however, or they're in violation of the terms of the plan. Most common loan errors submitted under the Voluntary Compliance Program are loans in excess of 72(p) limits and also loans where the terms of the loan do not match the plan provisions. To avoid loan errors, it's important to develop practices and procedures such as five-year plan limits, a reasonable interest rate, meeting dollar limits of 72(p) and repayments according to the terms of the plan, and a repayment schedule (at least quarterly).

I'd like to switch gears and discuss hardship distribution issues that we're seeing, and again with economic times of late we've seen a lot of hardship distributions. Hardship distribution failures in many cases could be avoided by simply following the provisions of the plan document. Also, it's very important to keep documentation to substantiate the reason for the hardship distribution. We find many errors regarding the application of these rules. There have to be provisions in place because the onus really is on the plan sponsor. The 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 immediate and heavy financial need if it's an excess amount of what's needed to relieve the hardship or if it could be satisfied from another source. The hardship rules, require a plan participant to have an immediate and heavy need and it has to be in certain qualifying category such as medical expenses for the participant, their spouse, dependent, or beneficiary; costs directly related to the purchase of a principal residence (excluding mortgage payments); tuition related to educational fees; payments necessary to prevent eviction from a principal residence, or foreclosure; funeral expenses for immediate family or for the individual; and certain expenses to repair damages on a principal residence. A plan could be more restrictive than the IRS Regulations and have limited hardship circumstances. Again, plan sponsors have to follow the terms of their plan document.

We also find many problems where hardship requests are made electronically by participants using a PIN and self certifying, but there's no documentation. Again, the onus is on the plan sponsor to keep proper records in case there's an audit.

One of the questions that was pre-submitted concerned documentation to substantiate safe harbor hardship distributions under a 401(k) plan. When providing for hardship distributions it's important to review the language in the plan documents to determine when, and under what circumstances, you can make that distribution. When you amend the plan document you have to make certain that the language regarding hardship distributions is contained in the most recent document. Establish hardship distribution procedures and determine if the procedures are sufficient to avoid mistakes. Only allow hardship distributions that meet the plan document and Internal Revenue Section 401(k) requirements. The Regulations allow a plan to rely on the participant's written representation that the hardship distribution is the only reasonably available source of funds when there is a submission that other financial resources are not available. Also it's very important to keep substantiation of the reasons for the hardship. We

find many errors regarding the application of the hardship rules and one of the questions that we got is what kind of documentation is necessary to substantiate hardship distributions under a 401K plan and this response actually apply to other plans as well but when providing for hardship distributions it's important to review the language in your plan document determine when and under what circumstances you can make a distribution.

When you amend a plan document make sure the language regarding the hardship distribution contained in that most recent document establish hardship distribution procedures, determine if the procedure is sufficient to avoid the mistake, and only allow hardship distributions that meet the plan document and the internal revenue definition of hardship distribution, and while hardship distributions must be to satisfy a real and financial need it also has to be the terms specifying under the plan to allow for a participant's written representation. It should be that the hardship distribution is only reasonably available for funds when there is submission that other financial resources are not available.

Reimbursement of compensation insurance liquidation of employee assets, cessation of elected contributions of employee contributions under the plan, currently available distributions are non taxable owned under the plan maintained by the employer, borrowing from commercial resources, if none of these can satisfy the need the participants should submit the following documentation with their request: a written representation of the hardship, amount necessary to cover the hardship. Another example of other resources could be plan loans Written representation that the hardship can't be relieved through other resources and the hardship distribution request needs to ask for a written statement of their application that that's the means to satisfy this real and necessary need. This written certification by the participant is acceptable unless the plan sponsor has actual knowledge to the contrary. If they do then that would be a problem.

Now I would also like to emphasize that participants should submit the following documentation with their hardship request:

- Written representation of the hardship
- Amount necessary to cover that hardship,
- Written representation that the hardship can't be relieve by other resources.

The information required is very important in order to ensure that the hardship request meets that definition under the regulations.

Tom will now cover a pre-submitted question on ineligible hardship distributions.

Harry: Just a reminder we can't reach the top of the hour.

Monika: Okay we'll conclude within five minutes.

Tom: Thank you. Yeah, the other question that came up about hardship is what happens if during the audit the agent determines that there was an ineligible hardship distribution? What I want to point out is that there's a fix-it guide that I was going to talk about but we don't have time to but on our website there are some fix-it guides that talk specifically about this. If the plan document does not allow for hardship distributions but in operations they allowed some, as Monika mentioned, EPCRS allows a retroactive amendment to the plan which does allow hardship distributions.

That's available under EPCRS but if a hardship distribution was made to participant that doesn't meet the plan document hardship requirements then correction may involve something in terms of a repayment to the plan of the amount that didn't meet the plan hardship requirement.

The correction will depend on the fact and circumstances in each situation, but I want to point out that if the plan's under exam the only correction program available under EPCRS is the one on the audit closing program, the Audit CAP. We would have to consider whether this was an insignificant or minor problem that could fit under SCP or if it was not because it would have to be resolved in Audit CAP.

Monika: We have a lot of documents that we provided at the end of the presentation that show you our good internal control tools, including our Plan Check-up checklists, our IRS Fix-It Guides, and our new QSAT(Questionnaire Self Audit Tool) that's going to be launched by the end of this year as an interactive document with internal control questions, that can be downloaded from our website and used to help plan sponsors to conduct annual self audits to find, fix and avoid costly mistakes,

Again, the new QSAT is going to be available very soon, so stay tuned because we are planning to do a phone forum to launch it. Please check out our website and look for our great, free tools and join us for the future phone forms.

We thank you very much for joining us today.