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Examination of the United States Railway Association's Financial Statements and Other Matters Concerning Its Operations. CED-77-64; B-164497(5). July 8, 1977. 26 pp. + 3 enclosures (4 pp.) + 2 appendices (11 pp.).

Report to the Congress; by Elmer B. Staats, Comptroller General.

Issue Area: Accounting and Financial Reporting (2800); Transportation Systems and Policies: Railroad Freight Transportation System (2407).
Contact: Community and Economic Development Div.
Budget Function: Commerce and Transportation: Ground Transportation (404).
Organization Concerned: United States Railway Association.
Congressional Relevance: House Committee on Interstate and Foreign Commerce; Senate Committee on Commerce, Science, and Transportation; Congress.
Authority: Government Corporation Control Act (31 U.S.C. 841). Regional Rail Reorganization Act of 1973 (P.L. 93-236). District of Columbia Non-Profit Corporation Act (P.L. 87-569). Railroad Revitalization and Regulatory Reform Act of 1976 (P.L. 94-210).

Although the financial statements of the United States Railway Association (USRA) for the period ended June 30, 1976 generally present the financial position of the association fairly, misstatements were discovered in several accounts. Findings/Conclusions: The equipment, prepaid expenses, accounts receivable, loans receivable, leasehold improvements, accrued travel expenses, and contract holdback accounts were found to be misstated as of June 30, 1976. Although the net effect of the misstatements is not material when compared with the size of the investment of the U.S. Government balance, several of the misstatements were material with respect to individual account balances. The USRA has taken corrective action on all of the items. With regard to the operations of the association, documentation for administrative expenses was inadequate; internal audit activities were limited; and recommendations made in a previous GAO report with regard to procurement and financial disclosure policies had been only partially implemented. Recommendations: The Chairman of the Board of the Association should: conduct a comprehensive inventory of furniture and equipment during the next year and as often as necessary thereafter; strengthen internal controls over relocation expenses; provide broader internal audit coverage of its financial and management operations and implement systematic followup procedures; and fully implement GAO's prior recommendations concerning procurement and financial disclosure. (Author/SC)

3042

REPORT TO THE CONGRESS

BY THE COMPTROLLER GENERAL OF THE UNITED STATES

Examination Of The United States Railway Association's Financial Statements And Other Matters Concerning Its Operations

GAO's opinion on the Association's June 30, 1976, financial statements is qualified because of misstatements in the equipment prepaid expenses, accounts receivable, loans receivable, leasehold improvements, accrued travel expenses, and contract holdback accounts.

GAO also found that improvements were needed in internal audit activities and internal controls over certain administrative expenses.

CED-77-64

JULY 8, 1977

COMPTROLLER GENERAL OF THE UNITED STATES
WASHINGTON, D.C. 20548

B-164497(5)

To the President of the Senate and the
Speaker of the House of Representatives

This report presents the results of our audit of the United States Railway Association's financial statements for the fiscal year ended June 30, 1976, and also discusses other matters concerning operations of the Association. Our audit was made pursuant to the Government Corporation Control Act (31 U.S.C. 841).

We are sending copies of this report to the Director, Office of Management and Budget; the Secretary of Transportation; and the Chairman, Board of Directors, United States Railway Association.

Elmer B. Staats

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

EXAMINATION OF THE UNITED STATES RAILWAY ASSOCIATION'S FINANCIAL STATEMENTS (JUNE 30, 1976) AND OTHER MATTERS CONCERNING ITS OPERATIONS

D I G E S T

The United States Railway Association, a non-profit, mixed-ownership Government corporation of the District of Columbia, was created under the Regional Rail Reorganization Act of 1973 to develop and implement a plan to reorganize bankrupt railroads in the Midwest and Northeast. On July 26, 1975, the Association sent its Final System Plan for reorganizing the bankrupt railroads to the Congress.

The Association's current role is to (1) control the flow of Government investment and loan funds to the Consolidated Rail Corporation, (2) monitor Consolidated Rail Corporation's performance, and (3) participate in litigation relating to the allocation of Consolidated Rail Corporation securities and compensation provided the bankrupt estates.

The Government Corporation Control Act requires GAO to periodically audit the Association's financial statements and to report the results to the Congress.

In GAO's opinion, except for the misstatement of certain accounts, the accompanying financial statements fairly present the financial position of the Association at June 30, 1976, the results of its operations, and the change in its financial position for the fiscal year then ended, in conformity with principles and standards of accounting prescribed by the Comptroller General of the United States.

GAO found the equipment, prepaid expenses, accounts receivable, loans receivable, leasehold improvements, accrued travel expenses, and contract holdback accounts to be misstated as of June 30, 1976. Although the net effect of the misstatements is not material when compared with the size of the investment of the U.S. Government balance, GAO found several of the misstatements to be material with respect to individual account balances. The Association has taken corrective action on all the above items. (See ch. 2.)

For other matters concerning operations of the Association, GAO found that:

--Documentation for administrative expenses, such as travel, representation, and relocation, was inadequate. (See p. 12.)

--Internal audit activities were limited. (See p. 16.)

--Recommendations in a previous GAO report that the Association more specifically define its procurement and financial disclosure policies had been only partially implemented. (See p. 19.)

GAO recommends that the Chairman of the Board of the Association:

--Conduct a comprehensive inventory of furniture and equipment during the next year and as often as necessary thereafter. (See p. 7.)

--Strengthen internal controls over relocation expenses. (See p. 16.)

--Provide broader internal audit coverage of its financial and management operations and implement systematic followup procedures. (See p. 18.)

--Fully implement GAO's prior recommendations concerning procurement and financial disclosure. (See pp. 22 and 24.)

AGENCY COMMENTS

The Association agreed to implement all the above recommendations except certain recommendations concerning procurement and financial disclosure.

The Chairman of the Association told GAO that the Association's new order on procurement policy contains competitive procedures that are consistent with the definition suggested by GAO and that in the future, contracts will be listed as competitive only if they meet the criteria of the competitive procedures noted in the revised order. With regard to the criteria for submission of contracts to the Board of Directors for approval, the Association told GAO that all officers and employees of the Association who are involved in the procurement process are aware that all contracts over $100,000 and those of a lesser amount, if they significantly impact on the substantive operations of the Association, must go to the Board for approval. GAO believes, however, that the procurement order should be appropriately revised to make certain what the Association considers a competitive contract and which contracts are to be submitted to the Board of Directors for approval. (See p. 24.)

The Association also continues to maintain that the standards for determining conflicts of interest are sufficiently specific. The position of the Association is that it is impossible to articulate generally applicable specific standards because a determination of conflicts represents a balancing of factors. While GAO agrees that a determination of a conflict represents a balancing of factors, it believes these factors should be discussed either in the regulations or in the implementing order issued on August 3, 1976, so that the same criteria are applied to all employees. (See p. 22.)

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ABBREVIATIONS

Conrail	Consolidated Rail Corporation
FRA	Federal Railroad Administration
GAO	General Accounting Office
USRA	United States Railway Association

CHAPTER 1

INTRODUCTION

The United States Railway Association (USRA), a non-profit, mixed ownership Government corporation, was created by the Regional Rail Reorganization Act of 1973 (Public Law 93-236) and was incorporated on February 1, 1974, in the District of Columbia under the provisions of the District of Columbia Non-Profit Corporation Act (Public Law 87-569). USRA was created to develop and implement a plan to reorganize bankrupt railroads in the Midwest and Northeast region.

The Regional Rail Reorganization Act of 1973 authorized USRA to identify a rail service system adequate for the region's service requirements and make recommendations for and assist in organizing the bankrupt railroads into an economically viable system. On July 26, 1975, USRA sent to the Congress its Final System Plan for reorganizing the bankrupt railroads.

The act also required the establishment of a profit-making corporation called the Consolidated Rail Corporation (Conrail) to operate and modernize parts or all of the restructured system USRA designed. Selected rail properties of the bankrupt railroads were conveyed to Conrail on April 1, 1976.

USRA's responsibilities were greatly altered by the Railroad Revitalization and Regulatory Reform Act of 1976 (Public Law 94-210) enacted on February 5, 1976, and the conveyance of rail properties to Conrail. USRA's role now is to (1) control the flow of Government investment and loan funds to Conrail, (2) monitor Conrail's performance, and (3) participate in litigation relating to the allocation of Conrail securities among the bankrupt railroads and to the fairness and equity of the compensation provided them for the property which was transferred under the Final System Plan.

Other USRA activities include

--making loans under section 211 for preconveyance debts of the reorganizing railroads;

--implementing any further restructuring of the region's railroads;

--assisting the Department of Transportation in negotiating initial operating and lease agreements on light density lines with regional, State, or local transportation authorities; and

--consulting with the Department on converting rail rights-of-way on discontinued lines to other uses.

USRA is managed by an 11-member Board of Directors consisting of three ex-officio Government members and eight other members, including a chairman appointed from the private sector. The ex-officio Government members are the Secretary of Transportation, the Secretary of the Treasury, and the Chairman of the Interstate Commerce Commission. The non-Government members are appointed by the President and confirmed by the Senate. The original non-Government members serve from 2- to 6-year terms and their successors serve 6-year terms.

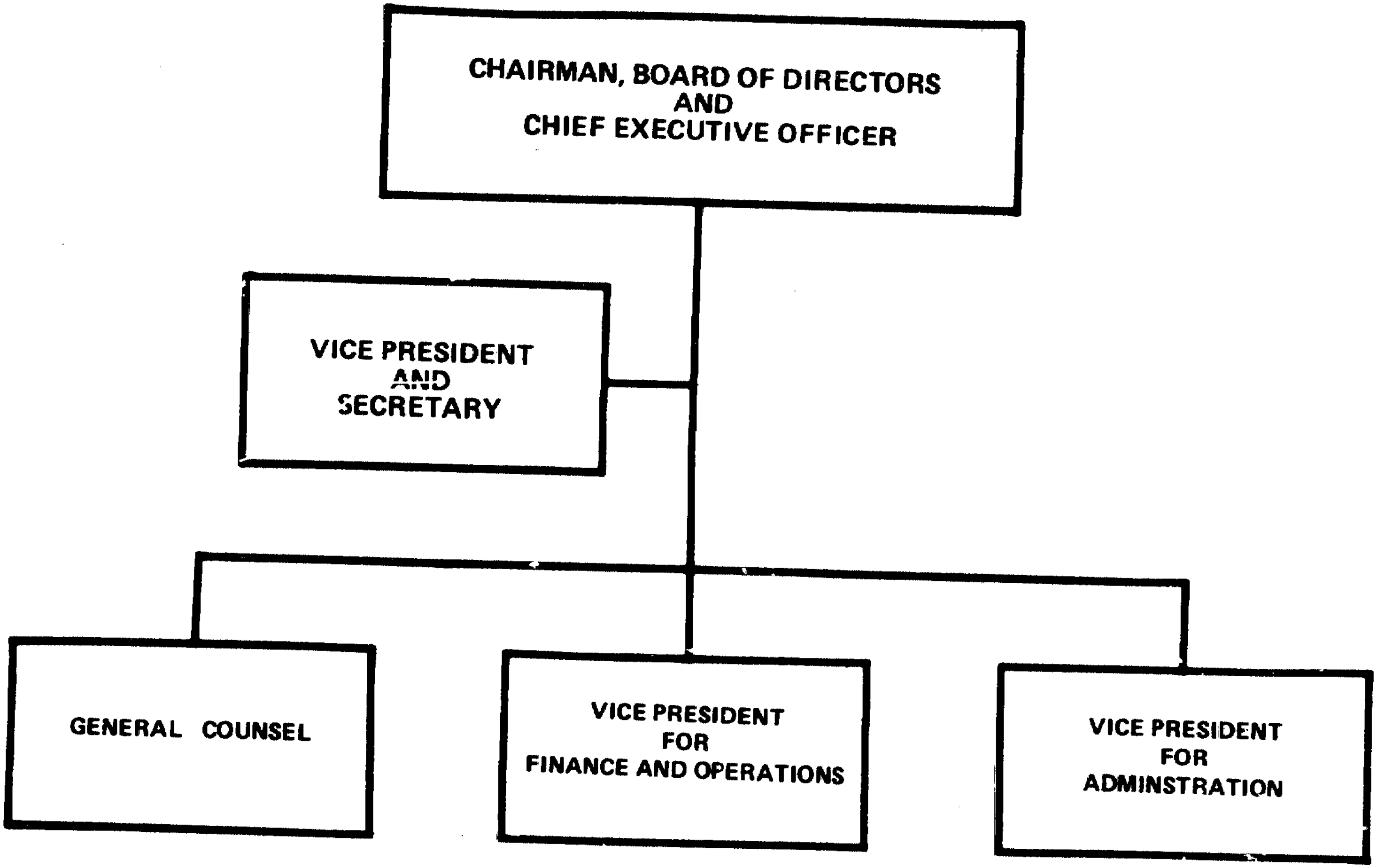
USRA has reorganized and consolidated because of its changing role. The Chairman of the Board has assumed the functions and duties of the President's office. The number of USRA employees decreased from a high of 311 employees on June 30, 1975, to 152 employees as of June 30, 1976. These employment figures include regular and summer employees and full-time consultants.

At June 30, 1976, legislation for USRA authorized a ceiling of $54 million for administrative expenses. Appropriations totaled $52.3 million. As of November 30, 1976, authorizations for administrative expenses were increased to $65 million and appropriations to $64.3 million. USRA was also appropriated an additional $2.026 billion for the purchase of Conrail securities over a 4-year period. Public Law 94-252 made available $1.465 billion through fiscal year 1977.

A public accounting firm developed the USRA accounting system to reflect the procedures required to administer and control USRA's appropriated funds. Although the accounting systems of all executive agencies are subject to the approval of the Comptroller General, the accounting systems of corporations under the Government Corporation Control Act, such as USRA, are exempt from such approval.

The USRA organization chart is shown on the following page.

UNITED STATES RAILWAY ASSOCIATION



As of November 1, 1976

CHAPTER 2

COMMENTS ON FINANCIAL STATEMENTS AND OPERATIONS

ACCOUNTABILITY AND CONTROL OVER FURNITURE AND EQUIPMENT NEED IMPROVEMENT

Because of the manner in which USRA maintained its property records, we could not identify the items that supported the June 30, 1976, furniture and equipment balance of $343,991. More specifically, the property records did not sufficiently describe items of furniture and, therefore, the proper unit price could not be applied.

The United States Railway Association's original accounting manual, which was in effect until December 1976, stated that the Vice President for Administration was to schedule an annual inventory of furniture and equipment. At June 30, 1976, no physical furniture inventory had ever been made. We also found that in some cases no physical inspection of equipment was made even though support service officials stated that inventories of equipment, such as cameras and calculators, had been made in the past.

According to the former property management officer, inventories of equipment were made by sending notices to each USRA office listing the items and serial numbers that were supposed to be located in that office. The office staff then took its own inventory and reported back to support services which equipment was present and which was missing from the list they had received. We believe that this type of inventory is appropriate on an interim basis only and should not be the sole means of verifying the existence of equipment.

Our observation of the physical furniture inventory showed that the computer printout descriptions of items were inadequate, making it impossible in many cases to match articles of furniture on hand with the descriptions. Further discrepancies were noted because all items received from the General Services Administration's excess stocks were not included in the computer printout. Because of these problems we were unable to assign a value to the portion of fixed assets represented by furniture.

As a result of our work, USRA's property records were expanded to include items received from the General Services Administration, pictures of all furniture on hand, and uniform descriptions for inclusion in the computer printout.

On March 23, 1977, the USRA Comptroller told us that, based on a complete physical inventory of fixed assets conducted during December 1976, the balance in the fixed asset account at June 30, 1976, should have been $381,259, of which $136,352 was attributed to equipment and the remaining $244,907 to furniture. Based on USRA's computations, fixed assets were understated by $37,268 at June 30, 1976.

Missing items not reported

During our observation of the physical inventory we discovered several pieces of equipment were missing for which no reports had been filed, although USRA procedures call for reports on the loss or theft of equipment. We also noted that although some items had been assigned to USRA employees, many of these items were, in turn, assigned to other employees. Because USRA employees were not required to sign a receipt for the equipment assigned to them, responsibility for a particular item could not be associated with a specific USRA employee.

As a result of our work, USRA officials told us that employees were now being required to sign a receipt for equipment items borrowed. We believe this practice should allow better recordkeeping concerning the location of all USRA equipment.

We found that equipment valued at $3,868 was lost or stolen as shown below:

Missing or stolen items	Total number of items	Total cost
Dictating machines	8	$1,397
Cameras	6	856
Typewriter	1	621
Calculators	15	618
Camera lens	3	215
Flash attachments	2	121
Binoculars	1	40
Total		$3,868

USRA officials believe that inadequate building security is one of the main causes of equipment thefts and stated that the most expensive items missing were taken from a locked storeroom where the number of keys was limited to two USRA people plus the security force at USRA's office building. USRA officials noted that they had been careful to avoid thefts and had distributed a number of memoranda and circulars to their staff describing proper security measures.

However, we also found some equipment thefts that were not caused by inadequate building security. For example, of 16 reports of loss or theft filed since inception of the Association to September 1, 1976, 7 showed that equipment items were stolen while left on the top of an employee's desk or in unlocked drawers. In some cases, the items had been missing for more than a year before a report of loss or theft had been filed. The lack of timeliness in filing a report and the $100 deductible per item has kept the insurance recovery down. Also, the insurance company will not pay a claim on items discovered missing through an inventory.

USRA officials told us that the late reported losses occurred during periods of heavy pressures, long hours, and maximum efforts in meeting severe legislative deadlines.

Disposal and retirement of fixed assets

Although USRA did not have a formal policy on the disposal or retirement of equipment or furniture items before November 1976, we noted it had sold equipment and furniture USRA purchased for $11,000 to either Conrail or USRA employees. We noted also that USRA loaned certain fixed assets to Conrail.

USRA officials told us that, before items were sold to employees, a check was made concerning the price USRA could expect from dealers for this type of used equipment. In every case the amount paid by USRA employees was at least as great as the price USRA could have received from local dealers. However, documentation for such price checks was available for only one of the six items sold to USRA employees. In addition USRA had no system for assuring fair and equitable sales to all USRA employees.

On November 2, 1976, USRA issued an order establishing uniform policies and procedures for acquiring, controlling, and disposing of USRA's furniture and equipment. The order stipulated that USRA's employees be permitted to purchase excess property on a fair and equitable basis but at a price no lower than could be obtained from outside USRA. The order also stated that reports of loss or theft be filed immediately upon discovery of loss or theft of property.

On March 23, 1977, USRA officials told us that overall recoveries were about 85 percent of the original purchase price and that Conrail had been billed for the loaned items, and payment in full had been received by USRA.

RECOMMENDATION

We recommend that the Chairman of the Board of USRA make sure that a comprehensive inventory of furniture and equipment is made during the next year and as often as necessary thereafter. We believe regular physical inventories provide a necessary check on the effectiveness of the accounting procedures to provide adequate and accurate information on all significant changes in the investment in property assets.

AGENCY COMMENTS

In a letter dated April 5, 1977, the Chairman of the Board agreed to conduct a comprehensive inventory of furniture and equipment during the next year. He also stated that the revised USRA accounting manual provides that a physical inventory of all nonexpendable property will be taken periodically but not less often than every 2 years.

LEASEHOLD IMPROVEMENTS OVERSTATED

A temporary improvement to office space occupied by USRA costing $14,494 had been included in the $246,810 balance of leasehold improvements at June 30, 1976. The USRA Comptroller agreed with us that the item should not have been capitalized and subsequently corrected the error in the fixed asset account.

PREPAID EXPENSES ACCOUNT OVERSTATED

The $16,331 balance in the prepaid expenses account at June 30, 1976, was overstated by $15,906. The balance consists of

--a $10,206 balance of an advance payment made in April 1974 to the Department of Transportation under a reimbursable agreement;

--a $5,700 advance insurance premium payment made January 3, 1975, to cover USRA up to February 8, 1975; and

--a $425 refundable deposit required by American Airlines for credit cards issued to USRA officers.

Records showed that USRA had already received the services under the reimbursable agreement with the Department of Transportation and that insurance coverage had been provided.

During our previous audit of USRA, we also identified discrepancies concerning the prepaid expenses account. In a March 21, 1975, letter to the President and Chief Operating Officer we reported that no portion of a $25,000 prepaid expense item had been expensed even though 3 months of services had been received. When we informed the USRA Comptroller of the overstatement he agreed the items should have been expensed but said that while statement contents are analyzed on a routine basis, occasionally some items were overlooked or a delay occurred in making corrections.

Because of the discrepancies noted during this and the previous audit with respect to prepaid expenses, we suggested that the Chairman of the Board require that the account balances be analyzed regularly as a means of minimizing the possibility of similar errors in the future and thus providing for more accurate financial information on assets.

AGENCY COMMENTS

In a letter dated April 5, 1977, the Chairman of the Board told us that procedures now provide for periodic review and analysis of account balances.

ACCOUNTS RECEIVABLE OVERSTATED

We believe the $621,588 accounts receivable balance at June 30, 1976, is overstated by $15,426 because USRA was seeking reimbursement from the Federal Railroad Administration (FRA) for personnel expenses specifically excluded from a reimbursable agreement for work involving financial assistance to railroads.

Although the reimbursable agreement states that only those USRA employees spending a major portion of their time on FRA activities would be reimbursed, USRA charged FRA for all employees spending any time on FRA projects. FRA informed USRA that bills for $7,282 and $8,144 for personnel expenses for the second and third quarters of fiscal year 1976 were not in compliance with the agreement.

As a result, future amounts charged to FRA did not include the personnel costs for USRA employees not spending a major portion of their time on FRA projects.

The USRA Comptroller agreed that USRA would probably not be able to collect these amounts but stated that, in his opinion, at June 30, 1976, the $15,426 was properly considered a good receivable. The USRA Comptroller was intent on convincing FRA that this was a fair and reasonable charge and should be reimbursed even though a literal reading of the agreement did not require FRA to pay for the time of USRA employees spending less than half their time on FRA activities. We believe, however, that because the agreement was so clear that a major portion of time had to be expended, USRA could not reasonably expect collection and, therefore, had no basis for the establishment of a receivable.

GENERAL LEDGER ACCOUNTS NOT ESTABLISHED FOR INTEREST INCOME AND EXPENSE

We believe the $85,224,148 loans receivable balance shown on the Statement of Financial Condition at June 30, 1976, is understated by $74,282, the excess of interest income received from the railroads over interest expense payable to the Federal Financing Bank.

The amount of interest USRA had to pay to the bank was in some cases less than the amount of interest USRA received from the railroads for loans made to them under the lending programs. Because USRA recorded the net balance of interest income over interest expense as a reduction to the loans receivable account, the account was understated by $74,282 on the Statement of Financial Condition at the end of the period.

At the time of our audit, the general ledger accounts set up to record transactions under USRA's lending programs involved only the cash, loans payable, and loans receivable accounts. USRA recorded interest income and expense in subsidiary ledgers and included interest income and expense information in attachments to its financial statements.

USRA revised its accounting manual as of December 1976 to establish interest income and interest expense accounts. The USRA Comptroller told us the practice of reducing loans receivable by the excess of interest income over expense would be discontinued. The loans receivable balance was appropriately increased during October 1976.

LIABILITIES OVERSTATED

Liabilities are overstated $43,416 because of a $60,227 overstatement in contract holdbacks and a $16,811 understatement in accrued expenses.

Accrued expenses not recorded

Our review disclosed that the vouchers payable and travel expenses accounts were understated at June 30, 1976, by at least $16,811 because all travel expenses incurred had not been reported to USRA. The accrued expenses balance on the Statement of Financial Condition at June 30, 1976, of $114,836, represents the combined balance of four accounts, one of which is the vouchers payable account established for recording travel tickets purchased through travel agencies, with USRA-issued credit cards, or through the Department of Transportation tele-ticketing service.

Credit entries normally are made in the vouchers payable account when an employee files a Report of Expenses indicating a travel ticket was charged. Debit entries are made when a billing is received from the transportation supplier for the charged tickets and payment is made. We found the vouchers payable account, normally a credit balance account, had a debit balance of $16,811 at June 30, 1976, because some employees who had received charged tickets did not file a Report of Expenses, and USRA paid the airlines for the trips. We believe the debit balance which existed in the account for over a year should have indicated that USRA's accounting procedures for recording charged travel tickets needed improvement. Although USRA paid for all the charged tickets, it had no knowledge that all the trips were actually taken.

The USRA Comptroller told us that following an internal audit of USRA travel practices he randomly selected and reviewed 100 travel tickets and found that 9 had not been reported and in one case a trip was not made. USRA reported that the ticket had been lost in this one case and set up a receivable from the employee to recoup the funds paid to the airline for the trip never taken. In addition, USRA officials told us that since July 1, 1976, USRA had instituted improved internal controls over travel tickets by setting up a new account and subsidiary ledger maintained by employee name to handle charged travel tickets.

Errors in accrued contract holdback account

We reviewed accounting and procurement records to support the accrued contract holdback account balance of $291,387 and found that it was overstated by $60,227. The contract holdback account represents the amounts withheld from a contractor pending satisfactory completion of the contract.

USRA's internal auditors reported to the Comptroller that their limited review of four subsidiary contract holdback accounts totaling almost $200,000 indicated that errors existed in the accounts at March 31, 1976, but only one account was later corrected.

USRA said it had a complete review of contract holdbacks underway. It attributed the errors to misinterpretation of the information procurement technicians provided.

We suggested that the Chairman of the Board make certain that the subsidiary contract holdback accounts are reconciled at least quarterly with the Office of Procurement files to preclude this type of discrepancy from occurring in the future.

AGENCY COMMENTS

In a letter dated April 5, 1977, the Chairman of the Board stated that the review of the contract holdback account had been completed and the necessary corrections made. In addition, he told us that procedures now provide for a separate record to be maintained for each contract and for reconciliation of these records to the general ledger account each month.

CHAPTER 3

OTHER MATTERS CONCERNING OPERATIONS OF USRA

INADEQUATE DOCUMENTATION FOR ADMINISTRATIVE EXPENSES

Our work indicated that documentation to support selected administrative expenses was inadequate and that improvement was needed in internal controls over administrative expenses.

We noted that officials at USRA made major revisions to their policies to improve the adequacy of internal controls in response to our suggestions, USRA internal auditors, and others.

Travel

We examined travel expenses amounting to more than $221,000, or about 59.8 percent of a total of $369,938 incurred during fiscal year 1976. Because USRA travelers were not required to indicate the purpose of trips taken on supporting documentation, we were unable to make any judgments as to propriety. During our review, USRA issued a revised order which required travelers to note the purpose of any trips on Reports of Expenses.

USRA noted it had a management control system which required prior oral authorization for travel by officials delegated such authority and later approval of travel expense reports. We believe, however, that the management control system in effect before June 30, 1976, did not provide adequate control, especially over those employees who had been issued USRA travel credit cards.

On May 27, 1976, the USRA Comptroller issued a memo stating that all credit cards should be returned to USRA except where the individual could make a reasonable case that such action would be personally inconvenient. Based on the listing which accompanied the May 27, 1976, memo, USRA issued 31 airline credit cards and 26 car rental credit cards. As of January 6, 1977, seven airline credit cards and six car rental cards had not been returned to USRA. An USRA official said these employees had made a reasonable case that such action would be personally inconvenient. However, the only document justifying the inconvenience was a single memo dated August 31, 1976, stating that eight USRA employees "have a need for new air travel cards." The memo did not provide any details regarding personal inconvenience.

We also noted that during fiscal year 1976 petty cash funds were used to pay traffic fines in 20 instances. The fines, most of which were parking violations assessed on employees traveling on official business, totaled $190. USRA advised us that the payment of traffic fines is a proper exercise of its administrative discretion. We disagree and believe that the payment of traffic fines is an unauthorized expenditure of appropriated funds.

In addition, we believe issuing credit cards to USRA employees weakens internal control over travel and is unjustified in view of revised travel procedures. USRA employees can now purchase tickets through the Department of Transportation travel office and also receive a travel advance to cover the cost of travel, lodging, and other expenses. With these options available to USRA travelers, we believe that allowing even a small number of employees to have USRA credit cards continues to provide an opportunity for possible misuse of travel funds.

We suggested that the Chairman of the Board reevaluate the necessity for all outstanding airline and car rental cards.

Expenses to host meals, receptions, and public functions

Representation expenses include the costs incurred by USRA officials to host meals, receptions, and public functions sponsored by USRA. Documentation concerning the purpose for representation expenses was inadequate in numerous instances, although USRA regulations stipulate that any claim should be documented.

We reviewed 502 representation charges totaling $17,894 or about 50 percent of a total of about $36,000 expended during fiscal year 1976.

We found that there was a general lack of supporting documentation for representation expenses and a general failure to relate representation to the conduct of USRA business. Our review showed that of the 502 charges reviewed there were 346 1/ that lacked support in several ways in that:

--231 charges totaling $4,946 were not supported by an explanation of business purpose.

1/Total charges for the four categories exceed 346 because in a number of instances a single charge lacked support in several ways and was included under each applicable category.

--44 charges amounting to $643 were not supported by information concerning where the expenditures were incurred.

--45 charges amounting to $1,314 omitted the names and business titles of guests.

We also found 169 charges amounting to $7,068 were approved for payment by the same individual requesting reimbursement.

Expenses incidental to relocation of employees' residences

USRA employees may receive reimbursement for actual costs incurred in relocating, or they may elect to travel back and forth between their USRA place of employment and their preemployment residence and be paid for travel and subsistence expenses incurred.

USRA's order on relocation states that payments instead of relocating will not exceed the sum of the following:

(1) $4,000 instead of miscellaneous relocation and subsistence expenses.

(2) A predetermined amount instead of the cost of sale of residence, normally 7 percent of the sale value of the residence.

(3) A predetermined average cost of move instead of cost of shipment and storage of household goods.

Our review of moving expenses included an examination of all payments made instead of relocating their residence to the USRA duty station and a selected sample of travel folders for employees who actually relocated. We reviewed voucher payments amounting to $62,027, or about 92 percent of the total spent in fiscal year 1976 for relocation.

Disbursements made to USRA employees who actually relocated were properly approved and conformed with USRA regulations. However, the accounting records on those employees who received payments instead of relocating their residences to the Washington, D.C., area were not accurately maintained and did not contain enough documentation of the appraised value of the employees' preemployment residences.

We found that of the 16 employees who elected to receive payments instead of relocating only 2 provided the Association with an independent appraisal of their homes. In one of the two cases, the appraisal was not submitted until after USRA had already approved the ceiling for the employee's relocation expenses. Until December 21, 1976, when USRA issued its revised policy on relocation allowances, USRA employees were not required to obtain an appraisal from a recognized real estate brokerage firm. The sale value was based on the employee's estimation of the value of his property. Since no independent appraisals of employees' residences were requested before December 1976, we could not determine the reasonableness of the upper limits established for payments instead of relocating.

In comments furnished to us on April 5, 1977, USRA officials stated that USRA was satisfied, with one or two exceptions, that the market value estimate of the employee was reasonable, given the former salary of the employee and the geographic area in which his house was located. The Association also stated that the impact of any overestimate would not be significant because USRA used only 7 percent of the value of the house in setting a relocation ceiling. We believe, however, that requiring employees to submit an independent appraisal insures that employees are not overpaid.

At the time of our review, USRA's accounting manual required that ledger sheets be maintained for each employee to record the cumulative relocation expenses paid to each employee in order to determine that USRA dollar limits were not exceeded. Our analysis of 9 of the 16 travel folders for individuals receiving payments instead of relocating indicated that the ledger sheets were incomplete and numerous omissions had been made. Although we found no overpayments during our review of selected travel folders, we identified omissions on the ledger sheets totaling more than $20,000.

CONCLUSIONS

We are aware of the fact that USRA has acted to improve its policies concerning travel, representation, and relocation. We believe that issuing revised orders on travel, relocation, and representation; establishing an employee travel ticket account; reducing the number of outstanding USRA credit cards; and getting Board of Directors' approval of fiscal programs for representation have greatly increased internal controls over administrative expenses at USRA.

RECOMMENDATION

We recommend, however, that the Chairman of the Board of USRA further strengthen internal controls by reviewing employee travel files to make sure that ledger sheets for relocation are accurately maintained.

AGENCY COMMENTS AND
OUR EVALUATION

In a letter dated April 5, 1977, the Chairman of the Board said that all outstanding airline and car rental credit cards are being withdrawn. Concerning the ledger sheets, he said they were maintained on a very informal basis and had no accounting significance in that they are not used as posting media nor do they support general ledger control accounts.

While we agree that the ledger sheets do not serve as posting media, the purpose of the ledger sheets, as explained in the accounting manual, is to prevent the dollar limits for employee reimbursed relocation expenses from being exceeded.

EFFORTS INITIATED TO IMPROVE
INTERNAL AUDIT ACTIVITIES

We found that the audit coverage provided at URSA was limited, that there was no system for planning audits, and that systematic procedures for followup on recommendations contained in internal audit reports had not been implemented.

As of June 30, 1976, the Office of Audits had issued 30 formal audit reports since inception of the Association Nineteen, or about two-thirds of these, involved contractors and recipients of USRA assistance. The remainder were internal audits relating directly to USRA operations. The Office of Audits consists of the Director and an assistant. The Director reports to the Vice President for Administration who is responsible directly to the Chairman and Chief Executive Officer.

Audit coverage and planning

Internal audit reports relating directly to USRA operations covered USRA's petty cash fund, payroll activities, overtime costs, travel advances and expenses, voucher payment procedures and accounting records, the financial operations of the executive dining room, and selected aspects of financial presentations for inclusion in the

Preliminary System Plan. No formal audits were made of the results of USRA progress and there have been no audits of fixed assets which, as of June 30, 1976, included $246,810 of leasehold improvements and $343,991 of property items, such as furniture and equipment. According to the Director of Audits, there were frequent discussions between the property manager and his office about the development of property records, and that a physical inventory was planned which was to provide for Office of Audits participation but was later deferred due to other priorities.

At the time of our review, no formal audits were in progress and none were scheduled. Two internal audits were completed shortly before we started our review and, according to USRA officials, further internal audits were deferred to avoid duplicating our work.

Procedures for action and followup on audit reports should be implemented

Although USRA had provided a followup system on the auditors' recommendations, the procedures were not followed. We found there was no systematic followup on findings, observations, or recommendations contained in internal audit reports to determine whether satisfactory corrective action had been taken.

According to USRA Order 1974-22, written comments are required to be furnished to the Director, Office of Audits, within a maximum of 21 calendar days after transmittal of the draft report. Although the internal auditors did discuss the draft reports with the heads of audited offices, our review showed that written comments were furnished for all external audits of contractors but for only 7 of the 11 internal audit reports.

The heads of the audited offices are also required to issue an initial progress report to the Vice President for Administration within 30 days following the issuance of a final audit report. Progress reports on all recommendations which had not been implemented or rejected, as well as summary schedules of the status of other recommendations, were also to be submitted quarterly to the Vice President for Administration.

Our review showed that these provisions were not being followed. In addition, we found that no reports were furnished to the Chairman and Chief Executive Officer. As a result, there is no assurance that adequate consideration is being given to audit reports by management officials or whether management actions to accomplish necessary changes or correct deficiencies are actually implemented. The Director of Audits told us that day-to-day close contact with the operating personnel diminished the need for formal followup on audit recommendations.

After we brought these matters to the attention of the Vice President for Administration, the following actions were taken:

--A detailed plan covering USRA's internal audit activities for the next 2 years was prepared.

--The plan included both reviews of USRA programs and financial operations.

--A schedule of the status of action taken on previous recommendations included in all internal reports was completed.

RECOMMENDATION

To provide broader audit coverage of the financial and management operations of USRA and make sure that systematic followup procedures are implemented, we recommend that the Chairman of the Board have periodic reports provided to him on the extent to which the planned internal audit activities are implemented and the status of recommendations contained in future internal audit reports.

AGENCY COMMENTS AND OUR EVALUATION

In an April 5, 1977, letter USRA agreed to implement our recommendation. USRA mentioned, however, that the report did not acknowledge that the audit staff consisted of two persons with a wide range of responsibilities. USRA also commented that while it can be stated that no formal internal reviews were made of program activities, recognition should be given to the participation of the USRA Office of Audits at various stages of the different programs, such as the 215 and 211 (h) programs (Sections 211 and 15 of the Regional Rail Reorganization Act of 1973, as amended, authorized USRA to provide financial assistance to the bankrupt railroads). According to USRA officials, the continuous involvement of the Office of Audits in the 215 program precluded the necessity of a post-review. USRA's Office of Audits also actively participated in the formulation of USRA policies and procedures. USRA officials believe that such active participation in USRA activities mitigates the need for formal audit.

We believe, however, that the active participation of the USRA auditors impairs their independence and diminishes their objectivity. One of the basic principles of internal auditing is that an internal auditor should not be given direct operating responsibilities nor should the auditor have the authority to direct changes in the organization's procedures. The primary function of the auditor is to direct particular attention to matters requiring corrective action and to maintain an independent outlook on all his work so that his opinions, conclusions, judgment, and recommendations are impartial. Such independence, impartiality, and objectivity are lost when the internal auditors actively participate in program activities of their organization.

NEED TO IMPLEMENT OUR PREVIOUS RECOMMENDATIONS

In our report to the Chairman, Subcommittee on Oversight and Investigations, House Committee on Interstate and Foreign Commerce, entitled, "Improvements Needed in Procurement and Financial Disclosure Activities of the U.S. Railway Association" (RED-76-41, dated November 5, 1975) we made recommendations to the Chairman of the Board of Directors to correct the weaknesses noted. During our recent examination of the financial records at USRA, we attempted to determine the extent to which USRA had implemented those recommendations.

Financial disclosure system

Recommendations partially implemented

In our November 1975 report, we recommended that USRA develop specific guidelines for reviewing the financial interests of USRA employees. Our followup work has shown that USRA issued an order establishing procedures in compliance with regulations published in the Federal Register by the Secretary of Transportation on January 30, 1974, governing USRA employee responsibility and conduct. However, USRA still has not developed specific guidelines containing criteria for determining conflicts in reviewing the financial interests of USRA employees. The order does, however, institute specific procedures for implementing several other recommendations made in our November 1975 report.

For example, we recommended that USRA publish a list in the Federal Register of positions for which employees are required to submit financial statements. Although this list has not been published in the Federal Register, USRA included in its order the positions for which employees are required to submit statements of employment and financial interest. According to the Assistant General Counsel responsible for the financial disclosure system at USRA, USRA has no authority to publish such a list in the Federal Register. We were told that USRA did discuss the publication of this list with Department of Transportation officials but no action was taken.

We recommended also that USRA enforce the reporting requirements and that involved employees, in fact, file within 30 days after entering employment. The new order prescribes that the Director of Personnel notify in advance all employees and consultants required to file a statement of employment and financial interest and followup and maintain a control record to insure that all employees required to file a statement do so.

As a test check of the system since our last report, we examined the financial disclosure statements for USRA employees who entered employment at USRA between January 1 and June 30, 1976. We found that, of the 17 employees who entered employment at USRA after January 1, 1976, all had submitted financial disclosure statements within the required 30-day period.

In our previous report we recommended that the Chairman require the reviewing official to sign and date financial disclosure statements to indicate they have been reviewed for possible conflicts of interest. Our test check revealed that, although some review of financial disclosure statements was evident, the Assistant General Counsel still did not sign or date the statements. As a result, there is no way to determine whether both statements had been reviewed for employees who submitted both initial financial disclosure statements and supplementary statements in the same fiscal year. USRA Order 1976-2 requires the reviewing officer to review all statements within 30 days after receipt and resolve conflicts of interest as soon as possible thereafter. We could not determine whether he was, in fact, complying with USRA's own orders since the reviewing officer did not date all of his reviews.

Recommendations not implemented

In our November 1975 report, we also recommended that USRA publish a list of positions for which the exemptions of appendix I 1/ of the published regulations do not apply or appropriately amend the regulations. The Assistant General Counsel stated that such positions do not exist at USRA, so the appendix would have neither meaning nor use. He stated that he would recommend deleting the appendix should the Department review the regulation. However, according to an official in the Office of General Counsel, Office of the Secretary of Transportation, no actions were being taken to amend or revise USRA's regulations.

We reviewed the supplementary financial disclosure statements of 54 USRA employees. We found no apparent conflicts of interest, according to USRA regulations, which are in general more liberal than Federal agencies' regulations. We noted, however, that USRA had taken no action regarding three holdings identified in our previous report as appearing to be conflicts of interest, and we identified five additional questionable holdings.

For example, in reviewing the supplementary financial disclosure statement of a prominent official under the Vice President for Administration, we noted his wife owns stock in an air freight carrier which could possibly be viewed as an alternate mode competitor with Conrail. When we questioned the Assistant General Counsel about this holding, he said that he had not inquired about it and that possibly he should have. But he reiterated that the ownership was secondary (that of the wife of an employee in a portfolio of 30 stocks) and the employee himself did not occupy a position where policy decisions could be made, therefore, there was probably little possibility of a conflict of interest.

Recommendation fully implemented

USRA Order 1976-2 requires the General Counsel to report on his review of the initial and supplementary statements not later than October 1 of each year which should include the number of statements received and a summary of the results of his review. This action was recommended in our previous report.

1/ Appendix 1 of the published regulations lists categories of financial interest which are deemed to be too remote or too inconsequential to affect the integrity of an employee's services in any manner in which he may act in his official capacity.

In his report to the Chairman dated October 1, 1976, the Assistant General Counsel noted that he had received 105 financial statements for the period ended June 30, 1976 (these included 85 supplementary statements and 20 new statements). He also mentioned that after review and consultation with employees, he found that no new employee had reported any employment or financial interest which could be considered to represent a material conflict of interest.

Recommendations

We recommend that the Chairman of the Board of USRA require the reviewing official to:

--Establish specific guidelines containing criteria for determining conflicts in reviewing the financial interests of USRA employees.

--Sign and date financial disclosure statements to indicate they have been reviewed and a determination has been made that the financial interests are not conflicts of interest.

We also recommend that the Chairman request the Secretary of Transportation to take the necessary action to make sure that:

--The list of positions required to submit financial statements for appendix 2 of USRA regul tions is published in the Federal Register.

--The list of positions for which the exemptions of appendix 1 do not apply is published in the Federal Register or the regulation pertaining to appendix 1 is appropriately amended.

Agency comments and our evaluation

In a letter dated April 5, 1977, USRA stated that based on the results of our work, the Assistant General Counsel had agreed to sign and date financial disclosure statements. USRA officials also told us that a memo was being prepared advising the Department of Transportation of our views and suggesting appropriate language to take the action recommended by us concerning appendixes 1 and 2 of the Department's regulation governing USRA employee responsibility and conduct.

USRA continues to maintain, however, that the standards for determining conflicts promulgated by the Secretary of

Transportation, are sufficiently specific. The position of USRA is that it is impossible to articulate generally applicable specific standards because a determination of conflicts represents a balancing of factors.

While we agree that a determination of a conflict represents a balancing of factors, we believe these factors should be discussed either in the regulations or in the implementing order USRA issued on August 3, 1976, so that the same criteria are applied by the reviewer in determining conflicts of interest. In addition, without specific guidelines another individual in the position of reviewer may not exercise the same judgment.

Procurement activities

In the November 1975 report, we recommended that only contracts in which the basic elements of competition are present be classified as competitive. We cited the following minimum actions to be taken before an award could be considered competitive:

--Firms to be considered should be contacted and made aware of the requirements of the needed services.

--Firms should be given an opportunity to make a proposal if interested.

--Selection should be made generally on a basis of written proposals, including price, made by firms and evaluated according to established criteria.

During our review USRA issued a new order on procurement canceling its previous procedures for expedited procurements. However, the order on procurement policy does not specifically define competition, and in a contract summary report furnished to us, USRA classified procurements competitive using the criteria in its order on expedited procurement.

We further recommended in our November 1975 report that criteria be developed to determine which contracts are to be submitted and approved by the Board. Although the procurement policy states that awards in excess of $100,000 or those that significantly impact on the substantive operations of USRA will be submitted, we believe the policy is too imprecise and creates doubt as to which contracts are to be approved by the Board.

Recommendations

We recommend that the Chairman of the Board incorporate appropriate language in the order on procurement so that only contracts where competition was present are classified as competi[illegible] and that more precise criteria be established to leave no doubt as to which contracts are to be submitted and approved by the Board.

Agency comments and our evaluation

In a letter dated April 5, 1977, USRA told us that the order on procurement policy issued January 31, 1977, describes competitive procedures that are consistent with the definition suggested by us and that in the future, contracts will be listed as competitive only if they meet the criteria of the competitive procedures noted in the revised order.

However, USRA may not always be successful in obtaining competition when the procedures in USRA's order on procurement policy are used. We believe the competitive classification should be limited to those cases where the competitive procedures are successful in eliciting competition.

Where an award is classified as competitive, there should be at least two responsible offerors who can satisfy the requirements of the solicitation and who independently compete for the contract by submitting priced offers responsive to the expressed requirements of the solicitation and the award is made at the lowest evaluated price.

With regard to the criteria for submission of contracts to the Board of Directors for approval, USRA told us that all officers and employees of USRA who are involved in the procurement process are aware that all contracts over $100,000 and those of a lesser amount, if they significantly impact on the substantive operations of USRA must go to the Board for approval.

We believe, however, that the procurement order should be appropriately revised to make certain what USRA considers a competitive contract and which contracts are to be submitted to the Board of Directors for approval.

CHAPTER 4

SCOPE OF AUDIT AND OPINION ON FINANCIAL STATEMENTS

We have examined the United States Railway Association's financial statements for the fiscal year ended June 30, 1976. We made our audit in accordance with generally accepted auditing standards and included such tests of USRA's accounting records and financial transactions for the fiscal years ended June 30, 1975 and 1976, and such other auditing procedures as we determined necessary.

In our opinion, except with respect to the accounts discussed below, the accompanying financial statements (schedules 1, 2, and 3) present fairly USRA's financial position at June 30, 1976, and the results of its operation and the change in its financial position for the fiscal year then ended, in conformity with the principles and standards of accounting prescribed by the Comptroller General of the United States.

--As explained on page 1, USRA property records did not permit a complete substantiation of the furniture and equipment balance of $343,991 at June 30, 1976.

--As explained on page 7, a temporary improvement costing $14,494 was erroneously capitalized and included in the $246,810 balance of leasehold improvements.

--As explained on page 7, the prepaid expenses balance of $16,331 contains services totaling $15,906 that have been received causing a material misstatement of prepaid expenses.

--As explained on pages 8 and 9, because USRA is seeking reimbursement from FRA for expenses specifically excluded from a reimbursable agreement, the accounts receivable balance of $621,588 is overstated by $15,426.

--As explained on page 9, the loans receivable balance of $85,224,148 is understated by $74,282, because USRA did not show net interest income in its balance sheet but reduced loans receivable instead.

--As explained on pages 10 and 11, the vouchers payable and travel expenses accounts were understated at June 30, 1976, by at least $16,811, and the

$291,387 accrued contract holdback account balance was overstated by $60,227 due to errors in the accounting and procurement records.

UNITED STATES RAILWAY ASSOCIATION

STATEMENT OF FINANCIAL CONDITION

AT JUNE 30, 1976

ASSETS

Letter of credit (fund 98X0100)	$ 52,300,000	
Less: withdrawals	43,620,000	$ 8,680,000
Letter of credit (fund 98X0111)	500,000,000	
Less: withdrawals	309,300,000	190,700,000
Cash:		
Regular		19,021
Special		125,149
Payroll		1,000
Imprest fund		1,500
Conrail securities		309,300,000
Accounts receivable		621,588
Prepaid expenses		16,331
Travel advances		12,042
Loans receivable		85,224,148
Fixed assets:		
Equipment	343,991	
Leasehold improvements	246,810	590,801
Deferred debits		2,236
Total assets		$595,293,816

LIABILITIES AND INVESTMENT OF U.S. GOVERNMENT

Liabilities:		
Accrued contract holdbacks		$ 291,387
Accrued salaries		6,034
Accrued expenses		114,836
Accrued fringe benefits		665,935
Payroll taxes withheld and accrued		67,076
Other--individual payroll deduction		30,438
Total liabilities		$ 1,175,706
Investment of U.S. Government		
Unobligated budget authority:		
Appropriation (fund 98X0111)	$190,700,000	
Appropriation (fund 98X0100)	6,148,586	$196,848,586
Undelivered orders		
Appropriation (fund 98X0100)		2,029,427
Amounts closed to assets:		
Appropriation (fund 98X0111)	309,300,000	
Appropriation (fund 98X0100)	590,801	309,890,801
Loans payable to Federal Financing Bank		85,349,296
Total investment of U.S. Government		594,118,110
Total liabilities and investment of U.S. Government		$595,293,816

GAO's opinion on these financial statements appears on pages 25 and 26.

The notes on page 30 are an integral part of this statement.

UNITED STATES RAILWAY ASSOCIATION

SUMMARY OF SOURCES AND APPLICATION OF FUNDS

FISCAL YEAR ENDED JUNE 30, 1976

Sources of funds:	
Appropriation for purchase of Conrail securities	$500,000,000
Appropriation for administrative expenses	22,300,000
Funds borrowed from the Federal Financing Bank	51,461,823
Total	$573,761,823
Application of funds:	
Purchase of Conrail securities	$309,300,000
Purchase of fixed assets	62,829
Operating expenses	18,065,222
Loans under Sections 211 and 215	51,606,862
Increase in working capital (note a)	194,726,910
Total	$573,761,823

a/ The amount by which total current assets exceeds total current liabilities is referred to as working capital. At June 30, 1976, and June 30, 1975, USRA's working capital balance was $198,986,830 and $4,259,920, respectively. The $194,726,910 increase in working capital at June 30, 1976, is represented by the difference between the two amounts.

GAO's opinion on these statements appears on pages 25 and 26. The notes on page 30 are an integral part of this statement.

SCHEDULE 3

EXPENDITURES FOR ADMINISTRATIVE EXPENSES FOR THE

CURRENT FISCAL YEAR AND CUMULATIVE

AT JUNE 30, 1976 (note b)

Organization	Personnel		Administrative services		Contractual services		Total	
	Current fiscal year	Cumulative	Current fiscal year	Cumulative	Current fiscal year	Cumulative	Current fiscal year	Cumulative
Chairman, Board of Directors	$ 246,531	$ 556,323	$ 50,997	$ 117,202	$ 86,278	$ 191,705	$ 383,806	$ 865,230
President	178,061	531,214	7,078	14,389	89,378	685,022	274,517	1,230,625
General Counsel	569,131	877,761	[illegible]6,957	47,572	2,027,911	3,161,591	2,633,999	4,086,924
Congressional Affairs	238,496	401,352	5,[illegible]9	11,347	8,750	8,750	252,795	421,449
Administration	1,353,573	3,036,613	1,745,979	3,994,889	215,210	463,344	a/3,314,762	a/7,494,846
Strategic Planning	482,947	797,453	24,021	37,649	228,929	470,456	735,897	1,305,558
Public and Governmental Affairs	552,885	1,198,428	34,325	67,45[illegible]	18,735	[illegible]8,561	605,945	1,344,442
Finance	995,492	2,009,683	36,157	69,453	4,809,990	9,052,842	5,841,639	10,131,982
Operations	1,560,529	4,047,812	163,992	425,605	2,230,711	12,230,294	3,955,232	16,703,711
Manpower Planning	85,975	390,230	1,351	4,833	42,133	142,157	129,459	c/ 537,220
Total	$6,263,620	$13,846,869	$2,106,406	$4,790,396	$9,758,025	$25,484,722	$18,128,051	$44,121,987

a/Includes funds for common facilities and services for the organization; e.g., space, building alterations, furniture, equipment, utilities, communications, and supplies.

b/Outlays of cash plus unpaid accrued expenditures.

c/Total expenditures for Manpower Planning is overstated by $14,703. This is due to vouchers totaling $12,333 which should have been recorded under Operations and $2,370 under Finance.

GAO's opinion on these financial statements appears on pages 25 and 26. The notes on page 30 are an integral part of this statement.

UNITED STATES RAILWAY ASSOCIATION

NOTES TO FINANCIAL STATEMENTS

JUNE 30, 1976

1. Summary of important accounting policies

The prescribed accounting period for USRA is the calendar month, with provision for preparing operating and financial statements monthly.

Expenditures for personnel services, fringe benefits, employee travel, representation, training, and relocation are on the basis of accrued expenditures with goods and contractual services on a cash basis.

The letters-of-credit amounts correspond with USRA's overall budgetary appropriations as enacted and amended by the Congress. USRA also obtains funds for loans to railroads by borrowing from the Federal Financing Bank. The funds are deposited in a special account, and disbursements are made only for loans to railroads and for principal and interest payments to the Federal Financing Bank.

2. Fixed assets are included at acquisition cost and are not depreciated because USRA does not attempt to develop cost accounting information concerning its activities.

3. Contract holdbacks refer to amounts withheld from a contractor under a cost-reimbursement type contract, pending satisfactory completion of the contract. The amount of holdback is determined in accordance with the terms of the contract.

4. Amounts closed to assets is a credit balance account representing the value of physical property and investments which have been capitalized in asset accounts.

5. The deferred debit account represents unusual or non-recurring transactions which have not been provided for elsewhere. Items are recorded in the account, pending later analysis and distribution to more appropriate accounts.

United States Railway Association
2100 Second Street, S W
Washington, D C 20595
(202) 426-1991

Arthur D Lewis
Chairman of the Board

April 5, 1977

Mr. Henry Eschwege
Director
Community and Economic
Development Division
General Accounting Office
Washington, D. C. 20548

Dear Mr. Eschwege:

Enclosed for your consideration are the comments of the United States Railway Association on the draft of the General Accounting Office's proposed report to the Congress titled "Comments on Financial Statements and Other Matters Concerning Operations of the United States Railway Association".

The Association would like to express its appreciation for the thorough and conscientious way in which the auditors have conducted this first comprehensive review of USRA pursuant to the Government Corporation Control Act, as amended. On our part, we have done everything in our power to assure that the auditors received the fullest cooperation in the performance of their review.

We are also pleased and grateful that GAO procedures call for this opportunity to review a proposed report in draft and for the audited agency to supply comments. I am convinced that the result will be a final report of enhanced accuracy and increased usefulness.

The Association fully realizes that the GAO has the obligation to conduct business type audits of government corporations such as USRA. We also attempt to benefit from these reviews, and I assure you that in each instance in which the final report documents the need for an improvement of an agency practice corrective action will be taken at once. In fact, as the audit has proceeded we have been making numerous improvements in the way in which the Association conducts its internal management. In some instances, these changes were stimulated by informal discussions or preliminary drafts generated by the GAO audit, but in most cases they have been the result of a comprehensive effort to review and update the Association's administrative policies and procedures which I initiated in April of 1976.

We realize that the fiscal period covered by the audit closed on June 30, 1976 and that some of the report's observations will reflect conditions found as of that date. We are concerned, however, that both the digest of the final report and the detailed text reflect fully the improvements instituted by the Association over the past nine months. You will note that relatively few of the practices or financial discrepancies about which the auditors have expressed reservations as of June 30, 1976, have escaped corrective action by the Association during the intervening months.

[See GAO note on this page.]

In this connection it should be recognized that until April 1, 1976 the Association's activity revolved primarily around the development and implementation of a systems plan for the restructuring of the northeastern bankrupt railroads. Since that date the Association's mission has undergone a substantial change and it is now engaged chiefly in the financial and operational monitoring of Conrail, the administration of financial assistance to Conrail and the defense of the Final System Plan against legal attack. We have made strenuous efforts to adjust the ways in which the Association conducts its business to reflect both the experience of the last three years and the changes which have taken place in the character of our mission.

GAO note: Deleted comments refer to matters not pertinent to this review.

As you know, the draft report covers procedures and areas not directly concerned with the financial statements. It is, therefore, our hope that with respect to differences of opinion between the auditors and the Association, the views of the Association, as well as significant explanations of the various conditions noted, will be made part of the final report.

We thank you again for the opportunity to review and comment on the draft report.

Sincerely,

Enclosure

ATTACHMENT
Page 1 of 7

U. S. RAILWAY ASSOCIATION COMMENTS
RE GENERAL ACCOUNTING OFFICE DRAFT REPORT

"COMMENTS ON FINANCIAL STATEMENTS AND OTHER MATTERS
CONCERNING OPERATIONS OF THE UNITED STATES RAILWAY ASSOCIATION"

Recommendation
(Page 6 of the GAO Draft Report)

The revised USRA accounting manual provides that a physical inventory of all nonexpendable property will be taken periodically but not less often than every two years. However, in order to assure the adequacy and effectiveness of current improved procedures, a physical inventory will be scheduled during the next year.

Missing Items Not Reported
(Pages 6-8 of the GAO Draft Report)

The draft report states that the lack of timeliness in filing a report of loss along with the $100 deductible per item has kept the insurance recovery down. In this respect, the report does not recognize the fact that these late reported losses occurred during periods of heavy pressures, long hours and maximum efforts in meeting severe legislative deadlines. Further, the report fails to consider the reduced insurance premiums when a "$100 deductible" provision is included in the insurance coverage.

Prepaid Expenses
(Page 9 of the GAO Draft Report)

An appropriate adjustment in the amount of $15,906 was made to the Association's prepaid expenses account on August 31, 1976, thereby correcting the overstatement appearing on the June 30, 1976 statements.

Current procedures provide for the periodic review and analysis of account balances.

Accrued Expenses
(Pages 13-14 of the GAO Draft Report)

The selective review performed by the USRA's Comptroller's Office was done as a follow-up of an internal audit report. It should be noted that in the case cited where a trip was not made, the ticket was lost and never used by the employee.

[See GAO note on this page.]

GAO note: Deleted comments refer to material discussed in our draft report but not included in this final report.

Contract Holdbacks
(Page 14 of the GAO Draft Report)

We agree the subsidiary contract holdback records were not in agreement with the general ledger control account. A review has been completed and necessary corrections made.

Current procedures provide for a separate record to be maintained for each contract and for reconciliation of these records to the general ledger account each month.

Expenses Incident to Relocation of Employee's Residence
(Pages 18-19 of the GAO Draft Report)

The draft report notes that USRA did not require an appraisal from a recognized real estate broker in order to establish a value for an employee's residence. The ceiling for payments in lieu of relocation was based in part on the market value of the employee's residence. Association staff was satisfied with one or two exceptions that the market value estimate of the employee was reasonable given the former salary of the employee and the geographic area in which his house was located. Since the Association used only seven percent of the value of the house in setting a relocation ceiling, the impact of any overestimate would not be significant.

The GAO report states that "in addition, our analysis of travel folders for individuals receiving payments in lieu of relocating indicated that numerous errors were made on the ledger sheet maintained in each folder." The report further includes a dollar difference between the amounts of paid vouchers contained in the folder and the "ledger sheets."

The "ledger sheets" constitute "cuff" records which are maintained on a very informal basis. They have no accounting significance in that they are not used as posting media nor do they support general ledger control accounts. No overpayments have been made nor does the GAO report include findings of overpayments because of inaccuracies in the "cuff" records. The sum of each employee's paid vouchers are reviewed from time to time to assure that payments made to him do not exceed his authorized limits. The GAO report attempts to attach a level of significance to the cuff records that is not deserved.

A regular annual review for the purpose of preparing a W-2 is conducted and no employee is cleared for termination without a detailed check of his payment record being made. We believe we have adequate safeguards to prevent any actual overpayments and our own check of these records in December and January did not reveal any significant errors during calendar year 1976.

Recommendation
(Page 20 of the GAO Draft Report)

While much comment is made in the draft report as to the possible adverse effects of the use of credit cards, their use is no different from the use of books of Transportation Requests in Federal agencies. However, all travel credit cards are being withdrawn at the request of the Chairman.

Efforts Initiated to Improve Internal Audit Activities
(Pages 20-22 of the GAO Draft Report)

The GAO draft audit report suggests many limitations of the internal audit activities within USRA. However, there is no acknowledgement that the audit staff, which consisted of only two persons, had a wide range of responsibilities in addition to internal audit. Further, the several references in the audit report to internal audit accomplishments tend to belie such implied limitation.

The draft report criticizes the lack of a formal audit plan. In this matter, it was the opinion of USRA management that a formal audit plan was not feasible in a new and changing organization. Management chose to use the small audit staff in those areas where it could be of maximum assistance to the Association.

While a formal internal audit plan had not been developed prior to the GAO review, the wide areas of internal audit coverage evidences a responsible approach to internal audit. The selection of sensitive areas for review can be evaluated on the basis of the conditions noted in the internal audit reports. Copies of all USRA internal audit reports were furnished to the GAO staff at the beginning of the audit engagement. The findings contained in those reports no doubt provided leads for audit coverage to the GAO staff.

Audit coverage and planning. The report states "No formal audits were made of the results of Association progress . . . ." This has been interpreted as meaning that no formal audits were made of the Association program activities.

While it can be states that no formal internal reviews were made of program activities, recognition should be given to the participation of the USRA Office of Audits at various stages of the different programs. For example, the extensive work done by the Office of Audits in connection with the Section 215 Program. The continuous involvement of the Office of Audits in this program precluded the necessity of a post-review. Management was currently apprised of the progress of the program through reports and informal discussions.

The Office of Audits review of the financial presentation in the Preliminary System Plan was a review of program activity. The conclusion reached by the Office of Audits in reference to a major area "Modified

Betterment Accounting" was the same conclusion that was adopted by USRA in developing the Final System Plan.

As to the Section 211(h) program, the Office of Audits assisted in the preparation of the request for proposals sent to prospective contractors and participated in the contractor selection. Subsequently, it was the Office of Audits that disclosed the conflict of using Section 211(h) funds for the payment by the estates of Section 215 vendors invoices; a matter which is now before the court.

Also, the active participation of the Office of Audits in the formulation of USRA policies and procedures mitigates the need for formal audit, especially during the initial stages of implementation.

Procedures for action and follow up on audit reports should be implemented. While formal follow-up action on implementation of recommendations was not taken, it was found that the day-to-day close contact between the audit staff and the operating personnel in a small organization diminished the need for such formal follow up. Prior to the start of the GAO review, the Office of Audits was requested by the Vice President for Administration to prepare a schedule of the status of action taken on prior internal audit recommendations. The schedule was completed during the GAO review.

Recommendation. Periodic reports will be provided to the USRA Chairman setting forth the progress of the internal audit program and the status of recommendations contained in future internal audit reports.

Financial Disclosure System
(Pages 23-28 of the GAO Draft Report)

USRA published an Order August 3, 1976 on the subject of "Employee Responsibility and Conduct" which was distributed to all employees and consultants. This Order establishes responsibility for review and control of the program along with reports to the Chief Executive Officer.

Page 23 of the draft GAO report states that "USRA still has not developed specific guidelines containing criteria for determining conflicts and reviewing the financial interests of USRA employees." Further, in the draft report it is recommended that USRA establish specific guidelines containing criteria for determining conflicts in reviewing the financial interests of USRA employees. In response to this same issue in a previous draft GAO report, USRA's Chairman commented, in his letter of October 7, 1975 that the current guidelines in the regulations, the standards promulgated by the Secretary of Transportation, are sufficiently specific. The determination of conflict represents a balancing of factors -- extent of financial interest, duties of employee involved, ability to influence particular decisions, etc. It is impossible under the circumstances to articulate generally applicable specific standards. If the auditors believe otherwise, USRA would be glad to consider such recommendations for transmittal to the Secretary of Transportation who (not USRA) is the only one who can adopt such standards.

Pages 25 and 26 of the draft report states that the November 5, 1975 report recommended that a list of positions for Appendix 1 be published in the Federal Register. The USRA Assistant General Counsel stated that Appendix 1 had neither meaning nor use, and that a recommendation would be made to the Department of Transportation to delete this part of the regulation. The draft report states that a check was made with an official in the Office of General Counsel, Department of Transportation who said no actions were being taken to amend or revise USRA's regulations. The draft report does not identify the General Counsel official in the Department of Transportation who said no action is being taken. There has been discussion between USRA General Counsel and the General Counsel of the Department of Transportation on this issue, going back to June 1976. With the personnel turnover at the Department of Transportation, it is understandable how the recommendation could have been dropped. The Association, is however, taking formal action to submit a new recommendation to the Department of Transportation.

Page 26 of the draft report states that "we reviewed the supplementary financial disclosure statements of 54 employees at USRA. We found no apparent conflicts of interest according to the regulations for USRA, which are in general more liberal than Federal agencies' regulations." (underscoring supplied) The regulations published by the Secretary of Transportation are the standards which USRA must use. Therefore, it is suggested that the underscored comments be deleted since they are inappropriate. The draft goes on to state that there are eight holdings which could be viewed as questionable, some of which had been identified in the previous report. All but one of the eight cases had been identified in a previous report. Therefore, a question is raised as to whether any useful purpose is being served in reporting such cases again when both USRA and GAO are of the opinion that there is no apparent conflict of interest. In this connection, there is quoted from the Chairman's letter to the Comptroller General, dated November 17, 1975, in mention to the previous report.

"Again, it is the intention of USRA to carry out the letter and spirit of the legal and regulatory provisions that govern our activities and this we clearly did in matters of financial disclosure. Had the Secretary's requirements been more stringent, as GAO apparently believes they should have been, I can assure you that we would still have complied faithfully with them.

"Unfortunately, the tone of the report suggests that the cases listed on page 30 and on pages 32 and 33 constitute departures from conflict of interest standards which the GAO feels should be applied to mixed-ownership corporations. We feel that there is virtually no potential for significant conflict in the cases cited. For example, airlines are not significant competitors of freight-hauling railroads. Nor does the holding of a small amount of stock in a railroad outside of the region present any serious problem of conflict. I also have difficulty conceiving of any standard which would make the holding of fifty shares of stock in a motor vehicle manufacturer a conflict of interest for an USRA official, particularly since the staff member is an editor without any policy responsibility whatsoever."

Recommendations (Page 27).

1. "Establish specific guidelines containing criteria for determining conflicts in reviewing the financial interest of USRA's employees." Based on the above discussion, it is recommended that this be deleted unless there are some specific suggestions for improving the standards published by the Secretary of Transportation.

2. "Sign and date financial disclosure statements to indicate they have been reviewed and a determination has been made that the financial interest are not conflicts of interest." As the draft report indicates, the Assistant General Counsel agreed to sign and date all financial disclosure statements in the future.

3. "We also recommend that the Chairman request the Secretary of Transportation to take the necessary action to insure that:

   -- The list of positions required to submit financial statements for appendix 2 of USRA regulations is published in the Federal Register.

   -- The list of positions for which the exemptions of appendix 1 do not apply is published in the Federal Register or the regulation pertaining to appendix 1 are appropriately amended."

A memorandum is being prepared advising the Department of Transportation of GAO's views and suggesting appropriate language to take the action GAO recommends concerning appendix 1 and appendix 2 of the Department's regulations governing USRA employee responsibility and conduct.

Procurement Activities
(Pages 28-29 of the GAO Draft Report)

The USRA Order on procurement policy and procedures, as revised January 31, 1977, includes information concerning competition which is very similar to the definition suggested by GAO. Future reports on contracts will list as competitive those which meet the criteria noted in Section 6 of the revised procurement order, copies of which have been provided to the GAO audit staff.

The auditors suggest that the procurement order is too imprecise and leaves doubt as to which contracts are to be approved by the Board. There is no doubt within USRA as to which contracts must go to the Board for approval. The procurement order, prior to issuance, was thoroughly discussed at several staff meetings, was explained in detail to the USRA Board and was approved by the Board. All officers and employees of USRA who are in any way involved in the procurement process are well aware that all contracts over $100,000 must go to the

Board for approval. Other contracts of lesser amount which significantly impact on the substantive operations of USRA must also go to the Board for approval. It is, therefore, USRA's opinion that the procurement order is well understood and sufficiently explicit in its present form.

Opinion on Financial Statements
(Page 30-31 of the GAO Draft Report)

GAO note: Deleted material suggested minor changes to the report. We have considered these changes in this final report.

PRINCIPAL OFFICIALS OF USRA HAVING MANAGEMENT RESPONSIBILITIES ASSOCIATED WITH MATTERS DISCUSSED IN THIS REPORT

	Tenure of office	
	From	To
CHAIRMAN AND CHIEF EXECUTIVE OFFICER:		
William K. Smith (acting) (note a)	July 1977	Present
Arthur D. Lewis (note b)	July 1974	June 1977
PRESIDENT AND CHIEF OPERATING OFFICER:		
Donald C. Cole (acting) (note a)	July 1977	Present
James A. Hagen (note c)	July 1975	May 1976
Edward G. Jordan	Mar. 1974	July 1975
GENERAL COUNSEL:		
Cary W. Dickieson	June 1976	Present
Jordan J. Hillman	Feb. 1975	May 1976
VICE PRESIDENT FOR ADMINISTRATION:		
Alan L. Dean	Mar. 1974	Present
COMPTROLLER:		
William H. Bozman	June 1974	Present

a/ Mr. Cole assumed the functions of the Chief Executive Officer on the resignation of Arthur D. Lewis in June 1977.

b/ Before this confirmation date, Mr. Lewis served USRA as a consultant.

c/ Mr. Lewis assumed the functions of the office of the President on the resignation of James A. Hagen in May 1976.