Management Information Report
Compliance with SFFAs #17: "Accounting for Social Insurance"
Report 03-07, May 22, 2003

INTRODUCTION

This management information report presents the results of the Office of Inspector General's (OIG) assessment of the Railroad Retirement Board's (RRB) compliance with requirements for disclosure of supplementary information for social insurance programs.

Background

The RRB is an independent agency in the executive branch of the Federal government. The RRB administers retirement/survivor and unemployment/sickness insurance benefit programs for railroad workers and their families under the Railroad Retirement Act (RRA) and the Railroad Unemployment Insurance Act (RUIA). These programs provide income protection during old age and in the event of disability, death or temporary unemployment and sickness. The RRB paid approximately $8.8 billion in benefits during fiscal year (FY) 2002.

The Federal Accounting Standards Advisory Board (FASAB) is the authoritative standards-setting body whose Statements on Federal Financial Accounting Standards (SFFAS) lead the hierarchy of Federal accounting standards. FASAB's Accounting and Auditing Policy Committee has authority to provide guidance related to existing accounting standards.

SFFAS #17 presents accounting standards for Federal social insurance programs, including the benefit programs established under the RRA. The standard requires that the financial reports of Federal agencies with responsibility for selected social insurance programs:

- reflect recognition of a liability when payments are due and payable to beneficiaries or service providers; and
- disclose specific information assessing the long-term sustainability of the program including its ability to raise resources from future program participants to pay for benefits proposed to present participants.

Prior OIG audits of the RRB's financial statements have identified areas of non-compliance in both the form and content of the social insurance disclosures since the agency was first required to publish them with its FY 2000 financial statements.

FASAB has proposed the reclassification of selected portions of the currently required information from its current designation of "required supplementary stewardship information" (RSSI) to an "integral part of the basic financial statements, essential for fair presentation in conformity with GAAP."[1] The reclassification issue is currently being debated within the Federal accounting and auditing community.

The Bureau of the Actuary, under the direction of the agency's Chief Actuary, supports RRB operations by providing statistical and actuarial services. The bureau is responsible for periodically determining the actuarial soundness of the benefit systems, recommending certain railroad retirement tax rates, and calculating the amount of the financial interchange with the social security system.

The Bureau of the Actuary also prepares the social insurance disclosures required under SFFAS #17 and submits them to the RRB's Bureau of Fiscal Operations for inclusion in the agency's published financial statements. The Bureau of Fiscal Operations is responsible for the RRB's internal and external financial reports, including the agency's annual financial statements.

Objective, Scope And Methodology

The objective of this evaluation was to assess compliance with the disclosure requirements of SFFAS #17. The scope of this review was limited to the social insurance disclosures as prepared for inclusion with the RRB's financial statements for the fiscal year ended September 30, 2002.

In order to achieve our objective, we:

- reviewed the draft RRA social insurance disclosures ;
- identifed applicable criteria and related guidance;
- considered prior audit opinions;
- interviewed responsible management and staff in the RRB's Bureau of the Actuary;
- developed a detailed comparison of the draft disclosures with the provisions of SFFAS #17;
- presented a detailed compliance assessment to responsible management prior to publication; and
- evaluated the social insurance disclosures as published with the RRB's FY 2002 financial statements.

Our work was conducted in accordance with generally accepted auditing standards as applicable to the objectives. Fieldwork was conducted at RRB headquarters during October and November 2002 and March 2003 in conjunction with the OIG's audit of the RRB's financial statements for the fiscal year ended September 30, 2002.

---

[1] Generally Accepted Accounting Principles.

The OIG's fieldwork was timed to provide management with the opportunity to make revisions prior to formal publication of the social insurance disclosures in the RRB's annual financial statements. The Bureau of the Actuary provided the draft disclosures to the OIG on September 18, 2002; the OIG responded with a detailed assessment on October 17, 2002. The RRB's audited financial statements were released on January 30, 2003.

RESULTS OF REVIEW

The social insurance disclosures for the railroad retirement program, as published with the RRB's audited financial statements for the fiscal year ended September 30, 2002, do not fully conform to FASAB requirements. We presented our findings to the Bureau of the Actuary based on a review of the document in draft. The Bureau of the Actuary reviewed the issues and made those revisions that they considered appropriate prior to publication. We have presented our findings with respect to those matters that were not adequately addressed by pre-publication revisions and no further recommendations for corrective action have been offered.

The RRB has not published social insurance disclosures that fully conform to the requirements of SFFAS #17 since such disclosures were first presented with the agency's FY 2000 financial statements. Agency management needs to be alert to the ramifications of FASAB's proposed reclassification of this information and take action to ensure that the proposed revision to SFFAS #17 does not become an obstacle to an unqualified audit opinion on future financial statements.

FY 2002 Social Insurance Disclosures

The RRB's published statement of social insurance for the railroad retirement program does not present projections for the required demographic groups and is based on cash flow projections that include interest on intragovernmental borrowing. In addition, the discussion of program sustainability focuses attention on selected program components and away from the the financial soundness of the program as a whole. As a result, the agency's FY 2002 social insurance disclosures for the railroad retirement program do not fully conform to the requirements of SFFAS #17.

SFFAS #17 established standards for reporting information on social insurance programs. These standards are intended to assist users in evaluating operations and aid in assessing the government's financial condition and the sufficiency of future budgetary resources. The standard requires that social insurance programs include in their financial reports:

- a clear and concise description of the program,
- how the program is financed,
- how benefits are calculated, and
- the program's financial and actuarial status.

The standard requires inclusion of a statement, commonly called the “statement of social insurance,” presenting the actuarial present values of future benefits, contributions and tax income.

We reviewed the draft social insurance disclosures prepared for inclusion with the RRB’s FY 2002 financial statements. We evaluated these draft disclosures against the requirements of SFFAS #17, and advised the Bureau of the Actuary that they did not meet the applicable requirements with respect to the reporting of financial and actuarial status. We also noted that, in some respects, the narrative and graphic presentations did not adequately address the objectives of SFFAS #17.

As a result of our discussions, the Bureau of the Actuary revised the draft social insurance disclosures to offer a more clear and concise program description, and improve the presentation of actuarial status by including comparative data for prior years. However, the Bureau of the Actuary determined not to revise certain other aspects of the presentation. As a result, the social insurance disclosures included with the RRB’s published financial statements for the fiscal year ended September 30, 2002, could not be considered in full conformance with FASAB standards.

The published statement of social insurance does not present projections for the demographic groups specified by SFFAS #17. In addition, the published cash flow projections are not presented net of interest on intragovernmental borrowing and lending in accordance with the standard. We also believe that the discussion of program sustainability does not achieve the objectives of the standard because it focuses on the financing issues related to selected program components rather than the railroad retirement program as a whole. Because these disclosures are presently classified as RSSI, this assessment did not affect the auditors’ opinion on the financial statements.[2]

A detailed discussion of our findings with respect to the FY 2002 demographic presentation, cash flow projections and discussion of program sustainability follows.

<u>Demographic Presentation</u>

The statement of social insurance, as published with the RRB’s financial statements for the fiscal year ended September 30, 2002, does not present projections for the demographic groups specified by SFFAS #17.

SFFAS #17 requires presentation of a statement of actuarial present values of future contributions, tax income and expenditures during the projection period to, from, or on behalf of:

- current participants who have not yet attained retirement age,
- current participants who have attained retirement age,
- those who are expected to become plan participants.

[2] Required Supplementary Stewardship Information, or RSSI, is not part of the basic financial statements and is subject to only limited review procedures.

The current actuarial model does not produce data in the demographic profile required by the standard. The draft disclosures project income and expenditures for:

- retired employees and dependents,
- employees not yet retired and dependents, and
- new entrants and dependents.

Interest on Intragovernmental Borrowings

The statement of actuarial present values, as published with the RRB's financial statements for the fiscal year ended September 30, 2002, does not present projections net of interest on intragovernmental borrowing and lending.

SFFAS #17 requires that cash flows be presented net of interest on intragovernmental borrowing and lending. The RRB's expenditures include interest on cash advances from the U.S. Department of the Treasury. The agency incurs in excess of $200 million per year in interest costs as a result of these borrowings.

Discussion of Program Sustainability

The description of the actuarial and financial status of the railroad retirement program, as published with the agency's financial statements for the fiscal year ended September 30, 2002, focuses attention on the performance of the individual components of the railroad retirement program. As a result, it does not provide a cohesive, meaningful summary of the program's current financial and actuarial status and financial outlook.

SFFAS #17 requires that the entities responsible for social insurance programs include in their financial reports, as required supplementary stewardship information, a clear and concise description of the program's financial and actuarial status. The description should include a discussion of the long-term sustainability and the financial condition of the program.

The RRB's presentation:

- over-emphasizes the dynamics of individual trust funds;
- does not convey the significance of the financial interchange with the Social Security system which provided approximately 34% of the RRA program's financing during FY 2002; and
- describes the relationship of employment taxes and taxable payroll to program solvency almost exclusively in terms of tier II tax rates.[3]

[3] The railroad retirement program is funded through a two-tier payroll tax system. Tier I taxes are assessed at the same rate paid by employers and employees under the Social Security System. The tier II tax is an additional payroll tax that is unique to the Railroad Retirement system.

The OIG's recommendations for corrective action were made prior to publication of the RRB's FY 2003 financial statements. Accordingly, the foregoing findings pertain only to those matters that were not adequately addressed by pre-publication revisions and no further recommendations for corrective action are presented here.

Management's Response

The Bureau of the Actuary disagrees with the findings as presented. In general, they believe their position on demographics is defensible, the treatment of interest complies with SFFAS #17 requirements and the OIG's criticism of the discussion of program sustainability is "subjective."

The Bureau of the Actuary has submitted its rationale concerning the demographic presentation to FASAB.

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

OIG's Comments on the Bureau of the Actuary's Response

In their response, the Bureau of Actuary detailed their position concerning the demographic presentation and stated that they have submitted their rationale to FASAB. However, their discussion of intragovernmental interest does not address the specific transaction questioned in our report. In addition, they have dismissed our findings concerning the sufficiency of the discussion of program sustainability as "subjective," which ignores the very specific criticisms that we offered.

The RRB's discussion of program sustainability ignores the overall dependence of the Railroad Retirement program on the solvency of the Social Security trust funds while highlighting the financing features of the tier II annuity component. This is an important aspect of the program's current financial condition and future sustainability which should be clearly communicated in the agency's social insurance disclosures.

Proposed Reclassification Would Increase The Impact Of Non-Conformance

RRB management needs to ensure that the agency will not be adversely impacted by FASAB's proposed reclassification of the social insurance disclosures presented in conjunction with its financial statements.

In December 2002, FASAB confirmed its previous tentative decision to classify the statement of social insurance as an integral part of the basic financial statements, and classify other information about social insurance as required supplementary information effective with FY 2005 reporting. No changes to the form and content of the disclosures have been proposed.

Currently, all social insurance disclosures required by SFFAS #17 are classified as required supplementary stewardship information (RSSI). For purposes of a financial statement audit, RSSI is subject to only limited review procedures which consist principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. Under most circumstances, non-conformance with form and content requirements will not impact the auditors' opinion on the financial statements.

Although not yet formally adopted, FASAB's planned reclassification will make the information about the RRB's financial and actuarial status that is disclosed in the statement of social insurance "essential for fair presentation in conformity with GAAP." As a result, the data presented will be subject to much more rigorous audit procedures. In addition, deficiencies in the form and/or content of the statement of social insurance could become the basis for an adverse or qualified opinion.

The OIG believes that the Bureau of Fiscal Operations needs to begin planning now to ensure the agency's ability to respond to a revised reporting standard. The limited procedures that auditors apply to RSSI may not have disclosed all of the non-conformances that will need to be addressed. In addition, the complexity of the processes that support preparation of the statement of social insurance may preclude revision on short notice.

<u>Recommendation</u>

We recommend that the Bureau of Fiscal Operations work with the Bureau of the Actuary to ensure future compliance with the requirements of SFFAS #17. These efforts should include:

- obtaining a detailed comparison of SFFAS #17 requirements with the RRB's current presentation;
- identifying any ambiguities in the standard that may require further research;
- assessing the agency's ability to comply with the existing requirements and the timeframe required to do so; and
- determining whether the RRB will need to take action in advance of formal adoption of the FASAB modifications to ensure the agency's ability to comply with the proposed revision.

<u>Management's Response</u>

The Bureau of Fiscal Operations cited the Bureau of the Actuary's position concerning the compliance of the RRB's FY 2002 social insurance disclosures but agreed to implement the OIG's recommendation "based on any new information from FASAB."

The full text of the Bureau of Fiscal Operations' response is included as Appendix II to this report.

OIG's Comments on the Bureau of Fiscal Operations' Response

We feel that the Bureau of Fiscal Operations' response may be shortsighted in its emphasis on information from FASAB. This response tends to focus the discussion on the single issue that was submitted to that standard-setting body. The qualitative issues pertaining to the content of the discussion of program sustainability are equally important and weighed heavily in the OIG's decision to assess the FY 2002 disclosures as not fully conforming to SFFAS #17.

UNITED STATES GOVERNMENT

MEMORANDUM

FORM G-115f (1-92)

RAILROAD RETIREMENT BOARD

May 9, 2003

TO: Henrietta B. Shaw
Assistant Inspector General, Audit

FROM: Frank J. Buzzi *Frank J. Buzzi*
Chief Actuary

SUBJECT: Draft of Management Information Report
Compliance with SFFAS #17: "Accounting for Social Insurance"

We have reviewed the above draft audit report dated April 30, 2003. Although no recommendations are directed to the Bureau of the Actuary, we are responsible for preparing the disclosures mandated by SFFAS #17 and appreciate the opportunity to review and comment on the report.

The draft of the report states on page 5 that **"The statement of social insurance, as published with the RRB's financial statements for the fiscal year ended September 30, 2002, does not present projections for the demographic groups specified by SFFAS #17.**

"SFFAS #17 requires presentation of a statement of actuarial present values of future contributions, tax income and expenditures during the projection period to, from, or on behalf of:

- **current participants who have not yet attained retirement age,**
- **current participants who have attained retirement age,**
- **those who are expected to become plan participants.**

"The current actuarial model does not produce data in the demographic profile required by the standard. The draft disclosures project income and expenditures for:

- **retired employees and dependents,**
- **employees not yet retired and dependents, and**
- **new entrants and dependents."**

The standard is not specific as to the definition of "retirement age" and, given that it applies to a number of unique government programs, was written to allow a certain amount of flexibility in the assumptions used. As stated on page 2, paragraph VI of the Executive Summary of the standard, "Although some RSSI (Required Supplementary Stewardship Information) is required for all programs, the differences in financing and benefits among programs require some tailoring of the RSSI." We feel that the use of our three demographic groupings in the actuarial projections is in compliance with the standard. We have submitted our rationale to the FASAB and are awaiting their reply.

On page 6, the draft report comments, **"SFFAS #17 requires that cash flows be presented net of interest on intragovernmental borrowing and lending. The RRB's expenditures include interest on cash advances from the U.S. Department of the Treasury."**

Page 10 of the standard states:

> "The cashflow information should show
> (i) total cash inflow from:
> 1) all sources and
> 2) excluding net interest on intragovernmental borrowing/lending, and
> (ii) total cash outflow."

Chart 1 in our statement of social insurance shows actuarial estimates of railroad retirement annual income (cash inflow from all sources), income excluding interest (cash inflow excluding interest), and expenditures (total cash outflow). Our chart was modeled after hypothetical illustrations included in Appendix B of the standard. For example, the sample chart of OASDI cash inflow and outflow on page 49 of the standard shows total inflow (defined on page 48 as payroll taxes, income tax on benefits, interest income, and miscellaneous reimbursement from the general fund); cash inflow excluding interest (defined on page 48 as income exclusive of interest on trust fund assets); and total outflow (defined as benefit payments, administrative expenses, net transfers to the Railroad Retirement program, and vocational rehabilitation expenses for disabled beneficiaries). We believe that our chart and the accompanying information comply with the requirements of the standard.

Finally, on page 6 the report states, **"The RRB's presentation:**

- **over-emphasizes the dynamics of individual trust funds;**
- **does not convey the significance of the financial interchange with the Social Security system which provided approximately 34% of the RRA program's financing during FY 2002; and**
- **describes the relationship of employment taxes and taxable payroll to program solvency almost exclusively in terms of tier II tax rates."**

Our original draft presentation, which was more detailed in some respects, including the workings of the financial interchange, was revised with the intention of being more clear and concise as a result of discussions with the Office of Inspector General. We believe that this finding is subjective and that the current version of our presentation is adequate. Hence, we respectfully disagree.

cc: Chief Financial Officer
Director of Fiscal Operations

UNITED STATES GOVERNMENT
MEMORANDUM

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

MAY 13 2003

TO : Henrietta B. Shaw
Assistant Inspector General, Audit

FROM : Kenneth P. Boehne
Chief Financial Officer

SUBJECT: Draft Management Information Report -
Compliance with SFFAS #17: "Accounting For Social Insurance"

Thank you for the opportunity to review and comment on the subject draft report.

The RRB's Chief Actuary also reviewed and commented on the draft report. He commented that "We feel that the use of our three demographic groupings in the actuarial projections is in compliance with the standard. We have submitted our rationale to the FASAB[1] and are awaiting their reply." The Chief Actuary also explained his presentation of total cash inflow from all sources and excluding net interest on intragovernmental borrowing/lending, and total cash outflow. He concluded that "We believe that our chart and the accompanying information comply with the requirements of the standard."

Nonetheless, we will implement the recommendation to work with the Bureau of the Actuary to ensure future compliance with the requirements of SFFAS #17 based on any new information from FASAB.

cc: Chief Actuary
Director of Fiscal Operations

[1] FASAB is the Federal Accounting Standards Advisory Board which published Statement of Recommended Accounting Standards Number 17, Accounting for Social Insurance.