FY 1998 Financial Statement Audit
Report No. 99-06, March 5, 1999

<u>Letter to Management</u>

To the Board Members:

We were engaged to audit the Principal Statements and Supplementary Schedules (hereinafter referred to as “financial statements”) of the United States Railroad Retirement Board (RRB) as of and for the year ended September 30, 1998, and have issued our report thereon dated March 5, 1999, in which we rendered a disclaimer of opinion due to the lack of sufficient audit evidence to determine the proper accounting and reporting of 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 financial statements 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 the Office of Management and Budget (OMB) Bulletin 98-08, 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 financial statements. Our consideration of internal control would not necessarily disclose all matters in internal control that might be reportable conditions.

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 RRB’s financial statements may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions.

We have reported a material internal control weakness as a result of our assessment of the RRB’s overall control environment. A full discussion of this issue is presented beginning on page. In addition we have identified an internal control weakness related to the availability of supporting documentation for payroll tax receipts. This latter weakness, a reportable condition that does not rise to the level of a material weakness, is discussed in detail on page .

We also noted other matters involving RRB’s internal control structure and its operation and these points are also included in the accompanying memorandum. Our work was not conducted for the primary purpose of making detailed recommendations about 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 RRB Board Members, RRB management, others within the organization of the RRB, OMB and Congress. However, this report is a matter of public record, and its distribution is not limited. To the extent that Congress and OMB intend to rely upon this letter and the accompanying memorandum, such reliance should take into account the basis upon which our recommendations were developed, as described above, and the limitations inherent in the internal control structure as described in our report. In addition, Congress and OMB should understand that the criteria used by us in our work could differ significantly from the criteria that they may be using for their purposes.

We wish to express our appreciation for the courtesies and cooperation extended to our representatives during the course of their work. We would be pleased to discuss these recommendations in greater detail or otherwise assist in their implementation.

Very truly yours,

Martin J. Dickman
Inspector General

Findings And Recommendations Of The Current Audit

Board Members

Overall Control Environment

The organizational structure of the Railroad Retirement Board (RRB) consists of 20 major operating units, plus the staffs of the Chairman, Management, and Labor members of the Board. As in prior audits, we continue to observe 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. We believe that the present administrative structure is the primary cause of this internal control weakness.
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.

The Board members function as chief executive officers (CEO), each one responsible to a different constituency. 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.

The agency has undergone extensive reorganization since this weakness was originally cited during Arthur Andersen LLP's audit of the RRB's FY 1993 financial statements. However, these changes have not impacted the overall control environment.

Agency initiatives include:

-- In fiscal year 1994, the RRB's Management Control Review Committee (MCRC) made an extensive effort to identify control techniques designed to meet the overall objectives of the RRB and increase bureau communication.

-- 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 Offices of Programs and Administration.

-- During fiscal year 1996, the MCRC developed a statement of reasonable assurance concerning the general control environment based on assessments submitted by individual bureau and office heads.

-- During fiscal year 1997, the RRB issued a revised guide for assessing and testing internal controls with emphasis on documentation and review of activities that cross organizational lines.

-- Effective January 1, 1999, the heads of the Bureaus of the Actuary, Information Systems and Fiscal Operations report directly to the Board. Prior to this reorganization, these units were part of Office of Administration and reported through the Director of Administration.

-- Effective January 1, 1999, the Board established an Executive Committee comprised of the executives responsible for each of the 5 largest organizational units. This committee has been charged with making recommendations for elimination of duplicate units and/or activities.

The OIG has reviewed the agency's management structure, including the effects of the several reorganization initiatives and made recommendations as follow:

-- The OIG studied the 1995 reorganization plan and concluded that it would "not provide a significant level of change" to the existing organization structure, primarily because the number of bureaus was not significantly reduced. (9/26/95)

-- The OIG has recommended that the RRB become a government corporation headed by an independent CEO, replacing the present Board structure with an advisory panel .(9/26/95)

-- The OIG has recommended that the Board reduce the agency's management structure to five major units reporting to an independent CEO. (9/27/96)

-- The OIG has also recommended that the agency downsize the field service to a maximum of 10 offices. The Office of Programs presently includes 53 field offices. (9/26/95)

The future impact of the reorganization effective January 1999 cannot be predicted at the present time.

The RRB did not include our finding concerning the overall control environment as a material weakness in 1997 and 1998 Federal Managers' Financial Integrity Act Report. This was based upon the agency actions mentioned above and a difference of opinion with the OIG as to the appropriate statutory scheme for the RRB. However, we believe the overall control environment continues to be a material weakness. The conditions that led to the original finding continue to exist and have an adverse effect on the agency's ability to meet its internal control objectives.

Since the agency has ceased reporting the material weakness and has declined prior recommendations for corrective action, we make no further recommendations regarding this matter.

Bureau of Fiscal Operations

Financial Interchange Estimates

During our audit, we were unable to adequately audit the financial interchange at September 30, 1998. 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 statement of financial position reflects the estimated net financial interchange transfer from the OASDI and HI Trust Funds in the following amounts:

	1998		1997	
Transfer From/To	Principal (billion)	Interest (million)	Principal (billion)	Interest (million)
SSA to RRB	$ 3.519	$ 145.6	$ 3.520	$ 157.6
RRB to HCFA	(.393)	(18.4)	(.385)	(18.7)
Net Financial Interchange Receivable at Year-End	$ 3.126	$127.2	$ 3.135	$138.9

The figures presented in the financial statements include estimates of amounts due but unpaid at the end of each fiscal year as well as estimated interest accrued through the end of each fiscal year. Actual determination and settlement of the amounts due at the end of the fiscal year will be made in June of the following fiscal year. The receivable amounts are classified as "Accounts Receivable – Intragovernmental" and "Interest Receivable – Intragovernmental," respectively, and the payable amounts are classified as "Accounts Payable – Intragovernmental" and "Interest Payable – Intragovernmental", respectively. Computation of the accruals involves extensive estimation which, in prior years, has resulted in significant differences between the amounts accrued and the actual settlement. As a result of the extensive estimation and the significance of the resulting differences from actual amounts, we were unable to apply audit procedures to these accruals to determine what adjustments, if any, to the receivable and/or payable and related net revenue amounts might be necessary.

As previously stated, differences between amounts accrued and the actual settlement have had a material impact on the financial statements. Below is a summary of the impact of financial interchange estimates on revenue as reported in the financial statements for fiscal years 1994 through 1997.

Impact of Financial Interchange Accrual Accounting Estimates on Revenue

Principal and Interest

Fiscal Year	1997 (millions)	1996 (millions)	1995 (millions)	1994 (millions)
Income Recognized	$ 3,198.6	$ 3,093.0	$ 3,637.3	$ 3,102.2
Less actual Income Realized	(3,249.7)	(3,181.3)	(3,010.2)	(3,565.5)
	=======	=======	=======	=======
Amount over (under)recognized	$(51.1)	$(88.3)	$ 627.1	$(463.3)
Over (Under) Recognized in…				
Prior Year	(75.5)	(163.8)	463.3	0.0
Current Year	24.4	75.5	163.8	(463.3)
	(51.1)	(88.3)	627.1	(463.3)
Total Difference as a % of : Total Revenue and Financing Sources	- .49%	- .86%	+5.79%	-4.51%
Excess of Revenue and Financing Sources over Total Expenses	-8.31%	-15.65%	+53.36%	-63.08%

(The figures presented include both principal and interest for the financial interchange accruals related to both the OASDI and Health Insurance trust funds. In FY 1994, there was no over or under recognition related to the prior year because of delays during the first year financial statement auidt, the actual settlement amount was included in the financial statements instead of an estimate.)

The Bureau of the Actuary prepares the accrual accounting estimates for the financial interchange. These estimates are prepared more than six months prior to the actual settlement date and represent the best available information concerning the future outcome of the interchange calculation prior to the final settlement. The Bureau of the Actuary has stated that no better information is available for inclusion in financial statements unless such statements are published after determination of the final settlement amount.

As a result we have concluded that the financial interchange amounts cannot be reasonably estimated for financial statement purposes. In the present context "a reasonable estimate" is a term of art describing an estimate that will not lead to a material misstatement of the agency's financial statements. While the accrual accounting estimate may be the best available estimate, it is not sufficiently predictive of the final outcome of the financial interchange to be considered "reasonable" for purposes of financial statement reporting.

During the FY 1998 audit, the Office of Inspector General reviewed the pertinent accounting literature and recommended a change in accounting principle to record and report on financial interchange during the year of settlement. The Bureau of Fiscal Operations consulted FASAB for concurrence. FASAB could not, based on the limited discussions that took place, endorse the recommended change.

Based on the lack of availability of "reasonable" accounting estimates, the OIG continues to recommend a change in accounting principle to record and report on financial interchange amounts during the year of settlement (**Recommendation #98-1).** The OIG acknowledges that the RRB will not be able to implement such a significant change without the concurrence of FASAB and/or the Office of Management and Budget. As result, in order to implement the foregoing recommendation, BFO should develop a full, factual presentation of the accounting, legal and technical issues that underly the financial interchange process for use in obtaining the necessary concurrence.

<u>Supporting Documentation</u>

The Internal Revenue Service collects railroad retirement taxes that are subsequently remitted to the RRB via the Department of the Treasury. All but the very smallest railroad employers make periodic tax deposits using an electronic payment system. The available systems are Fedwire, RRBLink and EFTPS. Fiscal year 1998 was the first full fiscal year in which all of these systems were available.

Although most tax deposits are being made electronically, the RRB is not able to effectively determine whether all tax deposits are being properly credited to the agency's trust funds. The quantity, quality and timeliness of data are not sufficient to permit detailed analysis of taxes deposited by railroad employers with amounts credited to the RRB's trust funds by the Department of the Treasury. As a result, the RRB cannot obtain a high level of assurance that all deposits are properly credited.

Although the RRB is the recipient of system information, the automated systems used to collect, transfer and report on electronic deposits belong to the Department of the Treasury. The design and operation of these systems is not under RRB control. The Bureau of Fiscal Operations (BFO) has been working with the appropriate parties to improve the system reporting.

Since the agency is already taking corrective action, we make no recommendation.

<u>Allowance from Doubtful Accounts</u>

During our review, we noted that the Bureau of Fiscal Operations (BFO) estimates the allowance for doubtful accounts using data from the last full fiscal year for which such data is available. For example, the allowance for doubtful accounts for fiscal year 1998 would be estimated based on debt recovery experience in fiscal year 1997. We recommend that BFO calculate the allowance for doubtful accounts based on data available through the third quarter of the most recent fiscal year **(Recommendation #98-2).**

BUREAU OF INFORMATION SERVICES

ACF2 Logon Usage

The Railroad Retirement Board (RRB) uses Computer Associates' Access Control Facility 2 (CA-ACF2) data security software package to control access to its mainframe computer, and the resources on the computer once system access has been obtained. This software package tracks logon activity and allows for the reporting of when access attempts are made, or when passwords have been changed. The RRB's computer security policy is to grant mainframe computer access only to those employees that need it for job performance.

Our review of ACF2 access reports showed that 23 RRB employees have never accessed the mainframe computer. Some of these individuals were given access rights as long as 10 years ago. We identified an additional 21 agency employees who did not access the mainframe computer at all during fiscal year 1998. Our review also identified nine employees of the Health Care Financing Administration with access rights to RRB's mainframe computer who either did not access the computer during 1998 or have never done so.

Based on our examination of the ACF2 access reports, it appears that at least 53 individuals have mainframe access who do not now require (and may never have required) such access.

We recommend that the Bureau of Information Services improve the internal controls over mainframe computer access by periodically reviewing the ACF2 access reports and verifying user's access needs for those employees who do not regularly use that access **(Recommendation #98-3).**

OFFICE OF PROGRAMS

Benefit Payment Accuracy

Audits of the financial statements of the RRB for fiscal years 1993-1997 resulted in a disclaimer of opinion based on the auditors' testing of benefit payment accuracy. The auditors concluded that the RRB might have an unrecognized liability for underpayment of benefits based on the audit's assessment of benefit payment accuracy. The agency was unable to quantify the financial impact of errors so that the auditors could make a determination concerning the materiality of the related amounts.

The Office of Programs, working with the OIG, has demonstrated that the RRB has sufficiently limited the recourse of claimants who believe that their benefits may have been calculated incorrectly. Following are the key factors influencing our decision:

--the Board has established time limits after which claimants may no longer initiate review of an agency decision and the decision is considered final (20 CFR Part 260);

--the Board has established regulations governing the reopening of final decisions when adjudicative errors are identified (20 CFR Part 261- this became effective September 29, 1997 and FY 1998 was the first full year during which this regulation was in place);

--the Office of Programs has demonstrated that the correction of adjudicative errors has not had a material monetary impact on the financial statements during the recent past;

--claims examiners in the Office of Programs do not routinely search for errors in previously adjudicated cases;

--claims examiners in the Office of Programs correct errors that come to their attention during the course of their regular assignment;

--the Office of Programs responds as appropriate to benefit errors identified by the Office of Inspector General and the Bureau of Quality Assurance;

--the Office of Programs prepares accrual estimates for workloads on-hand at the end of the fiscal year.

As a result of the foregoing, we do not assess a material internal control weakness related to benefit payment accuracy. We consider that the benefit payment accuracy issues that previously resulted in a disclaimer of audit opinion have been satisfactorily resolved. In addition, nothing has come to our attention to indicate that there has been material non-compliance with Railroad Retirement Act as concerns benefit entitlement or payment.

We will consider the remaining audit recommendation related to this finding (Recommendation #95-41) as closed. The Office of Inspector General will continue to provide oversight to specific benefit payment accuracy issues as part of its regular program audit activities.

RECOMMENDATIONS FROM PRIOR FINANCIAL STATEMENT AUDITS
Recommendations "Not Implemented" as of 09/30/1998

Bureau of Fiscal Operations

<u>Reconciliation of Payroll Tax Receipts</u>

During our 1995 review, we noted that a reconciliation between the amounts for payroll taxes, paid by the railroads to the IRS, and the amounts credited to the Trust funds accounts, at Treasury, is not being performed. The risk exists that all amounts paid by the railroads are not being deposited into the RRB Trust Fund Account. We recommend that a reconciliation between the amounts shown as payroll taxes paid on each railroad CT-1 and the amounts received and deposited in the Trust Fund Accounts be done on an annual basis. It is our understanding that the RRB has been working with the Department of Treasury and the IRS to develop a system to electronically collect taxes and obtain supporting information to facilitate reconciliation of tax deposits **(7/15/94 Report Recommendation #93-3).**

(Memorandum on Internal Control Structure, September, 30, 1995, Arthur Andersen LLP, page 27. The full text of the original auditors' recommendation is reproduced here. All references to "we" and "our" refer to Arthur Andersen LLP.)

Bureau of Supply and Service (BSS)

Fixed Asset Inventory

Administrative Circular BSS-2 requires the following: l) an annual inventory to be taken by accountable property officers (APO) in the bureaus; 2) a reconciliation of the APO's reports with the master accountable property record and 3) an independent verification review.

The FY 1995 inventory and reconciliation process was completed but the independent verification review was not performed in FY 1995.

We recommend that BSS strictly enforce their procedures regarding the performance of an independent verification review (**Recommendation # 95-28**).

(Memorandum on Internal Control, September 30, 1995, Arthur Anderson LLP, page 11. The full text of the original auditors' recommendation is reproduced here. All references to "we" and "our" refer to Arthur Andersen LLP).

Tracking/Transfer/Disposition of Accountable Property

BSS uses a paper-based system to document the transfer and disposition of accountable property. We observed a number of clerical errors associated with the forms and documents used in the tracking and documentation process. We also noted that bureaus frequently refer to assets by serial numbers rather than the assigned RRB asset number thus creating additional work and potential for error.

In addition, the use of forms SF-120 and SF-122 as a control over dispositions is of limited value since these forms are used only in cases where GSA is involved in the disposition process and GSA is no longer a major outlet for dispositions.

We recommend that BSS review its controls in this area and develop additional (or substitute) controls that will reduce paper handling, minimize clerical errors and enhance documentation of dispositions (**Recommendation # 95-29**).

(Memorandum on Internal Control, September 30, 1995, Arthur Anderson LLP, page 12. The full text of the original auditors' recommendation is reproduced here. All references to "we" and "our" refer to Arthur Andersen LLP).

Fixed Asset Dispositions

The Bureau of Supply and Service (BSS) does not record asset dispositions in the Fixed Asset Subsystem on a timely basis. As a result, the disposition of the assets are not recorded in the appropriate fiscal year. Assets of which the RRB physically disposed in fiscal years 1996 and 1992 were not removed from agency accounts until fiscal year 1997.

We recommend that BSS take action to ensure that fixed asset dispositions are recorded prior to the end of fiscal year of disposition (**Recommendation # 97-1**).

(Letter to Management, Office of Inspector General, Railroad Retirement Board, February 28, 1998, page 3. The full text of the original recommendation is reproduced here. All references to "we" and "our" refer to the Office of Inspector General.

BUREAU OF INFORMATION SERVICES

Management Control Program Evaluation

In compliance with the Federal Managers Financial Integrity Act (Integrity Act), the Railroad Retirement Board (RRB) has established a management control program. The management control program includes the identification of organizational units ("assessable units") for the purpose of performing internal control assessments. The internal control structure of each assessable unit is evaluated to determine the level of assurance that management is achieving in accomplishing its internal control objectives. The results are reported as a numeric score using a scale from 1(high level of assurance) to 5 (no assurance).

The computer services assessable unit within the Bureau of Information Services (BIS) received a score of "4" which indicates that management "... cannot state that all control objectives are being accomplished."

We recommend that BIS management improve internal controls over computer services to the extent that it can be assessed a rating of at least "2" which is the lowest level at which management can state that "all control objectives are being accomplished" (**Recommendation #97-3**).

(Letter to Management, Office of Inspector General, Railroad Retirement Board, February 28, 1998, page 4. The full text of the original recommendation is reproduced here. All references to "we" and "our" refer to the Office of Inspector General.)

OFFICE OF PROGRAMS

Survivor Initial Section (SIS)
Automated System for Files' Transfers

During our 1995 review, we noted that there can be delays prior to an application being assigned to an examiner in SIS. The application is mailed from the field office to the Initial Folder Preparation (IFP) section where it [is] matched with the claim folder and finally sent to SIS. Sometimes, there is a delay before the claim folder is received in SIS. An application is not processed until the claim folder is received in SIS. We recommend that an automated system, similar to the Initial Claims (IC) system used in BRB, be developed to efficiently transfer files from the field offices **(7/15/94 Report Recommendation #93-38).**

(Memorandum on Internal Control Structure, September 30, 1995, Arthur Andersen LLP, page 29. The full text of the original auditors' recommendation is reproduced here. All referenes to "we" and "our" refer to Arthur Andersen LLP.)

Backlog of Cases to be Reviewed

During our 1995 review, we noted that a backlog of call-up cases [in what is now the Disability Benefit Division] exists in the post-adjudication section. A disability case is scheduled to be reviewed, or called up, within a prescribed time frame to determine if the recipient continues to meet the eligibility requirements. Various time frames exist based upon the type of disability case. If a case is not reviewed on a timely basis, a risk exists that incorrect benefits will be paid. However, we noted no such instances in our review. We recommend that steps be taken to eliminate the backlog and complete these reviews on a timely basis (**1/ 13/ 1995 Report Recommendation # 94-1**).

(Memorandum on Internal Control Structure, September 30, 1995, Arthur Andersen LLP, page 19. The full text of the original auditors' recommendation is reproduced here. All references to "we" and "our" refer to Arthur Andersen LLP.)