

OFFICE OF INSPECTOR GENERAL
Audit Report

Management Information Report

**Concerns Related to the Railroad Retirement Board's
Audit and Compliance Division's Employer Audit Reports**

**Report No. 11-05
March 31, 2011**



RAILROAD RETIREMENT BOARD

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INTRODUCTION

This management information report presents the results of the Office of Inspector General's (OIG) review of the Audit and Compliance Division's (ACD) employer audit reports.

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 over \$10.7 billion in benefits to approximately 631,000 beneficiaries during fiscal year (FY) 2009.

For calendar year 2009, covered railroads 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 workers.¹ During FY 2009, railroads paid approximately \$4.7 billion in railroad retirement taxes and \$92.9 million in RUIA contributions.²

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 (RRTA), 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. The RRB and the IRS have a signed written agreement (coordination agreement) to facilitate the sharing of information between the agencies and to coordinate the administration of the RRTA and RRA.

The ACD performs three main reconciliations during their employer audits. They reconcile:

- creditable compensation reported to the RRB to wages reported to the IRS;

¹ A covered railroad is a railroad employer covered by the RRA of 1974, as amended, and RUIA. Tier I is the railroad retirement equivalent of social security wages and benefit amounts. Tier II is comparable to a private pension. 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 RRA. The term compensation means any form of payment made to an individual for services rendered as an employee for a (covered) employer.

² Railroad retirement benefits are funded by payroll taxes collected under the RRTA and railroad unemployment and sickness benefits are funded by contributions collected under the RUIA.

- creditable compensation reported to the RRB to taxable RRTA compensation reported to the IRS; and
- quarterly RUIA compensation reported to the RRB on Forms DC-1 to annual RUIA compensation reported to the RRB on Form BA-3.³

The OIG issued Audit Report No. 11-04, "Review of the Railroad Retirement Board's Audit and Compliance Division" on February 1, 2011. Some of the key findings were:

- audits were not conducted in accordance with generally accepted government auditing standards (GAGAS);
- audit results were not fully supported; and
- audit timeliness and follow-up need improvement.

Because of the deficiencies in ACD's audit and reporting process, the OIG initiated this review. This review supports the RRB's strategic plan's goal to safeguard customers' trust funds through prudent stewardship.

Objective

The objective of this review was to identify additional areas of concern related to ACD's employer audit reports.

Scope

The scope of this review was limited to the 26 employer audit reports issued by ACD in fiscal years 2008 through 2010. Our scope was limited to a review of the reports only and not of the supporting working papers.

Methodology

To accomplish our objective, we:

- reviewed the employer audit reports issued by ACD;
- reviewed the OIG's recent audit report on ACD;
- reviewed the coordination agreement between the RRB and IRS; and
- reviewed interviews with responsible ACD management and staff from other recent OIG audits related to ACD.

We conducted our fieldwork at the RRB's headquarters in Chicago, Illinois from January through March 2011.

³ Employers file Form DC-1, Employer's Quarterly Report of Contributions under the Railroad Unemployment Insurance Act, to report RUIA contribution liability. These reports include the amount of RUIA compensation subject to contribution. The total of the quarterly compensation amounts for an employer should agree with total RUIA compensation reported by the employer on Form BA-3, Annual Report of Creditable Compensation.

RESULTS OF REVIEW

The OIG's review of the employer audit reports issued by ACD identified several areas of concern. ACD's employer audit reports do not clearly answer one of the stated objectives and do not sufficiently explain how the completed audit work supports this objective. In addition, ACD does not clearly explain its use of materiality thresholds in their employer audit reports. Finally, ACD did not complete their employer audit reports in a timely manner and did not always select the best years for review based upon the timing of their audit work. Details of these findings follow.

Reporting on Accuracy of Creditable Service and Compensation

ACD's employer audit reports do not clearly answer one of their primary audit objectives of determining the accuracy of creditable service and compensation reports filed under the RRA. According to GAGAS, "auditors should present sufficient, appropriate evidence to support the findings and conclusions in relation to the audit objectives." GAGAS also states that "a finding or set of findings is complete to the extent that the auditors address the audit objectives."⁴

ACD's employer audit reports state that the audited employer generally administered its responsibilities under the RRA and RUIA in accordance with the laws and regulations applicable to the scope of the review. However, this overall conclusion does not adequately address the accuracy of service and compensation reporting. The employer audit reports do not specifically address the objective of determining the accuracy of service and compensation reported to the RRB. By comparison, the employer audit reports do specifically answer another audit objective of whether creditable compensation reported to the RRB agrees to taxable compensation reported to the IRS for RRTA purposes. However, this reconciliation is not meaningful to report users since the employer audit reports do not first establish the accuracy of compensation reported to the RRB.

ACD management told the OIG that they test the accuracy of creditable compensation in each employer audit by reconciling creditable compensation reported to the RRB to wages reported to the IRS. However, ACD only reported the results of this reconciliation in 12 of 26 reports. Reconciliation differences were reported for each of these 12 reports. Report readers must infer that the presented information addresses the accuracy of creditable compensation reported under the RRA. ACD's employer audit reports do not indicate that ACD tested the accuracy of creditable compensation and do not describe how the accuracy of creditable compensation is tested. GAGAS indicates that auditors should explain how completed audit work supports the audit objectives to allow knowledgeable users of their reports to understand how the auditors addressed the audit objectives.⁵

⁴ "Government Auditing Standards," GAO-07-731G, paragraph 8.14, July 2007 Revision.

⁵ "Government Auditing Standards," GAO-07-731G, paragraph 8.13, July 2007 Revision.

In order to provide more clarity in their employer audit reports, ACD should explain how the accuracy of creditable compensation reported to the RRB was tested and specifically conclude on the accuracy of this testing.

Use of Materiality in Employer Audit Reports

ACD uses materiality thresholds in their employer audit reports without defining these levels, or in some cases, informing the reader of their use. The OIG identified that ACD used a materiality threshold to determine that reconciliation differences did not need resolution or corrective action in 17 of 26 reports. However, the threshold amount was often not provided in the reports.

GAGAS defines materiality as the relative importance of a matter within the context in which is being considered, including quantitative and qualitative factors.⁶

The coordination agreement between the IRS and RRB does not define a materiality level for referral of RRTA matters to the IRS. In addition, the RRB's employer reporting instructions and filing instructions for reports of service and compensation do not define materiality thresholds for employer reporting.

ACD applied materiality thresholds to disregard differences in reconciliations of creditable compensation reported to the RRB and taxable compensation reported to the IRS. They also applied materiality to reconciliations of creditable compensation reported to the RRB and compensation subjected to quarterly RUIA contributions. ACD refers to the reconciliation differences below threshold amounts as immaterial, reconciled to an acceptable degree, or de minimis.⁷ However, ACD reports do not define the threshold for reconciled to an acceptable degree or de minimis differences. When ACD classifies a reconciliation difference as immaterial, they sometimes indicate in the report that the difference is immaterial because it constitutes less than 1% of the amount of compensation reported.

When ACD identifies compensation reporting errors, they normally recommend that employers file amended tax returns with the IRS to correct any applicable RRTA tax amounts. However, in some cases ACD determined that the compensation reporting differences were either immaterial, reconciled to an acceptable degree, or de minimis. Therefore, ACD did not recommend that employers file amended returns to correct the RRTA tax amounts. As a result, the OIG identified approximately \$50,000 in underreported and \$17,000 in over reported RRTA taxes, for a potential net loss of \$33,000 to the RRB's trust funds.

ACD management and staff informed the OIG that they also apply materiality thresholds to the reconciliation of creditable compensation reported to the RRB to wages reported to the IRS for each railroad employee. ACD does not investigate or report on individual differences of less than \$2,500 for employees of Class I employers and individual

⁶ "Government Auditing Standards," GAO-07-731G, paragraph 7.04 and footnote 89, July 2007 Revision.

⁷ De minimis is commonly defined as so small or minimal in difference that it does not matter or the law does not take it into consideration.

differences of less than \$1,000 for employees of all other railroad employers.⁸ ACD does not disclose these materiality thresholds in its reports. Although GAGAS allows auditors to use professional judgment when evaluating the significance of the results of audit work, these amounts are excessive when applied to each individual's creditable compensation.⁹

Audits Not Completed Timely Resulting in Potential Losses to Trust Funds

ACD issued 16 employer audit reports where the statute of limitations for amending RRTA taxes had expired by the report date for at least one of the audited years. In one of these reports, ACD identified potential additional RRTA taxes of approximately \$88,000. ACD indicated that the statute of limitations for amending these taxes had expired but the employer could voluntarily file returns to adjust the taxes. The employer chose not to file the amended returns resulting in a net loss of approximately \$88,000 to the RRB Trust Funds. In another employer audit report, ACD made no recommendation on underreported RRTA taxes of approximately \$1,400 for a year outside the statute of limitations.

There were five other audits where ACD identified underreported RRTA taxes where the statute of limitations had expired. However, the employers indicated they would file amended returns with the IRS. The remaining nine reports had no findings resulting in underreported RRTA.

The statute of limitations for amending railroad retirement tax returns expires three years after the date the return is due, or the date filed, whichever is later. Returns are due by the last day of February of the following calendar year.

The RRB currently has an agreement with the IRS to coordinate the administration of the RRTA by the IRS and the RRA by the RRB. Under Section 6.1(c) of this coordination agreement, the RRB Chief Financial Officer (CFO) is to provide a list of projected audits for each upcoming year to assist IRS in protecting the statute of limitations.¹⁰ In addition, Section 11.1 provides that the RRB CFO will send a written request asking the IRS to take appropriate steps to protect the RRTA statute of limitations in cases that have been fully developed by the RRB auditors and where there is potential significant financial impact to the RRB's trust funds. The agreement further states that the IRS will act at its own discretion and provide a written response to the CFO regarding their decision.

In an attempt to improve the timeliness of employer audit reports, ACD reduced their audit period from three to two years. From September 2009 through September 2010 ACD issued ten reports with a two year audit period. Although these reports were

⁸ 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.

⁹ "Government Auditing Standards," GAO-07-731G, paragraph 7.04, July 2007 Revision.

¹⁰ Protecting the statute of limitations refers to extending the number of years for which additional tax can be assessed.

issued in a more timely manner, the audit period in five of these reports still included a year where the statute of limitations had expired by the report date.

In addition, nine of these ten reports could have included a more current year in the audit period thereby decreasing the risk of losing a year to the statute of limitations. The audit period in each report was January 1, 2006 through December 31, 2007. However, all reports and other information required to audit 2008 should have been available well before on-site field work began on these audits.

The OIG is concerned about the effectiveness of the process for protecting the statute of limitations. The OIG acknowledges that the RRB does not have the authority to audit compliance with the RRTA. However, since reporting errors under the RRA generally result in an error in reporting under the RRTA, and taxes collected under the RRTA fund railroad retirement benefits, the RRB has a vested interest in ensuring that railroad employers are reporting and paying the correct amount of RRTA taxes. Therefore, ACD should attempt to confirm that the IRS has protected the statute of limitations for employers and tax years for upcoming ACD employer audits.

Conclusion

The OIG is not making formal recommendations based on our review of ACD employer audit reports because we recently issued Report No.11-04, "Review of the Railroad Retirement Board's Audit and Compliance Division" on February 1, 2011. This report made widespread recommendations for corrective action. However, we wanted to highlight additional OIG concerns for consideration during ACD's implementation of corrective action and revision of its policies and procedures. To further improve their employer audit reports, ACD should:

- specifically answer the objective of whether service and compensation reported to the RRB is accurate and should describe the work done to answer this objective;
- define materiality thresholds (including de minimis and reconciled to an acceptable degree) when used in employer audit reports;
- work with the IRS to establish a materiality threshold for referral of RRTA matters;
- reduce the materiality thresholds it uses for reconciliation differences when determining the accuracy of individual's creditable compensation reported to the RRB;
- periodically attempt to confirm that the IRS has protected the statute of limitations for upcoming ACD employer audits; and
- audit the most current years for which the needed reports and records are available. They should be cognizant of the statute of limitations in selecting years for review and in completing their audit reports.