CSX On-Time Performance Incentives: Inaccurate Invoices and Lack of Amtrak Management Review Lead to Overpayments

Final Report No. 406-2005

March 30, 2010

Audit Report Issued By:

NATIONAL RAILROAD PASSENGER CORPORATION
OFFICE OF INSPECTOR GENERAL
10 G STREET, N.E.
WASHINGTON, DC 20002

Memo

Date: March 30, 2010

To: Joseph H. Boardman, President and CEO

From: Ted Alves, Inspector General

Department: Office of Inspector General

Subject: CSX Transportation Inc. OTP

Cc: William Crosbie
Richard Phelps

Enclosed is our Final report on the audit of the CSX Transportation Inc. (CSX) on-time performance (OTP) bills. Our audit objectives were to verify the compliance of CSX claims for on-time performance incentives with the agreements (Appendix V-Performance Payments and Penalties) and to evaluate the adequacy of Amtrak management's oversight and controls of monthly OTP invoices.

We appreciate the courtesies and cooperation of your staff during this audit. If you have any questions regarding this report, please contact me at 202-906-4600 or Dan Krueger, Senior Director at 312-880-5303.

Ted Alves,
Inspector General

Attachment

EXECUTIVE SUMMARY

WHY WE DID THIS AUDIT

This audit was conducted:

- To determine whether CSX complied with the Agreements, Appendix V, which provides the basis for "performance payments and penalties".
- To evaluate the adequacy of Amtrak management's oversight and controls of monthly OTP invoices.

CSX Transportation Inc. (CSX) billed Amtrak over $171 million from April 1993 through April 2004 (our audit period) of which $34 million was for on-time performance (OTP) incentives for operating passenger trains on-time more than 80% of the time during a month. The remainder, $137 million, was for services CSX rendered for operating Amtrak passenger trains over its tracks. The $34 million billed by CSX for OTP incentives is the subject of this report.

CSX has a responsibility to comply with the terms of the operating agreement by accurately billing and supporting the amounts billed for OTP incentive payments and services. We reviewed all the agreements and corresponding amendments between CSX and Amtrak applicable to the audit period and analyzed the supporting documents for OTP incentives billed by CSX.

Amtrak overpaid CSX $20,052,519 for On-Time Performance incentives

We found that CSX over billed Amtrak by $20,052,519 for OTP incentives. This occurred because CSX did not bill Amtrak for OTP incentives in compliance with Appendix V of the operating agreement. Specifically, CSX did not provide documentation to support its OTP incentive claims and submitted inaccurate claims for departure and arrival times, and tolerances - such as, station, extra car, recovery time base, miscellaneous, curfew/maintenance of way, and Do-Not-Count (DNC) tolerances claimed.

We also found that Amtrak's Transportation Operations Management group did not perform a complete and thorough review to verify the OTP incentives billed by CSX prior to approving them for payment. In our August 2008 report, we advised Amtrak that invoices from host railroads were not thoroughly reviewed prior to payment. Specifically we reported that management controls were inadequate and ineffective and host railroads had consistently over billed Amtrak. We reported that management is responsible for establishing adequate systems of internal controls over its operations to provide reasonable assurance that Amtrak's assets are protected. We recommended, among other actions, that Amtrak perform thorough and complete reviews of host railroad bills prior to payment. Although management agreed to thoroughly review bills before making payments, nearly 2 years later management has not implemented our recommendations. We estimate, based upon our audit work during the last 10 years, the potential cost to Amtrak of not establishing effective and adequate controls over the OTP incentive review and payment process has cost Amtrak about $5 million per year on average.

We recommended that Amtrak management recover the $20,052,519 CSX over billed Amtrak for OTP incentives and make the funding commitment and provide a plan with milestone dates for implementing corrective actions. Management agreed with both recommendations and committed to provide an action plan by May 1, 2010.

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BACKGROUND

The Rail Passenger Service Act of 1970 created the National Railroad Passenger Corporation (NRPC), a.k.a. Amtrak, to operate a national rail passenger system. Amtrak was created with the understanding that the freight (host) railroads, such as CSX Transportation, Inc. (CSX), would provide certain services, equipment, and facilities to Amtrak in order for Amtrak to provide national rail passenger service. Host railroads can bill Amtrak for all costs that were considered "avoidable" had Amtrak not been allowed to operate over its tracks. In addition to "avoidable" costs, Amtrak elected to include incentives in the agreements with the host railroads to entice them to operate passenger trains on-time; i.e., within the mutually agreed upon running times between established checkpoints[1]. Generally, performance payments are calculated using provisions described in Appendix V of railroad operating agreements.

CSX summarizes and provides detailed schedules of its calculations for each train's operating performance monthly. The CSX schedules show the total runtime, tolerances claimed, and whether the train was "on-time" or late for each trip during the month. The "on-time" percentage is determined by dividing the number of times the train arrived "on-time" at the checkpoint by the number of trips operated to the checkpoint during the month.

Amtrak's Transportation Operations Management group reviews the CSX monthly bills and if Amtrak management disagrees with any portion of a bill, then they take exception to it and notify CSX by labeling it as an exception/exception notice and reduce the payment to CSX by the amount of the exception.

RESULTS OF AUDIT

Finding: Amtrak over paid $20,052,519 in OTP incentives

Our audit of the monthly OTP bills and schedules disclosed that CSX inaccurately billed Amtrak for on-time performance payments from April 1993 through April 2004. The inaccurate billing occurred because CSX did not comply with the tolerances allowed in Appendix V, Section A, of

[1] A checkpoint is a term used in the agreement to identify the endpoint of a trip or partial segment of a trip for purposes of calculating OTP incentives. This is usually a specific location such as a station or a cross-over point between two tracks on the same railroad or between different railroads. For example, there may be one or many checkpoints on a long distance train route. A route from Chicago to Pontiac, MI has only one checkpoint, the endpoint. A route such as the Sunset Limited has three checkpoints on the CSX railroad.

the agreement. Further, Amtrak management did not perform a complete and thorough review[2] to verify the OTP claims made by CSX. As a result Amtrak over paid CSX $20,052,519 for OTP incentives.

Performance Payments and Penalties

All of the agreements between Amtrak and CSX include an Article V, Section 5.1 (c), which gives CSX the right to additional payments for schedule adherence; i.e., OTP incentive payments, as set forth in Appendix V (Performance Payments and Penalties[3]). Appendix V states, "Performance payments will be paid for a train at each performance checkpoint where the train attains an on-time performance greater than 80% during a month. Performance penalties will be assessed against the train at performance checkpoints where the on-time performance is less than 70% during a month."

Percentage of total trips run on-time during the month per Appendix V, Table 1	Performance Payments and Penalties
80-100%	CSX earns incentive payments
70-80%	no incentives earned and no penalties assessed
0-70%	CSX incentive payments are recoverable up to the amount paid in the preceding 12 months

Appendix V provisions set forth the conditions that are to be used to determine the on-time percentage as well as how to apply the provisions and calculate the on-time percentage. Specifically, in determining whether a train arrived on time, Amtrak agreed to allow tolerances for specific delays that were not caused by or were generally beyond the control of the host railroad.

Appendix V, Section D, of the agreement between Amtrak and CSX is referred to as the "look-back" provision. The "look-back" provision limits Amtrak from applying penalties beyond the amount of performance payments earned for all passenger trains at all checkpoints in the

[2] Amtrak's Transportation Operations Management group took exception to $4,835,928 billed by CSX for the audit period. Although Amtrak's Transportation Operations Management performed a review, they agreed that the review was not a complete and thorough review; i.e., the review was not detailed enough to detect or prevent erroneous OTP claims made by CSX.

[3] CSX can earn incentive payments, but it is not required to pay and has never paid Amtrak a penalty for undesirable on-time performance; i.e., operating Amtrak passenger trains less than 70% on-time during the month. The agreement allows Amtrak to recover any performance payments made to CSX during the preceding 12 month period for operating Amtrak passenger trains less than 70% on-time during the month. Any performance payments made prior to the preceding 12 month period cannot be recovered by Amtrak.

preceding 12 month period. For example, the preceding 12 month period "look-back period" was applied as follows:

> In January 1995, CSX billed Amtrak $353,148 for OTP incentives. Our analysis showed that CSX should not have billed Amtrak because it operated Amtrak trains on time less than 70% of the time. According to the "Calculation of Performance Penalties" agreement provision, CSX owed Amtrak $149,540 for operating Amtrak trains on-time less than 70% of the time during January 1995, instead of earning $353,148 for OTP incentives as billed. We "looked-back" 12 months to January 1994 and verified that Amtrak paid $241,984 for OTP incentives to CSX. We were able to recapture the $149,540 owed Amtrak for January 1995 due to the "look-back" provision by offsetting it against the $241,984 paid to CSX in January 1994.

We calculated the "look-back" provision based upon discussions with Amtrak management. Refer to Exhibit B for Amtrak's interpretation of the 12 month "look-back" provision.

We found that CSX did not comply with the agreement provisions and submitted inaccurate OTP billings to Amtrak. The inaccurate claims occurred due to errors or omissions in the following areas:

a. Departure and/or arrival times.
b. Station dwell calculations.
c. Extra car tolerances.
d. Carry-forward calculations.
e. Miscellaneous tolerances.
f. Curfew/maintenance tolerances.
g. "Recovery time base" tolerances.
h. Using expired or incorrect agreement provisions.
i. Failing to take into account early arrivals at the stations.
j. Claiming "Do Not Count" (DNC) tolerances not stipulated in the agreement.[4]
k. Failing to include necessary trip detail notes to support claimed tolerances.

For example, when reviewing departure and/or arrival times we used the following procedure; if Amtrak held the train at a station longer than planned for boarding a large group of passengers, then the host railroad should not be penalized or lose its incentive because the delay was caused by Amtrak and was not attributable to the railroad. On the other hand, if CSX was responsible for a delay such as an Amtrak train being held at a station due to a signal problem or freight train congestion, then CSX was responsible for the delay and Amtrak would be entitled to recover incentive payments previously paid to CSX (subject to the "look-back" provision).

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[4] DNC tolerances are allowed to identify situations when neither CSX nor Amtrak is responsible for a delay, such as severe weather. Thus, the train will not be counted at such checkpoint as late or as operated in calculating the train's monthly on-time performance.

In summary, we audited 56 of 133 months for which records were available. Whenever records were not available, we did not question CSX OTP claims and allowed them in their entirety. Those claims were; however, subject to the "look-back" provision.

Overall, we are questioning the validity of the $20,052,519 in OTP incentive payments made to CSX. The $20,052,519 is comprised of the $16,741,104 Amtrak paid CSX in performance payments during for the 56 months audited plus $3,311,415 in performance penalties that are recoverable due to the "look-back" provision.

Railroad monthly billings are not thoroughly reviewed before payment

Although Amtrak's Transportation Operations Management group took exception to approximately $4.8 million billed by CSX for the audit period, management stated the reviews were not complete and thorough. In other words, the reviews were not detailed enough to detect or prevent erroneous OTP incentive claims made by CSX. In August 2008, we issued our report on Host Railroad Administration and Operations Management Controls (Report No. 401-2008). We reported that management controls were inadequate and ineffective and host railroads had consistently over billed Amtrak.

We reported that management is responsible for establishing an adequate system of internal controls over its operations to provide reasonable assurance that Amtrak's assets are protected. Internal controls help management achieve it goals, operate effectively and efficiently, and protect Amtrak from losses. Good business practice dictates that invoices be thoroughly and completely reviewed and amounts verified before being approved for payment.

We further reported that the Inspector General Act of 1978 (amended in October 1988) and Amtrak policy P/I 2.1.1 state that the OIG has an oversight responsibility. Ongoing detailed reviews of monthly host railroad billings are not a function of the OIG. This is a management function.

We recommended, among other actions, that Amtrak perform complete and thorough reviews of host railroad bills prior to payment. Management agreed that billing reviews could be more comprehensive, but stated that it would require additional staff whose cost might not be offset by a commensurate improvement in the accuracy of payments. We do not agree with Amtrak's position. Our audit results have consistently shown that Amtrak incurs significant and unnecessary loses due to inadequate billing reviews. Nearly two (2) years later, Amtrak has not implemented our recommendation. Amtrak needs to take action now and establish effective and adequate controls over the OTP incentive review and payment process.

Every month that Amtrak delays implementing our prior audit recommendations (report No. 401-2008) Amtrak loses money by overpaying host railroads for OTP incentives. Specifically, based on our audit results, Amtrak has recovered more that $10 million over the last 10 years in

OTP incentive overpayments. Further our on-going audits have identified an additional $40 million in potential recoveries. We estimate the potential cost to Amtrak of not establishing effective and adequate controls over the OTP incentive review and payment process is about $5 million per year on average[5].

CSX Management

In March 2008, we met with CSX management to discuss our results. CSX disagreed with the entire matter citing a variety of issues including our reliance on delay reports, misapplication of the "look-back" provisions, and statute of limitations. We believe CSX's position lacks merit. For example, CSX indicated Amtrak should not rely exclusively upon delay reports, yet CSX issued an internal memorandum that stated, "Effective at 12:01 am, September 12, 1994, CSXT will begin utilizing the Amtrak conductors delay reports for all trains operating over CSXT. The TMAI sheets should match the conductor delay reports or the Arrow system delay reports. It is imperative that this is implemented immediately." CSX also indicated any claims against them were subject to a three-year statute of limitations. We informed CSX that a National Arbitration Panel (NAP) ruled that the statute of limitations was an inappropriate defense in a NAP proceeding and therefore does not apply to our audit or time period.

RECOMMENDATIONS

We recommend that Amtrak management;

(1) Recover the $20,052,519 Amtrak overpaid CSX for OTP incentives, and

(2) Make the funding commitment and provide a plan with milestone dates, responsible office, and management official for implementing the recommendations in our 2008 report (No. 401-2008, dated August 21, 2008 including;

- performing real time thorough reviews prior to payment,
- developing formal written procedures and detailed steps to conduct reviews of railroad OTP incentive billings,
- clearly defining responsibilities and aligning the functions to ensure a separation of duties, this should include not having people who negotiate the contract administering it.

[5] $50 million divided by 10 years.

MANAGEMENT'S COMMENTS AND OIG RESPONSE

We provided Amtrak with a draft report on March 19, 2010 and received a response on March 26, 2010. Management's response is included in it's entirety in the Appendix to this report. Amtrak stated the report provides useful information on which it can take action to strengthen the review of host railroad billing practices. Amtrak also stated it expects to be able to initiate negotiations of overpayments with CSX after reviewing and analyzing OIG's methodology and records on which it based its findings. Amtrak agrees that a thorough review to verify on-time performance incentives billed by host railroads should be performed prior to the approval and payment of invoices. Amtrak plans to adopt protocols and guidance consistent with OIG's 2008 report recommendations to; 1) perform real time thorough reviews prior to making payments, 2) develop formal written procedures for conduction the billing reviews, and 3) clearly define responsibilities for conduction the reviews. Amtrak agreed to provide a detailed action plan with milestone dates by May 1, 2010 to address our recommendations.

We recognize that management has taken some actions to implement the 2008 recommendations including realigning the Host Railroad Group (contract negotiation) into the Transportation Department, continuing the efforts to implement simplified, automated "Delay Avoidance Incentives" with host railroads, and reinforcing the separation of duties between the Host Railroad Group (contract negotiation) and Contract Administration (contract bill review, payment, and audit).

We are encouraged by Amtrak's commitment to address the issues raised in this report. The recommendations will remain open pending implementation.

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<u>Audit Staff:</u>

Trig Alonso
Richard Bohne
Dan Krueger
Satish Parikh
See See Young
Raymond Zhang

Exhibit A
Scope and Methodology

We conducted this audit in accordance with the generally accepted government auditing standards (GAGAS). These 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. We conducted this review between 2004 and 2008. We used the following scope and methodology in conducting this review.

Scope

CSX billed $34,391,905 in OTP incentives for the audit period of April 1993 through April 2004 of which our audit included the net paid amount of $26,590,523. (See the table below for the breakout of the purpose and the amounts not included in the audit).

Schedule of Amounts billed by CSX and Net paid to CSX

	Agreement April 1993-March 1997	Agreement April 1997-May 1999	Agreement June 1999-April 2004	Totals
RF&P Auto Train Billed (Separate Agreement)	$ 2,965,454	$ -	$ -	$ 2,965,454
CSX Auto Train Billed (Separate Agreement)	$ 2,445,642	$ -	$ -	$ 2,445,642
CSX Billed	$ 13,211,958	$ 9,477,961	$ 6,290,890	$ 28,980,809
Billed by CSX	$ 18,623,054	$ 9,477,961	$ 6,290,890	**$ 34,391,905**
RF&P Auto Train Billed - Not Audited (**Note 1**)	$ (2,965,454)	$ -	$ -	$ (2,965,454)
Exceptions (CSX claims denied by Amtrak management)	$ (92,597)	(498,251)	$ (4,245,080)	$ (4,835,928)
Net paid to CSX	$ 15,565,003	$ 8,979,710	$ 2,045,810	**$ 26,590,523**

Note 1
CSX took over RF&P in 1991, but continued to bill Amtrak under separate agreements until they were merged in the April 1, 1997 agreement. This included spearate "Auto Train" agreements.

There were three CSX operating and two "Auto Train" agreements applicable during the audit period. The three operating agreements were effective on November 1, 1986, April 1, 1997, and June 1, 1999 respectively. Each operating agreement was further amended through Amendment Agreement Changes (AACs). Amtrak also had an operating agreement with the Richmond, Fredericksburg and Potomac Railroad (RF&P). CSX merged its operations with the RF&P in 1991. At that time, CSX also became responsible for the RF&P agreement dated January 1, 1977. The RF&P agreement, railroad operations, and monthly bills remained separate until the April 1, 1997 agreement (Second Agreement) became effective. All of these agreements were reviewed and used as the basis to determine the accuracy and validity of CSX monthly billings for on-time performance incentives and to verify the compliance of CSX claims with Appendix V of the agreement.

The right to perform an audit of CSX bills is included in Article V, Section 5.2(b) of the agreement. This section allows Amtrak to audit and/or evaluate any payment of both financial and operational issues. Both parties are required in Article V, Section 5.2(c) to maintain supporting accounting, operating, and mechanical department records that are to be available for inspection and/or copying. Although the agreement states that all such records must be retained a minimum of 36 months our legal counsel concluded the 36 month limitation does not apply to our audit or the time period.

A subpoena was issued to the CSX in 2003 to obtain documents for the audit period. However, because the audit period included dates back to April 1993, there were no Amtrak or CSX records available to review and verify the monthly billing claims for the months from April 1993 through October 1994.

Methodology

The audit included the following methods for gathering, analyzing and summarizing data:

- Reviewing the operating agreement and its amendments, focusing on sections that relate to the billing of OTP regarding train performance;
- Obtaining Train Operations Support System (TOSS) data and Amtrak Delay Reports (ADRs/CDRs) to enter trip data for analysis of OTP incentives claimed;
- Reviewing the detailed support of OTP billings submitted to Amtrak monthly by CSX;
- Comparing tolerances claimed by CSX with all available support documentation;
- Calculating over and/or under-billed amounts, as a result of any claim inaccuracies by CSX; and
- Communicating with host railroad groups for interpretation of agreement provisions.

Exhibit B

Amtrak Management Interpretation of 12 Month Look-back

COPY
12/31/08

July 5, 2000

Mr. G. B. Mott
AVP – Passenger Integration & NRPC Operations Officer
CSX Transportation, Inc.
500 Water Street, SC J-315
Jacksonville, FL 32202

Dear Mr. Mott:

This is to follow up our discussion about the interpretation of the 12-month look back limit for on-time performance penalties. The language concerning the 12-month look back limit is in Appendix V, Section D, which states:

"D. Remittance of Performance Payments and Penalties.
Performance payments will be paid to CSXT in accordance with section 5.2 (Billing and Payment). Penalties may be deducted from the amounts otherwise payable to CSXT pursuant to this Agreement or paid separately to Amtrak; provided, however, that penalties shall only apply up to the amount of performance payments earned for all trains at all checkpoints in the preceding twelve-month period."

As you can see, the language limits penalties to "performance payments earned", not "performance payments earned less performance penalties paid". "Performance Payments" and "Performance Penalties" are two separate and distinct terms utilized throughout Appendix V, beginning in the first paragraph. Only the performance incentives are utilized for the penalty limit because netting not only limits penalties in a given month but also limits future penalties even though performance payments were earned after the current month but before the future penalty. This is counterproductive to an effective incentive/penalty arrangement. If it were the intent of the parties to net payments and penalties, the language in Appendix V.D would have been stated that way.

Sincerely,

S

Gary A. Reinoehl
Senior Director Contract Administration

bcc: Lee Bullock
Fred Ohly
Richard Simonen

APPENDIX

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

Memo

AMTRAK

Date March 26, 2010
To Tel Alves

From Joseph H. Boardman
Department President and CEO
Subject OIG Audit Report No. 406-2005
cc Eleanor Acheson
William Crosbie
DJ Stadtler
Richard Phelps
Jessica Scritchfield

Message This is management's official response to the OIG Audit Report No. 406-2005 On-Time Performance Incentives.

The Office of Inspector General (OIG) draft audit report dated March 19, 2010, regarding CSX on-time performance incentive payments provides useful information on which Amtrak management can take action to strengthen the review of host railroad billing practices. Since the OIG's previous report in August 2008, the company has made a number of improvements. However, we recognize that more needs to be done to fully ensure that Amtrak pays accurate and supportable incentive amounts when operating on host railroads.

In response to the recommendations in the draft report, management will work with the OIG staff to fully understand the methodology used to calculate overpayments made to CSX and communications to date between OIG and CSX, and will then pursue, with the help of the Law Department, any amounts management believes to have been overpaid during the period from April 1993 through April 2004 that are recoverable under the law and within the terms of the applicable operating agreements between Amtrak and CSX. Management expects to be able to initiate negotiations of overpayments with CSX after reviewing and analyzing OIG's methodology and the records on which it based its findings.

Amtrak management also agrees that a thorough review to verify on-time performance incentives billed by host railroads should be performed prior to the approval and payment of invoices. Management will endeavor to adopt protocols and guidance consistent with the August 2008 OIG report, including the recommendations to (1) perform real time thorough reviews prior to making payments, (2) develop formal written procedures for conducting the billing reviews, and (3) clearly define responsibilities for conducting the reviews. Once management decides how it will proceed in this regard, we will inform the OIG and provide an action plan detailing how and when the changes will be implemented. We note, however, that management has already taken some actions to implement the 2008 recommendations including realigning the Host Railroad Group to the Transportation Department; continuing efforts to implement simplified, automated "Delay Avoidance Incentives" with host railroads; and reinforcing the separation of duties between the Host Railroad Group (contract negotiation) and Contract Administration (contract bill review, payment, and audit).

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Richard Phelps, Vice President - Transportation, will be responsible for making these changes. His staff will provide the OIG with a detailed action plan with milestone dates to implement the recommendations by May 1, 2010.