UNITED STATES RAILROAD RETIREMENT BOARD

OFFICE OF INSPECTOR GENERAL

To the Board Members:

The following report presents the results of our audits of the financial statements of the Railroad Retirement Board (RRB) as of and for the fiscal years ending September 30, 2003 and 2002.

Opinion on the Financial Statements

The RRB's financial statements, including the accompanying notes, present fairly, in all material respects, in conformity with U.S. generally accepted accounting principles, the financial position of the RRB, its consolidated net cost of operations and change in net position; combined budgetary resources; reconciliation of net cost to budgetary resources; and custodial activity as of and for the fiscal years ending September 30, 2003 and 2002.

Emphasis of Matters

The Railroad Retirement and Survivors' Improvement Act of 2001 provided for the establishment of the National Railroad Retirement Investment Trust (NRRIT) and directed the RRB to transfer "that portion of the Railroad Retirement Account that is not needed to pay current administrative expenses" and "the balance of the Social Security Equivalent Benefit Account not needed to pay current benefits and administrative expenses" to the NRRIT. The RRB transferred $1.5 billion to the NRRIT during fiscal year 2002 and $19.2 billion during fiscal year 2003. The transfer of cash to the NRRIT is treated as an outlay; the assets of the NRRIT are not reported as assets on the RRB's consolidated balance sheet.

Transfers-in from the Social Security Administration's Old Age and Survivor, and Disability Insurance trust funds; and transfers-out to the Federal Health Insurance Trust Fund represented $3.3 billion (net), or approximately 32%, of the $10.4 billion in total financing sources reported on the statement of changes in net position, before transfers-out to the NRRIT.

844 N RUSH STREET CHICAGO IL 60611-2092

Report On Internal Control

Our evaluation of internal controls disclosed material weaknesses in the overall control environment and information system security.[1] These weaknesses adversely impact the agency's ability to ensure the timely preparation of accurate financial reports. The details of our findings follow. However, the objective of our audit was not to provide an opinion on internal control. Accordingly, we do not express such an opinion.

Overall Control Environment

The RRB's overall control environment is not adequate to ensure that agency financial statements will be free of material misstatements and prepared in accordance with applicable guidance. As a result, each financial statement audit since FY 1993 has cited the agency for a material weakness in this area.

This weakness in internal control is the result of an organizational structure that does not provide proactive top-down leadership in addressing financial reporting issues. Management in the agency's various operating components does not seek assistance across organizational lines to resolve problems related to financial accounting and reporting. The OIG presented its findings regarding the RRB's overall control environment in OIG audit report # 02-08.

OMB has established a timetable for acceleration of financial statement reporting in the Federal government. The RRB has met previously established deadlines; however, this new timetable, which requires submission of audited financial statements for FY 2004 by November 15, 2004, represents a major challenge to existing agency resources. The OIG believes that the challenge of submitting audited financial statements in accordance with OMB's accelerated timetable will provide a significant test of the effectiveness of the agency's control environment over financial statement preparation and reporting.

Barring any new evidence to the contrary, the OIG will consider successful compliance with accelerated reporting deadlines as evidence of the adequacy of the agency's overall control environment with respect to financial statement reporting only.

[1] A material weakness is a reportable condition that precludes the entity's internal controls from providing reasonable assurance that material misstatements in the financial statement s would be prevented or detected on a timely basis. Reportable conditions are matters coming to our attention that, in our judgment, should be communicated because they represent significant deficiencies in the design or operation of internal control that could adversely affect the RRB's ability to meet the objectives described in this report.

RRB management does not agree with the OIG's assessment of the overall control environment and has not reported this material weakness in the agency's annual report on internal control and financial systems issued pursuant to the Federal Managers' Financial Integrity Act (FMFIA).

Information System Security

During FYs 2001, 2002, and 2003 the OIG conducted evaluations of information security pursuant to the provisions of the Government Information Security Reform Act and the Federal Information Security Management Act. Our reviews disclosed weaknesses in most 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 over financial reporting.

Agency management has begun the process of strengthening information security. However, corrective action has not been sufficient to eliminate the most significant weaknesses. Program management continues to be significantly undermined by a lack of training among key personnel. Access controls cannot be considered fully effective because of the weaknesses in account management in both the mainframe and end-user computing environments. The details of our findings concerning information security were presented to management in OIG audit reports # 02-04,"Review of Information Security at the RRB", February 5, 2002; #02-12, "Fiscal Year 2002 Evaluation of Information Security at the Railroad Retirement Board," August 27, 2002, and #03-11, "Fiscal Year 2003 Evaluation of Information Security at the Railroad Retirement Board," September 15, 2003.

RRB management has reported a material weakness in its information security program in the agency's annual report on internal control and financial systems issued pursuant to the FMFIA.

Compliance with Laws And Regulations

Our tests of compliance with selected provisions of laws and regulations disclosed no instances of non-compliances that are reportable under U.S. generally accepted government auditing standards or OMB guidance. However, the objective of our audit was not to provide an opinion on overall compliance with laws and regulations. Accordingly, we do not express such an opinion.

Consistency of Other Information

The RRB's Management Discussion and Analysis, required supplemental information, required supplementary stewardship information, and other accompanying information contain a wide range of data, some of which are not directly related to the financial statements. We did not audit and do not express an opinion on this information. However, we compared this information for consistency with the financial statements and discussed the methods of measurement and presentation with RRB officials. Based on this limited work, we found no material inconsistencies with the financial statements or nonconformance with OMB guidance.

Objectives, Scope, and Methodology

RRB management is responsible for (1) preparing the annual financial statements in conformity with U.S generally accepted accounting principles, (2) establishing, maintaining, and assessing internal control to provide reasonable assurance that the broad control objectives of the FMFIA are met, and (3) complying with applicable laws and regulations.

We are responsible for obtaining reasonable assurance about whether (1) the financial statements are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles and (2) management maintained effective internal control that provides reasonable, but not absolute, assurance that the following objectives were met.

- Financial reporting: Transactions are properly recorded, processed and summarized to permit the preparation of financial statements in conformity with U.S. generally accepted accounting principles and assets are safeguarded against loss from unauthorized acquisition, use or disposition.

- Compliance with laws and regulations: Transactions are executed in accordance with laws governing the use of budget authority and with other laws and regulations that could have a direct and material effect on the financial statements and any other laws, regulations, and governmentwide policies identified by OMB audit guidance.

We are also responsible for (1) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements and laws for which OMB audit guidance requires testing, and (2) performing limited procedures with respect to certain other information appearing in these annual financial statements. In order to fulfill these responsibilities, we:

- examined, on a test basis, evidence supporting the amounts and disclosures in the financial statements;
- assessed the accounting principles used and significant estimates made by management;
- evaluated the overall presentation of the financial statements;

- obtained an understanding of internal controls related to financial reporting, compliance with laws and regulation;
- obtained an understanding of the recording, processing, and summarizing of performance measures as reported in Management's Discussion and Analysis;
- tested relevant internal controls over financial reporting and compliance, and evaluated the design and operating effectiveness of internal controls;
- considered the process for evaluating internal controls and financial management systems under the FMFIA;
- tested compliance with selected provisions of the following laws and regulations:

    - Anti-Deficiency Act, as amended;
    - Prompt Payment Act;
    - Pay and Allowance System for Civilian Employees;
    - Provisions Governing Claims of the United States Government, including provisions of the Debt Collection Improvement Act;
    - laws providing for the appropriation of funds for the administration of the programs mandated by the Railroad Retirement and the Railroad Unemployment Insurance Acts, including the payment of benefits; and
    - provisions of the Railroad Retirement Act governing transfers of funds between the RRB and the Social Security Administration, the Centers for Medicare and Medicaid Services and the National Railroad Retirement Investment Trust.

We did not evaluate all internal controls relevant to operating objectives as broadly defined by FMFIA, such as controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to those controls over financial reporting and compliance with laws and regulations. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected. We also caution that projecting our evaluation to future periods is subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with controls may deteriorate.

We did not test compliance with all laws and regulations applicable to the RRB. We limited our tests of compliance to those laws and regulations that had a direct and material effect on the financial statements or that were required to be tested by OMB audit guidance that we deemed applicable to the financial statements for the fiscal years ended September 30, 2003, and 2002. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

We performed our work in accordance with U.S. generally accepted government auditing standards and OMB audit guidance.

RRB Management's Comments

RRB management was provided with a draft of this report and had no comment.

Martin J Dickman

Martin J. Dickman
Inspector General

January 23, 2004

SERIOUS MANAGEMENT CHALLENGES IDENTIFIED BY THE RAILROAD RETIREMENT BOARD'S OFFICE OF INSPECTOR GENERAL

The Office of Inspector General (OIG) is monitoring agency performance in addressing the most serious challenges facing the agency.

- Asset Stewardship
- Managing For Change
- Information Technology Security

Asset Stewardship

During FY 2002, the OIG began questioning the adequacy of oversight provided to the National Railroad Retirement Investment Trust (NRRIT).

The Railroad Retirement and Survivors' Improvement Act of 2001 (RRSIA) established the NRRIT, administered by seven Trustees, to invest funds not needed immediately to pay benefits under the Railroad Retirement Act. Through the end of FY 2003, the RRB has transferred in excess of $20 billion to the NRRIT.

The NRRIT was created as a non-governmental entity that is permitted, for the first time, to invest the assets accumulated to fund RRA programs in non-governmental investment vehicles. The legislation provides for only annual audited financial statements to be submitted six months after the end of each fiscal year. There is no requirement for interim reporting and NRRIT management does not report on the details of holdings or investment strategy outside of its annual report. RRSIA also gave the RRB the right to bring civil action against the NRRIT if any provisions of the RRA are violated. However, the RRB does not obtain sufficient information to assess whether the Trustees are fulfilling their fiduciary responsibilities under the Act.

Although the OIG has urged the agency to take a more active interest in the activities of the NRRIT, top management appears to be satisfied with its largely passive relationship with the NRRIT.

Managing For Change

The OIG has serious concerns about the continued viability of the RRB as a business entity. The agency serves a rapidly declining customer base administering benefit programs that are redundant of other Federal social insurance programs. The OIG has, for many years, urged the agency to transform itself to meet the challenges of providing efficient service delivery to shrinking worker and beneficiary populations.

During FY 1997, the RRB paid RRA benefits to 800,000 individuals. By FY 2002, the number had fallen to 684,000; a drop of nearly 15% in just five years. At the same time, the rail industry has been shrinking with an average worker population of only 227,000 supporting the entire system calendar year 2002. The agency's most recent actuarial forecast anticipates a continued decline in the numbers of both workers and beneficiaries. Yet the RRB continues to maintain a network of 53 field offices while field service staff represents approximately 29% of the agency's total personnel.

The retirement and survivor benefit programs administered under the RRA have been tied so closely to those administered under the Social Security Act, in both benefits and funding, that we have repeatedly urged top agency management to be proactive in redesigning the service delivery model for these programs.

Agency management has generally disregarded our recommendations for reinventing the agency's service delivery model.

Information Technology Security

The OIG has cited the agency with material weaknesses due to significant deficiencies in access controls in both the mainframe and end-user computing environments and in the training provided to staff with significant security responsibilities. Although agency management has completed many of the recommended corrective actions, the RRB has not completed corrective action to fully remediate the previously reported deficiencies in training and access controls that were the basis for the OIG's original finding of material weakness.

The RRB will be expanding the use of internet services in its communications with program beneficiaries and railroad employers in its efforts to comply with the Government Paperwork Elimination Act. The RRB can expect to face additional challenges in developing and maintaining a strong information security position as it responds to growing demand and opportunity for electronic outreach to its constituents.

Agency management has acknowledged the existence of the material weaknesses cited by the OIG. Management has implemented, or plans to implement, most of the recommendations for improved information security resulting from evaluations by the OIG and technical specialists under contract to the 01G.

Martin J. Dickman
Inspector General

October 10, 2003

Management's Comments in Brief

Most of the Inspector General's (IG) management challenges are a reiteration of previous recommendations and suggestions. We continue to respectfully disagree with the IG's statement submitted for inclusion in the Railroad Retirement Board's (RRB) Performance and Accountability Report for FY 2003. The RRB's management strategy in the areas of Asset Stewardship, Managing for Change and Information Technology is sound.

Asset Stewardship

The Railroad Retirement and Survivors' Improvement Act of 2001 created a non-governmental entity to handle investment of railroad retirement funds called the National Railroad Retirement Investment Trust. The Act provides that the Trust is to submit annual management reports to several government entities detailing its activities and have an independent qualified public accountant conduct an annual audit of its financial statements. Moreover, in accordance with a Memorandum of Understanding that includes the Department of Treasury and the Office of Management and Budget, the Trust submits monthly reports of investment activity and results to the RRB.

The Act does provide authority to the RRB to bring civil action against the Trust to enforce provisions of the Act. In order to carry out its responsibilities under the Act, the Board has established a team of senior agency employees, headed by the agency's General Counsel, with responsibility for reviewing Trust activities and advising the three-member Board concerning those activities. The General Counsel is located in Washington, D.C., which allows him to more closely coordinate activities with Trust staff. As a result, the Board Members are satisfied that sufficient controls are in place for the agency to fulfill its responsibilities under the Railroad Retirement and Survivors' Improvement Act with respect to the Trust.

Managing For Change

The agency has determined that its current structure of 53 field offices, under the direction of 3 regional offices, best serves its customers at the present time. The Board has already reduced the size of the field from 89 to 56 offices and the number of positions in the field by 25 percent. The current structure has many advantages over the concept of 6 service centers proposed by the IG. The IG's suggested structure would not significantly reduce costs considering required staffing levels, relocation expenses of current employees, and increased travel expenses. In fact, implementation would require significant new investments in technology. Further, Congress has shown support for the current structure as recently as July 23, 2003 as part of the Transportation and Infrastructure Committee – Waste Fraud and Abuse Report.

Finally, feedback from our customers clearly shows that although some of our customers are interested in using electronic services for certain matters, most still have a strong preference for personal service delivered at the local level. Also, smaller, local offices are better able to serve our aging customer population. Local offices can easily accommodate multiple and frequent requests for information/education events, thereby performing the public relations that are so vital to excellent customer service. Local offices also provide a strong deterrent to fraudulent activity, allowing the RRB to combat waste, fraud and abuse, and continue to serve as effective guardians of the agency's trust funds.

Information Security Weaknesses

The IG has conducted a number of reviews and cited the agency with a number of weaknesses in access controls and training of staff. We have made substantial progress toward closing the weaknesses identified by the IG. We have implemented most of the IG's recommendations, and have plans in place to complete action on the remaining recommendations during fiscal years 2004 and 2005.

This agency has demonstrated a commitment to provide and maintain the appropriate level of protection for the confidentiality, integrity, and availability of client information and the networks and systems that process it. The RRB continues its development of a comprehensive and integrated security program that addresses potential vulnerabilities. The RRB information security program will continue to improve the protection of its IT resources as described in the Federal Information Security Management Act Report for Fiscal Year 2003.

Page 130 is blank