

OFFICE OF INSPECTOR GENERAL
Audit Report

**Fiscal Year 2011 Financial Statement Audit
Letter to Management**

**Report No. 12-04
January 31, 2012**



RAILROAD RETIREMENT BOARD



UNITED STATES RAILROAD RETIREMENT BOARD

OFFICE OF INSPECTOR GENERAL

January 31, 2012

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 8, 2011, except for matters relating to the fair value of the net assets of the National Railroad Retirement Investment Trust as of September 30, 2011, as to which the date was November 15, 2011. 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 8, 2011; internal control was not among those matters to which we gave consideration between November 8th 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 and a significant deficiency in conjunction with our opinion on the financial statements. However, neither this letter, nor the attached memorandum, modifies our report dated as of November 8, 2011, and November 15, 2011, 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 See our report on the RRB's financial statements for a full description of the scope and methodology.

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 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,

Original signed by ...

Martin J. Dickman
Inspector General

Attachments

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

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Memorandum on Internal Control

MATERIAL WEAKNESSES

In conjunction with the Office of Inspector General's (OIG) opinion on the RRB's financial statements for the fiscal years (FY) ended September 30, 2011 and 2010, we reported the following material weaknesses.¹

Information Technology Security - Risk Management Framework

During FY 2011 the OIG evaluated the RRB's information security program pursuant to the provisions of the Federal Information Security Management Act of 2002 (FISMA). OIG auditors found that weaknesses regarding the review of contractor deliverables associated with the risk management framework continue to be found.² 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 - Applications and Services

During FY 2011, the OIG also identified a material weakness regarding information technology security application services because the RRB continues to use an unsupported server for some major applications. Although the agency has moved some of the servers to the virtual environment, this action does not alleviate the problems associated with processing data in an unsupported environment. Uncertainties exist in determining the timeframe in which this situation will be corrected as well as the necessary resources for completion. Recommendations for corrective action are provided in the FY 2011 FISMA audit report.³

¹ "Report on the Railroad Retirement Board's Fiscal Year 2011 Financial Statements," OIG Report No. 12-01, November 15, 2011.

² "Inspection of the Railroad Retirement Board's Agency Enterprise General Information Support System Certification and Accreditation," OIG Report No. 11-10, September 28, 2011.

"Inspection of the Railroad Retirement Board's Financial Management System's Continuous Monitoring Program," OIG Report No. 11-11, September 28, 2011.

"Evaluation of the Railroad Retirement Board's Benefit and Payment Operations System Continuous Monitoring," OIG Report No. 11-12, September 29, 2011.

³ "Fiscal Year 2011 Evaluation of Information Security at the Railroad Retirement Board," OIG Report No. 12-02, January 5, 2012.

Memorandum on Internal Control

Internal Control Over Non-Integrated Subsystems

The RRB's financial reporting control structure is not comprehensive with respect to the reconciliation of the general ledger to non-integrated subsystems. The OIG previously reported this issue as a result of its audits of the agency's financial statements.

The agency has taken action to address this material weakness by performing reconciliations of the various non-integrated subsystems that support financial accounting. Although this shows that progress is being made to address this material weakness, the agency's progress is not yet sufficient to ensure that all of the reconciliations are properly designed and effective.

RRB managers are working to address this weakness.

Budgetary Reporting

The Bureau of Fiscal Operations (BFO) is responsible for preparing agency financial statements, which includes the Statement of Budgetary Resources (SBR). During our fiscal year 2011 audit, we found significant unexplained variances in the September 30, 2011 SBR which resulted in the discovery of material errors of more than \$2 billion, which were corrected by BFO prior to the publication of the statement. We also discovered a \$170 million error in the June 30, 2011 SBR, which was subsequently corrected. In addition, the OIG identified other numerous instances of ineffective controls for budgetary transactions. As a result of these errors, the OIG has determined that BFO's internal controls over budgetary reporting are insufficient to ensure that a material misstatement would be prevented, detected and corrected on a timely basis.

Management within the Bureau of Fiscal Operations is working to address these weaknesses.

Recommendations

We recommend that the Bureau of Fiscal Operations:

1. provide training for the preparation of the Statement of Budgetary Resources; and
2. implement a review process for the Statement of Budgetary Resources to ensure the accuracy of calculations, consistency in recorded amounts, and effectiveness of controls.

Memorandum on Internal Control

Management's Response

The Bureau of Fiscal Operations will provide training for the preparation of the Statement of Budgetary Resources and implement a revised process for its review.

The full text of management's response is presented as Appendix III to this memorandum.

SIGNIFICANT DEFICIENCY**Railroad Audits**

The agency conducts external audits of railroad employers to ensure compliance under the Railroad Retirement and Railroad Unemployment Insurance Acts and verifies the accuracy and timeliness of reported compensation and contributions. Although the RRB does not have the authority to audit taxes under the Railroad Retirement Tax Act, agency staff reviews compensation amounts on which these payroll taxes are based. Creditable compensation paid by railroad employers impacts Railroad Unemployment Insurance Act contributions, which finances the railroad unemployment and sickness insurance programs. Consequently, audit findings could impact the RRB's trust funds, which are recorded in the agency's financial statements.

As a result of our review of the organizational unit that conducts the external audits, the OIG reported that the unit lacked comprehensive policies and procedures for conducting, reporting and documenting audits to ensure that compensation is reported in accordance with the law.⁴ A weak quality control system, the practice of not verifying all employer information with the Internal Revenue Service, and not issuing audit reports in a timely manner increases the risk that railroad reporting errors could remain undetected.

Management in the Bureau of Fiscal Operations is working to address these deficiencies.

⁴ "Review of the Railroad Retirement Board's Audit and Compliance Division," OIG Report No. 11-04, February 1, 2011.

Memorandum on Internal Control

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.

Readers should be aware that the noted errors were corrected prior to the publication of the FY 2011 Performance and Accountability Report. The errors that were uncorrected as of September 30, 2011 were provided to agency management on a Summary of Uncorrected Misstatements.

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

RRB Risks Issuing Incorrect Statement of Budgetary Resources and Financial Statement Notes

During our audit, we found errors in the SBR, the accompanying financial statement notes, and other documents even though they had been previously reviewed and approved by supervisory personnel.

BFO has established numerous procedures regarding the preparation, review and approval of financial statements, notes, and documents as contained in their Accounting Procedures Guide. However, errors continue to occur with respect to calculations, consistency in recorded amounts, and compliance with guidance because the preparation and review process are not thorough. See Appendix I for details regarding the errors identified during the audit and the BFO controls that did not prevent them from occurring.

BFO's ineffective review and approval process can lead to the issuance of an incorrect SBR and financial statement notes. It also hinders the agency's ability to meet mandated deadlines because the errors have to be corrected by BFO and reviewed again by the OIG.

Recommendations for corrective action for this audit finding are related to those made for the material weakness for budgetary reporting (see page 4 of this report). As a result, no additional recommendations will be made.

Memorandum on Internal Control

Social Insurance Requirements

Internal controls are not sufficient to ensure that information included in the annual Performance and Accountability Report reflects the latest changes in guidance for social insurance.

The Statement of Federal Financial Accounting Standards No. 37, *Social Insurance: Additional Requirements for Management's Discussion and Analysis and Basic Financial Statements*, became effective beginning in FY 2011, and requires: (1) a new presentation for the Statement of Social Insurance, (2) a new statement, Statement of Changes in Social Insurance Amounts, and (3) additional data for the management discussion and analysis section of the annual Performance and Accountability Report. Social insurance requirements are also provided in Office of Management and Budget (OMB) Circular No. A-136, *Financial Reporting Requirements*, which provides guidance for the entire Performance and Accountability Report.

Misinterpretation of the guidance by the Bureau of the Actuary led to the creation of a Statement of Social Insurance that did not have the necessary groupings as required by the Statement of Federal Financial Accounting Standards No. 37 and OMB Circular No. A-136. As a result, the presentation of the Statement of Social Insurance required correction prior to publication in the Performance and Accountability Report.

Recommendation

We recommend that the Bureau of the Actuary:

3. develop and implement controls to ensure compliance with accounting standards and OMB requirements that impact social insurance reporting.

Management's Response

The Bureau of the Actuary agreed to implement the recommendation.

The full text of management's response is presented as Appendix IV to this memorandum.

Memorandum on Internal Control

Quality Assurance Steps and Checklists for Social Insurance

Internal controls are not sufficient to ensure that the quality assurance section, and checklists referenced in the Actuary's internal policies and procedures, reflect the latest changes in guidance for social insurance reports and documents.

The Bureau of the Actuary Policies and Procedures for Actuarial Projections contains guidance and quality assurance checklists regarding social insurance requirements.

Portions of the Bureau of the Actuary Policies and Procedures for Actuarial Projections have been updated, however, due to oversight, the quality assurance section and checklists have not been updated to include requirements for the Statement of Changes in Social Insurance Amounts.

As a result, all necessary work steps may not be completed and potential errors could go undetected.

Recommendations

We recommend that the Bureau of the Actuary:

4. update the quality assurance steps and checklists in their Policies and Procedures for Actuarial Projections to include requirements for the Statement of Changes in Social Insurance Amounts; and
5. modify their procedure for updating the Policies and Procedures for Actuarial Projections to include a comprehensive review of all sections and checklists, and ensure timely and full compliance with the new requirements.

Management's Response

The Bureau of the Actuary agreed to implement the recommendations.

The full text of management's response is presented as Appendix IV to this memorandum.

Memorandum on Internal Control

BFO's Responsibility for Data Received from Other Bureaus

BFO does not always identify errors or non-compliance with applicable guidance for data provided to them from other agency bureaus.

We also observed that the existing control framework is over-reliant on the OIG's annual audit of the financial statements to ensure that these documents are accurate and comply with applicable guidance.

BFO is responsible for preparing agency financial statements and publishing the RRB's annual Performance and Accountability Report in accordance with OMB Circular No. A-136 and other financial reporting requirements. Other agency bureaus prepare portions of the report and submit them to BFO. The Bureau of the Actuary prepares the statement of social insurance and the statement of changes in social insurance amounts, notes, and other portions of the report that are all provided to BFO. The Office of Programs also prepares portions of the report that are provided to BFO, including improper payment data to which BFO must reconcile.

BFO does not have sufficient controls in place to ensure that data provided to them from other units is accurate, consistent with financial data provided in the financial statements, and presented in accordance with applicable guidance.

During our audit, we identified the following errors that were not detected by BFO: an outlay amount for improper payments was incorrect, and social insurance data had not been prepared in accordance with applicable guidance. Without sufficient internal controls, errors in financial statements and financial statement related documents could go undetected.

Recommendation

We recommend that the Bureau of Fiscal Operations:

6. develop and implement controls to ensure that documents received from other agency bureaus are accurate and prepared in accordance with applicable guidance.

Management's Response

The Bureau of Fiscal Operations agreed to develop and implement controls for documents received from other agency bureaus.

The full text of management's response is presented as Appendix III to this memorandum.

Errors in the Statement of Budgetary Resources and the Financial Statement Notes

We identified the following budgetary related errors during the FY 2011 audit.

Error	Type of Error		Control
	Accuracy	Compliance	
<u>June 30, 2011 SBR</u> Permanently Not Available overstated by \$16,372 Temporarily Not Available understated by \$16,372	X	X	Preparation and review of SBR Checklist. Annual review of external guidance by Senior Accountant and Accounting Officer.
<u>June 30, 2011 SBR</u> Obligations Incurred: Direct overstated by \$72,449	X		Adjusting journal entries and support are prepared by the BFO Accountant and approved by the Accounting Officer.
<u>June 30, 2011 Standard Form (SF) -133</u> Change in Uncollected Customer Payments from Federal Sources overstated by \$28,649	X		Preparation of SF-133 Checklist. Review of the SF-133 by the Accounting Officer or designee.
<u>September 30, 2011 SBR</u> Adjusting journal entries (AJEs) affecting Obligation Incurred: Direct understated by \$1.4 million	X		Adjusting journal entries and support are prepared by the BFO Accountant and approved by the Accounting Officer.
<u>March 31, 2011 SBR Workpapers</u> Unobligated Balance – brought forward Oct. 1 one account was overstated by \$23,471 and another account was understated by \$23,471	X		Preparation and review of SBR Checklist.
<u>FY 2011 SF 132</u> The transfer between funds was overstated by \$1,000	X		Preparation, review and approval of SF-132s.

Errors in the Statement of Budgetary Resources and the Financial Statement Notes

We identified the following errors in the financial statement notes during the FY 2011 audit.

Financial Statement Note and Description of Error	Type of Error		Control
	Accuracy	Compliance	
<u>Contingent Liabilities</u> Pertinent details regarding a \$20 million refund request had been omitted.	X		Totals in the workpapers are matched to the statement and notes, where applicable, on the financial statement checklists which are signed off by the reviewer.
<u>Subsequent Events</u> The decline in National Railroad Retirement Investment Trust assets was understated by \$.5 billion.	X		
<u>Earmarked Funds Note</u> The note did not separately identify \$10,000 as Liabilities Due and Payable.	X		
<u>Related Parties</u> The funds transfer to the Centers for Medicare and Medicaid Services was overstated by \$21 million.	X		
<u>Available Borrowing Authority, End of Period</u> Although required, this note was not prepared.		X	External guidance is reviewed annually by the Senior Accountant and the Accounting Officer.
<u>Adjustments to Unobligated Balance</u> This note was prepared although it was not required.		X	
<u>Terms of Borrowing Authority Used</u> This note did not discuss financing sources.		X	

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 25, 2011, in connection to our audit of the RRB's FY 2010 financial statements. The additional recommendations resulting from our audit of the agency's FY 2011 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
	10-03 #3	X	
	10-03 #4	X	
	11-03 #1		X
	11-03 #2	X	
	12-04 #1		X
	12-04 #2		X
	12-04 #6		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
TOTALS		3	13

**MEMORANDUM****JAN 26 2012**

TO : Diana Kruef
Assistant Inspector General for Audit

FROM : George V. Govan 
Chief Financial Officer

SUBJECT: Draft Letter to Management – FY 2011 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 (BFO).

We recommend that BFO:

1. ***provide training for the preparation of the Statement of Budgetary Resources.***

Concur. We will provide training for the preparation of the Statement of Budgetary Resources.

Target Completion Date: April 30, 2012

2. ***implement a review process for the Statement of Budgetary Resources to ensure the accuracy of calculations, consistency in recorded amounts and effectiveness of controls.***

Concur. We will implement a revised review process for the Statement of Budgetary Resources.

Target Completion Date: June 29, 2012

6. ***develop and implement controls to ensure that documents received from other agency bureaus are accurate and prepared in accordance with applicable guidance.***

Concur. We will develop and implement controls for documents received from other agency bureaus.

Target Completion Date: August 31, 2012

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

cc: John Walter, Chief of ATFS
Edmund Fleming, Accounting Officer
Samir Guirguis, Senior Cost Accountant
Rich Lannin, Senior Accountant
Elizabeth Stubits, Accountant
Edie Natividad, Accountant
Debra Stringfellow-Wheat, Supervisory Auditor

January 25, 2012



UNITED STATES GOVERNMENT

MEMORANDUM

TO : Diana Krueel
Assistant Inspector General for Audit

FROM : Frank J. Buzzi
Chief Actuary

A handwritten signature in cursive script, appearing to read "Frank J. Buzzi", is written over the printed name.

SUBJECT: Draft Letter to Management
FY 2011 Financial Statement Audit

Thank you for the opportunity to review and comment on the subject Draft Letter to Management.

We agree to implement recommendations 3, 4, and 5. Our target completion date for these recommendations is July 31, 2012.