Fiscal Year 1997 Financial Statement Audit
Report No. 98-07, February 27, 1998

Report on Internal Control

To the Board Members:

We audited the consolidated financial statements and supplementary schedules of the United States Railroad Retirement Board (the RRB) for the year ended September 30, 1997, and have issued our report thereon dated February 27, 1998 in which we rendered a disclaimer of opinion due to the lack of sufficient audit evidence to determine the proper accounting and reporting of benefit payments and the financial interchange receivable and/or payable, and related net revenue amounts.

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 consolidated financial statements and supplementary schedules and not to provide assurance on internal control. The maintenance of adequate internal control designed to fulfill 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, and 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. However, we noted certain matters involving internal control and its operations that we consider to be reportable conditions under standards established by Office of Management and Budget Bulletin 93-06, "Audit Requirements for Federal Financial Statements." Reportable conditions are matters coming to our attention that, in our judgment, relate to significant deficiencies in the design or operation of internal control and could adversely affect the RRB's ability to record, process, summarize, and report financial data consistent with the assertions of management in the consolidated financial statements and supplementary schedules. Our consideration of internal control would not necessarily disclose all matters in internal control that might be reportable conditions.

Our evaluation of the controls for performance information was limited to those controls designed to ensure the existence and completeness of the information. With respect to the performance measures control objectives, we obtained an understanding of relevant internal controls designed to permit preparation of reliable and complete performance information, and we assessed control risk.

MATERIAL WEAKNESSES

A material weakness is a reportable condition in which the design or operation of specific internal control does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material to the consolidated financial statements of RRB may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted the following matters involving internal control and its operation that we consider to be material weaknesses:

1. Accuracy of Benefit Payments

We noted errors in recomputing samples of RRB's benefit payments for retirement, survivor and disability benefits. We recomputed benefits being paid to 93 annuitants. As a result of our tests, we questioned the accuracy of 30 payments which contained a variety of adjudicative and clerical errors.

New regulations governing the administrative finality of payment adjudication decisions became effective September 29, 1997. Applying these regulations, the Office of Programs determined that, in 5 cases, the original payment decision should be re-opened and the original, incorrect action corrected. In addition, they determined that 14 cases would not qualify for re-opening under current rules. The Office of Programs has pended its decision on 11 cases in order to obtain further guidance concerning the application of the regulation concerning administrative finality. These cases include issues pertaining primarily to wages and compensation which have not previously been tested under this rule.

The Office of Programs - Operations, the organizational unit within the agency that is responsible for benefit payments, has established a target date of September 30, 1998 for corrective action.

The results of our tests of benefit payments are consistent with those of prior years and indicate that the RRB's benefit payment record and internal controls related thereto are not adequate to ensure the proper determination of, and accounting for, benefit payments. Accordingly, adjustments to the consolidated financial statements, if any, related to inaccurate benefit payments cannot be determined.

2. Overall Control Environment

The organizational structure of the RRB consists of 20 major operating units, plus the staffs of the Chairman, Management, and Labor members of the Board. The 1993 financial statement audit noted that the RRB's internal control environment is focused on control objectives and techniques designed to meet the organizational responsibilities of each of the individual operating units, rather than designed to meet the overall objectives of the RRB. In fiscal year 1994 the RRB's Management Control Review Committee (MCRC) performed extensive efforts to identify control techniques designed to meet the overall objectives of the RRB and increase bureau communication. During 1995, the MCRC was active in reviewing the initial bureau self-assessment projects to test and assess internal control techniques. In addition, effective January 3, 1995 the Board members initiated a reorganization plan that included the distribution of existing offices and bureaus to serve under the newly created Office of Programs or Office of Administration. Since that time, the Board Members have approved reorganizations of two bureaus and the Office of

Programs. During fiscal year 1996, the MCRC developed a statement of reasonable assurance concerning the general control environment, which has been submitted by bureau and office heads. During fiscal year 1997 the RRB issued a revised guide for assessing and testing internal controls. After reviewing the above agency actions, we have assessed this environment as a material control weakness for the following reasons:

a) A September 26, 1995 report of the Office of Inspector General (OIG) states that the 1995 reorganization plan "will not provide a significant level of change" to the existing organization structure, primarily because the number of bureaus was not significantly reduced. A September 27, 1996 report by the OIG states that the RRB should become a government corporation, effective fiscal year 1998, headed by an independent Chief Executive Officer (CEO). The present Board structure should be abolished and replaced by an advisory panel that would continue to represent the public interest, railway labor and railroad management.

The recent reorganization of two bureaus and the Office of Programs (OP) did not significantly change the overall organizational structure of the RRB. The current organization is essentially the same as the January 3, 1995, structure. The OP, Office of Administration and the Office of General Counsel still report directly to the Board. The internal OP reorganization reduced its seven bureaus to five operating components but the RRB is still comprised of 20 major operating units. The September 27, 1996, OIG report recommended five major units reporting to an independent CEO. Also, as of December, 1997, the RRB had 53 field offices within the OP. The September 26, 1995, OIG report recommended 10 field offices.

The reorganizations of the Bureau of Information Services and Bureau of Fiscal Operations were also internal. Reporting relations within the bureaus were changed, but these organizations remain as two of the nine units reporting directly to the Director of Administration. The September 27, 1996, OIG report recommended that the financial and information systems functions report directly to the CEO.

b) The RRB is administered by a three member Board appointed by the President, with the advice and consent of the Senate. By law, one member is appointed upon a recommendation made by railroad labor organizations, one upon recommendation of railroad employers and the third member, the Chairman, is to be independent of employees and employers, thereby representing the public interest. Board members function as CEOs responsible to their individual constituencies which may not have convergent interests. This structure results in Board members having significant involvement in the operational affairs of the agency. The lack of a single CEO makes it difficult to resolve issues on a timely basis.

c) As described elsewhere in this report, the results of our testing of benefit payments raise uncertainties regarding any financial impact that could result from erroneous benefit payments. This weakness was first reported in 1993 by the previous auditors and procedures were issued on July 31, 1995. On November 14, 1995 a majority of the Board Members passed proposed regulations regarding administrative finality which were published in the Federal Register for comment. Final regulations were published in the August 29, 1997 Federal Register and became effective September 29, 1997.

d) As described elsewhere in this report, the results of the RRB's financial interchange agreement with the Social Security Administration (SSA) and the Health Care Financing Administration (HCFA) historically results in significant revenues to the RRB. However, the settlement process between the RRB, SSA and HCFA is not timely and can result in significant adjustments to the revenue receivable and payable amounts estimated and recorded in RRB's year-end financial statements. The actual settlement of the 1996 financial interchange, which was recorded in 1997, resulted in a reduction in net revenue of $59.2 million from SSA and $15.1 million from HCFA. The current timetable for performing this settlement process precludes the preparation of timely annual financial statements that include the actual results of the financial interchange process.

3. Railroad Retirement Tax Deposits

As disclosed in RRB's "1997 Federal Managers' Financial Integrity Act Report," existing controls do not ensure that the Department of Treasury fully and accurately credits railroad retirement tax deposits to the railroad retirement trust funds. The Department of Treasury occasionally incorrectly credits railroad retirement tax deposits to other government accounts. The RRB's Bureau of Fiscal Operations has not had access to sufficient information from the IRS and the Department of Treasury to fully verify the accuracy of these tax deposits.

The Electronic Federal Tax Payment System (EFTPS), an automated clearing house system for processing railroad retirement taxes, was implemented in 1997. Allowing for an initial phase-in period, this system is expected to provide deposit information for nearly all railroad employers and all payments for calendar year 1998. Calendar year 1998 will be the first full year in which deposit information will be available for nearly all employers. Reconciliation will begin in 1999 after tax forms are submitted for 1998. Based on the foregoing, the agency has established a target date of June 1999 to correct the existing weakness.

INTERNAL CONTROL AND THE INTEGRITY ACT

As part of our audit, we also obtained an understanding of the RRB's process for evaluating and reporting on internal control and accounting systems as required by the Federal Managers' Financial Integrity Act (Integrity Act) and compared the fiscal year 1997 Integrity Act items that related to the RRB's consolidated financial statements with the evaluation we conducted of the RRB's internal control. The RRB reported material weaknesses in the areas of (1) Tax and Contribution Reconciliations, the General Ledger and (2) Inaccurate Benefit Payments.

The definition of a material weakness for financial statement purposes differs from the definition of such weaknesses for the purpose of the Integrity Act. According to Integrity Act guidance, a material weakness is a situation in which the designed procedures or degree of operations compliance therewith does not provide reasonable assurance that the objectives of internal control specified in the Integrity Act are being accomplished. These objectives are: (1) to provide management with reasonable assurance that obligations and costs comply with applicable law; (2) assets are safeguarded against waste, loss, unauthorized use and misappropriations; (3) revenues and expenses are recorded and accounted for properly so that accounts and reliable financial reports may be prepared and accountability of assets maintained; and (4) programs are efficiently and effectively carried out in accordance with applicable law and management policy. To determine whether to report matters as a material weakness, we used the definition of a material weakness included in the Office of Management and Budget's Bulletin 93-06, "Audit Requirements for Federal Financial Statements." According to the Bulletin, a material weakness in internal control is a reportable condition in which the design or operation of one or more of the internal control elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the consolidated financial statements and supplementary schedules may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

The RRB removed the overall control environment from the list of material weaknesses reported in its 1997 Federal Managers' Financial Integrity Act Report. This was based upon the agency actions taken to date and the agency's difference of opinion with the OIG as to the appropriate statutory scheme for the RRB. These issues are discussed in detail beginning on page 2 of this report.

However, we believe that the overall control environment should be reported as a material weakness under the Integrity Act. The conditions discussed in this report are reflections of an environment that adversely affect the RRB's ability to assure that transactions are being properly recorded in the financial statements.

OTHER REPORTABLE CONDITIONS

A reportable condition involves matters coming to our attention relating to significant deficiencies in the design or operation of the internal control structure that, in our judgment could adversely affect the entity's ability to record, process, summarize, and report financial data consistent with the assertions of management in the consolidated financial statements. We noted the following reportable condition:

For the largest accruals calculated by the Bureau of the Actuary (Financial Interchange receivables and payables), management does not obtain necessary information and calculate the accruals in a timely manner to be properly reflected in the financial statements. As a result of this, we were unable to apply audit procedures to the Financial Interchange receivables and payables to determine what adjustments, if any, might be necessary.

Although not considered to be reportable conditions, we also noted other matters involving internal control and its operations that we have reported to RRB management in a separate letter dated February 27, 1998.

These conditions (together with the other matters reported to RRB management in a separate letter) were considered in determining the nature, timing, and extent of the audit tests applied in our audit of the 1997 consolidated financial statements and supplementary schedules, and this report does not affect our report on these consolidated financial statement and supplementary schedules dated February 27, 1998. We have not considered internal control since the date of our report.

This report is intended solely for the information and use of the Board members, management, others within the organization of the RRB, and the Office of Management and Budget and should not be used for any other purposes. However, this report is a matter of public record, and its distribution is not limited.

Martin J. Dickman,
Inspector General

AUDITOR'S REPORT

February 27,1998

To the Board Members:

We audited the consolidated statement of financial position of the United States Railroad Retirement Board (RRB) as of September 30, 1997, and the related consolidated statements of operations and changes in net position, cash flows, combined statement of budgetary resources and actual expenses and the supplementary schedules for the year then ended. These consolidated financial statements and supplementary schedules are the responsibility of RRB's management. Other auditors were engaged to audit the consolidated financial statements and supplementary schedules of the RRB as of September 30, 1996 and 1995, whose reports dated January 10, 1997 and March 22, 1996, respectively, on those statements disclaimed an opinion because the scope of their work was not sufficient to enable them to express, and they did not express an opinion.

The RRB's accounting records and other documentation are inadequate to achieve the financial statement assertion regarding accuracy of benefit payments. Accordingly, adjustments to the consolidated financial statements and supplementary schedules, if any, related to inaccurate benefit payments, cannot be determined. Therefore, we were unable to obtain sufficient audit evidence to determine the proper accounting and reporting of benefit payments.

Financial Interchange occurs between RRB, the Social Security Administration (SSA) and the Health Care Financing Administration (HCFA). This financial interchange is intended to place the SSA's Old Age, Survivors and Disability Insurance (OASDI) Trust Funds and HCFA's Hospital Insurance (HI) Trust Funds in the same position in which they would have been had railroad employment been covered by the Social Security and Federal Insurance Contribution Acts. The consolidated statements of financial position reflect the estimated net financial interchange transfer from the OASDI and HI Trust Funds in the following amounts:

	1997	
	Principal (billions)	**Interest (millions)**
Transfer from/to:		
SSA to RRB	$ 3.520	$ 157.6
RRB to HCFA	(.385)	(18.7)
Net Financing Interchange Receivable at year-end	$ 3.135	$ 138.9

These amounts included estimates of amounts due but unpaid at the end of the fiscal year and estimated interest accrued for the fiscal year. Actual determination and settlement of the amounts due at the end of the fiscal year are typically made in June of the subsequent fiscal year. The receivable amounts are classified as "Accounts Receivable - Intragovernmental" and "Interest Receivable - Intragovernmental," respectively. The payable amounts are classified as "Accounts Payable- Intragovernmental" and "Interest Payable - Intragovernmental," respectively. The consolidated statement of operations and changes in net position reflects net revenues of approximately $ 3.076 billion and $ 309.9 million for 1997 relating to the principal and interest on these transfers and are classified in "Intragovernmental Revenues" and "Interest-Federal," respectively. We were unable to obtain sufficient audit evidence for these receivables and payables to determine the proper accounting of the receivable and/or payable and related net revenue amounts.

As described in note 1, these consolidated financial statements and supplementary schedules were prepared in accordance with principles and standards prescribed by the General Accounting Office, Office of Management and Budget (OMB) and the U.S. Department of Treasury including OMB Bulletin 94-01, which is a comprehensive basis of accounting other than generally accepted accounting principles.

Because we could not determine:

1. the effect of such adjustments, if any, as might have been disclosed had we been able to obtain sufficient audit evidence to determine the proper accounting and reporting of benefit payments, and

2. the effect of such adjustments, if any, as might have been disclosed had we been able to obtain sufficient audit evidence to determine the proper accounting and reporting of receivable and/or payable and related net revenue amounts,

the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the accompanying 1997 consolidated financial statements and supplementary schedules.

This report is intended solely for the information and use of the Board Members, management, others within the organization of the RRB, and OMB and should not be used for any other purpose. However, this report is a matter of public record, and its distribution is not limited.

Martin J. Dickman,
Inspector General

REPORT ON COMPLIANCE WITH LAWS AND REGULATIONS

February 27, 1998

To the Board Members:

We audited the consolidated financial statements of the United States Railroad Retirement Board (RRB) as of and for the year ended September 30, 1997, and have issued our report thereon dated February 27, 1998, in which we rendered a disclaimer of opinion due to the lack of sufficient audit evidence to determine the proper accounting and reporting of benefit payments and the financial interchange receivable and/or payable, and related net revenue amounts.

Compliance with laws and regulations applicable to the RRB is the responsibility of RRB's management. We performed tests of RRB's compliance with certain provisions of laws and regulations directly affecting the consolidated financial statements and supplementary schedules and certain other laws designated by the Office of Management and Budget (OMB), including the requirements referred to in the Federal Financial Management Improvement Act (Improvement Act) of 1996.

We included the following laws in our compliance testing:

Railroad Retirement Act of 1974, as amended, and related regulations
Railroad Unemployment Insurance Act
Anti-Deficiency Act
Debt Collection Act of 1982
Prompt Payment Act
Chief Financial Officer's Act of 1990
Budget and Accounting Procedures Act of 1950
Fair Labor Standards Act of 1938
Civil Service Retirement Act of 1930
Civil Service Reform Act of 1978
Federal Employees' Compensation Act
National Defense Authorization Act for 1991
Federal Debt Collection Procedures Act of 1990
Federal Employees' Health Benefits Act of 1959
Federal Employees' Group Life Insurance Act of 1980
Federal Managers' Financial Integrity Act of 1982
Social Security Independence and Program Improvements Act of 1994

However, the objective of our work was not to provide an opinion on overall compliance with such provisions. Accordingly, we do not express such an opinion.

Our tests of benefit payment accuracy determined that the RRB is not in compliance with the Railroad Retirement Act of 1974, as amended, and related regulations. We identified adjudication errors in the computation of benefit payments resulting in overpayments and underpayments. No provisions for any liability that may result has been recognized in the RRB's consolidated financial statements. We considered this instance of noncompliance in our audit of the RRB's 1997 consolidated financial statements.

The Improvement Act, which applies to agencies named in the Chief Financial Officer's (CFO) Act of 1990, is intended to assure compliance with Federal financial management systems requirements, applicable accounting standards, and the United States Standard General Ledger at the transaction level. Although the RRB is not named in the CFO Act, we considered the Improvement Act in our tests of compliance in order to assure comparability with the financial statement audits of other agencies performed under the CFO Act. We performed our tests using the implementation guidance for the Improvement Act issued by OMB on September 9, 1997.

We determined that RRB systems supporting benefit payments, railroad tax deposits and the financial interchange with the Social Security Administration do not meet certain financial management systems requirements established by the Improvement Act. We discuss these internal control weaknesses in detail in our Report On Internal Control. These weaknesses, which adversely impact the completeness, timeliness and reliability of the financial statements, have been reported to management in the audit reports and management letters resulting from current and prior year audits of the agency's financial statements.

This report does not modify our report dated February 27, 1998, on RRB's consolidated financial statements referred to in the first paragraph of this report. This report is intended solely for the information and use of the Board Members, management, others within the organization of the RRB, and the Office of Management and Budget and should not be used for any other purpose. However, this report is a matter of public record, and its distribution is not limited.

Martin J. Dickman,
Inspector General