United States General Accounting Office

GAO

Testimony

Before the Subcommittee on Transportation and Related Agencies, Committee on Appropriations, House of Representatives

For Release on Delivery
Expected at
10:00 a.m. EST
Wednesday
March 15, 2000

INTERCITY PASSENGER RAIL

Increasing Amtrak's Accountability for Its Taxpayer Relief Act Funds

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Mr. Chairman and Members of the Subcommittee:

Since 1971, the federal government has provided the National Railroad Passenger Corporation (Amtrak) with $23 billion in financial support. This support includes a total of about $2.2 billion in 1998 and 1999 through the Taxpayer Relief Act of 1997 (TRA). TRA funds were to be spent on acquiring capital improvements and maintaining existing equipment in intercity passenger rail service, among other things.

I am here today primarily to discuss Amtrak's use of TRA funds. My testimony summarizes the findings in our recent report on this subject.[1] More specifically, I will discuss (1) how much Amtrak has spent in TRA funds and what types of activities it has funded, (2) whether Amtrak used the funds in accordance with the act, and (3) to what extent the Amtrak Reform Council and the Internal Revenue Service (IRS) have overseen Amtrak's use of TRA funds.[2] Additionally, as you requested, I will offer some observations on Amtrak's capital needs, its progress toward reaching operational self-sufficiency, and the administration's fiscal year 2001 budget request for Amtrak.

In summary:

- Through June 1999 (the latest data available at the time of our review), Amtrak reported spending about $1.3 billion of the $2.2 billion provided under the Taxpayer Relief Act. Amtrak spent nearly two-thirds of the funds ($804 million) for capital improvements, including almost $400 million for its high-speed rail program. It spent the other third of these funds for equipment maintenance expenses ($427 million) and for debt servicing ($48 million). Amtrak's use of these funds for capital

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[1] *Intercity Passenger Rail: Amtrak Needs to Improve Its Accountability for Taxpayer Relief Act Funds* (GAO/RCED/AIMD-00-78, Feb. 29, 2000).

[2] The Amtrak Reform Council is an independent oversight body created by the Amtrak Reform and Accountability Act of 1997. Since TRA funds were provided to Amtrak as a refund of taxes attributed to railroads relieved of their responsibilities to provide intercity passenger rail service, IRS has responsibilities for overseeing Amtrak's use of these funds. Amtrak was the source of tax information contained in our February 2000 report and consented to our discussing such information with IRS officials and in our report.

improvements have largely supported the initiatives laid out in its strategic business plan.

- Our review of 23 Taxpayer Relief Act expenditures (totaling about $10 million) revealed the following:

  - Eighteen expenditures (totaling about $1 million) were consistent with the act.

  - For three expenditures (totaling about $9 million), we believe that Amtrak improperly spent Taxpayer Relief Act funds to reimburse itself for expenses incurred and paid prior to the act. We did not determine if Amtrak similarly reimbursed itself for other expenses incurred and paid prior to the act.

  - From information provided by Amtrak, we could not determine if two expenditures (totaling about $19,000) associated with a Northeast Corridor capital improvement project were eligible for Taxpayer Relief Act funding.

  In addition, we found that Amtrak does not review individual expenditures to determine if they are eligible for funding under the act. Rather, Amtrak presumes that any expenditure charged to a capital improvement project is an allowable expense, as long as it has reviewed and approved the project as qualified under the Taxpayer Relief Act. We recommended that Amtrak have its Inspector General, in consultation with the Corporation's external auditor, review the adequacy of Amtrak's internal controls over Taxpayer Relief Act funds. Amtrak agreed to take this action, and, in response to our finding, it has asked the Internal Revenue Service to determine whether the five expenditures we questioned are allowable expenses under the act**.**

- The Amtrak Reform Council has not yet monitored Amtrak's use of Taxpayer Relief Act funds, and the Internal Revenue Service has not yet examined Amtrak's use of these funds. The Council stated that it has lacked the resources to monitor Amtrak's use of these funds and explained that it was deferring that activity until after we completed our work, so as to avoid duplication of effort. According to the Internal Revenue Service, it is too early for the Service to have examined Amtrak's tax return, including Amtrak's use of Taxpayer Relief Act funds, because the first tax return showing Amtrak's use of these funds was filed in March 1999.

- Several other issues face Amtrak and the Congress. First, since fiscal year 1997, Amtrak has not had a multiyear plan that identifies its capital needs and sources of funds. Yet it has important capital needs that must be met and has identified a few of them. For example, Amtrak has stated that about $12 billion (in 2000 dollars) through 2025 will be needed to modernize the infrastructure between Washington, D.C., and New York City. In addition, in recent years, it needed about $300 million annually in capital funds to replace facilities and equipment that were wearing out. Second, Amtrak has made only modest progress in reducing its need for federal operating subsidies and meeting the requirement established by the Congress to be free of operating subsidies by the end of 2002. From 1995 through 1999, Amtrak reduced its need for operating subsides by $78 million. From 2000 through 2002, it must make further reductions totaling $291 million—nearly 4 times as much as it achieved in the past 5 years. Finally, the administration has requested $468 million in funding for fiscal year 2001 for a proposed expanded intercity rail passenger service program that could benefit Amtrak. The program would be supported by the Highway Trust Fund—which is funded from taxes on fuels used by trucks, buses, and passenger cars, among other things—and is likely to generate considerable debate from those who oppose using the Highway Trust Fund for non-highway purposes.

Background

TRA provided Amtrak with about $2.2 billion for "qualified expenses"—broadly defined as expenses incurred for acquiring equipment, rolling stock (such as locomotives and passenger cars), and other capital improvements; upgrading maintenance facilities; and maintaining existing equipment in intercity passenger rail service. The act also allows

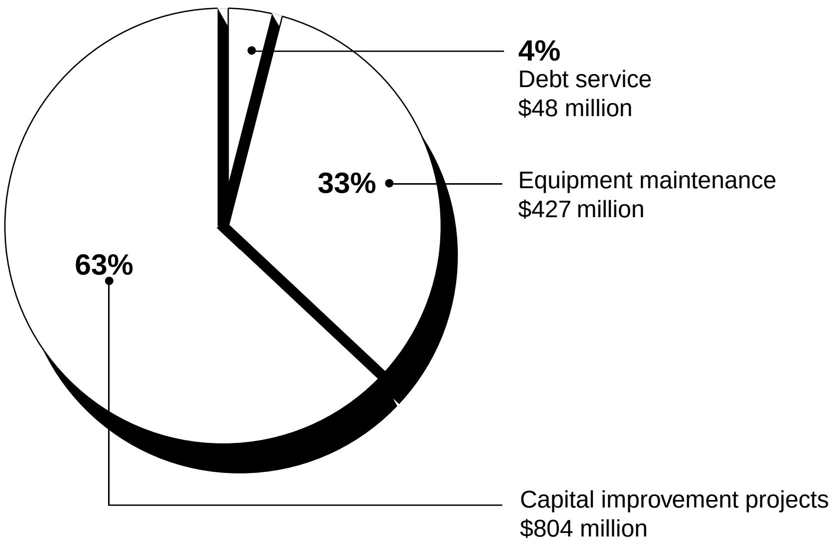
Amtrak to spend these funds for interest and principal on obligations incurred for these uses. TRA does not require that expenditures support intercity passenger rail service exclusively; for example, Amtrak could use TRA funds to purchase or improve assets that would benefit other aspects of its business, such as commuter service, as long as its intercity service also benefited. The act allows Amtrak to temporarily invest TRA funds and requires that the interest be used for qualified expenses. Any funds not obligated by January 1, 2010, as well as any funds used for purposes other than qualified expenses, are to be repaid to the United States. Under a March 1998 agreement with the IRS, Amtrak is to provide the IRS (as part of the Corporation's annual tax return) with an annual accounting of its disbursement of TRA funds until the funds have been fully expended or repaid. The IRS is ultimately responsible for determining whether TRA funds were spent in accordance with the act.

The Amtrak Reform and Accountability Act of 1997 (Amtrak Reform Act) established the Amtrak Reform Council and requires the Council to, among other things, evaluate Amtrak's performance, make recommendations to Amtrak for achieving cost containment and productivity improvements and financial reforms, and report quarterly to the Congress on Amtrak's use of TRA funds.

Amtrak Has Devoted TRA Funds Principally to Capital Improvement Projects

Through June 1999, the latest data available at the time of our review, Amtrak reported spending about $1.3 billion of its TRA funds for capital improvement projects ($804 million), equipment maintenance ($427 million), and debt service ($48 million). (See fig. 1.) In addition, Amtrak had earned about $52 million in interest on TRA funds, all of which was reinvested in TRA accounts. Amtrak's use of TRA funds for capital improvements has largely supported the initiatives laid out in its strategic business plan (adopted in Oct. 1998), such as implementing high-speed rail passenger service on the Northeast Corridor and expanding Amtrak's mail and express program.[3]

Figure 1: Proportion of TRA Funds Spent for Various Activities, Through June 1999



Source: GAO's analysis of Amtrak's data.

Amtrak has a long-term goal of using TRA funds for capital improvement projects. According to Amtrak, it uses TRA funds for equipment maintenance only when it is running low on cash.[4] To meet its long-term goal, Amtrak has begun to "repay itself" for the TRA funds used for equipment maintenance expenses. It repaid $100 million in October 1999. Amtrak expects to complete the repayment of TRA funds used for these

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[3]Express service is the delivery of higher-value, time-sensitive goods.

[4]Amtrak said that this situation is due to the timing of Amtrak's receipt of federal capital appropriations. Amtrak receives 40 percent of its federal capital appropriation on the first day of the fiscal year and the remaining portion on the first day of the next fiscal year.

expenses by the end of 2001 and does not anticipate borrowing additional TRA funds for this purpose after that time.

Limited Review Shows Mixed Results on Whether Amtrak Spent TRA Funds in Accordance With the Act

Our limited review of Amtrak's use of TRA funds found mixed results concerning whether Amtrak spent the funds in accordance with the act. While Amtrak does determine whether individual capital improvement projects and equipment maintenance functional categories meet TRA requirements, it does not determine whether individual expenditures for those projects and categories do so. Amtrak presumes that any expenditure meets TRA requirements if it is charged to a project approved by its board of directors and if the project has been reviewed by its legal department for TRA qualification. We examined (1) 10 of the 216 capital projects that Amtrak's board approved for TRA funding, (2) 23 capital improvement expenditures of the approximately 81,000 TRA expenditures recorded by Amtrak as of May 1999, and (3) all 48 categories of equipment maintenance expenses (such as extraordinary passenger car cleaning) to which Amtrak charged TRA funds.[5]

<u>Most Capital Projects We Reviewed Met TRA Criteria</u>

Nine of the 10 TRA-funded projects we reviewed met the criteria in the act as capital improvements in intercity passenger rail service. (The 10 projects were budgeted for a total of almost $29 million.) For example, Amtrak used TRA funds to carry out environmental remediation efforts at its Beech Grove maintenance facility in Indiana. The Beech Grove facility is primarily used to maintain equipment in intercity passenger rail service. Another project meeting TRA criteria was Amtrak's implementation of its

[5]We chose 10 projects that, from project descriptions, did not clearly appear to be capital improvements in intercity passenger rail service. We reviewed each project as a whole, rather than all the expenditures charged to a project. We also selected 10 expenditures that, on the surface, appeared likely to meet the requirements of the act and 10 others that did not. During the course of our review, we identified three expenditures of TRA funds for reimbursements of expenses that Amtrak incurred and paid before the act. Because this reimbursement seemed unusual, we investigated these three expenditures.

Human Resources Information System. This system is designed to calculate various aspects of pay and benefits for Amtrak's workers. While the project benefits Amtrak generally and does not relate directly to the transportation of passengers, it supports Amtrak's execution of administrative functions critical to providing intercity passenger rail service.

However, after reviewing Amtrak documents and discussing with Corporation officials the tenth project—to transform Northeast Corridor service (budgeted for $2 million)—we could not determine whether two of the project's three components are capital improvements under either the Internal Revenue Code or generally accepted accounting principles. (The three components are modifying passenger cars, developing and implementing an emergency response program for fire and rescue personnel, and developing operational and marketing strategies for Northeast Corridor service.) Specifically, it was unclear whether portions of the project were capital in nature (for example, having future benefits). If a project is not allowable under the act, then the expenses incurred for the project would not be allowable. In response to our findings, Amtrak asked the IRS to determine whether the two components of the Northeast Corridor capital project that we questioned were allowable under the act.

<u>Most Capital Improvement Expenditures We Reviewed Met TRA Eligibility Criteria</u>

Of the 23 capital improvement expenditures (totaling about $10 million) we reviewed, 18 (totaling about 1 million) were reasonably related to the acquisition of capital improvements in intercity passenger rail service and therefore were eligible for TRA funding. Examples of the 18 expenditures are payroll, the freight and shipping of an oven for a dining car, and the renovation of a retail facility at Amtrak's 30th Street Station in Philadelphia.

Five of the 23 expenditures presented a different picture. We determined that three of the five expenditures (totaling about $9 million) were for the reimbursement of expenses incurred and paid prior to the act and were not eligible for TRA funding. Specifically, Amtrak used $600,000 of TRA funds to reimburse itself for amounts paid in 1996 or 1997 to purchase two coach cars for use in passenger service in the Pacific Northwest. Similarly, Amtrak used $1.6 million of TRA funds to reimburse its cash account for payments made between January and August 1997 in connection with acquiring 98 new diesel locomotives. Finally, Amtrak used $7 million in TRA funds to reimburse its cash account for 1997 debt service payments that had not been included in its fiscal year 1997 capital plan as a result of underestimation. Amtrak believes that the three expenditures were eligible for TRA funding because neither the statute nor its legislative history specifically prohibits Amtrak from using the funds to reimburse pre-act expenses. We believe that TRA did not authorize Amtrak to reimburse itself for expenses incurred and paid prior to the act because, among other things, such use could effectively circumvent the restrictions imposed by the Congress on the use of these funds. Because we did not review all TRA expenditures, we did not determine if Amtrak similarly reimbursed itself for other expenses incurred and paid prior to this act. In response to a recommendation that we made, Amtrak agreed to have its Inspector General determine whether Amtrak has used TRA funds to reimburse itself for other expenses incurred and paid prior to the act.

In addition to the three capital improvement expenditures that, in our view, were clearly not eligible for TRA funding, we identified two other expenditures (totaling about $19,000) that were questionable. Specifically, Amtrak paid about $17,000 to an executive recruiting firm to identify candidates for a new position as Vice President for Northeast Corridor Service Initiatives. In addition, Amtrak spent approximately $2,000 for lunches for over 30 employees participating in meetings on the project over 2 days. From information provided by Amtrak, we could not determine whether the project to which the two questionable expenditures were charged—the project to transform Northeast Corridor service—was entirely capital in nature. Therefore, we could not determine whether these two expenditures, which appeared to relate to multiple aspects of the project, were allowable under the act. Amtrak disagreed with our findings and believes that these expenditures were eligible as TRA expenses. Despite these views, Amtrak stated that, to put to rest any question about its commitment to the proper expenditure of TRA funds, it has asked the IRS to determine whether the five expenditures were qualified expenses under the act.

We find Amtrak's lack of review of individual expenditures troubling because, without such a review, Amtrak does not have reasonable assurance that TRA funds are spent in accordance with the law. Therefore, we made several recommendations in our February 2000 report on this issue. In addition to the actions described above and in response to our recommendations, Amtrak has asked its Inspector General, in consultation with the Corporation's external auditor, to review the adequacy of Amtrak's internal controls over TRA funds. We will continue to follow up with Amtrak to determine whether its subsequent actions will adequately resolve the problems we found.

Equipment Maintenance Categories Were Eligible For TRA Funding

With regard to the TRA funds that Amtrak spent for equipment maintenance, we reviewed Amtrak's 48 broad functional categories, such as extraordinary passenger car cleaning and fumigation and shop overhead, and found they were appropriate for TRA funding. Because Amtrak allocates TRA funds to a pool of equipment maintenance expenses—rather than identifying the specific expenditures paid for with TRA funds—we did not determine whether individual expenses financed with TRA funds were eligible under the act. According to Amtrak, there is always a sizable pool of allowable equipment maintenance expenses, and it has used TRA funds for an amount smaller than the pool. We do not object to Amtrak's approach as long as the pool of qualified expenses is always larger than the amount of reimbursements for equipment expenses that Amtrak applies to the pool.

Neither the Amtrak Reform Council nor the IRS Has Yet Overseen Amtrak's Use of TRA Funds

The Amtrak Reform Council has not reviewed either the legality or merits of Amtrak's TRA expenditures. In addition, the Council has not made quarterly reports to the Congress on Amtrak's use of Taxpayer Relief Act funds, as required by the Amtrak

Reform Act.[6] According to the Council, it has not monitored Amtrak's use of TRA funds because of (1) a lack of financial resources provided by the Congress, (2) a legislative restriction prohibiting the Council from hiring outside consultants, and (3) a delay in obtaining the financial resources and authority to hire staff for the Council. In addition, the Council decided to defer monitoring TRA expenditures until after we completed our work, so as to avoid duplication of effort. Finally, the Council has stated that it would be more efficient in the future for Amtrak's external auditor to review Amtrak's TRA expenditures for compliance with the act.

The IRS has not yet examined Amtrak's use of TRA funds. Amtrak filed its income tax return for 1998—the first tax year for which TRA funds were available—in March 1999. (Amtrak's 1998 tax year ended Dec. 31, 1998.) As of February 2000, it was too early for the IRS to have reviewed the return, including Amtrak's use of TRA funds, according to IRS.

Observations on Amtrak's Capital Needs and Quest for Operational Self-Sufficiency and the Administration's Fiscal Year 2001 Budget Request

As you requested, I would now like to briefly discuss three related Amtrak topics: (1) the Corporation's capital needs, (2) its progress toward reaching operational self-sufficiency, and (3) the administration's fiscal year 2001 budget request to the Congress for intercity passenger rail.

Amtrak Lacks a Multiyear Plan for Addressing Substantial Capital Needs

The railroad industry is capital-intensive, and Amtrak is no exception. Amtrak faces expensive requirements that include modernizing the track and other infrastructure it owns, and purchasing locomotives, passenger cars, and other rolling stock—such as mail

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[6]The Council's recent annual report to the Congress did address TRA issues. However, it did not discuss the legality or merits of Amtrak's expenditure of TRA funds. See *A Preliminary Assessment of Amtrak, The First Annual Report of the Amtrak Reform Council* (Jan. 24, 2000).

and express cars. Yet, since fiscal year 1997, Amtrak has not produced a multiyear capital plan that identifies its capital needs and the sources of funds to meet these needs.

Amtrak's capital needs total many billions of dollars and the Corporation has identified some of these needs.[7] For example, in a recent study, Amtrak estimated that about $12 billion (in constant 2000 dollars) through 2025 will be needed to modernize the south end of the Northeast Corridor (between Washington, D.C., and New York City), which is used by its trains as well as commuter and freight railroads. In addition, in recent years, Amtrak has needed about $300 million in capital funds per year just to replace facilities and equipment that are wearing out. Finally, Amtrak recently announced a planned expansion of its route system that is aimed at improving its financial condition. While we have not looked at this plan in detail, we note that at least one element—the acquisition of about 2,000 mail and express cars—will require a substantial investment. Relatedly, Amtrak currently spends a considerable portion of its annual federal capital appropriations on equipment maintenance rather than on capital investment. This means that Amtrak is not spending these funds to make the enhancements that could improve its competitive position in the various markets it serves.

<u>Amtrak Faces Challenges in Reaching Operational Self-Sufficiency</u>

In 1994, the administration requested that Amtrak be free of operating subsidies by 2002. The Amtrak Reform and Accountability Act of 1997 prohibited Amtrak from using federal funds for operating expenses, except for an amount equal to excess Railroad Retirement Tax Act payments, after 2002.[8] Amtrak has made only modest progress toward operational self-sufficiency. In the past 5 fiscal years, 1995 through 1999, Amtrak has reduced its need for operating subsidies by only a total of $78 million. Over the next 3

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[7]*Intercity Passenger Rail: Amtrak Faces Challenges in Improving Its Financial Condition* (GAO/T-RCED-00-30, Oct. 28, 1999).

[8]Amtrak participates in the railroad retirement system, under which each participating railroad pays a portion of the costs for all retirements and benefits in the industry.

years, 2000 through 2002, it must make further reductions totaling $291 million---nearly 4 times as much as it has achieved in the past 5 years.

We believe that Amtrak will have difficulty meeting the requirement to be free of operating subsidies by the end of 2002. While it met its full year financial goals for reducing its need for operating subsidies for the first time in 1999, this goal was relatively modest. According to Amtrak, for fiscal year 1999, it reduced its need for operating subsides by $18 million. However, the bulk of the financial improvements—$291 million—that Amtrak must make are in 2000 and the next 2 years. In addition, in July 1999, we reported that Amtrak's current Strategic Business Plan, adopted in October 1998, contains over $200 million in net financial improvements that were either undefined or listed as actions not yet developed.[9] Amtrak expects to issue its next Strategic Business Plan later this month.

<u>Fiscal Year 2001 Budget Request Contains a New Intercity Passenger Rail Program</u>

The administration's budget request for fiscal year 2001 includes $521 million for capital funds for Amtrak and $468 million for a new grant program for expanded intercity rail passenger service. The Highway Trust Fund, which is funded from fuel taxes on trucks, buses, and passenger cars, among other things, would be the source of the funds for the new program. The proposal is likely to generate considerable opposition from those who are against using the Highway Trust Fund for non-highway purposes.

If the budget request is enacted, the Secretary of Transportation would award funds for the new program to Amtrak and/or a state (or consortium of states) for capital investments needed to support intercity passenger rail service across the country. The grants, which would be awarded on a 50/50 matching basis, could be used to acquire equipment, make infrastructure improvements, and undertake planning and design

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[9] *Intercity Passenger Rail: Amtrak's Progress in Improving Its Financial Condition Has Been Mixed* (GAO/RCED-99-181, July 9, 1999).

activities. The program would also require that the investments generate a positive financial contribution for Amtrak (as measured by Amtrak's recovering all variable and fixed/overhead costs associated with the new service) and public benefits in excess of public costs. To the extent that net revenues on a joint Amtrak-state venture do not occur, states would be responsible for the equivalent amount of Amtrak's net operating loss for the service.

The proposed program appears designed to ensure that the projects make money or at least recover their costs. This is a way to ensure that joint Amtrak-state projects do not adversely affect Amtrak's financial condition. (Amtrak has large financial losses—it lost $916 million in fiscal year 1999.) However, requiring states that participate in joint ventures with Amtrak to make up, dollar-for-dollar, any loss provides no incentive for Amtrak to maximize revenues and minimize costs.

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Mr. Chairman, this concludes my prepared testimony. I would be pleased to respond to any questions that you or Members of the Subcommittee may have.

Contact and Acknowledgements

For information regarding this testimony, please contact Phyllis F. Scheinberg at (202) 512-2834. Individuals making key contributions to this testimony were Helen Desaulniers, Richard Jorgenson, James Ratzenberger, and Teresa Spisak.

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