AMTRAK CORPORATE GOVERNANCE:

Implementing a Risk Management Framework is Essential to Achieving Amtrak's Strategic Goals

Memorandum

To: Thomas C. Carper, Chairman, Board of Directors
Joseph Boardman, President and CEO

From: Ted Alves

Date: March 30, 2012

Subject: *Amtrak Corporate Governance: Implementing a Risk Management Framework is Essential to Achieving Amtrak's Strategic Goals* (Report No. OIG-A-2012-007)

Both federal agencies and publicly traded companies have established processes to manage risk in order to help achieve their strategic goals and objectives. Amtrak's Board of Directors plays a key role in ensuring that the company accomplishes its stated goals in an efficient and effective manner. With the addition of three Board members since June 2010, the Board now has greater capacity to fulfill its governance responsibilities for Amtrak programs and operations. To better understand the company's approach to managing risk, the Board asked that we audit Amtrak's risk management process. This report provides the results of that audit.

Risk management provides a mechanism to identify and deal with any risk, but focuses on risks that could prevent a company from reaching its objectives. The enterprise risk management (ERM)[1] framework is widely used and generally regarded as a best practice model that organizations can use to deal effectively with potential future events that can adversely affect company operations, and to ensure that business processes and

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[1] The Committee of Sponsoring Organizations of the Treadway Commission (COSO) published *Enterprise Risk Management—Integrated Framework* in September 2004.

internal controls are operating effectively and efficiently. The key milestones in developing the current model of an ERM framework are summarized below.

In 1992, the Committee of Sponsoring Organizations of the Treadway Commission (COSO) published a document entitled *"Internal Control—Integrated Framework."* This document provided a framework for establishing a system of internal controls and provided evaluation tools that businesses and other entities could use to evaluate their control systems. The internal control framework consists of five interrelated components: control environment, risk assessment, control activities, information/communication, and monitoring.

This 1992 internal control framework was a precursor to COSO's 2004 *Enterprise Risk Management—Integrated Framework,* a roadmap to provide companies with a methodology for managing risks as well as taking advantage of opportunities to grow their businesses. That model consists of eight interrelated components: (1) the internal environment, (2) objective setting, (3) event identification, (4) risk assessment, (5) risk response, (6) control activities, (7) information and communication, and (8) monitoring.

Our objectives were to (1) determine the extent to which Amtrak manages risk in a corporate-wide, systematic manner; and (2) identify risk management best practices in public and private organizations and compare those with Amtrak's risk management activities. We used the COSO framework as a best practice to help us accomplish our objectives. For a detailed discussion of our audit scope and methodology, see Appendix I.

SUMMARY OF RESULTS

Amtrak currently does not have a formal, coordinated, and systematic enterprise-wide framework for identifying, analyzing, and managing risk. As our work progressed it became clear that Amtrak managers and executives do identify and mitigate risks. However, these efforts are often ad-hoc and narrowly focused on operational or compliance risks within individual departments. For example, Amtrak senior managers identify risks within their units based on their experience and knowledge of operations, and establish controls to address these risks within their units. However, because the company has not established a risk management process, these risks were not identified

using a formal organization-wide methodology. In addition, because Amtrak did not have a comprehensive risk management process, risk mitigation efforts may not be adequate to address root causes, and the Chief Executive Officer (CEO) and Board may not be informed of the risk and mitigation plans.

In discussing the results of our work with Amtrak senior executives, they agreed with the need to improve their risk management practices. The company then took initial steps toward addressing this issue by committing—in the October 1, 2011, *Strategic Plan*—to establish an ERM framework that is based on industry best practices. This is an important first step and shows a proactive approach on the company's part.

Recognizing this commitment, we focused on identifying best practices that could be adopted by the company. Our audit work noted that one of the keys to success for some organizations was to build a comprehensive ERM process using incremental steps, rather than starting with enterprise-wide effort. Given the ad-hoc nature of Amtrak's current risk management practices and control activities, it appears that an incremental approach could provide the greatest likelihood for implementation success. Further, focusing that approach on the ongoing implementation of a selected goal within the *Strategic Plan* could be a logical start to the implementation of an ERM framework.

Based on our judgment, together with input from Amtrak's senior executives, we believe that Amtrak should begin the ERM process by applying its principles to Goal 5 of the *Strategic Plan*—Financial and Organizational Excellence. This goal has three key advantages as a starting point for implementing an ERM framework:

- The goal relates to the entire organization and therefore would introduce and apply the ERM framework Amtrak-wide. This is a significant step that would help lay the foundation for broader implementation of the ERM framework over time.

- The goal addresses financial performance and overall business results. These are key areas at the heart of what an ERM framework is designed to help a company achieve. Further, improvements in these areas link directly to the overall goals of the Passenger Rail Investment and Improvement Act of 2008.[2] To the extent that ERM

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[2] The Passenger Rail Investment and Improvement Act authorized nearly $10 billion for Fiscal Years 2009–2013 for Amtrak's operating costs and capital investments, including actions to help Amtrak improve financial management, operate more efficiently, and improve services on existing routes.

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helps achieve this strategic goal, it would also help achieve the act's goal of making Amtrak less dependent on federal subsidies.

- Amtrak has weaknesses in its business processes and internal controls. Focusing on Goal 5 will result in an in-depth analysis of financial and operational controls with the objective of ensuring that they effectively and efficiently support improved business processes and financial performance.

We recommend that the Board of Directors and the President and CEO take the following actions:

1. In the long term, develop and implement an ERM process for the entire organization to include the Board of Directors, which is consistent with the COSO framework.
2. In the near term, using an incremental approach, develop and implement an ERM process, to include the Board of Directors, that focuses on Goal 5 of the Amtrak *Strategic Plan*—Financial and Organizational Excellence.

In commenting on a draft of this report, the Chairman of the Board of Directors and the President and CEO stated that it is imperative that the Board discuss our recommendations with an answer to the time, resources, and priority needed to make a commitment. Once the Board has had an opportunity to understand the commitment this will take, guidance will be provided to management, and the company will provide the Office of the Inspector General with more detailed information about Amtrak's plan to implement ERM. The full response to our draft report can be found in Appendix IV.

The company's response is consistent with the intent of our recommendations and reflects the incremental approach we are recommending to address the ERM issue. We will periodically follow up on the Company's implementation efforts.

AMTRAK'S PRESENT APPROACH TO MANAGING RISK IS AD-HOC, BUT IT HAS COMMITTED TO A FORMAL PROCESS

Amtrak does not currently have a formal, coordinated, systematic, enterprise-wide framework for identifying, analyzing, and managing risks. Amtrak does have some risk management activities in place, however these activities are often on an ad-hoc basis, and are narrowly focused on operational or compliance risks within a single operating

unit. In addition, because Amtrak does not have a comprehensive risk management process, risk mitigation actions may not be adequate to address root causes, and the CEO and Board may not be informed of the risk and mitigation plans.[3]

In discussing our observations with Amtrak senior executives, they acknowledged the need to improve their risk management practices. Amtrak's October 2011 *Strategic Plan* took initial steps toward that goal by committing to establishing an enterprise risk management framework based on industry best practices. This is an important first step and shows a proactive approach on the company's part to address this issue.
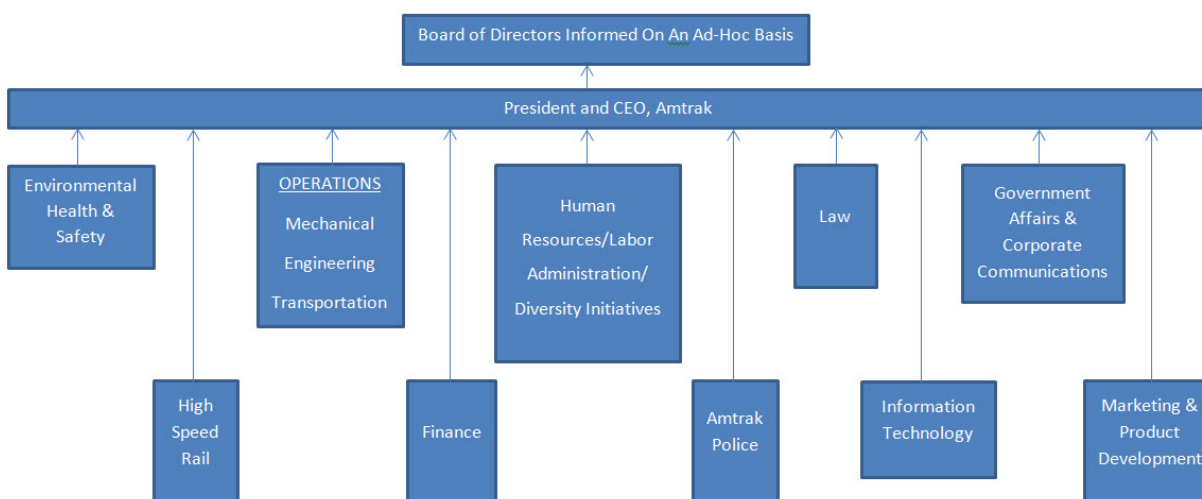
Amtrak's Current Risk Activities Yield Some Risk Mitigation Results

While Amtrak did apply certain aspects of the risk management components, this was done in an ad-hoc manner, without any company-wide policy or process to provide guidance and consistency. Figure 1 illustrates the stovepiped nature of Amtrak's current risk management process—that is, each unit addresses risk, for the most part, within that unit alone and not across the organization.

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[3] There are no statutory or legal requirements for the vast majority of private companies, including Amtrak, to implement ERM or, for instance, to form risk committees under the Board of Directors. The corporate environment outside of Amtrak has seen the emergence of a few laws or regulations that have ERM mandates or characteristics for some publicly traded corporations. See, for example, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Pub. L. 111-203 2010); the Sarbanes-Oxley Act of 2002 (Pub. L. 107-204); and the Securities and Exchange Commission Release 33-9089 (Feb. 28, 2010) and Item 407 of Regulation S-K, 17 CFR 229.400.

Figure 1. Amtrak's Traditional, Stovepiped Risk Management Approach

Source: Amtrak Office of Inspector General (OIG)

As discussed below, we analyzed the risk management processes in Amtrak organizational units as they relate to four COSO ERM components—risk identification, objective setting, risk response, and control activities. Amtrak's current risk management practices do not reflect an entity-wide management of risk, yet they do result in actions that mitigate certain risks and provide a good starting point for establishing a more comprehensive risk management program.

Specifically:

Risk Identification Component.

> **Risk Identification** - *According to COSO, the risk identification component involves the identification of potential events affecting achievement of an organization's strategic objectives.*

Currently, risk identification is performed on an ad-hoc basis and is limited because risk is identified on a unit-by-unit basis and not across the entire organization. Each of Amtrak's organizational senior managers provided us with a list of risks they have

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identified from their day-to-day operations; for example:

- *Information technology* (IT) systems and processes are not fully documented to ensure that they are working properly (IT)

- Losses occur due to *employee theft* (Transportation)

- Expertise could be lost due to a substantial number of *retirements* (Engineering, Transportation, Human Resources, Policy and Development, and Chief Financial Officer)

- Performance of adequate maintenance is hindered due to *obsolete material and technology* (Mechanical)

- Customer expectations may not be met due to *difficulties in upgrading current equipment* while minimizing costs (Mechanical)

- *Terrorism and criminal acts* may be directed toward Amtrak passengers, employees, and property (Amtrak Police Department, Finance)

- *Individual departments may be addressing the same risks independently*, raising the concern that more funds than necessary will be spent to address the same problem (Chief Financial Officer)

- Amtrak may not be maximizing its revenue through management of its ridership capacity by *adjusting pricing in response to market demand* (Marketing)

> ***Objectives-Setting***—*Strategic objectives are high-level goals that are aligned with the organization's mission; they should establish a basis for operational effectiveness, reliable financial reporting, and compliance with laws and regulations. To add assurance that a company will achieve its strategic objectives, management should identify risks and consider their implications.*

Objective Setting Component. Amtrak issued a new *Strategic Plan* in October 2011. The plan is a good step forward given that Amtrak did not have one for years and was slow to respond to recommendations to develop one. The plan contains organization-wide objectives and is intended to provide a compass by which all business decisions will be made. It contains a vision statement, corporate goals, performance targets, and proposed strategic activities. In addition, the plan includes seven corporate strategies that align with one or more corporate goals.

The *Strategic Plan* further identifies potential risks categorized as internal and external factors that may have a negative impact on future performance and prevent the company from reaching its goals. The plan also links strategies to goals, but it does not link the strategies to risks, nor does it describe how these risks could affect the achievement of the objectives or the manner in which Amtrak plans to mitigate them. Linking risks to strategic objectives helps identify and prioritize the most important risks that could prevent the achievement of those objectives.

For example, one of Amtrak's corporate strategies is to identify and invest in systems and technologies that will simultaneously reduce energy usage and operating expenses. This strategy aligns with two goals, *financial and organizational excellence* and *environment and energy*. Performance against this strategy includes measurements of a reduction in total diesel fuel consumption per seat mile, a reduction in locomotive electric consumption, and a reduction in station electrical use. In a memorandum transmitting the *Strategic Plan*, Amtrak's President and CEO stated that the company plans to develop tactical plans to guide its business units. However, it lacks a formal process to identify, discuss, or describe actions to address and manage the internal or external factors (risks) that may have a negative impact on Amtrak's ability to achieve its objectives.

> ***Risk Response*** *- According to the COSO framework, responding to risks on an organization-wide basis ensures that appropriate safeguards are put in place to mitigate problems that could negatively affect the company either financially or operationally. Once risks have been identified, management must determine the courses of action the organization should take to address them. Management's risk responses can be grouped into four categories-- avoidance, reduction, sharing, and acceptance.*

Risk Response Component. Amtrak's operational units have developed risk responses in several areas that Amtrak can build on as it begins to develop and implement a risk management framework. While some organizational units have developed risk responses to individual risks, Amtrak has not addressed the implications of these risks on an organization-wide basis. For example, some of the risks identified by Amtrak senior executives included the following:

- IT systems and procedures are not fully documented to ensure that they are working properly.

- Expertise could be lost due to a substantial number of retirements.

- Performance of adequate maintenance is hindered due to obsolete material and technology.

- Customer expectations may not be met due to difficulties in upgrading current equipment while minimizing costs.

However, while the risks were identified by each unit, they were not assessed collectively by the senior executives to consider such issues as their relative priority, adequacy of mitigation plans, and whether sufficient resources were being applied to address them. Further, they were not presented at the Board level in a structured manner so the Board could make its assessment of risk, mitigation plans, and resource adequacy. This leaves the company vulnerable to identified risks not being adequately addressed or other risks not being identified.

> *Control Activities - According to the COSO framework, control activities are the policies and procedures that implement management's decisions on what actions to take to mitigate risks and help to assure the effectiveness and efficiency of operations, reliability of financial reporting, and compliance with applicable laws and regulations. Control activities are similar to internal controls.*

Control Activities Component. Some units within Amtrak have control activities to address risks that the units have identified. Amtrak in general lacks an organization-wide system of internal controls that provides reasonable assurance that the operations are being carried out in an effective and efficient manner. The examples below demonstrate that, currently, some risks are addressed within operational units but not on an organization-wide basis. These examples of control activities implemented by Amtrak operating departments and offices are based on their initiative or in response to our prior audit or review recommendations.

- The Environmental Health and Safety Department conducts audits to monitor its performance against its regulatory requirements and internal policies, and to address any deficiencies. These audits are part of Amtrak's primary processes for monitoring and measuring environmental performance and reporting the status to specific Amtrak stakeholders.

- Amtrak's Transportation Department has taken action to improve the economy, efficiency, and internal controls of on-board food and beverage service. For example, Amtrak has established a centralized system to help automate the

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collection of revenue shortages, restructured staffing for dining cars to reduce labor costs, introduced seat-cart service for selected high-traffic routes to improve cost recovery, and introduced on-board electronic credit card technology to increase sales.

- Treasury Risk Management within the Finance Department reviews contracts with other organizations to ensure that Amtrak assumes the minimum amount of risk possible. The unit also assesses the potential liability for risks for which Amtrak decides to self-insure, such as property or personal injury damages.

- The Office of General Counsel provides advice to other Amtrak units to ensure that these units are in compliance with various laws and regulations. The primary purpose of these efforts is to protect Amtrak from the financial consequences of noncompliance with laws and regulations.

On the other hand, as some of our recent reports have shown, significant gaps exist in Amtrak's controls. For example, we reported that:

- Control weaknesses existed in human resources management related to planning for future needs, hiring and retaining staff, and the IT systems used to support human resources. Further, many of the recommendations made in previous reports had not been implemented. Amtrak's not identifying human capital as a risk and placing appropriate emphasis on it could result in the lack of requisite knowledge, skills, and experience among the company's key personnel that may threaten effective operation of the business. Amtrak management responded that it would reemphasize its commitment to addressing our findings and that the Chief Human Capital Officer would analyze our report and develop an action plan for addressing the open recommendations.[4]

- Amtrak had longstanding weaknesses in controls, processes, and resources for reviewing invoices for on-time-performance payments, resulting in overpayments of $37 million to host railroads. Amtrak's lack of an adequate process to verify the

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[4] Amtrak OIG reports *Human Capital Management* (OIG Report No. E-09-03, May 15, 2009) and *Human Capital Management: Lack of Priority Has Slowed OIG-Recommended Actions to Improve Human Capital Management, Training, and Employee Development Practices* (OIG Report No. E-11-04, July 8, 2011).

accuracy of payments made to host railroads creates the risk that assets (cash) are not being safeguarded, and that profits are not being achieved. Amtrak agreed and is taking action to apply additional resources and establish a process to thoroughly review invoices for on-time-performance incentives and other costs before making payments.[5]

- Amtrak provides food and beverage service on board most of its trains. But long-standing internal control weaknesses and gaps continue to make on-board food and beverage revenues and inventories vulnerable to fraud, waste, and abuse. We estimated that $4 million to $7 million of Amtrak's food and beverage sales could be at risk of theft unless these control risks are effectively mitigated. Amtrak management agreed with our recommendations and outlined an implementation plan to address these internal control weaknesses.[6]

- Amtrak did not meet the requirement to make all stations accessible to persons with disabilities by July 26, 2010. It is important that Amtrak address the Americans with Disabilities Act (ADA) organizational deficiencies because they increase the risk that funds will not be used efficiently and effectively and that Amtrak will not meet its goal of being ADA-compliant by September 30, 2015. In addition, Amtrak's current and ongoing lack of ADA compliance creates a potentially significant financial liability risk resulting from legal judgments for not being ADA-compliant and detracts from its strategic goals of improving safety and customer service for all of its passengers. Amtrak management agreed with our recommendations to develop a detailed spending plan to support the Fiscal Year 2012 ADA budget request, and provide Congress with an order-of-magnitude cost estimate for completing all ADA programs by September 30, 2015.[7]

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[5] Amtrak OIG reports *BNSF On-Time Performance Incentives: Inaccurate Invoices and Lack of Amtrak Management Review Lead to Overpayments* (OIG Audit Report No. 407-2003, September 24, 2010), *On-Time-Performance Incentives: Inaccurate Invoices Were Paid Due to Long-standing Weaknesses in Amtrak's Invoice-Review Process* (OIG Audit Report No. 403-2010, April 21, 2011), and *Amtrak Invoice-Review: Inaccurate Invoices Were Paid, But Progress is Being Made to Improve the Invoice-Review Process* (OIG Report No. OIG-A-2012-005, February 16, 2012).

[6] *Food and Beverage Service: Further Actions Needed to Address Revenue Losses Due to Control Weaknesses and Gaps* (OIG Report No. E-11-03, June 23, 2011).

[7] *Americans with Disabilities Act: Leadership Needed to Help Ensure That Stations Served by Amtrak Are*

Amtrak Is Committed to Developing a Risk Management Framework

Amtrak's October 2011 *Strategic Plan* cited the need to develop a systematic enterprise-wide risk management process. Specifically, the *Strategic Plan* noted:

> *Several challenges to Amtrak's success have been identified in this strategic plan. These enterprise risks require management attention, planning and remediation as set forth in this plan and elsewhere. To do so, Amtrak will establish an enterprise risk management framework that is based on industry best practices. This framework will be used to routinely assess the corporation and all business lines while developing a system of control.*

BEST PRACTICE APPROACH FOR IMPLEMENTING ERM AT AMTRAK

Recognizing that the company has committed to implementing an effective risk management process, we shifted the focus of our work to identifying best practices that Amtrak could adopt. (See Appendix II for a description of best practices and Appendix III for additional sources of ERM information.) There are various ways to implement an ERM program, ranging from a corporate-wide approach to one of more limited scope, such as focusing on specific risks. A COSO thought paper[8] described how an organization can start to move from informal risk management to ERM. One of the keys to success identified by COSO was building ERM in incremental steps. Given the ad-hoc nature of Amtrak's current risk management processes, it appears that the incremental approach provides the greatest likelihood for implementation success. Further, linking that approach to the ongoing implementation of the *Strategic Plan* also appears to be the most logical approach to start the implementation of an ERM framework.

Compliant (OIG Audit Report 109-2010, September 29, 2011).
[8] *Embracing Enterprise Risk Management, Practical Approaches for Getting Started*, COSO, January 2011.

Incremental Approach Is a Recommended Best Practice

Organizations have achieved ERM successes by taking an incremental, step-by-step approach to enhancing their risk management capabilities to provide a more enterprise-wide view over time, rather than undertaking one massive launch effort. They start with a simple process and build from there using incremental steps rather than trying to make a quantum leap to fully implement a complete ERM process. The COSO thought paper and our audit work also identified the following strategies for starting an ERM program:

Board and Senior Management Leadership, Involvement, and Oversight. Support from the Board of Directors and senior management is needed to get the right focus, resources, and attention for ERM. Directors need to demonstrate clear support for the initiative as well as overseeing what management has designed and implemented to manage top risk exposure. The Board and senior management set the tone for the organization's risk culture. Their involvement, leadership, and oversight are essential for ERM.

A Strong Leader to Drive the ERM Initiative. Finding a leader to head the initial ERM project is critical for success. Management should identify a leader with the right attributes to head this undertaking, such as having a broad knowledge of the business and its core strategies, strong relationships with directors and executive management, strong communication and facilitation skills, knowledge of the organization's risks, and broad acceptance and credibility across the organization. This leader will not necessarily be the person to head ERM in the long term, but the person to get the initiative started and to take responsibility for moving the organization's ERM initiative to the next level. The Board should be comfortable that management has put in place an effective ERM leader who is widely respected across the organization and who has accepted responsibility for overall ERM leadership.

Build on Existing Risk Management Activities. Amtrak has some informal risk management activities in place and can leverage and enhance these activities to move toward a more complete ERM program. For example, senior leaders use informal processes to identify risks. Amtrak's risk identification process could be improved by adding structure to this process to ensure that all risks have been identified, including emerging risks. The next steps in the process would include prioritizing the risks for probability and consequence, ensuring that appropriate mitigating processes are in

place to manage them, regularly reviewing the effectiveness of the management of the risks, and periodically reporting to the CEO and the Board on risk management.

Leverage Existing Resources. Many organizations have successfully entered the ERM arena by leveraging their existing risk management resources. Organizations often discover that they have the personnel on their existing staffs with the knowledge and capabilities relating to risks and risk management that can be effectively used as a start. For example, some organizations have appointed a management committee, sometimes headed by their Chief Financial Officer, to bring together a wide array of personnel from across the entity that collectively have sufficient knowledge of the organization's core business model and related risks and risk management practices to get ERM moving. Outside expert support can also be a useful way to leverage existing resources.

Continuing ERM Implementation. Given the evolutionary nature of ERM and the dynamic nature of risk, the process must be ongoing and not viewed as a one-time event. The initial risk assessment process will need periodic updating, and Amtrak will need to be attuned to the need to identify new, emerging risks. In addition, risk mitigation activities, which generally consist of improving business processes and controls, are an ongoing effort. Once the initial ERM process is operationalized, Amtrak should look for additional ways to expand implementation across the organization. Amtrak's risk management leaders need to continue to drive further development and maturity of the risk management processes.

Based on our analysis of Amtrak's risk management activities and the ERM process, we believe that an incremental approach to establishing an ERM process best fits Amtrak, given the company's current risk identification practices and weak internal control environment. Further, based on our judgment, together with input from Amtrak's senior executives, we believe that applying the ERM principles to Goal 5 of the *Strategic Plan* would be advantageous. Goal 5 of the plan states:

> **Goal 5—Financial and Organizational Excellence:** *Attain a standard of organizational excellence by aligning our products, services, processes, and culture with stakeholder expectations to improve financial performance and overall business results.*

While we recognize the importance of the other strategic goals, we believe that attaining financial and organizational excellence has three key advantages as a starting point for implementing an ERM framework. Specifically:

- First, the goal relates to the entire organization and therefore would introduce and apply the ERM framework Amtrak-wide. This is a significant step that would help lay the foundation for broader implementation of the ERM framework over time.

- Second, the goal addresses financial performance and overall business results. These are key areas that are at the heart of what an ERM framework is designed to help a company achieve. Further, improvements in these areas link directly to the overall goals of the Passenger Rail Investment and Improvement Act of 2008. To the extent that ERM is successful in helping to achieve this strategic goal, it would also help to achieve the act's goal of making Amtrak less dependent on federal subsidies.

- Third, as previously discussed, Amtrak has weaknesses in its business processes and internal controls. Focusing on Goal 5 will result in an in-depth analysis of financial and operational controls with the objective of ensuring that they effectively and efficiently support improved business processes and financial performance.

It is also important to note that while implementation will largely be carried out by the company's management team, the Board of Directors, given its fiduciary responsibility to represent stakeholders, plays a critical role in ERM as presented by COSO:

> *"An entity's board of directors plays a critical role in overseeing an enterprise-wide approach to risk management. Because management is accountable to the board of directors, the board's focus on effective oversight is critical to setting the tone and culture towards effective risk management through strategy setting, formulating high level objectives, and approving broad-based resource allocations."*

Currently, because the company has not established a disciplined risk management process, the Board's ability to oversee risks is limited. Our meetings with Amtrak Board members disclosed that they were not sure whether they were aware of all major risks facing Amtrak or the adequacy of the mitigation actions to address those risks. Many of the members supported a more structured risk management process. Further, the

Board's ability to oversee risks was also limited because it was not operating with full Board membership. With the addition of three new Board members since June 2010, Amtrak now has seven of nine members authorized by the Passenger Rail Investment and Improvement Act of 2008. As a result, the Board of Directors has been able to reconstitute two Board committees: the Audit and Finance Committee and the Personnel Committee. With this added leadership, the Board has greater capacity to fulfill its governance responsibilities over Amtrak programs and operations. There are various ways a Board can choose to implement its leadership role, to include

- providing clear support for ERM to ensure that the right focus, resources, and attention are applied;
- overseeing management's design and implementation of the ERM program;
- overseeing development of and participation in enterprise-wide strategy analysis;
- knowing the extent to which management has established an effective ERM program; and
- understanding the most significant risks and whether management is responding appropriately.

CONCLUSIONS

Amtrak can benefit in terms of improved service and cost effectiveness of operations by better managing risk. The company is to be commended for taking a proactive approach by committing to instituting a risk management process. Taking action shows a desire to focus on the costs and benefits of its risk management activities.

There is no one set model for starting an ERM program, but it is generally agreed that an incremental approach that is tailored to the organization's culture and capacity to absorb change works best. Amtrak is working to realign the organization with its strategic plan and at the same time recognizes that its business process control environment is weak. Consequently, linking its incremental implementation strategy with one important strategic plan goal appears to be a logical approach that would enhance the likelihood of a successful implementation. Starting the ERM process with Goal 5 of the *Strategic Plan* introduces the ERM framework to the entire organization,

focuses the ERM process on areas of critical need, and adds assurance that financial and organizational internal controls are operating effectively and efficiently.

RECOMMENDATIONS

In order to better and more systematically manage risk, we recommend that the Amtrak Board of Directors and President and CEO take action to:

1. In the long term, develop and implement an ERM process for the entire organization, to include the Board of Directors, which is consistent with the COSO framework.

2. In the near term, using an incremental approach, develop and implement an ERM process to include the Board of Directors that focuses on Goal 5 of the Amtrak *Strategic Plan*, Financial and Organizational Excellence.

MANAGEMENT COMMENTS AND OIG RESPONSE

In commenting on a draft of this report, Amtrak's Chairman, Board of Directors, and the President and CEO stated that they plan to implement ERM. They indicated that developing a formal ERM program is a complex undertaking and that this is an issue the Board of Directors considers to be extremely important for Amtrak's future success. They also commented that it is imperative that the Board discuss our recommendations with an answer to the time, resources, and priority needed to make a commitment. They added that, once the Board has had an opportunity to understand the commitment this will take, guidance will be provided to management, and the company will provide to the OIG more detailed information about their plan to implement ERM. Amtrak's complete comments appear as Appendix IV.

We believe the response by the Chairman and the President and CEO is consistent with the intent of our recommendations and reflects the need to take an incremental approach to implementing an ERM program. We also agree with the approach being taken by the Board of Directors to better understand the commitment this effort will require before taking its next steps. We look forward to receiving detailed information

about Amtrak's plan to implement ERM. We will periodically follow up on the company's progress in implementing our recommendations and report separately at the appropriate time.

Appendix I

SCOPE AND METHODOLOGY

Our objectives were to (1) determine the extent to which Amtrak manages risks in a corporate-wide systematic manner, and (2) identify risk management best practices in public and private organizations and compare those to Amtrak's risk management activities. We performed our audit work from May, 2011 through January 2012.

We interviewed eight Board members including Amtrak's President and CEO, 16 senior executives managing all aspects of Amtrak's operations and three management staff to determine whether Amtrak manages risk in a corporate-wide, systematic manner. We discussed with these senior executives the key risks faced by their departments, or Amtrak as a whole, and whether these risks are addressed on a corporate-wide, systematic basis or documented in corporate policies. We also reviewed Board of Directors' briefing documents and minutes of Board meetings to determine the extent to which risks are discussed with the Board.

We documented the extent to which Amtrak has implemented a risk management framework and processes, and compared Amtrak's framework and processes to the Committee of Sponsoring Organizations of the Treadway Commission (COSO) framework. We reviewed best practices implemented by other organizations. We also analyzed selected previous OIG reports to identify weaknesses in Amtrak's business processes and internal controls.

In addition to analyzing the COSO framework, we reviewed materials related to Enterprise Risk Management (ERM) from a number of sources, including the American Institute of Certified Public Accountants, the Institute of Internal Auditors, and PricewaterhouseCoopers.

To identify industry best practices, we researched and identified both public and private organizations that have established an ERM process for identifying, assessing, and mitigating risks. We identified 12 public and private organizations that already have or are in the process of establishing an ERM program and identified best practices that could assist Amtrak in developing its own ERM program. These organizations included nine federal agencies, one freight railroad company, one port authority, and

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one state university. We also identified and analyzed publications, articles, or documents relating to risk management that may be useful to Amtrak Management in establishing its Risk Management program. This search resulted in the identification of 27 publications or articles on Risk Management. These publications and articles are listed in Appendix III of this report.

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

Internal Controls

Our audit reviewed the activities used by Amtrak management to identify and manage risks. This included assessing Amtrak's risk identification, assessment, and mitigation practices, and management information used in Amtrak's risk management activities. We did not assess or test these controls. We also relied on our prior audits to generally comment on the overall condition of the Company's internal controls.

Computer-Processed Data

Due to the nature of the audit objectives and the audit methodology, we did not rely on computer processed data during the audit.

Prior Coverage

We reviewed the following audit reports and used information from those reports in conducting our analysis of issues:

Amtrak Invoice-Review: Inaccurate Invoices Were Paid, But Progress is Being Made to Improve the Invoice-Review Process (OIG Report No. OIG-A-2012-005, February 16, 2012)

On-Time Performance Incentives: Inaccurate Invoices Were Paid Due to Weaknesses in Amtrak's Invoice-Review Process (OIG Audit Report No. OIG-A-2012-004, February 15, 2012)

Americans with Disabilities Act: Leadership Needed to Help Ensure That Stations Served by Amtrak Are Compliant (OIG Audit Report No. 109-210, September 29, 2011)

Human Capital Management: Lack of Priority Has Slowed OIG-Recommended Actions to Improve Human Capital Management, Training, and Employee Development Practices (OIG Report No. E-11-04, July 8, 2011)

Food and Beverage Service: Further Actions Needed to Address Revenue Losses Due to Control Weaknesses and Gaps (OIG Report No. E-11-03, June 23, 2011)

On-Time Performance Incentives: Inaccurate Invoices Were Paid Due to Long-standing Weaknesses in Amtrak's Invoice-Review Process (OIG Audit Report No. 403-2010, April 21, 2011)

BNSF On-Time Performance Incentives: Inaccurate Invoices and Lack of Amtrak Management Review Lead to Overpayments (OIG Audit Report No. 407-2003, September 24, 2010)

Human Capital Management (OIG Report E-09-03, May 15, 2009)

Amtrak Management: Systemic Problems Require Actions to Improve Efficiency, Effectiveness, and Accountability (GAO-06-145, October 4, 2005) [Government Accountability Office]

Appendix II

KEY PRINCIPLES OF ENTERPRISE RISK MANAGEMENT COMPONENTS AND INDUSTRY BEST PRACTICES

This appendix presents key principles inherent in the eight ERM components that were included in the Committee of Sponsoring Organizations' (COSO) publication *Enterprise Risk Management—Integrated Framework,* and industry best practices we identified during our audit.

Component 1: Internal Environment

Risk Management Philosophy

- The entity's risk management philosophy represents the shared beliefs and attitudes characterizing how the entity considers risk in all activities.

Internal Environment Best Practices

✓ *The Board of Directors and senior management set the tone for the organization's risk culture; establish a risk-related committee at the board level.*

✓ *Produce a strategy statement that clarifies risk appetite, risk ownership, and the strategy to be used to identify and assess key risks.*

✓ *Create a new executive role, such as a Chief Risk Officer and Risk Office, with the responsibility across the entire organization for risk management.*

- It reflects the entity's values, influencing its culture and operating style.

- It affects how enterprise risk management components are applied, including how events are identified, the kinds of risks accepted, and how they are managed.

- It is well developed, understood, and embraced by the entity's personnel. It is captured in policy statements, oral and written communications, and decision- making.

- Management reinforces the philosophy not only with words but also with everyday actions.

Risk Appetite

- The entity's risk appetite reflects the entity's risk management philosophy and influences the culture and operating style.

- It is considered in strategy-setting, with strategy aligned with risk appetite.

Board of Directors

- The Board is active and possesses an appropriate degree of management, technical, and other expertise, coupled with the mindset necessary to perform its oversight responsibilities.

- It is prepared to question and scrutinize management's activities, present alternative views, and act in the face of wrongdoing.

- It has at least a majority of independent outside directors.

- It provides oversight to enterprise risk management and is aware of and concurs with the entity's risk appetite.

Integrity and Ethical Values

- The entity's standards of behavior reflect integrity and ethical values.

- Ethical values not only are communicated but also accompanied by explicit guidance regarding what is right and wrong.

- Integrity and ethical values are communicated through a formal code of conduct.

- Upward communications channels exist where employees feel comfortable bringing relevant information.

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- Penalties are applied to employees who violate the code of conduct, mechanisms encourage employee reporting of suspected violations, and disciplinary actions are taken against employees who knowingly fail to report violations.

- Integrity and ethical values are communicated through management actions and the examples they set.

Commitment to Competence

- Competence of the entity's people reflects the knowledge and skills needed to perform assigned tasks.

- Management aligns competence and cost.

Organizational Structure

- The organizational structure defines key areas of responsibility and authority.

- It establishes lines of reporting.

- It is developed in consideration of the entity's size and nature of activities.

- It enables effective enterprise risk management.

Assignment of Authority and Responsibility

- Assignment of authority and responsibility establishes the degree to which individuals and teams are authorized and encouraged to use initiative to address issues and solve problems, and provides limits to authority.

- The assignments establish reporting relationships and authorization protocols.

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- Policies describe appropriate business practices, knowledge, and experience of key personnel, and associated resources.

- Individuals know how their actions interrelate and contribute to achievement of objectives.

Human Resource Standards

- Standards address hiring, orientation, training, evaluating, counseling, promoting, compensation, and remedial actions, driving expected levels of integrity, ethical behavior, and competence.

- Disciplinary actions send the message that violations of expected behavior will not be tolerated.

Component 2: Objective Setting

Strategic Objectives

- The entity's strategic objectives establish high-level goals that align with and support its mission and vision.

- They reflect management's strategic choices as to how the entity will seek to create value for its stakeholders.

- Management identifies risks associated with strategy choices and considers their implications.

Objective Setting Best Practices

✓ *Link the ERM process to a company's strategic planning process. Use the objectives in the strategic plan as a basis for risk identification, risk assessment, and risk mitigation activities associated with the strategic plan.*

✓ *Include risk management in the strategic plan.*

Related Objectives

- Related objectives support and are aligned with selected strategy, relative to all entity activities.

- Each level of objectives is linked to more specific objectives that cascade through the organization.

- The objectives are readily understood and measurable.

- They align with risk appetite.

Selected Objectives

- Management has a process that aligns strategic objectives with the entity's mission and ensures the strategic and related objectives are consistent with the entity's risk appetite.

Risk Appetite

- The entity's risk appetite is a guidepost in strategy-setting.

- It guides resource allocation.

- It aligns organization, people, processes, and infrastructure.

Risk Tolerances

- Risk tolerances are measurable, preferably in the same units as the related objectives.

- They align with risk appetite.

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Component 3: Risk/Event Identification

> **Risk Identification Best Practices**
>
> ✓ *Use a combination of a top down and bottom up approach to identify risks.*
>
> ✓ *Once the risks are identified, conduct an executive workshop designed to further understand, evaluate, and prioritize the core business risks in the context of the achievement of the strategic plan. Create a risk inventory of all risks facing the organization, including, strategic, financial, operational, and regulatory threats.*
>
> ✓ *Focus on a small number of top risks.*

Events

- Management identifies potential events affecting strategy implementation or achievement of objectives that may have positive or negative impacts.

- Even events with a relatively low possibility of occurrence are considered if the impact on achieving an important objective is great.

Influencing Factors

- Management recognizes the importance of understanding external and internal factors and the type of events that can emanate therefrom.

- Events are identified both at the entity and activity levels.

Event Identification Techniques

- Techniques look to both the past and future.

- Management selects techniques that fit its risk management philosophy and ensure the entity develops needed event-identification capabilities.

- Event identification is robust, forming a basis for risk assessment and risk response components.

Interdependencies

- Management understands how events relate to one another.

Distinguishing Risks and Opportunities

- Events with negative impact represent risks, which management assesses and responds to.

- Events representing opportunities are channeled back to management's strategy or objective-setting processes.

Component 4: Risk Assessment

> **Risk Assessment Best Practices**
>
> ✓ *Perform an in-depth, prioritized analysis of the top three to five risks.*
>
> ✓ *Develop a disciplined approach to documenting, evaluating, and communicating risk mitigation.*
>
> ✓ *Develop standardized risk management tools for assessing risk.*

- In assessing risk, management considers expected and unexpected events.

Inherent and Residual Risk

- Management considers inherent risks.

- Once risk responses have been developed, management considers inherent and residual risks.

Estimating Likelihood and Impact

- Potential events are evaluated from two perspectives—likelihood and impact.

- In assessing impact, management normally uses the same, or congruent, unit of measure as used for the objective.

- The time horizon used to assess risks should be consistent with the time horizon of the related strategy and objectives.

Assessment Techniques

- Management uses a combination of qualitative and quantitative techniques.

- The techniques support development of a composite assessment of risk.

Relationships between Events

- Where correlation exists between events, or events combine and interact, management assesses them together.

Component 5: Risk Response

> **Risk Response Best Practices**
>
> ✓ *Develop tools, such as a matrix, to assess risk.*
>
> ✓ *Develop standardized risk management tools for assessing risk.*

- In responding to risk, management considers among risk avoidance, reduction, sharing, and acceptance.

Evaluating Possible Responses

- Responses are evaluated with the intent of achieving residual risk aligned with the entity's risk tolerances.

- In evaluating risk responses, management considers their effects on likelihood and impact.

- Management considers their costs versus benefits, as well as new opportunities.

Selected Responses

- Responses chosen by management are designed to bring anticipated risk likelihood and impact within risk tolerances.

- Management considers additional risks that might result from a response.

Portfolio View

- Management considers risk from an entity-wide, or portfolio, perspective.

- Management determines whether the entity's residual risk profile is commensurate with its overall risk appetite.

Component 6: Control Activities

Integration with Risk Response

- Management identifies control activities needed to help ensure that risk responses are carried out properly and in a timely manner.

> ***Control Activities Best Practices***
>
> ✓ *For each high-priority risk, the executive management team should identify the risk owners that will be accountable to identify current processes and controls in place, as well as planned initiatives. The team should develop additional initiatives that are needed to close any gaps.*

- Selection or review of control activities includes consideration of their relevance and appropriateness to the risk response and related objective.

- In selecting control activities, management considers how they interrelate.

Types of Control Activities

- Management selects from a variety of types of control activities, including preventive, detective, manual, computer, and management controls.

Policies and Procedures

- Policies are implemented thoughtfully, conscientiously, and consistently.

- Procedures are carried out with sharp, continuing focus on conditions to which the policy is directed.

- Conditions identified as a result of the procedure are investigated and appropriate corrective actions taken.

Controls over Information Systems

- Appropriate general and application controls are implemented.

Component 7: Information and Communication

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Information and Communication Best Practices

✓ *Communicate openly for risk management to succeed.*

✓ *The Board of Directors and senior management need to send a message to all parties about the importance of managing risk.*

✓ *Develop communication plans to address issues relating to risks and the risk-management process.*

✓ *Talk substantively about risk at every Board meeting.*

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Information

- Relevant information is obtained from internal and external sources.

- The entity captures and uses historical and present data as needed to support effective enterprise risk management.

- The information infrastructure converts raw data into relevant information that assists personnel in carrying out their enterprise risk management and other responsibilities; information is provided at a depth and in a form and time frame that are

actionable, readily usable, and linked to defined accountabilities—including the need to identify, assess, and respond to risk.

- Source data and information are reliable and provided on time at the right place to enable effective decision-making.

- Timeliness of information flow is consistent with the rate of change in the entity's internal and external environments.

- Information systems change as needed to support new objectives.

Communication

- Management provides specific and directed communication addressing behavioral expectations and responsibilities of personnel, including a clear statement of the entity's risk management philosophy and approach and clear delegation of authority.

- Communication about processes and procedures aligns with, and underpins, the desired culture.

- All personnel receive a clear message from top management that enterprise risk management must be taken seriously.

- Personnel know how their activities relate to the work of others, enabling them to recognize problems, determine cause, and take corrective action.

- Personnel know what is deemed acceptable and unacceptable behavior.

- There are open channels of communication and a willingness to listen, and personnel believe their superiors truly want to know about problems and will deal with them effectively.

- Communications channels outside normal reporting lines exist, and personnel understand there will be no reprisals for reporting relevant information.

- An open communications channel exists between top management and the Board of Directors, with appropriate information communicated on a timely basis.

- Open external communications channels exist, where customers and suppliers can provide significant input.

- The entity communicates relevant information to regulators, financial analysts, and other external parties.

Component 8: Monitoring

> **Monitoring Best Practices**
>
> ✓ *Have senior management, which comprises the Risk Oversight Committee, meet monthly to review reports from various risk areas across the company.*
>
> ✓ *Include regular progress reports and comparisons to previous risk assessments so changes and refinements can be made.*

- Management determines, through ongoing monitoring activities or separate evaluations, or a combination, whether the functioning of enterprise risk management continues to be effective.

Ongoing Monitoring Activities

- Monitoring activities are built into the entity's normal, recurring operations, performed in the ordinary course of running the business.

- They are performed on a real-time basis and react dynamically to changing conditions.

Separate Evaluations

- Separate evaluations focus directly on enterprise risk management effectiveness and provide an opportunity to consider the continued effectiveness of the ongoing monitoring activities.

- The evaluator understands each of the entity activities and each enterprise risk management component being addressed.

- The evaluator analyzes enterprise risk management design, and the results of tests performed, against the backdrop of management's established standards, determining whether enterprise risk management provides reasonable assurance with respect to the stated objectives.

Reporting Deficiencies

- Deficiencies reported from both internal and external sources are carefully considered for their implications for enterprise risk management, and appropriate corrective actions are taken.

- All identified deficiencies that affect the entity's ability to develop and implement its strategy and to achieve its established objectives are reported to those positioned to take necessary action.

- Not only are reported transactions or events investigated and corrected, but potentially faulty underlying procedures also are reevaluated.

- Protocols are established to identify what information is needed at a particular level for effective decision-making.

Appendix III

ENTERPRISE RISK MANAGEMENT RESOURSES

Web sites

The Risk and Insurance Management Society	www.rims.org
Committee of Sponsoring Organizations of the Treadway Commission (COSO)	http://coso.org/
PricewaterhouseCoopers	http://www.pwc.com/us/en/thought-leadership/risk.jhtml
American Institute of Certified Public Accountants (AICPA)	http://www.aicpa.org/_catalogs/masterpage/Search.aspx?S=risk+management
Institute of Internal Auditors (IIA)	http://www.theiia.org/guidance/standards-and-guidance/ippf/practice-guides/
Protiviti	http://www.protiviti.com/en-US/Pages/default.aspx
KPMG	http://www.kpmg.com/us/en/pages/default.aspx
University of California	http://www.ucop.edu/riskmgt/erm/dashboard.html
National Oceanic and Atmospheric Administration	http:www.NOAA.gov
British Columbia—Ministry of Finance	http:www.gov.bc.ca/fin

Publications

Enterprise Risk Management—Integrated Framework (Executive Summary)	COSO
Enterprise Risk Management—Integrated Framework (Application Techniques)	COSO
Strengthening Enterprise Risk Management for Strategic Advantage	COSO

Embracing Enterprise Risk management, Practical Approaches for Getting Started	COSO
Risk Assessment for Mid-Sized Companies	AICPA
A Unified Approach to Risk Management	AICPA
Effective Enterprise Risk Management Starts With A Conversation	AICPA
Adding Value, Not Bureaucracy: Linking Governance, Enterprise Risk Management, and Internal Controls	AICPA
Board and Audit Committee Involvement in Risk Management Oversight	AICPA
Seven Steps Toward a Proactive, Value-Added Enterprise Risk Management Program	AICPA
IPPF Practice Guide: Assessing the Adequacy of Risk Management	IIA
Assessing the Adequacy of Risk Management	IIA
Improving Board Risk Oversight Through Best Practices	IIA Research Foundation
Enterprise Risk Management: Trends and Emerging Practices	IIA Research Foundation
Global Best Practices	PricewaterhouseCoopers
Business risk model	PricewaterhouseCoopers
Ten Common Risk Management Failures and How to Avoid Them	Protiviti
Risk Management: A Look Back and a Look Forward	Protiviti
Profiles of Companies Building Effective ERM Programs	Protiviti

Enterprise risk oversight	Chartered Institute of Management Accountants and AICPA research series September 2010
Implementing Enterprise-wide Risk Reduction Across Operational and Financial Processes	Trent Derr, Syntex Management Systems, Inc.
Managing Risk in Government: An Introduction to Enterprise Risk Management	Dr. Karen Hardy
A Board Perspective on Enterprise Risk Management	McKinsey & Company
Risk Management Best Practices	Microsoft Corp.
Navigating Unchartered Waters—Best Practices for Managing Risks Across the Enterprise	GRC Daily
Best Practices in Risk Management: Private and Public Sectors Internationally	Treasury Board of Canada
Implementing an Enterprise Risk Management Evaluation	Lexis/Nexis
Overview of Enterprise Risk Management	Casualty Actuarial Society

Appendix IV

COMMENTS FROM THE CHAIRMAN OF AMTRAK'S BOARD OF DIRECTORS AND AMTRAK'S PRESIDENT AND CEO

NATIONAL RAILROAD PASSENGER CORPORATION
60 Massachusetts Avenue, NE, Washington, DC 20002
tel (202) 906-3960, fax (202) 906-2850

Memo

⟋AMTRAK

Date March 28, 2012

To Ted Alves, Inspector General

From Thomas Carper
Chairman, Board of Directors
Joseph Boardman
President and CEO

Subject Draft Report for Project No.
0062011: *Amtrak Corporate
Governance: Implementing a Risk
Management Framework is Essential
to Achieving Amtrak's Strategic
Goals*

cc

Message Thank you for your work and recommendations regarding Amtrak's efforts to implement an effective Enterprise Risk Management (ERM) program. You have outlined the goals that we expect to achieve and provided helpful guidance that we will take into consideration. Developing a formal ERM program using COSO, ISO 31000, or even part of A123 as a foundation, is a complex undertaking.

As you know, this is an issue the Board of Directors considers to be extremely important for Amtrak's future success. Because this report was created at the request of the Board, it is imperative that the Board discuss your recommendations with an answer to the time, resources and priority needed to make a commitment.

Once the Board has had an opportunity to understand the commitment this will take, guidance will be provided to Management, and the Company will provide to the OIG more detailed information about our plan to implement ERM.

Thank you again for your efforts.

Appendix V

ABBREVIATIONS

ADA Americans with Disabilities Act

AICPA American Institute of Certified Public Accountants

CEO Chief Executive Officer

COSO Committee of Sponsoring Organizations of the Treadway Commission

ERM Enterprise Risk Management

IIA Institute of Internal Auditors

IT Information Technology

OIG Office of Inspector General

Appendix VI

OIG TEAM MEMBERS

David R. Warren, Assistant Inspector General, Audits

Edward Stulginsky, Senior Director

Joseph Zammarella, Audit Manager

John Borelli, Consultant

William Dolan, Consultant

John Kalmar, Consultant

Kenneth Knouse, Consultant

OIG MISSION AND CONTACT INFORMATION

Amtrak OIG's Mission	Amtrak OIG's mission is to • conduct and supervise independent and objective audits, inspections, evaluations, and investigations relating to Amtrak programs and operations; • promote economy, effectiveness, and efficiency within Amtrak; • prevent and detect fraud, waste, and abuse in Amtrak's programs and operations; • review security and safety policies and programs; and • review and make recommendations regarding existing and proposed legislation and regulations relating to Amtrak's programs and operations.
Obtaining Copies of OIG Reports and Testimony	Available at our website: www.amtrakoig.gov.
To Report Fraud, Waste, and Abuse	Report suspicious or illegal activities to the OIG Hotline (you can remain anonymous): Web: www.amtrakoig.gov/hotline Phone: 800-468-5469

Congressional and Public Affairs	E. Bret Coulson, Senior Director
	Congressional and Public Affairs
	
	Mail: Amtrak OIG
	           10 G Street, N.E., 3W-300
	           Washington, DC 20002
	
	Phone: 202-906-4134
	
	Email: bret.coulson@amtrakoig.gov