OFFICE OF INSPECTOR GENERAL

Audit Report

Fiscal Year 2006 Financial Statement Audit Letter to Management

Report No. 07-01
February 9, 2007

RAILROAD RETIREMENT BOARD

U.S.A.

RAILROAD RETIREMENT BOARD

UNITED STATES RAILROAD RETIREMENT BOARD

OFFICE OF INSPECTOR GENERAL

February 9, 2007

Michael S, Schwartz
Chairman
U.S. Railroad Retirement Board

The purpose of this letter is to transmit a memorandum on internal control communicating certain matters concerning internal control that came to our attention during our recent audit of the Railroad Retirement Board's (RRB) financial statements.

We have audited the RRB's general purpose financial statements and issued our report thereon dated November 3, 2006, except for matters relating to the fair market value of the net assets of the National Railroad Retirement Investment Trust as of September 30, 2006, as to which the date was November 15, 2006. We performed our audit in accordance with U.S. generally accepted government auditing standards and OMB audit guidance as applicable to the scope of our audit.[1] We have not considered internal control since the end of our general purpose fieldwork on November 3, 2006; internal control was not among those matters to which we gave consideration between November 3rd and November 15th.

During our audit, we noted certain matters involving the RRB's internal control structure and its operation that, individually, did not rise to the level of a reportable condition, the details of which are presented in the attached memorandum. That memorandum also presents the full text of those matters previously reported as material weaknesses and reportable conditions in conjunction with our opinion on the financial statements. However, neither this letter, nor the attached memorandum, modifies our report dual dated as of November 3, 2006 and November 15, 2006**,** referred to above.

Our observations concerning internal control were presented to responsible agency management who were offered the opportunity to review and comment on the draft memorandum. Their responses are also attached.

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

[1] See our report on the RRB's financial statements for a full description of the scope and methodology.

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. 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.

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.

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

Very truly yours,

Martin J. Dickman

Martin J. Dickman
Inspector General

Attachments

cc: V.M. Speakman, Jr., Labor Member
Jerome F. Kever, Management Member
Kenneth P. Boehne, Chief Financial Officer
John M. Walter, Chair, Management Control Review Committee
Steven A. Bartholow, General Counsel
Frank J. Buzzi, Chief Actuary
Beatrice E. Ezerski, Secretary to the Board

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MEMORANDUM ON INTERNAL CONTROL

MATERIAL WEAKNESSES AND REPORTABLE CONDITIONS

In conjunction with our opinion on the RRB's financial statements for the fiscal years ended September 30, 2006 and 2005, we reported the following material weaknesses and reportable conditions.

Material Weaknesses

Information Security

During FY 2006, the OIG evaluated information security pursuant to the provisions of the Federal Information Security Management Act.[2] Our review disclosed continued weaknesses in many areas of the RRB's information security program. Significant deficiencies in program management and access controls make the agency's information security program a source of material weakness in internal control.

The RRB has undertaken the job of strengthening information security and has implemented many corrective actions recommended by the OIG and other technical specialists. During FY 2006, the agency completed corrective action to eliminate the previously reported significant deficiency in training. Previously identified significant deficiencies in access controls, risk assessments, and periodic testing and evaluation continue to exist, as well as other observed weaknesses in the agency's implementation of requirements for risk based policies and procedures, a remedial action process, continuity of operations, and inventory of systems.

The agency is addressing their significant deficiencies in the previously reported areas of access controls, risk assessments, and periodic testing and evaluation; however, much work remains to be completed.

Performance Measures

During FY 2005, the OIG identified a material weakness in internal control over the preparation and reporting of performance information due to inadequacies in the review and validation of data. Although management has made progress in addressing this weakness, the agency has not yet fully implemented planned corrective action.

During FY 2006, the Office of Programs, the organizational unit responsible for reporting on the largest number of complex statistically based indicators,

[2] "Fiscal Year 2006 Evaluation of Information Security at the Railroad Retirement Board," OIG Report #06-11, September 27, 2006.

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implemented new controls over the preparation, review and approval of performance data originating in that organization. In October 2006, the three-member Board approved an administrative circular establishing standards and assigning responsibility for collecting, documenting, validating, certifying, reporting and retaining performance information.

Although procedural changes have been formally approved, those changes have not been fully implemented, and agency management has not yet operated under these procedures during a period sufficient to evaluate their effectiveness.

Actuarial Projection Process

The RRB needs to strengthen controls over the actuarial projection process that supports the projections and estimates presented in the statement of social insurance, in the notes to the financial statements, and as required supplementary information.

During FY 2005, the OIG performed a detailed evaluation of controls over the actuarial projection process that disclosed inadequacies in internal control over the projection process and related reports.[3] Although responsible management and staff had described extensive controls over the preparation of projections, estimates and reports, they had not formalized their policies and procedures, did not capture evidence of the operation of controls, and did not perform periodic evaluations of compliance with internal requirements.

During FY 2006, the Bureau of the Actuary responded to the OIG's findings by documenting their internal control structure through the RRB's management control review process. This process included development of an updated chart of controls and a bureau-level assessment of the operation of those controls.
Corrective action taken during FY 2006 represents significant progress but management has not yet published formal policies and procedures, developed documentation to support the actuarial model or implemented a formal quality assurance process. These deficiencies were cited in the OIG's FY 2005 evaluation.

[3] "Review of Internal Control Over the Actuarial Projection Process," OIG Report #05-04, May 5, 2005.

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Reportable Conditions

Prompt Payment Act

As a result of an FY 2005 evaluation of controls over compliance with the Prompt Payment Act, the OIG reported that existing systems and procedures had not been effective in ensuring that interest is paid to vendors in accordance with the requirements of the law.[4] At that time, we observed that the RRB did not identify all invoices on which interest should be paid, did not pay the correct amount of interest when a late payment was recognized, and that controls were not adequate to ensure that required restrictions on early payment had been properly implemented.

During FY 2006, the Bureau of Fiscal Operations made substantial progress in correcting the deficiencies in both controls and compliance. However, most changes were implemented more than six months into the fiscal year and have not been tested by the full range of payment experience. In addition, we have observed that management has not yet ensured the level of uniform processing accuracy that would permit the OIG to conclude that the action taken has been fully effective.

Financial Reporting

Over the years agency responsibility for financial reporting has grown from preparation of financial statements within six months of fiscal year-end, to publication of an annual performance and accountability report within 45 days of fiscal year-end. Publication of that report is an exercise in public accountability of which preparation of accurate, reliable financial statements is but a single part.

The Bureau of Fiscal Operations is responsible for publishing the RRB's annual performance and accountability report. That organization has documented procedures and controls over its financial reporting process. During our audit we observed that existing procedures and controls need to be updated to fully ensure the quality of the RRB's response to the expanding responsibilities and short timeframes that are inherent to the reporting process. We also observed that the existing control framework is over-reliant on the OIG's annual audit of the financial statements to ensure the completeness and accuracy of the performance and accountability report.

The OIG and the Bureau of Fiscal operations have already begun discussing ways to strengthen the existing control framework.

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[4] "Review of Compliance with the Prompt Payment Act," OIG Report #05-06, June 15, 2005

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The foregoing finding concerning controls over financial reporting was based on errors and inconsistencies identified during the audit of the RRB's financial statements and supporting documentation that indicate that existing controls are not fully effective. The individual matters that contributed to our overall finding of a reportable condition in internal control over financial reporting are described in detail in the following section of this memorandum. Readers should note that all errors identified during the audit were corrected prior to final publication of agency financial statements.

MATTERS INVOLVING INTERNAL CONTROL THAT, IN THE AGGREGATE, REPRESENT A REPORTABLE CONDITION

During our audit, we noted certain other matters involving internal control that do not rise individually to the level of a material weakness or reportable condition. However, the many matters involving internal control that directly impact the reliability of the financial statements represent, in the aggregate, a reportable condition over financial reporting. A detailed description of these control issues follows.

Errors in the Statements and Related Support Indicate Control Deficiencies

The Bureau of Fiscal Operations (BFO) needs to strengthen controls over the preparation of financial statements.

During our audit, we identified errors in the statements and inconsistencies between the statements and the working papers that support them. These errors and inconsistencies indicate that controls over financial reporting need to be reviewed to ensure that existing controls are operating as designed and to determine what additional controls may be necessary.

<u>Incorrect Allocation of Earmarked Funds</u>

The allocation between "earmarked" and "all other" funds did not agree with the total of preceding lines which impacted the reported net change and ending balances for those two reporting categories. As a result, the Statement of Changes in Net Position for the period ended June 30th was revised as follows:

	Original	Revised	Difference
Net Change			
Earmarked Funds	$175,014,762	($94,751,368)	$269,766,130
All Other Funds	$21,984,567	$291,750,697	($269,766,130)
Ending Balances			
Earmarked Funds	$670,458,393	$400,692,262	$269,766,131
All Other Funds	$35,419,229	$305,185,360	($269,766,131)
Total	$705,877,622	$705,877,622	$0

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Inconsistencies in Earmarked Funds Note

Note #17 reported two different amounts for “Net Cost of Operations” as of September 30th.

Note #17 "Earmarked Funds"	Section: Statement of Net Cost	Section: Statement of Changes in Net Position	Difference
As Originally Reported			
Net Cost of Operations	$9,726,955,353	$9,726,957,766	($2,413)
As Revised			
Net Cost of Operations	$9,726,957,766	$9,726,957,766	$0

The special-purpose financial statement Note #22 “Earmarked Funds” was prepared inconsistent with general-purpose Note #17 with respect to the same $2,413.

Inconsistencies between the Statements and the Working Papers

BFO working papers are the supporting documentation for the preparation of the financial statements. One of BFO’s controls is the use of formatted Microsoft Excel spreadsheets to prepare statements from general ledger trial balance data that has been downloaded from the mainframe computer. The electronic spreadsheets are the “working papers” that document the preparation of the statements from source data.

We identified the three discrepancies between the Statement of Budgetary Resources (SBR) and BFO’s supporting working papers that lead us to question whether the working papers are being used effectively to prepare and support the statements.

- “Adjusted Unpaid Obligations brought forward, October 1” was correctly reported on the SBR as of March 31st, but the balance brought forward per the statement did not agree with the supporting working papers which reported a figure $1,373 higher.
- Line 7, “Total Budgetary Resources,” was correctly reported as of September 30th, but the amount reported on the statement disagreed with BFO working papers which reported a figure $68,739,835 lower than the statement.

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- Line 8, "Obligations Incurred," was correctly reported on the SBR as of June 30th, and the amount on the statement agreed with the total for that line item on the BFO working paper. However, that total did not agree with sum of individual cells in the BFO working paper; the total had been entered directly to the worksheet rather than computed from data in other worksheet cells. The total used in the statement and BFO working papers differed from the sum of amounts in other spreadsheet cells by $3,451.

Discrepancies of this type indicate that spreadsheet controls do not provide for adequate linkage between the final statements and the source working papers or for internal consistency. Such discrepancies are also symptomatic of an incomplete or inadequate review and approval process.

Inconsistencies In the Documentation of Adjusting Journal Entries

In addition to the working papers discussed above, BFO also summarizes adjusting journal entries (AJE) in a worksheet that accompanies the working papers and statements.

We identified differences between the AJEs shown on the working papers that support the financial statements and the worksheet summarizing those same entries. We have summarized the discrepancies in the following table.

				Error resulted in Incorrect…		
Period	**AJE #**	**Per AJE Worksheet**	**Per BFO Working Papers**	**AJE Worksheet**	**BFO Working Papers**	**Financial Statements**
3/31/06	49-T	$20.00	-0-	√		
3/31/06	abc	-0-	$40,393.68	√		
3/31/06	xyz	-0-	$38,393.95	√		
6/30/06	5-T	$17,467.00	-0-		√	
6/30/06	6-T	$38,115.00	-0-		√	
9/30/06	1-P	$24,689.00	-0-		√	
9/30/06	3-P	($24,689.00)	-0-		√	
9/30/06	12-P	($265.50)	-0-		√	**SBR Understated**
9/30/06	7-T	$27,174.63	$22,823.57		√	

Inconsistencies among the financial statements, BFO working papers and AJE worksheet indicate that BFO's review and approval process is not completed prior to release of the statements for audit.

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Incorrect Beginning Balance

The opening balances of three general ledger accounts did not agree with the prior year closing balances. As a result, the statement of financing as of June 30th included the following misstatements:

- Line 15, “Resources that Finance the Acquisition of Assets,” was overstated by $14,436.
- Line 19, “Increase in Annual Leave Liability,” was understated by $81,647.

Opening balances should be routinely checked at the beginning of each fiscal year to ensure the accuracy of financial reporting.

Budgetary Obligations Inconsistent with Proprietary Obligations

An April 2006 journal voucher (JV) 06-07-610 increased the allowance for railroad retirement bad debts and the related expense account, but the budgetary entries were omitted from the paper voucher and were not recorded in the general ledger. As a result, obligations reported in the June 2006 SBR were understated by $158,534.

The simultaneous recording of budgetary and proprietary entries is a strong control over the accuracy of budgetary reporting. The absence of budgetary entries should be recognized as a red flag for further review when non-standard vouchers are processed. As an additional control, budgetary obligations for benefit expense could be periodically reconciled with proprietary expense accounts.

Miscellaneous Misstatements

During the audit, we observed several large misstatements that appear to be due to the lack of an adequate report review and approval process.

- $2.6 billion in unrealized gains related to NRRIT-held investments were reported on the wrong line of the restated FY 2005 general-purpose statement of financing; and
- $1.7 billion in unrealized gains related to NRRIT-held investments were incorrectly reported as gains on disposition in a note to the special-purpose financial statements.

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Better Communication Needed to Ensure Adequacy of Accruals

During FY 2006, the year-end benefit accrual accounting estimates which are prepared by the Bureau of the Actuary did not include provision for a special benefit accrual payment that exceeded $40 million. The Office of Programs estimated the amount of the payments and notified the three-member Board and the agency's executive committee during the first week of October. However, neither BFO nor the Bureau of the Actuary recognized this as a matter that needed to be included in the agency financial statements.

Recommendations

We recommend that BFO:

1. review existing policies, procedures and controls related to financial reporting to identify existing controls that may not be operating as designed and consider the need for additional controls; and
2. develop formal lines of communication between BFO, the Bureau of the Actuary and other agency organizations that may originate transactions, to ensure the completeness of accruals.

Management's Response

BFO has agreed to review existing policies, procedures and controls related to financial reporting and revise and/or add to them as necessary. They have also agreed to develop formal lines of communication and document them.

The full text of management's response is presented as Attachment 1 to this memorandum.

Documentation Supporting Transaction Recording Not Always Adequate

BFO voucher files do not consistently include sufficient documentation to support transactions recorded in the general ledger. During our audit, we were unable to obtain adequate assurance concerning the accuracy and propriety of certain transactions from the voucher files alone. On further inquiry, we received additional documentation from BFO accountants who referred to desk files or other sources. However, we expected to see full documentation included as attachments in the paper voucher files.

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BFO personnel prepare paper vouchers that serve as the basis for input to the computer-based general ledger. The voucher is signed by the preparer and authorized by a supervisor or senior accountant. The paper voucher and any attachments are filed by accounting month and retained in BFO.

All transactions and other significant events need to be clearly documented, and the documentation should be readily available for examination.[5] Such documentation should be complete, accurate and facilitate tracing the transaction or event and related information from authorization and initiation, through its processing, to completion.[6]

The voucher files are the official, formally retained records that support general ledger accounting and should contain sufficient evidence to support transaction recording. In addition, absent such support, the supervisors and accountants who approve prepared vouchers do not have sufficient evidence to justify giving their approval.

A description of specific deficiencies observed during our audit follows.

<u>Transfers from the Department of Labor's Unemployment Trust Fund</u>

The Department of Labor holds and invests funds not needed immediately to pay railroad unemployment insurance benefits. Periodically, the Department of Labor transfers funds back to the RRB as needed to pay benefits. During FY 2006, BFO prepared 44 vouchers to support recording of such transfers in the general ledger.

The supporting documentation attached to the paper voucher was incomplete for 11 of the 44 vouchers. The 11 vouchers recorded $21.3 million in transfers.

We observed that 10 voucher files <u>did not include</u> confirmation of the receipt of funds. In addition, one voucher lacked evidence of management approval; only an unsigned, undated copy of a standard memorandum of approval had been attached to the voucher.

Evidence of management's approval and confirmation of receipt should be retained with the voucher for every transfer.

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[5] "Standards for Internal Control in the Federal Government," GAO/AIMD-00-21.3.1 (11/99), page 15.
[6] "Internal Control Management and Evaluation Tool," GAO-01-1008G (8/01) , page 43.

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Transfers from the NRRIT

The National Railroad Retirement Investment Trust (NRRIT) was established pursuant to the Railroad Retirement and Survivors' Improvement Act of 2001 (RRSIA)[7]. The NRRIT holds and invests funds not needed immediately to pay benefits from the railroad retirement account. Periodically, the NRRIT transfers funds back to the RRB as needed for the payment of benefits.

We reviewed voucher documentation supporting the 10 transfers from the NRRIT to the RRB's trust funds during FY 2006. We identified seven transfers totaling approximately $661 million for which the supporting documentation was incomplete and inconsistent.

None of the seven questioned vouchers included documentation to support senior management's approval of the transfer. In addition, one lacked evidence of the receipt of funds and four lacked support for the computation of the transfer amount.

Evidence of management's approval, confirmation of receipt and support for calculation of the transfer amount should be retained with the voucher for every transfer.

Redemption of Investments

Investments are redeemed periodically to fund benefit payments. Our tests of internal control for transactions processed during the first 9 months of FY 2006 identified 21 periodic investment redemptions. Supporting documentation for 19 of 21 redemptions was limited to a summary spreadsheet; memoranda authorizing the redemption and detailing the trust funds and amounts were not on file. The 19 redemptions for which file documentation was inadequate totaled $5.6 billion.

The accountant responsible for preparing these vouchers had retained the authorizing memoranda instead of attaching them to the voucher prior to filing. Evidence of management's approval should be retained with the voucher for every redemption.

[7] Public Law 107-90.

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Recording Contingent Liabilities

Our review of supporting documentation disclosed that contingent liabilities as of September 30, 2006, had been overstated by $28.7 million. The voucher supporting general ledger recording for this liability was not adequate to support the amount recorded. The support attached to this voucher included reference to a memorandum that had not yet been issued, and a note indicating that an informal communication with the Office of General Counsel had taken place.

Estimates of the monetary impact of legal liabilities should be provided in writing by the Office of General Counsel and be specific as to amount. The OIG identified the misstatement by comparing the amount recorded and reported in the RRB's financial statements with a written communication from the Office of General Counsel to the RRB's three-member Board; that document pre-dated the recording by BFO.

Benefit Payment Activity

The RRB makes periodic payment of railroad retirement benefits. Amounts disbursed to annuitants and withholding for taxes and Medicare premiums are summarized in an electronic spreadsheet and recorded monthly.

Our review of supporting documentation disclosed that:

- one of the 12 vouchers supporting withholding and transfer of Medicare premiums did not include the summary spreadsheet; and
- one of the 12 vouchers supporting withholding and transfer of income taxes did not include documentation to support reduction of the amount to be transferred to the Internal Revenue Service. The transfer amount had been properly reduced by a pending refund of $37,335.

Voucher Shows Incorrect General Ledger Accounts

During FY 2006, the RRB revised the method of accounting for unemployment and sickness contributions. These contributions are recorded using standard voucher codes that have been established in the automated general ledger. The paper voucher reports both the code and the numbers of the general ledger accounts that will be debited/credited by the transaction.

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BFO did not revise the related paper voucher form to correctly reflect the change in the accounts charged by the standard voucher until three months after the change had been implemented. As a result, the paper voucher on file does not agree with general ledger recording for approximately $21.4 million in contributions.

Recommendations

We recommend that BFO:

3. develop written procedures establishing requirements for voucher documentation; and
4. perform periodic quality assurance assessments to ensure compliance with established procedures for voucher documentation.

Management's Response

BFO has agreed to develop written procedures establishing requirements for voucher documentation. They will also perform periodic quality assurance assessments after hiring and training an additional staff member later this year.

The full text of management's response is presented as Attachment 1 to this memorandum.

Supervisory Review and Approval of Vouchers Not Fully Effective

BFO has not ensured that transactions entered into the automated general ledger are supported by properly approved vouchers.

Internal control over data entry to automated systems should include supervisory or independent review of data before it is entered into the application system. [8] Accounting transactions should be reviewed and approved by authorized personnel prior to recording to ensure the accuracy and propriety of transaction recording. BFO procedure provides for supervisory review of documentation supporting transactions prior to recording in the general ledger.

[8] "Internal Control Management and Evaluation Tool," GAO-01-1008G (8/01), page 48.

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During our audit, we observed transactions which had been recorded in the general ledger for which the supporting paper voucher had not been approved by a supervisor or senior accountant. We also identified transactions for which the paper voucher showed an approval dated after the transaction had been recorded in the general ledger.

Our review of 36 vouchers supporting the recording of benefit expense during the first 9 months of FY 2006 disclosed a total of 13 (35%) supporting disbursements of $4.3 billion for which the paper voucher had not been properly approved prior to recording in the general ledger. We identified:

- four vouchers with <u>no supervisory approval;</u>
- seven vouchers with approval dates <u>after</u> the date of general ledger posting; and
- two vouchers for which the <u>date of the approval had been omitted</u>.

We also identified the following additional transactions for which the date of voucher approval was after the date of general ledger posting:

- Five of 12 vouchers supporting the recording of transfers-in from the Social Security Administration totaling approximately $493 million in transfers;
- Four of 12 vouchers supporting the recording of employer contributions for the unemployment and sickness program totaling approximately $40 million; and
- One of 10 vouchers supporting the recording of a $10 million transfers-in from the NRRIT.

Approvals can be an effective control but only if applied consistently and timely.

<u>Recommendations</u>

We recommend that BFO:

5. remind staff responsible for data input that only properly approved vouchers should be recorded in the general ledger;
6. remind staff responsible for voucher approval of applicable BFO procedures; and
7. perform periodic quality control tests of voucher recording to ensure that the supervisory review of vouchers supporting general ledger accounting is being completed timely.

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Management's Response

BFO has reminded responsible staff of the requirements and procedures applicable to voucher preparation and approval. They will also perform periodic quality control tests after hiring and training an additional staff member later this year. The full text of management's response is presented as Attachment 1 to this memorandum.

OIG's Comments on Management's Response

Management's reminder (provided to the OIG as an attachment to management's response) instructs BFO staff that documentation supporting certain transactions should not be attached to the paper vouchers. Instead, staff are advised to store this documentation in binders separate from the voucher files.

We criticized this practice in the preceding finding which addressed the adequacy of supporting documentation (see page 11). We urge BFO to revisit this decision when they develop written procedures establishing requirements for voucher documentation (see recommendation #3).

OTHER MATTERS INVOLVING INTERNAL CONTROL

During our audit, we also noted certain other matters involving the RRB's internal control structure and its operation. Although these matters do not rise to the level of a material weakness or reportable condition, either individually or in the aggregate, they represent areas in which control weaknesses increase the risk of error or mishandling.

The details of our observations and recommendations for corrective action follow.

Management Control Review Process

The RRB's Management Control Review (MCR) program supports the agency compliance with the Federal Managers' Financial Improvement Act (FMFIA). During our audit, we observed that the RRB's MCR program does not include performance reporting among agency responsibilities for which controls must be formally identified and tested. In addition, the MCR documentation for General Ledger Accounting which includes financial reporting is out-of-date.

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Performance Reporting

The annual management assurances offered by the three-member Board pursuant to the requirements of FMFIA include controls over performance reporting. The existing MCR program is not adequate to support such assurances because it does not include formal identification and testing of controls over the preparation and reporting of performance measures.

General Ledger Accounting

MCR documentation has not been updated or controls tested since fiscal year 2000 (about 6 years). During that time, there have been changes to the financial reporting process which are not reflected in the MCR documentation such as:

- the implementation of PC-based spreadsheets to prepare agency financial statements from data downloaded from the mainframe computer;
- accounting for transfers to/from the NRRIT;
- use of FedInvest to purchase and redeem investments; and
- implementation of the special closing package process.

Recommendations

We recommend that the Management Control Review Committee take action to:

8. include performance reporting in the MCR program; and
9. obtain updated control documentation for general ledger accounting and ensure more frequent periodic testing.

Management's Response

The Management Control Review Committee has agreed to require testing of controls over the performance indicator data used for the Annual Performance Plan in the Performance and Accountability Report.

With respect to general ledger accounting, the Management Control Review Committee advised that the General Ledger Assessable Unit is scheduled for a management control review during fiscal year 2007. Their response did not address the issue of frequency of future testing.

The full text of management's response is presented as Attachment 2 to this memorandum.

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Reliability of Legal Representations

As part of the annual financial statement audit, the RRB must formalize representations concerning the status of outstanding litigation, claims and assessments in a letter to the Inspector General. The OIG relies on these representations in planning and performing the audit. The representation letters are ultimately transmitted to the Office of Management and Budget, the Government Accountability Office and the Financial Management Service of the U.S. Department of the Treasury (Treasury).

During the FY 2006 audit, the RRB's General Counsel transmitted the agency's interim legal representations in a letter dated August 24, 2006. However, that letter did not reflect an August 14, 2006 judgment which impacted the status and amount of probable loss in an IRS tax case with potential impact on the RRB's trust funds. As a result of this judgment, the amount for which the RRB is contingently liable was reduced by $15 million.

The Office of General Counsel did not obtain an update of the status of this case prior to preparing the interim legal letter.

<u>Recommendation</u>

10. We recommend that the Office of General Counsel ensure that its procedures for preparation of legal representations offered in conjunction with the financial statement audit are sufficient to ensure that the agency representations reflect the most current available information.

<u>Management's Response</u>

The Office of General Counsel concurs with the recommendation.

In their response, the Office of General Counsel explains that, the RRB is not a party to most of the pending litigation reported in the RRB's legal representation letter most of which is brought under the Railroad Retirement Tax Act which is administered by the Internal Revenue Service. The Office of General Counsel plans to send letters to the Internal Revenue Service and the Department of Justice advising them of the importance of pending litigation and of the need to provide timely updates on the status of pending litigation to the RRB. The Office of General Counsel will contact both organizations again immediately prior to the submission of legal representation letters and updates to such letters.

The full text of management's response is presented as Attachment 3 to this memorandum.

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Ensuring Compliance with Form and Content Requirements

The Office of Management and Budget (OMB) establishes requirements for the form and content of agency Performance and Accountability Reports. These requirements include pro forma financial statements, note disclosures and detailed instructions for other accompanying information. Treasury publishes crosswalks linking the accounts that comprise the U.S. Standard General Ledger to the lines in the pro forma financial statements.

OMB and Treasury periodically revise their guidance and instructions which are often published final after BFO has developed the formats for financial and performance reporting. As a result, BFO typically addresses this guidance through a change identification process.

During our audit, we observed that existing procedures are not sufficiently detailed to support this high risk process. Although BFO procedures are detailed with respect to the review of OMB form and content requirements, BFO procedures do not adequately address controls such as a documented review and approval process. In addition, currently documented procedures and controls do not specifically address changes in Treasury crosswalks.

<u>Recommendation</u>

11. We recommend that BFO develop more detailed procedures for the change identification process used to update the form and content of the RRB's performance and accountability report, or replace it with a more comprehensive identification of requirements. Whichever method BFO uses should be supported by controls that include at least one level of supervisory approval and retention of supporting documentation.

<u>Management's Response</u>

BFO has agreed to develop more detailed procedures for the change identification process. The full text of management's response is presented as Attachment 1 to this memorandum.

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Federal Financial System

The Federal Financial System (FFS) is the mainframe application that supports general ledger accounting. FFS is a database system that uses various interrelated tables to record, process, summarize and report accounting information. The system includes control features that permit management to monitor and limit spending as well as restrict user access to data and transactional authority.

Spending Control Features Not Fully Effective

FFS includes control features that will prevent spending documents from exceeding the available funds at the appropriation, apportionment or allotment levels. A spending document is any FFS system document that records an obligation, expenditure, or commitment.

FFS spending controls did not prevent expenditure of funds from a fund's budget object code with a zero balance. Benefit payments of $8.3 million were charged to Fund 0111 (Vested Dual Benefits), Budget Object Code 4222 (Benefit payments-Canadian) in November, 2005 even though there were no budgeted funds in this Budget Object Code.

This example indicates that controls designed to prevent the agency from exceeding appropriated and apportioned spending levels have not been fully implemented. These controls are intended to prevent the agency from inadvertently committing an anti-deficiency violation.

Incomplete FFS Table Entries

The use of pre-defined accounting entries for routine recurring transactions is a key element of FFS implementation and serves as a control over the accuracy of transaction processing.

The Accounting Entries Definition (ACED) table describes the transaction codes that are used to record accounting events in the system. The Accounting Entries Reference table (ACEN) controls the accounting entries that are made when a transaction described in the ACED table is processed. During our audit, we identified three transactions for which codes had been established in the ACEN table for which no corresponding description had been input to the ACED Table. Two of the three codes had been used in the general ledger during FY 2006.

MEMORANDUM ON INTERNAL CONTROL

-----------ACED TABLE-------------		Transactions Recorded	
DESCRIPTION	**CODE**	**Number**	**Amount**
No Description	SV 13	16	$16,044
No Description	SV 84	3	$6,000,000
No Description	SV 85	None	-0-

As a result, the automated system does not describe adequately the financial activities recorded.

Separation of Duties

BFO is the organizational owner of FFS, and the FFS system administrator is an employee in the Accounting, Treasury and Financial Systems Division of that organization.

During the early months of FY 2006, we observed that the FFS system administrator approved certain transactions that had been entered into the FFS system by other BFO personnel. This is inconsistent with the principle of separation of duties and defeats the purpose of requiring system approvals. The system administrator cannot be expected to have the knowledge or experience to make an informed decision concerning the propriety of transactions being recorded.

Based on subsequent tests, it appears that this practice was curtailed later in the year. However, it is our understanding that no formal policy had been adopted prohibiting a system administrator from entering, approving or correcting transactions.

Privacy Issues

Users are generally granted system privileges using pre-established standard profiles. These profiles may restrict users to “read-only” access to certain tables in the system or may permit a user to enter, change, or approve a broad or limited range of transactions.

The bank account information and social security/tax identification numbers of vendors, including agency employees, can be viewed by anyone with read-only access to the FFS system.

The RRB uses social security numbers as an identifier when agency employees are established as payees in the FFS system. Several system screens that show this identifier can be viewed by individuals who have been granted read-only access to the system. We also noted that one screen included in the read-only access user profile shows bank account numbers.

MEMORANDUM ON INTERNAL CONTROL

FFS screens that are included in the standard read-only profile include:

- the EFTH, VEND, PVHT, PVLT and VNAM screens which show employee social security numbers; and
- the EFTH screen which shows bank account information.

Recommendations

We recommend that BFO:

12. review the spending control settings in FFS and make adjustments to ensure that controls are operating to permit spending only where budget authority has been allocated;
13. require periodic review of FFS for missing or incomplete table entries;
14. formalize a policy formally prohibiting the administrators of systems owned by BFO from entering, approving or modifying transactions;
15. review the practice of using employee social security numbers as identifiers to determine the feasibility of ending that practice now or in the future; and
16. review the screens that are included in the various user profiles to identify personal information that may not be required by routine holders of those privileges.

Management's Response

In response to recommendation #12, BFO's Budget Division reviewed the FFS controls and responded that "controls are set at the fund level, and our review indicates that all are set for full control at the appropriation, apportionment and allotment levels."
The full text of the Budget Section's response is presented as Attachment 4 to this memorandum.

BFO has agreed to require periodic review of FFS for missing or incomplete table entries and has already formalized and issued a policy prohibiting administrators of systems owned by BFO from entering, approving or modifying transactions. With respect to FFS privacy issues, BFO has agreed to review the practice of using employee social security numbers as identifiers to determine the feasibility of ending that practice and to review the screens that are included in the various user profiles to identify personal information that may not be required by routine holders of those privileges. The full text of BFO's response on these matters is presented as Attachment 1 to this memorandum.

MEMORANDUM ON INTERNAL CONTROL

Posting Transactions to the General Ledger

The RRB needs to strengthen controls over the preparation of vouchers and the posting of transactions to the automated general ledger. It is crucial that these manual processes be as accurate and timely as possible since this information feeds the RRB's general ledger accounting system which, in turn, generates information for the financial statements.

Delayed Recording

Our review of 54 paper vouchers supporting transfers-in from the NRRIT and Department of Labor disclosed four vouchers that had been recorded in the general ledger more than seven calendar days after the transfer had been completed. The vouchers questioned during the audit totaled $296 million, including a single voucher for $163 million that was recorded 36 calendar days after transfer.

Inaccurate Posting

Our review of documentation supporting benefit payment expense identified two vouchers that had been recorded in the general ledger with an incorrect budget object code even though the paper voucher had been properly prepared. Both paper vouchers had been approved prior to or on the date of general ledger recording.

In addition, we identified an instance of double recording. Recoveries of unemployment and sickness receivables from the retirement annuities in current pay status were recorded twice when the Office of Programs forwarded revised information for recoveries that had previously been recorded. As a result, railroad retirement benefit expense was overstated at fiscal year-end by approximately $1 million and unemployment and sickness expense was understated by the same amount.

Recommendations

We recommend that BFO:

17. establish a standard for recording timeliness; and
18. perform periodic quality assurance testing to monitor timeliness and accuracy of posting to the general ledger.

MEMORANDUM ON INTERNAL CONTROL

Management's Response

BFO has agreed to establish a standard for recording timeliness. They will also perform periodic quality assurance testing after hiring an additional staff member later this year. The full text of management's response is presented as Attachment 1 to this memorandum.

Report on Budget Execution – Approved Copy Missing

Comparison of the SBR with Standard Form (SF) 133 "Report on Budget Execution" is a required part of the financial statement audit. The SF-133 is prepared by fund. The final signed SF-133 is the only evidence of review and approval by agency management that is retained in agency files.

Our audit included review of forms SF-133 as of the end of the first 6-month, 9-month and 12-month periods. The RRB had not retained a signed copy of the SF-133 for two funds reported as of March 31st.

Recommendation

19. We recommend that BFO review its procedures and controls related to the preparation, review and approval of forms SF-133 to ensure that preparation and approval at every level are documented.

Management's Response

BFO has agreed to review procedures and controls related to the preparation, review and approval of forms SF-133 to ensure that preparation and approval at every level are documented. The full text of management's response is presented as Attachment 1 to this memorandum.

Recording NRRIT Transactions

The National Railroad Retirement Investment Trust (NRRIT) was established pursuant to the Railroad Retirement and Survivors' Improvement Act of 2001 (RRSIA)[9]. The NRRIT holds and invests funds not needed immediately to pay benefits from the railroad retirement account. Periodically, the NRRIT transfers funds back to the RRB as needed for the payment of benefits.

Under RRSIA, the NRRIT is not a department, agency or instrumentality of the Government of the United States. In addition, the law specifically exempts the

[9] Public Law 107-90

MEMORANDUM ON INTERNAL CONTROL

NRRIT from compliance with Title 31, United States Code which governs the monetary and financial operations of the Federal government. The RRB provides limited accounting services to the NRRIT which include maintaining a general ledger for the NRRIT based on summary information provided by the NRRIT from its own accounting systems.

During our audit, we observed that transfers from the NRRIT had been treated as an intra-entity transaction between government funds under the RRB's control. The general ledger entries were documented with a single journal voucher that included both the transfer-in from the NRRIT and the related transfer-out by the NRRIT.

Recommendation

20. We recommend that BFO consider revising the accounting treatment and method of documentation for NRRIT transfers to treat the NRRIT as an independent entity, unrelated to the RRB.

Management's Response

BFO has agreed to revise the accounting treatment and method of documentation for NRRIT transfers to treat the NRRIT as an independent entity, unrelated to the RRB. The full text of management's response is presented as Attachment 1 to this memorandum.

UNITED STATES GOVERNMENT
MEMORANDUM

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

FEB 02 2007

TO : Henrietta B. Shaw
Assistant Inspector General for Audit

FROM : John M. Walter
Chief of Accounting, Treasury and Financial Systems
THROUGH: Kenneth P. Boehne
Chief Financial Officer

SUBJECT: Memorandum on Internal Control –
Fiscal Year 2006 Financial Statement Audit

Thank you for giving us the opportunity to comment on your draft Memorandum on Internal Control. We appreciate your recognizing that the financial reporting process has expanded responsibilities and shorter time frames. The process has expanded from preparation of financial statements within 6 months of the fiscal year-end, to publication of an annual Performance and Accountability Report within 45 days of the fiscal year-end. We have reviewed the above draft memorandum dated January 19, 2007, and our comments on recommendations are as follows:

Recommendations:

1. ***Review existing policies, procedures and controls related to financial reporting to identify existing controls that may not be operating as designed and consider the need for additional controls.***

   We will review existing policies, procedures and controls related to financial reporting and revise and/or add to them as necessary. Target date: July 31, 2007.

2. ***Develop formal lines of communication between BFO, the Bureau of the Actuary and other agency organizations that may originate transactions, to ensure the completeness of accruals.***

   We will develop additional formal lines of communication and document them. Target date: July 31, 2007.

3. ***Develop written procedures establishing requirements for voucher documentation.***

   We will develop written procedures establishing requirements for voucher documentation. Target date: July 31, 2007.

4. ***Perform periodic quality assurance assessments to ensure compliance with established procedures for voucher documentation.***

   We will perform periodic quality assurance assessments after hiring and training an additional staff member later this year.

5. ***Remind staff responsible for data input that only properly approved vouchers should be recorded in the general ledger.***

   We have reminded staff members responsible for data input that only properly approved vouchers should be recorded in the general ledger. See attachment A.

6. ***Remind staff responsible for voucher approval of applicable BFO procedures.***

   We have reminded staff members who are responsible for voucher approval regarding the applicable BFO procedures. In addition, this will be incorporated into written procedures. See attachment A. Target date: July 31, 2007.

7. ***Perform periodic quality control tests of voucher recording to ensure that the supervisory review of vouchers supporting general ledger accounting is being completed timely.***

   We will perform periodic quality control tests after hiring and training an additional staff member later this year.

11. ***We recommend that BFO develop more detailed procedures for the change identification process used to update the form and content of the RRB's performance and accountability report, or replace it with a more comprehensive identification of requirements. Whichever method BFO uses should be supported by controls that include at least one level of supervisory approval and retention of supporting documentation.***

    We will develop more detailed procedures for the change identification process. Target date: July 31, 2007.

13. ***Require periodic review of FFS for missing or incomplete table entries.***

We will require periodic review of FFS for missing or incomplete table entries. Target date: July 31, 2007.

14. ***Formalize a policy formally prohibiting the administrators of systems owned by BFO from entering, approving or modifying transactions.***

We have formalized and issued a policy prohibiting the administrators of systems owned by BFO from entering, approving or modifying transactions. See attachment B.

15. ***Review the practice of using employee social security numbers as identifiers to determine the feasibility of ending that practice now or in the future.***

We have already been in contact with the RRB's Privacy Officer regarding this recommendation. We will review the practice of using employee social security numbers as identifiers to determine the feasibility of ending that practice now or in the future. Target date: September 30, 2007.

16. ***Review the screens that are included in the various user profiles to identify personal information that may not be required by routine holders of those privileges.***

We will review the screens that are included in the various user profiles to identify personal information that may not be required by routine holders of those privileges. Target date: July 31, 2007.

17. ***Establish a standard for recording timeliness.***

We will establish a standard for recording timeliness. Target date: July 31, 2007.

18. ***Perform periodic quality assurance testing to monitor timeliness and accuracy of posting to the general ledger.***

We will perform periodic quality assurance testing after hiring an additional staff later this year.

19. ***We recommend that BFO review its procedures and controls related to the preparation, review and approval of forms SF-133 to ensure that preparation and approval at every level are documented.***

    We will review procedures and controls related to the preparation, review and approval of forms SF-133 to ensure that preparation and approval at every level are documented. Target date: July 31, 2007.

20. ***We recommend that BFO consider revising the accounting treatment and method of documentation for NRRIT transfers to treat the NRRIT as an independent entity, unrelated to the RRB.***

    We will revise the accounting treatment and method of documentation for NRRIT transfers to treat the NRRIT as an independent entity, unrelated to the RRB. Target date: July 31, 2007.

Attachments

cc: Lynn Harvey, Privacy Officer (BIS)
Linda Wimbourne, Management Analyst (OIG)

Walter, John

From: Fleming, Edmund
Sent: Thursday, January 25, 2007 8:30 AM
To: Yarber, Rita; Aguila, Jose; Brandt, Ralph; Fultz, Jenny; Guirguis, Samir; Lannin, Richard; Natividad, Editha; Pesola, Daniel; Ruf, Juanita; Scott, Othel; Stubits, Elizabeth; Wilke, Alvin
Cc: Walter, John
Subject: Vouchers

This email concerns two recommendations the auditors included in the Letter to Management Memorandum on Internal Control.

5. remind staff responsible for data input that only properly approved vouchers should be recorded in the general ledger;

Paper vouchers should have the transaction code, SGL accounts (both proprietary and budget where necessary) amounts, description, BOC's, and RSC's,. Sufficient documentation should be attached to the paper voucher to support the transaction except for 1) DOL transfers, 2) investment transactions, and 3) NRRIT transactions. These three types of transactions should have the documentation stored in a three ring binder; attached to the SV or JV should be a form that states where the supporting documentation can be located. After the reviewer has approved and dated the SV or JV, it can then be input into the FFS system and stamped "posted.".

6. remind staff responsible for voucher approval of applicable BFO procedures; and

All paper vouchers should be signed and dated by the reviewer and returned to the preparer for fling. The date of the approval should be prior to the date stamped "posted."

Thanks, Ed

Walter, John Attachment B

From: Walter, John
Sent: Tuesday, January 16, 2007 3:09 PM
To: Garmager, Kristofer; Zulevic, Michael
Cc: Boehne, Kenneth; Fleming, Edmund; Blalock, Georgia; McCarthy, Thomas; Miller, David
Subject: Policy

Tracking:

Recipient	Read
Garmager, Kristofer	Read: 1/16/2007 3:11 PM
Zulevic, Michael	Read: 1/31/2007 12:33 PM
Boehne, Kenneth	Read: 1/16/2007 3:10 PM
Fleming, Edmund	Read: 1/16/2007 3:16 PM
Blalock, Georgia	Read: 1/16/2007 3:43 PM
McCarthy, Thomas	Read: 1/16/2007 3:24 PM
Miller, David	Read: 1/16/2007 3:58 PM

Background

During the early months of FY 2006, the OIG observed that the FFS systems administrator approved certain transactions (at the request of other BFO personnel) that had been entered into the FFS system by other BFO personnel.

The OIG brought this matter to the attention of the system administrator and the manager in whose section the transactions originated; the OIG was advised that the practice would be curtailed which was confirmed by subsequent audit tests.

Policy

Please be advised that for the internal control purposes (separation of duties) you, as administrators of systems owned by BFO, are prohibited from entering, approving or modifying transactions on the BFO systems.

Thank you.

UNITED STATES GOVERNMENT

MEMORANDUM

FORM G-115f (1-92)

RAILROAD RETIREMENT BOARD

FEB 02 2007

TO : Henrietta B. Shaw
Assistant Inspector General for Audit

FROM : John M. Walter
Chair, Management Control Review Committee

SUBJECT: Draft Memorandum on Internal Control – Fiscal Year 2006 Financial Statement Audit

Thank you for giving us the opportunity to comment on your draft memorandum. We have reviewed the above draft memorandum dated January 19, 2007, and our comments on recommendations for the Management Control Review Committee are as follows:

Recommendations:

8. ***include performance reporting in the Management Control Review program.***

   The Management Control Guide (MCG) requires the responsible official for each assessable unit (AU) report annually on key performance indicators for their AU. We will revise the MCG to require testing of the controls over the performance indicator data used for the Annual Performance Plan in the Performance and Accountability Report. Target date: September 30, 2007.

9. ***obtain updated control documentation for general ledger accounting and ensure more frequent periodic testing.***

   The General Ledger Assessable Unit is scheduled, as part of the Management Control Plan and Schedule of Due Dates, for a management control review in fiscal year 2007. Target date: September 30, 2007.

cc: Kenneth P. Boehne, Chief Financial Officer
Catherine A. Leyser, Director of Assessment and Training
John Baer, Director of Retirement Benefits
Ronald J. Hodapp, Chief of Information Resources Management
Lloyd A. Kingsbury, Chief of Support Services – Administration
Rachel L. Simmons, Executive Assistant to the General Counsel
Georgia Blalock, Budget Officer
Hattie Fitzgerald, Financial Compliance Officer
Linda Wimbourne, Management Analyst
Bill Flynn, Executive Assistant

UNITED STATES GOVERNMENT

FORM G-115f (1-92)

MEMORANDUM

RAILROAD RETIREMENT BOARD

January 23, 2007

To: Henrietta B. Shaw
Assistant Inspector General, Audit

From: Steven A. Bartholow
General Counsel

Subject: Draft Letter to Management
FY 2006 Financial Statement Audit

This is in response to your memorandum dated January 19, 2007, requesting our response to Recommendation 10 contained in the above-referenced draft letter with respect to preparation of the legal representation letter. Recommendation 10 states as follows: "We recommend that the Office of General Counsel ensure that its procedures for preparation of legal representations offered in conjunction with the financial statement audit are sufficient to ensure that the agency representations reflect the most current available information."

We concur with your recommendation and will take the actions set out below.

Nearly all of the litigation reported in our legal representation letters is litigation brought under the Railroad Retirement Tax Act for refunds of taxes paid under that Act. The Railroad Retirement Tax Act is administered by the Internal Revenue Service, and the Railroad Retirement Board is not a party to such litigation. In the past, we have had an informal agreement with the Department of Justice that, despite the fact that the RRB is not a party to Tax Act litigation, the RRB should be kept informed concerning the progress of Tax Act litigation because of the impact of such litigation on the Board's administration of the Railroad Retirement Act. For the most part, this informal agreement with the Department of Justice has functioned well; however, we have not always been advised immediately of litigation developments.

We will send letters to both the Internal Revenue Service and the Department of Justice no later than March 1, 2007 advising the Service and Department of the importance of Railroad Retirement Tax Act litigation to the Railroad Retirement Board and of the need to provide timely updates to the Board of the status of litigation. We will also directly contact both the Internal Revenue Service and the Department of Justice immediately prior to the submission to the Office of Inspector General of legal representation letters and updates to such letters.

UNITED STATES GOVERNMENT

FORM G-115f (1-92)

RAILROAD RETIREMENT BOARD

MEMORANDUM

FEB 02 2007

TO : Henrietta B. Shaw
Assistant Inspector General for Audit

FROM : Georgia C. Blalock
Budget Officer

Georgia C. Blalock

THROUGH: Kenneth P. Boehne
Chief Financial Officer

Kenneth P. Boehne

SUBJECT: Memorandum on Internal Control –
Fiscal Year 2006 Financial Statement Audit

I was asked to review recommendation number 12 from your draft Memorandum on Internal Control, dated January 19, 2007. My comments follow:

12. **Review the spending control settings in FFS and make adjustments to ensure that controls are operating to permit spending only where budget authority has been allocated.**

    We have reviewed the FFS controls, as the Office of Inspector General (OIG) advised. These controls are set at the fund level, and our review indicates that all are set for full control at the appropriation, apportionment and allotment levels.

    It should be noted that controls in FFS are established to prevent overspending in accordance with the current approved apportionment for each fund, and with allotment level amounts as approved by RRB management. Funding for dual benefit payments is apportioned on line 8B1 of the SF-132 Apportionment and Reapportionment Schedule for the Dual Benefits Payments Account. All funds are allotted to account code 0111, organization/division code 2222, and budget object code 4220 – Benefit payments.

    In the example cited by the OIG, an error was made in entering the budget object code as 4222 – Canadian benefit payments, which did not include an allotted amount for the Dual Benefits Payments Account. However, the system included a spending code flag for object code 4222, which pointed to object class 4220. As a result, the dual benefits were charged correctly to the Dual Benefits Payments Account, budget code 4220, which did include sufficient funding. The flag for code 4222 has since been adjusted so that it is not associated with 4220, and will generate an error message "allotment not found" if such a keying error occurs again.

The data entry error did not create a risk of exceeding the apportioned or allotted funding for the account since full controls were in place at both levels.

I appreciate the opportunity to comment on this item. Please let me know if you would like to discuss this further.

cc: Linda Wimbourne, Management Analyst (OIG)
John Walter, Chief of Accounting Treasury and Financial Systems
Kris Garmager, Systems Administrator
Milt Vasich, Senior Budget Analyst