

OFFICE OF INSPECTOR GENERAL

Audit Report

**Audit of Federal Income Taxes Withheld From
Railroad Retirement Annuities**

Report No. 07-07

July 30, 2007



RAILROAD RETIREMENT BOARD

INTRODUCTION

This report presents the results of the Office of Inspector General's (OIG) review of federal income taxes withheld from annuity payments paid under the Railroad Retirement Act (RRA) by the Railroad Retirement Board (RRB).

Background

The RRB is an independent agency in the executive branch of the Federal government. The RRB administers the health and welfare provisions of the RRA which provide retirement-survivor benefits for eligible railroad employees and their families. During fiscal year 2006, the RRB paid over \$9.5 billion in retirement and survivor benefits to over 619,000 beneficiaries.

Pursuant to the Railroad Retirement Solvency Act of 1983 and effective beginning with the 1984 tax year, the RRB started withholding U.S. Federal Income Tax from RRA annuity payments.

The Taxation Accounting System (TAS) database and associated programs were developed to meet the tax reporting and tax withholding requirements of the Railroad Retirement Solvency Act of 1983. The TAS system calculates tax withholding and accounts for all taxable payments to, and recoveries from, individual beneficiaries. The TAS system also provides the data used to prepare the annual tax statements that are sent to beneficiaries showing benefits paid, repaid, and any taxes withheld during the year. The RRB also reports this information to the Internal Revenue Service (IRS).

The RRB uses an outside contractor to produce and mail tax statements. The RRB released over 600,000 original tax statements to beneficiaries for tax year 2005. The RRB filed annual tax returns with the IRS reporting over \$238 and \$253 million dollars in taxes withheld and deposited for tax years 2005 and 2006, respectively.

A railroad retirement annuity has several components. The RRB must withhold federal income taxes from those components that are not equivalent to social security benefits unless the beneficiary specifically directs otherwise. Citizens/residents and non-resident aliens are subject to different requirements.

Generally, citizens and residents of the United States may decline tax withholding or elect tax withholding and indicate the amount of taxes to be withheld from their annuities by filing the proper form with the RRB. If the beneficiary does not elect to decline withholding or specify the amount to be withheld, the RRB withholds taxes automatically at a rate prescribed by the IRS.

Nonresident aliens may not decline withholding. They are subject to mandatory tax withholding at a rate prescribed by the Internal Revenue Code unless they claim exemption under a tax treaty that is in effect between their country of legal residence and the United States. These treaties may reduce or eliminate the amount of withholding.

Benefits that are, by law, equivalent to social security benefits are subject to withholding only if the beneficiary voluntarily requests it.

After the end of each calendar year the agency releases an annual tax statement, Form RRB-1099-R, to railroad retirement annuitants reporting pension benefits paid, repaid and taxes withheld. Other forms are used to decline withholding, elect withholding status or request voluntary withholding of taxes from social security equivalent benefits. Appendix I describes these forms and their role in the process.

The RRB's Office of Programs is responsible for computing tax withholding, issuing annual tax statements and maintaining the electronic record of transactions in the TAS system. The Office of Administration is responsible for transfer to storage and subsequent retrieval of paper documents collected during the tax withholding process pursuant to the requirements of the agency's records disposition schedule.

The RRB's strategic plan has identified as agency goals "to provide excellent customer service" and "to serve as responsible stewards for our customers' trust funds and agency resources." This audit supports the RRB in achieving those goals.

Objective

The objective of this audit was to assess the accuracy of federal taxes withheld from RRA annuity payments.

Scope

The scope of our audit was annuitants receiving Form RRB-1099-R for calendar years 2005 and 2006. Form RRB-1099-R is issued to all annuitants who receive benefits during the calendar year whether they have had taxes withheld or not.

The lack of adequate agency documentation to support certain transactions created a limitation on the scope of our audit procedures that prevented us from completing all audit steps required to respond fully to the audit objective. As a result of this scope limitation, we were not able to express an opinion concerning the accuracy of federal taxes withheld from RRA annuity payments and reported

to annuitants on Form RRB-1099-R for calendar years 2005 and 2006. The details of the internal control weaknesses that created this scope limitation are discussed in the results section of this report and in Appendices II and III which present our sampling methodology.

The scope of this audit specifically excluded tests of benefit entitlement and benefit amounts including the allocation between taxable and non-taxable annuity components.

Methodology

To accomplish our objective, we:

1. identified the laws, regulations and procedures applicable to pension tax withholding;
2. compared the criteria to the agency's policies and procedures;
3. interviewed responsible staff and management;
4. used statistical acceptance sampling to determine whether:
 - amounts withheld for income taxes were calculated correctly based on the input to the TAS system during calendar years 2005 and 2006,
 - input to the TAS system agreed with tax withholding election forms filed by the annuitant for amounts withheld during calendar years 2005 and 2006, and
 - annual reports to the annuitant accurately reported the amounts withheld for calendar years 2005 and 2006;
5. tested non-statistical samples of randomly selected annuitant records to assess selected aspects of agency compliance with requirements that apply to certain small subgroups such as non-resident aliens and those who elect voluntary tax withholding; and
6. used data analysis, a non-statistical random sample and judgment sampling (non-random, non-statistical) to test the records of certain individuals who did not have taxes withheld from their annuities to determine whether taxes should have been withheld because of an election or requirement.

A detailed description of our sampling methodology is presented in appendices II and III to this report.

Our work was performed in accordance with generally accepted government auditing standards applicable to this type of audit. Fieldwork was conducted at RRB headquarters in Chicago, Illinois during January 2007 through April 2007.

RESULTS OF AUDIT

We express no opinion concerning the accuracy of federal taxes withheld from RRA annuities. The lack of adequate support precluded a full assessment of the accuracy of amounts withheld; however, we were able to verify that the RRB withholds taxes from RRA benefits when required and that tax statements correctly reported amounts withheld.

We were not able to test the accuracy of amounts withheld because the RRB was not able to provide all requested supporting tax election forms for inspection during the audit and the automated system that supports taxation accounting overwrites certain historical information related to tax elections.

In addition to the foregoing lack of support for transaction processing, we observed that although agency procedures provide that tax withholding elections be made only using specific tax election forms, the RRB does not always require annuitants to file the proper forms. We also observed that agency procedures for computing tax withholding amounts have not been updated to reflect a change in computational methodology.

The details of our findings and recommendations follow.

Action Needed to Ensure Proper Document Storage and Retrieval

Tax withholding election forms are not readily available for inspection. Agency personnel were not able to locate all of the forms that should have been available for review during the audit. In addition, during the review process, we observed tax election forms that had been misfiled.

The agency's current document retention schedule requires the RRB to retain paper tax withholding election forms for five years. In the RRB Records Disposition Handbook (February 2001), Schedule 21, Item 21-3 "Withholding Certificate for Railroad Retirement Payment," is described as a "File consisting of Form RRB W-4P that is completed throughout the tax year by annuitants to indicate the withholding desired for the portion of their annuity considered a private pension." The schedule provides as follows: "AUTHORIZED DISPOSITION: Destroy when 5 years old."

As part of our audit, we compared the information in the RRB's automated system with the tax withholding election forms filed by annuitants in order to assess the accuracy of agency actions to withhold taxes. We requested tax election forms for those individuals who had filed elections in prior years; once tax withholding is elected it remains in effect until revoked. All of the forms requested for audit testing should have been available for inspection based on the published record retention schedule.

None of the annuitant election forms filed during calendar year 2002 were available for review because the agency could not locate the boxes in which they had been filed. In addition, selected forms filed in other years could not be located in the storage boxes in which, based on the agency's filing system, they should have been found.

Our review of 113 randomly selected tax withholding cases included 38 cases where the tax withholding election form should have been maintained based on the applicable agency record retention schedule. We requested these supporting paper tax withholding forms filed by annuitants of which 20 (53%) were not available for inspection.

- (1) Twelve of the 38 forms could not be located because they had not been filed according to agency procedure.
- (2) Eight of the 38 forms could not be located because they had been filed in calendar year 2002, the year for which the agency could not locate any of the forms.

During our examination of boxed records, we also observed forms that had been misfiled when they were boxed for storage. For example, several boxes labeled as containing tax year 2005 documents also contained documents from tax years 2001 through 2004. In addition, agency procedure requires documents to be sorted and boxed in batches based on the last two digits of the annuitant's RRB claim number.¹ Some boxes that we received contained forms on which the last two digits of the RRB claim number did not agree with the box label.

The lack of adequate supporting documentation created a limitation on the scope of our audit procedures that prevented us from assessing the accuracy of amounts withheld. The effect of this scope limitation on the audit is discussed in more detail on page 2 of this report.

Agency management could not offer a reason for the non-compliance with record retention requirements and filing procedures. Subsequent to the presentation of this finding, agency management reported the missing boxes of Forms W-4P for tax year 2002 to the U. S. Computer Emergency Readiness Team within the U.S. Department of Homeland Security as an incident involving personally identifiable information. The missing forms include name, social security number and address of the filer. After further investigation, agency management concluded that the missing forms, a total of approximately 35,000 forms in six boxes, had been unintentionally destroyed after having been emptied into shredding containers.

¹ The RRB claim number is a six or nine digit number with an alphabetical prefix. This number identifies the annuitant's records at the RRB and is usually a social security number or an equivalent identification number.

Recommendation

We recommend that the Office of Programs:

1. implement controls to ensure proper filing of tax withholding documents; and

the Office of Administration implement additional controls to ensure that:

2. documents subject to published retention schedules are destroyed only on the specific instruction of an authorized agency official; and
3. documents pending destruction or transportation to an offsite storage location are stored securely consistent with requirements for the protection of personally identifiable information.

Management's Response

Management concurs with the recommendations. In response to recommendation #1, the Office of Programs will review the requirements and options, and develop a plan within six months. In response to recommendation #2, the Office of Administration plans to update the Administrative Circular IRM-4 to reflect specific instructions for destruction of documents subject to retention schedules. In response to recommendation #3 the Office of Administration has advised that they have constructed a secured area for storage of sensitive records prior to shipment to the Federal Records Center.

The full text of management's response is included as Appendices IV and V to this report.

Automated System Overwrites Data

The automated system that supports tax computation and withholding is not programmed to retain any history of tax withholding election data. Whenever a new election form is filed, the old information is overwritten and permanently lost.

Annuitants who are subject to tax withholding may request changes to their withholding status. For example, they may request additional amounts be withheld, ask to reduce the amount withheld, or decline withholding. The annuitant submits the properly signed form to the agency and agency personnel input the updated election information into the automated system. The system then re-calculates the amount of withholding which may impact the net amount paid.

The U.S. Government Accountability Office Standards for Internal Control in Federal Government requires that transactions be fully supported.

Absent a complete history in the automated system, it is not possible to determine the basis for any tax withholding not computed under the current election criteria. The only evidence of a prior election would be that the payment history would show changes in the amounts withheld; however, the basis for that change would not be detailed. The annuitant's paper-based request to change their withholding is retained only for the five-year period provided for in the agency's retention schedule after which time it is destroyed.²

As a result, the automated system does not provide a complete historical record of tax withholding activity and no other available electronic resource provides an adequate substitute.

Due to the lack of historical information, the RRB was unable to fully support the history of tax withholding transactions for some annuitants. The lack of adequate support created a limitation on the scope of our audit procedures that prevented us from assessing the accuracy of amounts withheld. The effect of this scope limitation on the audit is discussed in more detail on page 2 of this report.

Recommendation

4. We recommend that the Office of Programs provide for a complete automated transaction history.

Management Response

Management concurs in principal with the recommendation. However, in lieu of changes to the TAS system, management prefers to take alternate action. The Office of programs has begun imaging Forms RRB-W4P for 2006 and later. In addition, the Office of Programs plans to image TAS system recertification letters by September 30, 2008.

The full text of management's response is included as Appendix V to this report.

Agency Needs to Ensure Consistent Use of Approved Forms

Contrary to agency procedures, the Office of Programs accepts letters and other informal documents to process tax withholding requests in lieu of official forms.

According to current procedure, an annuitant must file Form RRB W-4P to elect tax withholding, decline tax withholding, or control the amount of taxes withheld from their benefit payments. The RRB will also accept IRS Form W-4P. If a

²See our prior finding concerning the availability for inspection of annuitant tax withholding forms.

beneficiary does not file one of those forms, tax withholding is mandatory and taxes are withheld at a rate prescribed by the Internal Revenue Code.³

During our review, we observed that field offices and headquarters personnel sometimes accepted letters or screen prints, signed by the annuitant, in lieu of one of the approved forms to process tax withholding requests. The Office of Management and Budget approved Form RRB W-4P or IRS Form W-4P includes important notices and information concerning the rights and responsibilities of the annuitant with respect to the payment and withholding of taxes. When the proper form is not provided and completed, there is no evidence that the annuitant has received the proper information prior to filing.

As a result of the audit, the Office of Programs issued an agency-wide reminder to responsible employees that only Form RRB W-4P or IRS Forms W-4P or W-4V, are acceptable to effect or change citizen tax withholding.

Recommendation

5. We recommend that the Office of Programs implement additional controls to ensure that only Form RRB W-4P or IRS Forms W-4P or W-4V, are used to process citizen tax withholding requests.

Management's Response

The Office of Programs concurs with recommendation #5. In addition to the previously released reminder, the Office of Programs plans to initiate a periodic review of the forms as part of its quality assurance program on the imaging.

The full text of management's response is included as Appendix V to this report.

Procedures Need to be Updated for Current Rounding Methodology

The RRB's available written procedures for calculating tax withholding have not been updated to reflect a change in determining taxable pension amounts.

The Tax Operating Manual contains instructions for Form G-309, Tax Withholding Worksheet, and indicates that a beneficiary's taxable amount should be entered in dollars and cents when computing the amount of tax withholding.

³ The mandatory rate prescribed by the Internal Revenue Code is applicable whenever a beneficiary does not file a Form RRB W-4P or IRS Form W-4P. According to the RRB's Office of Programs Tax Operating Manual, if tax withholding elections are not filed using Form RRB W-4P or IRS Form W-4P, the mandatory tax withholding will be applied. For purposes of determining whether the agency had properly computed and applied withholding, we treated informal communications between annuitants and the agency as if the annuitant's intent had been properly documented.

However, current practice is for the RRB to round down to the nearest whole dollar prior to applying applicable tax rates.

RRB management indicated that the tax accounting system was revised in 1998 to round the pension amount subject to tax withholding down to the nearest dollar prior to calculating the tax withholding amount. However, the instructions for Form G-309, Tax Withholding Worksheet, were never revised to reflect this change. As a result, procedures do not reflect management's directives and are not consistent with current practices.

Recommendation

6. We recommend that the Office of Programs ensure that all written procedures for calculating tax withholding amounts are accurate and consistent with current practice.

Management's Response

The Office of Programs concurs with the recommendation #6 and has advised that they have revised the tax withholding worksheet procedures to be consistent with current practice.

The full text of management's response is included as Appendix V to this report.

Appendix I

Description of Tax Forms Reviewed

During our audit, we obtained and reviewed information on the annual tax statements and reviewed available tax forms filed by annuitants.

Annual Statements

Form RRB-1099-R Statement

The RRB issues annual tax statements to individuals who were paid or who repaid railroad retirement annuities or had tax withholding for the previous year.

Form RRB-1042S Statement

The RRB issues annual tax statements to nonresident aliens who were paid or who repaid social security equivalent benefits or had tax withholding for the previous year.

Forms Filed by Annuitants

Form RRB W-4P - Withholding Certificate for Railroad Retirement Payments

RRB citizen annuitants use this form to inform the RRB whether they want federal taxes withheld from their pension components, and how much to withhold.

IRS Form W-4V - Voluntary Tax Withholding

RRB citizen annuitants use this form to inform the RRB whether they want federal taxes withheld from social security equivalent railroad retirement benefits.

Form RRB 1001 - Nonresident Questionnaire

Nonresident RRB annuitants use this form to furnish citizenship, residency, and tax treaty exemption information to the RRB.

Appendix II Sampling Methodology and Results Statistical Sampling

We used statistical sampling to assess the accuracy of Federal taxes withheld and reported.

Objective

The sampling objective was to determine whether:

1. the RRB accurately reported amounts withheld to annuitants on Form RRB-1099-R
2. the amount of federal tax withheld from payments had been correctly calculated based on the annuitant's tax election filing as input to the automated system; and
3. data in the automated system was accurate with respect to annuitant tax election filings.

Scope

We selected our sample from the universe of 190,906 calendar year 2005 tax statements with federal taxes withheld and tested agency performance through calendar year 2006.

Review Methodology

We used two-step attribute acceptance sampling with a 90% confidence level and 5% tolerable error which directed a 59 case sample for step one and 54 case sample for step two. The threshold for acceptance was zero errors for step one and two errors for step two. If step one was accepted at the parameters (zero errors) we would conclude based on the results. If step one identified one or more errors resulting in rejection at that step, we would proceed to step two. If step two identified three or more errors we would reject the sample.

Federal Tax Withheld/Reported (Form RRB-1099-R Statement)

We calculated the total calendar year 2005 and 2006 tax withheld based on the tax withholding amounts in the system and compared these totals to the electronic Form RRB 1099-R statements. An error was defined as an auditor determination that the auditor-calculated federal tax withheld amount was not consistent with the federal tax withheld per the Form RRB-1099-R Statement.

Appendix II Sampling Methodology and Results Statistical Sampling

Federal Tax Withholding Amount

To assess the accuracy of system-calculated withholding amounts, we recalculated the calendar year 2005 and 2006 withholding amounts using tax withholding election data as recorded in the automated system that supports tax accounting. An error was defined as an auditor determination that the auditor-calculated tax withholding amount was not consistent with the TAS system withholding amount.

Data Input for Tax Withholding Elections

To assess the accuracy of tax withholding election data as recorded in the automated system that supports tax accounting, we compared system information with the original tax election document filed by the annuitant. An error was defined as an inconsistency in any **one** of the following five areas of testing:

- marital status,
- election status,
- tax withholding allowance,
- additional withholding amount, and
- tax withholding rate.

Results of Review

Our evaluation of 113 randomly selected tax withholding cases from a population of 190,906 tax statements identified exceptions as shown below.

Audit Objective	Exceptions Identified ⁴	Results
Assess the Accuracy of Federal Taxes Withheld/Reported on Form RRB-1099-R.	None	90% confident that tax statements accurately report amounts withheld for at least 95% of the universe.
Assess the Computational Accuracy of Federal Tax Withholding Amounts.	9	Testing could not be completed for 9 sample items because the automated system overwrites prior data which precluded full testing.
Assess the Accuracy of Tax Withholding Election Data Input to the Automated System.	20 38 forms were requested for review based on the agency's published record retention schedule.	Testing could not be completed because supporting tax election forms could not be located for review. Twelve forms could not be located because they had not

⁴ Some cases had more than one exception.

**Appendix II
Sampling Methodology and Results
Statistical Sampling**

Audit Objective	Exceptions Identified ⁴	Results
		<p>been filed according to agency procedure.</p> <p>Eight forms could not be located because they had been filed in calendar year 2002, a year for which the agency could not locate any forms.</p>

The exceptions cited were due to scope limitations caused by an insufficient audit trail that prevented full testing of amounts withheld. Although, no errors were identified in the cases that were fully reviewed, cases that could not be tested represent audit exceptions that preclude sample acceptance.

The lack of an adequate audit trail is a weakness in internal control which is discussed more fully in the results section of this report including recommendations for corrective action.

Audit Conclusion

We express no opinion concerning the accuracy of federal taxes withheld from RRA annuities. The lack of adequate support precluded a full assessment of the accuracy of amounts withheld; however, we were able to verify that the RRB withholds taxes from RRA benefits when required and that tax statements correctly reported amounts withheld.

Appendix III Sampling Methodology and Results Non-Statistical Sampling

We used non-statistical sampling to supplement statistical sampling (see Appendix II) for citizens without tax withholding and certain small subgroups of transactions that were under-represented in the statistical sampling process.

Objective

The sampling objective was to obtain assurance about the accuracy of tax withholding decisions applied to U.S. Citizens with no taxes withheld, non-resident aliens, individuals requesting voluntary withholding and the overall accuracy of recent processing.

Scope

The scope of non-statistical sampling tests was limited to selected transactions and attributes as follows.

Transactions Tested	Source & Method of Sample Selection	Universe Size	Attribute Tested
U.S. Citizens with no taxes withheld during calendar year 2005	Selected at random from the electronic file containing calendar year 2005 tax statement data.	445,746	a. Reporting Accuracy b. Accuracy of Amount Withheld c. Data Input Accuracy
U.S. Citizens with no taxes withheld during calendar year 2005 with taxable pension components <u>exceeding</u> IRS thresholds for mandatory withholding ⁵	Data analysis and non-random selection from the electronic file containing calendar year 2005 tax statement data.	1,679	Accuracy of Amount Withheld
Non-Resident Aliens	Selected at random from Tax Treaty Exemption Forms on the RRB's Document Imaging System filed during calendar years 2005 and 2006.	1,910	a. Accuracy of Amount Withheld b. Data Input Accuracy
Individuals electing voluntary tax withholding	Selected at random from Voluntary Tax Election Forms on the RRB's Document Imaging System filed during calendar years 2005 and 2006.	645	a. Accuracy of Amount Withheld b. Data Input Accuracy

⁵ When the taxable portion of an annuity exceeded approximately \$1,472.00 per month in 2005 and \$1,497.00 per month in 2006 formulas that are used to calculate periodic withholding will always result in taxes withheld unless the annuitant has declined withholding or claimed a marital status and/or withholding allowances that reduce the computed withholding to zero.

**Appendix III
Sampling Methodology and Results
Non-Statistical Sampling**

Transactions Tested	Source & Method of Sample Selection	Universe Size	Attribute Tested
Annuitants filing tax election forms during calendar years 2005 and 2006	Selected at random from tax election forms on the RRB's Document Imaging System filed during calendar years 2005 and 2006	22,281	a. Accuracy of Amount Withheld

Review Methodology

Our test methodology was the same as the statistical sample described in Appendix II, except that some transactions were not tested for all attributes, and different tax forms were examined as applicable to the type of transactions. More detailed description of the review process and the definition of an audit exception is presented in conjunction with the results of our review in the following section of this report.

These samples are described as non-statistical because they were not designed to provide an independent basis for drawing inferences about the population as a whole. In general, the sample sizes are too small for that purpose.

Results of Review

Our non-statistical sampling tests of data accuracy disclosed the same lack of audit trail that was identified by our statistical sample review process. We again identified transactions for which the automated system that supports tax withholding activity had overwritten prior data thus preventing us from testing the accuracy of data input into the system and the accuracy of the amount withheld.

See appendix III for the details of our non-statistical sampling tests.

Audit Conclusion

The results of our supplementary non-statistical sampling tests are consistent with the result of the statistical sampling tests reported in Appendix II. The lack of adequate support precluded a full assessment of the accuracy of amounts withheld. Limited tests of reporting accuracy and mandatory withholding disclosed no errors.

**Appendix III
Sampling Methodology and Results
Non-Statistical Sampling**

Transactions Tested	Attribute Tested	Test Performed	Definition of Audit Exception	Audit Exceptions
<p>U.S. Citizens with no taxes withheld during calendar year 2005</p> <p>Universe Size: 445,746 Sample Size: 25</p>	<p>a. Reporting Accuracy</p> <p>b. Accuracy of Amount Withheld</p> <p>c. Data Input Accuracy</p>	<p>a. Compared amounts withheld for taxes with amounts reported to the annuitant on Form RRB-1099-R.</p> <p>b. Re-calculated the tax withholding amount using data in the automated system.</p> <p>c. Compared tax election form, if one was filed by the annuitant, with the data input to the automated system. When no form was filed, we recalculated applicable withholding based on mandatory rates established by the IRS.</p>	<p>a. Amount reported to the annuitant does not agree with the amount withheld.</p> <p>b. Auditor re-calculation does not agree with amount withheld.</p> <p>c. Automated system reports information inconsistent with the form filed by the annuitant or IRS mandated rates.</p>	<p>a. None</p> <p>b. Testing could not be completed for one sample item because the automated system overwrites prior data.</p> <p>c. Testing could not be completed for one sample item because the automated system overwrites prior data.</p>
<p>Non-Resident Aliens</p> <p>Universe Size: 1,910 Sample Size: 25</p>	<p>a. Accuracy of Amount Withheld</p> <p>b. Data Input Accuracy</p>	<p>a. Re-calculated the tax withholding amount using data in the automated system.</p> <p>b. Compared tax treaty exemption form filed by the annuitant with the data input to the automated system.</p>	<p>a. Auditor re-calculation does not agree with amount withheld.</p> <p>b. Automated system reports information inconsistent with the form filed by the annuitant.</p>	<p>a. None</p> <p>b. None</p>

**Appendix III
Sampling Methodology and Results
Non-Statistical Sampling**

Transactions Tested	Attribute Tested	Test Performed	Definition of Audit Exception	Audit Exceptions
<p>Individuals electing voluntary tax withholding</p> <p>Universe Size: 645 Sample Size: 25</p>	<p>a. Accuracy of Amount Withheld</p> <p>b. Data Input Accuracy</p>	<p>a. Re-calculated the tax withholding amount using data in the automated system.</p> <p>b. Compared the voluntary withholding form filed by the annuitant with the data input to the automated system.</p>	<p>a. Auditor re-calculation does not agree with amount withheld.</p> <p>b. Automated system reports information inconsistent with the form filed by the annuitant.</p>	<p>a. Testing could not be completed for one sample item because the automated system overwrites prior data.</p> <p>b. Testing could not be completed for one sample item because the automated system overwrites prior data.</p>
<p>U.S. Citizens with no taxes withheld during calendar year 2005 with taxable pension components exceeding IRS thresholds for mandatory withholding.</p> <p>Universe Size: 1,679 Sample Size: 72</p>	<p>Accuracy of Amount Withheld</p>	<p>Re-calculated the tax withholding amount using data in the automated system.</p>	<p>Auditor re-calculation does not agree with amount withheld.</p>	<p>None</p>

**Appendix III
Sampling Methodology and Results
Non-Statistical Sampling**

Transactions Tested	Attribute Tested	Test Performed	Definition of Audit Exception	Audit Exceptions
Annuitants filing tax election forms during calendar years 2005 and 2006 Universe Size: 22,281 Sample Size: 25	a. Data Input Accuracy	a. Compared the voluntary withholding form filed by the annuitant with the data input to the automated system.	a. Automated system reports information inconsistent with the form filed by the annuitant.	a. Testing could not be completed for two sample items because the automated system overwrites prior data.



UNITED STATES GOVERNMENT

MEMORANDUM

RAILROAD RETIREMENT BOARD

July 16, 2007

TO : Letty Benjamin Jay
Acting Assistant Inspector General, Audit

FROM : Henry M. Valiulis
Director of Administration/Senior Executive Officer

SUBJECT: Draft Report – Audit of Federal Income Taxes Withheld From
Railroad Retirement Annuities

This is in reply to your July 9, 2007 memorandum regarding the above subject. The following are the Office of Administration's responses to the recommendations directed to our organization.

Recommendation:

- 2. Documents subject to published retention schedules are destroyed only on the specific instruction of an authorized agency official.**

We agree. Administrative Circular IRM-4 entitled *Records Disposition* will be updated to reflect this recommendation. The update should be completed by September 30, 2007.

- 3. Documents pending destruction or transportation to an offsite storage location are stored securely consistent with requirements for the protection of personally identifiable information.**

We agree. A secured area has already been constructed on the 11th floor for the Office of Programs. The Office of Administration has also created another lockable secure area for temporary storage of sensitive records prior to shipment to the FRC.

cc: Director of Programs
Supervisory Contract Specialist

**MEMORANDUM**

JUL 24 2007

TO: Letty Jay
Acting Assistant Inspector General, Audit

FROM: Catherine A. Leyser *Catherine A. Leyser*
Director of Assessment and Training

THROUGH: Dorothy Isherwood *D. Isherwood*
Director of Programs

SUBJECT: **Draft Report – Audit of Federal Income Taxes Withheld from RR annuities**

**Overall
Comments**

This audit points out that the auditors were unable to express an opinion on the accuracy of federal taxes withheld from RR annuities due to the lack of supporting documentation. Certain tax withholding election forms were missing, and there was no history. We recognize that there was a problem with forms being destroyed prematurely, and filed incorrectly, so that some of the cases you reviewed did not have the information needed for validation. Specifically 9 out of 113 cases reviewed were unavailable and could not be verified. However, as is indicated in Appendix II of your report, the 104 cases for which you did find forms, the withholding amounts were accurately calculated. We have no reason to believe that the cases for which the forms could not be located were inaccurate.

The initiatives to image tax withholding forms and tax recertification letters will preclude the kinds of exceptions you cite in this audit and when completed and in place for a sufficient amount of time, should enable you to revisit this area and have enough documentation on which to base an audit decision. When those are fully implemented we will ask that the auditors plan for another review, so that an opinion can be expressed.

We also have taken steps to address the premature destruction of the forms for 2001 and 2002.

Specific recommendations for the Office of Programs are addressed below.

**Recommendation
1**

We recommend that the Office of Programs implement controls to ensure proper filing of tax withholding documents.

OP Response We concur. We will review the requirements and our options, and develop a plan within 6 months.

Recommendation 4 We recommend that the Office of Programs provide for a complete automated transaction history.

OP Response We concur. We do not, however, plan to make changes to the automated Tax Accounting System to maintain a history of tax withholding election data. The benefits of the recommended changes would be of limited value and agency resources are not available for such a project. Alternatively, beginning with forms for 2006 and later, Forms RRB-W-4P are being imaged, which will provide for a history of the forms. In addition, we plan to image the letters released to annuitants regarding tax withholding from monthly annuity payments by September 30, 2008. Together with the imaged Forms RRB-W-4P, the TAS recertification letters will provide for a complete automated history of tax withholding.

Recommendation 5 We recommend that the Office of Programs implement additional controls to ensure that only Form RRB W-4P or IRS Form W-4P or W-4V, are used to process citizen tax withholding requests.

OP Response We concur. A reminder was sent to all field offices and the Director of Operations on May 8, 2007 stressing the procedure contained in TOM-I-205.10.02, which provides that tax withholding elections may only be made using Form RRB-W-4P or IRS Forms W-4V and W-4P.

Within 6 months, A&T will initiate a periodic review of the forms as part of its QA on the imaging.

Recommendation 6 We recommend that the Office of Programs ensure that all written procedures for calculating tax withholding amounts are accurate and consistent with current practice.

OP Response We concur. The instructions for completion of Form G-309, Tax Withholding Worksheet, were revised May 10, 2007 (Procedure Transmittal No. 07-73) to be consistent with the Taxation Accounting System's rounding of amounts and calculation of tax withholding amounts. We have provided copies of this to the auditors under separate cover. We consider this recommendation as implemented.

cc: Director of Administration
Director of Policy and Systems
Director of Operations
Director of Field Service