

OFFICE OF INSPECTOR GENERAL
Audit Report

**Review of the Railroad Retirement Board's
Audit and Compliance Division**

**Report No. 11-04
February 01, 2011**



RAILROAD RETIREMENT BOARD

EXECUTIVE SUMMARY

The Office of Inspector General (OIG) reviewed the RRB's Audit and Compliance Division (ACD) in the Bureau of Fiscal Operations (BFO). The ACD conducts external audits of railroad employers to ensure compliance under the Railroad Retirement Act and Railroad Unemployment Insurance Act, and verifies the accuracy and timeliness of reported compensation and contributions. The purposes of the review were to determine if ACD's audits were conducted in compliance with Generally Accepted Government Auditing Standards (GAGAS), and if audit results were factually accurate and supported by competent evidence.

The OIG conducted this audit at the RRB headquarters in Chicago, Illinois from April through November 2010.

Key Findings

- Audits Were Not Conducted in Accordance with GAGAS.
- Audit Reports Included an Unmodified GAGAS Statement.
- Audit Results Were Not Fully Supported.
- An error could impact reported creditable compensation amounts by an estimated \$1.7 million.
- Audit Timeliness and Follow-Up Need Improvement.

Key Recommendations

To improve operations, we recommend that BFO:

- Establish comprehensive written policies and procedures to ensure audits are conducted in compliance with required GAGAS.
- Remove the GAGS statement from ACD's audit reports until they can ensure that all required GAGAS have been met.
- Require ACD management and audit staff to complete a comprehensive GAGAS training course.
- Institute a system for quality control which includes procedures to verify that the audit work meets the requirements of GAGAS.
- Quantify the differences in creditable compensation identified during the audit.
- Implement effective management controls including a control environment which promotes conscientious management.

Management's Response

BFO agreed to take corrective action for all 17 of our recommendations. The full text of management's response is included in this report as Appendix VI.

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INTRODUCTION

This report presents the results of the Office of Inspector General's (OIG) review of the Railroad Retirement Board's Audit and Compliance Division (ACD) in the Bureau of Fiscal Operations.

Background

The Railroad Retirement Board (RRB) is an independent agency in the executive branch of the Federal government. The RRB administers the retirement/survivor and unemployment/sickness insurance benefit programs for railroad workers and their families under the Railroad Retirement Act (RRA) and the Railroad Unemployment Insurance Act (RUIA). These programs provide income protection during old age and in the event of disability, death, temporary unemployment, or sickness. The RRB paid almost \$10.7 billion in benefits to over 631,000 beneficiaries during fiscal year (FY) 2009.

For calendar year 2009, covered railroads (employers) reported to the RRB Tier I and Tier II creditable service and compensation of \$15.34 billion and \$14.27 billion, respectively, for approximately 260,700 workers¹. During FY 2009, railroads paid approximately \$4.7 billion in railroad retirement taxes and \$92.9 million in RUIA contributions.²

Prior to 1991, the OIG developed and implemented a program to audit the payroll records of railroad employers. In 1991, the U.S. District Court, Northern District of Texas, ruled that the OIG lacked statutory authority to conduct tax compliance audits. On March 19, 1993, the agency's three-member Board (The Board) approved the establishment of the ACD within the RRB's Bureau of Fiscal Operations (BFO).

ACD conducts external audits of employers to ensure compliance under the RRA and RUIA, and verifies the accuracy and timeliness of reported compensation and contributions. Although the ACD does not have the authority to audit taxes under the Railroad Retirement Tax Act, its staff reviews the compensation amounts on which these payroll taxes are based.

An error in reporting compensation generally results in a related error in reporting railroad retirement tax liability. ACD informs employers of additional potential railroad retirement tax liability, recommends that they report these amounts to the Internal Revenue Service (IRS), and provides employer audit results to the IRS.

ACD currently consists of nine employees, including the chief of the division, four

¹ A covered railroad is a railroad employer covered by the RRA of 1974, as amended and RUIA.

² Benefits under the RRA are based in part on the individual's years of service and amount of compensation credited to the individual under the Act. The term compensation means any form of payment made to an individual for services rendered as an employee for a (covered) employer.

auditors, one coverage specialist, one compliance specialist, one information technology specialist, and a secretary. The annual staffing and administrative budget for personnel compensation, travel, training, and equipment for FY 2009 was approximately \$559,000.

In 1994, the Board approved general guidance procedures for ACD. The division follows the guidance provided by the Government Accountability Office's (GAO) Government Auditing Standards, commonly referred to as generally accepted government auditing standards (GAGAS). The ACD has prepared an audit guide that provides additional guidance for employer audits.

The RRB continually evaluates the effectiveness and efficiency of its operations using ongoing assessments and reviews of management controls. Under the direction of a Management Control Review Committee, composed of senior managers from its program, information services, administrative, and financial operations, the RRB has divided these operations functionally into 43 assessable units. The ACD employer audit area is defined as an assessable unit within BFO. For a detailed description of the RRB's management control review process, see Appendix III.

Internal control is an integral component of an organization's management that provides reasonable assurance concerning the effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. Pursuant to the provisions of the Federal Managers' Financial Integrity Act of 1982, GAO has issued Standards for Internal Control in the Federal Government. These standards provide the overall framework for establishing and maintaining internal control and for identifying and addressing major performance and management challenges and areas at greatest risk of fraud, waste, abuse, and mismanagement.

This review supports the RRB's strategic plan's goal to safeguard customers' trust funds through prudent stewardship.

Audit Objectives

The audit objectives were to determine if ACD's:

- audits were conducted in compliance with GAGAS (Management Control Objective #7); and
- audit results were factually accurate and supported by competent evidence (Management Control Objective #1).

Scope

The scope of the audit was limited to ACD's audit reports that were issued in FY 2009, as well as the audit documentation completed for those audits and the policies, procedures, and controls in place during the performance of those audits.

Methodology

To accomplish our objectives, we:

- reviewed prior OIG audit findings;
- reviewed applicable laws, regulations, and GAGAS;
- evaluated applicable policies and procedures, including operating procedures, audit documentation checklist, and audit guide;
- selected a judgmental sample of railroad employer audits to review as described in Appendix I of this report;
- assessed ACD's compliance with professional standards, as described in Appendix II of this report;
- identified and tested selected management controls as described in Appendices III and IV;
- agreed all facts and numbers from the sampled audit reports to audit documentation to determine if they were factually accurate and supported by sufficient competent evidence, as described in Appendix V of this report; and
- interviewed responsible management and staff.

We conducted this performance audit 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 basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We conducted our fieldwork at the RRB's headquarters in Chicago, Illinois from April to November 2010.

RESULTS OF AUDIT

Our review found that ACD's audits were not conducted in compliance with GAGAS and their audit reports included an unmodified GAGAS statement.

We also found that ACD's audit results were not always supported by sufficient, appropriate evidence. Therefore, we could not verify the accuracy of all facts and figures in their audit reports. During our review, we identified one error related to the verification of employer information with IRS information that could impact the reported creditable compensation amounts by as much as \$1.7 million. In addition, a weak quality control system and their practice of not verifying all employer information with IRS information increased the risk that errors would go undetected.

Lastly, our review disclosed that ACD's audit reports were not issued timely and ACD did not perform proper audit follow-up procedures to determine if appropriate corrective action had been taken in response to their audit recommendations.

The details of our findings and recommendations for corrective action follow. The full text of management's response is included in this report as Appendix VI.

Audits Were Not Conducted in Accordance with GAGAS

Although ACD's reports stated that their audits were conducted in compliance with GAGAS, our review disclosed that ACD did not comply with many of the standards.

GAO is responsible for setting the professional auditing standards by which all government auditors should conduct their work. GAO states that "generally accepted government auditing standards (GAGAS) provide a framework for conducting high quality government audits and attestation engagements with competence, integrity, objectivity, and independence."³

According to GAGAS, when auditors comply with all applicable GAGAS requirements, they should use the standard statement prescribed by GAGAS in their audit report which states that the audit was performed in accordance with GAGAS. When auditors do not comply with all applicable GAGAS requirements, they should include a modified GAGAS compliance statement in the audit report. For a modified statement, auditors should indicate the standards that were not followed or language that the auditor did not follow GAGAS.⁴

Our review revealed that the main cause of ACD not being GAGAS compliant is that ACD lacked comprehensive policies and procedures for conducting, reporting, and documenting their audits. Although ACD had a high-level policy from the Board that

³ "Government Auditing Standards," GAO-07-731G, paragraphs 1.03 and 1.11, pages 5, 6, and 9, July 2007 Revision.

⁴ "Government Auditing Standards," GAO-07-731G, paragraphs 8.30 and 8.31, page 169, July 2007 Revision.

directed them to conduct employer audits and explained how to select the employers to audit, ACD did not have comprehensive policies and procedures for conducting those audits and documenting their work. In many cases, ACD audit staff told us that they conducted the audits using “past practices” rather than by following written policies and procedures.

In addition, the management control environment in the ACD is extremely lax. For example, management allowed the use of altered certificates in support of training for auditors. Although GAO allows for altered certificates as long as they are annotated as such, the certificates provided to our team had no annotations and were passed off as originals. We also found evidence that audit documentation had been completed and added to the audit documentation files more than a year after the audit report was issued. This action was also subsequent to our notification of the commencement of this audit.

Each one of the findings outlined in the coming pages is a deficiency in and of itself. When combined, the deficiencies are significant, and the OIG is concerned that ACD’s audit findings and recommendations would not withstand scrutiny by interested parties. GAGAS are supposed to provide a framework for performing high-quality audit work with competence, integrity, objectivity, and independence.⁵ The OIG believes that the lack of adherence to so many of the standards severely limits the effectiveness of the division as a whole.

We reviewed a sample of three of the eight audit reports issued by ACD during FY 2009. All of the ACD employer audit reports indicated that GAGAS were followed and would be classified as performance audits under the standards. We found that ACD lacked documentation to show compliance with the following standards.

Auditor Independence

ACD maintained no documentation to show that management monitored the auditors’ independence or personal impairments to independence. For example, ACD maintained no independence and impairment statements for any of the audit staff.

GAGAS state that “auditors and audit organizations must maintain independence so that their opinions, findings, conclusions, judgments, and recommendations will be impartial and viewed as impartial by objective third parties with knowledge of the relevant information.”⁶

Professional Judgment

The use of professional judgment was not evident in the audit documentation examined during our review. For example, ACD had no comprehensive quality control program to ensure the quality of their work or to ensure compliance with GAGAS. ACD’s quality

⁵ “Government Auditing Standards,” GAO-07-731G, introduction, page 1, July 2007 Revision.

⁶ “Government Auditing Standards,” GAO-07-731G, paragraph 3.03, page 29, July 2007 Revision.

control program for the audit process consisted of a checklist which was not always followed correctly, or which contained steps that were marked as completed when they actually were not. In addition, ACD's audit documentation did not have evidence that a risk assessment or discussion of indicators of fraud occurred during the planning process. They also did not document the reasons for not completing some audit steps.

ACD's failure to document policies and procedures based on GAGAS substantially weakened ACD's ability to exercise professional judgment in planning and performing the audits, and in reporting the results.

GAGAS state that "auditors must use professional judgment in planning and performing audits and attestation engagements and in reporting the results."⁷ GAGAS also state that "professional judgment includes exercising reasonable care and professional skepticism. Reasonable care concerns acting diligently in accordance with applicable professional auditing standards and ethical principles."⁸

Competence

ACD had no documentation to show that management had assessed the audit team's professional competence prior to each audit. Also, the individual assigned to perform a quality control review of the audit reports and ensure that the reports meet GAGAS did not have the minimum 24 hours of training related to government audits in a two-year period. Lastly, documentation was not complete to ensure that all of ACD's auditors had completed their 80 hours of Continuing Professional Education (CPE) requirements in a two-year period. Moreover, some CPE certificates obtained by the audit team appeared to be altered, leading the OIG audit team to question their validity.

GAGAS state that "the staff assigned to conduct an audit or attestation engagement under GAGAS must collectively possess the technical knowledge, skills, and experience necessary to be competent for the type of work being performed before beginning work on that assignment. The staff assigned to a GAGAS audit or attestation engagement should collectively possess:

- a. knowledge of GAGAS applicable to the type of work they are assigned and the education, skills, and experience to apply this knowledge to the work being performed...."⁹

GAGAS also state that "auditors performing work under GAGAS, including planning, directing, performing field work, or reporting on an audit or attestation engagement under GAGAS, should maintain their professional competence through CPE. Therefore, each auditor performing work under GAGAS should complete, every two years, at least 24 hours of CPE that directly relates to government auditing, the government environment, or the specific or unique environment in which the entity operates."¹⁰

⁷ "Government Auditing Standards," GAO-07-731G, paragraph 3.31, page 48, July 2007 Revision.

⁸ "Government Auditing Standards," GAO-07-731G, paragraph 3.32, page 48 and 49, July 2007 Revision.

⁹ "Government Auditing Standards," GAO-07-731G, paragraph 3.43, pages 51 and 52, July 2007 Revision.

¹⁰ "Government Auditing Standards," GAO-07-731G, paragraph 3.46, page 53, July 2007 Revision.

Quality Control and Assurance

The quality controls to ensure that the audits were conducted in accordance with GAGAS were ineffective. During our review, we found that ACD used an internal checklist to ensure that all required items and work steps for the audit were completed. However, in many cases we found that the checklist item was checked “yes” even though there was no evidence that the step or the item had been completed. Also, there was no justification and/or explanation for not completing some audit steps.

We also found that although an ACD’s staff member’s job description stated that one of his duties was to ensure that all work meets GAGAS, we found no evidence that he performed this function.

Additionally, some of the management control techniques that were listed as “present” or “effective” during their last management control review in June of 2007, were no longer in effect, and current control techniques were not always effective.¹¹ See Appendices III and IV. For example, management control review documentation showed that the audit staff’s training hours and CPE were tracked using the auditors’ time sheets. However, ACD staff and management stated that they did not use the timesheets anymore. Management told us that they track CPE’s on a separate database. However, we found that the database was not always accurate or current.

Lastly, although GAGAS requires organizations performing audits in accordance with GAGAS to have an external peer review at least once every three years or to modify their GAGAS compliance statements in the audit reports, ACD never had an external peer review, yet the audit reports included the standard GAGAS compliance statement rather than a modified GAGAS compliance statement.

GAGAS state that “each audit organization performing audits or attestation engagements in accordance with GAGAS must:

1. establish a system of quality control that is designed to provide the audit organization with reasonable assurance that the organization and its personnel comply with professional auditing standards and applicable legal and regulatory requirements; and
2. have an external peer review at least once every three years. An audit organization’s noncompliance with the peer review requirements results in a modified GAGAS compliance statement.”¹²

¹¹ The RRB has established a Management Control Review Committee (MCRC) to establish and oversee a process to identify and eliminate management control weaknesses. The MCRC provides guidance to manager’s in performing the individual evaluations that support the assessment of the adequacy of internal controls.

¹² “Government Auditing Standards,” GAO-07-731G, paragraph 3.50, page 55, July 2007 Revision.

Audit Planning

Audits were not adequately planned or sufficiently documented to address the audit objectives. For example, although GAGAS state that planning must be done to reduce audit risk we found no evidence that any assessment of risk was done in planning any of the audits. Although ACD staff told us that they thought one overall risk assessment had been completed by the chief of the division for all of their audits rather than individually, none of the audit staff ever recalled seeing it. They stated that no other assessment of risk was done during the planning of their audits, nor was it included as a step in the audit guide. In addition, audit documentation did not show that they had completed many of the planning steps required by GAGAS, including gaining an understanding of the audit entities' internal controls, assessing the risk of fraud, and documenting their sampling plan.

GAGAS state that “auditors must adequately plan and document the planning of the work necessary to address the audit objectives.”¹³

Audit Supervision

Evidence of supervision was not adequate to demonstrate that ACD audit staff was properly supervised. Although the audit documentation showed that a supervisor had initialed and dated the table of contents page of each audit documentation binder showing that they had performed a review, there was no indication of what the supervisor actually reviewed. For example, we found no annotations on any of the audit documentation to indicate that the supervisor had checked calculations or agreed information back to source documentation. In addition, some audit steps outlined in their audit programs (guides) were not completed and there were no reasons given and no evidence that a supervisor had approved the deviation from the program.

GAGAS state that “audit supervisors or those designated to supervise must properly supervise the audit staff.”¹⁴

Audit Documentation

ACD maintained no policies and procedures to ensure proper documentation. In addition, the audit documentation filing system was disorganized and difficult to follow. As a result, some audit documentation was missing or incomplete and it was difficult to identify the preparer of the audit documentation, the reason the work was performed, and the results. Moreover, in some cases, although internal checklists showed that audit steps had been completed, there was no audit documentation for these steps.

GAGAS state that “auditors must prepare audit documentation related to planning, conducting, and reporting for each audit. Auditors should prepare audit documentation in sufficient detail to enable an experienced auditor, having no previous connection to

¹³ “Government Auditing Standards,” GAO-07-731G, paragraph 7.06, page 124, July 2007 Revision.

¹⁴ “Government Auditing Standards,” GAO-07-731G, paragraph 7.52, page 147, July 2007 Revision.

the audit, to understand from the audit documentation the nature, timing, extent, and results of audit procedures performed, the audit evidence obtained and its source and conclusions reached, including evidence that supports the auditors' significant judgments and conclusions. Auditors should prepare audit documentation that contains support for findings, conclusions, and recommendations before they issue their report.”¹⁵

Our review found that the two overriding causes for ACD's noncompliance with GAGAS were its lax management control environment and lack of comprehensive policies and procedures for conducting, reporting, and documenting their audits. In addition, their management control information was outdated, existing controls were not effective, their system of quality control was insufficient, and their audit documentation files were disorganized.

Recommendations

We recommend that BFO:

1. re-communicate to all ACD management and staff the RRB's goal of maintaining a strong control environment by having a positive and supportive attitude toward internal control and conscientious management;
2. immediately remove the standard GAGAS compliance statement from ACD's employer audit reports until they can ensure that all required GAGAS have been met;
3. establish comprehensive, written policies and procedures which will ensure that employer audits are conducted in accordance with all required GAGAS;
4. establish a system of quality control which includes procedures to verify that the audit work meets the requirements of GAGAS;
5. establish comprehensive, written procedures for audit documentation;
6. update existing management control review documentation to include all required controls related to compliance with GAGAS;
7. complete an immediate management control review for the controls related to the employer audits, and provides a certification statement to the Management Control Review Committee;
8. require that ACD management and audit staff complete a comprehensive GAGAS training course; and
9. conduct a feasibility study to determine if obtaining an electronic audit documentation filing system for ACD would be cost effective.

¹⁵ "Government Auditing Standards," GAO-07-731G, paragraph 7.77, pages 156 and 157, July 2007 Revision.

Management's Response

In response to recommendation 1, BFO has advised us that ACD has always maintained a positive and supportive attitude toward internal control and conscientious management. They have agreed to re-communicate RRB's goal of maintaining a strong control environment to ACD staff. The target date for this corrective action is March 4, 2011.

In response to recommendation 2, BFO has advised us that the standard GAGAS compliance statement will not be included in future ACD audit reports pending further review. The target date for corrective action is June 30, 2011.

In response to recommendation 3, BFO has advised us that ACD will prepare an audit guide supplement that will include comprehensive written policies and procedures. The target date for this corrective action is September 30, 2011.

In response to recommendation 4, BFO has advised us that ACD will prepare an audit guide supplement to document a system of quality control. The target date for this corrective action is September 30, 2011.

In response to recommendation 5, BFO has advised us that ACD will prepare an audit guide supplement for comprehensive, written procedures for audit documentation. The target date for this corrective action is September 30, 2011.

In response to recommendation 6, BFO has advised us that ACD will update existing management control review documentation. The target date for this corrective action is September 30, 2011.

In response to recommendation 7, BFO has advised us that a review will be conducted and the certification will be forwarded to the Management Control Review Committee. The target date for this corrective action is September 30, 2011.

In response to recommendation 8, BFO has advised us that ACD management and audit staff will complete a Yellow Book training course. The target date for this corrective action is May 2, 2011.

In response to recommendation 9, BFO has advised us that a feasibility study will be conducted. The target date for this corrective action is September 2, 2011.

Audit Reports Were Not Fully Supported

Audit results were not always supported by sufficient, appropriate evidence. During our review we found that the facts and figures which could be agreed back to supporting documentation were materially accurate. However, we could not agree a significant number of facts and figures because ACD's audit documentation lacked a proper audit trail. Therefore, we could not verify the accuracy of all facts and figures in their audit reports. See Appendix V.

GAGAS state that "auditors must obtain sufficient, appropriate evidence to provide a reasonable basis for their findings and conclusions."¹⁶ The standards explain that "appropriateness is the measure of the quality of evidence that encompasses its relevance, validity, and reliability in providing support for findings and conclusions related to the audit objectives."¹⁷

We also found that their practice of not verifying all employer information with IRS information and ineffective quality controls increased the risk that errors would go undetected. See the following areas of concern.

IRS Information Was Not Always Obtained, Utilized, or Maintained

ACD did not obtain, utilize, or maintain sufficient evidence to show that they had adequately tested the reasonableness of creditable compensation amounts that were reported by the employers. For example, although ACD told us that they compared employer-submitted documentation for creditable compensation to IRS documentation, they did not always obtain or maintain all of the IRS documentation. Instead, they relied on employer-submitted information. For example, for one audit, although they said that they had compared employer submitted documentation to the IRS documentation for the subject three years of the audit, we found no evidence of the IRS documents in ACD's designated secure location.

In addition, although there were indications that employers had filed amendments with the IRS for some years related to the sampled audits, we found that ACD did not verify that the amendments had been filed, obtain the amended information from the IRS, or validate the amounts the employers said were being amended. As a result, for one of the three audit reports we reviewed, creditable compensation amounts for employees of the subject railroad were incorrect for as many as three years (2005, 2006, and 2007). We estimate that the differences between the originally reported amounts and the amended amounts for creditable compensation could be as much as \$1.7 million for the three years. See Appendix V for the details of our estimate. When we brought this issue to ACD's attention, they admitted that more analysis would be needed to completely quantify the differences. However, we completed our audit work before ACD staff could provide us this information.

¹⁶ "Government Auditing Standards," GAO-07-731G, paragraph 7.55, page 147, July 2007 Revision.

¹⁷ "Government Auditing Standards," GAO-07-731G, paragraph 7.56, page 147, July 2007 Revision.

When we asked why they had not obtained the amendments or why some IRS documentation was not in their files, ACD staff told us that they do not request amended IRS forms, and the IRS was, at times, slow to get them the information they needed.

Ineffective Quality Controls

Quality control procedures for verifying audit results were not effective. Although ACD staff stated that all facts and numbers were verified before the draft audit reports went out to the employers for comments, audit documentation did not show the extent of the verification performed. For example, statements and facts in the draft audit report had a check mark next to them showing that the reviewer had read them. However, the report and audit documentation supporting the report had no annotations to show that the reviewer had verified all of the information. Moreover, ACD did not always re-check facts and numbers before issuing the final reports, even though significant changes had been made from the draft to the final report.

We were advised that their current practices call for changes from the draft to the final report be re-verified on a line item basis only. ACD does not routinely review and/or compare the final report to the last verified audit report draft as a quality control check. These procedures were based on past practices as no formal procedures for a comparison currently exist.

We believe that their practices of not obtaining and maintaining IRS information related to employer audits, taking the employers' submitted data at face value, and not verifying all information in the final report significantly increased the risk that errors will go undetected.

Recommendations

We recommend that BFO:

10. obtain, utilize, and maintain documentation for all IRS information needed to conduct employer compliance audits, including any filed amendments;
11. establish a comprehensive quality control program, to include procedures to re-verify all changes made between drafts and final reports, and to ensure that audit results are adequately supported by sufficient appropriate evidence; and
12. quantify the differences in creditable compensation amounts for 2005, 2006, and 2007 for the subject railroad.

Management's Response

In response to recommendation 10, BFO has advised us that ACD will prepare an audit guide supplement to obtain, utilize, and maintain documentation for all IRS information needed to conduct employer compliance audits, including any filed amendments. They have also advised us that if IRS information is not readily available in time to complete an audit, it will be noted in the work papers. The target date for this corrective action is September 30, 2011.

In response to recommendation 11, BFO has advised us that ACD auditors routinely verify changes and will prepare an audit guide supplement to include procedures to re-verify changes and ensure audit results are supported. The target date for this corrective action is September 30, 2011.

In response to recommendation 12, BFO has advised us that ACD has quantified the differences in creditable compensation amounts for 2005, 2006, and 2007 for the subject railroad and that they provided us with some of the information. Their target date for corrective action is September 30, 2011.

Other Matters

Audit Timeliness and Follow-Up Need Improvement

During the course of our review, we found that ACD's audit reports were not timely enough and its audit follow-up not complete enough to ensure that employers took the appropriate corrective actions.

We found that of the three sampled audit reports, one report was issued approximately five years after the audit began, and one audit report was issued beyond the statute of limitations for filing the appropriate amendments with the IRS. In addition, ACD did not conduct the proper audit follow-up to determine if the employers had taken corrective action in response to their recommendations.

Although GAO does not outline specific standards for audit timeliness, audits should be issued timely enough to allow for responsible officials to take appropriate corrective action. For employer audits, this means that ACD's audit reports should be issued timely enough for employers to take action within the applicable statute of limitation.

One possible cause for untimely audit reports are that ACD's stated goals rely heavily on starting a certain number of audits rather than completing them. In addition, existing management control review documentation and control techniques aim to conduct audits in a timely manner rather than to complete them in a timely manner.

ACD management stated that many of the delays were due to on-going issues with the audited railroads. However, there was no evidence in the audit documentation files to justify or explain the delays. ACD staff told us that they weren't sure why audits were

not timely. However, they pointed out that former ACD management had been more proactive about prompting the audit staff to keep the audits moving.

During our final briefing, BFO management told us that they had been continually stressing the importance of audit timeliness to ACD staff and they felt that they had made great strides in this area. They stated that as of the beginning of FY 2010, they had only one old audit on their list of open audits. However, we note that during our audit, we found no evidence that management control documentation had been changed to restate the timeliness goals in terms of completing audits and issuing reports.

In the case of audit follow-up, although ACD's audit programs state that they will follow up with the audited employers every 30 days until all recommendations have been completed or otherwise resolved, follow-up logs showed no follow-up activity in the last year even though two of the three audits in our sample had open audit recommendations. As a result, for two of our three sampled audits, ACD was not certain if the subject employers had taken any corrective action for the three open audit recommendations.

GAGAS state that one of the purposes of audit reports is to "...facilitate follow-up to determine whether appropriate corrective actions have been taken."¹⁸

BFO advised us that the inadequate follow-up was due to the lack of a centralized database to log and monitor follow-up activities. They stated that work had begun on creating such a database. BFO also advised us that the problems cited in this report were due to high management turnover. However, we note that at the time of our audit, current management had been in place for more than two years.

Recommendations

We recommend that BFO:

13. re-state their employer audit control objectives in their MCR charts of controls to emphasize the timely completion of audits;
14. add management control techniques to their charts of control to ensure that employer compliance audits are completed in a timely manner;
15. immediately follow up on the status of all of their existing open audit recommendations;
16. comply with their audit follow-up procedures for employer compliance audits; and
17. document all follow-up activities for employer audits in a centralized location.

¹⁸ "Government Auditing Standards," GAO-07-731G, paragraph 8.05, page 160, July 2007 Revision.

Management's Response

In response to recommendation 13, BFO has advised us that over the past two fiscal years, ACD has focused on the completion of audits on a timely basis. They also advised us that while ACD has made progress in this area, they will re-state in the MCR charts of control their commitment to the timely completion of audits. The target date for this corrective action is September 30, 2011.

In response to recommendation 14, BFO has advised us that ACD will add management control techniques to their charts of control to ensure that employer compliance audits are completed in a timely manner. The target date for this corrective action is September 30, 2011.

In response to recommendation 15, BFO has advised us that ACD had begun following up on the status of all of their existing open audit recommendations. The target date for this corrective action is August 1, 2011.

In response to recommendation 16, BFO has advised us to see the response for recommendation 17 below as the follow-up procedures will be based on the log. They also advised us that the log will help them to meet their established time lines. The target date for this corrective action is August 1, 2011.

In response to recommendation 17, BFO has advised us that ACD is in the process of developing an audit follow-up log that will cover audit issues for reports. They also advised us that the log will list target dates for open items from audit reports and will be kept in a central location. The target date for this corrective action is August 1, 2011.

APPENDICES

SAMPLING METHODOLOGY AND RESULTS Non-Statistical Sample Selection

This appendix presents the methodology and results of our selection of a non-statistical sample of the Railroad Retirement Board's Audit and Compliance Division's (ACD) audits.

Sample Objective

Our objective was to judgmentally select a sample of ACD's audit reports issued in Fiscal Year (FY) 2009.

Sample Universe

We judgmentally selected our sample from the population of eight employer audit reports that were issued by the ACD in FY 2009.

Selection Methodology and Results

The non-statistical sample was based on auditor's judgment after an initial review of ACD audit reports issued in FY 2009. Our initial review showed that ACD had issued audit reports for one Class I railroad and seven non-Class I railroads during FY 2009.¹⁹ A class I major railroad was selected due to the significant dollar volume. ACD issued only one class I employer audit in FY 2009.

We selected an additional two audit reports to review. The remaining two ACD audit reports selected were for non-Class I railroads. These audits were selected because of the amount of dollars reviewed and the initial disclosed findings or reconciliation differences, even though those differences were later resolved.

In the end, we selected three ACD employer audit reports to review, including reports for one Class I railroad, one non-class I railroad, and one union.

Conclusion

The judgmental sample consisted of three audit reports and the supporting audit documentation related to those reports. The sample selected represents approximately 38 percent of the universe.

¹⁹ A Class I railroad in the United States, or a Class I railway (Class I rail carrier) in Canada, is one of the largest freight railroads, as classified based on operating revenue. Smaller railroads are classified as Class II and Class III. The exact revenues required to be in each class have varied through the years, and they are now continuously adjusted for inflation. For 2009, U.S. Class I Railroads are line haul freight railroads with 2008 operating revenues in excess of \$401.4 million.

TESTING METHODOLOGY AND RESULTS

Compliance with GAGAS

This appendix presents the methodology and results of our testing of ACD's compliance with generally accepted government auditing standards (GAGAS).

Objective

The objective of our test was to determine if the sampled audits were conducted in compliance with GAGAS.

Scope

We reviewed three of the eight audit reports issued by ACD in FY 2009.

Review Methodology

All of the ACD employer audit reports indicated that GAGAS were followed and would be classified as performance audits under the standards. The Council of the Inspectors General on Integrity and Efficiency's (CIGIE) *Guide for Conducting External Peer Reviews of the Audit Organizations of Federal Offices of Inspector General* dated March 2009 was used as a tool to test compliance with GAGAS.

We tested the following areas:

- policies and procedures;
- adherence to general standards; and
- adherence to standards for performance audits.

Specifically, we tested compliance with the following standards/chapters in GAGAS:

- General Standards: Independence, Professional Judgment, Competence, and Quality Control and Assurance (Chapter 3);
- Field Work Standards for Performance Audits: Planning, Supervision, Obtaining Sufficient Appropriate Evidence, and Preparing Audit Documentation (Chapter 7); and
- Reporting Standards for Performance Audits (Chapter 8).

Evaluation Criteria

ACD's overall compliance with GAGAS was determined by assessing whether or not the sampled audits complied with a majority of the items tested.

Results of Compliance Tests

ACD Policies and Procedures – Our review showed that ACD was noncompliant with 42 out of 45 (93%) applicable items related to policies and procedures for all three audits reviewed.

ACD's Adherence to General Standards – Our review showed that ACD was noncompliant with 12 out of 14 (86%) applicable items related to adherence to the general standards (Independence, Professional Judgment, Competence, and Quality Control and Assurance) for all three audits reviewed.

ACD's Compliance with GAGAS for Performance Audits – Our review showed that ACD was noncompliant with 42 out of 67 (64%) items related to compliance with GAGAS for performance audits (Planning, Supervision, Obtaining Sufficient Appropriate Evidence, Preparing Audit Documentation, and Reporting) for two of three audits reviewed and noncompliant with 43 of 67 (64%) items for the third audit.

In addition, we found that ACD's audit reports included an unmodified GAGAS statement which outlined that their audits were conducted in compliance with GAGAS. The GAGAS reporting standards require a modified GAGAS statement if audits are not subject to peer review and also requires a modified statement if certain standards are not met.

Conclusion

Based on the results of our test, we conclude that ACD's audits were not conducted in compliance with GAGAS and the audit reports included an unmodified GAGAS statement.

DESCRIPTION OF RRB'S MANAGEMENT CONTROL REVIEW PROCESS

The RRB continually evaluates the effectiveness and efficiency of its operations using ongoing assessments and reviews of management controls. Under the direction of a Management Control Review Committee (MCRC) composed of senior managers from its program, information services, administrative, and financial operations, the RRB has divided these operations functionally into 43 assessable units. The ACD employer audit area is defined as an assessable unit within BFO.

An assessable unit's documentation includes a chart of controls. A chart of controls documents and evaluates:

- the inherent risks associated with accomplishing the mission of the assessable unit and the integrity risks to the mission essential assets and resources;
- the control objectives established to combat these inherent and integrity risks; and
- the control techniques designed to accomplish the control objectives.

Control objectives are identified and developed for each assessable unit with the objectives of internal control in mind. The three objectives are effectiveness and efficiency of operations, compliance with laws and regulations, and reliability of financial reporting.

Control techniques are procedures, methods, and devices that are incorporated in (preventive controls) or monitor individual transactions and assets (detection controls). Control techniques are employed to combat specific risks and accomplish specific control objectives for the assessable unit. Each control objective has one or more control techniques to provide reasonable assurance that the control objectives are achieved in an efficient and effective manner.

The ACD's chart of controls for employer audits outlines seven control objectives as follows:

1. Audit results are factually accurate and supported by competent evidence;
2. Audits are conducted in a timely manner;
3. Audits are completed in the most cost efficient methods available;
4. Audit information, plans, or reports are protected from unauthorized disclosure;
5. Audit findings are resolved and implemented in a timely manner;
6. Audit recommendations are tracked and implemented in a timely manner; and
7. Audit conducted in compliance with applicable laws and regulations (GAGAS).

Controls for ACD's employer audits were last tested and determined to be in place and effective on June 19, 2007 as part of the management control review process.

TESTING METHODOLOGY AND RESULTS

Compliance with Selected Management Controls

This appendix presents the methodology and results of our testing of selected management control objectives and related control techniques over ACD's employer audits.

Objective

To determine if selected management control techniques were properly designed, in place, and effective to ensure that the associated management control objective would be met.

Scope

For our sampled audit reports, we reviewed all 16 control techniques related to their first management objective of ensuring that audit results are factually accurate and supported by competent evidence.

In addition, we did an in-depth review of ACD's own audit documentation checklist (control technique #16) because they lacked comprehensive policies and procedures for conducting audits and documenting their work.

We also tested ACD's one control technique related to their seventh management control objective of ensuring that audits are conducted in compliance with GAGAS.

Review Methodology

For each of the three audits, we completed a questionnaire to assess whether or not the control techniques were properly designed, in place, and operating effectively and efficiently to ensure that the related control objective would be met. To accomplish this, we:

- obtained and reviewed documentation from the last management control review for employer audits, including the charts of control;
- interviewed responsible management and staff;
- obtained and reviewed any existing policies, procedures, and practices, including ACD's audit documentation checklist and audit guide;
- obtained and reviewed the draft and final reports, and all audit documentation related to those reports, for the three sampled audits; and
- developed and executed a checklist to test and evaluate the control techniques.

Evaluation Criteria

We assessed each audit report as overall “compliant “ for the management control objective if at least 90 percent of the control techniques were in place and operating effectively to help meet the management control objective. Conversely, if more than 10 percent of the control techniques were not in place or not effective, the report was considered non-compliant for the management control objective.

Results of Review

For Management Control Objective #1, “Audit results are factually accurate and supported by competent evidence,” our review found that none of the three audit reports were overall compliant for the 16 management control techniques. The details are as follows:

- For the first audit, 5 of 16 (31%) of the management control techniques were either not in place (evidenced in audit documentation) or not operating effectively.
- For the second audit, 6 of 15 (40%) (One technique was not applicable for this audit.) of the management control techniques were either not in place (evidenced in audit documentation) or not operating effectively.
- For the third audit, 9 of 16 (56%) of the management control techniques were either not in place (evidenced in audit documentation) or not operating effectively.

For our in-depth review of control technique #16, we found that ACD’s audit documentation was not prepared in accordance with their own audit documentation checklist between 45 and 89 percent of the time.

For Management Control Objective #7, “Audits conducted in compliance with applicable laws and regulations (GAGAS),” we found that they had only one management control technique for this objective which stated “The audit report reflects audit conducted in accordance with Generally Accepted Government Auditing Standards.” We concluded that this one control technique was properly designed but not sufficient to ensure that their audits were conducted in compliance with GAGAS. Merely making a statement in the audit report that the audits were conducted in accordance with GAGAS is not enough to ensure actual GAGAS compliance.

Conclusion

Overall, ACD’s management control techniques were in place, but not sufficient, properly designed, or effective to accomplish their management objectives of ensuring that audit results are factually accurate and supported by competent evidence, and also ensuring that audits are conducted in compliance with applicable laws and regulations (GAGAS).

TESTING METHODOLOGY AND RESULTS

Verification of the Accuracy and Support for ACD's Audit Reports

This appendix presents the results of our review of ACD's audit reports.

Objective

To determine whether ACD's audit results, for selected audit reports, were factually accurate and supported by sufficient, appropriate, and competent evidence.

Scope

We reviewed three of eight ACD audit reports issued in FY 2009.

Review Methodology

For the three sampled audits, we obtained a copy of ACD's verified draft audit report and the associated audit documentation files and completed the following steps to test for the accuracy of ACD's audit results and to determine if the results were supported by sufficient, appropriate evidence:

1. reviewed audit reports and documentation for accuracy, completeness, clarity, and conciseness;
2. agreed amounts to the supporting audit documentation;
3. reviewed the audit documentation, noting agreement of amounts and findings to ACD supporting audit documentation;
4. reviewed ACD's audit documentation, noting if ACD had obtained sufficient, competent and relevant evidence to support audit findings and conclusions in the audit report; and
5. completed OIG's point sheet relating to issues with ACD's verification.

Evaluation Criteria

Audit results were considered accurate and supported by sufficient competent evidence if the facts and figures in the report were calculated correctly and could be agreed back to the source audit documentation.

Results

For all three audits, we found that the facts and figures which could be agreed back to supporting documentation were materially accurate. However, we could not agree a significant number of facts and figures because ACD's audit documentation lacked a proper audit trail. We identified one error related to the verification of employer information with IRS information that could impact the reported creditable compensation amounts by as much as \$1.7 million. The details of this error are explained on the next page.

We also found that for all three reports, ACD's audit results were not supported by sufficient, appropriate, and competent evidence (audit documentation). Examples of the types of exceptions found are outlined below:

- Significant changes from the draft to the final audit report were not verified;
- Audit documentation was added to the file subsequent to the issuance of the final report. Therefore, results were not supported when the report was issued;
- The support given for many of their facts and figures is "Auditor Statement" rather than actual audit documentation;
- Reasons for audit decisions made were not documented; and
- Facts and figures could not be agreed to source documentation (poor audit trail).

Conclusion

ACD's audit results were not always supported by sufficient, appropriate evidence. Therefore, we could not verify the accuracy of all facts and figures in their audit reports.

ERROR IDENTIFIED DURING TESTING

For one of the audit reports we found that ACD had not compared creditable compensation amounts provided by the employer with those that had been filed with the IRS. As a result creditable compensation amounts in ACD's final report were inaccurate because the amounts were based on proposed employer amended IRS forms for calendar years (CYs) 2006 and 2007 which were never filed. During our review, we estimated the error to be approximately \$1.7 million for CYs 2006 and 2007. (See the table below for the calculations related to our estimate.) While the \$1.7 million reflects only 0.4 percent of the combined creditable compensation for that employer for CYs 2006 and 2007, we brought this error to ACD's attention to demonstrate the risks of poor quality controls.

OIG Estimate of Error

Creditable Compensation per IRS Form CT-1	CY 2006	CY 2007	Net Amount CYs 2006 & 2007
Tier I			
Original Amount	\$108,469,280	\$118,124,533	
Amended Amount	<u>\$107,954,640</u>	<u>\$117,745,465</u>	
Difference	<u>\$514,640</u>	<u>\$379,068</u>	<u>\$893,708</u>
Tier II			
Original Amount	\$100,806,674	\$108,787,291	
Amended Amount	<u>\$100,382,029</u>	<u>\$108,379,761</u>	
Difference	<u>\$424,645</u>	<u>\$407,530</u>	<u>\$832,175</u>
Total Estimated Error Original vs. Amended			<u>\$1,725,883</u>
Original Amount Tier 1	\$108,469,280	\$118,124,533	
Original Amount Tier II	<u>\$100,806,674</u>	<u>\$108,787,291</u>	
Total	<u>\$209,275,954</u>	<u>\$226,911,824</u>	<u>\$436,187,778</u>
Percentage			<u>0.4%</u>



UNITED STATES GOVERNMENT

MEMORANDUM

Appendix VI

FORM G-115f (1-82)

RAILROAD RETIREMENT BOARD

JAN 31 2011

TO : Diana Kruei
Assistant Inspector General for Audit

FROM : Henry Rueden *ORIGINAL SIGNED BY:*
Chief of Audit and Compliance
THROUGH: John M. Walter *ORIGINAL SIGNED BY:*
Chief of Accounting, Treasury, and Financial Systems

SUBJECT: Draft Report – Review of the Railroad Retirement Board's
Audit and Compliance Division

Thank you for the opportunity to comment on the OIG Draft Report. Comments on the recommendations are as follows:

Recommendations:

We recommend that BFO:

1. **re-communicates to all ACD management and staff the RRB's goal of maintaining a strong control environment by having a positive and supportive attitude toward internal control and conscientious management;**

ACD has always maintained a positive and supportive attitude toward internal control and conscientious management. RRB's goal of maintaining a strong control environment will be re-communicated to ACD staff. Target date: March 4, 2011.

2. **immediately remove the standard GAGAS compliance statement from ACD's employer audit reports until they can ensure that all required GAGAS have been met;**

The standard GAGAS compliance statement will not be included in future ACD audit reports pending further review. Target date: June 30, 2011.

3. **establishes comprehensive, written policies and procedures which will ensure that employer audits are conducted in accordance with all required GAGAS;**

ACD will prepare an audit guide supplement that will include comprehensive, written policies and procedures.
Target date: September 30, 2011.

4. **establishes a system of quality control which includes procedures to verify that the audit work meets the requirements of GAGAS;**

ACD will prepare an audit guide supplement to document a system of quality control. Target date: September 30, 2011.

5. **establishes comprehensive, written procedures for audit documentation;**

ACD will prepare an audit guide supplement for comprehensive, written procedures for audit documentation. Target date: September 30, 2011.

6. **updates existing management control review documentation to include all required controls related to compliance with GAGAS;**

ACD will update existing management control review documentation.
Target date: September 30, 2011.

7. **completes an immediate management control review for the controls related to the employer audits, and provides a certification statement to the Management Control Review Committee;**

A review will be conducted and the certification will be forwarded to the Management Control Review Committee. Target date: September 30, 2011.

8. **requires that ACD management and audit staff complete a comprehensive GAGAS training course; and**

ACD management and audit staff will complete a Yellow Book training course. Target date: May 2, 2011.

9. **conducts a feasibility study to determine if obtaining an electronic audit documentation filing system for ACD would be cost effective.**

A feasibility study will be conducted. Target date: September 2, 2011.

10. **obtains, utilizes, and maintains documentation for all IRS information needed to conduct employer compliance audits, including any filed amendments;**

ACD will prepare an audit guide supplement to obtain, utilize, and maintain documentation for all IRS information needed to conduct employer compliance audits, including any filed amendments. If IRS information is not readily available in time to complete an audit, it will be noted in the work papers. Target date: September 30, 2011.

11. **establishes a comprehensive quality control program, to include procedures to re-verify all changes made between drafts and final reports, and to ensure that audit results are adequately supported by sufficient appropriate evidence; and**

ACD auditors routinely verify changes and will prepare an audit guide supplement to include procedures to re-verify changes and ensure audit results are supported. Target date: September 30, 2011.

12. **quantifies the differences in creditable compensation amounts for 2005, 2006, and 2007 for the subject railroad.**

ACD has quantified the differences in creditable compensation amounts for 2005, 2006, and 2007 for the subject railroad and provided some of the information to the OIG. Target date: September 30, 2011.

13. **re-states their employer audit control objectives in their MCR charts of controls to emphasize the timely completion of audits;**

Over the past two fiscal years, ACD has focused on the completion of audits on a timely basis. While ACD has made progress in this area, we will restate in the MCR charts of control our commitment to the timely completion of audits. Target date: September 30, 2011.

14. **adds management control techniques to their charts of control to ensure that employer compliance audits are completed in a timely manner;**

ACD will add management control techniques to the charts of control to ensure that employer compliance audits are completed in a timely manner. Target date: September 30, 2011.

15. immediately follows up on the status of all of their existing open audit recommendations;

ACD has begun following up on the status of all of their existing open audit recommendations. Target date: August 1, 2011.

16. complies with their audit follow-up procedures for employer compliance audits; and

Please see response to item number 17 below as all follow-up procedures will be based on the log. The log will help us meet our established time lines. Target date: August 1, 2011.

17. documents all follow-up activities for employer audits in a centralized location.

ACD is in the process of developing an audit follow-up log that will cover audit issues for reports. The log will list target dates for open items for audit reports and will be maintained in a central location. Target date: August 1, 2011.

We would like to note that ACD has already taken action to address some of the issues that are discussed in this report. For example, when the OIG auditors pointed out that independence statements were needed, we had each auditor complete and sign a statement and submitted copies of the statements to the OIG. Similarly, we have taken action to ensure that documentation concerning continuing professional education (CPE) requirements is maintained.

If you have any questions, please contact me at extension 4679.

cc: William J. Flynn, Executive Assistant
Debra Stringfellow-Wheat, Supervisory Auditor