UNITED STATES RAILROAD RETIREMENT BOARD

OFFICE OF INSPECTOR GENERAL

FISCAL YEAR 2000 FINANCIAL STATEMENT AUDIT
Report No. 01-03, February 23, 2001

LETTER TO MANAGEMENT

To the Board Members:

We have audited the consolidated balance sheet of the Railroad Retirement Board (RRB) for the fiscal years ended September 30, 2000 and 1999, and the related: consolidated statements of net cost, changes in net position and financing; combined statement of budgetary resources; and statement of custodial activity (hereinafter referred to as the "principal financial statements") for the years then ended and have issued our report thereon dated February 2, 2001. We conducted our audit in accordance with: generally accepted auditing standards; the standards applicable to financial audits contained in Government Auditing Standards, issued by the Comptroller General of the United States; and, Office of Management and Budget (OMB) Bulletin No. 01-02, "Audit Requirements for Federal Financial Statements."

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, 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.

During our audit of the RRB's principal financial statements, we noted certain matters involving internal control and its operations that we consider to be reportable conditions under standards established by OMB Bulletin 01-02. 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 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.

In our report on internal control, dated February 2, 2001, we reported a material weakness in the RRB's overall control environment and reportable conditions related to debt recovery accounting and the reporting and accounting of transactions in the Dual Benefits Payment account. During our audit, we also noted other matters involving the RRB's internal control structure and its operation. The details of our findings concerning internal control are presented in the attached summary memorandum. However, neither this letter, nor the attached memorandum, modify our report on the financial statements dated February 2, 2001, referred to in the first paragraph of this letter.

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

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

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

Very truly yours,

Martin J. Dickman
Inspector General

February 2, 2001

MEMORANDUM ON INTERNAL CONTROL

THE FINANCIAL INTERCHANGE AND THE AUDITOR'S OPINION

Arthur Andersen LLP was engaged to audit the financial statements of the Railroad Retirement Board for fiscal years (FY) 1993, 1994 and 1995. Subsequent audits were undertaken by KPMG Peat Marwick LLP (1996) and the Office of Inspector General (1997, 1998 and 1999).

Each year the auditors disclaimed an opinion citing uncertainties relating to the accounting and reporting of receivables and payables stemming from the RRB's financial interchange with the Social Security Administration and the Health Care Financing Administration.[1] The financial interchange is a major financing source and the accuracy of these receivables and payables was judged to be of potential material impact.

When the Office of Inspector General (OIG) assumed responsibility for the financial statement audit in FY 1997, we reviewed the matter extensively. Our work included examination of the basis for the disclaimer by the predecessor public accountants, including their materiality thresholds. We reviewed applicable accounting and auditing standards and recommended that the Bureau of Fiscal Operations obtain definitive guidance to determine whether the RRB could use a non-accrual treatment for the financial interchange.

Based on our work, we have concluded that:

- it is not possible to obtain more accurate estimates of the financial interchange receivables and payables,
- accrual accounting treatment is mandated; and
- unless the OIG accepts a higher degree of risk, it will never be possible to express an opinion on the RRB's financial statements.

Since more accurate accounting estimates cannot be obtained and a change in accounting principle is not indicated, we have concluded that it is appropriate for the OIG to accept a higher level of audit risk with regard to the potential for material misstatement resulting from the financial interchange.

Accordingly, the accuracy of financial interchange accrual accounting estimates will not, by itself, present a cause for disclaimer. However, the existence of pending events that are not, or cannot, be considered in preparing the estimates may present a cause for qualification of the OIG's opinion in future years.

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[1] Except FY 1993. Arthur Andersen did not cite the financial interchange as a basis for disclaimer on the FY 1993 statements because audit fieldwork was delayed and estimates had been replaced by actual results when the audit was completed. Arthur Andersen cited other reasons for their disclaimer that year.

In addition, the accuracy of the financial interchange estimate must be considered when evaluating the potential effect of all uncertainties and uncorrected errors in the financial statements. At some future date, this aggregate evaluation could result in a disclaimer or qualification of the auditor's opinion on the financial statements.

In the absence of any pending events that have not been considered in estimating the financial interchange payables and receivables, the OIG has expressed an unqualified opinion on the RRB' financial statements for FY 2000.

MATERIAL WEAKNESS

Overall Control Environment

The RRB's overall control environment is not adequate to ensure that agency financial statements will be free of material misstatements and prepared in accordance with applicable guidance. As a result, each financial statement audit since FY 1993 has cited the agency for a material weakness in this area.

We believe that the RRB's present administrative structure is the primary cause of this internal control weakness. Management in the agency's various operating components does not seek assistance across organizational lines to resolve problems related to financial accounting and reporting when they arise. 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 the overall objectives of the RRB. As a result, the agency has experienced difficulties in resolving financial accounting and reporting issues that require cross-organizational cooperation.

The RRB is administered by a three member Board appointed by the President, with the advice and consent of the Senate. Under the provisions of the Railroad Retirement Act, one member is appointed upon recommendations made by representatives of railroad employees and one member is appointed from recommendations made by representatives of railroad employers. The third member, designated to chair the agency, is appointed without the recommendation by either employers or employees and cannot have an interest, financial or otherwise, in either group, effectively representing the public interest.

The Board members have significant involvement in the operational affairs of the agency and the lack of a single chief executive officer makes it difficult to resolve issues on a timely basis. The Board members tend to function as chief executive officers with each member responsible to a different constituency.

Although 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, we continue to believe that the lack of a single chief executive impedes the agency's ability to solve problems, including those related to financial management and reporting. We have observed a lack of the pro-active, top-down leadership that is required for the timely identification and resolution of significant financial accounting and reporting problems.

Effective January 1, 1999, the Board established an Executive Committee comprised of the executives responsible for each of the agency's 5 largest organizational units. Although the Board has assigned responsibility for facilitating cross-organizational cooperation in the design and implementation of internal controls to the Executive Committee, the impact of this change on the agency's ability to identify and correct internal control related problems that cross organizational boundaries has not been demonstrated. To-date, this committee has not had a role in resolving problems related to financial statement reporting.

Agency management believes that previous reorganizations and the amplified role of the executive committee have eliminated the material weakness. The RRB did not include our finding concerning the overall control environment as a material weakness in the statements of assurance that were issued pursuant to the Federal Managers' Financial Integrity Act, for FYs 1997, 1998, 1999, or 2000.

The OIG believes 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 related to financial statement reporting. Although the RRB has implemented changes to the agency's organizational structure, we have not observed a related change in the agency's organizational culture.

Although the weakness in the overall control environment is closely related to the RRB's management structure, the agency's organizational culture, which includes the professional interaction of management and staff and their response to financial accounting and reporting issues, is a key factor. Meaningful improvement in the RRB's overall control environment must include both a streamlined administrative form as well as an organizational culture that functions to foster a positive attitude towards financial accounting and reporting throughout the agency.

Improvement in the overall control environment can only be achieved by proactive, top down initiative. Since the RRB no longer formally recognizes the overall control environment as an area of material weakness, we will make no further formal recommendations for corrective action at the present time. However, the OIG will continue to evaluate the overall control environment for improvement in both form and function.

REPORTABLE CONDITIONS

Accounting for the Dual Benefits Payment Account

Beneficiaries under the Railroad Retirement Act (RRA) receive payments during the first week of each month for benefits due and payable at the end of the prior month. A single payment is issued that combines all benefit components to which they are entitled. Beneficiaries under the RRA may receive one or more of the following annuity components: tier I, tier II, supplemental, or vested dual benefits.

The RRA of 1974 required that tier I benefits be reduced by any Social Security benefits also payable. The law also provided for a restoration of benefits to certain individuals who were considered vested under both the RRA and Social Security Acts at the end of 1974. Qualifying annuitants receive an additional benefit called the Vested Dual Benefit that is funded by annual appropriation from general revenues and separately accounted for in the Dual Benefits Payment account.

The RRB accounts for transactions in the Dual Benefits Payment account on a cash basis. As a result, benefits that were certified to the Department of the Treasury during September 2000 for disbursement during the first week of October are not recognized as a liability in the FY 2000 financial statements. Other benefit payment components certified for payment at the same time, were subject to accrual as “Benefits Due and Payable” at September 30. The use of cash, rather than accrual, accounting resulted in an understatement of approximately $15 million in the agency’s benefit payment liability on the FY 2000 financial statements.

Unlike the other components of benefits paid under the RRA, the Vested Dual Benefit, paid from the Dual Benefits Payment Account, is funded by annual, one-year appropriations. However, if the annual appropriation (or a continuing resolution) has not been enacted, the benefit payments previously certified for disbursement in October will be paid from the Railroad Retirement Account, the account from which tier II benefits and the non-social security equivalent benefit portion of tier I benefits are paid.

The use of the cash basis for the accounting and reporting of transactions in the Dual Benefits Payment account is a departure from generally accepted accounting principles which require accrual accounting. Management in the Bureau of Fiscal Operations believes that cash basis accounting is mandated because limitations on the use of the annual appropriation create a situation in which there is no true liability to pay the benefit. As support for its decision to use the cash basis of accounting, agency management has cited legal opinions and interpretations providing guidance on appropriation management.

Management’s reliance on legal opinions alone, the most recent of which is 12 years old, without a thorough review of pertinent, current accounting standards, weakens the agency’s ability to ensure full compliance with generally accepted accounting principles.

We recommend that the Bureau of Fiscal Operations determine the proper accounting and reporting of transactions pertaining to the Dual Benefit Payments Account in consideration of the applicable provisions of law, regulation and generally accepted accounting principles. **(Recommendation #00-1)**

Accounting for Benefit Overpayment Recoveries

During FY 2000, the OIG identified weaknesses in internal control over debt recovery transactions that adversely impact the ability of the agency to ensure the reliability of financial reporting and the safeguarding of accounts receivable. We identified errors in the recording of debt recovery transactions that included:

- returned benefit payments that had not been credited to debtor accounts;
- benefit payments that had been erroneously credited to debtor accounts as recoveries;
- delayed recording of certain RUIA debt recoveries; and
- abnormal balances in the general ledger unapplied cash accounts.

An examination of these errors identified weaknesses in the related internal controls. The present internal control structure, as it relates to debt recovery accounting, does not:

- consistently provide for the establishment, review and reconciliation of general ledger controlling accounts for benefit payment activity;
- include review of all systems output; and
- prevent or detect certain unauthorized and/or unsupported transactions.

In addition, the present internal control environment does not provide management with sufficient information concerning the number and value of non-conforming transactions to provide the basis for an evaluation of potential financial impact.

These weaknesses in internal control were brought to management's attention in the Office of Inspector General's audit report, #00-16, dated September 29, 2000. In response, the Bureau of Fiscal Operations has convened a cross-organizational workgroup to address these problems. The workgroup is charged with resolving the issues identified and expects to issue a report by June 30, 2001.

OTHER MATTERS INVOLVING INTERNAL CONTROL

Automated System for Files' Transfers[2]

During our 1995 review, we noted that there can be delays prior to an application being assigned to an examiner in SIS.[3] 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. **(Report Recommendation #93-38)**

Project Management Reporting

The Bureau of Information Services' (BIS) project management system does not accurately reflect estimates of staff time that will be required to complete systems development projects.

BIS uses a project management system to track both estimated and actual staff time required to complete systems development projects. These estimates are then used to project the total cost of completing the project in-house. As the system's development project progresses, actual staff time is recorded in the project management system on an on-going basis. Estimated project costs can then be compared to the actual experience on an on-going basis to permit the assessment of timeliness and efficiency.

BIS's operating procedures require resource estimates to be entered into the project management system for all projects. However, our review determined that the initial estimates of project cost are frequently omitted or inaccurate. BIS monitored 352 new projects with its project management system during FY 2000 but recorded estimated staff time for only 151 (43%). We also identified three projects for which inaccurate estimates had been entered.

Without complete and accurate initial estimates of staff time requirements, the project management system will not provide agency management with the information necessary to assess the timeliness and efficiency of its operations. In addition, the RRB will require accurate project management information in order to measure its performance against goals and objectives for the management of major technology projects established in the RRB's strategic plan pursuant to the Government Performance and Results Act of 1993. Major projects comprised 6.7% of BIS time for projects started during Fiscal Year 2000.

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[2] *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 references to "we" and "our" refer to Arthur Andersen LLP.

[3] Survivor Initial Section

We recommend that BIS strengthen their internal controls to ensure uniform, complete, and accurate time reporting in their Project Management System. **(Report Recommendation #00-2)**

Systems Development Lifecycle

Project management does not fully comply with established procedures.

The Bureau of Information Systems' (BIS) operating procedures identify a systems development lifecycle (SDLC) designed to enhance agency management's control over the development and maintenance of computer application systems. The SDLC establishes requirements for review and approval of certain activities. For example, major projects (those expected to require at least 1,000 hours to complete) must be approved by the Automated Data Processing (ADP) steering committee and the requirements definition document (RDD) must be submitted to the Office of Inspector General (OIG) for review and comment.

We identified two projects that did not fully comply with the review and approval requirements of the SDLC. The Program Rate and Entitlement History Database Restructure project (1,292 hours) was not approved by the ADP Steering Committee. The RDD for Umbrella for Implementation of Senior Citizens Freedom to Work Act of 2000 (2,521 hours) was not submitted to the OIG for review and comment.

We recommend that BIS management develop controls to ensure full compliance with the SDLC requirements in its current operating procedures. **(Report Recommendation #00-3)**

Problem Resolution Reporting

Logs used to track user reports of mainframe computer problems do not provide management in the Bureau of Information System's (BIS) with an adequate basis for assessing the status or timeliness of problem resolution.

BIS maintains logs that record problems with the RRB's mainframe system as reported by users throughout the agency. Those logs record the problem reported, the date of the report and whether or not the problem has been resolved. However, the log does not identify when the problem was resolved and, as a result, does not provide a basis for assessing the timeliness of problem resolution. In addition, detailed records that support problem resolution are not always consistent with the status reported in the summary log.

We recommend that BIS modify the problem logs to include the date that each reported mainframe computer problem is resolved and develop controls to ensure the consistency of summary and detail records that support the problem resolution process. **(Report Recommendation #00-4**)

STATUS OF PRIOR AND CURRENT YEAR RECOMMENDATIONS

We have reviewed the implementation of recommendations resulting from prior audits of the RRB's financial statements. The table below presents a summary of the status of recommendations pending when we issued our "Letter to Management" dated February 18, 2000, in connection with our audit of the RRB's FY 1999 financial statements. The additional recommendations resulting from our audit of the agency's FY 2000 financial statements are also included.

	#	Implemented	In Progress	Declined
THE BOARD				
Control Environment	99-1	X		
BUREAU OF FISCAL OPERATIONS				
Reconciliation of Payroll Tax Receipts	93-3	X		
Financial Interchange	98-1	X		
Time and Attendance Records	99-2	X		
Accounting for the Dual Benefits Payment Account	00-1		X	
OFFICE OF PROGRAMS				
Automated System for Files' Transfer	93-38		X	
Backlog of Cases to be Reviewed	94-1	X		
BUREAU OF INFORMATION SERVICES				
Management Control Program Evaluation	97-3	X		
Project Management reporting	00-2		X	
Systems Development Lifecycle	00-3		X	
Problem Resolution Reporting	00-4		X	