



*Employee Plans Noncompliance Referrals
Are Productive Sources of Work, but
Processing Controls Need to Be Improved*

September 24, 2007

Reference Number: 2007-10-185

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Redaction Legend:

1 = Tax Return/Return Information

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FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

September 24, 2007

MEMORANDUM FOR COMMISSIONER, TAX EXEMPT AND GOVERNMENT ENTITIES
DIVISION

Michael R. Phillips

FROM:

Michael R. Phillips
Deputy Inspector General for Audit

SUBJECT:

Final Audit Report – Employee Plans Noncompliance Referrals Are
Productive Sources of Work, but Processing Controls Need to Be
Improved (Audit # 200610023)

This report presents the results of our review of the Employee Plans (EP) function's process for controlling and evaluating referrals of noncompliance. The overall objective of this review was to determine whether this process ensured the most productive referrals¹ were selected by the EP Classification office for examination. The Director, EP, requested that we assess this process.

The Internal Revenue Service (IRS) receives referrals throughout the year when there are questions or concerns that employers or pension plan sponsors may not be complying with Internal Revenue Code sections governing employee benefit plans. This audit was conducted as part of the Treasury Inspector General for Tax Administration Office of Audit Fiscal Year 2007 Annual Audit Plan.

Impact on the Taxpayer

Referrals were a productive source of EP function examinations because they had among the highest total additional assessments and average assessment per return. These assessments provide a means for bringing pension plans back into compliance with the tax laws and avoid jeopardizing the tax-exempt status of the plans or taxpayers' retirement savings. However, there is still a risk that potentially productive referrals are not being examined, and there were delays in processing and evaluating a large number of referrals. Improved controls in these areas will

¹ Defined as those referrals having the most potential for noncompliance.



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provide greater assurance that pension benefits will be available when needed by plan participants who are depending on them.

Synopsis

Overall, referrals demonstrated favorable results when compared to other examination sources during Fiscal Years 2004 through 2006. For example, the change rate² for referral cases was between 18 percent and 30 percent higher than that for EP function examinations as a whole.

EP function management has made improvements to enhance referral processing. For example, EP function management directed that, starting in February 2007, referrals were to be distributed as part of the regular workload of EP Examination function groups, in lieu of being considered discretionary work. In addition, a new project for low-dollar referrals sent from the Department of Labor was implemented. These referrals were previously closed without action because of the low dollar amount but are now processed through correspondence contacts that usually result in additional tax assessments. While EP function management has made improvements, additional actions could be taken to improve key controls used in processing referrals. These include 1) providing better assurance that potentially productive referrals are being examined, 2) ensuring classification specialists and Examination function field groups timely process referrals, and 3) improving feedback to the Department of Labor on the quality of referrals.

Field group managers have the discretion to close referrals with no further action, either before or after they are assigned to an examiner. We reviewed 56 referrals the IRS had closed after deciding not to start an examination; for 13 (23 percent), the IRS did not provide an explanation for closing the referral. As a result, we could not determine if criteria for taking no further action were appropriately applied.

Within the EP Classification office, there were delays in classifying referrals. For example, management data for 532³ of the 851 referrals closed by Examination function field groups during Fiscal Years 2004 through 2006 showed the average time to classify the referrals was 78 calendar days, well beyond the 30 business-day (equivalent to approximately 45 calendar days) time period used to evaluate the success of referral processing. The delays also extended into the Examination field groups. Management data from Fiscal Years 2004 through 2006 showed it took an average of 326 calendar days to evaluate and close cases originating from referrals compared to only 278 calendar days to evaluate and close cases originating from all sources during the same period.

² The change rate is measured by calculating the percentage of returns on which noncompliance is found and the plan sponsor is required to correct the pension plan to bring it into compliance with the law in form or operation.

³ A total of 851 referrals were closed during this period. However, management data were either missing or inconsistent for 319 cases.



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In June 2003, the IRS and the Department of Labor executed a Memorandum of Understanding that sets forth procedures for coordinating examination and litigation activities between the two agencies. Part of the Memorandum requires that both agencies provide one another with information for evaluating referrals and showing whether a referral resulted in an examination and/or an additional tax assessment.⁴ One area of concern expressed by Department of Labor staff was the lack of IRS feedback on the ultimate disposition of referrals once they are sent to an IRS Examination function group. EP function management developed a Department of Labor Case Assignment Sheet to meet the requirement to document either the reason(s) for not selecting a referral for examination or the amount of any additional tax assessed. In addition to providing feedback on specific referrals, this information allows the Department of Labor to update its enforcement tracking database and assess the usefulness of referrals sent to the IRS for audit consideration. However, EP Examination field groups did not always return the Case Assignment Sheets.

Recommendations

We recommended the Director, EP, 1) require group managers to adequately document the reason for closing a referral without an examination; 2) ensure referrals are timely processed; 3) ensure the IRS is meeting the requirement to provide feedback to the Department of Labor on the results of the referrals closed by EP Examination function groups; and 4) monitor key performance indicators, such as total closures, to determine whether changes in the method of distributing referrals have increased the volume of referrals examined.

Response

IRS management agreed with our recommendations and provided planned actions to address them. These actions include reviews and tracking mechanisms to ensure Examination function field staff adhere to all documentation and timeliness requirements. For example, the EP Classification office manager plans to complete quarterly reconciliation reviews of the referral database and conduct timely workload reviews of assigned inventory. In addition, the EP function plans to include statistical data on referrals in regular quarterly reports, which will allow for monitoring the progress of referrals worked using standard business measures. Management's complete response to the draft report is included as Appendix IV.

⁴ The IRS may assess taxes that are reported on Return of Excise Taxes Related to Employee Benefit Plans (Form 5330).



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Copies of this report are also being sent to the IRS managers affected by the report recommendations. Please contact me at (202) 622-6510 if you have questions or Nancy A. Nakamura, Assistant Inspector General for Audit (Headquarters Operations and Exempt Organizations Programs), at (202) 622-8500.



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Abbreviations

| | |
|-----|--------------------------|
| EP | Employee Plans |
| IRS | Internal Revenue Service |



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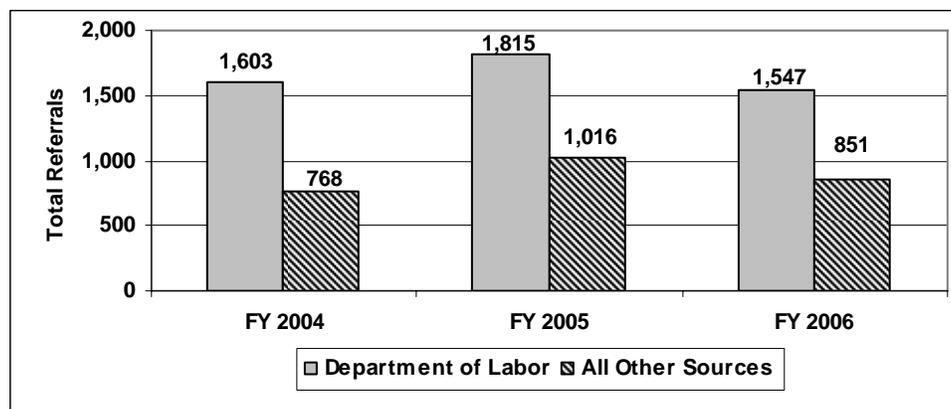
Background

The Internal Revenue Service (IRS) receives referrals throughout the year when there are questions or concerns that employers or pension plan sponsors may not be complying with Internal Revenue Code sections governing employee benefit plans. The Employee Plans (EP) function within the Tax Exempt and Government Entities Division is responsible for administering provisions of the Internal Revenue Code to ensure pension plans meet all requirements for tax-exempt status. Examples of the benefits of tax-exempt status include:

- The income of the plan is exempt from Federal taxes.
- Contributions to and expenses incurred by the plan sponsor are tax deductible.
- Participants are not taxed on their benefits/contributions until distributions are received from the plan.

The referrals originate from a variety of sources both within and outside the IRS. For example, other IRS business functions prepare referrals if potential noncompliance is identified when employees are performing day-to-day business activities. Most referrals received from sources outside the IRS originate from the Department of Labor (see Figure 1), but sources also include Congressional inquiries, media leads, and referrals from other third parties.

Figure 1: Total EP Function Referrals Received (Fiscal Years 2004 – 2006)



Source: Returns Inventory Classification System.¹ FY = Fiscal Year.

¹ We did not verify the accuracy of this information. The Returns Inventory Classification System provides users with access to return and filer information related to the filing and processing of employee plans, exempt organizations, and government entities forms.



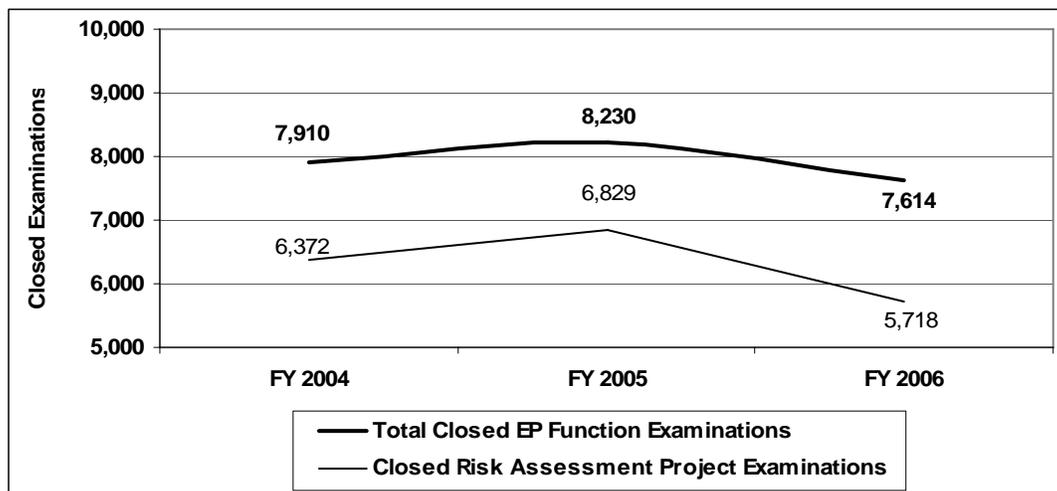
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Referrals of noncompliance are generally processed and evaluated by classification specialists who review them to determine whether they have examination potential. The staff consists of employees with prior Examination function field experience and appropriate tax law training. Referrals with significant potential for changes to plan form, operation, and tax are typically selected for examination.

Once selected, the referrals are assigned to field groups for further analysis to determine whether retirement plans comply with all Internal Revenue Code provisions to protect plan assets and participants' benefits. Field groups may conduct examinations based on the information provided. If their analyses determine examinations are not warranted, groups close referrals with no further action. Field groups may also close referrals if existing workload or the amount of time allowed by law would not permit the examination to be completed timely.

The number of referrals EP Examination function field groups audit each fiscal year is related to priorities established in the annual work plan prepared by EP function management. As shown in Figure 2, for Fiscal Years 2004 through 2006, the EP Examination function's primary emphasis was its Risk Assessment project, which accounted for over 75 percent of all completed EP function examinations during this 3-year period. Under the Risk Assessment project, EP Examination function staff categorized qualified pension plans in distinct market segments and conducted tests to identify segments having the highest degree of potential noncompliance.

Figure 2: Totals of All Closed EP Function Examinations and Totals of Closed Risk Assessment Project Examinations (Fiscal Years 2004 – 2006)



Source: Audit Information Management System² Report 20 (Fiscal Years 2004 - 2006).
FY = Fiscal Year.

² We did not verify the accuracy of this information. The Audit Information Management System provides an automated inventory and activity control for active examination cases.



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The Director, EP, requested that we assess the EP function's process for controlling and evaluating referrals to ensure the most productive referrals (those having the most potential for noncompliance) are selected for examination. The audit was performed at the EP Classification offices in El Monte, California, and Baltimore, Maryland, during the period August 2006 through May 2007. The audit was conducted in accordance with *Government Auditing Standards*. Detailed information on our audit objective, scope, and methodology is presented in Appendix I. Major contributors to the report are listed in Appendix II.



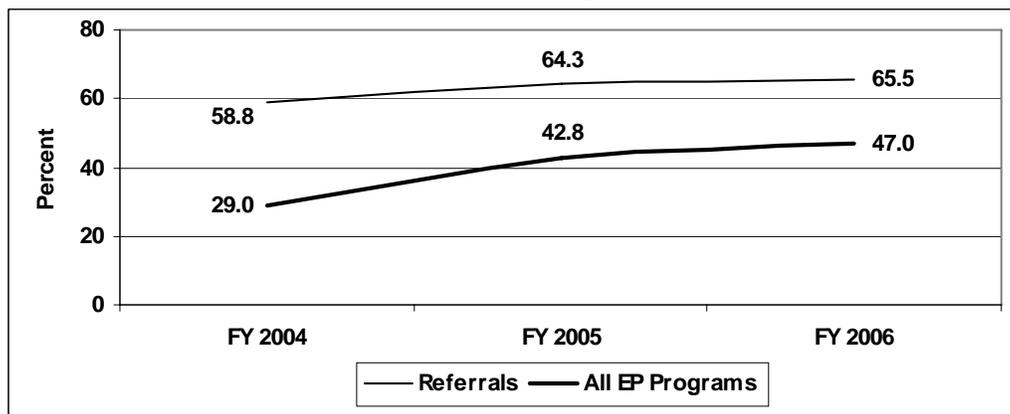
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Results of Review

Improving Key Controls Would Provide Better Assurance That All Potentially Productive Referrals Are Timely Selected and Examined

Overall, referrals demonstrated favorable results when compared to other examination sources for Fiscal Year 2004 through Fiscal Year 2006. Statistically, referrals ranked high when compared to other examination projects in terms of the measures EP function management uses to track performance. For example, Figure 3 shows the change rate³ for EP function referrals was between 18 percent and 30 percent higher than that for EP function examinations as a whole.

Figure 3: Change Rates for EP Function Referrals and EP Function Examinations Overall (Fiscal Years 2004 – 2006)



Source: Audit Information Management System Report 20 (Fiscal Years 2004 - 2006).⁴
FY = Fiscal Year.

Figure 4 shows referrals were a productive source of examinations because they had among the highest total additional assessments and average assessment per return. These assessments provide a means for bringing pension plans back into compliance with the tax laws and avoid jeopardizing the tax-exempt status of the plans or taxpayers' retirement savings.

³ The change rate is measured by calculating the percentage of returns on which noncompliance is found and the plan sponsor is required to correct the pension plan to bring it into compliance with the law in form or operation.

⁴ We did not verify the accuracy of this information.



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Figure 4: Total and Average Additional Assessments for Selected EP Function Examination Projects (Fiscal Years 2004 – 2006)⁵

| Fiscal Year | Project | Total Additional Assessments | Fiscal Year Rank ⁶ | Average Assessment per Closure |
|-------------|--|------------------------------|-------------------------------|--------------------------------|
| 2006 | General Risk Assessment | \$5,839,645 | 1 | \$1,101 |
| 2005 | | \$2,780,838 | 3 | \$555 |
| 2004 | | \$1,420,459 | 2 | \$254 |
| 2006 | Training Cases | \$512,343 | 5 | \$928 |
| 2005 | | \$398,533 | 7 | \$771 |
| 2004 | | \$135,228 | 6 | \$186 |
| 2006 | Referrals | \$524,456 | 4 | \$1,754 |
| 2005 | | \$1,001,782 | 4 | \$5,245 |
| 2004 | | \$541,684 | 3 | \$4,836 |
| 2006 | Reported Funding Deficiency ⁷ | \$1,543,232 | 2 | \$4,662 |
| 2005 | | \$32,519 | 15 | \$215 |
| 2004 | | \$1,478,254 | 1 | \$17,598 |

Source: Audit Information Management System Report 20 (Fiscal Years 2004 - 2006).⁸

The value of working referrals has prompted EP function management to make changes to further improve the processing of referrals within the Examination function. For example, EP function management directed that, starting in February 2007, referrals were to be distributed as part of the regular workload of EP Examination function groups. The prior process considered referrals to be discretionary work, which meant they were sometimes given a lower priority by the Examination function field groups.

In addition, a new project for low-dollar referrals sent from the Department of Labor was implemented. These referrals had been previously closed without action because of the low dollar amount but are now processed through correspondence contacts that usually result in additional tax assessments. This change was based on EP function management's concern that

⁵ These programs were selected because they accounted for a significant portion of total additional tax assessments during Fiscal Years 2004 – 2006.

⁶ We determined the Fiscal Year Rank based on the total additional assessments for each Project as shown in Audit Information Management System Report 20.

⁷ Forms 5500 (Annual Return/Report of Employee Benefit Plan) that report a funding deficiency. Classifiers in the EP function perform research on the returns and attempt to contact plan sponsors to request an explanation and/or resolution of the funding deficiencies.

⁸ We did not verify the accuracy of this information.



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plan sponsors were not complying with existing regulations for timely depositing plan contributions.

While EP function management has already made improvements, additional actions could be taken to improve some of the key controls used in the processing of referrals, including (1) providing better assurance that potentially productive referrals are being examined, (2) ensuring classification specialists and Examination function field groups timely process referrals, and (3) improving feedback to the Department of Labor on the quality of referrals. Improved controls in these areas will provide greater assurance that pension benefits will be available when needed by plan participants who are depending on them.

Processes in the Examination function field groups do not ensure potentially productive referrals are being examined

Field group managers have the discretion to close referrals with no further action, either before or after they have been assigned to an examiner. For example, these actions can be taken if the manager determines an examination is not warranted or if the number of returns assigned to the field group exceeds the number of returns that can be worked timely. We reviewed 56 referrals the IRS closed during Fiscal Year 2006 after deciding not to start an examination; for 13 (23 percent), the IRS did not provide an explanation for closing the referral. As a result, (1) we could not determine whether the criteria for taking no further action were appropriately applied, and (2) there is a risk that potentially productive referrals are not being examined.

Referrals closed without an examination must be approved by the field group manager. However, if the referrals were initiated within the EP function, there is no requirement for managers to document the reasons for closing referrals before they are assigned to an examiner. We could not determine whether the criteria for closing referrals without an examination were appropriately applied for 7 of the above 13 referrals because the 7 referrals originated from within the EP function.

There were also [redacted] referrals from the Department of Labor and [redacted] from the Small Business/Self-Employed Division closed before assignment to an examiner. While EP function managers should include an explanation for closing these referrals without an examination, none of the four cases contained the required explanation. EP function managers are also required to include an explanation for closing referrals that are not examined after assignment to an examiner. Two referrals were closed in this manner, but neither included the required explanation.

We could not determine why managers did not document the case file to show the reasons these remaining 6 of 13 referrals were not examined. Ensuring managers document the reasons for closing referrals and following up on any closures that do not include an explanation would provide better assurance that all potentially productive referrals are examined and strengthen the system of internal controls for EP function referrals.



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Classification specialists and Examination function field groups did not timely process referrals

One measure used to evaluate the success of referral processing is a 30 business-day (equivalent to approximately 45 calendar days) time period for determining whether referrals should be forwarded to an Examination function field group for audit. Once a referral is received in the field, group managers should immediately assign it to an examiner.

Within the EP Classification office, there were delays in classifying referrals and a lack of information system data for monitoring the timeliness of actions by classification specialists. For example, management data for 532⁹ of the 851 referrals closed by Examination function field groups during Fiscal Years 2004 through 2006 showed the average time to classify them was 78 calendar days. Nearly 30 percent were closed at least 60 calendar days after receipt by the EP Classification office, including 8 percent that took more than 6 months to complete processing.

While referrals are considered highly productive, the classification specialists' first priority was analyzing nonreferral sources of work, as specified in the annual work plan, to meet the inventory needs of Examination function field groups. After completing this work, classification specialists' next priority was analyzing referrals and distributing those having the most potential for change to field groups. EP function management also worked with the Department of Labor to forward referrals more frequently to avoid receiving large volumes of referrals at one time.

There is also a lack of management information for monitoring the age of classification inventory because classification specialists did not always enter all required date-related fields into the EP function system used to manage workload. Of the 851 referrals recorded on the system, 287 (34 percent) did not include the date the referral was received. Therefore, EP function management could not monitor how timely these cases were being worked or whether they met the 30 business-day standard. There were also no routinely generated reports to identify and monitor cases older than 30 business days.

The delays also extended into the Examination function field groups where field staff did not evaluate the referrals until they had completed their assigned inventory of nonreferral cases. Management data for Fiscal Years 2004 through 2006 showed it took an average of 326 calendar days to evaluate and close cases originating from referrals compared to only 278 calendar days to evaluate and close cases originating from all sources during the same period. Nearly 75 percent of the referrals were not closed within 6 months of receipt in the field, including 36 percent that took over a year to complete.

These processing delays could cause potentially productive referrals to be nonproductive if the IRS is unable to contact plan sponsors to obtain clarifying information or complete an

⁹ A total of 851 referrals were closed during this period. However, management data were either missing or inconsistent for 319 cases.



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examination within the amount of time allowed by law. Also, plans could continue operating in violation of the law for extended periods of time if the referrals involved issues that would disqualify plans from retaining their tax-exempt status.

As previously stated, earlier this year, EP function management took action to improve the processing of referrals within the Examination function. Prior to that, Examination function field groups received referrals as a supplement to their regular inventory of cases, and field group managers considered cases originating from specialized projects as higher priority than cases originating from referrals. However, starting in February 2007, referrals were to be included as part of examiners' regular inventory of cases. Incorporating referrals with other workload was intended to reduce the time needed to start evaluating referrals in the field. EP function management should determine whether the change in distributing referrals improves both the number examined and the time needed to evaluate them by using management data currently available on the Returns Inventory Classification System.

The EP Examination function did not always provide the Department of Labor with feedback on the quality of referrals

EP function management needs to enhance the existing process to provide better assurance that the Department of Labor receives feedback on the quality of referrals (such as whether plan sponsors took needed actions to ensure plans complied with all applicable tax provisions).

In June 2003, the IRS and the Department of Labor executed a Memorandum of Understanding that sets forth procedures for coordinating examination and litigation activities between the two agencies. Part of the Memorandum requires that both agencies provide one another with information for evaluating referrals and showing whether a referral resulted in an examination and/or an additional tax assessment.¹⁰

To identify and resolve issues and areas of concern, EP function management held quarterly meetings with Department of Labor staff as required. These meetings included discussions on those areas of the Memorandum of Understanding that needed to be clarified or updated.

One area of concern expressed by Department of Labor staff was the lack of IRS feedback on the ultimate disposition of referrals once they are sent to an IRS Examination function group. EP function management developed a "DOL [Department of Labor] Case Assignment Sheet" to meet the requirement to document either the reason(s) for not selecting a referral for examination or the amount of any additional tax assessed. In addition to providing feedback on specific referrals, this information allows the Department of Labor to update its enforcement tracking database and assess the usefulness of referrals sent to the IRS for audit consideration.

¹⁰ The IRS may assess taxes that are reported on Return of Excise Taxes Related to Employee Benefit Plans (Form 5330).



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EP Examination function field groups did not always return these Assignment Sheets. There is no control in place to identify instances in which field staff did not return Assignment Sheets after evaluating referrals. Thus, EP function management had no means of identifying the referrals for which field groups did not return the Assignment Sheets or quantifying the extent to which this was occurring. The small number of Assignment Sheets returned also limited feedback to EP function classification specialists who could use the information to identify reasons referrals were not selected for examination. In addition, not receiving this information precluded the Department of Labor from determining the ultimate disposition of referrals, such as the reason(s) IRS field staff did not work them.

Recommendations

The Director, EP, should:

Recommendation 1: Require group managers to adequately document the reason for closing a referral without an examination for all cases and ensure documentation standards are being met.

Management's Response: The IRS agreed with the recommendation. The Director, EP Examinations, plans to issue a directive to all Area Managers requiring appropriate case documentation by the field managers as to why a referral is being surveyed.

Recommendation 2: Ensure referrals are timely processed by:

- a. Enhancing existing management information and providing additional management oversight to more effectively monitor the age of referrals in EP Classification office inventory and identify over-age referrals.
- b. Reminding EP Classification office staff to enter all required timeliness-related fields in the Returns Inventory Classification System database.
- c. Developing a process to measure any change or improvement in the amount of time needed to examine referrals once they become part of examiners' regular inventory.

Management's Response: The IRS agreed with the recommendation. The Classification office manager plans to complete quarterly reconciliation reviews of the referral database, conduct timely workload reviews of assigned inventory, and include referrals as a monthly agenda topic during group meetings. The Manager, Exam Planning and Programs, plans to include statistical data on referrals in regular quarterly reports to the Area Manager, Exam Planning and Review. This will allow the Area Manager, Exam Planning and Review, to monitor the progress of referrals worked using standard business measures.



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Recommendation 3: Ensure the IRS is meeting the requirement to provide feedback (specifically, the Department of Labor Case Assignment Sheet) to the Department of Labor on the results of the referrals closed by EP Examination function groups.

Management's Response: The IRS agreed with the recommendation. The EP Classification office plans to transmit the cover sheet and a tracking sheet to the assigned examiner when the referral is assigned to a field group and to place a freeze code on the Audit Information Management System for the referral. This will preclude the case from closing until the Classification office sends the Department of Labor information showing the disposition of the case.

Recommendation 4: Monitor key performance indicators, such as total closures, to determine whether changes in the method of distributing referrals have increased the volume of referrals examined.

Management's Response: The IRS agreed with the recommendation. Each quarter, the Manager, Exam Planning and Programs, plans to provide statistical data on referrals to the Area Manager, Exam Planning and Review. This will enable the Area Manager, Exam Planning and Review, to monitor the progress of referrals worked using standard business measures.



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Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to determine whether the EP function's process for controlling and evaluating referrals of noncompliance ensured the most productive referrals were selected by the EP Classification office for examination. For several tests, we relied on information accumulated by the IRS and the EP function in Audit Information Management System reports and the Returns Inventory Classification System.¹ We did not verify the accuracy of these data because doing so was not necessary to accomplish our audit objective. To accomplish the objective, we:

- I. Determined whether EP function management had established the processes necessary to effectively control and evaluate the referrals of noncompliance received by the EP Classification office.
 - A. Interviewed EP function management and identified the EP Classification office's procedures for controlling, evaluating, and selecting referrals for examination.
 - B. Determined whether EP function referrals were consistently processed at the EP function centralized referral evaluation sites in El Monte, California, and Baltimore, Maryland.
 - C. Interviewed the EP Classification office manager to assess the adequacy of management's system for monitoring referrals.
 - D. Interviewed EP function management to assess the adequacy of the feedback the Classification office receives from the Examination function groups on the closed referrals.
 - E. Determined whether opportunities existed for improving the coordination of pension funding referrals received from the Department of Labor.
- II. Determined how EP function management measured the success of their process for evaluating referrals of noncompliance and whether they had established an effective method for measuring the productivity of referrals selected for examination.

¹ The Audit Information Management System provides an automated inventory and activity control for active examination cases. The Returns Inventory Classification System provides users with access to return and filer information related to the filing and processing of employee plans, exempt organizations, and government entities forms.



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- A. Interviewed EP function management to determine what performance measures and data they used to evaluate referrals received.
 - B. Obtained management information reports to identify trends in referral closures.
 - C. Evaluated inventory data to identify all referrals that were surveyed/closed with no action either before or after assignment² for Fiscal Years 2004 through 2006. We identified all 82 referrals surveyed in Fiscal Year 2006 and obtained/analyzed closed case files for 56 referrals to determine why they were not examined.³
 - D. Assessed the effectiveness of EP function management's method for monitoring the productivity of referrals.
 - E. Determined whether any causes or factors were inhibiting management from monitoring the length of referral processing time in EP Classification offices.
- III. Determined whether the EP function's process for evaluating referrals of noncompliance ensured the referrals selected by Classification offices for examination were productive.
- A. Obtained and analyzed inventory data for all EP Classification office referrals closed by Examination function field groups during Fiscal Years 2004 through 2006.
 - B. Evaluated inventory data to determine the percentage of time referral examinations resulted in a tax change when compared to other types of examination sources such as risk assessment returns.
 - C. Evaluated inventory data to compare how often the EP Classification office decided to take no further action on referrals in comparison to other types of cases the Classification office selected for audit, such as Risk Assessment project returns.
 - D. Interviewed selected EP Examination function group managers and reviewed the Internal Revenue Manual to determine the procedures for controlling, evaluating, and selecting EP function referrals received from the EP Classification office for audit.
 - E. Interviewed selected EP Examination function group managers to obtain feedback on the productivity of the referrals they received from the EP Classification office for audit.

² Under certain circumstances, returns initially selected for examination may not be examined. These cases may be closed by survey after approval by the group manager.

³ For the 82 referrals, there were only 56 case files that contained complete documentation.



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Appendix II

Major Contributors to This Report

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Appendix III

Report Distribution List

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Employee Plans Noncompliance Referrals Are Productive Sources of Work, but Processing Controls Need to Be Improved

Appendix IV

Management's Response to the Draft Report

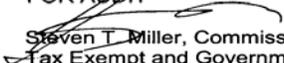


DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

RECEIVED
SEP 10 2007

SEP 7 2007

MEMORANDUM FOR MICHAEL R. PHILLIPS, DEPUTY INSPECTOR GENERAL
FOR AUDIT

FROM: 
Steven T. Miller, Commissioner
Tax Exempt and Government Entities Division

SUBJECT: Management Response to Draft Audit Report – Employee Plans
Noncompliance Referrals Are Productive Sources of Work, but
Processing Control Need to Be Improved (Audit # 200610023)

I have reviewed your draft report dated August 3, 2007, outlining opportunities for improvement in Employee Plans processing controls for referrals of noncompliance. I appreciate your thorough look at our program and your ideas for enhancing it.

We echo your comments that third party referrals are a productive part of our examination program, as they have historically had a higher "change rate" than other sources of examination. I was also pleased to note your observation that the EP Classification Unit has "made improvements to enhance referral processing" since your last review of this program. We will continue to work towards further improvements in our control and timeliness in the processing of all referral work. In fact, as noted in the report, the Classification Unit has already started to prioritize referrals so it is no longer left to the discretion of the field office groups as to whether or not these cases will be examined.

We address the specific recommendations outlined in Audit Report # 200610023 in the attachment. If you have any questions about our response, please have your staff contact Rick Westley at (202) 283-9513 or Karl Zoric at (410) 962-9536.



*Employee Plans Noncompliance Referrals Are Productive Sources
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Attachment

RECOMMENDATION 1:

Require group managers to adequately document the reason for closing a referral without an examination for all cases and ensure documentation standards are being met.

CORRECTIVE ACTION:

The Director, EP Examinations will issue a directive to all Area Managers requiring appropriate case documentation by the field managers on why the referral is being surveyed.

PROPOSED CORRECTIVE ACTION COMPLETION DATE:

October 31, 2007

RESPONSIBLE OFFICIAL

Director, EP Examinations

CORRECTIVE ACTION MONITORING PLAN:

We will monitor this process through group reviews conducted by the Area Manager and by conducting a post-closing review of a sample of surveyed referrals.

RECOMMENDATION 2:

Ensure referrals are timely processed by:

- a. Enhancing existing management information and providing additional management oversight to more effectively monitor the age of referrals in EP Classification office inventory and identify over-age referrals.
- b. Reminding EP Classification office staff to enter all required timeliness-related fields in the Returns Inventory Classification System database.
- c. Developing a process to measure any change or improvement in the amount of time needed to examine referrals once they become part of examiners' regular inventory.

CORRECTIVE ACTIONS:

In response to recommendations (a) and (b) the Classification manager will:

- (1) Complete quarterly reconciliation reviews of the referral database;
- (2) Conduct timely workload reviews of assigned inventory; and
- (3) Include referrals as a monthly agenda topic during group meetings.

In response to recommendation (c) the Manager, Exam Planning & Programs (EP&P) will include statistical data on referrals in regular quarterly reports to the Area Manager Exam Planning & Review (EP&R). This will allow the Manager EP&R to monitor the progress of referral worked using standard business measures.



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PROPOSED CORRECTIVE ACTION COMPLETION DATES:

- (a) September 30, 2007 and on going
- (b) September 30, 2007 and on going
- (c) December 31, 2008

RESPONSIBLE OFFICIAL:

Manager, EP&R

CORRECTIVE ACTION MONITORING PLAN:

We will monitor this process through the completion of operational reviews by Area Managers and by monitoring referrals against standard business measures.

RECOMMENDATION 3:

Ensure the IRS is meeting the requirement to provide feedback (specifically, the Department of Labor case assignment sheet) to the Department of Labor on the results of the referrals closed by EP Examination function groups.

CORRECTIVE ACTION 3:

Classification will transmit the cover sheet and a tracking sheet to the agent when the referral is assigned to a field group. Classification will place a freeze code on AIMS for the referral. This will preclude the case from closing until Classification sends the Department of Labor information showing the disposition of the case.

PROPOSED CORRECTIVE ACTION COMPLETION DATE:

September 30, 2007

RESPONSIBLE OFFICIAL:

Manager, EP Classification

CORRECTIVE ACTION MONITORING PLAN:

We will monitor this process through our regular scheduled quarterly meetings with DOL.

RECOMMENDATION 4:

Monitor key performance indicators, such as total closures, to determine whether changes in the method of distributing referrals have increased the volume of referrals examined.

CORRECTIVE ACTION 4:

Each quarter, the Manager EP&P will provide statistical data on referrals to the Area Manager EP&R. This will enable the Manager EP&R to monitor the progress of referrals worked using standard business measures.



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PROPOSED CORRECTIVE ACTION COMPLETION DATE:

December 31, 2007

RESPONSIBLE OFFICIAL:

Manager, EP&R

CORRECTIVE ACTION MONITORING PLAN:

We will monitor this process through the completion of operational reviews by Area Managers and by monitoring referrals against standard business measures.