FINANCIAL SECTION
AUDITOR’S REPORTS

UNITED STATES RAILROAD RETIREMENT BOARD

OFFICE OF INSPECTOR GENERAL

To the Board Members:

The following report presents the results of the Office of Inspector General's (OIG) audits of the financial statements of the Railroad Retirement Board (RRB) as of and for the fiscal years ended September 30, 2008 and 2007.

OPINION ON THE FINANCIAL STATEMENTS

We have audited the accompanying balance sheet of the RRB as of September 30, 2008 and 2007; the related statements of net cost, changes in net position, and budgetary resources for the years then ended; and the statements of social insurance as of January 1, 2008, 2007, and 2006.

We did not audit the financial statements of the National Railroad Retirement Investment Trust (NRRIT). The net assets of the NRRIT represent approximately 82% and 86% of the total assets reported by the RRB for fiscal years 2008 and 2007, respectively. NRRIT assets represent approximately 97% of the reported railroad retirement program's social insurance fund balance as of January 1, 2008 and 2007. Related changes in the net value of investments held by the NRRIT are reported as a source of financing which contributed a net loss of $7.3 billion during FY 2008 and a net gain of $3.3 billion during FY 2007.

Pursuant to the Railroad Retirement and Survivors' Improvement Act of 2001, the NRRIT retains the services of an independent auditor to opine on its financial statements. With respect to the assets of the NRRIT as of September 30, 2008 and 2007; and January 1, 2008, 2007, and 2006, the financial statements of the NRRIT were audited by other auditors whose reports have been furnished to us, and our opinion, insofar as it relates to the amounts included for the NRRIT, is based solely on the report of the other auditors.

In our opinion, the financial statements of the RRB referred to above, 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 changes in net position, and combined budgetary resources as of and for the fiscal years ended September 30, 2008, and 2007; and the financial condition of the Railroad Retirement program as of January 1, 2008, 2007, and 2006.

As described in the statement and related notes, the statement of social insurance presents the actuarial present value of the future income to be received, and expenditures to be paid to or on behalf of participants in the Railroad Retirement

844 N RUSH STREET CHICAGO IL 60611-2092

program during a period sufficient to illustrate the program's long-term sustainability. In preparing the statement of social insurance, management considers and selects assumptions and data that it believes provide a reasonable basis for the assertions in the statement. However, because of the large number of factors that affect the statement of social insurance and the fact that future events and circumstances cannot be known with certainty, there will be differences between the estimates in the statement of social insurance and the actual results, and those differences may be material.

The RRB's statement of social insurance presents the fund balance of the Railroad Retirement program and the related estimate of actuarial surplus which is computed by adding the fund balance to the estimated excess (or shortfall) of the present value of future income over the present value of future expenditures for the 75 year projection period. These additional line items are presented to ensure that a reader would not be misled about the financial condition of the program. The program's current financing structure creates an inverse relationship between income and program assets; thus, the financial condition of the program cannot be understood without direct reference to the fund balance and the related actuarial surplus or deficiency. This relationship is disclosed in Note 15 to the financial statements.

Emphasis of Matters

NRRIT

Pursuant to the Railroad Retirement and Survivors' Improvement Act of 2001, the NRRIT is authorized to invest railroad retirement assets in a diversified investment portfolio. As of September 30, 2008, the reported value of the net assets of the NRRIT was approximately $7.3 billion lower than reported at September 30, 2007. The RRB discusses its relationship with the NRRIT in Note 2 and Note 5 to the financial statements, and describes the impact of changes in the social insurance fund balance on actuarial projections in Note 15.

Financial Interchange

The RRB discloses transactions with related parties in Note 2 to the financial statements. The RRB, Social Security Administration and Centers for Medicare and Medicaid Services are parties to a financing arrangement described as a financial interchange. Under this arrangement, transfers-in from the Social Security Administration's Old-Age and Survivors Insurance and Disability Insurance trust funds and transfers-out to the Federal Health Insurance trust fund represent approximately $3.6 billion (net), or approximately 26% of the nearly $13.8 billion in total financing sources reported on the RRB's statement of changes in net position for FY 2007. For FY 2008, financial interchange transfers of $3.6

billion (net) represented about 35% of the financing sources before considering the reduction in the reported value of NRRIT assets.

Restatement

The RRB has restated the FY 2007 statement of budgetary resources to reflect changes in accounting for (1) trust fund transfers that fund the agency's administrative appropriations and (2) cash advances received from the U.S. Treasury under the financial interchange. Both transactions were previously reported as nonexpenditure transfers.

For FY 2008, The Office of Management and Budget (OMB) directed the RRB to report the transfers funding administrative appropriations as expenditure transfers and Treasury advances as borrowing authority for budgetary purposes. The FY 2007 statement of budgetary resources was restated to permit comparability.

The OIG rendered an unqualified opinion on the RRB's FY 2007 financial statements. The aforementioned restatements would not have altered that opinion. RRB management discloses the restatement in Note 21 to the financial statements.

REPORT ON INTERNAL CONTROL

In planning and performing our audit, we considered the RRB's internal control over financial reporting and compliance.[1] We did this to determine our procedures for auditing the financial statements and to comply with OMB audit guidance, not to express an opinion on internal control. Accordingly, we do not express an opinion on internal control over financial reporting and compliance or on management's assertion on internal control included in Management's Discussion and Analysis.

With respect to previously reported control deficiencies, our current-year evaluation disclosed that RRB management has completed action to strengthen controls over the social insurance fund balance. Agency efforts to correct weaknesses in its information security program are not yet complete and the previously reported material weakness continues to exist. We have also concluded that the previously reported weakness in internal control over financial reporting, previously classified as a significant deficiency, now represents a material weakness.[2]

---

[1] The definition of internal control as it relates to the basic financial statements is presented in the footnotes on page 6.

[2] A material weakness is a significant deficiency, or combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the financial statements will not be prevented or detected. A significant deficiency is a control deficiency, or combination of control deficiencies, that adversely affects the entity's ability to initiate, authorize, record, process or

In addition evaluation of internal control during FY 2008 disclosed a significant deficiency as a result of the lack of reconciliation of benefit payment subsystems with the general ledger.

Although not considered to be material weaknesses or significant deficiencies, we will report other matters involving internal control and its operation to RRB management in a separate letter.

Material Weaknesses

Information Security

During FY 2008, the OIG evaluated information security pursuant to the provisions of the Federal Information Security Management Act.[3] 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.

RRB efforts to strengthen information security continue and progress is being made; however, previously identified significant deficiencies in access controls, risk assessments, and periodic testing and evaluation continue to exist. In addition, the agency's information security program is not yet fully compliant with current requirements for risk based policies and procedures, a certification and accreditation program, or a comprehensive remedial action process.

Agency management is working to address the weaknesses in its information security program. Although some progress has been made, much work remains to be completed.

Financial Reporting

We first reported this control deficiency in the report on internal control issued with our opinion on the RRB's FY 2006 audit of the RRB's financial statements. Management action has not fully addressed the underlying cause and the condition has deteriorated. Although we observed notable efforts to strengthen internal control over financial accounting during FY 2007, we find that the RRB has been unable to sustain that improvement during FY 2008. In addition, a quality

---

report financial data reliably in accordance with generally accepted accounting principles (GAAP) such that there is more than a remote likelihood that a misstatement of the entity's financial statements that is more than inconsequential will not be prevented or detected. A control deficiency exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

[3] "Fiscal Year 2008 Evaluation of Information Security at the Railroad Retirement Board," OIG Report #08-05, September 30, 2008.

assurance process implemented during FY 2007 has not proven to be fully effective.

An effective control structure allows management and/or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

The Bureau of Fiscal Operations (BFO) is responsible for preparing agency financial statements and publishing the RRB's annual performance and accountability report. During our FY 2006 audit, we observed that existing procedures and controls over the financial reporting process needed to be updated to fully ensure the quality of the RRB's response to the expanding responsibilities and short timeframes inherent to the Federal financial reporting process. We also observed that the existing control framework was overly reliant on the OIG's annual audit of the financial statements to ensure the completeness and accuracy of the performance and accountability report.

During FY 2007, we found the agency-reporting process much improved by the efforts of BFO management and staff. BFO responded to the OIG's prior year finding by implementing OIG-recommended corrective actions and by implementing an enhanced year-end financial statement review process of their own design.

During our FY 2008 audit, we identified material transactions that were recorded incorrectly which were not detected and corrected timely because the primary control, supervisory review and approval of transactions, is not operating as designed. As a result, financial accounting controls cannot be relied upon to ensure that material errors will be detected to prevent misstatements in financial reporting. In addition, controls over financial statement preparation are not fully effective.

Significant Deficiency

Reconciliation of Benefit Payment Subsystems with the General Ledger

Current accounting procedures do not provide for periodic reconciliation of the general ledger with the benefit payment systems in which those transactions originate. There is no compensating control that would provide similar assurance concerning the completeness of recording and reporting for benefit payment expense which exceeded $10 billion during FY 2008.

Significant accounts should be reconciled to the general ledger timely; the lack of such reconciliations represents a control deficiency. The detailed records concerning payments adjudicated and issued is stored in various automated systems that support the benefit payment process. Benefit payment activity is manually recorded in the general ledger from summary data originating in other systems.

This weakness was brought to management's attention in connection with earlier audits.[4] Upon detailed review, management did not implement the recommended reconciliation process citing the inability of existing benefit payment subsystems to support a cost-effective control and reconciliation process. Since that time, the OIG has identified a more cost-effective reconciliation process. RRB financial managers have been receptive to reconsidering the issue and have agreed to study the OIG's suggestion.

COMPLIANCE WITH LAWS AND REGULATIONS

Our tests of compliance with selected provisions of laws and regulations disclosed no instances of non-compliance 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

Management's Discussion and Analysis, required supplementary 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 Federal Managers' Financial Integrity Act (FMFIA) are met, and (3) complying with applicable laws and regulations.[5]

---

[4] "Review of Internal Control Over Financial Accounting for Debt Recoveries," OIG Report #00-16, September 29, 2000, page 10.

"Letter to Management," OIG Report #02-07, February 8, 2002, page 5.

[5] **Internal Control** as it relates to the financial statements is a process, affected by the agency's management and other personnel, designed to provide reasonable assurance that the following objectives are met: (1) Reliability of financial reporting - transactions are properly recorded, processed, and summarized to permit the preparation of the Basic Statements in accordance with generally accepted accounting principles, and assets are safeguarded against loss from

We are responsible for obtaining reasonable assurance about whether the financial statements are presented fairly, in all material respects, in conformity with U.S. generally accepted accounting principles. We are also responsible for (1) obtaining a sufficient understanding of internal control over financial reporting and compliance to plan the audit, (2) testing compliance with selected provisions of laws and regulations that have a direct and material effect on the financial statements, and any other laws for which OMB audit guidance requires testing; and (3) 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 proprietary and budgetary financial statements;
- assessed the accounting principles used and significant estimates made by management in preparing the proprietary and budgetary financial statements;
- assessed the factors, data, assumptions and model used to prepare the long-term actuarial projections presented in the statement of social insurance;
- evaluated the overall presentation of the financial statements;
- obtained an understanding of the entity and its operations, including its internal control related to financial reporting, compliance with laws and regulations (including execution of transactions in accordance with budget authority);
- tested relevant internal controls over financial reporting and compliance, and evaluated the design and operating effectiveness of internal control;
- considered the process for evaluating and reporting on internal control and financial management systems under the FMFIA; and
- performed tests of compliance with selected provisions of laws and regulations, including laws governing the use of budget authority, and other laws and regulations that could have a direct and material effect on the RRB's basic financial statements:
    - Anti-Deficiency Act, as amended;
    - provisions of the Railroad Retirement Act governing financing and the payment of benefits;

---

unauthorized acquisition, use, or disposition; and (2) Compliance with applicable laws, regulations, and government-wide policies - transactions are executed in accordance with laws governing the use of budget authority, government-wide policies, and laws identified by OMB, and other laws and regulations that could have a *direct and material effect on the Basic Statements.*

- provisions of the Railroad Unemployment Insurance Act governing financing and the payment of benefits; and
- provisions of the Social Security Act that provide for certification of benefits to the RRB for payment (42 U.S.C. § 405(i)).

We did not evaluate all internal controls relevant to operating objectives as broadly defined by the FMFIA, such as controls relevant to preparing statistical reports and ensuring efficient operations. We limited our internal control testing to controls over financial reporting and compliance. Because of inherent limitations in internal control, misstatements due to error or fraud, losses, or noncompliance may nevertheless occur and not be detected by our audit. 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 also caution that our internal control testing may not be sufficient for other purposes.

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 impact on the RRB's financial statements or that we deemed otherwise applicable to the financial statements for the fiscal year ended September 30, 2008. We caution that noncompliance may occur and not be detected by these tests and that such testing may not be sufficient for other purposes.

The NRRIT was established pursuant to the Railroad Retirement and Survivors' Improvement Act of 2001 (Public Law 107-90). Under that law, the NRRIT is not a department, agency or instrumentality of the Government of the United States. In addition, the law specifically exempts the NRRIT from compliance with Title 31, United States Code which governs the monetary and financial operations of the Federal government. The law also provides that the NRRIT annually engage an independent, qualified public accountant to audit the financial statements of the NRRIT. Accordingly, the OIG has not audited the books and records of the NRRIT, nor had any input into the selection of the independent accountant retained by the NRRIT, nor provided oversight to that firm in the execution of their responsibilities. Our opinion on the RRB's financial statements, insofar as it relates to the amounts included for the NRRIT, is based solely on the report of the auditor retained by the NRRIT, and our assessments of internal control and compliance do not extend to the operations of the NRRIT.

Except to the extent that the foregoing arrangement may have affected the planning and execution of our audit, we performed our work in accordance with U.S. generally accepted government auditing standards and OMB audit guidance.

RRB MANAGEMENT'S COMMENTS

The offices of the Chief Financial Officer and the Board Members have reviewed our report and offered comments expressing management's intention to address the material weakness described in our report.

With respect to internal control, management notes that information security is a significant challenge to which they have devoted substantial effort and resources and that they will continue to do so. Regarding financial reporting, management notes that they have implemented actions to improve the agency's financial accounting and reporting processes, such as issuing additional written guidance to the accounting staff and implementing a more comprehensive year-end financial statement review. Additional actions are being evaluated and planned. In response to the significant deficiency regarding the reconciliation of benefit payment subsystems with the general ledger, management has agreed to review the suggested reconciliation process and determine what action to take.

In their reply, they also thank OIG management and staff for working closely and cooperatively with agency personnel to help ensure that the RRB would be able to meet this year's reporting deadline of November 17, 2008.

The full text of management's response follows as an attachment to this report.

Original signed by:

Martin J. Dickman
Inspector General

November 6, 2008, except for matters relating to the fair market value of the net assets of the NRRIT as of September 30, 2008, as to which the date is November 17, 2008.

UNITED STATES GOVERNMENT

ATTACHMENT

FORM G-115f (1-92)

MEMORANDUM

RAILROAD RETIREMENT BOARD

NOV 14 2008

TO : Letty Benjamin Jay
Assistant Inspector General for Audit

FROM : Kenneth P. Boehne Original signed by:
Chief Financial Officer

SUBJECT: FY 2008 Financial Statement Audit – Auditor's Report;
Re: Your memorandum dated November 12, 2008

My office, and those of the Board Members, have reviewed the Office of Inspector General's draft report and have the following comments.

You reported material weaknesses in your draft report dealing with information security and financial reporting. Regarding the former, the Railroad Retirement Board continues to recognize that information security is a significant challenge. We have devoted substantial effort and resources to correct weaknesses in the agency's information security program. We will continue to do so in order to address the weaknesses identified by the Office of Inspector General. Regarding the latter, we have implemented actions to improve the agency's financial accounting and reporting processes, such as issuing additional written guidance to the accounting staff and implementing a more comprehensive year-end financial statement review. Additional actions are being evaluated and planned.

You also reported a significant deficiency regarding the reconciliation of benefit payment subsystems with the general ledger. We will review with you the suggested reconciliation process and determine what action to take.

We again thank you and your staff for working closely and cooperatively with us these past few months to help ensure that the RRB will be able to meet this year's reporting deadline of November 17.

cc: The Board
Executive Committee