

OFFICE OF INSPECTOR GENERAL
Audit Report

**Fiscal Year 2009 Financial Statement Audit
Letter to Management**

**Report No. 10-03
March 11, 2010**



RAILROAD RETIREMENT BOARD



UNITED STATES RAILROAD RETIREMENT BOARD

OFFICE OF INSPECTOR GENERAL

Memorandum

March 11, 2010

Michael S. Schwartz
Chairman
U.S. Railroad Retirement Board

The purpose of this letter is to transmit a memorandum on internal control communicating certain matters concerning internal control that came to our attention during our recent audit of the Railroad Retirement Board's (RRB) financial statements.

We have audited the RRB's general purpose financial statements and issued our report thereon dated November 9, 2009, except for matters relating to the fair market value of the net assets of the National Railroad Retirement Investment Trust as of September 30, 2009, as to which the date was November 16, 2009. We performed our audit in accordance with U.S. generally accepted government auditing standards and OMB audit guidance as applicable to the scope of our audit.¹ We have not considered internal control since we obtained sufficient appropriate audit evidence to support the audit opinion on November 9, 2009; internal control was not among those matters to which we gave consideration between November 9th and November 16th.

During our audit, we noted certain matters involving the RRB's internal control structure and its operation that, individually, did not rise to the level of a significant deficiency, the details of which are presented in the attached memorandum. That memorandum also presents the full text of those matters previously reported as material weaknesses in conjunction with our opinion on the financial statements. However, neither this letter, nor the attached memorandum, modifies our report dated as of November 9, 2009 and November 16, 2009, referred to above.

Our observations concerning internal control were presented to responsible agency management who were offered the opportunity to review and comment on the draft memorandum. Their responses are also attached.

¹ See our report on the RRB's financial statements for a full description of the scope and methodology.

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.

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.

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

Very truly yours,

Original signed by ...

Martin J. Dickman
Inspector General

Attachments

cc: V.M. Speakman, Jr., Labor Member
Jerome F. Kever, Management Member
Kenneth P. Boehne, Chief Financial Officer
John M. Walter, Chair, Management Control Review Committee
Henry Valiulis, Senior Executive Officer
Steven A. Bartholow, General Counsel
Beatrice E. Ezerski, Secretary to the Board

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MATERIAL WEAKNESSES

In conjunction with the Office of Inspector General's (OIG) opinion on the RRB's financial statements for the fiscal years (FY) ended September 30, 2009 and 2008, we reported the following material weaknesses.¹

Information Security

During FY 2009 the OIG evaluated the RRB's information security program pursuant to the provisions of the Federal Information Security Management Act (FISMA).² OIG auditors concluded that although the RRB has implemented all nine program elements required by FISMA and made notable progress in addressing previously cited deficiencies, the security program, as a whole, remains undermined by weaknesses in access control and controls over the certification and accreditation process.

RRB information technology managers are working to address the remaining weaknesses.

Financial Reporting

RRB financial managers have worked to strengthen internal control over financial reporting during FY 2009. During the third quarter of FY 2009 the agency implemented enhanced controls to address the weaknesses that, in the aggregate, were the basis for the OIG's assessment of a material weakness during the prior year.³ However, because these enhanced controls were not implemented until mid-year, they could not be relied upon to ensure the accuracy of accounting and reporting for FY 2009 and had not been in operation for a period of time sufficient to support an assessment of overall effectiveness.

RRB financial managers have expressed their commitment to a quality financial reporting process and have been responsive to OIG recommendations.

Internal Control Over Non-Integrated Sub-Systems

Internal controls do not ensure the completeness of transactions originating in non-integrated sub-systems.

An organization's financial statements are presented with management's implicit assertion that all transactions and other events and circumstances that occurred

¹ "Report on the Railroad Retirement Board's FY 2009 Financial Statements," OIG Report No.10-02, November 20, 2009.

² "Fiscal Year 2009 Evaluation of Information Security at the Railroad Retirement Board," OIG Report No. 10-01, November 12, 2009.

³ "Fiscal Year 2008 Financial Statement Audit Letter to Management," OIG Report No. 09-02, March 2009.

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during a specific period and that should have been recognized in that period have, in fact, been recorded (completeness) and that liability, revenue, and expense components are recorded at appropriate amounts (accuracy, valuation, allocation).

The RRB's financial reporting structure relies on an automated general ledger which receives information electronically from both integrated and non-integrated sub-systems that support transaction processing. The RRB's control structure is not comprehensive with respect to the reconciliation of the general ledger to non-integrated sub-systems. As a result, errors in intermediary manual processes may occur and go undetected indefinitely.

The OIG has previously recommended that the RRB perform reconciliations of activity originating in non-integrated benefit payment sub-systems. We also brought this issue to management's attention in connection with our audits of agency financial statements for FYs 2000, 2001 and 2008. Although financial managers recently implemented a reconciliation process for one major sub-system, the current reconciliation process is not comprehensive with respect to all such systems and transaction flows.

RRB financial managers are receptive to evaluating the feasibility of implementing an expanded program of reconciliations with the understanding that such a program will require extensive cross-organizational coordination and cooperation. They have agreed to study the matter, together with program managers, in order to identify a solution that provides for a comprehensive reconciliation process with adequate separation of duties.

Recommendations

We recommend that the Bureau of Fiscal Operations (BFO):

1. inventory the various non-integrated processes that support financial accounting which should be subject to reconciliation; and
2. work with the Executive Committee to secure the cross-organizational cooperation necessary to implement a comprehensive reconciliation process with adequate separation of duties.

Management's Response

BFO has agreed to work with other bureaus and offices to inventory and study the various non-integrated processes that support financial accounting. They have also agreed to work with the Executive Committee to secure the cross-organizational cooperation necessary to implement a comprehensive reconciliation process. The full text of management's response is presented as Attachment 1 to this memorandum.

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OTHER MATTERS INVOLVING INTERNAL CONTROL

During our audit, we also noted certain other matters involving the RRB's internal control structure and its operation. Although these matters do not rise to the level of a material weakness or significant deficiency, either individually or in the aggregate, they represent areas in which control weaknesses increase the risk of error or mishandling.

The details of our observations and recommendations for corrective action follow.

Accounting Procedures Need Updating

During our audit, we found that agency accounting procedures are not always updated in a timely manner. Documented procedures provide guidance to internal and external sources regarding the agency's policy on various subjects and also identify specific directions for employees in carrying out their responsibilities.

The Bureau of Fiscal Operations (BFO) has not documented some of the detailed procedures for major accounting activities in the Accounting Procedures Guide. BFO management advised us that procedures are updated when time permits and that they do not have personnel designated to update procedures on a regular basis. We also found that BFO's Administrative Circular governing Budget Execution had not been updated since January 2000. It references outdated guidance, OMB Circular A-34, which was superseded by OMB Circular A-11, Preparation, Submission and Execution of the Budget. In order for these policies and procedures to be effective, they should be maintained and updated on a regular basis.

Recommendations

We recommend that BFO:

3. review the Administrative Circular governing Budget Execution and make updates as needed; and
4. ensure that procedures for major accounting activities are included in the Accounting Procedures Guide.

Management's Response

BFO has agreed to update the Administrative Circular governing Budget Execution. They have also agreed to ensure that procedures for major accounting activities are included in the Accounting Procedures Guide. The full text of management's response is presented as Attachment 1 to this memorandum.

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Personally Identifiable Information in the Trial Balance

During our audit, we identified various instances of employee names and social security numbers appearing on the hard copy of the trial balance. The purchasing system uses RRB employees' social security numbers as part of the Vendor/Provider number when processing transactions for receipts and disbursements. These transactions appear on the trial balance with the employee's name and social security number. Federal agencies are required to safeguard personally identifiable information (PII) in their possession and prevent its breach. The posting of an employee's PII on the trial balance puts them at risk for identity theft.

Recommendations

We recommend that BFO:

5. revise the content of the trial balance to exclude RRB employees' social security numbers; and
6. implement procedures to safeguard the trial balances that contain PII.

Management's Response

BFO has agreed to revise the content of the trial balance to exclude any reference to vendor /provider numbers that have social security numbers as part of them. They have also agreed to implement procedures to safeguard the older trial balances that contain PII. The full text of management's response is presented as Attachment 1 to this memorandum.

Accounting for RUIA Contributions Could Be More Effective

During our audit, we observed that BFO's procedures for depositing contributions paid by railroad employers under the Railroad Unemployment Insurance Act (RUIA) are not fully effective. Contributions are taxes paid by railroad employers to finance the unemployment and sickness benefits paid under the RUIA.

The RUIA includes the following requirement for allocating employer contributions between the fund that finances administrative activity and the account that finances benefit payments.

The contributions required by this chapter shall be collected by the Board and shall be deposited by it with the Secretary of the Treasury of the United States, such part thereof as equals 0.65 per centum of the total compensation on which such contributions are based to be deposited to the credit of the fund

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and the balance to be deposited to the credit of the account.⁴

Electronic deposits are initially allocated between the fund and the account on an estimated basis because accurate allocation between the fund and the account must, according to the law, be based on total taxable compensation paid by railroad employers to their employees. Taxable compensation cannot be determined for contributions paid electronically until the railroad employer files its quarterly report of compensation with the RRB.

BFO does not have a procedure to re-allocate contributions once they receive the necessary additional information about compensation. As a result, current procedures for allocating contributions between the fund and the account are not fully effective in meeting the requirements of the RUIA.

Recommendation

We recommend that BFO:

7. use the quarterly reports of compensation paid by railroad employers to re-allocate contributions between the fund and the account on a periodic basis to better comply with the allocation requirements of the RUIA.

Management's Response

BFO has agreed to study this matter and plans to re-allocate contributions between the fund and the account on a periodic basis. The full text of management's response is presented as Attachment 1 to this memorandum.

BFO and the Office of General Counsel Could Strengthen Coordination

Better coordination between BFO and the Office of General Counsel would strengthen and expedite the financial statement preparation process. According to the RRB's Management Control Guide, proactive cooperation between responsible officials is a key indicator of an effective interactive control environment.

During our audit, we observed that BFO does not request information about the likelihood of loss due to legal contingencies as early as they could. Instead of contacting the Office of General Counsel for this information, BFO waits until the Office of General Counsel submits the information before completing the final financial statements and submitting them for audit. Delays in completing the financial statements increase the risk that financial reporting deadlines will not be met. In addition, we observed that BFO does not have a fully effective process

⁴ Railroad Unemployment Insurance Act §8(i)

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for reviewing the likelihood of loss information and as a result, the financial statements may not be fully accurate.

We also observed that the Office of General Counsel's formal assessment of the likelihood of loss on litigation for claims involving potential tax refunds to be paid from agency trust funds required additional review and revision due to an inconsistency in the original submission. The Office of General Counsel's likelihood of loss assessment determines the financial reporting of contingent liabilities; accordingly, it is critical that this assessment is complete, accurate, and timely.⁵

Recommendations

We recommend that BFO:

8. coordinate a schedule for the earlier receipt of financial statement information from the Office of General Counsel; and
9. strengthen the review process over the information used for the Commitments and Contingencies Note.

Management's Response

BFO has agreed to issue and coordinate a revised schedule to obtain earlier receipt of financial statement information from the Office of General Counsel. They have also agreed to strengthen the review process over the information used for the Commitments and Contingency Note. The full text of management's response is presented as Attachment 1 to this memorandum.

We recommend that the Office of General Counsel:

10. strengthen the review process to ensure that the likelihood of loss assessment is complete, accurate, and timely.

Management's Response

The Office of General Counsel has no objection to the recommendation. They will provide an internal litigation report that addresses the OIG's concerns. The full text of management's response is presented as Attachment 2 to this memorandum.

⁵ Federal Accounting Standards Advisory Board, "Recognition of Contingent Liabilities Arising from Litigation," Statement of Federal Financial Accounting Standards No. 12, December 1998, pages 10, 12 & 13.

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Controls Over FMFIA Could Be Improved

In connection with the FY 2009 Financial Statement Audit, the OIG cited the RRB with a material weakness for internal control over non-integrated subsystems. This material weakness was also included in the agency's Federal Managers' Financial Integrity Act (FMFIA) assurance statement reported in the Performance and Accountability Report (P&AR). However, the management control certifications signed by the Senior Executive Officer and Management Control Review Committee do not include this material weakness.

In accordance with the RRB's Management Control Guide, management control certifications provide support for the FMFIA assurance statement reported in the annual P&AR. Management control certifications from organization heads are summarized and submitted to the Board Members documenting the overall control environment and the management controls of the agency. This internal publication provides the support for the FMFIA assurance statement reported in the annual P&AR.⁶

During our audit, we notified RRB management that the RRB would be cited with a material weakness for internal controls over non-integrated subsystems. Although the management control certification from the Management Control Review Committee postdated our discussion, this material weakness was not included in their management control certification.

The RRB has not included the material weakness for internal control over non-integrated subsystems in their management control certifications. As a result, the FMFIA assurance statement reported in the P&AR is inconsistent with the management control certifications and not fully supported.

Recommendations

We recommend that the Executive Committee:

11. implement procedures to determine if there are any new material weaknesses identified during the financial statement audit, prior to completing the management control certification.

Management's Response

The Executive Committee has agreed to contact the Chief Financial Officer via email to verify that no new material weaknesses have been identified prior to the completion of the management control certification. The full text of management's response is presented as Attachment 3 to this memorandum.

⁶ "Documentation of Federal Managers' Financial Integrity Act Activities, Results, and Plans Supporting the Fiscal Year 2009 Railroad Retirement Board Performance and Accountability Report", October 2009.

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We recommend that the Management Control Review Committee:

12. implement procedures to determine if there are any new material weaknesses identified during the financial statement audit, prior to completing the management control certification; and
13. update procedures to include a comparison of the Management Control Certification submitted to the Board Members with the FMFIA assurance statement reported in the annual P&AR for consistency.

Management's Response

The Management Control Review Committee has agreed to implement and update procedures for this fiscal year's process. The full text of management's response is presented as Attachment 4 to this memorandum.



UNITED STATES GOVERNMENT

MEMORANDUM

FORM G-115f (1-82)

RAILROAD RETIREMENT BOARD

MAR 04 2010

TO : Diana Kruef
Acting Assistant Inspector General for Audit

FROM : John M. Walter *John M. Walter*
Chief of Accounting, Treasury, and Financial Systems

Through: Kenneth P. Boehne
Chief Financial Officer *Kenneth P. Boehne*

SUBJECT: Draft Letter to Management – Fiscal Year 2009 Financial Statement Audit

Thank you for the opportunity to comment on the Draft Letter to Management. Our comments on the recommendations are as follows:

Recommendations:

We recommend that the Bureau of Fiscal Operations:

- 1. inventory the various non-integrated processes that support financial accounting which should be subject to reconciliation.***

We will work with other bureaus and offices to inventory and study the various non-integrated processes that support financial accounting. Target date is: August 16, 2010.

- 2. work with the Executive Committee to secure the cross-organizational cooperation necessary to implement a comprehensive reconciliation process with adequate separation of duties.***

We will work with the Executive Committee to secure the cross-organizational cooperation necessary to implement a comprehensive reconciliation process. A target date for implementation will be established after reviewing the inventory of non-integrated processes.

- 3. review the Administrative Circular governing Budget Execution and make updates as needed.***

The Administrative Circular governing Budget Execution will be updated. Target date is: July 30, 2010.

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4. ensure that procedures for major accounting activities are included in the Accounting Procedures Guide.

We will ensure that procedures for major accounting activities are included in the Accounting Procedures Guide. Target date is: September 30, 2010.

5. revise the content of the trial balance to exclude RRB employees' social security numbers.

We are revising the content of the trial balance to exclude any reference to vendor/provider numbers that have social security numbers as part of them. Target date is: March 31, 2010.

6. implement procedures to safeguard the trial balances that contain PII.

We are implementing procedures to safeguard the older trial balances that contain PII. Target date is: April 30, 2010.

7. use the quarterly reports of compensation paid by railroad employers to re-allocate contributions between the fund and the account on a periodic basis to better comply with the allocation requirements of the RUIA.

We are studying this matter and plan to re-allocate contributions between the fund and the account on a periodic basis. Target date is: August 31, 2010.

8. coordinate a schedule for the earlier receipt of financial statement information from the Office of General Counsel.

We will issue and coordinate a revised schedule to obtain earlier receipt of financial statement information from the Office of General Counsel. Target date is: August 31, 2010.

9. strengthen the review process over the information used for the Commitments and Contingencies Note.

We will strengthen the review process over the information used for the Commitments and Contingencies Note. Target date is: August 31, 2010.

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cc: Georgia Blalock, Budget Officer
Ed Fleming, Accounting Officer
Rich Lannin, Senior Accountant
Liz Stubits, Accountant
Edie Natividad, Accountant
Dave Miller, Finance Officer
Bill Flynn, Executive Assistant
Jill Roellig, Management Analyst



UNITED STATES GOVERNMENT
MEMORANDUM

FORM G-115f (1-92)
RAILROAD RETIREMENT BOARD

MAR 08 2010

TO : Diana Kruei
Acting Assistant Inspector General for Audit

FROM : Steven A. Bartholow
General Counsel

A handwritten signature in black ink, appearing to read "S. Bartholow", written over the printed name "Steven A. Bartholow".

SUBJECT : Draft Letter to Management
FY 2009 Financial Statement Audit

This is in response to your memorandum dated February 18, 2010 concerning the draft letter to Management concerning the FY 2009 Financial Statement Audit. In that draft letter, you recommend that BFO and the Office of General Counsel Strengthen Coordination of legal contingency reporting. With respect to the Office of General Counsel, you recommend that our office "strengthen the review process to ensure that the likelihood of loss assessment is complete, accurate, and timely."

I have no objection to the recommendation. I believe that we have in place an internal litigation report that addresses your concerns. I will be submitting it for your review. Going forward, I will send the Chief Financial Officer a copy of the litigation report as it is updated each month.

cc: Chief Financial Officer
Assistant General Counsel
Assistant General Counsel/Director of Hearings and Appeals



UNITED STATES GOVERNMENT

MEMORANDUM

FORM G-1151 (1-92)

RAILROAD RETIREMENT BOARD

March 3, 2010

TO : Diana Kruei
Acting Assistant Inspector General for Audit

FROM :  Henry M. Valiulis
Senior Executive Officer/Director of Administration

SUBJECT: Draft Letter to Management
FY 2009 Financial Statement Audit

Thank you for the opportunity to comment on the subject draft letter. My comment on the recommendation directed to the Executive Committee is as follows:

Recommendation:

We recommend that the Executive Committee (EC):

- 11. implement procedures to determine if there are any new material weaknesses identified during the financial statement audit, prior to completing the management control certification.***

The Executive Committee concurs with the recommendation and will adopt the recommendation by contacting the Chief Financial Officer via email to verify that no new material weaknesses have been identified prior to the completion of the management control certification. Implementation of this procedure will be for this fiscal year's process. Our target date is: September 30, 2010.



UNITED STATES GOVERNMENT

MEMORANDUM

FORM G-1157 (1-82)

RAILROAD RETIREMENT BOARD

MAR 04 2010

TO : Diana Kruef
Acting Assistant Inspector General for Audit

FROM : Management Control Review Committee

SUBJECT: Draft Letter to Management – Fiscal Year 2009 Financial Statement Audit

Thank you for the opportunity to comment on the Draft Letter to Management. The FMFIA documentation transmittal memorandum which the Chief Financial Officer released to the Board Members stated that the Office of Inspector General recently notified us that for fiscal year 2009 they will be reporting Non-Integrated Subsystems as a material weakness. Nevertheless, in the future, we plan to include any recently identified material weaknesses in the Management Control Certification memorandum itself. Our comments on the recommendations are as follows:

Recommendations:

We recommend that the Management Control Review Committee (MCRC):

- 12. implement procedures to determine if there are any new material weaknesses identified during the financial statement audit, prior to completing the management control certification; and**

We will implement procedures for this fiscal year's process. Our target date is: November 30, 2010.

- 13. update procedures to include a comparison of the Management Control Certification submitted to the Board Members with the FMFIA assurance statement reported in the annual P&AR for consistency.**

We will update procedures for this fiscal year's process. Our target date is: November 30, 2010.

John M. Walter
Chair
Chief of Accounting, Treasury, and
Financial Systems

Catherine A. Leyser
Alternate Chair
Director of Assessment and Training

Patricia Kirch
Director of Unemployment & Programs
Support – Operations

Charles P. Mierzwa
Records Officer

Sally Mui
Executive Assistant to Senior Executive
Officer/Director of Administration

Eric T. Wooden
General Attorney

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cc: Kenneth P. Boehne, Chief Financial Officer
Hattie Fitzgerald, Financial Compliance Officer
Paula Lewis, Systems Accountant
Bill Flynn, Executive Assistant
Jill Roellig, Management Analyst