AMTRAK
OFFICE *of* INSPECTOR GENERAL
NATIONAL RAILROAD PASSENGER CORPORATION

GOVERNANCE:

Addressing Remaining Shortcomings Would Lead to a Budget Development Process More Fully Aligned with Leading Practices

OIG-A-2017-004 | January 17, 2017

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AMTRAK OFFICE of INSPECTOR GENERAL
NATIONAL RAILROAD PASSENGER CORPORATION

Memorandum

To: Charles Moorman
President and Chief Executive Officer

From: Tom Howard
Inspector General

Date: January 17, 2017

Subject: *Governance: Addressing Remaining Shortcomings Would Lead to a Budget Development Process More Fully Aligned with Leading Practices*
(OIG-A-2017-004)

Since its creation in 1970, Amtrak (the company) has had to rely on federal assistance—$46 billion to date—because passenger revenue and other funding sources do not cover the company's costs. For example, in fiscal year (FY) 2016, Congress provided federal grants of about $930 million to cover the company's capital maintenance and improvement costs and almost $300 million to cover its net operating loss.[1] However, the company has an extensive backlog of state-of-good-repair projects, and the annual capital grant amounts have not been sufficient to meet all of its needs. In recent years, the company has made some improvements to its capital budgeting process, but the amount of reprogramming that occurs throughout the year is still significant. In addition, over the past two years, the company has not generated the revenue it expected and has had to reduce its planned operating budget through a series of spending cuts.

Given that the company's needs have exceeded the level of funding available each year, it is particularly important to optimize the value of the company's capital and operating expenditures through a sound budget development process. In this report, we identify shortcomings in the company's budget development process as compared to leading practices for budgeting, and we discuss possible solutions that are in line with these leading practices. To identify these practices, we reviewed literature and interviewed a number of experts—including executives of other passenger railroads and railroad associations, transportation and budgeting consultants, and representatives of government and private-sector entities. Because the process for both the capital and

[1] Congress appropriates funds for the company within the Department of Transportation (DOT), which provides the funds to the company in federal grants.

operating budgets includes common elements, such as submitting budget requests and reviewing them for approval, our results in this report address one overall budget process.

SUMMARY OF RESULTS

To make optimum budget decisions about how best to use their funds, successful organizations follow a set of leading practices. The company has improved its budget development process, especially with recent reform efforts, and the process now incorporates a number of leading practices. Nevertheless, the company still faces several challenges in developing its annual budget, and shortcomings in that process undermine efforts to make optimum decisions about how best to use available resources in line with leading practices.

The company is not consistently using strategic goals, long-term plans, and priorities to drive budget decisions. For example, the company has a multi-year strategic plan, a related strategy management system, and long-term financial plans that are intended to help achieve operational and financial improvements. But company departments are not fully committed to strategic and long-range planning efforts and do not always use them to drive decisions about how best to use each available dollar. Also, executive leadership sets spending priorities for only a small portion of capital funding targeted for new strategic initiatives—not for most of the company's capital budget. These shortcomings hinder efforts to use the budget to help the company achieve its strategic goals.

Two conflicts about who makes budget decisions have also impeded the budget process—especially across-the-board budget cuts. One conflict is between the Finance department and other departments about the role Finance plays in making budget decisions, and the other is about the role of business lines in budget decisions. These conflicts waste time and resources, and divert management's attention to reactive—rather than strategic—budget decisions. The conflicts arise in part because the company has not clearly delineated and enforced a policy with clear roles for making budget decisions, contrary to leading practices.

Limitations in three information systems that feed budget development impede the company's ability to provide accurate and reliable budgets. The company is addressing some of these limitations; however, it recognizes that these efforts will not address all of the systems' current shortcomings. The company has an opportunity to leverage its progress by assessing the extent of remaining gaps and identifying ways to fill them.

Successfully addressing these shortcomings will help the company improve its budget development process and optimize the value of its capital and operating expenditures. Therefore, we recommend that the company take actions to incorporate additional leading practices in its budget development process by ensuring that it (1) is based on achieving strategic goals, long-term plans, and priorities; (2) clearly delineates roles and accountability for results; and (3) is supported by information systems that provide reliable estimates.

In commenting on a draft of this report, the company's Executive Vice President/Chief Financial Officer (CFO) agreed with one of our recommendations, partially agreed with the other four, and provided information on the proposed actions the company plans to take to implement these recommendations. The actions are positive steps that will help improve the budget development process. However, as discussed later in this report, we question whether the actions proposed in response to three of the recommendations will fully resolve the shortcomings in the budget process identified in this report. Accordingly, we request that as the company implements the recently announced new organizational structure, it consider how the changes offer opportunities for additional actions to more fully address those three recommendations.

BACKGROUND

From FY 2014 through FY 2017, the company budgeted an average of about $1 billion a year for capital projects and estimated that expenses were more than $3 billion a year for operations.[2] The process the company uses to develop these budgets has been evolving, and changes over the past two years include the following:

- establishing several new executive teams to review and decide on budgets
- dividing capital project requests into three tiers for review: Tier I for projects that respond to legislative mandates, Tier II for projects to achieve a state-of-good-repair, and Tier III for strategic initiatives

[2] FY 2013–2015 data are actuals, FY 2016 data are estimated as of August 2016, and FY 2017 data are budgeted. Core operating expenses include salaries, wages, and benefits; train operations; fuel, power, and utilities; and professional fees.

- requiring departments to complete a business case for each capital project request that includes the project's scope, schedule, planned delivery, projected capital and operating costs, and anticipated savings

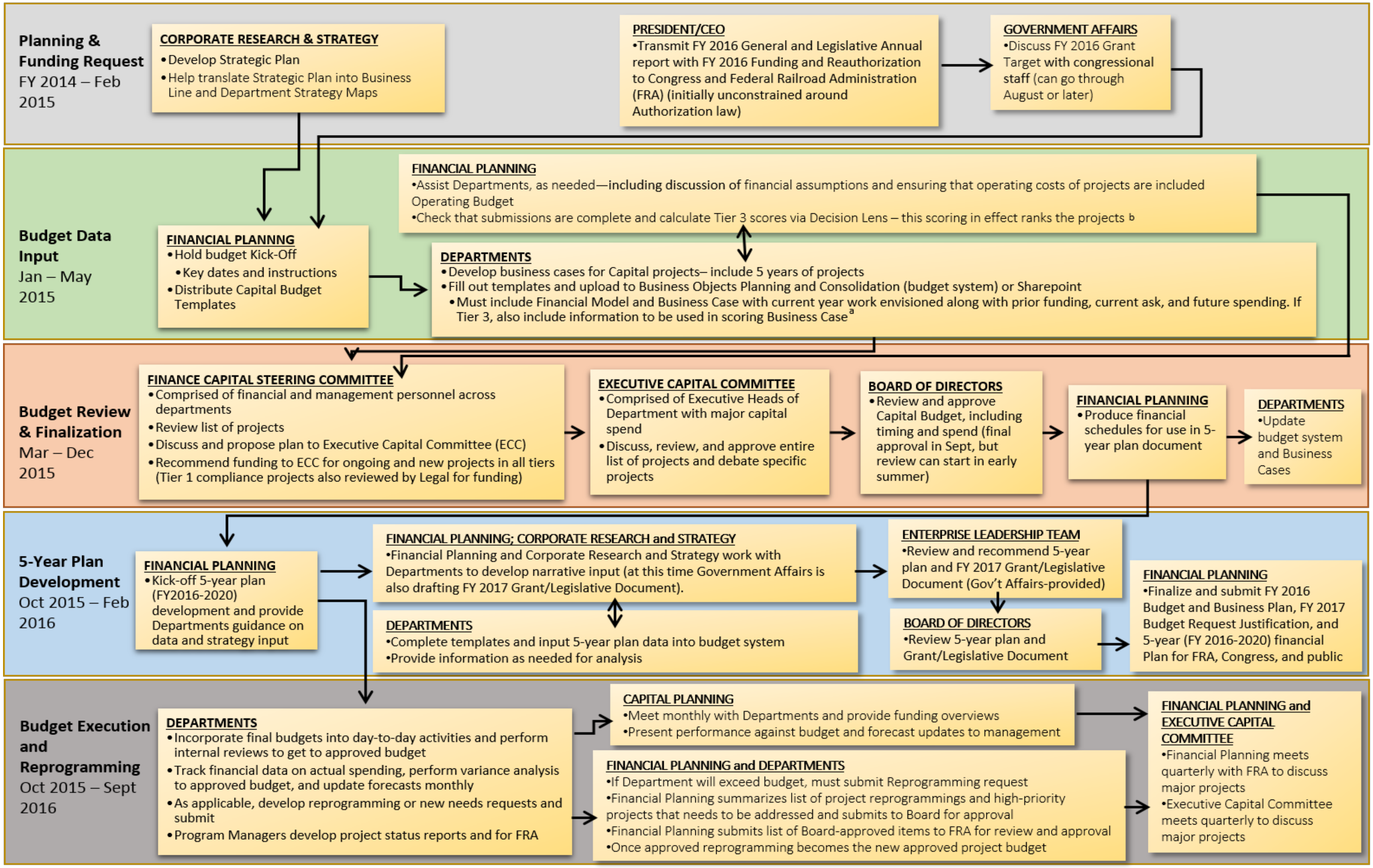
The company anticipates further changes as it responds to a legislative mandate to manage company funding in two new accounts: (1) the Northeast Corridor (NEC) and (2) the National Network, which is made up of all other routes.[3]

We assessed the budget development process for both the capital and operating budgets, beginning with strategic and long-term planning through assessments of spending, and we focused on the FY 2016 process. To define the process, we reviewed documents from the Finance and operating departments, and we interviewed key members of the executive leadership team and budget managers involved in the budget process.[4] Based on that review, we summarized the FY 2016 budget processes for the capital and operating budgets in Figures 1 and 2. As these figures show, the processes share many elements.

[3] The Fixing America's Surface Transportation Act (FAST Act), Pub. L. No. 114-94 (2015) requires the company to reform its accounting structure into at least an account for the Northeast Corridor and an account for the remaining National Network. According to the Act, the company had one year from the date of enactment (until December 4, 2016) to implement the new structure and accounting methodology improvements. According to the Vice President for Government Affairs and Corporate Communications, Amtrak and the Federal Railroad Administration finalized the account structure levels in late December 2016.

[4] When we refer to "departments" in this report, we mean divisions, such as the Engineering or Mechanical Divisions, as well as business lines, such as the Long Distance line. When we refer to "managers," we mean officials who have responsibilities for key finance and budget decision-making in departments, such as vice presidents and budget managers.

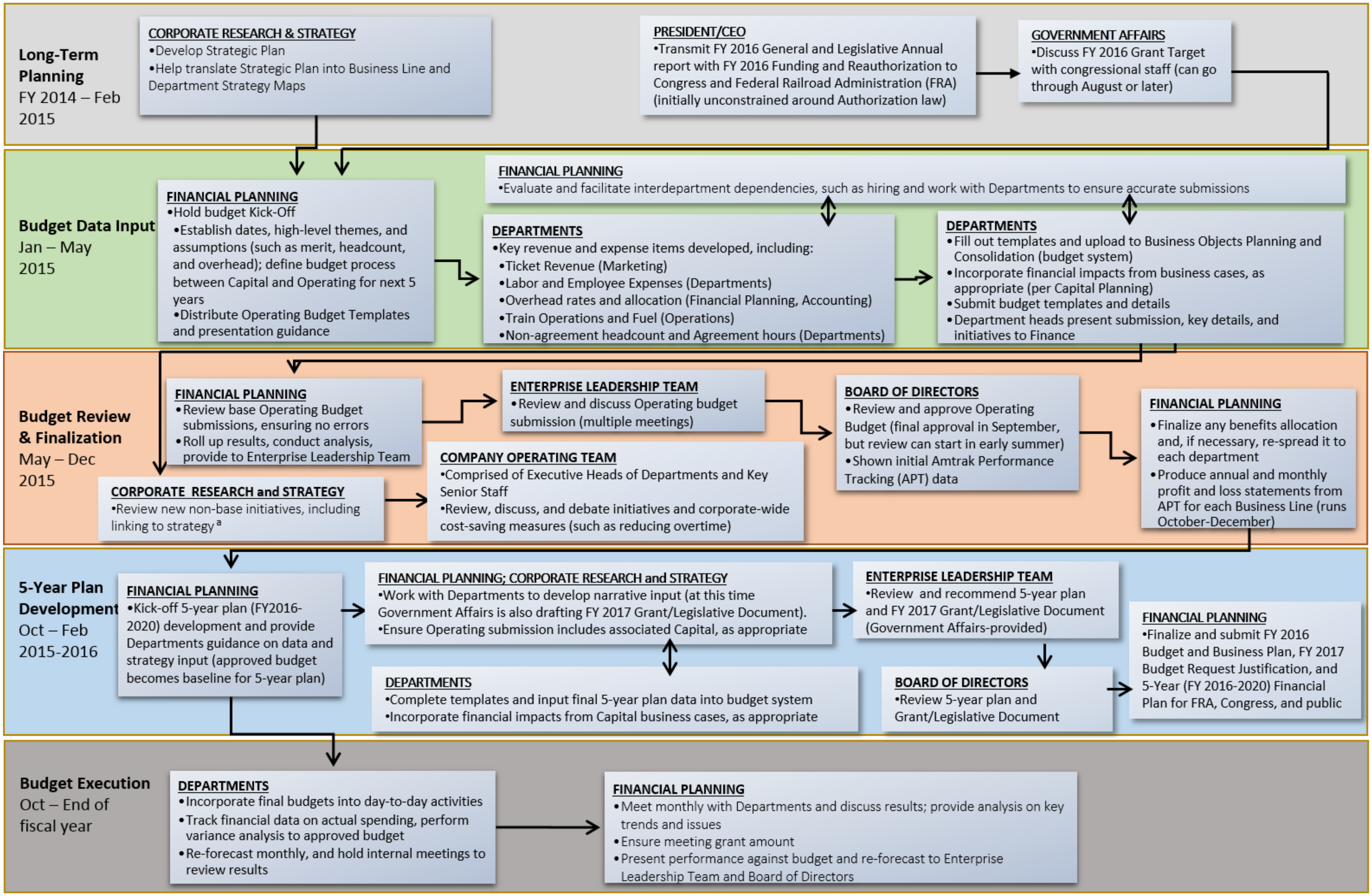
Figure 1. Amtrak's Fiscal Year 2016 Capital Budget Process



Source: OIG analysis of company documentation and interviews with company officials.

Note: [a] The company uses an IT system referred to as "Decision Lens" to help calculate business case scores.

Figure 2. Amtrak's Fiscal Year 2016 Operating Budget Process



Source: OIG analysis of company documentation and interviews with company officials.

Note: [a] Non-base initiatives are efforts proposed by departments that are not already a part of their business as usual, or base, budget activities. These items are reviewed by the Corporate Research and Strategy group for alignment to the company's Strategic Goals.

To identify challenges in the process, we analyzed information and interviewed executives and managers from the following company organizations:

- the Finance department and several of its offices, because they oversee the process
- the Engineering department, because of the size and scope of its budget
- the Long Distance business line, in part because of its role as a pilot in implementing the company's strategy management system[5]
- the Corporate Research and Strategy office, because it is responsible for the strategy management system
- the Marketing department, because it manages revenue estimates for the budget

For additional details related to our scope and methodology and a list of the leading practices we identified, see Appendix A.

EFFORTS TO USE STRATEGIC AND LONG-TERM PLANS AND PRIORITIES TO DRIVE BUDGET DECISIONS HAVE HAD MIXED RESULTS

The company has taken steps to establish a comprehensive strategy management system, plan its finances for the long-term, and improve the budget process. However, departments have not consistently used the results of the strategy management system or the five-year financial and other plans to drive funding decisions, and budget process changes have not resulted in executive leadership having a say in priorities for the bulk of the company's funding.

[5] A strategy management system promotes the management of an organization's resources in order to achieve its goals and objectives. This involves setting goals and objectives, evaluating strategies, and making sure that the strategies are rolled out across the organization.

Department Budget Decisions Are Not Consistently Based on Achieving Strategic Goals and Priorities

By using a strategy management system, the company intended that its strategic plan and goals would drive department strategies and goals. But the company has not ensured that departments consistently use the system as a basis for budget decisions, contrary to leading practices.

Leading Practice: *Leaders define clear goals, corresponding strategic plans, and realistic priorities that drive budget development, including investment decisions.*

In 2011 the company published its first strategic plan[6] and began using a Balanced Scorecard approach to measure progress toward achieving the goals outlined in the plan.[7] The company established a strategy management system, including a corporate strategy map, allowing departments to define their own related strategy maps and goals, all with an aim to implement financial and operational improvements.[8] To reinforce this, the company began asking departments to identify which strategic goal each of their budget initiatives addresses.

The company's efforts have had mixed results. The Long Distance business line embraced the system in part because it received dedicated training and support as the pilot implementation group. The Long Distance general manager said that the budget group used the system to develop a strategy map for the business line and uses the map to make budget decisions and achieve cost savings. For example, consistent with its strategy map, the Long Distance line undertook an initiative to right-size off-peak

[6] We previously reported that the company initiated multiple planning efforts from 2005 through 2008, but that none of them resulted in a comprehensive strategic plan. In October 2009, the company issued strategic guidance and a five-year financial plan. For that report, see *Amtrak's Strategic Planning* (E-10-01, August 17, 2010). The company's most recent strategic plan covers FY 2014–2018.
[7] The Balanced Scorecard approach is a strategic planning and management system used extensively in business and industry, government, and nonprofit organizations worldwide. The scorecard is used to align business activities to the vision and strategy of the organization, improve internal and external communications, and monitor organizational performance against strategic goals.
[8] A strategy map is a diagram used to document the primary strategic goals that an organization or management team is pursuing. The company's strategy map lays out how the company manages talent and technology, and it defines specific goals with objectives intended to help prioritize investments and improvements.

winter train service. Managers expect the initiative to save almost $4 million in annual operating costs through already-realized lower fuel and operations costs and anticipated lower labor costs. Conversely, the Engineering department also used the system to develop its own strategy map, but a budget manager said that it had little relevance to their budget decisions because the department has a more immediate need to address a backlog of maintenance and an unpredictable amount of weather damage each year. The Corporate Research and Strategy Office previously reported that a lack of funds has slowed the progress of system implementation company-wide and requested additional resources to address this but did not receive them.

The Chief Operations Officer (COO), CFO, Chief Information Officer (CIO), head of Corporate Research and Strategy,[9] and others acknowledged that the company's strategy should drive investment decisions but does not, and that it will take executive leadership to make this happen. Without this commitment, including dedicating resources to implementation and holding departments accountable for results, the company cannot ensure that its funding is targeted to achieving its goals and is consistent with leading practices.

Five-Year Financial Plans Have Little Impact on Investment Decisions

> ***Leading Practice:*** *Organizations develop longer-term plans that they then translate into shorter-term plans and an annual budget request.*

The company develops five-year plans that lay out anticipated budget activities and costs, but departments do not use the plans to guide their budget development. In 2008, Congress required that the company annually provide a financial plan that projects five years of revenues, expenditures, capital funding requirements, and operational funding needs.[10] Each year, Finance works with other departments to produce and submit a plan to comply with the law, but managers we interviewed said they did not use the plan to inform their budget decisions, contrary to leading practices. In addition, the company and states in the NEC

[9] The views expressed here reflect statements made by individuals who held these positions at the time of our review. In January 2017, the CEO announced a new organizational structure that included changes to some of these positions.

[10] The Passenger Rail Investment and Improvement Act of 2008 (PRIIA) Pub. L. No. 110-432, Div. B, 122 Stat. 4907 (2008), required the company to submit to Congress a five-year operating and capital financial plan bound by the authorized funding levels. Subsequent legislation has continued the requirement. The FAST Act repealed this requirement and substituted new requirements for a five-year business line plan by February 2017 and a five-year asset plan by February 2019.

published the first five-year capital plan for the corridor in April 2015; however, according to a Finance manager, the plan has no influence on budget decisions, and our review of FY 2016 budget guidance and submissions confirmed this.

An Engineering budget manager told us that long-term plans are irrelevant because the company depends on annual and unpredictable federal funding. Other managers argue that federal funding has been somewhat flat and, therefore, predictable. It is important to anticipate future needs to manage available funding when it is constrained. The Metropolitan Transportation Authority (MTA) in New York previously took a longer-term view of their infrastructure needs, which helped the city address the earlier crisis it faced from the poor state of its infrastructure. MTA starts with a 20-year capital needs assessment and then develops 5-year capital funding plans that it uses to guide its short-term decisions on where to use its funds. If company executive leadership does not establish that budget decisions align with longer-term plans—contrary to leading practices—the company will continue to spend resources to develop five-year plans without realizing benefits from this investment.

Executive Leadership Does Not Review Priorities for Activities that Make Up Most of the Budget

> ***Leading Practice:*** *Leaders define clear goals, corresponding strategic plans, and realistic priorities that drive budget development, including investment decisions.*

As a result of process changes, executive leadership now reviews priorities for a small portion of funds targeted for new initiatives but does not review priorities for the remainder of the company's budget. In FY 2014, partly in response to our September 2013 evaluation of the company's capital planning,[11] the company began grouping capital projects into three tiers: legally mandated (Tier I), state-of-good-repair (Tier II), and initiatives or enhancements (Tier III).[12] We had also recommended that the company rank spending in each tier to be consistent with leading practices and to be able to make strategic tradeoff decisions between different types of projects. The company did not make that change; instead,

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[11] *Corporate Governance: Planned Changes Should Improve Amtrak's Capital Planning Process, and Further Adoption of Sound Business Practices Will Help Optimize the Use of Limited Capital Funds*, (OIG-E-2013-020), September 27, 2013.

[12] The company initially created two separate tiers for initiatives and enhancements for a total of four tiers, but merged the two because funding constraints made the distinction irrelevant, according to a Finance department official.

departments rank and executive leadership approves funding priorities for projects only within Tier III. However, because the company has an extensive backlog of state-of-good-repair projects, most of the capital funds are assigned to Tier II (about 60 percent in FY 2016). As a result, executive leadership does not have a say in setting priorities for most of the company's funds.

Two Finance budget managers stated that the process changes did not call for executive leadership to rank priorities within each tier in order to enable executive leadership to spend their limited time on more strategic budget decisions. Nonetheless, several executives acknowledged that even though the company has hundreds of projects at any given time, it does not set priorities among the projects very well. For example, the CFO stated that reviewing priorities for Tier II projects is important because some are more critical than others. A CEO with a regional railroad similarly discussed how scrutinizing all of his Engineering department's proposals led to finding ways to cut costs and postpone activities without negative impacts so that funding could go to higher priorities.

By not expecting executive leadership to set priorities for a greater share of the company's funds and by not holding the team accountable for these decisions, the company cannot ensure that its budget funds its greatest needs.

For FY 2017, the company issued guidance to departments to similarly group their operating budgets into four categories in order to more clearly identify activities across the company and more effectively allocate resources during this challenging budget environment. It is too early to assess the results of this effort, but if executive leadership sets priorities only for proposals in the strategic initiatives category, as with the capital budget, the company will not be setting priorities for most of its operating funds.

UNCLEAR ROLES IN BUDGET DECISIONS AND ACCOUNTABILITY FOR RESULTS LEAD TO CONFLICTS THAT UNDERMINE THE PROCESS

Conflicts about the roles of Finance, other departments, and business lines in making budget decisions have resulted in reactive rather than strategic decisions. Moreover, these conflicts have discouraged accountability for results. Unless the company establishes and enforces such roles and accountability, these conflicts will persist.

Conflicts Over Budget Decisions Hinder Departments' Commitment to the Process

> ***Leading Practice:*** *Finance acts as a facilitator in the budgeting process.*
>
> ***Leading Practice:*** *Leaders hold managers accountable for budget decisions.*

Our work identified two sets of conflicts over budget decisions: first, conflicts between the Finance department and other departments about the role Finance plays in making budget decisions; and second, conflicts about the role of business lines in budget decisions.

First, Engineering and Long Distance budget managers told us they are frustrated with Finance implementing across-the-board percentage cuts several times during the budget review process, giving departments little time to respond, and seeking no input from them on the effects of these cuts on their operations. Managers said that this practice provides little transparency for changes to the budget and discourages departments' commitment to the process and results. These managers said they would prefer that Finance act more as a facilitator, which is consistent with leading practices, and provide more communication and collaboration on decisions, which is consistent with internal control frameworks for private-sector organizations. Few managers saw the across-the-board cuts as an effective way to make adjustments; the managers believe that the company should make cuts based on strategic priorities and other factors.

Finance managers said they recognize that departments should be involved in budget decisions and want to act as facilitators, but doing so is challenging because some departments are not held accountable for submitting an initial budget within the targets that departments had agreed to meet. For example, in FY 2016, the Operations department budget request exceeded the target by about $130 million (9 percent), and the Information Technology department request exceeded it by about $9 million (5 percent), according to the CFO. Finance and executive leadership then have to spend time and resources going through multiple rounds of cuts to get to a budget amount that ensures that the company's net operating loss is within the federal supplemental grant amount. Finance managers said that executive leadership's time could be better spent focusing on more strategic budget decisions.

Second, business lines also had concerns about the role they play in budget decisions. The Long Distance budget managers said that although department budget decisions may directly affect business lines—decisions about track maintenance, for example—

they have little influence on these decisions. Some managers involved in the budget process noted that the company created the business lines in order to operate more like a business but left the authority for budget decisions with the support departments. Other managers said that departments should coordinate budgets with business lines, but they should not have a say in department budgets because departments know their business best. The COO and Long Distance managers acknowledged that if business lines see that their input has little impact, they will have little commitment to, and accountability for, the budget process or its results.

Lack of Delineated Roles Established in Policy and Enforced Contribute to Conflicts

> ***Leading Practice:*** *Leaders create policies and procedures for the budgeting process that include clearly defined roles and responsibilities.*

The conflicts we identified occur in part because the company has not clearly defined roles in budget decisions and enforced them. The company has numerous documents that outline responsibilities for implementing the steps in the budget process, such as requiring executive leadership to review budgets. However, we did not find any policies that specifically delineated the roles that each of the departments, business lines, and Finance are to play in making budget decisions, especially budget cuts. For example, at the time of our review, the company was in a multi-year effort to update its capital programming policy. The draft policy includes a high-level summary of the budget process but does not delineate roles. The company does not have a similar policy for the operating budget at this time.

The lack of defined roles contradicts leading practices, and several Engineering budget managers agree that this is a significant gap in the budget process. The COO recounted how the company had recognized and resolved a similar conflict and gap. Organizational components disagreed on who should make certain infrastructure decisions, so the components worked together to better define specific roles and responsibilities in detail, and the company established them in policy. Likewise, budget managers at the MTA in New York explained how it gave responsibility for capital planning and budget development to a separate entity, the Capital Program Management Department, which reports directly to the Board of Directors, and kept fiduciary responsibilities for capital projects within Finance.

By not calling for departments to collaborate and lay out their respective roles in budget decisions, not establishing the roles in policy, and not holding departments accountable for complying with it, executive leadership will not help to resolve conflicts that impede the budget process.

INFORMATION SYSTEMS DO NOT PROVIDE ALL THE DATA OR MEANS TO BUILD AND VALIDATE BUDGETS; UPDATES WILL NOT FILL ALL GAPS

Limitations in three financial management systems used to support budget development hinder the company's ability to develop accurate and reliable budgets.

Main System Used to Support Budget Development Has Limitations

> ***Leading Practice:*** *Users and finance have effective financial management systems that provide the information needed to facilitate budget development and execution.*

Finance's role is to validate that departments' budget input is accurate and reliable, but Finance faces several challenges that limit its ability to validate this information, according to a manager in that department. For example, Finance must review a significant volume of data—the capital budget alone contains hundreds of business cases that include out-year cost estimates. In addition, as managers from Finance and Engineering explained, some of the budget information that departments submit is unique data that they extract from their own information systems and calculate using stand-alone spreadsheets. Furthermore, Finance does not have a centralized budget development system that is fully integrated with other systems, providing transparency over departments' unique data and calculations or alternative information to validate them. This is contrary to leading practices and internal control frameworks for private-sector organizations.

Finance uses its Business Planning and Consolidation (BPC) system to support budget development, but managers from Finance and other departments identified limitations in using this system for this function.[13] For example, BPC is not fully integrated with other systems that would provide Finance alternative data to validate the accuracy of department submissions. For example, business line managers said that they use the Labor Management System to develop labor cost estimates. This system is not

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[13] Finance's past attempt to purchase an automated budget module failed because the module could not accommodate the unique way in which the company is funded, according to Finance managers.

integrated with BPC, so managers extract data from the labor system and other sources to develop budget input and manually enter the input into BPC. This takes time and poses risks of inaccuracies. The system's open architecture enables many users to input data but also increases the risk of inaccurate entries. Given these limitations, a Finance manager said that Finance can see if department submissions are complete, but it cannot see all of the data or calculations that departments use to generate submissions in order to validate that they are accurate and reliable.

In February 2016, the Federal Railroad Administration (FRA) awarded the company an $8.4 million grant to upgrade BPC, and the company plans to deploy the first phase of the upgraded system by the end of 2017.[14] Planned changes include better integrating it with other systems, such as the human capital information system, and minimizing or eliminating some of the customized databases, calculations, and manual processes that departments use. According to a Finance manager, the company is in the process of defining what changes it will make in the initial upgrade and expects to make several additional future upgrades but has not yet defined the scope of work of these efforts.

System Used To Develop Business Line Budgets Has Inaccuracies

> ***Leading Practice:*** *Organizations have information to validate assumptions and input used to build the budget.*

In developing business line budgets, the company directly assigns them certain costs, such as for personnel aboard trains that the lines manage, and indirectly allocates other costs, such as corporate marketing costs. The company uses its Amtrak Performance Tracking (APT) system to make the allocations. The company uses a similar process and the same system to allocate some costs to states that reimburse the company for services provided, such as for company personnel used on state routes.[15] However, state representatives reported allocation errors, such as the company charging states for police service they did not use. In a January 2016 report,

[14] In its annual appropriations to the company, Congress authorized FRA to withhold up to one half of one percent of the funds for monitoring and oversight of the company's grant activity. FRA did not spend all the money previously withheld for monitoring and oversight from FY 2009 through FY 2014 and returned $8.4 million to the company in this grant to strengthen the company's reporting capabilities. The company estimates that the project will include $8.4 million in capital costs to deploy the upgraded system and $4.3 million to maintain it over six years.

[15] PRIIA of 2008 tasked the company to collaborate with relevant states to determine the methodology the company would use to allocate costs when billing states for reimbursement for services provided.

the Government Accountability Office also identified state concerns about the transparency and accuracy of the company's cost information used for allocations.[16] In addition, company managers and state representatives identified the problem that system cost data are too detailed for budgeting purposes—such as developing business line budgets—and must be converted, taking time.

Several efforts could help make the cost data more useful for budgeting. For example, the company is working with states via the State Amtrak Intercity Passenger Rail Committee to resolve data inaccuracies and in April 2015 initiated a project to fix coding errors. In a May 2016 report on FAST Act implementation, FRA noted that complying with the requirement to establish the two new NEC and National Network accounts and track costs accordingly should help the company assign more costs.[17] In fact, in a separate correspondence to the company in July 2016, we reported that it directly assigned about 55 percent of FY 2015 costs, an increase from 20 percent assigned in 2013, according to the DOT Office of Inspector General. Nevertheless, FRA noted that APT still has limitations the agency will need to help the company address to further improve cost allocation.

System Indirectly Supporting Revenue Estimates Is Not Performing Well

In 2014, the company implemented a new Revenue Management System to forecast passenger demand, allocate train seats to match demand, set ticket prices, and perform a number of other functions. This information, in turn, informs budget revenue estimates, according to two Marketing managers. Because actual revenue has been less than budgeted and this required unexpected cuts, the former CEO tasked the CIO with ensuring that the system is working as intended and not contributing to the revenue shortfall.

The company brought in a consulting firm to check the system. In June 2016, the firm reported a number of problems, including very high demand-forecast errors, difficulty in responding to changes in demand, and sub-optimal allocation of seats. In addition, the company diagnosed several more strategic problems, including poor coordination

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[16] *Better Reporting, Planning, and Improved Financial Information Could Enhance Decision Making*, (GAO-16-67), January 6, 2016.
[17] *Account Structure Definition and Accounting Methodology Improvements to Address Section 11201 of the Fast Act of 2015*, Federal Railroad Administration, U.S. Department of Transportation, May 2016.

and some distrust between Marketing and other departments on what actions to take to increase or decrease revenue, and an insufficient number of staff in the revenue management function. The contractor proposed a series of short-term, tactical changes to try to stop the revenue loss and longer-term strategies, such as developing an advanced network planning capacity. The company approved the contractor's statement of work in May 2016.

The company is aware that its current efforts to improve the three systems will not address all of their limitations as tools for budget development and validation. Leveraging this progress—by identifying what limitations remain, their significance, and opportunities to address them—will help to ensure that the company has the system support for budgeting in line with leading practices and can attest to accurate and reliable budgets.

VIEWS ARE MIXED ON HOW WELL THE COMPANY RESPONDS TO VARIANCES BETWEEN BUDGETED AND ACTUAL SPENDING

> ***Leading Practice:*** *Organizations have information to identify variances between the budget and actual spending, and use variance analyses to forecast how to adjust spending and revise budget development.*

The company issues monthly accounting reports that compare actual spending to both the approved operating budget and past spending trends and identify any variances. However, the company is inconsistent in how well it makes adjustments based on the lessons learned from these variances. For example, leading practices suggest that organizations use variance analyses to manage spending. Two Finance managers said they use the monthly variance reports to try to ensure that company spending is on track and to forecast remaining spending to stay within the authorized amount of the operating grant. Similarly, an Engineering budget manager said that the variance analyses can help the department ensure that units in the field do not exceed their approved spending levels.

Leading practices also suggest that organizations use variance analyses to revise their budget development processes, but the COO and the CFO said that departments are inconsistent in using the information for this purpose. According to the COO, some departments adjust their budgets based on actual spending—for example, when steel prices declined, the Mechanical department adjusted the prices it used to develop future estimates—but other departments did not make adjustments. According to the

CFO, some departments simply build their new budget by taking last year's approved budget and adding a percentage increase for expected inflation. He added that when variance analyses show that a department has cost savings, some departments do not want to reflect these savings in future budgets because the company, rather than the department, would then decide how to use the freed-up funds. The COO also said that the company does not do a good job of using the variance data more strategically to assess company performance, such as asking what the company is getting for its money.

The company is taking some actions to address this problem. For example, in November 2015, Finance started conducting monthly teleconferences with department representatives to assess their operating budget variances, according to a Finance manager. Initial meetings were a challenge because representatives did not have the necessary data, but the manager sees departments making progress in collecting the right data and understanding and adjusting for variances.

CONCLUSIONS

The company has improved its budget development process, especially with recent reform efforts, and the process now incorporates a number of leading practices. Nevertheless, the company still faces several challenges in developing its annual budget, and shortcomings in that process undermine efforts to make optimum decisions about how best to use available resources in line with leading practices. Successfully addressing these shortcomings by incorporating additional leading practices in its budget development process will help the company optimize the value of its capital and operating expenditures.

RECOMMENDATIONS

We recommend a number of actions to help ensure that the company uses its funds to achieve its goals, long-term plans, and priorities; avoids costly conflicts over budget decisions; and has the information systems necessary to develop and execute valid and reliable budgets. Specifically, we recommend that the CEO take the following actions:

1. Task the executive leadership team with the following:
    a) Ensure that departments consistently base their budget decisions on achieving the company's strategic goals and objectives, as well as the related funding priorities the company establishes in any long-term financial and investment plans it generates.

b) Reconsider how they can set priorities for a greater share of the company's capital and operating funds.

c) Ensure that their respective departments submit budgets in line with agreed-to financial targets.

d) Delineate department roles and accountability in budget decisions, establish these roles and accountability in policy, and ensure that departments comply with it.

2. Task the CFO and Marketing Director with determining the extent to which the proposed changes to the three information systems supporting budget development fully address their current limitations—particularly the lack of integration with other systems and data inaccuracies—to help ensure that the company is aware of the remaining problems and can begin taking steps to address them.

MANAGEMENT COMMENTS AND OIG ANALYSIS

Amtrak's Executive Vice President/CFO provided comments on a draft of this report on December 1, 2016. He agreed with one of our recommendations, partially agreed with the remaining four, and provided additional information on the proposed actions the company plans to take to implement the recommendations. The actions are positive steps that will help improve the budget development process. However, as discussed below, we question whether the proposed actions to implement three recommendations (1a, 1b, and 2) will fully resolve the shortcomings in the budget process identified in this report.

In January 2017, the CEO announced a new organizational structure that included a new leadership team, realigned departmental responsibilities, established new lines of accountability for various activities, and emphasized five key objectives aimed at ensuring long-term success. We request that as the company implements these new organizational changes, it consider how these changes offer opportunities for additional actions that will more fully address recommendations 1a, 1b, and 2, and update us accordingly.

The company's planned actions and our analysis are summarized below.

- **Recommendation 1a:** Management agreed with our recommendation that departments consistently base their budget development decisions on achieving the company's strategic goals and objectives, including those in its long-term financial plans. The company's response noted that the Financial Planning and Analysis (FP&A) group is to design and implement a consistent process to evaluate funding proposals that considers strategic objectives and enterprise risks. The company expects to have this process in place by September 2017, in time for the FY 2018 budget cycle. However, we question whether the FP&A group has the authority to fix the enterprise-wide problems we identified. Specifically, we found that it requires executive leadership to ensure that all departments consistently develop budgets based on achieving the company's strategic and long-term plans.

- **Recommendation 1b:** Management partially agreed with our recommendation that the executive leadership team set priorities for a greater share of the company's funds. As noted above, the FP&A group is leading an effort to update the budget process, in part to enable the company to better prioritize activities and projects. However, in its comments, the company did not specify how it would improve scoring or whether this would result in increased executive leadership involvement in setting priorities for a greater share of company funds as we recommended. In addition, the FP&A group does not have authority over the executive leadership team to hold them accountable for collaborating on spending priorities for greater portions of the budget, such as state-of-good-repair capital projects, as we recommended. Because of this lack of authority, we question whether the changes we are seeking in the existing process can be achieved without more explicit executive leadership involvement and active CEO direction and oversight.

- **Recommendation 1c:** Management partially agreed with our recommendation that departments submit budgets in line with agreed-to financial targets. The Finance department plans to work with company leadership to establish the necessary policies and processes to accomplish this revision, but recognized that targets may change throughout the year based on more current financial information. Nevertheless, the CFO stated that only budgets that meet final approved targets will be accepted. The company's planned actions to update policies and processes by June 2018, once implemented, would address the recommendation.

- **Recommendation 1d:** Management partially agreed with our recommendation to delineate department roles and accountability for budget decisions, establish them in policy, and ensure compliance. In his comments, the CFO stated that roles and responsibilities in the budget process are already delineated, but our work demonstrated that this is not the case. Specifically, we could not find any policies that delineated the roles of the various departments and found that conflicts over roles hindered the overall process. Nevertheless, the CFO noted that accountability for budget decisions is evolving; in January 2017, the CEO announced changes to the company's leadership. The FP&A group will work toward developing a policy and obtaining Board of Director concurrence on the policy prior to the end of FY 2017. This planned action, once implemented, would address the recommendation.

- **Recommendation 2:** Management partially agreed with our recommendation to determine the extent to which proposed changes to three information systems supporting budget development fully address their current limitations. Management agreed with our assessment that limitations exist in the information systems and described ongoing actions to address these gaps. These actions include upgrading and expanding the current BPC system to incorporate more data from other systems. In addition, the Marketing department has created and is implementing a program to improve the existing Revenue Management System. Management also stated that although Finance has a good understanding of what needs to be done to other systems that help in the budget development process, these changes will need to wait for available funding. However, this position is not fully responsive to the intent of our recommendation. Without considering whether these system changes merit a higher priority for funding, we question whether the system weaknesses we identified—particularly the lack of integration with other systems and data inaccuracies—will be fully addressed.

For management's complete response, see Appendix B.

APPENDIX A

Scope and Methodology

This report provides the results of our review to identify challenges in the company's budget development process as compared to leading practices in budgeting, and to present possible solutions in line with these practices. The scope of our work focused on the following:

- the company's process to develop its FY 2016 capital and operating budgets, beginning with strategic and long-term planning as input and extending through budget execution—specifically, assessments of actual spending to identify process improvements.
- the steps to identify, validate, and apply leading practices for budget development.
- the relevant corporate offices with a role in the process, including:
    - the Corporate Research and Strategy office which manages the company's strategic planning and management systems.
    - the Finance department which manages the process.
    - the Marketing department which builds the budget revenue estimates.
- the Engineering department and Long Distance business line as case studies on how the process currently works (we selected Engineering because it controls the largest portion of company funds, and we chose Long Distance because it has shown success implementing the company's strategy management system).

We conducted our audit work from December 2015 through December 2016 in Philadelphia, Pennsylvania; New York, New York; and Washington D.C.

To conduct our work, we first gained an understanding of the company's baseline budget process by analyzing relevant company documents and by interviewing key executives and managers involved in the process. We used this information (1) to identify the steps in the process and the parties responsible for these steps and (2) to show them in a graphic format for both the operating and capital budgets. We validated the accuracy of our graphics with Finance managers.

To identify leading practices that would serve as criteria to assess the company's process, we reviewed budgeting literature and interviewed experts—including executives of other passenger railroads and railroad associations, consultants in transportation and budgeting, and representatives of government and private-sector finance and audit agencies. From this, we compiled a list of leading practices and validated them with several experts and company executives. To provide timely information to the company as it considers process reforms, we focused our work on key practices, which we identify in applicable sections of this report. However, we consider all of the practices important to a successful process. Table 1 lists the 15 leading practices that we identified during our audit.

Table 1. Leading Practices

Leading Practice	Leading Practice
1. *Leaders define clear goals, corresponding strategic plans, and realistic priorities that drive budget development, including investment decisions.	9. Users assess how key cost drivers and risks affect budgets and account for effects in estimates.
2. Leaders set cost management as a major goal and set targets to achieve it (for example, targets for operating loss, return on investment, or spending can be at the organizational level or department/user level).	10. Users plan for operational impacts of capital projects into the operational budget.
3. *Leaders create policies and procedures for the budgeting process that include clearly defined roles and responsibilities.	11. *Leaders hold managers accountable for budget decisions.
4. *Organizations develop longer-term plans that they then translate into shorter-term plans and an annual budget request.	12. *Users and finance have effective financial management systems that provide the information needed to facilitate budget development and execution.
5. Leaders define how to plan for and use unpredictable budget funds, in part to provide consistency across the organization.	13. *Organizations have information to validate assumptions and input used to build the budget, identify variances between the budget and actual spending, and use variance analyses to forecast how to adjust spending and revise budget development.
6. Leaders, Finance, and users adhere to a standard and transparent budget review and approval process that also provides for flexible approaches, depending on differing needs across departments.	14. Users incorporate actual, audited costs to inform budget estimates to the extent possible vs formulas to allocate costs.
7. Leaders use budget-related metrics to inform budget development.	15. Users forecast all workforce costs and schedule them across project plans and budget estimates.
8. *Finance acts as a facilitator in the budgeting process.	

Note: Leading practices with an asterisk after the number are discussed in this report.

To identify challenges and opportunities for improvement, we assessed (1) the extent to which the company's process included steps consistent with leading practices and in some cases internal control frameworks for the private sector, and (2) how well departments implemented these steps. We did this by reviewing the relevant documentation the company provided to look for indicators that the process incorporated leading practices. We also interviewed executives and budget managers in the departments and offices we identified above to gain their perspectives on how well the company implements these practices.

We conducted this performance audit in accordance with generally accepted government auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

Internal Controls

Our report focuses on the company's budget development process, which includes a number of internal controls throughout the organization. Our objective did not include a review of the quality of data or reporting that result from the budget development process; therefore, we did not conduct a complete review of all of the controls associated with budget development. However, as discussed in the report, we did identify an internal control concern associated with the main system used to support budget development.

Computer-Processed Data

Although we more broadly assessed the role that several computer systems played in the budget development process, our analyses and findings do not rely on computer-generated data from these or any other systems.

Prior Audit Reports

We identified and reviewed the following reports by our office and the Government Accountability Office as relevant to this review:

Amtrak OIG

- *Governance: Alignment with Best Practices Could Improve Project Management Office Implementation* (OIG-A-2016-002), December 16, 2015
- *Amtrak: Top Management and Performance Challenges—Fiscal Year 2016 and Beyond* (OIG-SP-2015-015), September 30, 2015
- *Quality Control Review: Independent Audit of Amtrak's Consolidated Financial Statements for Fiscal Years Ended 2013 and 2012* (OIG-A-2015-003), January 13, 2015

- *Amtrak: Top Management and Performance Challenges* (OIG-SP-2014-012), September 29, 2014
- *Governance: Improved Policies, Practices, and Training Can Enhance Capital Project Management* (OIG-A-2014-009), July 15, 2014
- *Corporate Governance: Planned Changes should Improve Amtrak's Capital Planning Process, and Further Adoption of Sound Business Practices Will Help Optimize the Use of Limited Capital Funds* (OIG-E-2013-020), September 27, 2013
- *Amtrak's Strategic Planning* (E-10-01), August 17, 2010

Government Accountability Office

- *Amtrak: Better Reporting, Planning, and Improved Financial Information Could Enhance Decision Making* (GAO-16-67), January 2016
- *Amtrak Management: Systemic Problems Require Actions to Improve Efficiency, Effectiveness, and Accountability* (GAO-06-145), October 2005
- *Best Practices Methodology: A New Approach for Improving Government Operations* (GAO/NSIAD-95-154), May 1, 1995

APPENDIX B

Management Comments

NATIONAL RAILROAD PASSENGER CORPORATION

AMTRAK

Memo

Date December 1, 2016

From Gerald Sokol Jr., Executive Vice President/Chief Financial Officer

To Tom Howard, Inspector General Department Finance

cc Rhonda Lynn Seegal, Senior Vice President Finance
Charles S. Farmer, Vice President Financial Planning & Analysis
Matthew L. Gagnon, Senior Director, Amtrak Controls

Subject: "GOVERNANCE: Addressing Remaining Shortcomings Would Lead to a Budget Development Process More Fully Aligned with Leading"

This memorandum provides Amtrak's response to the OIG November 1, 2016 audit report: GOVERNANCE: Addressing Remaining Shortcomings Would Lead to a Budget Development Process More Fully Aligned with Leading Practices (Project No. 003-2016).

We appreciate the efforts and thoughtful evaluation by the entire OIG audit team, and the spirit in which the recommendations are made. We also welcome the on-going constructive dialogue we have with OIG's representatives. We believe that this process can help increase the likelihood of success as we make planned improvements in Amtrak's budgeting process.

As you are aware, this is a period of change at Amtrak as the newly appointed CEO Wick Moorman is making his assessment and setting strategic priorities. Mr. Moorman has made it a priority for Amtrak to align all budget decisions with the Corporation's goals and objectives. In addition, Amtrak is in the initial phase of operating under the new FAST Act, with a focus on two accounts: the NEC and National Network. The Financial Planning and Analysis (FP&A) group is leading an effort, involving personnel from all areas of the business, to re-focus and enhance the existing operational and capital budgeting processes, to design and implement a consistent evaluation process which considers strategic objectives and enterprise risks in allocating operating and capital funds. We expect to have this process in place by September 2017, for the FY 2018 budget cycle, and will further enhance the process in conjunction with efforts to implement a new budgeting application.

Thank you for this opportunity to comment on the audit report. As indicated in our responses, we agree with all or part of all of the recommendations and have assigned responsibility for each; to appropriate Amtrak associates to take timely actions to address.

<u>Recommendation 1a:</u>
Ensure that departments consistently base their budget decisions on achieving the company's strategic goals and objectives, as well as the related funding priorities the company establishes in any long-term financial and investment plans it generates.

NATIONAL RAILROAD PASSENGER CORPORATION

Management Response/Action Plan:

We agree with this recommendation. The Company is undergoing a transition with the appointment of the CEO Wick Moorman. During this transition Amtrak will align budget decisions with the CEO's strategic goals and objectives for the company. In addition, the Financial Planning and Analysis (FP&A) group is leading an effort, involving personnel from all areas of the business, to enhance the existing operational and capital budgeting processes, to ensure that there is a consistent scoring process which considers strategic objectives and enterprise risks in prioritizing the allocation of operating and capital funds. We expect to have this process in place by September, 2018, for the FY 2018 budget cycle, and will further enhance the process in conjunction with efforts to implement a new budgeting application.

Recommendation 1b:

Task the executive leadership team with the following:
Reconsider how they can set priorities for a greater share of the company's capital and operating funds.

Management Response/Action Plan:

We partially agree with this recommendation, and, as indicated above, in our response to recommendation 1a, we are exploring methods and tools to enable us to better score and prioritize the activities and projects to which we actively allocate operating and capital funds. The FP&A group is leading this effort and expect to have this process in place by September, 2018, for the FY 2018 budget cycle.

Recommendation 1c:

Task the executive leadership team with the following:
Ensure that their respective departments submit budgets in line with agreed-to financial targets.

Management Response/Action Plan:

We partially agree with this recommendation. We will work with Amtrak leadership to establish policies and processes which ensure that submitted budgets are in line with stated financial targets. As with most organizations, the initial budget targets are developed before all factors that may impact the final budget are well understood by individual departments and divisions. Therefore, we will continue to follow our budget schedule to accumulate and specify the underlying assumptions to reach the final and best budget for the corporation. Ultimately, based on more complete information, final financial targets will be established and provided to Amtrak leadership, and each division will be held accountable to develop budgets and deliver results. Only budgets which meet the final approved financial targets will be accepted. The FP&A expects to have the budget process updated by June, 2018, for the FY2018 cycle.

Recommendation 1d:

Task the executive leadership team with the following:
Delineate department roles and accountability in budget decisions, establish these roles and accountability in policy, and ensure that departments comply with it.

Management Response/Action Plan:

We partially agree with this recommendation. Amtrak currently does delineate department roles and responsibilities in the budget process. However, with the new CEO and changes in the leadership structure, accountability in who makes decisions within the budget process is still in process. Financial Planning and Analysis (FP&A) will work toward a policy agreed to by the Amtrak board of directors prior to the end of fiscal year 2017.

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Recommendation 2:
Task the CFO and Marketing Director with determining the extent to which the proposed changes to the three information systems supporting budget development fully address their current limitations—particularly the lack of integration with other systems and data inaccuracies—to help ensure that the company is aware of the remaining problems and can begin taking steps to address them.

Management Response/Action Plan:
Management agrees that there are limitations with the current system and issues in the budget development process. The first step in addressing the issue was a decision by Financial Planning & Analysis to upgrade and expand the current SAP/BPC system to incorporate data from more systems. We are evaluating the budgeting process in order to move from old systems into this new upgraded SAP/BPC system. While we have a good understanding of what needs to be done, due to financial constraints, other systems that help in the development of the budgeting process will need to wait until funding comes available. The Marketing Department has created, and is implementing a detailed program for both the short term tactical changes as well as longer term strategic improvements identified in the June 2016 audit of the Revenue Management system. These changes will address the opportunities for the Revenue Management System to optimize our passenger demand forecasts, the allocate train seats to match demand, and the setting of ticket prices.

APPENDIX C

Abbreviations

APT	Amtrak Performance Tracking
BPC	Business Planning and Consolidation system
CEO	Chief Executive Officer
CFO	Chief Financial Officer
CIO	Chief Information Officer
COO	Chief Operations Officer
DOT	Department of Transportation
FAST Act	Fixing America's Surface Transportation Act
FP&A	Financial Planning and Analysis group
FRA	Federal Railroad Administration
FY	fiscal year
MTA	Metropolitan Transportation Authority (New York)
NEC	Northeast Corridor
PRIIA	Passenger Rail Investment and Improvement Act
the company	Amtrak

APPENDIX D

OIG Team Members

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OIG MISSION AND CONTACT INFORMATION

Mission

The Amtrak OIG's mission is to provide independent, objective oversight of Amtrak's programs and operations through audits and investigations focused on recommending improvements to Amtrak's economy, efficiency, and effectiveness; preventing and detecting fraud, waste, and abuse; and providing Congress, Amtrak management, and Amtrak's Board of Directors with timely information about problems and deficiencies relating to Amtrak's programs and operations.

Obtaining Copies of Reports and Testimony

Available at our website www.amtrakoig.gov

Reporting Fraud, Waste, and Abuse

Report suspicious or illegal activities to the OIG Hotline

www.amtrakoig.gov/hotline

or

800-468-5469

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