

OFFICE OF INSPECTOR GENERAL
Audit Report

**Fiscal Year 2012 Financial Statement Audit
Letter to Management**

**Report No. 13-03
January 28, 2013**



RAILROAD RETIREMENT BOARD



UNITED STATES RAILROAD RETIREMENT BOARD

OFFICE OF INSPECTOR GENERAL

January 28, 2013

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 6, 2012, except for matters relating to the fair value of the net assets of the National Railroad Retirement Investment Trust as of September 30, 2012, as to which the date was November 15, 2012. We performed our audit in accordance with U.S. generally accepted government auditing standards and Office of Management and Budget (OMB) audit guidance as applicable to the scope of our audit.¹ We have not considered internal control since we obtained sufficient appropriate audit evidence to support the audit opinion on November 6, 2012; internal control was not among those matters to which we gave consideration between November 6th 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 significant deficiency, 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 in conjunction with our opinion on the financial statements. However, neither this letter, nor the attached memorandum, modifies our report dated as of November 6, 2012, and November 15, 2012, 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.

¹ "Report on the Railroad Retirement Board's Fiscal Year 2012 Financial Statements," OIG Report No. 13-01, November 15, 2012.

In planning and performing this audit, we considered internal control in order to determine our auditing procedures for the purpose of issuing our report on the RRB's 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,

Original signed by ...

Martin J. Dickman
Inspector General

Attachments

cc: Walter A. Barrows, Labor Member
Jerome F. Kever, Management Member
George V. Govan, Chief Financial Officer
Karl T. Blank, General Counsel
John M. Walter, Chief of Accounting, Budget, and Financial Management
Martha P. Rico, Secretary to the Board

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Letter to Management
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MATERIAL WEAKNESSES

In conjunction with the Office of Inspector General's (OIG) opinion on the Railroad Retirement Board's (RRB) financial statements for the fiscal years (FY) ended September 30, 2012 and 2011, we reported the following material weaknesses.

Information Technology Security - Risk Management Framework

During FY 2012, the OIG evaluated the RRB's information security pursuant to the provisions of the Federal Information Security Management Act (FISMA). OIG auditors found that weaknesses regarding the review of contractor deliverables associated with the risk management framework continue to be found. Although agency managers are working to strengthen controls, management action had either not been completed as of the end of the current reporting period, or had not been in place long enough to permit evaluation.

Information Technology Security - Configuration Management²

During FY 2012, the OIG evaluated the RRB's information security pursuant to the provisions of FISMA. OIG auditors found that weaknesses associated with the configuration management of some agency systems continue to be found. Although agency managers are working to remediate these weaknesses, management action had not been completed as of the end of the current period.

Budgetary Reporting

In FY 2011, we reported a material weakness for budgetary reporting and recommended that the Bureau of Fiscal Operations (BFO) provide training for the preparation of the statement and implement a review process to ensure the accuracy of calculations, consistency in recorded amounts and effectiveness of controls. In an effort to address this material weakness, BFO staff conducted budgetary training for the accountants in March 2012. Although BFO has made an effort toward attempting to address this weakness, the training was not sufficient to prevent the financial reporting errors found in the June 30, 2012 Statement of Budgetary Resources. In addition, corrective action remains to be taken regarding an improved review process to ensure the accuracy of calculations, consistency in recorded amounts and effectiveness of controls.

² This material weakness was previously referred to as Information Technology Security Application and Services.

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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 significant deficiency, 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. The full text of management's responses is presented as Appendix II and Appendix III in this report.

Inaccurate Reported Amount for Distributed Offsetting Receipts

BFO's internal controls over budgetary reporting are still insufficient. During our audit, we found that the June 30, 2011 comparative amount provided for the June 30, 2012 Statement of Budgetary Resources (SBR) for the line caption "Distributed Offsetting Receipts" was not accurately reported in the financial statement provided to the Office of Management and Budget (OMB).

Control activities help to ensure that all transactions are completely and accurately recorded. OMB Circular A-136 requires the RRB to submit quarterly comparative financial statements, which includes the SBR.

BFO's review process for the June 30, 2012 comparative statements was not effective. During FY 2011, BFO corrected the amount recorded as Distributed Offsetting Receipts reported on the June 30, 2011 SBR. However, the corrected amount was not recorded in the June 30, 2012 comparative SBR.

The amount recorded as Distributed Offsetting Receipts as of June 30, 2011 in the June 30, 2012 comparative SBR was understated by \$170 million, which caused the agency's outlays to be overstated by \$170 million. This impacted the accuracy of the RRB's reported budgetary amounts provided to OMB for the comparative SBR reported as of June 30, 2012.

Recommendations for corrective action for this audit finding are related to those currently pending for the material weakness for budgetary reporting made in our FY 2011 Letter to Management audit report.³ As a result, no additional recommendations will be made.

³ "Fiscal Year 2011 Financial Statement Audit Letter to Management," OIG Report No. 12-04, January 31, 2012.

Letter to Management
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Delay in Establishing Budgetary Allotments

Internal controls are insufficient for the timely establishment of budgetary allotments in the RRB's Federal Financial System (FFS) and verification of existing allotments prior to voucher preparation. BFO's accounting section prepared a voucher to record receipt of a \$137 million funds transfer from the Department of Treasury for quarterly income taxes and the voucher failed FFS edits because the budgetary allotment had not been prepared in FFS by BFO's budgetary section. BFO's accounting section did not initiate communication with the budgetary section regarding this issue until seven days later.

Treasury issues a warrant transferring quarterly income tax receipts to the Federal Payments to Railroad Retirement Account. A budgetary allotment for the funds must be established in FFS by BFO's budgetary section before the funds transfer can be recorded. BFO's accounting section prepares a standard voucher to record the funds transfer, invests the funds on the day of receipt, and then prepares another voucher to record the investment of the funds.

An apportionment is a plan approved by OMB to spend resources provided by one of the annual appropriations acts, a supplemental appropriations act, a continuing resolution, or a permanent law (mandatory appropriations). The apportionment specifies and limits the obligations that may be incurred and expenditures that can be made (or makes other limitations, as appropriate) for specified time periods, programs, activities, projects, objects or any combination thereof. It may be further subdivided into allotments, suballotments, and allocations.

One of the RRB's strategic goals is to serve as responsible stewards for their customers' trust funds and agency resources. As such, they are committed to fulfilling their fiduciary responsibilities to the railroad community by running the agency in an efficient and effective manner.

BFO's budgetary section does not have sufficient controls to ensure the timely establishment of budgetary allotments in FFS. In addition, BFO's accounting section does not have sufficient controls to ensure that the budgetary allotments have been established in FFS prior to preparing a voucher to transfer the funds. Untimely communication between the accounting and budgetary sections contributed to the delayed corrective action.

Due to the delay in establishing the allotment, BFO was not able to invest the funds until 10 days later, which caused the RRB to lose approximately \$112,600 in interest.

Letter to Management
Memorandum on Internal Control

Recommendations

We recommend that the Bureau of Fiscal Operations:

1. improve the internal controls over the timely establishment of the budgetary allotments in FFS related to quarterly income tax receipts;
2. improve internal controls to verify that budgetary allotments have been created in FFS prior to recording funds transferred for quarterly income tax receipts; and
3. establish internal controls for timely follow-up of intra-bureau communication for funds transferred for quarterly income tax receipts.

Management's Response

The Bureau of Fiscal Operations agreed to implement the recommendations.

Management Schedule Conflicted with Legal Representation Letter

Internal controls are not sufficient to ensure that the management schedule, which shows how the information in the legal letter is considered in the financial statements, accurately supports the legal representation letter prepared by the General Counsel. We found that the amounts recorded by BFO in the management schedule did not accurately reflect the amounts provided in the legal representation letter.

OMB Circular No. A-136, Financial Reporting Requirements, requires agencies to submit interim and final legal representation letters. Management schedules are required to accompany the legal representations showing how the information contained in the legal representations was considered in preparing the financial statements. The schedules should be consistent with information presented in the legal representation letters and notes to the financial statements.

The review and approval process for the management schedule was not effective. The management schedule contained inaccurate amounts of approximately \$25,191. Weaknesses in the preparation and review process, if not corrected, could lead to future errors.

Letter to Management
Memorandum on Internal Control

Recommendation

We recommend that the Bureau of Fiscal Operations:

4. strengthen the controls over the preparation, review and approval of the management schedule to ensure that information provided is consistent with information presented in the applicable legal representation letter.

Management's Response

The Bureau of Fiscal Operations agreed to implement the recommendation.

Incomplete Legal Letter File

We found that internal controls over the legal letter file maintained by the Office of the General Counsel was not sufficient to ensure that it contained documentation to support changes in the status of the legal cases. The Office of the General Counsel maintains a legal letter file called the "Board Financial Statements File" to support information provided in the quarterly reports that they prepare and provide to BFO regarding litigation, claims and assessments and legal representation letters for the financial statement audit. We found that the "Board Financial Statements File" did not sufficiently support the change in status, the likelihood of loss, and the amount of loss for the cases.

The legal letter file should contain documentation of contacts with the Department of Justice or Internal Revenue Service to update the status of Railroad Retirement Tax Act litigation. The file should also contain monthly updates on the status of litigation from various attorneys which are compiled into a monthly litigation report.

The lack of sufficient documentation was caused by inadequate internal controls over the legal letter file.

BFO records contingent liability amounts based on the legal representation letter prepared by the Office of the General Counsel. When documentation maintained to support the legal representation file is inadequate, it is difficult to assess the accuracy and reasonableness of the data provided in the legal representation letter.

Letter to Management
Memorandum on Internal Control

Recommendation

We recommend that the Office of General Counsel:

5. strengthen its internal controls to ensure that information relevant to cases discussed in quarterly reports of litigation, claims and assessments or legal representation letters is maintained in the "Board Financial Statements File."

Management's Response

The Office of General Counsel concurred with this recommendation.

Status of Prior and Current Year Recommendations

We have reviewed the implementation of recommendations resulting from prior audits of the RRB's financial statements. The table below presents a summary of the status of recommendations that were pending when we issued our "Letter to Management" dated January 31, 2012, in connection to our audit of the RRB's FY 2011 financial statements. The additional recommendations resulting from our audit of the agency's FY 2012 financial statements are also included.

Bureau	Report and Recommendation Number	Current Status	
		Implemented	In Progress
BUREAU OF FISCAL OPERATIONS			
	08-01 #9		X
	10-03 #2	X	
	11-03 #1	X	
	12-04 #1		X
	12-04 #2		X
	12-04 #6		X
	13-03 #1		X
	13-03 #2		X
	13-03 #3		X
	13-03 #4		X
BUREAU OF ACTUARY			
	09-02 #9		X
	09-02 #10		X
	12-04 #3		X
	12-04 #4		X
	12-04 #5		X
OFFICE OF PROGRAMS			
	09-02 #12		X
	09-02 #13		X
OFFICE OF GENERAL COUNSEL			
	13-03 #5		X
TOTALS		2	16



UNITED STATES GOVERNMENT
MEMORANDUM

January 23, 2013

TO : Diana Krueel
Assistant Inspector General for Audit

FROM : George V. Govan
Chief Financial Officer

GEORGE GOVAN

Digitally signed by GEORGE GOVAN
DN: cn=US, o=U.S. Government,
ou=Railroad Retirement Board,
cn=GEORGE GOVAN,
0.9.2342.19200.100.1.1=60001002289
652
Date: 2013.01.23 07:28:47 -0600

SUBJECT: Draft Letter to Management – FY 2012 Financial Statement Audit

This is in response to your request for comments on the above draft audit report. Following are my comments on recommendations addressed to the Bureau of Fiscal Operations.

We recommend that the Bureau of Fiscal Operations:

- 1. improve the internal controls over the timely establishment of the budgetary allotments in FFS related to quarterly income tax receipts.***

We will improve the internal controls over the timely establishment of the budgetary allotments in FFS related to quarterly income tax receipts.

Target Completion Date: May 31, 2013

- 2. improve the internal controls to verify that budgetary allotments have been created in FFS prior to recording funds transferred for quarterly income tax receipts.***

We will improve the internal controls to verify that budgetary allotments have been created in FFS prior to recording funds transferred for quarterly income tax receipts.

Target Completion Date: May 31, 2013

3. *establish internal controls for timely follow-up of intra-bureau communication for funds transferred for quarterly income tax receipts.*

We will establish internal controls for timely follow-up of intra-bureau communication for funds transferred for quarterly income tax receipts.

Target Completion Date: May 31, 2013

4. *strengthen the controls over the preparation, review and approval of management schedules to ensure that information provided is consistent with information presented in the applicable legal representation letter.*

We will strengthen these controls.

Target Completion Date: May 31, 2013

If there is any additional information you need, please advise me.

cc: John Walter, Chief of ABFM
Elizabeth Stubits, Lead Budget Analyst
Rich Lannin, Senior Accountant
Edie Natividad, Accountant
Debra Stringfellow-Wheat, Supervisory Auditor




UNITED STATES GOVERNMENT
MEMORANDUM

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

January 24, 2013

TO : Diana Krueel
Assistant Inspector General for Audit

FROM : Karl T. Blank 
General Counsel

SUBJECT : Draft Letter to Management
FY 2012 Financial Statement Audit

This is in reply to your memorandum of January 9, 2013, transmitting a draft letter to management on internal control.

With respect to the file maintained by the Office of General Counsel to document potential liabilities to the Railroad Retirement Account arising from litigation concerning either the Board or the Internal Revenue Service in the administration of the Railroad Retirement Tax Act, recommendation number 5 states:

We recommend that the Office of General Counsel strengthen its internal controls to ensure that information relevant to cases discussed in quarterly reports of litigation, claims and assessments or legal representation letters is maintained in the "Board Financial Statements" file.

This is to advise that I concur with the recommendation.

cc: Chief Financial Officer