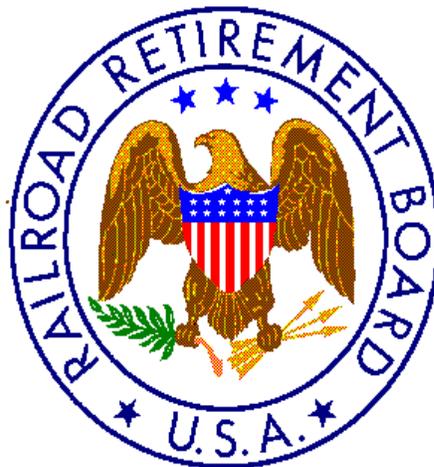


OFFICE OF INSPECTOR GENERAL

Audit Report

**The Railroad Retirement Board Lacks Adequate Controls
over Creditable Compensation Related to Injury Settlements**

**Report No. 15-03
January 29, 2015**



RAILROAD RETIREMENT BOARD

EXECUTIVE SUMMARY

The Office of Inspector General (OIG) for the Railroad Retirement Board (RRB) conducted an audit to determine if internal controls are adequate to ensure that railroad employers are reporting creditable service and compensation related to injury settlements, including the proper allocation of service months, in accordance with RRB regulations.

Findings

Our audit determined that internal controls over creditable service and compensation related to injury settlements are not adequate. The RRB does not track creditable compensation and service months reported as part of an injury settlement; does not require documentation to support the reported service and compensation; and does not have adequate controls to ensure that service and compensation are reported in compliance with agency regulations.

While total financial impact of non-compliance cannot be determined due to the RRB's lack of monitoring, documentation, and controls, the RRB trust funds lost between \$3,000 and \$11,000 for each identified instance of non-compliance, such as awarding service months before the date of injury or awarding service months when the monthly allocation is not appropriate. Approximately 4,000 non-fatal, on-the-job injuries are reported to the Federal Railroad Administration each year.¹ If all of these injuries resulted in injury settlements with reportable service and compensation, the RRB trust funds could lose between \$12 and \$44 million per year due to non-compliance with RRB regulations related to the allocation of service and compensation in an injury settlement.

Recommendations

We made recommendations to the Office of Programs to: track creditable compensation related to injury settlements, and the effect on benefit eligibility; implement controls to ensure compliance with agency regulations related to service months credited from an injury settlement; and request adjustment reports from the railroad employers to correct improperly reported service and compensation, recover the improper payment, and determine what, if any, actions can be taken to recover the lost taxes in the examples we identified.

¹ Federal Railroad Administration, Office of Safety Analysis (fra.dot.gov/OfficeofSafety) Query ran on July 14, 2014.

RRB Management's Comments & Our Response

The Office of Programs did not concur with the first two recommendations. For the third recommendation, the Office of Programs said that they had reviewed the errors cited in our audit report. They stated that they would contact the railroad employers and request the corrections to the employee records based on our audit findings. They indicated that, after the corrections to the employee accounts have been received, they would then determine if adjudicative actions are needed. They also stated that they would refer any tax related information to the Internal Revenue Service.

We reiterate our stance that a robust system of internal control over its programs would necessitate that the agency track creditable compensation related to injury settlements and the effect it has on benefit eligibility, as well as ensure compliance with agency regulations related to service months credited from an injury settlement in order to ensure that the agency is paying benefits to individuals who are eligible and to reduce the risk of improper payments.

TABLE OF CONTENTS

EXECUTIVE SUMMARY i

INTRODUCTION

Background..... 1
Objective 3
Scope..... 3
Methodology 3

RESULTS OF AUDIT

Lack of Monitoring over Creditable Compensation Related to Injury Settlements..... 4
 Recommendation..... 5
 RRB Management’s Comments & Our Response 5

Inadequate Controls to Ensure Employer Compliance with Regulations 6
 Recommendation..... 7
 RRB Management’s Comments & Our Response 7
 Recommendation..... 9
 RRB Management’s Comments & Our Response 10

APPENDIX

Appendix I – Management’s Response – Office of Programs..... 11

INTRODUCTION

This report presents the results of the Office of Inspector General's (OIG) audit of internal controls over creditable compensation related to injury settlements.

Background

The Railroad Retirement Board (RRB) is an independent agency in the executive branch of the Federal government. The RRB's mission is to administer comprehensive retirement/survivor and unemployment/sickness insurance benefit programs for railroad workers and their families under the Railroad Retirement Act (RRA)² and the Railroad Unemployment Insurance Act.³

The RRA provides for retirement and disability annuities to railroad employees, their spouses, and their survivors. These annuities are funded by employment taxes paid by both the railroad employer and employee. Retirement and disability annuities are paid to eligible employees and their families based on service months credited for compensation earned in those months. Eligibility is based on the number of service months, type of annuity, and certain qualifying events, such as disability or attainment of a certain age. For example, an employee generally needs 240 service months and has to be unable to perform his or her regular railroad occupation to be eligible for an occupational disability. With 360 service months, an employee is eligible for a retirement annuity, upon attaining age 60.

The RRA requires that railroad employers report service (months) and compensation (pay, including certain benefits) for railroad employees, on an annual basis. Generally, railroad employers self-report to the RRB normal annual compensation on one form for all employees. After the annual compensation has been reported, employers are required to report any adjustments to service and compensation to correct errors in the annual reports or to report additional compensation for such things as injury settlements, or adjustments to vacation pay. Adjustment reports normally only indicate an increase or decrease to service and compensation and do not indicate the reason for the adjustment.

The RRB sends railroad employees a "Certificate of Service Months and Compensation" for any year that they perform railroad service and/or receive railroad compensation. If the employee does not agree with the reported service months or compensation, they can file an "employee protest" to request correction of the reported amounts. The RRB's Office of Programs is responsible for obtaining and recording the reported service and compensation from the railroad employers and for processing employee protests.

² 45 United States Code (U.S.C.) Chapter 9.

³ 45 U.S.C. Chapter 11.

In some cases, an individual may be injured on-duty or become ill and not have the necessary service months to qualify for an annuity. Employees injured while on-duty for railroad employers are generally not covered by workers' compensation and must seek restitution from their railroad employer through a personal injury award or settlement. Settlements for on-duty injuries to railroad employees are usually made under the Federal Employers' Liability Act. The RRA allows for qualifying service months to be credited to an employee as part of an injury settlement with the railroad employer.⁴ The amount paid by an employer, with respect to an identifiable period of absence from active service of the employer, on account of personal injury, is known as "pay for time lost."

RRB regulations require that employers allocate "pay for time lost," including the lost wages portion of an injury settlement, to the months in which the time is actually lost; that the allocation relates to the employee's normal monthly pay; and that the employee must maintain an employment relationship with an employer for any month credited. The employment relationship ends when an employee resigns, relinquishes his or her rights, or retires. Ordinarily, the compensation allocated to each month credited as part of a settlement should be at least ten times the employee's daily pay rate in order to be an acceptable relationship to normal monthly pay. "Pay for time lost" should be reported to the RRB by the railroad employer on either an adjustment report or on their annual report.

On July 18, 2014, the OIG issued a Management Information Report (MIR) on the provisions of the RRA that essentially allow railroad employees to purchase an occupational disability annuity from the RRB as part of an injury settlement with their railroad employer.⁵ The RRB is not a party to this settlement, but may ultimately be obligated to pay an annuity to the employee as a result of the settlement. During the preparation of the MIR, the OIG was not able to quantify the number of annuities paid by the RRB to annuitants who had purchased their annuities through an injury settlement because of limitations in agency systems and a lack of necessary documentation. Based on these limitations, the OIG is performing this review of internal controls over compensation reported as a result of an injury settlement.

This audit supports the RRB's Strategic Goal II to "[s]erve as responsible stewards for our customers' trust funds and agency resources."⁶ One objective for achieving that goal is to ensure the accuracy and integrity of benefit programs. In carrying out its mission the RRB states that it will pay benefits to the right people, in the right amounts, and in a timely manner. This audit directly addresses this key area of performance.

⁴ 45 U.S.C. §231(h)(2).

⁵ RRB OIG, *Financial Impact of Injury Settlements Awarding Service Months to Qualify Railroad Employees for Occupational Disability Benefits*, 14-08 (Chicago, IL.: July 18, 2014).

⁶ RRB, *Performance and Accountability Report, Fiscal Year 2014* (Chicago, IL.: November 2014).

Objective

The audit objective is to determine if internal controls are adequate to ensure that railroad employers are reporting creditable service and compensation related to injury settlements, including the proper allocation of service months, in accordance with RRB regulations.

Scope

The scope of this audit is creditable compensation under the RRA, reported to the RRB as part of injury settlements, from July 1, 2011 through June 30, 2014.

Methodology

To accomplish the audit objective, we:

- identified criteria from Government Accountability Office's (GAO) *Standards for Internal Control in the Federal Government*,⁷
- reviewed applicable laws and regulations;
- reviewed agency documentation, including policies and procedures;
- interviewed agency management and staff;
- identified examples of non-compliance with agency regulations;
- determined the dollar impact on the RRB trust funds (the annuities involved affect more than one RRB trust fund) for each of the examples identified in this report; and
- estimated the upper limit of the financial impact of improper allocation of service and compensation related to injury settlements.

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 June 2014 through October 2014.

⁷ GAO, *Standards for Internal Control in the Federal Government*, GAO/AIMD-00-21.3.1 (Washington, D.C.: November 1999).

RESULTS OF AUDIT

Our audit determined that internal controls are not adequate to ensure that railroad employers are reporting creditable service and compensation related to injury settlements, including the proper allocation of service months, in accordance with RRB regulations. The RRB's Office of Programs:

- does not track creditable compensation and service months reported as part of an injury settlement;
- does not require documentation to support the reported service and compensation; and
- does not have adequate controls to ensure that service and compensation are reported in compliance with agency regulations.

The total financial impact of non-compliance cannot be determined due to the RRB's lack of monitoring, documentation, and controls; however, the RRB trust funds lost between \$3,000 and \$11,000 for each identified instance of non-compliance. Approximately 4,000 non-fatal, on-the-job injuries are reported to the Federal Railroad Administration each year.⁸ If all of these injuries resulted in injury settlements with creditable service and compensation, the RRB trust funds could lose between \$12 and \$44 million per year due to non-compliance with RRB regulations related to the allocation of service and compensation in an injury settlement.

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

Lack of Monitoring over Creditable Compensation Related to Injury Settlements

The RRB does not have adequate monitoring controls over creditable compensation reported as part of an injury settlement. To accomplish the audit objective, we sought to examine the injury settlements that resulted in service month credits for all cases from July 1, 2011, through June 30, 2014. When we requested this information, management in the RRB's Office of Programs (Management) told us that there was no single repository for this information. Although Management provided sources of partial information, they could not provide a complete listing.

GAO's *Standards for Internal Control in the Federal Government (Standards)* provides that agency management should assess and continually monitor program performance to provide reasonable assurance that the agency is achieving its objectives. The *Standards* also provide that information should be recorded and communicated to management and others to enable them to carry out their responsibilities. In addition, the *Standards* identify risk assessment as a necessary component of internal control.

⁸ Federal Railroad Administration, Office of Safety Analysis (fra.dot.gov/OfficeofSafety) Query ran on July 14, 2014.

Management needs to comprehensively identify risk and in doing so should consider all significant interactions between the entity and other parties.

Management stated that they do not need to specifically track creditable compensation reported as part of an injury settlement. They further stated that they do not see any business or legal reason to distinguish creditable compensation reported as part of an injury settlement any differently than the reporting of regular service and compensation. Management currently relies on Internal Revenue Service (IRS) audits, RRB railroad employer audits, and employee protests to address the risk of improperly reported creditable compensation and service months. However, these three controls do not reduce the risk of improper payments to an acceptable level. IRS audits address taxable compensation under the Railroad Retirement Tax Act (RRTA), not creditable compensation under the RRA. While RRB railroad employer audits do address creditable service and compensation, the audit program does not directly include steps to review service and compensation reported as part of an injury settlement. While employee protests may be useful in identifying under reported or unreported service and compensation, employees may not have a sufficient understanding of RRB regulations to ensure that the allocation of service months in their injury settlements complies with the regulations. Lastly, employees would have no incentive to protest over reported service and compensation.

Due to a lack of information, Management does not know how many individuals qualify for an RRB annuity based on the service months reported as part of an injury settlement. Therefore, Management cannot assess the risks related to individuals qualifying for RRB annuities through an injury settlement. Management does not know the number of these cases nor the dollar amount of benefits paid to these annuitants. Without this information, Management cannot make informed decisions concerning the volume, dollar amount, or appropriateness of service month credits arising from injury settlements. Consequently, the RRB is not adequately addressing the risk of over reported service and compensation that results in eligibility for an RRB annuity or a higher annuity payment.

Recommendation

1. We recommend that the Office of Programs track creditable compensation related to injury settlements and the effect on benefit eligibility.

RRB Management's Comments & Our Response

The Office of Programs did not concur with recommendation 1. The Office of Program's response to recommendations 1 and 2 are summarized in this report following recommendation 2 and the full text of their response can be found in Appendix I.

We continue to believe that as part of a robust system of internal controls it is necessary for the Office of Programs to track creditable compensation related to injury settlements in order to ensure that the agency is paying benefits to individuals who are eligible, and

to reduce the risk of improper payments. As discussed in this report, internal control standards provide that information should be recorded and communicated to management and others to enable them to carry out their responsibilities.

Inadequate Controls to Ensure Employer Compliance with Regulations

The RRB does not have adequate controls to ensure compliance with agency regulations related to service months awarded through an injury settlement. RRB regulations require that employers allocate “pay for time lost” to the months in which the time is actually lost; that the allocation relates to the employee’s normal monthly pay; and that the employee must maintain an employment relationship with an employer for any month credited. The employment relationship ends when an employee resigns, relinquishes his or her rights, or retires. Ordinarily, the compensation allocated to each month credited as part of a settlement should be at least ten times the employee's daily pay rate in order to be an acceptable relationship to normal monthly pay.

The RRB does not require railroad employers to submit documentation, such as settlement documents or allocation worksheets, to support service and compensation reported for injury settlements. The RRB does provide several types of employer education, including a “pay for time lost” allocation worksheet on its web site. While education may lower the number of unintentional reporting mistakes by employers, it does not prevent or detect any mistakes that do occur.

GAO’s *Standards* provides that internal control and all transactions need to be clearly documented, and the documentation should be readily available for examination. The *Standards* also provide that the agency must have control activities to help ensure that all transactions are completely and accurately recorded. Information from agency operations needs to be available to determine whether the agency is achieving its compliance requirements under various laws and regulations.

Management does not require documentation supporting reported “pay for time lost” because they do not see a legal or business need for specific controls over this area. Management considers service and compensation reported as part of an injury settlement to be the same as any other service and compensation reported by employers. Therefore, they do not require “pay for time lost” for injury settlements to be specifically identified on service and compensation reports. As a result, they cannot assess compliance with regulations.

The OIG considers service reported due to an injury settlement to be a higher risk than other compensation because the injury settlement is often used to provide the service months required to qualify for an RRB retirement or disability annuity. As such, the parties involved in the injury settlement, employer and employee, have a vested interest in qualifying the employee for an annuity. The employee receives a lifetime annuity from the RRB, at a minimal cost to the railroad employer. While the railroad employer has to pay any railroad retirement taxes due on the reported compensation, they have no

additional financial responsibility to the employee related to the RRB retirement or disability annuity.

The RRB cannot identify all annuities that are based, in part, on service credited through an injury settlement. Therefore, the agency cannot determine the risk of improper payments related to injury settlements. While this prevented the OIG from quantifying the overall risk of non-compliance and estimating the total dollar impact, we were able to identify three examples of non-compliance. We found:

- one example where five service months were reported prior to the date of injury, which resulted in an improper payment of approximately \$11,000; and
- an additional two examples of reported compensation that did not meet the minimum required to relate to normal monthly pay (i.e., ten times the employee's daily rate of pay). If the railroad employers had reported the additional compensation necessary to meet the minimum requirement, the RRB trust funds would have received over \$3,000 in additional taxes for each individual.

Recommendation

We recommend that the Office of Programs:

2. implement controls to ensure compliance with agency regulations related to service months credited from an injury settlement. At a minimum, the agency should require railroad employers to submit supporting documentation for any service and compensation reported as part of an injury settlement. The documentation should include both the legal settlement and an allocation worksheet. This documentation should be readily available for examination and periodically reviewed.

RRB Management's Comments & Our Response

The Office of Programs did not concur with recommendation 2.

Regarding recommendations 1 and 2, the Office of Programs indicated that employers covered under the RRA are required by law to accurately report service and compensation paid to their employees for services rendered. The service and compensation agreed to in an injury settlement is reported on the Forms BA-3, Annual Report or BA-4, Adjustment Report. The Office of Programs stated that in order to ensure accurate reporting of injury settlements it would need to establish a new information collection that would require compliance by all employers. This collection would require clearance from the Office of Management and Budget (OMB) since it will establish a new reporting burden and would still rely on the employers to report settlement information and fail to resolve some of the issues with non-reporting identified in the audit.

The Office of Program's response explains challenges in collecting information through two forms, though does not provide alternatives to meet the intent of the recommendations, which is to improve controls over tracking and to ensure compliance with agency regulations related to service months credit from an injury settlement. As we have previously stated in this report, the OIG believes that existing controls are inadequate to ensure that railroad employers are reporting creditable service and compensation related to injury settlements, including the proper allocation of service months, in accordance with RRB regulations. A robust system of internal controls serves to both detect and prevent errors. We do not believe that existing controls are adequate for the following reasons:

- The legal reporting requirement does not prevent or detect an intentional or unintentional error in reporting of service and compensation and we identified no compensating controls. The RRB is ultimately responsible for ensuring that control activities assure that information is both complete and accurate.
- The BA-4 is used for any kind of adjustment and there is no required annotation to show if the adjustment is for an injury settlement or another reason unless reporting an adjustment outside of the statute of limitations. Various straightforward options could be considered to modify the form, and thus provide the Office of Programs the information needed to help carry out its internal control responsibilities. Without collecting any information, Management has no basis on which to assess if service and compensation are being reported accurately or identify potential outliers or anomalies in reporting that could indicate necessary follow-up or oversight.
- Although the Office of Programs has some controls over the accuracy of service and compensation reported on annual (BA-3) and adjustment (BA-4) reports, these controls would not prevent or detect errors in the allocation of service months resulting from injury settlements. The RRB simply trusts that they are accurate without a mechanism to verify their accuracy.

Further, in its response, the Office of Programs indicated that if changes to the BA-3 and BA-4 were approved by OMB, it would have to revise every reporting medium and restructure the EDM database to store this new information, for little, if any return.⁹ We do not believe this conclusion is supported. Without information on the full extent of injury settlements, which could serve as the basis for identifying errors, it is unlikely that the Office of Programs could properly estimate the return on investment as a result of the changes. In the three examples we were able to identify, we found approximately \$17,000 in improper payments.

⁹ EDM - The Employment Data Maintenance (EDM) system contains the service and compensation for all individuals who have worked in railroad service.

Finally, the Office of Programs stated that the Audit and Compliance Section (ACS) in the Bureau of Fiscal Operations reviews injury settlements as part of their railroad employer audit process and that during each audit, auditors routinely look and ask for any indication that the employer paid “pay for time lost” awards and request information on “pay for time lost” in the initial Information Document Request (IDR). Based on our audit work, we disagree with this assertion. We found that ACS does not routinely look at the allocation of service and compensation months for injury settlements as part of their audit process for railroad employers. In addition, although ACS may ask for information on injury settlements in its IDR to railroad employers that are to be audited, a review of their audit guide found that it does not include specific steps to look at the allocation of service months for injury settlements. Without audit steps, there is no assurance that this information is being reviewed and for what purpose. Moreover, even if their audit guide included steps for reviewing the allocation of service months for injury settlements, they have only completed audits for an average of three railroad employers per year; therefore, it would take many years before their audits would cover all railroad employers.

Although the Office of Programs did not concur with recommendations 1 and 2, they agreed to take some steps including: develop an annual reminder to request that employers report all settlements to the RRB; provide training on pay for time lost and injury settlements during the National Rail Employer Training Seminar (NRETS) and at any other appropriate employer training opportunities; and establish dialogue with applicable industry representatives to discuss this area of reporting and to ensure proper awareness of reporting requirements. We do not believe that these steps provide adequate controls to ensure the proper allocation of service months or that all settlements are recorded or tracked. These steps continue Management’s reliance on self-reporting by employers when employers may have a vested interest in qualifying the employee for an annuity.

Recommendation

We recommend that the Office of Programs:

3. request adjustment reports from the railroad employers to correct improperly reported service and compensation, recover the improper payment, and determine what, if any, actions can be taken to recover the lost taxes in the examples we cited in this report.

RRB Management's Comments & Our Response

Regarding this recommendation, the Office of Programs stated that it had reviewed the cases cited in this audit report and will contact the employers and request the corrections to the employee records based on the audit findings. Once the corrections to the employee accounts have been received, the Office of Programs indicated that it will determine if adjudicative actions are needed. Further, the Office of Programs stated that it will refer any related tax information to the IRS since it is the responsibility of the employer to properly submit their tax deposits under the RRTA. The administration of the RRTA falls under the purview of the IRS.

If implemented, the actions described above should satisfy the intent of the recommendation. We would, however, like to emphasize the importance of correcting any improper payments that have been identified.



UNITED STATES GOVERNMENT

MEMORANDUM

January 12, 2015

TO : Heather J Dunahoo
Assistant Inspector General for Audit

FROM: Janet M. Hallman *Janet M. Hallman*
Director of Program Evaluation and Management Services
For Director of Programs

SUBJECT: Adequate Controls over Creditable Compensation Related to Injury Settlements

This is in response to the OIG audit to determine if the Railroad Retirement Board (RRB) has adequate controls over creditable compensation that is reported due to injury settlements. Based on our analysis which is explained below, we do not concur with your findings that the controls over creditable compensation that reported due to injury settlements are inadequate.

OIG Recommendation #1

We recommend that the Office of Programs track creditable compensation related to injury settlements and the effect on benefit eligibility.

OIG Recommendation #2

We recommend that the Office of Programs implement controls to ensure compliance with agency regulations related to service months credited from an injury settlement. At minimum, the agency should require railroad employers to submit supporting documentation for any service and compensation reported as part of an injury settlement. The documentation should include both the legal settlement and an allocation worksheet. This documentation should be readily available for examination and periodically reviewed.

OP Response

We do not concur with the recommendations.

Employers covered under the Railroad Retirement Act are required by law to accurately report service and compensation paid to their employees for services rendered. The service and compensation agreed to in an injury settlement is reported on the Forms BA-3, Annual Report or BA-4, Adjustment Report. In order to ensure accurate reporting of injury settlements we would need to establish a new information collection that would require compliance by all employers. This collection would require clearance from the Office of Management and Budget since it will establish a new reporting burden. However this new collection would still rely on the employers to report settlement information and fail to resolve some of the issues with non-reporting

identified in the audit. If approved by OMB, we would have to revise every reporting medium and restructure the EDM database to store this new information, for little, if any return.

Additionally, the Audit and Compliance Section (ACS) in the Bureau of Fiscal Operations does review injury settlements as part of their Railroad Employer audit process. During each, auditors routinely look and ask for any indication that the employer paid Pay for Time Lost Awards and request information on pay for time lost in the initial Information Document Request (IDR).

We do, however, plan on taking the following actions to ensure that employers properly report service and compensation related to injury settlements.

- Develop an annual reminder to request that employers report all settlements to the RRB.
- Provide training on pay for time lost and injury settlements during the NRETS and at any other appropriate employer training opportunities.
- Establish dialogue with applicable industry representatives to discuss this area of reporting and to ensure proper awareness of reporting requirements.

OIG Recommendation #3

We recommend that the Office of Programs request adjustment reports from the railroad employers to correct improperly reported service and compensation, recover the improper payment and determine what, if any, actions can be taken to recover the lost taxes in the examples we cited in the report.

OP Response

We have reviewed the cases cited in the audit report and we will contact the employers and request the corrections to the employee records based on the audit findings. Once the corrections to the employee accounts have been received cases we will determine if adjudicative actions are needed.

We will refer any related tax information to the Internal Revenue Service since it is the responsibility of the employer to properly submit their tax deposits under the Railroad Retirement Tax Act (RRTA). The administration of the RRTA falls under the purview of IRS.