
Office of Inspector General

Audit Report

*Supplementary Report on Internal Control
Systems and Compliance with Laws
and Regulations Related to the Federal
Railroad Administration's Financial
Statement for Fiscal Year 1995*

Report Number: AD-FR-7-005

Date Issued: April 21, 1997





Memorandum

U.S. Department of
Transportation

Office of the Secretary
of Transportation

Office of Inspector General

Subject: INFORMATION: Supplementary Report on
Internal Control Systems and Compliance
with Laws and Regulations Related to the
Federal Railroad Administration's Financial
Statement for Fiscal Year 1995
Report Number: AD-FR-7-005

Date: April 21, 1997

From: John L. Meche, Director 
Office of Information Technology,
Financial, and Secretarial Audits

Reply to Meche:x61496
Attn of:

To: Associate Administrator for Administration
and Finance, RAD - 1

This is our report for your information and use. Your March 26, 1997, comments on the February 20, 1997, draft report were considered in preparing this report. A synopsis of the report follows this memorandum.

FRA concurred with all recommendations. Actions taken were reasonable. The recommendations are resolved, subject to followup requirements of Department of Transportation Order 8000.1 C.

I appreciate the cooperation and assistance extended by FRA officials. Please call James Cayelli at (202) 366-1534 or me at (202) 366-1496 if you have any questions concerning this report.

Attachment

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U.S. Department of
Transportation

Office of Inspector General

Supplementary Report on Internal Control Systems and Compliance with Laws and Regulations Related to the Federal Railroad Administration's Financial Statement for Fiscal Year 1995

Report Number: AD-FR-7-005

April 21, 1997

Objectives

The internal control and compliance objectives for our audit covering the four funds and activities subject to the Chief Financial Officers (CFO) Act were to determine whether Federal Railroad Administration (FRA) (i) had in place an adequate internal accounting and administrative control structure that provided reasonable assurance of achieving established internal control objectives, and (ii) complied with laws and regulations which (a) could have a direct and material effect on the financial statement or (b) were specified by Office of Management and Budget (OMB) and FRA.

Conclusions

Except for the need to improve internal controls over estimating liabilities and expenses, FRA had adequate internal accounting and administrative control procedures for the areas reviewed. In addition, except for requirements for reporting interest revenue and transfers, FRA substantially complied with laws and regulations directly affecting the financial statements for the four funds and activities subject to the CFO Act. In our view, the exceptions noted above did not meet the definition of a material weakness either from a financial statement auditing perspective or from the standpoint of reporting to the President and Congress under the Federal Managers' Financial Integrity Act. Further, in our view, the weaknesses discussed in the body of this report, if not corrected timely, will not adversely affect the Department's consolidated financial statement.

Monetary Impact

Specific monetary impacts in the form of savings were not identified for the reportable conditions found. However, correcting these weaknesses will help ensure the accuracy, timeliness, and reliability of financial information and compliance with OMB requirements.

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U.S. Department of
Transportation

Office of Inspector General

Recommendations

We recommended FRA provide guidance to responsible personnel to (i) estimate accounts payable and related expenses based on actual performance and costs incurred rather than billed amounts, and (ii) implement Treasury's procedures for recording miscellaneous receipts when recording interest revenue from loan receivables in order to conform with the reporting requirements of OMB Bulletin No. 94-01.

Management Position

FRA concurred with both recommendations and has taken corrective actions.

Office of Inspector General Comments

Management actions taken were reasonable.

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I. INTRODUCTION

Background

The Federal Railroad Administration (FRA) was created pursuant to Section 3(e)(1) of the Department of Transportation Act of 1966. The Federal Railroad Administrator heads FRA and is the primary advisor to the Secretary of Transportation on FRA mission requirements. FRA's mission is to promulgate and enforce rail safety regulations; administer financial assistance programs for designated railroads; conduct research and development in support of improved railroad safety and national rail transportation policy; manage the continuing responsibilities regarding the rehabilitation of Northeast Corridor rail passenger service; and consolidate Government support of rail transportation activities, including high-speed passenger service.

FRA's four funds and activities subject to the Chief Financial Officers (CFO) Act for Fiscal Year (FY) 1995 consisted of the Amtrak Corridor Improvement Program, the General Fund for Union Station Mortgage Payments, the Railroad Rehabilitation and Improvement Program, and the Trust Fund Share of the High Speed Rail Program. FRA's Combined Principal Financial Statement for these four funds reported total assets of about \$129.6 million as of September 30, 1995, and total revenues of about \$7.8 million and expenses of \$7.7 million for FY 1995.

Objectives, Scope, and Methodology

Our audit was performed in response to the financial statement audit provisions of the CFO Act of 1990. The audit objectives pertaining to internal controls and compliance were to determine whether FRA had (i) in place for each of the four funds an internal accounting and administrative control structure that provided reasonable assurance of achieving established internal control objectives, and (ii) complied with laws and regulations which could have a direct and material effect on the financial statement or were specified by the Office of Management and Budget (OMB) and FRA.

The audit was conducted under the methodology prescribed in the President's Council on Integrity and Efficiency and General Accounting Office (GAO) Financial Statement Audit Manuals and was performed in accordance with OMB Bulletin No. 93-06 and Government Auditing Standards prescribed by the Comptroller General of the United States. The audit work was performed at FRA Headquarters Offices located in Washington, D.C.

Internal Controls

The management of FRA is responsible for establishing and maintaining an internal control structure. In fulfilling this responsibility, management estimates and judgments are required to assess the expected benefits and related costs of internal control mechanisms, policies, and procedures. The objectives of an internal control structure are to provide management with reasonable, but not absolute, assurance that transactions are properly recorded and accounted for to permit the preparation of reliable financial reports in accordance with applicable accounting policies and to maintain accountability over assets; funds, property, and other assets are safeguarded against loss from unauthorized use or disposition; transactions are executed in compliance with laws and regulations having a direct and material effect on the financial statement; and data supporting reported performance measures are properly recorded and accounted for to permit preparation of reliable and complete performance information.

Our internal control review was directed toward identifying deficiencies which should be considered reportable conditions under standards established by the GAO, the American Institute of Certified Public Accountants, and OMB Bulletin No. 93-06. Reportable conditions are matters coming to our attention involving significant deficiencies in the design or operation of the internal control structure which, in our judgment, could adversely affect the entity's ability to ensure the objectives of the internal control structure, as previously defined, are being achieved. A material weakness is a reportable condition where the design or operation of one or more specific internal control mechanisms does not reduce to a relatively low level the risk of material errors or irregularities occurring and not being detected within a reasonable time by employees in the normal course of performing their assigned functions.

The work we performed included obtaining an understanding of the significant internal control policies, procedures, and mechanisms as well as assessing the level of control risk relevant to all significant activity cycles, classes of transactions, and/or account balances. While we obtained an understanding of FRA's internal control structure and related control mechanisms, we were precluded from testing any of the mechanisms to assess more fully whether the controls were effective and working as designed. This occurred because FRA accounting records for the period under review were not available. Substantially all FRA accounting records covering FY 1995 were contaminated by hazardous biological and/or chemical agents and were sealed until a proper disposal method could be determined. Accordingly, our audit

work did not necessarily identify all reportable conditions associated with the internal control structure established for FRA's four funds. Furthermore, the objective of this work was not to render an opinion on the overall systems of internal control. The categories of significant internal control policies, procedures, and mechanisms subjected to review during this audit are listed at exhibit A.

At the FRA, some of the internal controls in the various activity cycles are dependent on automated information system processing. In accordance with Government Auditing Standards, our review of these controls must be performed by or under the supervision of an information systems control specialist. However, such a specialist was not available within the Office of Inspector General to review these controls and these controls were thus not reviewed.

Compliance with Applicable Laws and Regulations

Compliance with laws and regulations applicable to FRA is the responsibility of FRA management. We tested compliance with those laws and regulations directly affecting the financial statement and certain other laws and regulations designated by OMB and FRA. The specific laws and regulations subjected to review during this audit are listed at exhibit B.

Our tests of compliance with laws and regulations were directed toward identifying, for those items tested, whether FRA complied in all material respects with the provisions of those laws and regulation directly affecting the financial statement and certain other laws and regulations designated by OMB and FRA. Material instances of noncompliance are failures to follow requirements, or violations of prohibitions, contained in law or regulations which cause us to conclude that the aggregation of the misstatements resulting from those failures or violations is material to the principle statements, or the sensitivity of the matter would cause it to be perceived as significant to others. With respect to items not tested, nothing came to our attention to cause us to suspect FRA had not complied in all material respects with these provisions.

Prior Audit Coverage

OMB Bulletin No. 93-06 requires disclosure of the status of known but uncorrected significant internal control findings (and associated recommendations) that affect the objectives of the current audit. The following two audit reports contained internal control findings and associated recommendations which are subject to the disclosure requirements of OMB Bulletin No. 93-06.

Audit Report No. AS-FR-5-019, issued June 29, 1995, identified one material internal control weakness and two nonmaterial reportable conditions. The material weakness related to the inability of FRA's accounting system to process day-to-day credit reform activities and provide adequate support for balances reported on the Combining Statement of Financial Position. The nonmaterial reportable conditions involved (i) inadequate disclosure activity for Washington Union Station and inconsistent reporting of accrual transactions and (ii) inadequate tracking of, or reporting for, three performance measures. FRA implemented all recommendations associated with these issues.

Audit Report No. AD-FR-6-004, issued February 29, 1996, presented our unqualified opinion on FRA's Combined Statement of Financial Position and Combined Statement of Operations for the year ended September 30, 1995, and briefly summarized the internal control and compliance problems discussed in more depth in this report.

II. FINDINGS AND RECOMMENDATIONS

Except for the need to improve internal controls over estimating liabilities and expenses (Finding A), FRA had adequate internal accounting and administrative control procedures for the areas reviewed. In addition, except for requirements for reporting interest revenue and transfers (Finding B), FRA substantially complied with laws and regulations directly affecting the financial statements for the four funds and activities subject to the CFO Act. In our view, the exceptions noted above did not meet the definition of a material weakness either from a financial statement auditing perspective or from the standpoint of reporting to the President and Congress under the Federal Managers' Financial Integrity Act. Further, in our view, the weaknesses discussed in the body of this report if not corrected timely will not adversely affect the Department's consolidated financial statement. FRA financial management officials concurred with the findings and acknowledged the need to take the recommended corrective actions.

Finding A. FRA Needs to Improve Controls Over Estimating Liabilities and Expenses

FRA did not properly estimate related liabilities and expenses associated with the Trust Fund Share of the High Speed Rail Program. As a result, FRA (i) understated the "Governmental Liabilities-Accounts Payable" line item while overstating the "unexpended Appropriation" line item on the draft Statement of Financial Position and (ii) understated the "Appropriated Capital Used" and "Program or Operating Expenses" line items on the draft Statement of Operations by about \$3.4 million each.

Discussion

Paragraph 74 of the Statement of Federal Financial Accounting Standards (SFFAS) No. 1, entitled "Accounting for Selected Assets and Liabilities," defines accounts payable as amounts owed by a Federal entity for goods and services from, progress in contract performance made by, and/or rents due to, other entities. Further, in paragraph 79 the standard states for:

facilities or equipment constructed or manufactured by . . . grantees according to [grant] agreements . . ., amounts recorded as payable should be based on an estimate of

work completed under the . . . agreement. The estimate of such amounts should be based primarily on . . . actual performance progress and incurred costs.

Due to lack of guidance, the FRA Office of Passenger and Freight Services, improperly estimated the related accounts payable for High Speed Rail Program grants as of September 30, 1995. They improperly based accounts payable estimates on billed amounts instead of actual performance progress and incurred costs as required by the SFFAS. During the audit, FRA recorded audit adjustments to increase the value of each of these line items by about \$3.4 million on the final versions of the Combined Statement of Operations.

FRA needs to improve internal controls by developing procedures to accurately estimate related liabilities and expenses associated with the Trust Fund Share of the High Speed Rail Program. This weakness represents an internal control breakdown in estimating liabilities and expenses at yearend. In order to ensure related line items on the Statement of Financial Position and Statement of Operations are accurately reported, FRA needs to instruct responsible personnel on the proper method for estimating accounts payable and related expenses for grants from the Trust Fund Share of the High Speed Rail Program.

Recommendation

We recommended FRA's Associate Administrator for Administration and Finance, in conjunction with the Office of Passenger and Freight Services provide guidance to responsible personnel on the proper procedures to use at yearend when estimating actual performance and costs incurred for accounts payable and related expenses.

Management Response

FRA concurred with the finding and recommendation and has implemented corrective actions. Staff from the Associate Administrator for Administration and Finance (Office of Financial Services) provided verbal guidance to the Fund Administrator and program managers on (i) how accounts payable and related expenses should be estimated and (ii) the importance of including actual performance progress and incurred cost in accounts payable estimates.

Office of Inspector General Comments

Corrective actions taken are responsive to the recommendation and we consider the recommendation resolved.

Finding B. FRA Needs to Ensure Interest Revenue and Related Transfers are Reported in Accordance with OMB Bulletin No. 94-01

FRA did not report interest revenue and related transfers to the Treasury on its draft Combined Statement of Operations as required by OMB Bulletin No. 94-01. As a result, in drafting the Statement of Operations, FRA understated the “Interest and Penalties, Non-Federal” line item by \$5.1 million and overstated the “Less: Taxes and Receipts Transferred to the Treasury or Other Agencies” line item by about \$5.5 million.

Discussion

In prescribing guidelines for the Statement of Operations, OMB Bulletin No. 94-01 (appendix B, page 31, paragraph 7) requires amounts transferred to the Treasury, which have been reported as financing sources, to be reported on the “Taxes and Receipts Transferred to the Treasury or Other Agencies” line item (a contra-revenue account). These guidelines further expand this definition to include receipts which may not be retained for the use of the reporting entity. Appendix B, page 30, paragraph 3 of the OMB Bulletin also requires interest earned from all non-Federal sources to be reported as revenue.

FRA was not using the proper procedures for recording interest income and related transfers to the Treasury because it was unaware of the guidance in OMB Bulletin No. 94-01. According to FRA financial personnel, they did not report \$5.1 million interest revenue earned on credit reform loans because they thought it would be misleading to show positive earnings on their Statement of Operations for the interest received which had to be transferred to the Treasury due to FRA’s lack of authority to use the funds. Instead, FRA first credited and then debited the same interest revenue account as interest payments were received and subsequently transferred to the Treasury. Under this approach, the account would show a zero balance and thus not be reflected on the Statement of Operations. However, FRA recorded about \$400,000 of interest revenue without subsequently recording the corresponding transfer to the Treasury. Consequently, the overstatement of the “Less: Taxes and Receipts Transferred to the Treasury or Other Agencies” line item exceeded the understatement of the “Interest and Penalties, Non-Federal” line item by that amount. During the audit, FRA recorded an audit adjustment to increase the “Interest and Penalties, Non-Federal” line item by \$5.1 million and decrease the “Less: Taxes and Receipts Transferred to the Treasury or Other Agencies” line item by about \$5.5 million on the final version of the Combined Statement of Operations.

FRA needs to comply with OMB Bulletin No. 94-01 requirements to ensure proper recording of interest revenue and related transfers. We understand FRA's concerns about reporting unjustified positive earnings. However, full compliance with the requirements of OMB Bulletin No. 94-01 in reporting the interest revenue and related transfers to the Treasury, would not have impacted net operations. In our view, reporting all revenue and contra-revenue items on the Statement of Operations is important to ensure full disclosure of the current year's operations.

According to the Department of the Treasury's Financial Standards and Reporting Division, these transactions should be recorded in the same manner as miscellaneous receipts. The Division has guidance on recording these transactions so the proper line items, as discussed above, are affected. During the audit, we provided FRA a copy of the Treasury guidance.

Recommendation

We recommended FRA's Associate Administrator for Administration and Finance instruct financial personnel to implement the Treasury guidance for recording miscellaneous receipts when recording interest revenue from loan receivables in order to conform with the reporting requirements of OMB Bulletin No. 94-01.

Management Response

FRA concurred with the finding and recommendation and has implemented corrective action. To address the issue in Finding B, personnel of the accounting office were instructed of the importance and the necessity of complying with the provisions of OMB Bulletin No. 94-01. FRA now reports all revenue and contra-revenue items on its Statement of Operations.

Office of Inspector General Comments

Corrective actions taken are responsive to the recommendation and we consider the recommendation resolved.

FEDERAL RAILROAD ADMINISTRATION INTERNAL CONTROL REVIEW RESULTS FOR ACTIVITY CYCLES AND MATERIAL ACCOUNTS REVIEWED			
Cycle/Account Description	Controls Adequate*	Reportable Condition	Report Reference
ACTIVITY CYCLES			
Disbursement		x	Finding A
Revenue	x		
Investment	x		
Property	x		
Receivable	x		
Cash Receipts	x		
ASSET ACCOUNTS			
Fund Balance with Treasury	x		
Investments-Intragovernmental	x		
Accounts Receivable-Intragovernmental	x		
Accounts Receivable-Governmental	x		
Credit Program Receivable and Related Foreclosed Property	x		
Property and Equipment	x		
LIABILITY ACCOUNTS			
Other Liabilities-Intragovernmental	x		
Debt-Intragovernmental	x		
Accounts Payable-Governmental		x	Finding A
Other Liabilities-Governmental			
NET POSITION			
Unexpended Appropriations		x	Finding A
Invested Capital	x		
Future Funding Requirements	x		
REVENUE ACCOUNTS			
Appropriated Capital Used		x	Finding A
Revenues-Sales of Goods and Services	x		
Interest and Penalties, Non-Federal	x		
Interest, Federal	x		
Other Revenue and Financing Services	x		
EXPENSE ACCOUNTS			
Less: Taxes and Receipts-Transferred to Treasury or Other Agencies	x		
Program or Operating Expenses		x	Finding A
Cost of Goods Sold to the Public	x		

* See Scope Page 1

FEDERAL RAILROAD ADMINISTRATION COMPLIANCE TEST RESULTS				
ITEM TESTED	TYPE OF TEST	SUBSTANTIAL COMPLIANCE	REPORTABLE CONDITION	REPORT REFERENCE
LEGISLATION				
Chief Financial Officers Act	Complete	x		
Federal Manager's Financial Integrity Act	Complete	x		
Anti-Deficiency Act and Federal Appropriations Law	Indirect	x		
Credit Reform Act	Indirect	x		
Debt Collection Act	Indirect	x		
OMB GUIDANCE				
Statement of Federal Financial Accounting Standards	Complete	x		
Bulletin No. 94-01	Complete		x	Finding B
Circular No. A-127	Indirect	x		

AUDIT TEAM MEMBERS

The following is a listing of the audit team members who participated in the Federal Railroad Administration's Fiscal Year 1995 Financial Statement audit.

James Cayelli, CPA
John Francis
Elizabeth Hanson, CPA
Kimberley Bolding

Program Director
Project Manager
Auditor-in-Charge
Auditor



U.S. Department
of Transportation

Federal Railroad
Administration

Memorandum

Subject: Draft Supplementary Report on Internal Control Systems and
Compliance with Laws and Regulations Related to the Federal
Railroad Administration's Financial Statement for FY 1995 Date: MAR 26 1997

From: *Ray Rogers*
Ray Rogers, Associate Administrator
for Administration and Finance Reply to
Attn. of:

To: Alexis M. Stefani
Director, Office of Transportation Program Audits, JA-10

We have reviewed your draft report and we concur with your finding and recommendations. FRA has implemented your recommendations.

The following corrective actions were taken:

FINDING A - Staff from the Office of Financial Services met with the Fund Administrator and program managers of the Office of Passenger and Freight Service to discuss the recommendation contained in the draft report. The discussion addressed the Statement of Federal Financial Accounting Standards (SFFAS) No. 1 and how accounts payable and related expenses should be estimated. Emphasis was placed on understanding the significance and importance of including actual performance progress and incurred cost in account; payable estimates.

FINDING B - Personnel of the accounting office were instructed of the importance and the necessity of complying with the provisions of OMB Bulletin No. 94-01. FRA now reports all revenue and contra-revenue items on its Statement of Operations.

If you have any questions or need more information, please contact me on (202) 632-3200 or Gerald Schoenauer of my staff on (202) 632-3291.

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