

CHAPTER 10-BASIC EXAMINATION TECHNIQUES

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TAX EXEMPT AND GOVERNMENT ENTITIES*

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INTRODUCTION-

OVERVIEW

Chapter 7.6 of the Internal Revenue Manual (IRM) provides Employee Plans (“EP”) agents with general techniques and procedures to examine retirement plans. Additional information sources, such as fraud referral procedures, are indexed in IRM Handbook No. 4.2, Section 1.8, Other Applicable Handbooks.

The IRS Restructuring and Reform Act of 1998 (RRA) impacts the procedures relating to the EP/EO examination program. These RRA provisions include the following:

- Act section 3001 Burden of proof
- Act section 3411 Taxpayer confidentiality privilege
- Act section 3417 Notice of IRS third party contact
- Act section 3705 IRS employee contacts

EXAMINATION JURISDICTION

TE/GE, EP function, has examination responsibility for all EP returns and certain non-return units as well as employment tax returns of the plan’s trust and information returns. While examiners in the other operating divisions have examination responsibility for other Federal tax returns, EP agents are required to perform a package audit and inspect all federal returns to ensure they have been filed properly. See IRM 7.6.3, Special Case Processing Procedures for the package audit procedures.

The Tax Exempt Quality Measurement System (TEQMS) for Examination has eight quality standards to assess organizational performance. These standards are:

1. Examination Planning
2. Examination Scope
3. Documents/Operational Compliance
4. Examination Techniques
5. Workpapers/Reports
6. Application of Law/Tax Determination
7. Timeliness
8. Customer Relations/Professionalism

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Form 5464, Case Chronology Record, is used on all examinations to document actions taken. It's imperative that your actions be noted on this form in order to meet the quality standards. Activity should be commensurate with the time charged. Appropriate use of time depends on:

- ◆ the complexity of the issues,
- ◆ whether research was performed and warranted,
- ◆ whether internal sources of information were obtained, and
- ◆ other documentation in the file.

Conducting the Examination

PRE-CONTACT ANALYSIS

The examination process begins with assignment of the case. Your pre-contact analysis becomes part of the workpapers. TEQMS measures whether the pre-audit plan identified material issues. Initial requests for information must be clear and concise and address potential issues selected. Your work papers must clearly identify who was contacted, their organizational relationship, the records (and information requested), and the pertinent dates.

Start the pre-plan by reviewing the return for pertinent data taking into consideration the items on Form 5772, EP/EO Work paper Summary. Return data includes

- type of plan,
- type of business,
- number of participants,
- amount of contribution and benefits paid,
- trust investments, and
- change in asset values.

Note all large, unusual or questionable items.

Review the return charge-out document and classification sheet for special projects and condition codes. The classification sheet contains indicators as to the whether the plan has applied for consideration under EP Compliance Resolution System (“EPCRS”) or requested a waiver. Area managers receive updates monthly on all Plans being considered under Voluntary Compliance Program (VCP). When the plan has requested VCP, you may be able to survey the return (see Rev. Proc. 2001-17, section 10.12). The classification sheet also provides the trust EIN.

Query internal sources for additional information. Review IDRS for the following information:

- INOLES for current the taxpayer’s address on the most recently filed return
- EMFOLT for return due date and statute expiration date
- EMFOLL for plan history, including information on favorable letter requests
- ERTVU for Form 5500 line item entries
- BRTVU for the plan sponsor’s tax return data. This tells you the amount deducted for Pension/PSP contributions, Officers’ compensation, net taxable income or loss, etc
- AIMDISA for current exam status. Your assigned return should be in status 12 when contact is first made on the case. Also check the AIMS data for the sponsor’s income tax return. If a related income tax return is open, contact that examiner to coordinate the examinations.
- See the attached Exhibit for more information on IDRS command codes.

Check the EP/EO Determination System (EDS) for information regarding the status of pending requests for determination letters or caveats on determination letters that have been issued. If a request for a determination letter is pending, do not close the examination without first ensuring that the request will receive favorable treatment. However, the group manager may approve closing the examination without waiting by indicating such approval on Form 5464.

When examining large complex organizations, it may be necessary to obtain assistance from the Computer Audit Specialist (CAS) in your area. See IRM Part 4 for details on obtaining assistance from the CAS. If engineering assistance is needed, also refer to IRM Part 4.

Query external sources such as www.benefitslink.com and www.freeERISA.com and Choice Point.

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Consider these items, errors, inconsistencies and incomplete responses on Form 5500:

- A final Form 5500 that indicates that the Plan has not applied for a favorable determination letter ruling.
- A Large percentage of assets classified as “Other Assets” on the balance sheet (Questionable assets.)
- Large distributions on income statement. (Check vesting; determine if the participant included the distribution in income; determine if participant is subject to early distribution tax)
- Section 401(k) plans that are top heavy. (Providing top-heavy minimums for non-key employees who did not receive employer contributions; treatment of matches used to meet top-heavy minimum)
- Top-heavy plans covering self-employed individuals. (Determine the correct earned income for self-employed individual.)
- A Low percentage of participants compared to number of employees. (Coverage problem under Code section 410.)
- A Large percentage of loans to participants compared to total assets or large dollar amounts of loans. (Prohibited transaction; Code section 72(p) and 72(t) tax issue.)
- Funding deficiency on the Schedule B for a defined benefit plan. (Under funded plan and excise tax.)
- A Funding deficiency on the Form 5500 for a defined contribution plan. (Under funded plan and excise tax.)
- The date of the most recent amendment is prior to 1993. (Did not amend for TRA 86.)
- A “yes” answer to the question, “Did any amendment during the current year result in the retroactive reduction of accrued benefits for any participant?” (Reduction in plan benefits.)
- When comparing multiple years, noting if there is a large drop in plan participants. (Plan partial termination.)
- Large amounts of assets in real estate. (Unrelated business income.)
- Where the return indicates the plan terminated a long time ago but distribution did not take place. (Distribution must occur as soon as administratively feasible, usually within 1 year – see Revenue Ruling 89-87.)
- A Terminated plan where the date of the most recent amendment is not current. (Terminated plans must be amended for the current law prior to termination – see Notice 87-57.)
- A Large decrease in number of plan participants from beginning of year to end of year. (Partial termination.)
- When comparing multiple years, there is a large change in assets. (Reason for large fluctuation.)
- Large amounts for administrative expenses. (Valid plan expenses?)
- Large amounts of liabilities. (Reason for plan liabilities.)
- A Large percentage of plan assets in any one investment (e.g., mortgages.) (Diversity of assets.)
- A Small ESOP plans (less than 10 participants.) (Closely held stock and stock valuation question.)

- Plans terminated soon after they are established. (Failure to meet the permanency requirement.)

EXHIBIT 1 – IDRS RESEARCH – VARIOUS COMMAND CODES

IDRS command codes can provide additional information regarding the employer, the plan under examination, and other plans maintained by the employer. Form 6882 should be used for the request. See IRM 7.6.3.5.3.1

- ◆ **INOLES** provides the most current name, address, and filing requirements for the entity. It may also indicate the EINs of subsidiaries.
- ◆ **INOLEP** provides a list of all plans maintained by the employer.
- ◆ **EMFOLI** also provides a list of plans maintained by the employer along with the years that a transcript can be requested, and the years that the return can be viewed through IDRS.
- ◆ **EMFOLD** shows the plan administrator information from Form 5500
- ◆ **EMFOLL** shows information regarding the plan sponsor such as business code and telephone number. It also includes information regarding the plan's determination letter, such as the date of the most recent determination letter, file folder number, plan effective date, application status date, and termination date.
- ◆ **EMFOLT** is a transcript of the 5500 filing for a particular tax period (TC 150 posting). It includes the filing date and statute expiration date. A TC 154 posting indicates that a 5330 was filed for that period. The TC 154 posting will also show the IRC section and amount of the tax assessed on the 5330
- ◆ **ERTVU** shows the 5500 line items for a particular plan and tax period. You can review the 5500 series returns for the prior and/or subsequent year or for other plans maintained by the employer.
- ◆ **BMFOLT** (for Form 1120 and 1065) or **IMFOLT** (for Form 1040) shows the date that the employer's taxable return was filed and whether any extensions of time to file were granted. They also show the statute date, tax per return and subsequent tax adjustments.
- ◆ **BMFOLI** (for Form 1120 and 1065) or **IMFOLI** (for Form 1040) gives a complete snapshot of taxpayer's filing history
- ◆ **BRTVU** (for Form 1120 and 1065) or **RTVUE** (for 1040) gives basic information from the tax return, including the specific line item for the pension deduction claimed for a specific tax period.
- ◆ **AMDISA** using a "P" after the EIN provides a listing of all 5500 returns under examination, using an "N" after the EIN provides a listing of all 5330 returns under examination.
- ◆ **AMDISA** without no "P" or "N" provides a listing of taxable returns, for the plan sponsor, that are under examination.

EXHIBIT 2– PRE-AUDIT WORK PAPER

Employer:
Plan Name:
Plan Number:

Plan Year:
Agent:
Date:

PRE-AUDIT ANALYSIS

A. RETURN
ANALYSIS:
Business Code:
Type of Plan:
Master/Prototype
Plan:

Effective Date of
Plan:
Date of
Amendment(s):
Any Other Plans:

Current
Operation:
Participants –
PYB/PYE:
Employees:
Plan features:
Contribution
amount:
Distribution
amount:
Assets @
PYB/PYE:
Large, Unusual,
Questionable
Items:

B. IDRS
ANALYSIS
ASED, per
EMFOLT: AIMS:
ERTVU Info:
BRTVU Info:

C. PROJECT
CODE:

D. DOL, PBGC
DATA:

E. OTHER INFO:

CONTACTING THE TAXPAYER

Taxpayers may be contacted by telephone or in writing to schedule the initial appointment. Telephone contact with the Plan Sponsor is preferable to explain and schedule the audit, determine the availability of books and records and identify the audit site. If the Taxpayer will not be present at the exam, explain Disclosure and forms 2848 and 8821.

If you attempt to reach a taxpayer by telephone, but instead reach the taxpayer's secretary, family member or another third party, do not tell the third party that you work for the IRS unless expressly asked. Under the Third Party Contact rules, employees can only seek additional information from the person answering the telephone if the taxpayer under investigation is a business and contact is made with employees who are acting within the scope of their employment. See IRM 7.6.2.2.3 for additional information.

EXAMPLE 1

You are examining the Form 5500 of Jane Ash MD PC Profit Sharing Plan. When you phone Dr. Ash to schedule the appointment, you may tell the receptionist that you are calling from the IRS if the receptionist asks.

Customize and mail the appointment letter, Letter 1346. Your letter should list specific records, information and documents the taxpayer should have available at the initial appointment.

Publication 1, Your Rights As a Taxpayer, must be included with all initial notification contacts, including the appointment letter or OCEP notification letter. If it has not been mailed to the taxpayer in advance of the interview, provide it at the initial meeting. The publication fulfills the requirement in Internal Revenue Code section 7521(b)(1)(A) that taxpayers be informed of the examination process and their rights under such process at or before the initial interview. See RRA Act Section 3503.

After initial contact is made, the agent should assure that AIMS is updated to status 12. Prepare AIMS update request, Form 5595, to update AIMS to status 12. The case file should include the updated AMDISA print and/or Form 5595, approved by the manager.

POWER OF ATTORNEY

Accountants, attorneys, enrolled agents or other representatives from whom a taxpayer has requested assistance on tax problems may submit information and inquiries to IRS. When employees contact taxpayers who are represented by an authorized power of attorney (POA), be aware that in any situation involving any written contact (including a FAX) between the IRS and a taxpayer, the taxpayer must receive the original copy of the correspondence and the authorized representative must be sent a copy of such correspondence, unless otherwise indicated on the Form 2848, Power of Attorney and Declaration of Representative.

When the examiner secures a Power of Attorney, the form must be forwarded to the Ogden Processing Center within 10 workdays. TEQMS will accept any of the following items (not all inclusive) to meet this quality aspect:

1. The agent can complete the "For Official Use Only" box in the top right corner of the Form 2848,
2. The agent can write the date received and the date forwarded to the Service Center on the top of the Form 2848,
3. The agent can include a copy of the fax transmittal cover page that was used to transmit the Form 2848 to the Service Center, or
4. The agent can document the date transmitted to the Service Center on the case chronology record.

INITIAL INTERVIEW

The initial interview is a very important part of the examination process. It enables you to get an initial understanding of the business and plan operations. A properly planned and executed interview will provide an understanding of the taxpayer's financial history, business operations, and accounting records. Interviews should be used to obtain information needed to make informed judgments about the scope and depth of the examination and correctly resolve issues. Interviews are used to obtain leads, develop information and establish evidence.

Under IRC section 7521(b)(2), an agent must suspend an interview if the taxpayer states that he/she wishes to consult with a representative or otherwise seek advice. This provision does not apply to an interview initiated by administrative summons and will not be used to repeatedly delay or hinder the examination process. Pub. 1 advises the taxpayer of this right.

During the interview, you can also explain the examination process and appeal rights. This must be noted on the Case Chronology Record.

This chapter has two exhibits of sample interview questions. One list is from the Exam Review staff in Baltimore. Customize your interview to the specific circumstances of the case.

EXHIBIT 3--INTERVIEW WORKPAPER

Initial Interview

Date:	
Plan:	
Individual Interviewed:	
Title:	
Place of Interview:	

Background

1. What type of entity is the Plan Sponsor?
2. What is the employer's revenue source?
3. How long have you been in this line of business?
4. Who are the owners? What is the percentage of their ownership?
5. Do the owners/partners/shareholders have any interest or investment in any other business, partnership, corporation or business venture of any kind?
6. Are they a member of a Controlled Group or Affiliated Service Group?
7. Are there any temporary or part time employees?
8. Are there any leased employees?
9. Who are the Employer's HCEs?

10. Who are/were the Key Employees for the plan within the last 5 years?
11. Are there any family members employed? If so, do they participate in the Plan?

Plan Administration

12. Who is the person within the Taxpayer's organization that is the most familiar with the Plan's operations?
13. What outside professionals, if any, are involved in the Plan's administration, and what do they do?
14. Who maintains the Plan documents?
15. How are employees informed of the Plan and/or changes to the Plan?
16. Who determines when an employee is eligible to participate in the Plan, and how is the employee notified that he/she is eligible?
17. What systems or procedures does the Taxpayer have in place to gather demographic data (compensation, age, date of birth, etc.) from the Taxpayer's payroll/personnel systems and transfer that data to the people administering the Plan?
18. Who determines what a terminated participant's vesting is upon termination of service?
19. How does the Taxpayer determine how much money to put into the Plan each year?
20. How are contributions paid?

21. If a DC plan, who does the allocation report?
22. Who provides a terminated or retired participant with all the required notices and consent forms?
23. If a DB plan, who determines what a participant's benefit is upon termination, retirement, or death?
24. Who actually pays out the benefits and how do they do it?
25. Who is responsible for tax withholding and filing Forms 945 and 1099-R?
26. Who holds the Plan's assets; is there a custodian?
27. Who manages the Plan's investments?
28. Who prepares the 5500 series returns?
29. Are there participant-directed accounts?
30. Do you currently maintain any other plans?
31. If so, what types are they?
32. Did you previously maintain any other plans?
33. If so, what were they, and what happen to them?
34. Have there been any prior examinations of tax returns or forms 5500 series returns by IRS, DOL, or PBGC?

35. Has the return under examination been amended?
36. Have any of your plans been submitted under VCR or VCAP? If so what were the issues, and how were they resolved?
37. Did you discover any operational or form defects while preparing for the examination? Do you have anything to disclose before we start the examination?

Eligibility/Coverage/Participation

38. Is there a census done for an outside administrator?
39. What type of system is used to maintain the payroll (in-house or third-party vendor)? How many payrolls are maintained; are they centralized?
40. Does the plan pass the coverage requirements of Code section 410(b) using the Average Benefit Test?
41. Were leased employees and other members of your controlled group/affiliated service group been considered when determining whether coverage was met?
42. What specific reports are prepared and available relating to Eligibility, Coverage and Participation?

Vesting

43. Who determines what a participant's vesting is upon termination of service?
44. How are dates of hire and termination determined?

Allocations

45. If any testing is required, who performs the test?
46. If a DB plan, who does the accrued benefit calculations?

415 limits

47. If applicable, who does the IRC section 415(e) calculations?
48. Does the Administrator have any special procedures to insure that IRC section 415 is not violated?

CONCLUSION:

Based on ..., a full scope examination is warranted.

Or

Based on ..., the examination may be limited to these issues:

EXHIBIT 4 – INTERVIEW QUESTIONS FROM EXAM REVIEW

Sample Initial Interview Questions

- ◆ Name of Person
Interviewed _____
- ◆ Position of Person
Interview _____
- ◆ Type of business:

- ◆ Did you receive Publication 1?

Any questions?

- ◆ Has there been any prior exam by IRS, DOL or other government
agency? _____ If yes, when? _____. What were the results?

- ◆ How long has the plan been in existence?

- ◆ Who is the Plan Administrator?

- ◆ Who is/are the Trustee(s)?

- ◆ Who handles trust assets?

- ◆ Who manages the plan's investments and makes investment decisions?

- ◆ Who is the person within the taxpayer's organization that is most familiar with
the plan's operation?

- ◆ What outside professionals, if any, are involved in the plan's administration?

- ◆ How long has the employer been in business?

- ◆ Any items unique to this plan?

- ◆ Has the return under examination been amended? _____ If yes, please
provide a copy

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- ◆ Who does the required testing (ADP, ACP, 415, 416, etc.)?

- ◆ Have there been any amendments since the last IRS determination letter?
_____ If yes, and they are effective during PY under exam, provide copy.

- ◆ Who maintains plan records?

- ◆ What records are maintained by the ER/Trustee/Plan Administrator?

- ◆ Does the plan permit investment in life insurance? _____ If yes, are the PS-58 costs reported on Form 1099-R?

- ◆ Does the employer hire any temporary help?

- ◆ Does the employer use leased employees?

- ◆ Who does the plan cover?

- ◆ What information is provided to new employees for acknowledging eligibility and participation?

- ◆ Who determines when an employee is eligible to participate in the plan, and how is the employee notified that he/she is eligible?

- ◆ What system or procedure is in place to gather demographic data (compensation, age, DOB, DOH, etc.) from the taxpayer's payroll/personnel system and transfer such data to the people administering the plan?

- ◆ How do you account for re-hires in your payroll system?

- ◆ Who gathers employee census information?

- ◆ I will be requesting personnel file information or other source documentation to verify dates of birth and dates of employment for employees that I select in my sample. Will this information be readily available for my review?

- ◆ 401(k) – How are new employees informed about the plan?

- ◆ 401(k) – Are there employer matching contributions?

- ◆ 401(k) – Who performs the ADP and ACP testing?

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- ◆ 401(k) – Was a discretionary profit sharing contribution made this year?

- ◆ 401(k) – Does the plan permit self-directed accounts? _____
- ◆ DB- Who performs the actuarial services for the plan? _____
- ◆ Are there any administrative or corporate minutes kept concerning the plan for this year under audit?

- ◆ Were employees furnished with the SPD? ____ When? ____ SMM? ____
When? _____
- ◆ Who prepares the Form 5500 series return?

- ◆ Which of these forms must the Employer file? 1120 ____ 1120S ____
Consolidated Return ____ 1040, Schedule C ____ 1065 ____ 990 _____
- ◆ Is the corporate year-end the same as the plan year-end?

- ◆ When was the plan sponsor's tax return filed?

- ◆ Was there an extension?

- ◆ Who are the officers?

- ◆ Who are the HCEs?

- ◆ Is the employer a member of a controlled group, affiliated service group, or if a closely held corporation, do shareholders have interests in other corporations, partnerships, or proprietorships?

- ◆ Does another company control or does this company have control of more than 50% of any other entity?

- ◆ What are the names and acquisition date of all entities owned by the employer?

<u>Entities</u>	<u>Acquisition Date</u>	<u>Comments</u>
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- ◆ What are the names of all owners and the percentage of ownership?

OWNERS	OWNERSHIP PERCENTAGE

- ◆ How many plans does the employer maintain?

- ◆ Does the employer maintain other retirement plans?

<u>Plan Name</u>	<u>Type</u>	<u>Effective Date</u>	<u>Status</u>

- ◆ Has the employer terminated any plans within the current or preceding five plan years?

- ◆ Are there any related examinations currently being conducted? Is so, what is the current status of the exams? _____

- ◆ Has the trust ever made loans to related parties?

- ◆ Identify all Key Employees of the employer (in current year and prior 5 years)

- ◆ Has an analysis been performed to determine if this plan is top heavy? _____ If yes, please supply me with a copy.

- ◆ Have there been any significant plan occurrences, such as plan mergers, consolidations or the removal of a significant number of employees?

- ◆ Has the plan been involved in a partial termination in the current or preceding plan year?

- ◆ Has anyone rolled over funds into this plan?

- ◆ Does the plan administrator make allocations, prepare 1099Rs, distribute assets?

- ◆ How are forfeitures handled in this plan? [Please describe the timing of the allocation of forfeitures, and whether used to reduce the contribution or re-

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- ◆ allocated among remaining participants].

- ◆ What is the procedure for making distributions (timing of notices, consents, payments)? _____
- ◆ Who determines what a terminated participant's vesting is upon severance from service? _____
- ◆ Who provides a terminated/retired participant or beneficiary with all the required notices and consent forms?

- ◆ Who is responsible for issuing 1099-Rs for distributions?

- ◆ Who is responsible for tax withholding and filing Forms 945 and 1099-Rs?

- ◆ Have there been any prohibited transactions in the current or preceding plan years and have they been fully corrected?

- ◆ Any Forms 5330 or 990-Ts ever filed?

- ◆ Is the taxpayer currently involved in any bankruptcy proceedings?

- ◆ Are there any current court proceedings or other matters pending with respect to the plan that you would like to disclose?
- ◆ Are there any matters regarding plan form, operation or correction actions that you would like to disclose before I get started?

- ◆ ESOP – If stock not publicly traded, how often is stock valued at FMV by an independent appraiser? _____
- ◆ ESOP – If stock not publicly traded, please describe how you handle the put option given to participants, as well as the repurchase of stock, per Code section 409(h)? _____

- ◆ ESOP – Did any event occur which required the pass through of voting rights to participants and beneficiaries (i.e., corporate merger or consolidation, recapitalization, reclassification, liquidation, dissolution or sale of substantially all assets of trade or business, which would have entitled participants to direct plan on allocated shares per 409(e))?

- ◆ ESOP – Did all qualified participants (age 55 with 10 YOP) receive the right to diversify (or receive distribution) as required by Code section 401(a)(28)? _____

Disclaimer – This document is not a check sheet for interview questions. They represent a sampling of questions that may be appropriate for your examination. The questions above were a composite of the type of questions we have observed in various examination work papers.

SCOPE OF EXAMINATION

All examinations vary in scope. To determine the scope of the exam, you consider:

- the issues identified,
- the adequacy of the books and records,
- the existence of effective internal controls, and
- the size of the entity, or special project selections.

Pursue the examination to a point where, with reasonable certainty, you conclude that all items necessary for a proper determination of qualification and tax liability have been considered. Extend the examination to include all large, unusual and questionable items. Consider the amount of time necessary to develop an issue in light of all the facts and circumstances. Indicate in the workpapers the scope and depth of each issue and the reason for termination or extension of its review. Most small examinations will be conducted as full scope exams.

EXAMPLE 3:

You are examining a Form 5500 for a 401(k) Profit Sharing Plan. You determine in the pre-audit analysis and the interview that the Employer has never sponsored other plans and has never made non-elective or matching contributions to this plan. The plan permits self-directed investments. You may decide to limit this audit to plan document qualification, eligibility, ADP test and distributions.

STATUTE OF LIMITATIONS

All necessary action to protect the Government's interest must be taken in a case when expiration of the statutory period for assessment of any additional or potential tax is imminent. This responsibility extends not only to the liability of the entity, but also to the liabilities of the related taxpayers. See IRM 121.2, for procedures on statute control and a chapter in this text.

EP WORK PAPERS

While the taxpayer's records are the primary source of factual data to support the return, your workpapers provide the principal support for your examination. The workpapers document:

- the procedures applied,
- the audit tests performed,
- the information inspected, and
- the conclusions reached during the exam.

Your workpapers should provide a clear understanding of the reason for each examination adjustment.

The agent's work papers are the connecting link between the return and the examination report. TEQMS standards require that workpapers be

- clear, concise, legible, initialed, labeled, dated, organized and indexed.

These standards also apply to correspondence with the taxpayer, supporting documentation and information requests. If superseded workpapers are included in the file, they should be clearly marked as such.

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Work papers, which serve to effectively explain the areas covered during an examination, should set forth the following:

- Evidence gathered to show the work performed
- Methods and procedures followed
- Legal authority, such as the Code, Regulations and rulings
- Procedural requirements, such as Revenue Procedures or the IRM
- Actions taken
- Conclusions reached

Work papers must contain sufficient information for subsequent actions, such as:

- Preparing correspondence to taxpayers and/or their POA
- Preparing the examination report
- Managerial and technical review
- Submitting cases to Appeals or preparing technical advice requests
- Determining the audit trail and scope of the audit in a subsequent examination

On each case, consider that the work papers may be used in court to support the government's position. In the appeal procedure, conferences are usually held without the agent being present to substantiate the findings. The proper place for recording all that the agent knows about the issues is in his/her workpapers. With complete documentation, the necessity for further examination is reduced considerably.

EXHIBIT 4 – ISSUE WORKPAPER

XYZ Company Employee Profit Sharing and Thrift Savings Plan
Plan # 001 PYE 199912

ELIGIBILITY AND ENTRY

Plan Provisions:

Plan § 3.1 provides that all employees become eligible to participate when they have attained age 21 and have performed a year of service. The plan does not provide for any other exclusion.

§ 1.32 defines a year of service as a plan year in which the employee performs 1000 hours of service. However, an initial year of service for eligibility is the 12-month period beginning on the day the employee first performs an hour of service. Subsequent years of service for eligibility are the plan years beginning with the plan year starting during the initial year.

§ 3.2 provides that an eligible employee will begin participation on the first January 1 or July 1 following his meeting the requirements of § 3.1.

Operations:

To determine eligibility, I reviewed the company's payroll records, as well as copies of 940's, 941's,

W-2's, W-3's and state employment tax returns for the year being examined and the two previous years.

For the year under examination, the company employed 13 employees, including the three doctors and Mrs. XX. Twelve employees were participating in the plan; one was excluded. I examined the personnel records related to the participants, and verified that all were over 21 years of age; all were employed before June 30, 1997 and all had previously completed a year of service. Consequently, all twelve are correctly participating in the plan for this entire year.

One employee was excluded from participation. XX was born on August 29, 1969 and has been employed as a clerk full-time since October 18, 1998. XX did not perform a year of service before the second Plan Entry Date within this plan year. XX is eligible to participate on January 1, 2000. Accordingly, XX was correctly excluded from plan participation in 1999.

Conclusion:

The plan's provisions meet the minimum requirements of Code section 410(a).

All eligible employees are participating. Plan terms were followed operationally and the plan satisfies the eligibility and entry requirements of Code section 410(a).

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(Agent Name)

Date

FORMS 5772, 5773, AND 5464

The basic work papers for preparing EP examination cases are:

1. Form 5772 (EP/EO Workpaper Summary),
2. Form 5773 (EP/EO Workpaper Continuation Sheet), and
3. Form 5464 (Case Chronology Record).

Forms 5772 and 5773 simplify and standardize the examination workpapers. These forms are designed as working tools for pre-examination planning and use during the examination. Their purpose is to provide an orderly presentation of workpaper material, including an indexing system. Their use makes it unnecessary to repeat workpaper information elsewhere in the file.

FORM 5772

Form 5772 is used for all EP examinations. It may be used for pre-examination planning and as the first page of the workpapers. Form 5772 contains a list of procedural and technical reminders. Review the list as part of the planning process.

FORM 5773

Form 5773 is used for the following purposes:

- To summarize the findings of the examination
- As an index to other workpapers
- Document the agent's review of issues, materials, and records relevant to the examination issues listed on the Classification Record

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During pre-examination planning, enter the items that should be verified, together with applicable comments. Use of these forms as working tools for pre-examination planning cannot be overemphasized. Lack of preparation seriously detracts from professional performance.

Index work papers as you prepare them. The index letters need not correspond to the reference code from the Examination Program Guide. When additional workpapers for explanations, analyses, schedules, etc., are required, prepare and index them under the index letter and subheading assigned to the specific item of discussion.

Explain any unusual, large, or questionable items appearing on the return that might raise doubt in the mind of a reviewing official as to the adequacy of the examination. Workpapers must contain the facts gathered as well as the conclusions reached. In completing the forms, give a brief explanation of the items checked on Form 5772 and the extent of the verification. Simply stating that an item is "okay" is not sufficient.

EXHIBIT 5 – FORM 5773

This is an example based on the prior exhibit of the Eligibility workpaper.

	PRE-AUDIT COMMENTS	PROCEDURES and CONCLUSIONS
	<p>PLAN/ENTITY BACKGROUND Review IDRS, ASED, Special Project Form, Plan's History, Form 5500, Interview, Plan Document, Package Exam.</p>	
	<p>ELIGIBILITY, PARTICIPATION, COVERAGE Review Payroll records. Review plan document for eligibility requirements. Verify that the excluded employees are not eligible to participate in the plan per plan terms. Determine if plan meets coverage under §410(b).</p>	<p>Reviewed the plan document and all employee records and employment tax returns. The plan provides that all employees are eligible to participate in the plan upon completion of one year of service and attaining age 21, with semiannual entry dates. There are 13 employees, 12 are participating and one is correctly excluded. The plan meets the eligibility and coverage requirements of Code sections 410(a) and 410(b) – see page B-01.</p>
	<p>R VESTING Determine if plan's vesting schedule meets §411(a). Calculate participants' vested percentages, based on years of vesting service, and compare calculations to plan records. Determine if any participant should be 100% vested due to NRA, plan termination or other plan provisions.</p>	

FORM 5464

The case chronology record (CCR) documents examination activities and delays encountered during the audit. The CCR should reflect complete and accurate documentation of case history including follow-up dates.

Case chronology records should be used to record contacts with taxpayers, representatives, or third party contacts as well as examination research, report writing, and managerial involvement. It must document the hours charged and a description of the actions taken on the case, along with any causes for delay in completing the examination.

Agents should use Form 5464 to document:

- When information was requested from the taxpayer
- When information was received from the taxpayer
- Whether the taxpayer responded fully and reasonably
- Reasons given for delays
- Reasons why taxpayer could not or would not provide the information
- The precise documents or other information provided by the taxpayer

Many of the quality standards in TEQMS require that certain actions be taken in a timely manner. These actions must be noted on the CCR with the date taken and the date for follow-up. See the exhibit on TEQMS, EP Examination Tips.

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EXHIBIT 6– Reminders for TEQMS, EP Examination Tips

Task	Actions
<input type="checkbox"/> Statute Analysis	Document WP as to analysis of SOL & perform adequate EPMF (ex. – EMFOLT) research to verify filing date.
<input type="checkbox"/> IDRS Pre-plan Research	WP documentation to support adequate research prior to initial appointment.
<input type="checkbox"/> Form 2848 or 8821	Review, perfect and forward to SC within 10 workdays. Annotate form and CCR when sent to SC. Ogden SC – fax (801) 620-4249 Ogden SC – 1600 W. 1200 South St, Stop 6737-OSC, Ogden, UT 84201
<input type="checkbox"/> Pre-Audit Contacts	Annotate CCR that inquiry made as to availability of records prior to initial appointment.
<input type="checkbox"/> Multi-Year/Related Returns	Document file as to the inspection of subsequent, prior and related returns.
<input type="checkbox"/> Initial Interview	WP documentation to support adequate interviews.
<input type="checkbox"/> Taxpayer Rights	Pub 1 sent to TP & POA, with documentation that confirms Pub 1 sent. Agent reviewed rights with TP/POA and answered any questions as to rights.
<input type="checkbox"/> Start of Exam (status 12 to first appt)	Field – <u>45 days</u> to start (or documentation to explain delay). OCEP – <u>30 days</u> to start (or documentation to explain delay).
<input type="checkbox"/> Package Audit	Document WP as to extent of package audit.
<input type="checkbox"/> Significant Activity (substantive work)	Field – no more than <u>45 days</u> between significant activity (or acceptable documentation explaining gaps). OCEP – No more than <u>30 days</u> between significant activity (or acceptable documentation explaining gaps).
<input type="checkbox"/> Correspondence follow-up	<u>14 days</u> to respond to or follow-up on correspondence (after due date).
<input type="checkbox"/> Telephone Calls	<u>3 business days</u> to return calls.
<input type="checkbox"/> Case Chronology Record (CCR)	Include explanations for delays, actions taken on case, and Manager interactions with case file.
<input type="checkbox"/> TP/POA apprised of case closing	Contact TP/POA prior to closing with results of the audit and document the CCR.
<input type="checkbox"/> Timely Case Closure (Agreed Cases)	<u>10 days</u> to close <u>agreed</u> cases (after determination made).
<input type="checkbox"/> Timely Case Closure (Unagreed Cases)	<u>20 days</u> to close <u>unagreed</u> cases (after closing conference held or offered).
<input type="checkbox"/> Form 895	Required when, at any time, less than <u>210 days</u> remain prior to the SOL expiration date.
<input type="checkbox"/> Red Folders	Required for all cases where less than <u>210 days</u> remain prior to the SOL expiration date at time of closing.
<input type="checkbox"/> Secretary	Secretary initials and dates CCR upon receipt of

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	closed case.
<input type="checkbox"/> Group Manager	Manager should approve closing by initialing and dating case file as part of review within <u>10</u> days of receipt from agent.

EXHIBIT – Package Audit check sheet

PACKAGE AUDIT

FORM	FILED?	NOTES
EP:		
5500		
SCH. A		
B		
P		
SSA		
1099R		
945		
990-T		
5330		
4571		
5558		
2758		
EXAM:		
1120, 1040, 1065		
7004		
940		
941 –1 st qtr		
2 nd qtr		
3 rd qtr		
4 th qtr		
W-2, W-3		
W-4		
DOL:		
SPD/SA R/SMM		
Fidelity Bond		
Statutory Exemptio n		
PBCG:		
Form 1 Premium		

CONCLUSION:

REVIEWING THE PLAN DOCUMENT

After the interview, you can review the plan documents:

- ◆ Adoption agreement
- ◆ Boilerplate document or base document
- ◆ Administrative policies
- ◆ Loan policies
- ◆ Trust agreement

DOCUMENT ISSUES:

You may have to check several sections to determine the operational provisions.

- **Eligibility** –definition of eligible and excluded employees, eligibility requirements, entry dates. But you may have to check other plan sections to find adopting employers or service with prior employers.
- **Compensation** – This may be defined in multiple places and be different for each source of money or for top heavy contributions.
- **Forfeitures** – When does a participant forfeit? When and how are forfeitures used? When are forfeitures available?
- **Distributions** – Often not followed in accordance with the plan. Does the document only allow distributions to participants after the next plan year? Are earnings allocated? Does the document require interest if the distribution occurs after a specific date?
- **Loans** – Read the loan procedure. How is the interest rate determined? Will the loan be administered as defined in the loan procedure?
- **Participant investment direction** – Does the plan allow for it?
- **Allocation language** – Is it clear? Are contributions in this plan offset by contributions in other plans? Davis Bacon plans often do this.
- **Allocation criteria** – Watch out for standardized prototypes: Did the Sponsor allocate matching contributions for all participants who defer even if they terminate and don't have sufficient hours? What about the earnings/losses on these contributions?
- What if the language in the document is not clear or definitions are missing?
- How flexible are the testing correction methods? For example, QNEC language?
- Watch out for timing of amendments. When was the document or amendment executed? When is the change effective?

EXHIBIT 7 - PLAN DOCUMENT REVIEW

Attached is a sample form that some administration firms use to keep track of plan provisions or for checking them annually.

**DEFINED CONTRIBUTION
SUMMARY OF PLAN DOCUMENT PROVISIONS**

Sponsor Name:

Other Adopting Employers:

Plan Name:

Trustees:

Fiscal Year End: _____ / _____

Plan Year End: _____ / _____ Short Year if Any: _____ / _____

Limitation Year: _____ / _____

Checklist done by _____ on _____ / _____ / _____

EFFECTIVE DATES AND PLAN TYPE

Money Purchase

Target Benefit

Profit Sharing

Profit Sharing/401(k)

ESOP

Stock Bonus

403(b)

Plan #: _____ Prototype Volume Submitter Individual Design
Plan

Other Plans of the Employer:

Plan Effective Date: _____

Latest Document Restatement Date: _____

Most Recent Amendment Date: _____

Favorable Letter Date: _____

ELIGIBILITY

Section Page #

ELIGIBLE CLASS

Class Exclusions – specify: _____

AGE/SERVICE REQUIREMENTS

1 Year (1,000 hours) 1 Year (_____ hours)
_____ months 2 Years

Age 21 Age _____ No Minimum Age

All employed on _____

Applies to all sources of money

Election to waive participation?

ENTRY DATES

1/1 & 7/1 1/1, 4/1, 7/1 & 10/1 6/30 & 12/31

Monthly Other: _____

On or next following Preceding Nearest

Service with the following predecessor employers is recognized:

CONTRIBUTION TYPE

Section Page #

Discretionary

Discretionary Match

Formula: _____% of Compensation

_____ % of Base plus _____ % Excess

Integration Level \$ _____, or SSWB

Match: _____ % of the first _____ % of Comp or up to a match of

\$ _____

Target Benefit _____.

ALLOCATION METHOD

Section Page #

As contributed by formula

Non-integrated

Integrated – Integration Level \$ _____, or SSWB

Age-Weighted

New Comparability Groups Tiers

Group A _____	Tier 1 _____
Group B _____	Tier 2 _____
Group C _____	Tier 3 _____
Group D _____	Tier 4 _____
Group E _____	Tier 5 _____

QNEC allocated pro-rata, QNEC allocated _____

Forfeitures Allocated with Employer Contributions

Forfeitures Reduce Employer Contributions

Matching Forfeitures Reduce Employer Matching

Matching Forfeitures Allocated as supplemental Match.

CONTRIBUTION CONDITIONS

Section Page #

DEFINITION OF COMPENSATION

All Compensation

Includes elective contributions

Compensation counted from the first day of Plan Year

Compensation counted from Entry Date.

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Excluded Compensation
Bonuses Commissions Overtime
Other: _____

Section Page #

HOURS/SERVICE REQUIREMENTS FOR ALLOCATION PURPOSES

1,000 Hours _____ Hours

Last Day Requirement No Last Day Requirement

Eligible for Allocation PY of termination because of Death, Disability or Retirement.

Standardized Prototype (500 hours or last day)

Applies to Match Does not Apply to Match

Section Page #

401(k) ELECTIONS

Minimum Deferral _____% Maximum Deferral _____%

Changes in Deferrals

Quarterly _____

EMPLOYEE CONTRIBUTIONS

Section Page #

Voluntary Permitted Voluntary Not Permitted

Mandatory Contribution – _____% of Compensation

VESTING

Section Page #

6-Year Graded 7-Year Graded 5-Year Cliff 3-Year Cliff 100%

Immediate Other

Match Subject to Vesting

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All Years of Service counted for Vesting

Vesting Service Exclusions

Exclude Service before Age 18

Exclude Service before Effective Date

Exclude Service before _____ Date

1000 hours of service

Other: _____

Elapsed time

Service with predecessor counted

Name of predecessor: _____

TOP HEAVY VESTING SCHEDULE

6-Year Graded

3-Year Cliff

FORFEITURES

Section

Page #

Earlier of Cash Out or 5 B-I-S

Deemed 0% distribution applies

Other: _____

Forfeitures do not apply

NORMAL RETIREMENT AGE/DATE

Section

Page #

Age 65

Age 55

Age 65/5P

Age

Actual Age

First Month After

Anniversary Date

After Other

EARLY RETIREMENT AGE/DATE

Section Page #

None Age 55 Age _____ with _____ Service/Part

Actual Age First Month After Anniversary Date

After Other

DISTRIBUTIONS

Section Page #

Lump sum Lump sum/Installments No annuities

Cash only Cash/Property

Immediate payout After Break-in-Service

MISCELLANEOUS PROVISIONS

Section Page #

Participant Loans Allowed Not Allowed

Minimum Loan Amount \$ _____

Interest Rate Prime Plus _____ Other _____

Loan available for General Purpose Hardship

Loan available from All sources Other _____

Directed Accounts Allowed Not Allowed

Hardship Distributions Allowed Not Allowed Safe harbor

Other: _____

In-Service Distributions Allowed Not Allowed

Requirements: _____

Profit Sharing Plan subject to J&S requirements: Yes No

Top Heavy Minimum provided in this Plan

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Top Heavy Minimum provided in _____

Special Distribution Provisions: _____

Other Provisions: _____

CONCLUSION: The plan document includes current law provisions and is qualified in form.

End of Exhibit
