



*Additional Process Improvements
Are Needed Due to Continued Growth in
the Voluntary Correction Program for
Retirement Plans*

December 11, 2009

Reference Number: 2010-10-012

This report has cleared the Treasury Inspector General for Tax Administration disclosure review process and information determined to be restricted from public release has been redacted from this document.



TREASURY INSPECTOR GENERAL
FOR TAX ADMINISTRATION

DEPARTMENT OF THE TREASURY

WASHINGTON, D.C. 20220

December 11, 2009

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 – Additional Process Improvements Are Needed
Due to Continued Growth in the Voluntary Correction Program for
Retirement Plans (Audit # 200910015)

This report presents the results of our review to assess the Internal Revenue Service's (IRS) efforts to 1) improve the efficiency of processing Employee Plans Voluntary Correction Program (VCP) cases to ensure timely processing and 2) increase participation through outreach efforts. The former Tax Exempt and Government Entities Division Commissioner requested this review, which was part of the Treasury Inspector General for Tax Administration's Fiscal Year (FY) 2009 Annual Audit Plan coverage under the major management challenge of Tax Compliance Initiatives.

Impact on the Taxpayer

The VCP permits retirement plan sponsors to pay a fee and receive the IRS' approval for correction of retirement plans any time before an audit. While the IRS has taken actions that have significantly reduced the number of calendar days required to process VCP applications, further improvements will be needed due to increased customer demand, reduced staffing, and the significant number of applications not being closed within timeliness goals. Providing timely service on VCP applications is important because correcting errors in a timely and efficient manner protects the favorable treatment of employees' retirement benefits and reduces the uncertainty of any potential tax liabilities for both employees and retirement plan sponsors.



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Synopsis

To assist retirement plan sponsors, the Employee Plans function completed a significant number of actions to promote the VCP with preparers and sponsors responsible for administering retirement plans. While we could not determine whether there is a direct link between outreach activities and the number of VCP applications received, we have noted that increased outreach activities have corresponded with an increasing number of VCP applications being received. The number of VCP applications increased nearly 60 percent (from 1,877 to 2,973) between FYs 2006 and 2008.

To meet the increased customer demand, VCP management made several changes to VCP applications and procedures that reduced processing time from 379 to 195 calendar days, nearly 50 percent. In addition, VCP management addressed a key Pension Protection Act of 2006¹ provision by continually updating and improving the system of correction programs already available and making the programs more accessible to small business employers.

However, about 22 percent of applications were still not being closed within timeliness goals in FY 2008, and there is no guarantee that future budgets and priorities will allow for increased staffing to work the growing number of applications. Taking these factors into account, additional processing improvements will need to be made to cut down on the time it takes to process certain applications and handle the increasing volume of applications.

Providing timely service on VCP applications allows plan sponsors to make needed changes and ensures that both employees and plan sponsors continue to receive favorable treatment for retirement benefits. Based on our review of 220 VCP applications that were closed in FY 2008 and interviews with VCP personnel, we identified 5 areas where we believe additional processing improvements can be made that will further improve the Employee Plans function's ability to timely process VCP applications.

Recommendation

To ensure the VCP provides timely service to those in the retirement plan community who are voluntarily attempting to bring their retirement plan into compliance with tax-exempt laws, we recommended the Director, Employee Plans: a) reinforce the need for staff conducting the initial screening of VCP applications to determine whether case files have all needed information, b) expand the "streamlined" application process to include more common types of failures, c) expand the VCP Revenue Procedure to include a checklist that provides retirement plan sponsors with specific options they can use to identify the type of plan failure, d) analyze the staffing mix for VCP revenue agent groups to determine the most effective mix of positions and

¹ Pub. L. No. 109-280, 120 Stat. 1055.



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responsibilities, and e) survey retirement plan sponsors upon completion of the VCP process to ask how it could be improved.

Response

Tax Exempt and Government Entities Division management agreed with our recommendation and outlined several planned corrective actions, as well as one alternative corrective action. They have hired additional staff and created a hiring proposal for FYs 2010 through 2012 based on a review of the current staffing mix to improve initial screening and processing timeliness. Management also agreed with our recommendation to expand the streamlined application process and plans to seek input from stakeholders to develop process improvements. Lastly, they plan to develop a survey to obtain feedback on an ongoing basis to identify and make further improvements to the VCP. Management's complete response to the draft report is included as Appendix IV.

Office of Audit Comment

Tax Exempt and Government Entities Division management provided an alternate corrective action for our recommendation to expand the VCP Revenue Procedure to include a checklist that provides retirement plan sponsors with specific options for identifying the type of retirement plan failure that led to the VCP application and the actions they are taking to correct them. We recommended this as an interim step until a VCP application form could be developed. Tax Exempt and Government Entities Division management commented that it currently has two sample application forms (one for streamlined applications and another for more complex plan failures). Tax Exempt and Government Entities Division management plans to gain experience with these forms and create an official IRS form. Since management has developed sample application forms which include the information we recommended, we agree with the IRS' alternate corrective action.

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 Nakamura, Assistant Inspector General for Audit (Management Services and Exempt Organizations), at (202) 622-8500.



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Abbreviations

EP	Employee Plans
FTE	Full-Time Equivalent
FY	Fiscal Year
IRS	Internal Revenue Service
VCP	Voluntary Correction Program



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Background

The Internal Revenue Code provides significant tax incentives for retirement plan sponsors that establish and maintain retirement plans that comply with Internal Revenue Code requirements. Generally under these plans, income set aside for retirement is deductible by employers and not taxable to employees until distributed after retirement. By statute, plan sponsors not properly maintaining retirement plans can lose the tax-exempt status of these deductions. In addition, employees whose funded benefits have grown tax-free lose the right to protect their benefits from current taxation.

In 1998, the Internal Revenue Service (IRS) consolidated a set of programs designed to assist plan sponsors whose retirement plans had been noncompliant with applicable Internal Revenue Code requirements. The Employee Plans (EP) Compliance Resolution System is a comprehensive group of correction programs available to retirement plan sponsors to correct Qualification Failures¹ while continuing to provide employees with retirement benefits on a tax-exempt basis. The three components of the EP Compliance Resolution System are:

- (1) Self-Correction Program: Permits retirement plan sponsors to correct plan failures without contacting the IRS or paying a fee.
- (2) Voluntary Correction Program (VCP): Permits retirement plan sponsors to pay a fee and receive the IRS' approval for correction of plan failures any time before an audit.
- (3) Audit Closing Agreement Program: Permits retirement plan sponsors to pay a tax as a sanction and correct a plan failure while the plan is being audited by the IRS.

The Voluntary Correction Program allows retirement plan sponsors to inform the IRS about certain types of errors in their plans and obtain approval of their proposed method for correcting them.

Sponsors of retirement plans apply to operate their plans as tax exempt by submitting to the IRS a retirement “plan document” that describes how the plan is organized and how it should operate. Because of frequent tax law changes, retirement plan documents require periodic revision to ensure retirement plans remain in compliance with all current regulations. If changes are not made timely or the retirement plan sponsor determines that their retirement plan is not operating in accordance with tax-exempt laws, the plan sponsor may prepare a VCP application for submission to the IRS. The application, required fee, and all information required by Revenue

¹ A Qualification Failure occurs when a plan does not meet all Internal Revenue Code requirements in a manner that adversely affects the qualification of the plan for tax-exempt status.



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Procedure 2008-50² are then sent to the EP function offices located in Washington, D.C., where EP function staff remove and deposit remittances for the associated VCP fees and forward the application to a VCP assistant who “pre-screens” the application for obvious omissions.

If the VCP application was submitted as a “streamlined” application,³ it could be worked by EP function staff at either the National Headquarters or one of four IRS area offices.⁴ While most non-streamlined applications are examined by revenue agents in the field offices, revenue agents in the National Headquarters review applications involving more complex issues. If EP function staff agree that the actions proposed by a retirement plan sponsor to bring a retirement plan back into compliance are adequate, the EP function issues a “compliance statement,” which serves as the IRS’ written concurrence to the corrective actions proposed for the retirement plan.

The VCP experienced significant growth from Fiscal Year (FY) 2006 to FY 2008. As shown in Figure 1, while the number of VCP applications increased nearly 60 percent, the number of resources, or full-time equivalents (FTE),⁵ dedicated to the program dropped 37 percent during this same period.

² I.R.B. 2008-35, 464.

³ Streamlined applications involve common retirement plan errors that can be corrected quickly.

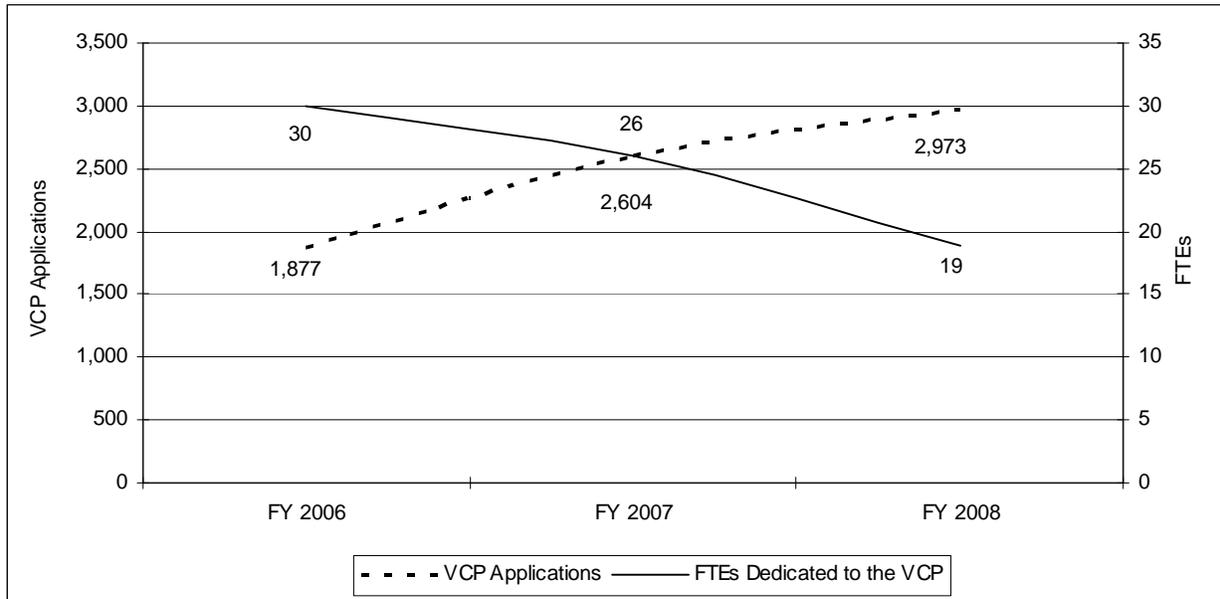
⁴ A geographic organizational level used by IRS business units and offices to help their specific types of taxpayers understand and comply with tax laws and issues.

⁵ A measure of labor hours in which 1 FTE is equal to 8 hours multiplied by the number of compensable days in a particular fiscal year. For FYs 2006 and 2007, 1 FTE was equal to 2,080 staff hours. For FY 2008, 1 FTE was equal to 2,096 staff hours.



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Figure 1: Total VCP Applications Compared to VCP Resources (FY 2006 to FY 2008)



Source: EP Compliance Resolution System Research and Inventory Management System, November 2008 Business Performance Review.⁶

The former Tax Exempt and Government Entities Division Commissioner recommended we perform an audit of VCP case processing procedures to identify potential suggestions that would assist with reducing the time needed to process cases and reduce inventory. We determined that the VCP accounts for about 80 percent of EP Compliance Resolution System cases. As a result, we limited our review to the VCP portion of the EP Compliance Resolution System.

This audit was conducted while changes were being made to the VCP, such as moving certain types of cases to another program within the EP function. As a result, this report might not reflect the most current status of the EP function's VCP.

This review was performed at the EP function's National Headquarters in Washington, D.C., and also included interviews of VCP group managers and revenue agents from Baltimore, Maryland; Brooklyn, New York; Chicago, Illinois; Dallas, Texas; El Monte, California; Evansville, Indiana; Philadelphia, Pennsylvania; and Seattle, Washington.

We conducted this performance audit during the period November 2008 through June 2009 in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable

⁶ This information was not independently verified because the accuracy of these statistics did not affect the accomplishment of our audit objective.



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basis for our findings and conclusions based on our audit objective. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objective. 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

The Employee Plans function has completed a significant number of actions to promote the VCP. In addition, VCP management has taken actions that have significantly reduced the number of calendar days required to process VCP applications, from 379 calendar days in FY 2006 to 195 calendar days in FY 2008. However, about 22 percent of applications were still not being closed within timeliness goals in FY 2008. In addition, the number of VCP applications has increased nearly 60 percent from 1,877 applications in FY 2006 to 2,973 applications in FY 2008, and there is no guarantee that future budgets and priorities will allow for increased staffing. Taking these factors into account, additional processing improvements will need to be made to cut down on the time it takes to process certain applications and handle the increasing volume of applications.

Providing timely service on VCP applications is important because correcting errors in a timely and efficient manner protects the favorable treatment of employees' retirement benefits and reduces the uncertainty of any potential tax liabilities for both employees and plan sponsors. Based on our review of 220 VCP applications that were closed in FY 2008 and interviews with VCP personnel, we identified 5 areas where we believe additional processing improvements can be made that will further improve the EP function's ability to timely process VCP applications.

A Significant Number of Outreach Activities Were Completed and the Number of Voluntary Correction Program Applications Received Has Increased

The EP function strives to provide retirement plan sponsors with information on the laws and processes for receiving and maintaining tax-exempt status and assist with correcting mistakes that may occur during plan administration. To assist retirement plan sponsors, the EP function completed a significant number of actions to promote the VCP with preparers and sponsors responsible for administering retirement plans. While we could not determine whether there is a direct link between outreach activities and the number of VCP applications received, we have noted that increased outreach activities have corresponded with an increased number of VCP applications being received. The following are several of the outreach activities that have been completed by the EP function.

- Creating "Fix-It Guides."
- Conducting workshops at IRS Tax Forums and providing presentations to practitioner groups.



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- Creating newsletters.
- Responding to Advisory Committee on Tax Exempt and Government Entities recommendations.

Collectively, these actions address a key Pension Protection Act of 2006⁷ provision: continually updating and improving the system of correction programs already available and making the programs more accessible to small business employers. Media coverage related to the September 2008 revision of the procedures for submitting a VCP application included

very favorable comments about the IRS' continued efforts to improve the program and make it more accessible to small business employers by simplifying the application process.

The EP function addressed a key Pension Protection Act of 2006 provision by increasing activities to promote the VCP.

Creating “Fix-It Guides”

In response to customer feedback, the EP function's “Correcting Plan Errors” webpage includes user-friendly “Fix-It Guides” with tips on how to find, fix, and avoid common mistakes in retirement plans. The Fix-It Guides detail the most common mistakes that the IRS sees and how to find them, fix them, or prevent them from happening. This document is geared to retirement plan sponsors of both sophisticated larger employers and also less sophisticated smaller employers, as the guides are designed to identify and correct very common errors.

Data provided by the EP function showed the “Correcting Plan Errors” webpage⁸ averaged 3,664 accesses per month during 2008 versus 3,362 per month in 2006, an increase of 9 percent.⁹ The “Correcting Plan Errors” webpage also includes fill-in “streamlined application” forms. In addition, video instructions from the VCP manager are available to assist retirement plan sponsors with using the Fix-It Guides.

Conducting workshops and providing presentations

The EP function staff delivered 93 presentations and exhibits to an estimated 43,500 event attendees between FY 2006 and FY 2008.¹⁰ While the number of events attended remained

⁷ Pub. L. No. 109-280, 120 Stat. 1055.

⁸ The EP function's “Tax Information for Retirement Plans Community” webpage contains information on a variety of topics for the Retirement Plan Community, including a detailed description of the VCP via links to the “Correcting Plan Errors” webpage and Revenue Procedure 2008-50.

⁹ This information was not verified because there was no independent source of data to validate the number of accesses to the webpage.

¹⁰ While many of these presentations included information about the VCP, there is no means of positively correlating how many people attended presentations that included VCP-related information. In addition, this information was not verified because there was no independent source of data to validate the number of presentations and attendees.



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stable during this period, the total number of customers reached increased by nearly 60 percent. These presentations are usually made by VCP revenue agents at the request of various practitioner groups, such as the American Institute of Certified Public Accountants, and include general information about the types of retirement plans available, the process of obtaining tax-exempt status, and some of the more common problems practitioners may experience when setting up and administering a retirement plan.

In addition to the general presentations, EP function staff developed a Retirement Plan Pitfalls Workshop that was presented at each of the six IRS Nationwide Tax Forums in FY 2008. The workshop was developed to encourage small-business practitioners to use online IRS Fix-It Guides.

The workshop sessions also provided practitioners with the opportunity to ask questions about specific issues they may be dealing with or are having difficulty resolving. According to IRS documentation, more than 300 (61 percent) of the 493 attendees at the workshops completed the surveys and indicated an overwhelmingly positive response to the materials presented. For example, nearly 90 percent of the respondents felt the material was helpful in understanding how to find and fix errors in their retirement plans.

Creating newsletters

The EP function publishes two newsletters that have frequent articles on current VCP issues. These are available on the EP function's "Retirement Plans Community" webpage.

- The Retirement News for Employers newsletter is designed for employers/business owners and their tax advisors. This newsletter provides practical retirement plan information and every issue contains VCP-related information. From the beginning of FY 2006 to the end of FY 2008, there was an increase of more than 300 percent in the number of newsletter subscriptions (from 7,868 to 33,663 per month).¹¹
- The Employee Plans News is geared toward retirement plan practitioners (attorneys, accountants, actuaries, and others) and presents information about retirement plans. The average number of queries of this newsletter increased nearly 30 percent between FYs 2006 and 2008. The majority of this growth took place during FY 2008, when the number of queries increased from 22,000 per month to nearly 44,000 per month.¹²

¹¹ Information on newsletter accesses and queries could not be verified because there was no independent source of data available for verification.

¹² Information on newsletter accesses and queries could not be verified because there was no independent source of data available for verification.



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Responding to Advisory Committee on Tax Exempt and Government Entities Recommendations

The Advisory Committee on Tax Exempt and Government Entities was established in May 2001 to provide a public forum for discussion of relevant issues between IRS officials and representatives of the entities served by the Tax Exempt and Government Entities Division. This provides a means for the IRS to receive regular input on developing and implementing IRS policy issues related to these groups.

In June 2008, the Committee issued its annual report with seven VCP-related recommendations, and the EP function has completed or is working the majority of these recommendations. For example, EP is working to establish a new program that would allow retirement plan sponsors to submit a notice that a VCP application is forthcoming and, in the event of an audit in the interim, the notice would allow the sponsor to be treated as though a VCP application was actually filed.

The Employee Plans Function Has Reduced the Time Needed to Process Voluntary Correction Program Applications

To meet increased customer demand, the EP function made several changes to VCP applications and processing procedures that increased application closures and reduced application processing time. For example, receipts of VCP applications have increased nearly 60 percent between FY 2006 and FY 2008, while the resources devoted to the program dropped by 37 percent. However, despite the reduction in VCP staff, the EP function was able to reduce both the amount of time needed to review and evaluate VCP applications as well as the in-process inventory of VCP applications assigned to revenue agents. These improvements resulted from several actions by EP function management and are discussed in the following sections.

The EP function completed a process analysis study and created a streamlined application process

During FY 2007, VCP management implemented the recommendations of a process analysis team, which contributed to a 42 percent reduction in the time taken to complete work on a VCP application. These improvements, made at the group level, included having the VCP coordinators or group managers close some cases based solely on information included with the VCP application, allowing certain cases to bypass a review by the VCP coordinator while still being reviewed by the group manager.

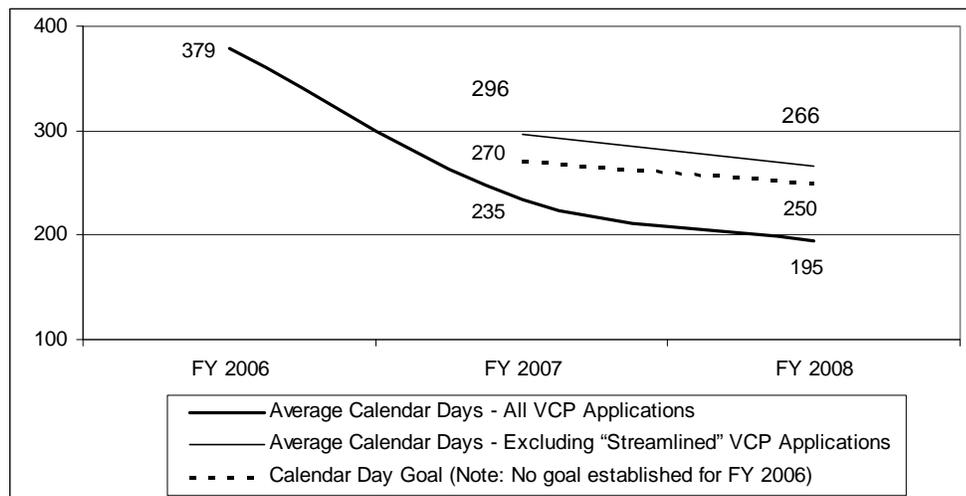
Also, EP function management worked to update the VCP Revenue Procedure in both FY 2007 and FY 2008 to implement and further improve the streamlined application process. Following these changes, VCP closures increased by more than 10 percent. Our analysis of management information data showed the relative small number of hours used to close streamlined cases accounted for decreases of 61 and 71 calendar days needed to process a VCP application during FY 2007 and FY 2008, respectively.



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In addition, overall VCP application processing time dropped by 184 days (nearly 50 percent) between FY 2006 and FY 2008. As shown in Figure 2, most of these improvements can be attributed to implementing the streamlined application process in FY 2007.

Figure 2: Average Calendar Days Required to Process VCP Applications From FY 2006 Through FY 2008



Source: EP Compliance Resolution System Research and Inventory Management System database, November 2008 Business Performance Review.

Making these changes improved customer service by providing more timely responses to retirement plan sponsors who submitted VCP applications and also allowed sponsors to reduce the amount of time that their plans were not in compliance with tax-exempt statutes. This reduces a retirement plan's risk of losing tax-exempt status or suffering revenue losses for penalties and/or taxes.

The EP function changed the way it processed applications that included a determination letter request

When submitting a VCP application, retirement plan sponsors may sometimes need to obtain the IRS' assurance that their retirement plan is designed to comply with applicable tax-exempt laws by requesting an IRS determination letter. The determination letter process is a key interaction with the IRS because a favorable determination letter gives retirement plan sponsors assurance their retirement plans qualify for favorable tax treatment, as long as the plan operates under the terms on which the determination letter was issued.

In the past, revenue agents in VCP groups simultaneously worked both VCP applications and any related determination letter requests to provide retirement plan sponsors with a "one-stop shopping" approach. While we applaud the IRS' efforts to provide a one-stop shopping approach, we noted that VCP revenue agents often did not have the full skill set needed to



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process determination letter requests and would need to consult with EP Determinations program personnel to ensure the determination letter request was completed satisfactorily. In addition, the inclusion of a determination letter request with a VCP application often increased the amount of time it took to process VCP applications.

The EP function completed a study in February 2009 which proposed changes to how it processes VCP applications with related determination letter requests. This was based on the premise that the EP Determinations program was better equipped to deal with issues related to retirement plan documents that were not timely amended. As a result of the study, when a VCP application is received with a determination letter request, the Determinations program will address the determination letter request and the VCP will address the remainder of the VCP application. This change was intended to provide more timely processing of VCP applications by eliminating the need for VCP revenue agents to evaluate determination letters.

Based on our analysis of VCP applications that were closed in FY 2008, this action should further improve the number of calendar days needed to process a VCP application. For example, 547 (22 percent) of 2,492 VCP applications closed during FY 2008 had a related determination letter request. Figure 3 illustrates the potential additional improvement in the number of calendar days required to process a VCP application by comparing calendar days for VCP applications received with and without a related determination letter request.

Figure 3: Average Calendar Days to Process VCP Applications Received During FY 2008 – With and Without a Determination Letter Request

	Calendar Days to Process VCP Applications With a Determination Letter Request	Calendar Days to Process VCP Applications Without a Determination Letter Request	Additional Calendar Days Needed to Process VCP Applications With a Determination Letter Request
Average Calendar Days to Review VCP Applications	289	168	121

Source: Analysis of the EP Compliance Resolution System Research and Inventory Management System database.



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Additional Actions Are Needed to Improve Voluntary Correction Program Case Processing Efficiency

While VCP management has taken actions that have significantly reduced the number of calendar days required to process VCP applications, further improvements will be needed to increase the number of VCP applications that receive timely service. One of the EP function's FY 2008 and FY 2009 Work Plan priorities is to improve customer service by reducing VCP application inventory and processing time. The FY 2008 and FY 2009 goal for processing VCP applications was 250 days and 225 days, respectively.

Our analysis showed that the VCP did not always meet its timeliness goals. For example, in FY 2008, 543 (22 percent) of the 2,492 closed VCP applications exceeded the 250 calendar day goal in the EP function's Work Plan. Opportunities to improve the number of VCP applications processed within the EP function's established goals are discussed in the sections that follow.

We identified five opportunities for further improving the timeliness of VCP application processing.

Screeners who review incoming VCP applications do not determine whether all information is provided

Once VCP application cases are received by revenue agents in field offices, many require followup with the retirement plan sponsor to obtain documentation not provided with the original application. VCP procedures require screeners to look for obvious omissions in applications as they are received; however, the scope of their review is very limited due to the large volume of applications received and the limited number of staff available to review them.

We determined that 91 (41 percent) of the 220 closed VCP applications included at least 1 request for additional information. In total, these 220 cases included 394 instances where revenue agents requested additional information. An in-depth review of the 10 most common types of information requested showed that 8 were included on a checklist of everything required to be submitted with a VCP application, which is contained in the VCP Revenue Procedure. This indicates that some retirement plan sponsors are unaware of IRS information about the types of information not included with the VCP application. Figure 4 provides the results of our analysis.



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Figure 4: Analysis of Additional Information Requested From Retirement Plan Sponsors

Ten Most Common Types of Additional Information Requested	Total Requests	Percentage of all Requests	Requested Information on VCP Checklist (Yes/No)
Plan Details	49	12.4%	Yes
Failure Specifics and Steps to Prevent It in the Future	45	11.4%	Yes
Error Correction/Interest Calculations and Terms	25	6.3%	Yes
Compliance Statement Sent to Power of Attorney to Be Reviewed	24	6.1%	No
Standard VCP Forms	21	5.3%	Yes
Individual Participants Information (Contributions, Personal Information, etc.)	20	5.1%	No
Payroll Correction/Match Correction Calculation	14	3.6%	Yes
Request Additional Fees	11	2.8%	Yes
Taxpayer Financial Information/Assets	11	2.8%	Yes
Number of Affected Participants	9	2.3%	Yes
Total Requests for the Ten Most Common Types of Additional Information	229	58.1%	
Other Types of Information Requested	165	41.9%	
Total Number of Requests for Additional Information	394		

Source: Analysis of a judgmental sample of 220 VCP application files closed during FY 2008.

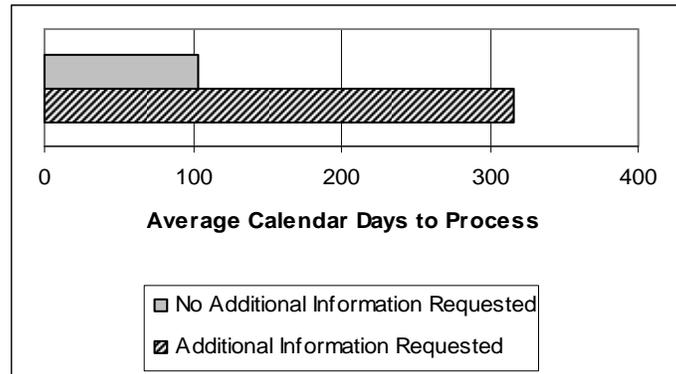
While VCP procedures require screeners to scan for obvious omissions in applications as they are received, the scope of their review is very limited due to the large volume of applications received and the limited number of staff available to review them. Also, since the majority of VCP applications are received during a relatively short time period (usually in late January and early February), there are very large spikes in receipts. During these periods, revenue agents from nearby offices assist the three Washington, D.C., screeners with the screening process. However, even with these additional employees, the heavy volume of incoming VCP applications, combined with limited staff to review them, necessitate that screeners conduct a limited initial review.

While it is understandable why the screening of applications is limited, we believe performing a more thorough upfront screening would be worthwhile because having revenue agents in field offices subsequently request additional information significantly increases case processing time. As shown in Figure 5, our analysis of 220 sample application cases showed a 200 percent increase in the average number of calendar days needed to process a VCP application (from 104 days to 316 days) when revenue agents had to request additional information from retirement plan sponsors.



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Figure 5: Impact on Case Processing Time When Additional Information Is Requested From Retirement Plan Sponsors



Source: Analysis of a judgmental sample of 220 VCP application files closed during FY 2008.

The streamlined application process does not include some frequent types of errors that cause retirement plan sponsors to submit VCP applications

The VCP Revenue Procedure lists the errors retirement plan sponsors can correct via the streamlined process. However, we identified additional frequent errors that are not included in the streamlined process. If the streamlined process was expanded to include additional types of retirement plan errors, application processing time would be further reduced.

Between its inception in 2006 and the latest update in 2008, the streamlined process has evolved to include more types of errors. For example, initially the only error eligible for streamlined processing was related to not timely amending retirement plans to reflect tax law changes. The latest Revenue Procedure included eight additional schedules with errors that can be corrected using this process.

The streamlined application process has improved service by reducing the amount of time needed to process applications with common and oftentimes easily resolved issues. For example, nearly 70 percent of all VCP closures in FY 2008 were submitted using the streamlined procedure. However, the IRS would realize additional benefit by continuing to expand the process to include additional types of common errors.

At the present time, the EP function has not fully identified all types of errors that could be processed using streamlined procedures. For example, several VCP staff we interviewed thought that opportunities existed to expand the streamlined application process to include additional types of plan failures.

Continuing to increase the number and types of errors eligible for streamlined processing benefits both retirement plan sponsors and the IRS by providing a more timely, efficient, and less cumbersome option for retirement plan sponsors to correct errors.



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Checklists in the Revenue Procedure do not include a list of options that clearly identifies the type(s) of errors that would result in submitting a VCP application

The VCP Revenue Procedure includes a series of forms and checklists to assist retirement plan sponsors and their representatives in preparing an application and ensuring it contains all required information. However, when analyzing the information provided, VCP staff often have difficulty identifying the specific issue(s) which led to the VCP application being submitted. For example, VCP applications usually have many attachments that provide additional details about the error(s) leading to the VCP application and can be very lengthy. Revenue agents must sort through large amounts of data to locate specific pieces of information needed to clearly identify and understand the exact nature of both the retirement plan failure and the proposed method of making corrections.

The forms used for a VCP application do not include a list of options to identify the type of retirement plan failure or the proposed corrective action. The VCP Program Manager views Appendices D and F of the current Revenue Procedure as its VCP “application forms,” while Appendix C helps retirement plan sponsors ensure the application is complete. VCP management plans to make these forms “official” after gaining more experience and perfecting them.

Having an application form specific to the VCP would provide a means of more clearly identifying the nature of the plan failure and proposed corrective action. Doing so would improve the review process by reducing the amount of time needed to locate this information in documentation provided with the VCP application.

The staffing mix for VCP revenue agent groups has not been analyzed

In addition to the VCP, there are two other groups staffed by revenue agents in the EP function. These are the Examinations program (where revenue agents audit retirement plans to ensure they are following applicable Internal Revenue Code regulations) and the Determinations program (where revenue agents assess whether retirement plans qualify for tax-exempt status).

Within the VCP, revenue agents examine VCP applications and determine if proposed corrective actions will bring retirement plans into compliance with tax-exempt laws. However, there are some revenue agents who serve as coordinators and provide program support to VCP group managers. This support consists of advising the manager and other personnel working VCP applications on the correct fee amounts required for processing a VCP application, the development of issues associated with the retirement plan failure, the proposed action that will



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correct the plan failure, and the drafting of compliance statements notifying the retirement plan sponsor of the results of the IRS' review of the VCP application.¹³

We compared revenue agent staffing in the Examinations and Determinations programs with the VCP and identified a relatively large difference (25 and 32 percent, respectively) in the ratio of revenue agents to supervisors. However, as shown in Figure 6, if plans to hire five additional revenue agents come to fruition, the VCP would have a far more comparable staffing pattern.

Figure 6: VCP Revenue Agent Staffing Compared to Similar EP Programs

EP Function	Current Ratio: Revenue Agents to Supervisors	Difference Between VCP Ratio and Other EP Programs	Revised Ratio: Revenue Agents to Supervisors (Adding 5 Revenue Agents to the VCP)	Difference Between Revised VCP Ratio and Other EP Programs
VCP	6.3		7.5	
Examinations	7.8	24%	7.8	4%
Determinations	8.3	32%	8.3	11%

Source: Analysis of the IRS' Discovery Directory.

Though each program has a different expertise and revenue agents from each of these programs serve a separate and distinct function in the administration of the overall EP function, the skill sets of the revenue agents in these programs and the issues they deal with are often similar. Under the current alignment, every VCP group has about five revenue agents working cases and one revenue agent serving as a coordinator with either no inventory of cases or a limited inventory of cases. Conversely, Examinations and Determinations programs have approximately eight revenue agents working cases in each group. We question why the ratio of revenue agents working cases to supervisors is significantly lower in the VCP groups.

The VCP Program Manager views the coordinator position as one that is critical to maintaining a high level of quality in the VCP, since no formal quality review program exists for VCP application cases and there is a need to balance assurance that applications are processed accurately with the need to process cases faster. In addition, the VCP Program Manager noted that other EP function programs (such as Examinations and Determinations) have similar positions which provide the same type of support and have an entirely separate function devoted to quality review (one of the primary responsibilities of the coordinator position). However, since the coordinators are primarily managed within the individual groups and no statistical information is tracked, it is difficult to measure the impact the position is having on the quality of case work.

¹³ The coordinator also provides input to the National Headquarters analysts on VCP procedure updates, supplies information to the revenue agents about the procedure updates, and serves as the contact person for customer inquiries about the VCP.



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The VCP Program Manager also noted that coordinators oftentimes maintain their own inventory in addition to performing their coordinator responsibilities. However, our analyses showed their impact on reducing the inventory backlog has been minimal since the four coordinators combined accounted for only 360 of the closures in FY 2008, and the majority of these closures involved simpler issues that lower-graded employees could have worked. For example, VCP management information reports showed that 285 (79 percent) of the 360 cases met the criteria of work that is typically performed by revenue agents at the GS-11 and GS-12 levels¹⁴ (while all VCP coordinators who worked them were GS-13 revenue agents).

Shifting resources to a span of control that is more consistent with the EP Examinations and Determinations functions should enable the VCP to work more cases. As the volume of retirement plans using the VCP increases, there will be a need to devote staff to work the growing inventories. The EP function may need to consider other options for filling this resource void by either reducing the number of coordinators or reducing some of the responsibilities required of the coordinator position so that the coordinators can have a bigger impact on reducing case inventories. For example, while resources devoted to the VCP dropped from a total of 30 FTEs in FY 2006 to 19 FTEs in FY 2008, the VCP continued with a structure that maintained four group managers with each manager having one coordinator.

VCP management has not surveyed customers to obtain feedback for improving the program

Feedback enables management to identify program deficiencies, address customer service issues, and recognize opportunities for improvement. A Treasury Inspector General for Tax Administration report issued in September 2003¹⁵ noted that the Tax Exempt and Government Entities Division had not established clear, measurable goals for the three EP Compliance Resolution System programs (including the VCP) or an effective way to measure the impact educational and marketing efforts have on compliance.

In response, the EP function advised it planned to analyze the feasibility of surveying VCP applicants to help determine the impact of its outreach efforts. Ultimately, the Tax Exempt and Government Entities Division decided to forgo this action because of challenges involved with developing and obtaining approval for using surveys.

There were several focus group sessions held during FY 2008 to obtain input from benefits groups and professionals. This included identifying areas where the VCP was both working well

¹⁴ VCP applications at the Grade 11 level can be closed quickly based on the information submitted and generally require no additional contact with the retirement plan sponsor or representative. Cases at the Grade 12 level may require additional contact with the retirement plan sponsor or representative, but no coordinator approval of correction method is required. In other words, VCP revenue agents can generally close the case assuming information in the initial submission will not materially change during the course of their review.

¹⁵ *Additional Strategies Are Needed to Ensure the Employee Plans Compliance Resolution System Will Accomplish Its Intended Purposes* (Reference Number 2003-10-190, dated September 12, 2003).



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or could be improved. In total, the groups made 12 recommendations, 2 of which were included as updates in the latest VCP Revenue Procedure. However, we did not identify any efforts to obtain feedback on an ongoing basis from those who have filed a VCP application. By not conducting surveys to obtain ongoing feedback from VCP customers, the EP function could miss opportunities to identify and make further improvements to the program.

Recommendation

Recommendation 1: To ensure the VCP provides timely service to those in the retirement plan community who are attempting to bring their retirement plans into compliance with tax-exempt laws, the Director, Employee Plans, should:

- a. Reinforce the need for staff conducting the initial screening of VCP applications to determine whether case files have all needed information prior to sending them to revenue agents in field offices for evaluation.
- b. Evaluate whether opportunities exist to expand the “streamlined” application process to include more common types of failures.
- c. Until a VCP application form is developed, expand the VCP Revenue Procedure to include a checklist that provides retirement plan sponsors with specific options for identifying the type of retirement plan failure that led to the VCP application and the actions they are taking to correct them.
- d. Analyze the staffing mix for VCP revenue agent groups to determine the most effective mix of positions and responsibilities. This analysis should include reviewing the duties of the coordinator position and analyzing the span of control between group managers and revenue agents.
- e. Survey retirement plan sponsors upon completion of the VCP process to determine what components of the program worked well and how it could be improved.

Management’s Response: Tax Exempt and Government Entities Division management agreed with our recommendation and outlined several planned corrective actions, as well as one alternative corrective action. Tax Exempt and Government Entities Division management also provided comments on its corrective actions. Tax Exempt and Government Entities Division management’s corrective actions and selected comments are as follows:

- a. Management commented that perfecting VCP applications as much as possible on the front-end would promote more efficient case processing by the agents in the groups. They hired additional staff for the VCP, which will assist in improving initial screening.
- b. Management commented that they agreed with our recommendation to expand the streamlined application process and plans to reevaluate the program and seek input from stakeholders in order to continue developing process improvements



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- c. Management commented that it has two sample application forms (one for streamlined applications and another for more complex plan failures) and stated that, after gaining experience with the sample VCP application form and streamlined application form, the EP function will finalize them and create an official IRS form.
- d. Management analyzed the staffing mix for the VCP. The EP function recently submitted a hiring proposal for FYs 2010 through 2012 based on a review of the current staffing mix, span of control, and assigned duties. As a result of this proposal, the Tax Exempt and Government Entities Division has approved six new hires for FY 2010. The additional staffing is intended to promote improved upfront case processing as well as case processing timeliness. Tax Exempt and Government Entities Division management is also in the process of developing a FY 2012 Hiring Initiative to meet future program needs.
- e. The EP function is working with the Tax Exempt and Government Entities Division's Strategic Planning Office to develop a survey for users of the VCP to obtain feedback on an ongoing basis to help identify and make further improvements to the program.

Office of Audit Comment: Tax Exempt and Government Entities Division management provided an alternate corrective action for our recommendation to expand the VCP Revenue Procedure to include a checklist that provides retirement plan sponsors with specific options for identifying the type of retirement plan failure that led to the VCP application and the actions they are taking to correct them. We recommended this as an interim step until a VCP application form could be developed. Management commented that it currently has two sample application forms and plans to create an official IRS form. Since management has developed sample application forms which include the information we recommended, we agree with the IRS' alternate corrective action.



Appendix I

Detailed Objective, Scope, and Methodology

The overall objective of this review was to assess the IRS' efforts to 1) improve the efficiency of processing VCP applications to ensure timely processing and 2) increase participation through outreach efforts. To accomplish the objective, we:

- I. Obtained current and historical staffing and receipt information and determined whether the current staffing and procedures enabled the EP function to timely process VCP applications.
 - A. Evaluated staffing devoted to the VCP during FYs 2006 through 2008 in comparison to VCP application receipts, inventory-in-process, and VCP closures.
 - B. Evaluated whether existing processes and procedures were sufficient for timely processing VCP applications and ensuring that incoming applications were appropriate for the VCP.
 1. Obtained an extract from the EP Compliance Resolution System Research and Inventory Management System to identify any processing delays by quantifying the amount of time expended to control, assign, review, and close VCP application cases. This was accomplished by selecting a judgmental sample of 220 (8.8 percent) of 2,492 closed VCP application cases from FY 2008. We used judgmental sampling because we did not plan to project our results. We did not verify the completeness of the System because we did not have a basis for comparison. In addition, we did not verify the accuracy of the data in the System because doing so was not necessary to accomplish our audit objective.
 2. Determined whether EP function management had made modifications to or considered modifying its staffing to address the increase in VCP receipts.
 3. Interviewed management officials and frontline staff to obtain their input on whether existing Internal Revenue Manual processes and procedures contained sufficient detail for both timely processing VCP applications and identifying cases that should be worked outside of the VCP.
 4. Determined whether any analyses had been conducted to identify inefficiencies and update processes and procedures to improve screening, determining eligibility, or overall processing of VCP applications.



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- II. Evaluated the EP function's outreach efforts to increase retirement plan sponsors' participation in the VCP and what measures EP function management used to evaluate the program's performance.
 - A. Interviewed EP function management and reviewed both existing Internal Revenue Manual procedures and EP function directives to identify what processes are in place to measure the VCP.
 - 1. Determined whether the Internal Revenue Manual contained any measures (e.g., days to process VCP applications) for the VCP.
 - 2. Identified any division-level documentation containing measures or goals (e.g., volume of closures) for the VCP.
 - B. Determined the extent and nature of completed and planned actions by EP function management to make small employers more aware of the VCP and to address recommendations and suggestions from the Advisory Committee on Tax Exempt and Government Entities.
 - 1. Interviewed management to determine whether the IRS developed promotional materials for use at the 2008 IRS Tax Forum and obtained feedback on what methods were used to gauge the overall success of these efforts (e.g., any statistics showing attendance at VCP-related presentations and documentation for any issues or questions submitted by preparers).
 - 2. Obtained documentation of other outreach methods to make the retirement plan community more aware of the types of voluntary compliance programs that are available. We determined if EP function management had statistical data for gauging how many practitioners are using available educational materials as well as any past/ongoing efforts to increase their awareness of such information.

Internal Controls Methodology

Internal controls relate to management's plans, methods, and procedures used to meet their mission, goals, and objectives. Internal controls include the processes and procedures for planning, organizing, directing, and controlling program operations. They include the systems for measuring, reporting, and monitoring program performance. While part of our objective was to assess IRS efforts to improve the efficiency in the processing of VCP applications, our assessment did not evaluate controls for ensuring accuracy of actions. Instead, the assessment was generally limited to activities relevant to the timely processing of VCP applications. In addition, we reviewed outreach efforts to increase participation in the VCP. We determined that the following internal controls were relevant to our audit objectives: the EP function's policies, procedures, and practices for processing VCP applications and the EP function's outreach efforts to increase retirement plan sponsors' participation in the program. We evaluated these controls



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by interviewing management and other employees associated with the processing of VCP applications, reviewing application case files, and reviewing materials used to promote the VCP.



Additional Process Improvements Are Needed Due to Continued Growth in the Voluntary Correction Program for Retirement Plans

Appendix II

Major Contributors to This Report

Nancy A. Nakamura, Assistant Inspector General for Audit (Management Services and Exempt Organizations)
Troy D. Paterson, Director
James V. Westcott, Audit Manager
Steve T. Myers, Lead Auditor
John M. Jarvis, Auditor
Donald J. Martineau, Auditor
Jeffery R. Stieritz, Auditor



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Appendix III

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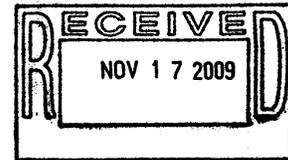
Additional Process Improvements Are Needed Due to Continued Growth in the Voluntary Correction Program for Retirement Plans

Appendix IV

Management's Response to the Draft Report



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



November 17, 2009

MEMORANDUM FOR MICHAEL R. PHILLIPS
DEPUTY INSPECTOR GENERAL FOR AUDIT

FROM: Sarah Hall Ingram, Commissioner *Sarah Hall Ingram*
Tax Exempt and Government Entities Division

SUBJECT: Draft Audit Report – Additional Process Improvements
Are Needed Due to Continued Growth in the Voluntary
Correction Program for Retirement Plans
(Audit # 200910015)

I reviewed the subject draft report and agree with your findings. I appreciate your recognition of the importance of timely service in the area of retirement plan voluntary compliance, and its impact on the protection of the retirement savings of the American taxpayer, as well as your acknowledgement of the significant strides we have made in improving customer service under the Voluntary Correction Program (VCP) despite an unprecedented increase in filings.

The VCP promotes the proper maintenance of retirement plans and the provision of benefits promised to participants by permitting a plan sponsor to correct errors it has discovered in its retirement plan and preserve the tax benefits available for employer and employees. Since its inception, there have been more than 20,000 users of this program.

The Tax Exempt and Government Entities Division has been a forerunner in promoting taxpayer voluntary compliance, and we are continually looking for ways to improve our services and programs. Partnering with our customer stakeholders has been critical to the development of our correction programs over the past 20 years, and we welcome your suggestions as to how to further improve our VCP processes to ensure quality customer service.

A detailed response to your recommendations is attached. If you have questions, please call me at (202) 283-2500, or Joyce Kahn at (202) 283-9586.

Attachment



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Attachment

To ensure the VCP provides timely service to those in the retirement plan community who are attempting to bring their retirement plans into compliance with tax-exempt laws, the Director, Employee Plans should:

RECOMMENDATION 1a.

Reinforce the need for staff conducting the initial screening of VCP applications to determine whether case files have all needed information prior to sending them to revenue agents in field offices for evaluation.

CORRECTIVE ACTION 1a.

We agree that perfecting a VCP application as much as possible on the front-end would promote more efficient case processing by the agents in the groups. We have hired additional staff to assist in this endeavor. We have allotted six new hires for Voluntary Compliance, which will enable us to improve initial screening.

IMPLEMENTATION DATE

Completed September 30, 2009

RESPONSIBLE OFFICIAL

Manager, Employee Plans Voluntary Compliance

RECOMMENDATION 1b.

Evaluate whether opportunities exist to expand the "streamlined" application process to include more common types of failures.

COMMENT

We agree with your recommendation to expand the streamlined application process to include more common types of failures. As is acknowledged in your report, creating a streamlined application process has resulted in improvements to case processing time and has increased the number of cases closed. During the past several years, Employee Plans has adopted numerous process efficiencies, some of which are identified in your report. As is true generally in regard to the development of our correction programs, many of these efficiencies were adopted as a result of stakeholder input and the experience we acquire in processing our cases. Partnering with our customer base has been one of the cornerstones upon which the Employee Plans Compliance Resolution System is based.

CORRECTIVE ACTION 1b.

We will continue to reevaluate the program and seek input from our stakeholders in order to continue developing process improvements.



Additional Process Improvements Are Needed Due to Continued Growth in the Voluntary Correction Program for Retirement Plans

IMPLEMENTATION DATE

September 30, 2011

RESPONSIBLE OFFICIAL

Manager, Employee Plans Voluntary Compliance

RECOMMENDATION 1c.

Until a VCP application form is developed, expand the VCP Revenue Procedure to include a checklist that provides retirement plan sponsors with specific options for identifying the type of retirement plan failure that led to the VCP application and the actions they are taking to correct them.

COMMENT

We agree that there is merit in developing tools that assist plan sponsors in clearly identifying the plan failures and the correction methods that are the subject of their VCP submissions. In addition to the EPCRS revenue procedure, which sets forth in detail the information and documents required to identify a plan failure and proposed correction method in a VCP application, Employee Plans has created several tools designed to assist plan sponsors in developing quality VCP submissions. These include: (1) Fix-It Guides, which assist plan sponsors in identifying plan errors, (2) a mandatory VCP application checklist, which is designed to ensure that plan sponsors address each requirement of the revenue procedure; (3) a web-based application guide, which focuses on what a plan sponsor must do to properly and completely identify a plan failure and the proposed correction method; (4) newsletter articles providing VCP application filing tips; (5) an online list of common failures in filing VCP applications; and (6) a streamlined VCP application, which pre-populates the description of the failure and correction method for simpler failures. Setting forth the failure and correction method for the plan sponsor, as is done in the VCP streamlined applications, ensures that the statements of the failure and proposed correction method are clear; however, that format does not lend itself well to more complex plan failures. To assist plan sponsors with more complex plan failures, Employee Plans has provided another sample application form, which leads the plan sponsor into presenting the plan failure and correction method in an organized manner. Use of this sample application form is not mandatory at present. We continue to investigate additional ways of improving the quality of VCP submissions.

CORRECTIVE ACTION 1c.

After we gain experience with the sample application form and the streamlined application form, Employee Plans will finalize them and create an official IRS form.

IMPLEMENTATION DATE

September 30, 2011



Additional Process Improvements Are Needed Due to Continued Growth in the Voluntary Correction Program for Retirement Plans

RESPONSIBLE OFFICIAL

Manager, Employee Plans Voluntary Compliance

RECOMMENDATION 1d.

Analyze the staffing mix for VCP revenue agent groups to determine the most effective mix of positions and responsibilities. This analysis should include reviewing the duties of the coordinator position and analyzing the span of control between group managers and revenue agents.

CORRECTIVE ACTION 1d.

We agree with your recommendation to analyze the staffing mix for VCP. Employee Plans recently submitted a hiring proposal for fiscal years (FY) 2010-2012 based on our review of our current staffing mix, span of control and assigned duties. As a result of this proposal, TE/GE has approved six new hires for Voluntary Compliance for FY 2010. The additional staffing is intended to promote improved up-front case processing as well as case processing timeliness. We are also in the process of developing a FY 2012 hiring initiative to meet future program needs.

IMPLEMENTATION DATE

Completed October, 2009

RESPONSIBLE OFFICIAL

Manager, Employee Plans Voluntary Compliance

RECOMMENDATION 1e.

Survey retirement plan sponsors upon completion of the VCP process to determine what components of the program worked well and how it could be improved.

COMMENT

We agree with your recommendation to obtain feedback from VCP filers on an ongoing basis. As your report notes, several years ago Employee Plans analyzed the feasibility of surveying VCP applicants to help determine the impact of outreach efforts and abandoned that endeavor based on the challenges involved in developing and obtaining approval for using surveys. Instead, Employee Plans gathered input from benefits groups and professionals through focus group discussions. Last year, Employee Plans developed an online survey, the first of its kind in TE/GE, to obtain feedback on the Self-Correction Program.

CORRECTIVE ACTION 1e.

Employee Plans is working with TE/GE's Strategic Planning Office to develop another survey for users of VCP to obtain feedback on an ongoing basis to help identify and make further improvements to the program.



Additional Process Improvements Are Needed Due to Continued Growth in the Voluntary Correction Program for Retirement Plans

IMPLEMENTATION DATE

September 30, 2010

RESPONSIBLE OFFICIAL

Manager, Employee Plans Voluntary Compliance