

**OFFICE OF INSPECTOR GENERAL**

# **Audit Report**

**Assessment of the Federal Managers' Financial Integrity Act  
Process at the Railroad Retirement Board**

**Report No. 07- 05  
April 30, 2007**



**RAILROAD RETIREMENT BOARD**

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## INTRODUCTION

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This report represents the results of the Office of Inspector General's (OIG) audit of the Federal Managers' Financial Integrity Act process at the Railroad Retirement Board (RRB).

### Background

The Federal Managers' Financial Integrity Act (FMFIA) of 1982 (Public Law 97-255 codified in 31 U.S.C. 3512) requires Executive branch agencies to establish and maintain internal control to ensure that Federal programs operate efficiently, effectively, and in compliance with relevant laws. Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Internal Control*, was created to implement the FMFIA. Management is responsible for developing and maintaining effective internal control. Effective internal control provides assurance that significant weaknesses in the design or operation of internal control, that could adversely affect the agency's ability to meet its objectives, would be prevented or detected in a timely manner.

Agencies are also required to provide certain assurances regarding the effectiveness of the internal controls and financial management systems that support the preparation of agency financial statements. Assurance statements related to the FMFIA and compliance with the Federal Financial Management Improvement Act (FFMIA) are provided in the annual Performance and Accountability Report (P&AR).<sup>1</sup> Assurances regarding compliance with the FFMIA are required for agencies subject to the Chief Financial Officers Act.

The RRB created the Management Control Review Committee (MCRC) to establish and oversee a process to identify and eliminate management control weaknesses and financial non-conformances. The MCRC is responsible for ensuring the adequacy of corrective action plans and preparing the information required by FMFIA for inclusion in the agency's annual P&AR. The RRB uses the management control review process as a means of reviewing critical agency processes in order to provide reasonable assurance of the effectiveness and efficiency of agency programs and operations.

The MCRC prepared a Management Control Guide in December 2006 to provide guidance for compliance with FMFIA. Agency managers prepare management control documentation for the agency's assessable units

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<sup>1</sup> These assurances are required by OMB Circular A-136, *Financial Reporting Requirements*.

and submit it to the MCRC. Assessable units, defined by agency management, encompass all agency activities that can impact the RRB's mission. Periodic management control reviews are conducted for the assessable units. Agency managers and office heads prepare certifications annually which assess their unit's substantial compliance with the requirements of the FMFIA.

This audit addresses the RRB's strategic objective to ensure effectiveness and efficiency of operations.

### **Objective, Scope and Methodology**

The audit objectives were to determine whether:

1. management assurance statements comply with the requirements of OMB Circular A-123 and are fully supported by management control documentation, and
2. management control guidance and documentation satisfy the requirements of the FMFIA and OMB Circular A-123.

To accomplish the audit objectives, we:

- ◆ identified the criteria provided in the FMFIA and OMB Circular A-123;
- ◆ compared the management control guidance provided on the MCRC's website on the RRB Intranet to the criteria provided in the FMFIA and OMB Circular A-123;
- ◆ compared the most current management control review documentation as of December 31, 2006 for each assessable unit to the criteria provided in the FMFIA and OMB Circular A-123;
- ◆ compared the management assurance statements included in the Fiscal Year 2006 P&AR to the guidance provided in FMFIA, OMB Circular A-123 and the FFMIA;
- ◆ reviewed the annual management certifications to determine if they sufficiently support the management assurance statements made in the Fiscal Year 2006 P&AR; and
- ◆ interviewed members of the MCRC.

Our work was performed in accordance with generally accepted government auditing standards as applicable to the objectives. Fieldwork was conducted during January through March 2007 at RRB headquarters in Chicago, Illinois.

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## RESULTS OF AUDIT

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We found that the assurance statement regarding compliance with the FFMIA provided in the RRB's Fiscal Year 2006 P&AR was not applicable for the RRB and the assurances provided regarding the reliability of performance information are not supported by MCRC documentation.

We determined that other assurance statements were supported by MCRC documentation and the other guidance provided by the MCRC was in accordance with FMFIA and OMB Circular A-123 guidance.

We also found that the MCRC needs to:

- ◆ improve the effectiveness of the management control review process to identify control objectives and develop control techniques,
- ◆ increase the frequency of reviews, and
- ◆ prioritize the schedule of future management control reviews.

The details of our findings and recommendations follow.

### **FFMIA Assurance Statement and Guidance Not Applicable for the RRB**

The management assurance statement made in the RRB's Fiscal Year 2006 P&AR regarding compliance with the FFMIA was not applicable for the RRB. It stated, "The financial management systems of this agency provide the agency with reliable, timely, complete, and consistent performance and other financial information to make decisions and efficiently operate and evaluate programs and substantially satisfy the requirements of the Federal Financial Management Improvement Act §803(a), the Government Performance and Results Act, and OMB Circular A-11."

The FFMIA assurance statement is only applicable for agencies subject to the Chief Financial Officers (CFO) Act. The RRB is not a CFO Act agency.<sup>2</sup>

The RRB reported compliance with the FFMIA because the agency was emulating CFO Act agencies. Internal agency management control documentation asserted compliance with the CFO Act because the instructions are provided in the Management Control Guide.

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<sup>2</sup> CFO Act agencies are identified in Appendix A of OMB Bulletin 06-03, *Audit Requirements for Federal Financial Statements*.

This assurance statement provides readers of the P&AR with information which implies that the RRB is subject to the CFO Act.

### Recommendations

The Management Control Review Committee should:

1. remove all references to compliance with the FFMIA from the Management Control Guide, and
2. exclude assurances regarding compliance with FFMIA in future Performance and Accountability Reports.

### Management's Response

The Management Control Review Committee concurs with the recommendations. The full text of management's response is included in the Appendix to this report.

### **Lack of Support Regarding the Reliability of Performance Information**

The MCRC does not have sufficient support for the management assurance statement provided in Fiscal Year 2006 P&AR regarding the reliability of performance information. The RRB is required to make assurance statements to satisfy the requirements of FMFIA § 2. The portion of the RRB's assurance statement made in the Fiscal Year 2006 P&AR regarding performance information states that the system of internal control for the agency is functioning and provides reasonable assurance as to the reliability of performance information.

The MCRC uses management control certifications to support the management assurance statements made in the annual P&AR. However, MCRC guidance does not require assurance statements regarding the reliability of performance information. As a result, assurances have been made for which the MCRC does not have documented evidence.

MCRC documentation and guidance also lacked the identification and testing of controls over performance measures. The OIG previously recommended that the MCRC include performance reporting in the management control review program.<sup>3</sup> The MCRC's response to the

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<sup>3</sup> OIG audit report *Fiscal Year 2006 Financial Statement Audit Letter to Management*, Report No. 07-01 dated February 9, 2007 (recommendation number 8)

audit recommendation states that the Management Control Guide will be revised to require testing of the controls over performance indicator data used for the Annual Performance Plan in the P&AR. As a result of this pending issue, no additional recommendation is made.

### Recommendation

3. The Management Control Review Committee should revise the Management Control Guide to require that the control certifications include assurances regarding the reliability of performance information.

### Management's Response

The Management Control Review Committee concurs with the recommendation. The full text of management's response is included in the Appendix to this report.

### **Management Control Review Process has not been Effective in Identifying Control Objectives or Developing Control Techniques**

The RRB's management control review process has not been effective in identifying control objectives or developing control techniques. This process has not been effective because it did not identify the weaknesses in the control assessment for various assessable units.

A comprehensive system of internal control includes a risk assessment process, implementation of appropriate control activities, and monitoring to assess the quality of performance over time. The RRB established the MCRC to oversee the agency's internal control assessment process and provide guidance to managers in performing the individual evaluations that support the assessment of the adequacy of internal control agency wide.

The MCRC reviewed and accepted documentation regarding control effectiveness even though there were numerous instances of:

- ◆ control techniques describing procedures and statements that are insufficiently detailed to determine how they function as internal controls;
- ◆ control objectives that do not completely address the agency's mission or satisfy FMFIA objectives;

- ◆ control techniques that do not fully meet the assessable unit's control objectives;
- ◆ control techniques that are not operating effectively; and
- ◆ control techniques being considered "effective" even though they have not been tested.

In addition, financial assertions defined by the Government Accountability Office (GAO) and the President's Council on Integrity and Efficiency (PCIE) are not used as objectives for the RRB's 23 financial assessable units. The FMFIA requires that agencies provide reasonable assurance for the preparation of accounts and reliable financial and statistical reports. GAO and PCIE guidance provided in the *Financial Audit Manual* explains that the financial statement assertions are management representations that are embodied in the financial statements. The financial assertions currently defined are existence or occurrence, completeness, rights and obligations, valuation or allocation, and presentation and disclosure.

The three objectives of internal control (effectiveness and efficiency of operations, compliance with laws and regulations, and reliability of financial reporting) are not always stated as separate objectives.

Our review of the management control documentation shows that, while some of the control techniques address the internal control objectives as well as some of the financial assertions, they should be stated as separate objectives to obtain assessable unit wide coverage.

Guidance issued by the MCRC does not require the use of these objectives. Many of the control objectives and techniques formally reviewed and approved by the MCRC are very old because recent management control reviews have not been conducted for them. Since many of the documents were formally reviewed and approved by the MCRC, more emphasis has been placed on controls to prevent fraud and OMB has revised OMB Circular A-123.

As a result of these conditions, agency management does not have an adequate basis for reliance on the management control review when providing assurance on the effectiveness of internal control agency wide.

## Recommendations

The Management Control Review Committee should:

4. develop a schedule for working with the assessable units to update their control objectives and techniques so that they meet agency and GAO standards for internal control;
5. revise the Management Control Guide to require that management control documentation include the three objectives of internal control: effectiveness and efficiency of operations, compliance with laws and regulations, and reliability of financial reporting; and
6. revise the Management Control Guide to require that management control documentation include the financial assertions as defined in the GAO and PCIE Financial Audit Manual.

## Management's Response

The Management Control Review Committee concurs with the recommendations. The full text of management's response is included in the Appendix to this report.

### **Infrequent Management Control Reviews**

Based on the current management control review schedule, the OIG determined that between 9 to 14 years will have elapsed for 13 assessable units from the date of their last management control review to the next scheduled review. In addition, seven assessable units have never been reviewed by the MCRC.

Continuous monitoring and testing should help to identify poorly designed or ineffective controls and should be reported upon periodically. Also, periodic assessments should be integrated as part of management's continuous monitoring of internal control.

A cause for infrequent reviews is that the MCRC allows responsible officials to postpone their management control reviews for various reasons, but the MCRC does not have documented guidelines for time extensions allowed. In addition, the MCRC recently eliminated a category of assessable units that were not scheduled for review and determined that every assessable unit should be reviewed once every five years and that some may warrant a more frequent review.

The effect of infrequent management control reviews increases the risk that control objectives, and techniques identified years ago insufficiently address the current work environment and new guidance provided by governing agencies. In addition, infrequent management control reviews do not provide for the tests of controls in a timely manner. As a result, controls that do not work may go undetected and may not prevent or detect errors and potential fraudulent situations.

### Recommendation

7. The Management Control Review Committee should define and document an allowable timeframe for requested extensions or postponements of management control reviews.

### Management's Response

The Management Control Review Committee concurs with the recommendation. The full text of management's response is included in the Appendix to this report.

### **No Priority Given to the Scheduling of Management Control Reviews**

The MCRC created a schedule to review every assessable unit once within a five-year period. However, management control documentation shows the need for more frequent reviews. For example, annual certifications prepared in calendar year 2006 for three assessable units indicate they cannot state that all control objectives are being accomplished. Only one was scheduled for a review during calendar year 2007, while the other two were scheduled for review in 2008 and 2011.<sup>4</sup> In addition, although the MCRC has recognized the possibility of performing management control reviews more frequently for some assessable units, those assessable units have not been identified.

Agency managers should continuously monitor and improve the effectiveness of internal control associated with their programs. This continuous monitoring, and other periodic assessments, should provide the basis for the agency head's annual assessment of and report on internal control, as required by the FMFIA.

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<sup>4</sup> The next management control review for these three assessable units are: Application Development in 2007; Records Management in 2008; and Human Resource Management in 2011.

The MCRC prepares a five-year management control review plan every year. Currently, the only criteria that the MCRC uses to schedule the next management control review is a period of five years after the last review. The MCRC's Management Control Guide indicates that some assessable units might be considered for more frequent review, such as those that are highly vulnerable or have high impact, as determined by the MCRC and the organization head.

According to the GAO publication *Standards for Internal Control in the Federal Government*, the scope and frequency of separate evaluations should depend primarily on the assessment of risks and the effectiveness of ongoing monitoring procedures. Separate evaluations may take the form of self assessments as well as review of control design and direct testing of internal control.

The MCRC follows its predefined management control review schedule. In addition, the MCRC has not formally defined criteria for use in prioritizing the order in which the assessable units are to be reviewed. Comments obtained from the MCRC explained that self-prepared risk assessments could be used in the future to identify the assessable units that warrant more or less frequent reviews. RRB risk assessments are self-assessed based on guidance provided by the MCRC in the Management Control Guide.

The absence of more frequent reviews for assessable units that are critical to the agency, based on risk or mission importance, could result in delaying the detection of control objectives that are not being accomplished. This could impact the achievement of the unit's mission.

### Recommendations

The Management Control Review Committee should:

8. revise the Management Control Guide to formally document criteria for identifying the assessable units that should be reviewed more frequently than once every five years;
9. identify the assessable units that should be reviewed more frequently than once every five years;
10. determine and document the timeframe in which the frequency of review will be re-evaluated; and

11. revise the Management Control Guide to reflect that the management control review schedule will be modified as necessary when potential deficiencies are reported.

#### Management's Response

The Management Control Review Committee concurs with the recommendations. The full text of management's response is included in the Appendix to this report.



UNITED STATES GOVERNMENT  
**MEMORANDUM**

APR 25 2007

**TO :** Henrietta B. Shaw  
 Assistant Inspector General for Audit

**FROM :** Management Control Review Committee

**SUBJECT:** Draft Audit Report: Assessment of the Federal Managers' Integrity Act Process at the Railroad Retirement Board

Thank you for giving us the opportunity to comment on your draft audit report dated April 11, 2007. We have reviewed the report and note that your office "found that the assurance statement regarding compliance with the FFMIA provided in the RRB's Fiscal Year 2006 P&AR was not applicable for the RRB and the assurances provided regarding the reliability of performance information are not supported by MCRC documentation." We plan to exclude from the Performance and Accountability Report (P&AR) the assurance statement regarding compliance with the FFMIA in the future and revise the Management Control Guide (MCG) regarding performance information in light of the new Administrative Circular RRB-2, Procedures for Documentation, Validation, and Certification of Performance Information. We also were pleased to note that your office determined "that other assurance statements were supported by MCRC documentation and the other guidance provided by the MCRC was in accordance with FFMIA and OMB Circular A-123 guidance."

There is one item in the report on which we would like to further comment. In the Background section of the report, you state "The MCRC prepared a Management Control Guide in December 2006...."

A number of years ago the Management Control Review Committee (MCRC) eliminated the paper guide and put the guidance on the MCRC web site. We received reports from the Responsible Officials that it was difficult to use the guidance without a comprehensive paper version. In 2006 the MCRC redeveloped a comprehensive guide and issued paper copies. The new revised guide is being used by the Responsible Officials for the first time this year.

The MCRC is already working on revisions of the guide based on our review of this year's submissions. These changes, along with the changes you are recommending, will be incorporated into the guide and a new guide reissued by December 31, 2007. The revised guide will be used in 2008.

Our comments on recommendations for the MCRC are as follows:

**Recommendations:**

- 1. Remove all references to compliance with the FFMI from the Management Control Guide.**

We will remove all references to compliance with the FFMI from the MCG.

Target date: January 31, 2008.

- 2. Exclude assurances regarding compliance with FFMI in future Performance and Accountability Reports.**

We will exclude assurances regarding compliance with FFMI in future P&ARs starting with fiscal year 2007.

Target date: January 31, 2008.

- 3. The MCRC should revise the Management Control Guide to require that the control certifications include assurances regarding the reliability of performance information.**

We will revise the MCG to require that the control certifications include assurances regarding the reliability of performance information in light of the new Administrative Circular RRB-2, Procedures for Documentation, Validation, and Certification of Performance Information.

Target date: January 31, 2008.

- 4. Develop a schedule for working with assessable units to update their control objectives and techniques so they meet agency and GAO standards for internal control.**

We will develop a schedule for working with assessable units to update their control objectives and techniques so they meet agency and GAO standards for internal control.

Target date: January 31, 2008.

5. ***Revise the Management Control Guide to require that management control documentation include the three objectives of internal control: effectiveness and efficiency of operations, compliance with laws and regulations, and reliability of financial reporting.***

We will revise the MCG to require that management control documentation include the three objectives of internal control.

Target date: January 31, 2008.

6. ***Revise the Management Control Guide to require that management control documentation include the financial assertions as defined in the GAO and PCIE Financial Audit Manual.***

We will revise the MCG to require that management control documentation include the financial assertions as defined in the GAO and PCIE Financial Audit Manual.

Target date: January 31, 2008.

7. ***The Management Control Review Committee should define and document an allowable timeframe for requested extensions or postponements of management control reviews.***

We will define and document a process for requesting extensions or postponements of management control reviews in the MCG, to include an allowable timeframe.

Target date: January 31, 2008.

8. ***Revise the Management Control Guide to formally document criteria for identifying the assessable units that should be reviewed more frequently than once every five years.***

We will revise the MCG to formally document criteria for identifying the assessable units that should be reviewed more frequently than once every five years.

Target date: January 31, 2008.

**9. Identify the assessable units that should be reviewed more frequently than once every five years.**

We will identify the assessable units that should be reviewed more frequently than once every five years.

Target date: January 31, 2008.

**10. Determine and document the timeframe in which the frequency of review will be re-evaluated.**

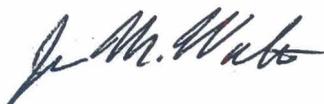
We will determine and document the timeframe in which the frequency of review will be re-evaluated.

Target date: January 31, 2008.

**11. Revise the Management Control Guide to reflect that the management control review schedule will be modified as necessary when potential deficiencies are reported.**

We will revise the MCG to reflect that the management control review schedule will be modified as necessary when potential deficiencies are reported.

Target date: January 31, 2008.



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