

OFFICE OF INSPECTOR GENERAL
Audit Report

Audit of the Account Benefits Ratio

Report No. 10-12
September 29, 2010



RAILROAD RETIREMENT BOARD

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INTRODUCTION

This report presents the results of the Office of Inspector General's (OIG) audit of the Railroad Retirement Board's (RRB) Account Benefits Ratio (ABR).

Background

The RRB is an independent agency in the executive branch of the Federal government. The RRB administers the 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. These programs provide income protection during old age and in the event of disability, death, temporary unemployment or sickness. The RRB paid over \$10.8 billion in benefits during fiscal year 2009. Of the total, \$4.2 billion in benefits were paid from the Railroad Retirement Account to approximately 590,000 retirement and survivor beneficiaries. The RRB is headquartered in Chicago, Illinois, and has 53 field offices across the nation.

RRA benefits and the payroll taxes that support the benefits are based on a two-tier system. Payroll taxes paid by railroad employers and their employees are the primary source of funding. Tier I payroll taxes, paid by employees and employers, are the same as social security payroll taxes. Tier II taxes finance railroad retirement benefits over and above social security levels. Employers and employees pay different rates for Tier II payroll taxes, which are based upon the ratio of certain asset balances to the total of benefits and administrative expenses paid under the railroad retirement program.

The RRA was amended by the Railroad Retirement and Survivors' Improvement Act of 2001 (RRSIA) which was enacted on December 21, 2001. This legislation provided for significant changes to the benefit structure and financing of future benefits. The benefit provisions include improving widow and widower benefits, elimination of the maximum benefit limitation, restoring the unreduced annuity feature for those retiring at age 60 with 30 years of service, and reducing the vesting provision to five years of service (for service credited after December 31, 1995).

The financing provisions included in the act provided for the establishment of a National Railroad Retirement Investment Trust (NRRIT) that is responsible for the investment of surplus railroad retirement revenues, the placement of a pre-determined structure for establishing the Tier II tax rates, and the elimination of the supplemental annuity tax.

Section 108 of RRSIA requires that, "on May 1st, beginning in 2003 and each year thereafter, the RRB shall compute a projection of the ABR and the average account benefits ratio (AABR) for each of the next five fiscal years." This same section also requires that the RRB certify to the Secretary of the Treasury (Treasury) on or before November 1st, beginning in 2003 and each year thereafter, the ABR for the fiscal year just ended.¹

¹ Public Law 107-90, December 21, 2001, Section 108.

The ABR is defined as "...with respect to any fiscal year, the amount determined by the Railroad Retirement Board by dividing the fair market value of the assets in the Railroad Retirement Account and of the National Railroad Retirement Investment Trust (and for years before 2002, the Social Security Equivalent Benefits Account) as of the close of such fiscal year by the total benefits and administrative expenses paid from the Railroad Retirement Account and the National Railroad Retirement Investment Trust during such fiscal year." The AABR is defined by RRSIA to mean "...with respect to any calendar year, the average determined by the Secretary (of the Treasury) of the ABRs for the 10 most recent fiscal years ending before such calendar year."²

The RRB's Bureau of Fiscal Operations (BFO) is responsible for calculating the ABR, the RRB's Bureau of the Actuary (Actuary) is responsible for projecting the ABR and the AABR for the upcoming five-year period, and the RRB's three-member Board (the Board) is responsible for certifying the ABR to Treasury.

This audit supports an objective in the RRB's Strategic Plan to ensure that the trust fund assets are projected, collected, recorded, and reported appropriately.

Audit Objective

The audit objective was to determine if the agency calculates the ABR accurately and certifies the ABR to Treasury timely in accordance with section 108 of RRSIA.

Scope

The scope of the audit was the ABR information submitted to Treasury prior to November 1, 2008 and November 1, 2009.

Methodology

To accomplish our objective, we:

- obtained an understanding of applicable laws and regulations;
- identified and assessed the procedures and internal controls over the RRB's calculation of the ABR;
- verified the accuracy of the ABR;
- traced data used in the calculation of the ABR to supporting documentation; and
- determined if the ABR information that was due to be submitted to Treasury prior to November 1, 2008 and November 1, 2009 was submitted timely.

² Public Law 107-90, December 21, 2001, Section 204d.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

We conducted our fieldwork at the RRB's headquarters in Chicago, Illinois from December 2008 through August 2009 and from March 2010 through September 2010.

RESULTS OF AUDIT

Our audit found that for the 2008 and 2009 ABR submissions, the RRB calculated the ABRs accurately and certified the ABRs to Treasury timely in accordance with section 108 of RRSIA. However, a Management Control Review for the ABR needs to be completed and certain internal controls need strengthening.

The details of our findings and recommendations for corrective action follow. The full text of managements' response is included in this report as Appendices I and II.

Management Control Review for the ABR Needs to be Completed

A management control review and related risk assessment has never been completed for the ABR. This occurred because BFO had not previously included controls related to the calculation of the ABR in an assessable unit.

According to the Government Accountability Office's (GAO) "Standards for Internal Control in the Federal Government," a comprehensive system of internal control includes a risk assessment process, implementation of appropriate control activities and monitoring to assess the quality of performance over time.³ The RRB has established a Management Control Review Committee (MCRC) to oversee the agency's internal control assessment process. The MCRC provides guidance to managers in performing the individual evaluations that support the assessment of the adequacy of internal controls agency wide. According to the MCRC's Management Control Guide, assessable units are defined by the program's mission, the policies and procedures governing it, or its process flow. Financial assessable units include the traditional control areas concerned with the flow of funds (revenues and expenditures), related assets, and financial information.⁴

During our audit, we reviewed existing management control review documentation and found no evidence that controls related to the ABR had been tested during previous management control reviews. At that time, BFO staff advised us that they had intended to include the ABR, and control techniques for the ABR, in the General Ledger/Cash Management Assessable Unit for future management control reviews; however, the control techniques had yet to be documented.

³ "Standards for Internal Control in the Federal Government," GAO/AIMD-00-21.3.1 (11/99), page 7.

⁴ "Management Control Guide," RRB BFO, December 2010 revision, page 3-3.

BFO subsequently provided documentation outlining the proposed control techniques for the ABR as part of the General Ledger/Cash Management Assessable Unit. This documentation indicated that the controls had not yet been tested. The next management control review for the General Ledger/Cash Management Assessable Unit is scheduled for May 2011. The lack of a management control review for the ABR increases the risk that the ABR will not be calculated correctly or that it will not be certified to the Treasury timely.

Since BFO indicated that they had intended to include the ABR in the General Ledger/Cash Management Assessable Unit, we reviewed the "Responsible Official's Certifications of the General Ledger/Cash Management Assessable Unit" dated August 31, 2009 and July 13, 2010. In both of these certifications, the responsible official stated that "I cannot state with reasonable assurance that no material weakness exists; the unit's mission is being accomplished; that waste, fraud and abuse are at or near the lowest reasonably preventable level; or that all control objectives are being accomplished." The certifications indicate that the above statement was due to an OIG's finding of a material weakness in the financial reporting for FY 2008 during our Financial Statement Audit. We are concerned that if BFO includes the ABR in the General Ledger/Cash Management Assessable Unit, BFO may not be able to provide reasonable assurance that the ABR's control objectives are being accomplished due to the existing material weakness affecting the rest of the assessable unit. The ABR being included as part of the General Ledger/Cash Management Assessable Unit, while the material weakness still exists, increases the risks that the ABR's control objectives will not be met.

Recommendations

We recommend that BFO:

1. complete an immediate separate interim management control review and related risk assessment for the controls related to the ABR; and
2. provide a separate certification statement to the MCRC regarding the testing and the effectiveness of the ABR controls.

Management's Response

BFO has agreed to complete a separate interim management control review (test of controls) and related risk assessment for the controls related to the ABR and to provide the results to the MCRC. They have also agreed to provide a separate certification statement regarding the testing and the effectiveness of the ABR controls to the MCRC.

Accounting Procedures Guide Needs More Detail

BFO's Accounting Procedures Guide does not include detailed procedures for the supervisory review of the ABR calculation.

According to GAO's Standards for Internal Control in the Federal Government, "Internal controls should generally be designed to assure that monitoring occurs in the course of normal operations." BFO's Accounting Procedures Guide contains detailed procedures for the calculation of the ABR. It also states that a cross referenced worksheet should be included for the senior management's and Chief Financial Officer's (CFO) review.⁵

We reviewed BFO's Accounting Procedures Guide and the detailed documentation related to the calculation of the ABRs for the 2008 and 2009 submissions. We found no exception with the actual calculation of the ABRs for 2008 and 2009, and documentation showed that a supervisor had signed off on the ABRs indicating that a review was performed. However, there was no indication of what the supervisor actually reviewed. For example, we found no tick marks or annotations on any of the schedules to indicate that the reviewer had checked calculations or traced information back to source documentation. Additionally, the Accounting Procedures Guide does not include detailed procedures outlining the extent of or the steps to be taken in the supervisory review.

BFO staff told us that they provide ample documentation to the reviewer, but they could not dictate how the reviewer does his or her job. They did not provide a reason as to why the Accounting Procedures Guide did not include any detail related to the supervisory review. BFO management subsequently told us that they do perform an extensive review of the ABR calculation; however, the exact procedures followed for the review were not included in the Accounting Procedures Guide. They agreed that the importance of the ABR calculation merits putting detailed procedures into the Accounting Procedures Guide and providing detailed documentation of their review efforts.

Without detailed procedures for the supervisory review, there is an increased risk that the ABR could be calculated incorrectly and the error might not be detected prior to certification.

⁵ "The Accounting Procedures Guide," May 4, 2010 revision, Section 12.

Recommendation

We recommend that BFO:

3. revise their *Accounting Procedures Guide* to include the exact procedures to be performed during the supervisory review of the ABR.

Management's Response

BFO has agreed to revise their *Accounting Procedures Guide* to include the exact procedures to be performed during the supervisory review of the ABR.

Comparison of the ABR Calculation to Audited Financial Statements is Needed

The procedures for the calculation of the ABR do not include a provision to measure and compare the detail obtained for the calculation to independently verified financial results.

According to GAO's Standards for Internal Control in the Federal Government, control activities need to be established to monitor performance.⁶ In addition, controls should call for comparisons of data so that analyses can be made. Lastly, controls should be aimed at validating the integrity of performance measures and indicators.

We reviewed documentation related to the calculation of the ABR's for the 2008 and 2009 submissions and found that the information for the calculation of the ABR is gathered, and the ABR is calculated, prior to the completion of the financial statement audits for both the RRB and the NRRIT. This occurs because RRSIA specifies that the certification of the ABR must be made prior to November 1st of each year, which is before the completion of the financial statement audits for both the RRB and the NRRIT. As a result, there is a potential risk that the ABR may be calculated and certified using incorrect information.

BFO informed us that the RRB's General Counsel had previously concluded that, as written, the law does not allow for changes to the ABR once it has been certified. Consequently, a change to a previously certified ABR, or a change to the ABR due date to coincide with the completion of the financial statement audit, would involve a change in legislation that might prove difficult and time consuming. Therefore, to improve the quality of subsequent ABR calculations, we make the following recommendation.

⁶ "Standards for Internal Control in the Federal Government," GAO/AIMD-00-21.3.1 (11/99), page 20.

Recommendation

We recommend that BFO:

4. amend their Accounting Procedures Guide to include a subsequent comparison of the information used in the ABR calculation to the audited financial statements of the RRB and the NRRIT, to determine if procedures need to change to ensure accurate financial information.

Management's Response

BFO has agreed to amend their *Accounting Procedures Guide* to include a subsequent comparison of the information used in the ABR calculation to the audited financial statements of the RRB and the NRRIT, to determine if procedures need to change to ensure accurate financial information.

Subsequent Review of Projections May Be Needed

Significant declines in the value of the NRRIT investments, a major component of the ABR, minimized the usefulness of the 2008 ABR and AABR projections. During the first nine months of 2008, the value of the NRRIT investments dropped 21 percent, from \$32 billion to \$25.3 billion.

Although the RRB satisfied the RRSIA's requirements for calculating the ABR and AABR projections in both 2008 and 2009, we believe the agency could have better met their strategic goal of providing excellent customer service by revising the projections when significant market changes occurred during the year.

The RRB prepares an annual report that includes the projection of the ABR and the AABR for at least 25 years and the projected tier II tax rate for the same period, based on the projected value of the AABR. The combined value of cash and investments for the NRRIT and the RRB are used to determine the projected values of the ABR and the AABR.

The RRB uses the market value of the NRRIT investments when they calculate the projections for the year. The projections are computed assuming an increase in the value of the investments. However, during the first nine months of 2008, the market value of the NRRIT investments decreased significantly and the RRB did not consider revising the projections to reflect the changing market conditions.

We believe that one of the intended purposes of these projections is to assist the RRB's customers in making financial decisions related to their retirement. Therefore, if the projections made in 2008 were outdated, their usefulness to the customers was minimized.

Recommendation

We recommend that the Bureau of the Actuary:

5. formally advise the Board when changes in the market value of investments are significant enough to render previous projections unreliable so that the Board may notify its constituents.

Management's Response

The Bureau of the Actuary has agreed to inform the Board if their projections are expected to have an impact on some decision that the Board must make, and if the market value of the investments change significantly after their projections are made.



UNITED STATES GOVERNMENT
MEMORANDUM

FORM G-1157 (1-02)
 RAILROAD RETIREMENT BOARD

SEP 27 2010

TO : Diana Kruel
 Assistant Inspector General for Audit

FROM : John M. Walter *John M. Walter*
 Chief of Accounting, Treasury, and Financial Systems

THROUGH: Kenneth P. Boehne
 Chief Financial Officer *Kenneth P. Boehne*

SUBJECT: Draft Report – Audit of the Account Benefits Ratio

Thank you for the opportunity to comment on the subject draft report. BFO comments on the following recommendations are below:

We recommend that BFO:

- 1. complete an immediate separate interim management control review and related risk assessment for the controls related to the ABR.**

A separate interim management control review (tests of controls) and related risk assessment for the controls related to the ABR will be completed and provided to the MCRC. Target date: November 1, 2010.

- 2. provide a separate certification statement to the MCRC regarding the testing and the effectiveness of the ABR controls.**

A separate certification statement will be provided to the MCRC regarding the testing and the effectiveness of the ABR controls. Target date: November 1, 2010.

- 3. revise their Accounting Procedures Guide to include the exact procedures to be performed during the supervisory review of the ABR.**

The *Accounting Procedures Guide* will be revised to include the exact procedures to be performed during the supervisory review of the ABR. Target date: January 15, 2011.

4. ***amend their Accounting Procedures Guide to include a subsequent comparison of the information used in the ABR calculation to the audited financial statements of the RRB and the NRRIT, to determine if procedures need to change to ensure accurate financial information.***

The *Accounting Procedures Guide* will be amended to include a subsequent comparison of the information used in the ABR calculation to the audited financial statements of the RRB and the NRRIT, to determine if procedures need to change to ensure accurate financial information. Target date: January 15, 2011.

If you or your staff have any questions, please contact Edmund Fleming or Elizabeth Stubits at extensions 7120 and 3326, respectively.

cc: Ed Fleming, Accounting Officer
Elizabeth Stubits, Accountant
Bill Flynn, Executive Assistant
Debra Stringfellow-Wheat, Supervisory Auditor
Management Control Review Committee



UNITED STATES GOVERNMENT

MEMORANDUM

September 28, 2010

TO : Diana Kruel
Assistant Inspector General for Audit

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

SUBJECT: Draft Report—Audit of the Accounts Benefit Ratio

We appreciate the opportunity to review and comment on the draft report on the audit of the Accounts Benefit Ratio.

Regarding Recommendation #5, our long term projections are made as of a certain point in time, and they are made once a year. It is understood that the market value of investments is bound to change between one year's set of projections and the next. If our projections are expected to have an impact on some decision that the Board must make, and if the market value of investments has changed significantly since those projections were made, we will certainly inform the Board of the effect of those changes on the projections. We do not feel that it is necessary to inform the Board of changes in the market value of investments on a routine basis, since the Board is undoubtedly aware of significant changes in the market through various sources including meetings with and reports from the NRRIT and information in the news media.

cc: Chief Financial Officer