



UNITED STATES RAILROAD RETIREMENT BOARD

OFFICE OF INSPECTOR GENERAL

Fiscal Year 2005 Financial Statement Audit

LETTER TO MANAGEMENT
Report No. 06-01, November 15, 2005

To the Board Members:

We audited the consolidated financial statements of the Railroad Retirement Board (RRB) and have issued our report thereon dated October 27, 2005, in which we rendered an unqualified opinion. We conducted our audit in accordance with U. S. generally accepted government auditing standards and the Office of Management and Budget's (OMB) audit guidance.

In planning and performing this audit we considered internal control in order to determine our auditing procedures for the purpose of issuing our report on the RRB's principal financial statements and not to provide assurance on internal control. The maintenance of adequate internal control designed to fulfill the RRB's control objectives is the responsibility of management. Because of inherent limitations in any system of internal control, errors or irregularities may nevertheless occur and not be detected. Also, controls found to be functioning at a point in time may later be found deficient because of the performance of those responsible for applying them. There can be no assurance that controls currently in existence will prove to be adequate in the future as changes take place in the organization.

A material weakness is a reportable condition that precludes the entity's internal controls from providing reasonable assurance that material misstatements in the financial statements, required supplementary information, or performance measures would be prevented or detected on a timely basis. Reportable conditions are matters coming to our attention that, in our judgment, should be communicated because they represent significant deficiencies in the design or operation of internal control that could adversely affect the RRB's ability to meet its internal control objectives.

In our auditor's report dated October 27, 2005, we reported material weaknesses in the RRB's information security program, performance measurement program and the actuarial projection process. We also described reportable conditions related to compliance with the Prompt Payment Act and accounting for leases. During our audit, we also noted other matters involving the RRB's internal control structure and its operation. The details of our findings concerning internal control are presented in the attached summary memorandum. However, neither this

letter, nor the attached memorandum, modifies our report dated October 27, 2005, referred to in the first paragraph of this letter.

Our work was not conducted for the primary purpose of making detailed recommendations about the RRB's system of internal control. Had we done so, other matters might have come to our attention that we would have reported to you.

This report is intended solely for the information and use of the management of the RRB, OMB, and Congress, and is not intended to be and should not be used by anyone other than these specified parties.

We wish to express our appreciation for the many courtesies and cooperation extended to us during the audit.

Very truly yours,

A handwritten signature in black ink that reads "Martin J. Dickman". The signature is written in a cursive style with a long horizontal line extending from the end of the name.

Martin J. Dickman
Inspector General

October 27, 2005

Memorandum on Internal Control

Material WeaknessesInformation Security

During FY 2005, the OIG evaluated information security pursuant to the provisions of the Federal Information Security Management Act.¹ Our review disclosed continued weaknesses in many areas of the RRB's information security program. Significant deficiencies in program management and access controls make the agency's information security program a source of material weakness in internal control.

The RRB has undertaken the job of strengthening information security and has implemented many corrective actions recommended by the OIG and other technical specialists. However, the agency has not completed the corrective action needed to eliminate the previously reported deficiencies in training and access controls that were the basis for the OIG's original finding of material weakness. In FY 2005, we reported that the RRB is experiencing difficulty in achieving an effective, FISMA compliant security program and reported two new significant deficiencies resulting from delays in meeting FISMA requirements for risk assessments and periodic testing and evaluation.

Performance Measures

The RRB needs to strengthen internal control over the measurement and presentation of performance measures reported pursuant to the Government Performance and Results Act of 1993 (GPRA). GPRA requires Federal agencies to establish program goals, measure performance and report annually on their accomplishments. OMB currently requires that these reports be published with agency financial statements as part of an integrated performance and accountability report.

Existing controls over the measurement of agency performance do not include verification of data generated by automated systems. As a result, the RRB has not adequately ensured that performance information presented as required supplementary information has been recorded, processed, and summarized to permit preparation of performance information in accordance with management's criteria.

During FY 2005, the OIG performed detailed tests of two performance indicators. Audit tests disclosed that the RRB had materially overstated its performance with respect to timeliness because claims had been misclassified and system generated

¹ "Fiscal Year 2005 Evaluation of Information Security at the Railroad Retirement Board," OIG Report #05-11, September 28, 2005

data did not include all processing time.² As a result, the agency has withdrawn prior-year performance information for those two indicators and qualified its presentation of current-year performance. Inaccuracies in other performance indicators may have occurred and not been detected or disclosed to users of the information.

In response to the OIG's initial findings, the RRB implemented a management attestation process to clarify responsibility for performance data; however, that initiative did not adequately ensure that data would be verified or supporting documentation retained.

1. We recommend that the RRB ensure that the internal control process for performance indicators includes validation of data and retention of supporting documentation.

Actuarial Projection Process

The RRB needs to strengthen controls over the actuarial projection process that supports the projections and estimates presented in the statement of social insurance and related disclosures which are published with the agency's financial statements as required supplementary stewardship information.

During FY 2005, the OIG performed a detailed evaluation of controls over the actuarial projection process that disclosed inadequacies in internal control over the projections and related reports.³ Although responsible management and staff have described extensive controls over the preparation of projections, estimates and reports, they have not formalized their policies and procedures, do not capture evidence of the operation of controls and do not perform periodic evaluations of compliance with internal requirements.

Implementation of prior OIG recommendations for corrective action is pending.

Reportable Conditions

Controls Over Compliance with the Prompt Payment Act

The RRB needs to strengthen controls to ensure compliance with the Prompt Payment Act.

During FY 2005, the OIG performed a detailed evaluation of controls over compliance with the Prompt Payment Act and concluded that existing systems and

²"Review of Customer Service Performance Measures For Timeliness of Initial Railroad Retirement Annuity Payments," OIG Report #05-05, May 17, 2005

³"Review of Internal Control Over the Actuarial Projection Process," OIG Report #05-04, May 5, 2005

procedures had not been effective in ensuring that interest is paid to vendors in accordance with the requirements.⁴ The RRB does not identify all invoices on which interest should be paid and does not pay the correct amount of interest when a late payment is recognized. In addition, controls are not adequate to ensure that required restrictions on early payment have been properly implemented.

Many of the problems identified by our audit had been reported repeatedly in the agency's internal assessments of Prompt Payment Act compliance; however, that process was not adequate to disclose the overall impact of errors or effect changes in agency performance.

Implementation of prior OIG recommendations for corrective action is pending.

Accounting for Leases

The RRB does not have adequate controls to ensure that leases are properly classified, justified and reported. Existing procedures do not include formal evaluation and documentation of pre-contract review to identify capital leases and ensure their proper recording and reporting. As a result, capital leases may not be treated in compliance with established requirements for budgetary and proprietary accounting.

During our review, we questioned the classification of an agency lease for a mainframe computer processor that was being expensed as an operating lease rather than capitalized. We were advised that existing agency documentation would not support a response and additional research would be required. Capital leases are treated differently than operating leases for both budgetary and proprietary accounting.

We recommend that the Division of Acquisitions Management:

2. implement a pre-contract review process to document agency justification, classification and financial reporting determination for lease agreements.
3. complete its review of the lease questioned by the audit to determine whether it is a capital or operating lease and the effect of that determination on the accounting and reporting of that lease.

⁴ Review of Compliance with the Prompt Payment Act," OIG Report #05-06, June 15, 2005

OTHER MATTERS INVOLVING INTERNAL CONTROLComputation of Prompt Payment Act Interest

The Federal Financial System (FFS) is using incorrect interest rates to compute interest under the Prompt Payment Act.

4. We recommend that the Bureau of Fiscal Operations (BFO) implement procedural and/or programming changes to ensure that the proper interest rates are used.

Separation of Duties

The Office of Programs has not provided for adequate separation of duties and supervisory review of taxes withheld from benefit payments. A single individual is responsible for identifying periodic withholding, calculating a grand total, entering the details of the transaction to the electronic payment system, and authorizing the transfer of funds.

For calendar year 2003, the RRB paid the U.S. Treasury approximately \$1 million more in taxes than was actually withheld from benefit payments. The incorrect fund transfers were self-authorized by the individual entering the data.

5. We recommend that the Office of Programs take action to ensure proper separation of duties and supervisory review of tax transfer transactions.

Pending Tax Credits Not Recorded Timely

For calendar year 2003, the RRB paid the U.S. Treasury approximately \$1 million more than was actually withheld in taxes from individuals. At least \$800,000 of the overpayment was made in August of 2003. The RRB filed for a credit in March 2004 which was subsequently used to reduce the amount of taxes paid in December 2004.

The Office of Programs, which is responsible for processing these transactions, did not advise BFO of the pending credit until it had been used. As a result, the agency's FY 2004 financial statements understated the related receivables and overstated benefit expense.

6. We recommend that the Office of Programs establish a procedure for the timely communication of overpayments and underpayments to BFO.

Validation and Reconciliation of Personnel Record Changes

RRB employee personnel records are maintained in the General Services Administration (GSA) payroll system. Bureau of Human Resources (HR) regularly updates employee records for various reasons such as step increases, promotions, and other personnel actions. Employees can also update selected data in their personnel records. The GSA system provides HR with reports documenting the record changes or suspected errors. In response to these reports, HR validates the changes or corrects the errors.

HR has not formalized its procedures for validating or correcting changes to employee personnel records. In addition, HR does not retain copies of the reports provided by GSA and does not retain documentation to support actions taken by HR in response

We recommend that HR:

7. develop written procedures to document their investigation procedures, and
8. maintain records of the exceptions and results of investigation and reconciliation.

Verification of Department of Labor Transfers

The RRB records funds transferred from the Department of Labor's (DOL) Unemployment Trust Fund without confirming the actual receipt of these funds in RRB accounts.

Although BFO confirms the transfers-out from the DOL's Unemployment Trust Fund, the systems consulted indicate only that a transfer was made from DOL but do not indicate the account receiving the funds. As a result, identification of errors or discrepancies would be delayed until disclosed during the cash reconciliation process.

9. We recommend that the RRB confirm the receipt of transfers from the DOL's Unemployment Trust Fund in the proper RRB accounts soon after the transfer occurs.

MANAGEMENT'S RESPONSE

Management has agreed to review our findings and recommendations and will advise the OIG of their planned actions through the regular audit follow-up process.