**Review of Internal Control Over Financial Accounting For Obligations, Expenditures and Accounts Payable Report No. 01-04, April 6, 2001**

## Executive Summary


The Railroad Retirement Board is a Federal agency in the executive branch of government with an administrative appropriation that exceeded $90 million in fiscal year (FY) 2000.

The objective of this audit was to determine whether internal control was adequate to ensure proper accounting and reporting of administrative obligations, expenditures, and accounts payable during FY 2000. The scope of this audit was limited to goods and services procured in support of agency administrative activities, excluding the salary and benefits of agency personnel. The RRB recognized nearly $19 million of such expense in its financial statements for FY 2000.

During FY 2000, internal control was generally adequate to ensure proper accounting and reporting of obligations, expenditures, and accounts payable to permit the preparation of financial statements that are free of material misstatement. However, we did identify weaknesses in internal control that adversely impact the agency's ability to ensure compliance with laws and regulations and safeguard assets.

Our tests of internal control disclosed that current agency procedure does not provide for the identification of procurements that may not have been processed subject to applicable management controls. As a result, transactions may not be executed in accordance with applicable law, implementing regulation and management policy. In addition, valid obligations may not be accurately recorded and reported.

Our examination of system security profiles in the agency's automated financial management system disclosed a lack of separation of duties that permits a few individuals to execute all key aspects of disbursement transactions which increases the RRB's risk of loss from error or fraud.

As a result of our audit, management officials have issued memoranda to agency personnel concerning their responsibilities in the procurement process and obtained the opinion of legal counsel about specific appropriation management issues. In addition to these actions, the OIG has recommended that the agency take action to address the problem of procurements that circumvent established management controls and the weakness related to lack of separation of duties in disbursement-related activities.

Our report also presents two additional matters for management's information without recommendation for corrective action.

-- Our analysis of payment vouchers processed during the first nine months of FY 2000 indicated that the receiver, a feature of the automated financial management system used to record receipt and acceptance of goods and services, may be under-used.

-- Our sample review identified a case in which claim folder documentation did not include the identity or signature of the claims examiner who authorized payment to a medical consultant as required by Office of Program's procedure. Because the

transaction was fully documented on the agency's automated financial management system, this omission was not classified as an error for audit purposes.

The Bureau of Fiscal Operations has taken, or plans to take, corrective action to strengthen internal control as recommended in this report. In addition, the Bureau of Supply and Service expects new procedures for the acceptance of goods/services and certifying invoices to be issued in the near future. These new procedures are expected to address concerns that the automated receiver may be under-used.

## Introduction

This report presents the results of the Office of Inspector General's (OIG) review of internal control over financial accounting for obligations, expenditures and accounts payable.

## Background

The Railroad Retirement Board (RRB) is a Federal agency in the executive branch of government with an administrative appropriation that exceeded $90 million in fiscal year (FY) 2000.

The RRB administers the health and welfare provisions of the Railroad Retirement Act (RRA) which provides retirement-survivor benefits for eligible railroad employees, their spouses, widows and other survivors. During FY 2000 approximately 724,000 annuitants received benefits totaling $8.3 billion under the RRA.

The RRB also administers the Railroad Unemployment Insurance Act (RUIA) which provides unemployment and sickness insurance to workers in the rail industry. During FY 2000, the RRB paid $76.5 million to the 14,000 individuals qualifying for unemployment benefits and 23,000 individuals qualifying for sickness benefits under the RUIA.

The RRB prepares annual financial statements on the accrual basis of accounting in accordance with the principles and standards prescribed by the General Accounting Office (GAO), the Office of Management and Budget (OMB) and the Federal Accounting Standards Advisory Board (FASAB).

Internal control is an integral component of an organization's management that provides reasonable assurance concerning the effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. Pursuant to the provisions of the Federal Managers' Financial Integrity Act of 1982, the GAO has issued standards for internal control in government. These standards provide the overall framework for establishing and maintaining internal control and for identifying and addressing major performance and management challenges.

The Federal Financial System (FFS) is the mainframe software application that supports the agency's financial management operations including the financial statement reporting process.

The following terms have unique meaning in the Federal financial management environment:

-- obligation refers to the dollar amount of the orders placed, contracts awarded, services received, and other transactions occurring during a given period that would require payment (expenditure) during the same or future period;

-- expenditures occur when checks are issued, cash is disbursed or funds are transferred to liquidate a Federal obligation; and

-- accounts payable are amounts owed to others for goods and/or services received.

The RRB's strategic plan states that "we will safeguard our customers' trust funds through prudent stewardship" as the agency's second strategic objective in meeting its overall goal of providing excellent customer service. This audit addresses this important area of management performance.

## Objective, Scope and Methodology

The objective of this review was to determine whether internal control was adequate to ensure proper accounting and reporting of administrative obligations, expenditures, and accounts payable during FY 2000.

The scope of this audit was limited to goods and services procured in support of agency administrative activities. The RRB recognized nearly $19 million of such expense in its FY 2000 financial statements. Specifically excluded from the scope of this audit were the salary and benefits of agency personnel as well as benefits paid under the RRA and RUIA program which are a program, rather than administrative, expense.

In order to achieve our objective, we:

-- reviewed applicable laws and regulations;

-- interviewed personnel in the Office of Programs and the Bureau of Fiscal Operations (BFO);

-- reviewed management's internal control risk assessments;

-- tested internal controls by reviewing samples of payments made during the first nine months of FY 2000;

-- reviewed the FFS security profiles of selected employees;

-- reviewed a listing of expenditures for which the payment amount exceeded the amount of a previously established obligation;

-- analyzed the use of FFS receivers in conjunction with payment vouchers; and

-- reviewed the general ledger entries created by FFS.

Our work was performed in accordance with generally accepted government auditing standards as applicable to the objective. Fieldwork was conducted on-site at RRB headquarters during April 2000 through January 2001.

## Results of Review

Our review determined that, during FY 2000, internal control was generally adequate to ensure proper accounting and reporting of obligations, expenditures, and accounts payable. However, we identified the following control weaknesses:

-- invoice approval procedures permit payment for goods or services that may not have been subject to the management controls designed to ensure compliance with laws and regulations, and

-- a lack of separation of duties over cash disbursements that diminishes the agency's ability to prevent errors and fraud.

We identified two procurements that were processed to payment outside of the established network of management controls. We have also questioned the agency's compliance with applicable legal and regulatory requirements. However, we did not identify any instances in which the lack of separation of duties resulted in a loss to the government.

A detailed discussion of our findings and recommendations follows.

### Internal Control Is Adequate for Financial Reporting

Internal control over obligations, expenditures and payables is adequate to ensure the reliability of financial reporting. Although we identified weaknesses in the implementation and design of internal control, those weaknesses do not adversely impact the ability of agency management to prepare financial statements that are free of material misstatement.

OMB Bulletin 01-02, "Audit Requirements for Federal Financial Statements," describes internal control, as it relates to the financial statements of Federal agencies, as a process designed to provide reasonable assurance that the following objectives are met:

-- transactions are properly recorded, processed, and summarized to permit the preparation of the financial statements in accordance with generally accepted accounting principles;

-- transactions are executed in accordance with laws governing the use of budget authority and other laws and regulations that could have a direct and material effect on the principal financial statements; and

-- assets are safeguarded against loss from unauthorized acquisition, use, or disposition.

## Financial Reporting

The present system of internal control is adequate to ensure that obligations, expenditures and payables are recorded, processed, and summarized in a manner that will permit preparation of agency financial statements in accordance with generally accepted accounting principles.

We conducted tests of transactions, on a sample basis, to determine whether controls have been implemented, are operating as designed and constitute an effective control. Since sampling involves an examination of less than the entire population of transactions, we cannot conclude that existing controls, whether considered individually or collectively, are 100% effective.

Our audit tests did identify some transactions that were processed to payment outside of the framework of established controls. These payments, which totaled $88,000, were not recorded in the FFS system until the vendor invoice was submitted and payment was authorized. In one case, the agency's promise to pay $6,000 in future vendor travel costs remained unrecorded on September 30, 2000.

However, we can conclude that at least 95% of transactions are being processed within the established control framework. This outcome provides the assurance concerning the effectiveness of internal control that is required to support financial reporting.

## Compliance with Laws and Regulations

The RRB has implemented controls designed to ensure agency compliance with laws and regulations that govern activities such as appropriation management and the timeliness of payment to vendors of goods and services.

These controls are centered in the FFS system that is used to record and process the agency's financial obligations, expenditures and accounts payables. This process begins with the initial commitment of funds by requisition through acceptance of the goods or services and the final liquidation of the account payable with a cash disbursement. The FFS is also used to coordinate and record the approval process and manage the agency budget.

Our review determined that the controls designed to ensure compliance with applicable laws and regulation were operating. However, we identified two training procurements that had circumvented the major management controls designed to ensure legal and regulatory compliance. As a result, we cannot conclude that internal control is adequate to ensure compliance with laws and regulations governing the procurement process or the management of appropriated funds.

BFO staff records receipt of an invoice for goods or services on FFS and processes payment through the automated system. However, if an invoice for goods or services is received that has not previously been recorded on FFS as a purchase order or miscellaneous obligation, BFO requests an authorizing signature from the responsible organizational unit prior to processing the payment. The current control structure does not provide for questioning or rejecting invoices approved in this manner. As a result, payment may be made for goods or services that have not been subject to the appropriate management review and approval process that is centered in FFS.

Although the exceptions identified by the audit represent a weakness in the design of internal control, they do not adversely impact the ability of agency management to prepare financial statements that are free of material misstatement.

<u>Safeguarding of Assets</u>

The RRB has implemented internal controls designed to ensure that assets, in this case funds deposited to the agency's account with the Department of the Treasury, are safeguarded against loss from unauthorized acquisition, use, or disposition.

The FFS is password protected to prevent unauthorized access. In addition, the FFS includes a core security system that limits the privileges of FFS users to the specific activities determined by the requirements of their job description. These security profiles mirror the separation of duties that exists in agency operations.

We reviewed FFS security profiles for selected individuals and observed that, in most cases, system access and authorizations have been appropriately assigned. However, we did identify several exceptions in which individuals had authorization to initiate transaction processing in a manner that exposes the agency to risk of loss.

Although the exceptions identified by the audit represent a weakness in the implementation of internal control, they do not adversely impact the ability of agency management to prepare financial statements that are free of material misstatement.

## Procurement Controls Can Be Circumvented

Internal control should provide reasonable assurance that transactions are executed in accordance with applicable laws and regulations. Although the RRB has established internal procedures designed to ensure such compliance, transactions may be processed to payment without being subject to established controls.

Current agency procedure does not provide for the identification of procurements that may not have been processed subject to applicable management controls. As a result, transactions may not be executed in accordance with applicable law, implementing regulation and management policy. In addition, valid obligations may not be accurately recorded and reported.

Our audit identified two agreements executed using procedures intended for training procurements that should have been handled as service contracts. (The individual who initiated these procurements has stated that they were not aware that other procedures might apply.) Under current agency procedure, service contracting is subject to a more thorough review and approval process than is required for simple training procurements.

Payments totaling $88,000 were disbursed without being subject to the management controls that provide for the review of service contracts for compliance with the Federal Acquisitions Regulations (FAR) and appropriations law. In addition, the agency's obligation to pay an additional $6,000 in vendor travel expenses remained unrecorded at fiscal year-end. These agreements were executed at the bureau level without the involvement of the Bureau of Supply and Service.

Responsibility for the training of agency personnel has been delegated to the various organizational units within the RRB. Each unit is authorized to plan and execute training agreements using form SF-182, "Request, Authorization, Agreement and Certification of Training." Delivery of a signed SF-182 to a training vendor obligates the government to pay for training services.

However, the SF-182 is designed to process training requests for individuals. In the cases questioned by the audit, the SF-182 was used to obligate the government for payment of bulk and group training agreements for which it was not designed. These agreements were valued at $66,000 and $28,000 ($22,000 for training, $6,000 for vendor travel), respectively, of which $88,000 was paid in advance.

Training agreements processed using form SF-182 can be processed to payment with only the signature of the head of the user organization. By comparison, Basic Board Order (BBO) 5, "Procurement, Property, Supplies and Service," which communicates agency procedures governing the procurement of goods and services, establishes a hierarchy of approvals for procurements as shown below.

| LEVEL | APPROVING INDIVIDUAL OR GROUP | TYPE OF TRANSACTION |
|---|---|---|
| First | Head of the User Organization | All Requisitions |
| Second | Director of Supply and Service | All Requisitions |
| Third | Executive Committee | Requisitions over $25,000 |
| Fourth | The Three-member Board | Requisitions over $100,000 |

If the training agreements questioned by the audit had been treated as service contracts, they would have been subject to several levels of management review and approval. In addition, the procurement of training services would have become the responsibility of the Bureau of Supply and Service which has the expertise to ensure compliance with applicable laws and regulation.

A discussion of the transactions questioned by the audit follows.

Bulk Training Agreement

The RRB entered into an agreement with a single vendor for 254 training units priced at $260 each for a total of $66,040. The agreement was executed using form SF-182. A separate form was executed for each of the two organizational units funding the agreement. The agreement did not specify the classes to be provided, when classes would take place or who would attend.

The forms SF-182 were executed February 11, 2000, and payment was processed based on the vendor's invoice that same month. No obligation of funds was recorded in the FFS system; advance payment was approved by the user organization upon receipt of invoice. Training valued at approximately $10,000 was still unused at September 30, 2000.

This agreement should have been handled as a service contract and subject to the requisition approval process. In this case, because the procurement exceeded $25,000, the agreement would have been subject to review and approval by both the Director of Supply and Service and the RRB's Executive Committee.

Agreement for Group Training

The RRB entered into an agreement to receive training services, valued at $22,000, at RRB headquarters. In addition, the agency agreed to pay up to $6,000 in related travel expenses incurred by the instructor for a total cost of $28,000.

Form SF-182 was executed August 16, 2000, and payment was processed based on the vendor's invoice in September. No obligation of funds was recorded in the FFS system; payment of $22,000 was approved by the user organization directly upon receipt of invoice; no funds related to the travel expenses were obligated or disbursed during FY 2000.

The training agreement was executed without specifying a date. The class for which the agency had contracted and paid could not take place during FY 2000 because the RRB personnel for whom the training was intended were not available. The class was later scheduled to take place in March 2001.

This agreement should have been processed as a service contract and subject to the requisition approval process. In this case, because the total cost of the procurement exceeded $25,000 the agreement would have been subject to review and approval by both the Director of Supply and Service and the RRB's Executive Committee.

Compliance With Laws and Regulations

Our examination of these agreements raises issues concerning the ability of the agency to ensure compliance with laws and regulations governing procurement activity and appropriation management.

Because the agreements for bulk and group training services were not subject to management controls designed to ensure compliance with Federal Acquisitions Regulations (FAR), compliance with all applicable FAR provisions has not been assured. The FAR includes detailed requirements that govern the various aspects of procurement activity including:

-- contract financing methods (payments in advance);
-- required levels of vendor competition;
-- limits on sole source procurement;
-- multi-year service contracts; and
-- contract language.

In addition, both agreements are service contracts that raise appropriation law issues because vendor performance takes place, in full or in part, in a fiscal year other than the one from which they were funded.

In general, services are viewed as chargeable to the appropriation current at the time the services are rendered (GAO/OGC-91-5, Appropriations Law, Volume I, pages 5-22).

According to the GAO:

> The Comptroller General has held that the question of whether to charge the appropriation current on the date the contract is made or to charge funds current at the time the services are rendered depends on whether the services are “severable” or “entire.” (GAO/OGS-91-5, Appropriations Law, Volume 1, pages 5-22 to 5-23)

The Comptroller General has held that a single training course is a non-severable service but that the individual courses making up a curriculum are severable. When an individual course begins in one fiscal year and completion extends into the next, the non-severable nature of the service justifies charging the prior year appropriation rather than the one in effect when the course is completed or pro-rating the expense between two fiscal years. However, individual, severable training classes that begin and end in a single fiscal year should be charged to the appropriation in effect when the training services are rendered.

The RRB’s bulk training agreement was designed to provide individual training classes. Course selection and attendance was not specified at the time the SF-182 was issued. This is <u>not</u> an instance in which a single, non-severable course extends across fiscal years. The classes provided under the agreement were scheduled separately for any number of different individuals at a variety of dates and times. At the end of FY 2000, all of the training to be provided under this agreement had not been scheduled.

The group training services to be provided on-site at RRB headquarters appear to be non-severable. However, severability is not an issue since there was no performance under the contract during FY 2000. The RRB did not confirm the availability of its personnel and facilities before entering into the agreement. As a result, the agency was unable to detail the designated staff to training before the end of the fiscal year and the class could not be held during FY 2000.

The two agreements neither restricted contractor performance to FY 2000 nor provided an escape clause for the RRB in the event that all services were not provided during FY 2000.

The OIG believes that the cost of training services, including vendor travel expenses, rendered during FY 2001 under both the bulk and group training agreements should be charged to the RRB's FY 2001 appropriation.

In addition, if the entire agreement for group training is properly an expense of FY 2001, the agreement may be a contract entered into in advance of the FY 2001 appropriation and, as such, a violation of the Anti-Deficiency Act. The Anti-Deficiency Act (31 U.S.C.§ 1341) prohibits Federal employees from making or authorizing an expenditure or obligation exceeding an amount available in an appropriation for expenditure or obligation.

As a result of this audit, the Chief Financial Officer:

- issued a memorandum reminding agency bureau and office heads of their financial management responsibilities and of the role of the FFS system in managing administrative funds, and

- obtained the guidance of the agency's general counsel concerning the appropriation law issues raised by this audit.

The RRB's General counsel has concluded that "all of the costs for the training at issue . . . should be chargeable to the fiscal year 2000 appropriation and that, consequently, there is no violation of the Anti-Deficiency Act (Legal Opinion L-2001, January 5, 2001).

In addition, the Director of Supply and Service has issued a memorandum to remind top management of the designated agency procurement officials (individuals who may commit the RRB to contractual obligations). That memorandum also includes information concerning the competition requirements established in the FAR.

Recommendation

We recommend that BFO develop procedures to identify invoices submitted for payment without the prior creation of an obligating document on FFS when such invoices may indicate that applicable agency controls have been circumvented so that remedial action can take place (Recommendation #1).

Management's Response

BFO has released a memorandum to bureau and office heads reminding them and their staff to enter an obligating document on FFS at the time they expect to incur an obligation. In addition, BFO will provide bureau and office heads with a quarterly report listing payment vouchers processed without reference to an obligating document so that they can take any necessary remedial action.

The full text of BFO's response is included as Appendix I to this report.

**Separation of Duties**

During our review of FFS security profiles, we identified several cases in which inadequate separation of duties increases the RRB's risk of loss from error or fraud.

Internal control should be designed to provide reasonable assurance that agency assets are safeguarded from unauthorized acquisition, use, or disposition through prevention or prompt detection.

GAO's "Standards for Internal Control in the Federal Government" states that transactions and other significant events should be authorized and executed only by persons acting within the scope of their authority. It also states that key duties and responsibilities need to be divided or segregated among different people to reduce the risk of error or fraud; no one person should control all key aspects of a transaction.

Our examination of FFS system security profiles disclosed that several members of BFO's staff have FFS accesses and authorizations that permit them to execute all key aspects of a disbursement transaction. For example, these individuals can establish new vendors, create obligations and authorize payment vouchers without obtaining a second level of authorization at any step.

In addition, the Director of Supply and Services has FFS system accesses and authorizations that enable him to order goods and services up to $25,000 and approve payment without the knowledge or participation of other agency personnel. The Director of Supply and Service was granted the standard FFS accesses for both a procurement official and a bureau director. This circumstance, unique to this director's position within the agency organizational structure, creates a weakness in internal control due to lack of separation of duties.

As a result of the instances in which the principle of separation of duties has not been fully implemented, the RRB is exposed to increased risk of loss through error or fraud.

Recommendations

We recommend that BFO:

- modify FFS system accesses and authorizations as necessary to eliminate the instances of inadequate separation of duties identifiedby the audit (Recommendation #2);

- establish a monetary threshold above which payment vouchers will require a second level of authorization (Recommendation #3); and

- review FFS system security profiles to identify any other potential instances where lack of separation of duties increases the agency's risk of loss (Recommendation #4).

Management's Response

BFO has implemented, or plans to implement, the recommended corrective actions. Bureau management has modified the FFS system accesses of Treasury, Audit and Debt Recovery Division staff to eliminate instances of inadequate separation of duties in the processing of payment vouchers. They have also modified FFS to require a second level of approval for payment vouchers of $100,000 or more. BFO's Financial Management section will review FFS system security profiles to identify any potential instances where lack of separation of duties increases the agency's risk of loss.

In addition, the Director of Supply and Service has stated that he never used the FFS receiver transaction and requested that his authority to enter receivers into the FFS system be removed as soon as the control weakness was brought to his attention.

## *OTHER MATTERS OF INTEREST*

During the audit, we identified two matters that do not warrant recommendations for corrective action but which may be of interest to agency management. The following information is presented for management's information and whatever action they may deem appropriate.

Payment Authorization for Medical Examinations

The RRB contracts with a single vendor to provide the consultative medical opinions that are used in the adjudication of disability claims. As part of the sample review process, we traced 10 payment vouchers to the supporting documentation in the disability applicant's claim folder. In one case, the claim folder documentation did not include the identity or signature of the claims examiner who authorized payment.

The Office of Programs Disability Benefits Division (DBD) requires the services of medical consultants in the adjudication of claims for disability benefits. Medical consultants review the medical evidence submitted in support of an applicant's claim and provide a written opinion of their evaluation of the evidence.

Unlike payment vouchers for most other goods and services which are entered into FFS by BFO personnel upon submission of an approved invoice, payment vouchers for medical consultant opinions are authorized by claims examiners in DBD.

A payment voucher is automatically created when the claims examiner advises the FFS that the consultant's opinion has been received and accepted. FFS captures the authorizing examiner's computer user identification as part of the audit trail for financial accounting purposes.

In addition, the Office of Programs requires the authorizing examiner to sign the form on which the consultant's opinion has been submitted. The consultant's opinion is then filed in the applicant's claim folder to document the authorizing examiner's identity. An applicant's claim folder is subject to several reviews during the claim adjudication process and the identity of the authorizing examiner may be of interest to future users of the evidence in the file.

Because the transaction was fully documented on FFS, the omission of the authorizing examiner's signature was not considered an error for audit purposes. However, management may have program objectives that relate to this requirement.

FFS Receiver May Be Under-used

The receiver is an FFS system document that can be used to record receipt and acceptance of goods and services. Use of a receiver is optional. The purchase order that is created to record the order specifies whether an automated receiver will be used to signify acceptance. If no receiver is required, the vendor's invoice must be manually approved prior to processing.

The receiver feature of FFS may be under-used. We analyzed 20,651 payment vouchers entered onto the FFS system between October 1, 1999 and June 30, 2000 (nine months). Approximately two-thirds of the payment vouchers were processed using a receiver. However, by special arrangement with the vendors, all payments to medical consultants are processed using FFS receivers. (The RRB has entered into contracts that centralize the procurement of medical consultant services that support the disability program.) Of the remaining 8,552 payment vouchers processed, only 10% were processed with automated FFS receiver. The following table presents the results of our analysis.

Payment Vouchers Processed 10/01/1999 – 06/30/2000

| | Receiver | Without A Receiver | TOTAL | % Processed with a Receiver |
|---|---|---|---|---|
| Medical Consultants | 12,099 | 0 | 12,099 | 100% |
| Other Vendors | 865 | 7,687 | 8,552 | 10% |
| Total | 12,964 | 7,687 | 20,651 | |
| | 63% | 37% | 100% | |

When a receiver is entered into FFS, the recipient of the goods or services is authorizing the processing of payment upon submission of an invoice by the vendor. The system captures the identity of the authorizing party and an account payable is recognized. When the invoice is received, BFO personnel create a payment voucher on FFS.

When a receiver is not required, the recipient of the goods or services must manually authorize payment of the invoice when it is submitted. Once manual authorization has been received, BFO personnel will enter a payment voucher. In the absence of a receiver, creation of the payment voucher results in recognition of the account payable.
The 20,651 payment vouchers entered during the first nine months of the fiscal year represent goods and services valued at approximately $9.7 million of which only $4.0 million was processed using an automated receiver.

Management's Response

The Bureau of Supply and Service expects new procedures for the acceptance of goods/services and certifying invoices to be issued in the near future. These new procedures are expected to address concerns that the automated receiver may be under-used.