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The Alaska Railroad: Its Management Is Being Improved, Its Future Needs To Be Decided. CED-78-137; B-114886. July 27, 1978. 60 pp. + 2 appendices (13 pp.).

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

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The Federal Government has owned and operated the Alaska Railroad (ARR) since 1923. The ARR has played an important role in developing Alaska and in meeting national defense needs; it has become an integral and essential part of Alaska's transportation system. The environment in which the ARR now operates has changed considerably since 1923, however, and competing transportation modes have grown rapidly.
Findings/Conclusions: Because it operates in a competitive environment, the ability of the ARR to attract customers is essential. The railroad had management weaknesses, including: no overall marketing plan, a tariff structure which did not insure that it could meet costs and reinvestment needs, and unreasonably low real estate rental rates. The ARR did not have an adequate system of internal controls; as a result, the potential for improper financial transactions existed; potential operating revenues were lost; and property and materials were not adequately protected. Financial management procedures and practices were inadequate, resulting in inaccurate and unreliable accounting data. Pay scales were unreasonably high in relation to other Federal agencies in Alaska. Recommendations: The Secretary of Transportation should direct the General Manager of the ARR to: periodically make a systematic assessment of transportation needs in its service area, develop a plan for actively marketing its services, determine the actual cost of

providing service on specific commodities so that its tariff can be set fairly, and evaluate the effect of the railroad's marketing and rate policies on consumers and competitors. The General Manager of the ARR should assess its procedures and implement an effective management and control system. He should also establish procedures designed to give reliable accounting data, adequate control over the expenditure of funds, and compliance with Federal regulations. The Congress should decide whether the Federal Government should continue its ownership and operation of the ARR. (RRS)

7139

BY THE COMPTROLLER GENERAL

Report To The Congress

OF THE UNITED STATES

The Alaska Railroad: Its Management Is Being Improved; Its Future Needs To Be Decided

The Alaska Railroad has not effectively managed some of its affairs and there is doubt what its future role will be.

Some of its weaknesses are

--no overall marketing plan,

--loss of revenue, and

--inadequate financial management procedures and practices.

However, the Federal Railroad Administration and the Railroad have taken actions to correct many of the problems.

The Congress should decide whether the Federal Government should continue to own and operate the Railroad.

UNITED STATES GENERAL ACCOUNTING OFFICE

CED-78-137

JULY 27, 1978

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

B-114886

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

This report discusses the Alaska Railroad's present and future role and outlines a number of opportunities for improving its management. Since we completed our audit, the Federal Railroad Administration and the Alaska Railroad have taken action to correct many of the problems discussed in this report, but we believe continuing attention is necessary.

We made our review pursuant to the Budget and Accounting Act, 1921 (31 U.S.C. 53), and the Accounting and Auditing Act of 1950 (31 U.S.C. 67).

We are sending copies of this report to the Director, Office of Management and Budget, and to the Secretary of Transportation.

Comptroller General
of the United States

COMPTROLLER GENERAL'S
REPORT TO THE CONGRESS

THE ALASKA RAILROAD:
ITS MANAGEMENT IS BEING
IMPROVED; ITS FUTURE
NEEDS TO BE DECIDED

D I G E S T

The Alaska Railroad has played an important role in developing Alaska and in meeting national defense needs. It has become an integral and essential part of Alaska's transportation system, and has indirectly helped to develop other Alaskan resources--38 percent of its total revenue in 1975 resulted from transportation services provided for the trans-Alaska oil pipeline. (See p. 2.)

However, the railroad had many management weaknesses; its future is questionable.

--It had no overall marketing plan.

--Its tariff structure did not insure that it could meet its costs and reinvestment needs. (See p. 9.)

--Its real estate rental rates were unreasonably low; some lessees were allowed to use railroad property without paying a cash consideration. (See p. 17.)

The railroad also did not have an adequate system of internal controls. The potential for improper financial transactions existed, potential operating revenues were being lost, and property and materials were not adequately protected. (See p. 25.) For example

--some vouchers were paid without supporting documentation (see p. 26),

--weights of shipments were not verified (see p. 27), and

--credit was extended to many customers who were not authorized to receive it. (See p. 31.)

Its financial management procedures and practices were inadequate, resulting in inaccurate and unreliable accounting data. Pay scales were unreasonably high in relation to other Federal agencies in Alaska. The Railroad also failed to comply with regulations governing travel, leave, and procurement. (See p. 37.)

The Government has appropriated about $214 million through fiscal year 1977 to finance construction, maintenance, and operations. (See p. 2.) There is doubt about the Railroad's future. The executive branch has expressed a desire to sell the Railroad, which would require approval by the Congress. Management decisions appropriate for the Railroad's future as a Government enterprise probably would differ from those appropriate for an enterprise which will be sold. (See p. 55.)

GAO is making a number of recommendations to improve the Railroad's effectiveness and is recommending that the Congress decide whether the Federal Government should continue to own and operate the Railroad. (See pp. 14, 23, 35, 53, and 60.)

DEPARTMENT OF TRANSPORTATION COMMENTS

The Department of Transportation said that GAO had made a contribution in performing its review of the Alaska Railroad's management, particularly in the areas of real estate, internal control, and financial management.

As a result the Railroad has made considerable changes, and the Federal Railroad Administration will continue to exercise an oversight role. The Department summarized its comments as follows.

--There is acknowledgement within the Federal Railroad Administration of the need to strengthen the Railroad's marketing effort.

--The Alaska Railroad has embarked on a course of obtaining fair market value for its leases in direct response to GAO's findings.

--There were many inadequacies in the Railroad's system of internal controls, but corrective action has been taken in many of the areas to rectify the situation and such action will continue to institute a sound internal control system.

--Many of the Railroad's financial management procedures and practices were inadequate, but action has been taken to remedy the situation. (See app. I.)

Contents

ABBREVIATIONS

ARR	Alaska Railroad
CSC	Civil Service Commission
DOT	Department of Transportation
FRA	Federal Railroad Administration
FTR	Federal Travel Regulations
GAO	General Accounting Office
GSE	General Schedule Equivalent
ICC	Interstate Commerce Commission
OMB	Office of Management and Budget

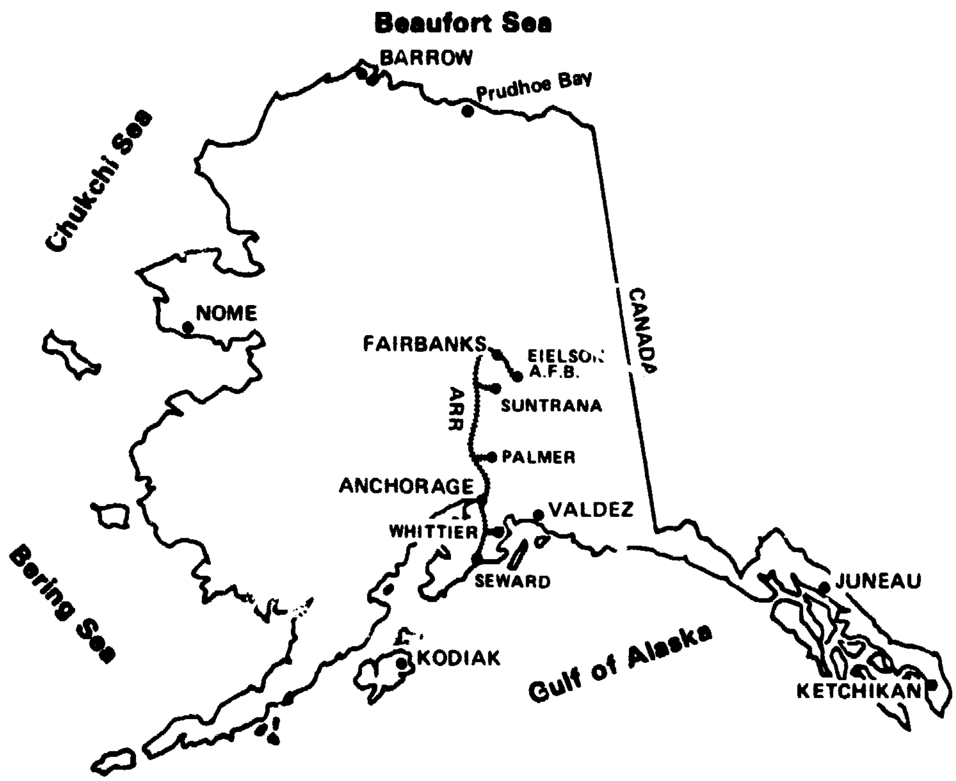
CHAPTER 1

INTRODUCTION

In 1914 the Congress authorized construction and operation of the Alaska Railroad (ARR). Construction was completed in 1923, and the Federal Government has owned and operated ARR ever since. The 1914 act (43 U.S.C. 975) intended that ARR would serve both national and Alaskan needs. The stated purpose was:

> "* * * to aid in the development of the agricultural and mineral or other resources of Alaska, and the settlement of the public lands therein, and so as to provide transportation of coal for the Army and Navy, transportation of troops, arms, munitions of war, the mails, and for other governmental and public uses, and for the transportation of passengers and property * * *."

In fiscal year 1977, ARR operated 478 miles of single main line track from the ice-free ports of Seward and Whittier through Anchorage to Fairbanks. Branch lines extended to Palmer, the Fairbanks International Airport, Eielson Air Force Base, and the Suntrana coal fields.



ARR's ROLE IN ALASKA

ARR has played an important role in developing Alaska and in meeting national defense needs. It has become an integral and essential part of Alaska's transportation system. By 1975 70 percent of Alaska's population lived in the area served by ARR (known in Alaska as the "railbelt").

ARR serves the Suntrana coal fields and transports coal to public utilities and military bases. By transporting materials and supplies, ARR has indirectly helped to develop other Alaskan resources. For example, ARR estimated that 38 percent of its total revenue in calendar year 1975 resulted from transportation services provided for the trans-Alaska oil pipeline.

ARR serves the national defense by transporting coal, equipment, and petroleum products to military bases. In fiscal year 1976 ARR transported 98,499 tons of petroleum and 288,322 tons of coal for the military.

THE FEDERAL INVESTMENT

Since it created ARR in 1914, the Congress has appropriated about $214 million to finance construction, maintenance, and operations. The Congress appropriated about $57 million between 1914 and 1924 to build ARR and appropriated another $15 million between 1925 and 1939 to help meet operating expenses. The Congress provided $95 million between 1947 and 1955 to help rehabilitate ARR after heavy use in World War II, and provided about $26 million of disaster recovery funds after an earthquake caused considerable damage to ARR in 1964. Between 1974 and 1977, the Congress appropriated ARR another $21 million for capital replacement, improvements, and maintenance. In addition, the Federal Government has provided land to ARR, and other Federal agencies have transferred or donated property or funds.

THE PROFIT AND LOSS RECORD

ARR has sustained several large operating losses since 1967 and has only had marginal profits in other years, except for fiscal years 1975 and 1976 when profits were higher because of trans-Alaska pipeline business. The following table shows ARR's profit and loss record for the past 10 years.

ARR Profit and Loss Record
FY 1968 through FY 1977

Fiscal year	Profit or loss(-)
1968	-1,399,000
1969	313,000
1970	212,000
1971	-3,095,000
1972	287,000
1973	-2,960,000
1974	-1,061,000
1975	5,808,000
1976	4,081,000
1976 Transition quarter a/	-1,113,000
1977	-960,000

a/ The Federal Railroad Administration (FRA) stated that ARR's $1.113 million loss in the 1976 transitional period was caused by a deliberate ARR decision to use pipeline profits to reduce longstanding deferred maintenance.

RESPONSIBILITY FOR ARR

The 1914 act gave the President responsibility for ARR. Operational responsibility for ARR was delegated to the Secretary of the Interior in 1923. In 1966 the Congress passed legislation creating a Department of Transportation (DOT) and making the Secretary of Transportation responsible for ARR. The Secretary of Transportation subsequently placed the responsibility for ARR in FRA, an agency of DOT.

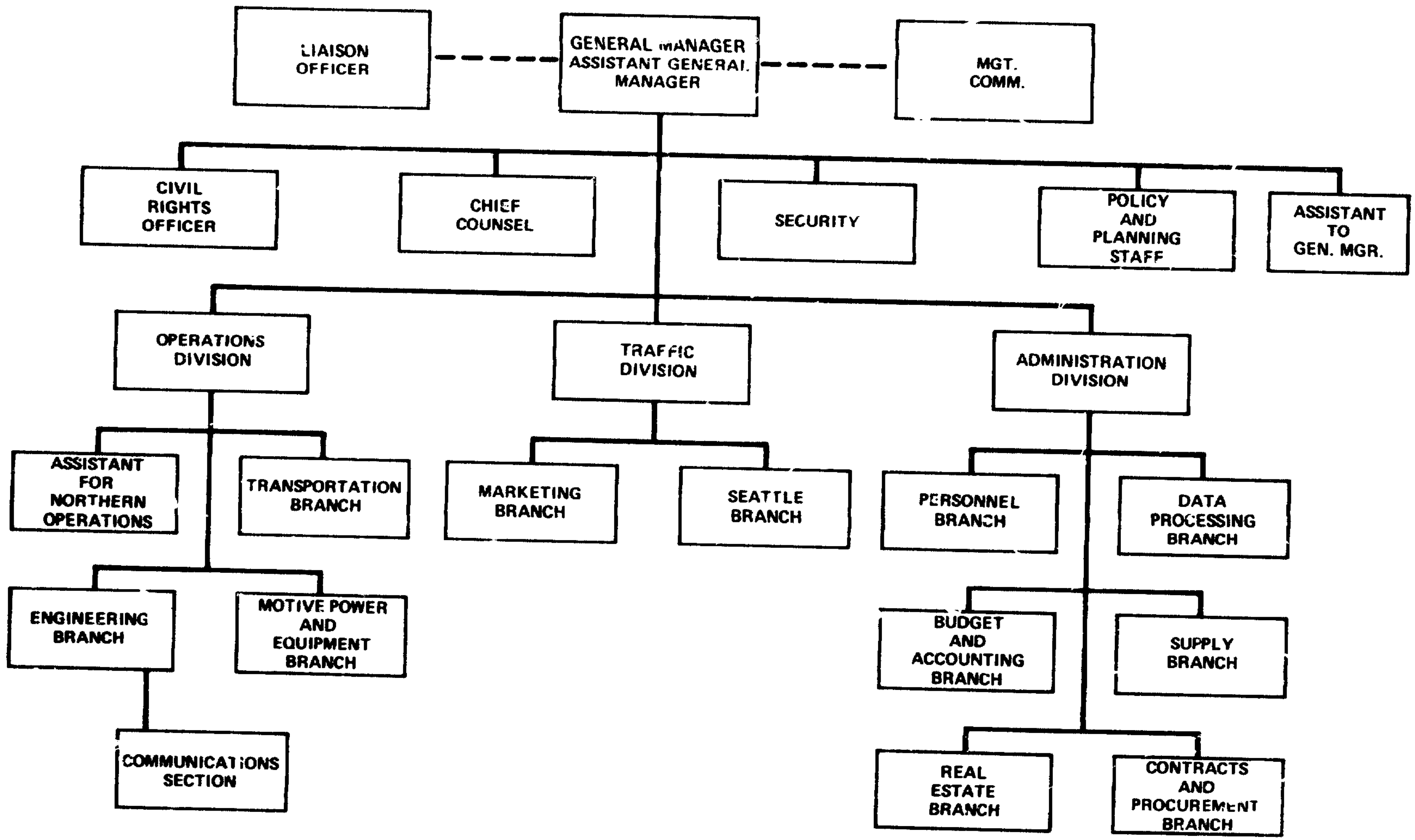
ARR ORGANIZATION

ARR's three major divisions are shown as follows and in the organization chart on page 4.

--The Operations Division directs and performs all rail line operations and station services; maintains equipment, track, and structures; provides engineering services and communications; and administers ARR's safety program.

--The Traffic Division directs and administers all matters relating to tariffs, negotiations on

THE ALASKA RAILROAD



traffic agreements, and solicitation of freight and passenger traffic.

--The Administrative Division directs and administers all matters relating to administrative support of ARR, including personnel, budget and accounting, data processing, supply, contracts and procurement, and real estate.

Many of ARR's former general managers have not stayed with ARR long enough to provide continuity. From 1946 to 1978 there have been nine general managers; five stayed about 2 years or less. However, many of ARR's other management personnel have many years of service with ARR.

FRA's RELATIONSHIP WITH ARR

According to FRA's former Deputy Administrator, past interest in ARR by both the Department of the Interior and DOT was governed by the personal interest of the administrators involved, and since there were few issues concerning ARR, it was allowed to operate independently. With the construction of the trans-Alaska pipeline, however, FRA became more interested in ARR's activities and conducted a management review in 1975 to assess whether ARR could respond adequately to the resulting business increase.

The former official said that FRA previously had difficulty monitoring ARR activities because of the distance between ARR and FRA offices and ARR's attitude toward FRA.

The 1975 management review

FRA completed its management review in 1975. A joint team, composed of staff from FRA and the Office of the Secretary of Transportation, evaluated a number of functions, including organizational structure, staffing, personnel management, financial condition, management systems, rolling stock, and fixed operations.

The review team found several problems in ARR's operations. For example:

--ARR's administrative functions were fragmented.

--ARR did not have complete and adequate manpower management control systems in place, and its budget cycle did not call for definitive data supportive of manpower requests.

--Union contracts had not been renegotiated for several years and there were inconsistencies with current Executive orders; no focal point existed for management to deal with the unions.

--There was an absence of any system, procedure, or process that summarizes, displays, or highlights for top management the key data from all the management control and planning systems ARR used.

Although ARR had taken steps to correct some of these problems, they had not been resolved at the time of our review.

FRA involvement in ARR management

As a result of FRA's 1975 management review, a management committee was formed in 1976 to provide advice to ARR's general manager. The committee presently includes FRA's Associate Administrator for Administration; Associate Administrator for Policy and Program Development; Chief Counsel; Director, Office of Planning and Budget Development; and Special Assistant to the Administrator; and ARR's General Manager. The committee meets at least quarterly to provide advice on matters affecting ARR's efficiency. The committee was specifically responsible for commenting on FRA's recommendations pertaining to (1) the annual budget, (2) staffing levels, (3) capital improvements over $300,000, (4) major procurements, (5) executive level personnel actions, (6) compensation plans, (7) major operational matters and expenses, and (8) the safety program.

PHYSICAL CONDITION OF THE RAILROAD

In June 1975 ARR's general manager submitted a $424.5 million 5-year budget program to FRA. The general manager described ARR's condition as follows:

--Track and roadbed were built on unstable ground and were poorly maintained.

--Bridges and culverts were old. Bridge load capacity was low and some culverts were subject to failure.

--ARR's frequent, sharp curves required high maintenance cost and slow train speeds.

--Rails and ties were old and in poor condition.

--Tunnels were unlined, unventilated, and supported by 30-to 50-year-old untreated timber. Tunnel clearances were substandard and tunnel roadbeds were poor.

--Maintenance and snow removal equipment was obsolete.

--Passenger equipment was old and its maintenance cost was high.

--Buildings were old and deteriorated and utility systems were inadequate.

--Port facilities required corrosion protection. Gantry cranes were old and inadequate.

--The Anchorage railroad yard was generally deteriorated and congested.

During fiscal year 1977 appropriation hearings before a Subcommittee of the House Committee on Appropriations, the FRA Administrator said that $29.25 million would cover all ARR's maintenance that had been deferred over the past 15 to 20 years and restore ARR's physical plant to a normalized condition.

At FRA's request, two former ARR general managers inspected the railroad during 1975. The FRA Administrator reported the former managers' findings in a May 1976 letter to Senator Stevens of Alaska. The Administrator said that rail, ballast, and tie conditions were acceptable for the tonnage projected through 1980, with continued normalized maintenance, but that the tunnels needed considerable maintenance expenses. The Administrator reported that economic conditions did not justify line relocation. He also said that there were load limits on ARR's bridges, but that upgrading could be deferred.

As shown in the table below, ARR made substantial capital expenditures for facilities and equipment during fiscal years 1975 through 1977. According to the general manager, these have significantly improved ARR's operating capabilities.

Capital Expenditures

	FY 1975	FY 1976	FY 1977	Total
	(000 omitted)			
Buildings	$ 546	$ 450	$ 200	$ 1,196
Other structures and facilities:				
Roadbed and track	700	3,020	1,535	5,255
Tunnels	560	-	575	1,135
Pollution control	70	-	120	190
Communications system	-	120	140	260
Bridges	370	870	300	1,540
Other	90	200	-	290
Equipment:				
Locomotive purchases and rebuilding costs	2,124	4,003	3,800	9,927
Freight train cars	370	6,370	875	7,615
Caboose rebuilding costs	-	280	-	280
Construction and maintenance	1,102	1,495	330	2,927
Communications	-	90	-	90
Shop	77	-	-	77
Other	116	612	125	853
Total	$6,125	$17,510	$8,000	$31,635

SCOPE OF REVIEW

We reviewed ARR's efficiency and effectiveness by (1) examining laws and regulations pertaining to ARR specifically, and other railroads generally, (2) interviewing ARR personnel, (3) examining ARR's procedures and records, and (4) traveling the full length of ARR to obtain first-hand knowledge of operating and physical conditions. We also interviewed officials from FRA, the Port of Anchorage, State and local governments, and Alaskan businesses. We completed our review in mid-1977.

CHAPTER 2

ARR's MARKETING EFFORTS

ARR plays an important role in providing transportation within the State of Alaska, but the environment in which ARR now operates has changed considerably since operations began in 1923. Nationally, the competitive position of the railroad industry has deteriorated over the last half century, and railroads are no longer the dominant transportation mode for either freight or passengers. In Alaska, competing transportation modes, particularly highway and air transport, have grown rapidly.

ARR has traditionally operated with the objective of producing enough revenue to cover costs and, because it operates in a competitive environment, its ability to attract customers is essential. ARR, however, had no specific overall marketing plan to overcome numerous competitive problems. Opportunities existed, but ARR needed to improve its timeliness, its services, and its tariffs to compete more effectively and to be self-sufficient. Despite competitive pressures, ARR had not analyzed existing markets to assess whether changes in service were needed.

Freight tonnage and revenue remained relatively constant with only moderate average annual increases from 1957 to 1974. Freight revenue came primarily from a few specific products and was subject to the effect of one-time events. Although the Federal Government had been a primary user of ARR, its use is diminishing.

ARR tariffs did not fully consider the total costs to provide service, and the overall tariff structure did not assure that ARR could meet its costs and its reinvestment needs.

RESULTS OF PAST MARKETING EFFORTS

Alaska's economy grew steadily each year since 1960, but ARR's average freight tonnage and revenue increased only slightly. Between fiscal years 1950 and 1957, the average annual freight tonnage was 1,363,551 tons while the average tonnage from fiscal years 1967 to 1974 was 1,421,341 tons, an increase of 4 percent. Average annual freight revenue from 1950 to 1957 was $14,033,563 and increased to $14,643,097 between 1967 and 1974.

ARR significantly increased its freight tonnage and revenues in fiscal years 1975 and 1976 because of the trans-Alaska pipeline construction. These 2 years averaged 2,026,356 revenue tons, a 42.6 percent increase over the average tonnage betweeen fiscal years 1967 and 1974. In fiscal year 1975 freight revenue was about $32.5 million, and in fiscal year 1976 it increased to about $42.8 million. In fiscal year 1977, ARR's freight tonnage increased to 2.3 million tons, but freight revenues dropped to $28.5 million. According to ARR, tonnage was up because of increases in low-revenue short-haul gravel movements while revenues were down because of decreases in high-revenue long-haul pipeline related freight.

In recent years there have been a number of one-time events--in addition to pipeline construction--affecting ARR.

--A longshoremen's strike in fiscal year 1972 prevented a container service company from providing its regular service between Seattle, Washington, and Anchorage, Alaska. ARR arranged with another carrier to handle the container traffic and, as a result, port tonnage at Seward in fiscal year 1972 increased about 236 percent over the previous year.

--In fiscal year 1976, failure of Arctic ice to "go out" during the summer forced cargo bound for the North Slope to travel via ARR and highway rather than by barge.

The Federal Government was the major user of ARR for many years, and the military depended on ARR to transport needed supplies. However, the Government's use of ARR has been declining. For example, in 1969 the military utilities in Anchorage converted from coal to natural gas, reducing ARR's coal traffic by over 100,000 tons annually. In fiscal year 1967, the Federal Government's freight represented 59.4 precent of ARR's freight tonnage and 36.1 percent of its freight revenue. By fiscal year 1976, these percentages had declined to 21.7 percent and 9.6 percent, respectively.

MARKETING EFFORT NEEDS IMPROVEMENT

The kind of service ARR provides is critical to its ability to attract customers. However, ARR's traffic officer, who is responsible for marketing and pricing activities, said that there were no specific plans to attack the problems ARR faced and that ARR had not done much to broaden its traffic base because it did not feel it could do much.

ARR generally had not performed marketing studies on competitive problems and lacked a comprehensive marketing approach that (1) recognized where opportunities existed and (2) developed ways to provide marketable services. ARR's marketing policy to meet competitive challenges for its customers seemed to be based on individual cases. According to the traffic officer, when competitors tried to attract business from an ARR customer, ARR then tried to change its rate or policy. The assistant general manager stated that ARR evaluated each case individually and tried to develop a means to get a customer's business.

A 1976 DOT-funded study on ARR's future freight market commented that it was essential for ARR to become more active in marketing its services. The report said that the most important future consideration was for ARR to be sensitive to its customers' needs and to develop services to meet those needs. In assessing the effect of ARR's future action or inaction, the report made the following points:

--ARR's failure to respond in a firm marketing sense to the recent expansions by competitors within Alaska would likely result in erosion of ARR's traffic base. ARR should broaden its traffic base to protect against market fluctuations, which it has experienced in the past.

--Specific issues and needs had been identified. If ARR did not address these issues positively and aggressively, it would most likely experience a very limited or decreasing traffic market.

ARR's RATE DETERMINATIONS

Customers pay ARR according to published tariffs. In a March 1956 report to the Congress (B-114886), we noted that ARR's rates did not cover all costs. ARR still does not base its tariffs on total costs.

Total cost information could improve ARR's marketing efforts because ARR would better understand which commodities it makes a profit on. Budgeting efforts could also be improved because ARR could more readily identify ways to reduce costs. ARR's traffic officer, who negotiates and sets ARR tariffs, said that he had no information about the total cost of transporting specific commodities and their relation to ARR's profit or loss.

Rate determination

ARR used several approaches to determine tariffs. In some cases, a percentage was added to the existing rates of the North Pacific Coast Freight Bureau to reflect the differences in prices between Alaska and the North Pacific States. For other tariffs, the traffic officer stated that ARR used what it costs to run the trains, but maintenance and administrative expenses were not included. He said that he had no information about the relationship between overhead costs and tariff . The traffic officer told us that price increases were based on special studies when ARR believed that an operation might be costing more than it was returning in revenue. Other than these special studies, he said that ARR had no information on the profitability of the commodities hauled.

ARR's office of policy and planning made an analysis of freight rates for fiscal year 1976, which showed that ARR was losing money on several commodities transported intrastate, such as coal, petroleum, gravel, and logs. Coal and petroleum represent the major portion of ARR's tonnage. Although the traffic officer said that the 1976 analysis provided useful information, he said he did not plan to use the study to change any tariffs.

ARR MARKETING AND RATE POLICIES

Because ARR must compete with other modes of transportation to generate adequate revenue to cover its costs, its pricing and marketing policies profoundly affect the other modes. The question of fairness necessarily comes into play. If ARR operates efficiently and competes effectively for transportation by offering lower rates than competing modes, consumers benefit, but the owners of the competing modes may suffer. For example, it seems reasonable for ARR to charge rates that would allow it to break even, since the Government has not stated a desire to profit from the railroad. But privately owned companies must turn a profit in the long run to stay in business. Therefore, ARR's competitors are worse off than they would be if the railroad were privately owned and had to charge rates that would allow revenues to exceed expenses. Because ARR did not have a consistently applied system for ensuring that rates were related to the cost of providing the service, it could conceivably have been charging rates considerably lower than its costs or considerably higher. In the first case, competing modes suffer; in the latter case, consumers suffer.

There is a suggestion that ARR need not even set its rates at a level that covers costs. In Executive Order 11107, dated April 25, 1963, the President directed the Secretary of the Interior to allocate from time to time the proper portion of ARR's capital investment to national public purposes, and directed the Interstate Commerce Commission to exclude for valuation and cost finding purposes in its rate approval proceedings, the portion of capital investment allocated to national public purposes. In effect, the President was allowing ARR to charge rates that would not cover all its costs and which could conceivably be disallowed as unfair if ARR were privately owned, apparently under the assumption that ARR was providing services that would not be provided by a private carrier. However, ARR's traffic officer told us that none of ARR's capital investment has been allocated to national public purposes.

CONCLUSIONS

ARR was not an efficient competitor at the time of our review. This report presents a number of areas where ARR could increase its revenue or reduce its costs through better management.

Consumers in Alaska may have been denied the lower transportation costs a more efficient railroad could have provided directly through its own rates, and indirectly by competing more effectively with other modes. The question of whether a privately owned railroad would have been more efficient than ARR cannot be answered. But if ARR becomes an efficient railroad, the effect on competing modes increases in importance.

Assuming that Federal ownership and the policy of ARR self-sufficiency continues, ARR should more effectively market its services. ARR should periodically and systematically assess transportation needs in the area it serves to identify how it can design services that appeal to a broader base of customers. ARR should have an effective plan for more actively marketing its services and meeting competitive problems, including continuous contact with potential and existing customers to determine customer needs.

As discussed in greater detail in chapter 6, we believe that the Congress should reconsider the appropriateness of Federal ownership and operation of ARR. In doing this, particular attention should be given to the possible economic effects on consumers and privately owned competitors.

We also believe that ARR should determine its actual costs for providing service on specific commodities so that tariffs can be set fairly in conjunction with a continuous marketing strategy.

RECOMMENDATIONS TO THE SECRETARY OF TRANSPORTATION

We recommend that the Secretary of Transportation direct the general manager of ARR to

--periodically make a systematic assessment of transportation needs in its service area,

--develop an effective plan for actively marketing its services,

--determine the actual cost of providing service on specific commodities so that its tariffs can be set fairly, and

--evaluate the effect of the railroad's marketing and rate policies on consumers and competitors in light of the changing transportation system in Alaska.

AGENCY COMMENTS AND OUR EVALUATION

In commenting on a draft of this report (see app. I), DOT stated that it has been concerned about ARR's marketing effort, and acknowledged the need to strengthen it. DOT also pointed out that it sponsored a study of ARR's future freight market in 1976, and that the shipping companies that have customers who ship to Alaska by railcars are marketing for ARR. DOT stated that ARR is aware that a more aggressive effort must be made and recently established a new incentive rate tariff giving lower rates to customers using greater volume in freight cars. But DOT also said that unless ARR controls water shipment to Alaska, it does not have the technical facilities with which to effectively compete in its market and to buy those facilities is prohibitive given ARR's financial position at this time. DOT said that ARR's competitors move freight door-to-door in a faster time frame and control all aspects of the transportation chain, while ARR moves only from siding to siding once the cargo arrives in Alaska. Referring to our comment that ARR's marketing policy to meet competitive challenges for ARR customers seems to be based on individual cases, DOT said that ARR's marketing personnel only rarely have an opportunity to devise tariffs and policies for the benefit of specific customers, because ARR is a public carrier and rate tariffs and policies must apply to all shippers.

DOT stated that ARR agrees that improvements and refinements in its costing techniques are necessary. DOT said that costing techniques and ratemaking are complex issues the entire railroad industry faces, and that a compendium entitled "Railroad Accounting" published in 1976, including presentations by railroad managers, accounting experts, and Government officials, pointed out numerous deficiencies and problems existing in costing and pricing. DOT said that it is sponsoring a cost research program to develop a framework for railroad costing techniques in light of the fact that the rail industry has collected inadequate data for pricing according to basic economic principles. DOT also said that other industry experts realize that, as an industry wide accounting problem, costs of specific functions and handling specific commodities are difficult to determine and that there are industry, government, and educational institution task forces trying to overcome these problems. Therefore, DOT stated that pricing and rate determination are not problems faced only by ARR.

DOT also stated that in a past case where a shipper had protested an ARR tarifff, FRA had determined that ARR's rate policy was sound and that all rates more than covered variable expenses, which, according to the Railroad Revitalization and Regulatory Reform Act of 1976, are to be considered just and reasonable and contributing to the going concern value of the firm.

DOT said that the railroad industry fully understands that it is impossible for all rates to cover fully allocated expenses (variable and fixed), and that a balance must be achieved among the product mix to enable the rate mix to cover fully allocated costs. DOT said that competitive rates have a great impact on ARR rates and that to remain competitive ARR must, at times on various products, set rates that will not cover fully allocated costs but which will cover variable costs.

We recognize that for competitive reasons, privately owned transportation companies sometimes charge rates that do not cover the full cost of providing the service.

Whether a Government-owned enterprise should do the same seems to be a policy decision that should be made with a clear understanding of the implication and consequences. A DOT evaluation of the effect of ARR's marketing and rate policies on consumers and competitors would help to highlight the problem so that a conscious policy determination could be made by DOT or FRA.

CHAPTER 3

CHANGES ARE NEEDED TO IMPROVE THE MANAGEMENT OF THE ALASKA RAILROAD'S REAL ESTATE

ARR could increase its annual rental revenues to at least $2.4 million if the real estate program were managed more effectively. ARR rental rates were unreasonably low.

ARR had about 33,000 acres of land, most of which was being used for railroad purposes (track, right-of-way, stations, yards, etc.). Some of the land was leased to others and, as of December 31, 1976, provided annual revenue of about $921,000. There were about 295 active leases, but we were unable to determine how much land ARR leased because 29 leases did not specify the size of the area involved. The remaining leases accounted for about 890 acres.

REAL ESTATE MANAGEMENT

General guidance for management of ARR's real estate program is provided in the Office of Management and Budget (OMB) Circular A-25, dated September 23, 1959, which states:

> "Where federally owned resources or property are leased or sold, a fair market value should be obtained. Charges are to be determined by the application of sound business management principles, and so far as practicable and feasible in accordance with comparable commercial practices."

Until May 25, 1977 (see p. 21), ARR had no specific guidelines for management of its real estate program, except a May 7, 1973, memorandum from the assistant general manager stating that ARR's intent was to use its properties to obtain freight revenues. The real estate officer told us that ARR's practices and procedures had evolved from unwritten directives issued over the years.

Records for rentals and leases were maintained in the real estate branch, which was staffed by a real estate officer and a secretary. In March 1977 a realty specialist position was also announced for this branch. Administrative Order ARR-14, dated December 7, 1971, authorized the real estate officer to enter into contracts for land leases and agreements. However, the assistant general manager also negotiated some real estate leases.

ARR did not advertise its real estate and had no formal procedures to insure competitive methods for awarding leases. The real estate officer told us that a prospective lessee would approach ARR about taking over an existing lease or about leasing land that was vacant.

The assistant general manager told us that rail shippers could get the same service by truck and that an incentive was necessary to get them to ship by rail. He said that leasable property not accessible by rail should be rented at the fair-market rental, but that the property accessible by rail should not. According to the assistant general manager, no one would rent ARR land if ARR did not offer lower rents because ARR required lessees to (1) pay for spur track installation, (2) install warehouse doors situated for rail service, (3) get prior sublease approval, and (4) be subject to a 90-day cancellation clause.

According to the real estate officer, applicants for land were supposed to fill out an application which required potential lessees to explain, among other things, what they want the land for and how much freight they expect to ship by rail. Only about 44 percent of the active lease files we reviewed contained an application and about 37 percent of the applications that had been prepared did not state how much freight the applicant intended to ship by rail. As a result, it was not possible to determine whether traffic potential had actually been a consideration for granting more than half the leases.

Even if traffic potential was a consideration in the leases, ARR had no way of knowing how much effect the leasing program had on freight revenues. According to an ARR official, it could not readily be determined which lease holders are rail customers and, according to another ARR official, ARR did not know how much revenue each customer was providing. Lease terms did not require using the railroad and did not stipulate that potential rail traffic was a basis for granting leases. According to the real estate officer, these conditions and stipulations were not included in the leases because ARR's chief counsel believed they were unenforceable.

LOSS OF REVENUE BECAUSE OF LOW RENTAL RATES

Prior to May 25, 1977, ARR had no written policy for determining rental rates. We reviewed most lease files but were unable to determine whether any specific policy had been consistently followed in setting rental rates.

ARR's rental rates for land in Anchorage were low compared to other rental land rates in the vicinity. In terms of cash consideration, ARR's lease rates ranged from nothing to $0.258 per square foot per year, with an average of $0.045 for those leases with rental rates. The Port of Anchorage, which is immediately adjacent to ARR's land, was charging $0.03 (for one parcel scheduled to be adjusted in 1977) to $0.24 per square foot per year for its land, according to a port official. The second lowest rate was $0.122 per square foot per year. An August 1976 appraisal report for the municipality of Anchorage listed 14 comparative land transactions for 12 parcels near ARR's land. Nine sites had railroad trackage, and we believe that they would be comparable to ARR's rail-served land. The adjusted unit prices for these nine sites ranged from $3.12 to $4.23 per square foot with an average of $3.58. At a 6-percent rate of return, this represented an average rental value of $0.21 per square foot per year. Of the approximately 134 ARR leases in the Anchorage area for which we could calculate a rental rate, only 10 had a rental rate above $0.15 per square foot per year.

ARR was losing potential revenue because of these low rental rates. As of December 31, 1976, ARR's annual income from approximately 145 leases in the Anchorage area was about $712,000. Raising the average rental rate to $0.15 per square foot per year would raise the annual income from about $712,000 to about $2.4 million.

Land used by shippers without monetary consideration

We found two instances where ARR allowed a lessee to use ARR land for which no monetary consideration was paid. In the first lease, ARR allowed 180 days' use of a 45,000 square foot parcel of land to store material shipped on ARR. In the second lease, ARR allowed a sand and gravel company to use an area of about 180,000 square feet for a disposal site for 5 years without monetary consideration.

The real estate officer justified the first lease by saying that (1) ARR was only supplying a staging area which it normally provides for all shippers, (2) the lease was part of the package used to attract this shipper, (3) the land was not being used, and (4) the material consideration for the lease was that the lessee absolved ARR from any damage or injury claims. The real estate officer told us that ARR had been doing this sort of thing for years. He said that the justification for the second lease was that the lessee was to eventually fill the land by using it as a disposal area, thereby making it usable for ARR's purposes.

According to a provision of the Economy Act, Government-owned property may be leased for "money consideration only." 40 U.S.C. 303(b) states:

> "Except as otherwise specifically provided by law, the leasing of buildings and properties of the United States shall be for a money consideration only, and there shall not be included in the lease any provision for the alteration, repair, or improvement of such buildings or properties as a part of the consideration for the rental to be paid for the use and occupation of the same.* * *"

Unusual treatment of some lease holders

We found four cases where lessees in Anchorage were being charged significantly higher rental rates than other lessees of neighboring land. The rental rates for these four parcels might be close to the fair rental values. However, the lower rental rates charged for other parcels in this vicinity, and the fact that these higher rates were not based on recent appraisals, leads us to conclude that these four lessees may have received unusual treatment in setting and adjusting their rental rates.

For example, lessee A was paying $0.134 per square foot per year for an odd-shaped parcel at the end of a row of rectangular parcels. Lessee A originally leased the parcel on July 1, 1950, and the rental rate was last increased on July 1, 1975. The adjoining parcel was leased to lessee B on July 1, 1975, but lessee B was paying only $0.06 per square foot per year.

ARR's real estate officer told us that the rate for lessee B's parcel should have been adjusted when the lease was issued in 1975, but he had overlooked it.

Leases for land development

ARR recently granted two leases in Anchorage that provide incentives to encourage the lessees to develop ARR land. Both leases are for 25 years with renewal options for another 25 years. These leases, involving about 110 acres of land, provided for an annual rental of $0.15 per square foot, less an incentive rate of $0.135 per square foot for the first 10 years to allow the lessees to amortize development costs. The leases also provided that no rental payments were required during the first 3 years, to offset the cost of engineering studies.

The leases stated that after the 10-year incentive period, the rental rate may be adjusted but will not exceed 6 percent of the fair-market value. The assistant general manager told us that he had calculated the rates to allow the lessees to amortize their development costs. However, we were unable to locate any documents indicating how the rates had been calculated. The traffic officer told us that ARR had not made any studies to determine what it would cost to develop this land because ARR did not have any development money available.

NEW REAL ESTATE POLICY

On May 25, 1977, about the time we completed our review, ARR's general manager issued ARR Order 4300.1--Alaska Railroad Land Policy.

In the basic land use policy section, the order stated, in part:

"a. It is the policy of The Alaska Railroad that all lands will be analyzed and a determination made as to present and potential best usage. A real estate master plan reflecting these determinations and codified in accordance with DOT Order 4300.1 will be prepared, and will be reviewed and updated annually.* * *

"b. Lease or sale of Railroad resources or real property will be at Fair Market Value (reference OMB Circular A-25). * * * Lease rental rates shall be the Fair Market Rental Rate, established by an appraisal using methods established and recognized by the appraisal industry.* * *

"c. Real estate holdings, where practical and available for lease, will be leased primarily with the intent of producing the maximum amount of freight and rental revenues.

"d. It is the policy of The Alaska Railroad to develop its own lands. Where this is not feasible, lease agreements may provide for improvements to be made by lessees with appropriate pay-back arrangements.* * *"

The leasing guidelines section of this order contained the following statements:

> "The Alaska Railroad real estate holdings, where practical and available for lease, should be leased with the intent of producing the maximum amount of freight and lease revenues for The Alaska Railroad. A Fair Market Rental will be established similar to those in other areas so that rental rates cannot be construed as a rebate or as preferential treatment by any person or governing agencies scrutinizing the leases.* * * Appraisals and lease rate adjustments must be fully documented in accordance with industry practices and Federal regulations. Lease rate adjustments will be made following each appraisal and whenever other changes to existing leases are made, but no more often than once a year.* * *"

In addition, the leasing and permit procedures section stated that:

> "a. All lease and permit negotiations shall be conducted by the Real Estate Officer. The one exception to this is that Agents at Anchorage, Fairbanks, and Whittier, and the Dock Superintendent at Seward are authorized to negotiate short-term leases (less than 90 days) for use of open storage lands and freight house facilities.
>
> "b. Negotiations will be based on written policy insofar as possible.
>
> "c. Where written policy is not sufficient, policy guidance shall be sought through the Chief, Administration Division.
>
> * * * * *
>
> "h. All lease rentals are to be evaluated (appraised) on the minimum of 5-year increments."

We believe that this order has the potential to correct most of the problems we noted with ARR's real estate program, if effectively implemented.

The real estate officer prepared a plan to re-evaluate leasehold rentals during fiscal years 1977 and 1978. This plan proposed to (1) identify parcels to be appraised in 1977 and leases which could be adjusted in fiscal years 1977 and 1978, (2) contract for the appraisal of the identified parcels, and (3) implement the new rental rates. As of May 1977, 45 parcels (26 in Anchorage and 19 in Fairbanks) had been identified to be appraised and two contracts had been awarded for these appraisals. These contracts required the appraisals to be completed by late June 1977.

CONCLUSIONS

We believe that ARR did not manage its real estate program effectively and that ARR could have increased its annual rental revenues from about $921,000 to at least $2.4 million per year. The ARR real estate policy issued in May 1977 has the potential to correct most of the problems we noted, if applied effectively.

RECOMMENDATIONS TO THE SECRETARY OF TRANSPORTATION

We recommend that the Secretary of Transportation direct the Administrator, FRA to closely monitor the implementation of ARR's new real estate policy to ensure that ARR fully implements the provisions of OMB Circular A-25 and maximizes the revenue-generating potential of its real property. The Secretary should also direct the Administrator, FRA to evaluate the section of the new real estate policy relating to improvements made by lessees for compliance with 40 U.S.C. 303(b) and to revise existing leases that are inconsistent with this provision of law.

AGENCY COMMENTS

In its comments on our draft report (see app. I), DOT agreed that implementation of ARR's May 25, 1977, real estate policy will correct the problems noted. DOT said that ARR has now instituted a recurring appraisal program which should help assure fair rental values, and that ARR's real estate staff has been expanded.

DOT told us that, as of April 1, 1978, of the 295 leases, 97 were reappraised, and that a like number is to be reappraised in 1978 and 1979. The first reappraisal effort in 1977 resulted in new rates representing rental increases varying from as little as 20 percent to as much as 1,800 percent, or as little as $200 per year to as high as $34,300 per year. Recognizing the impact of the more significant increases, DOT said a plan was implemented to phase-in the increases over a period of 3 to 5 years for those leases most affected. Where the overall increase would be at least $1,000 and 100 percent, the catchup period would be 3 years. If, in applying the 3-year catchup, the annual increases each exceed 100 percent and $3,000, the catchup period would be extended to 5 years.

DOT said that the estimated annual income from 56 lease parcels in Anchorage, reappraised in 1977, will increase by $475,000 when fully implemented in 1981. The average rental rate for these parcels had been $.09 a square foot. The new fair-market value would result in $.23 a square foot. DOT also said that ARR leases about 1,200 acres of real estate, and that the land areas can be calculated from a plat attached to the leases. However, DOT said that land areas will be inserted in all lease files.

DOT said that use permits instead of leases should have been issued where real estate use without a money rental was involved. DOT said that one parcel was no longer being used and that the lease on the other parcel expired on July 31, 1979, when the lease probably would be changed to a use permit.

Finally, DOT said that the Alaska Railroad Management Committee was reestablished in February 1978 and will meet at least quarterly to review and provide advice on programs including real estate.

CHAPTER 4

INTERNAL CONTROLS NEED TO BE IMPROVED

ARR did not have an adequate system of internal controls. As a result, the potential for improper financial transactions existed, potential operating revenues were being lost, and property and materials were not adequately protected.

Since we began our review, FRA and ARR have taken action to correct many problems. DOT's comments on our draft report, outlining specific improvements that have been made in areas discussed in this chapter, are included at appropriate places in the chapter.

An internal control system comprises a plan of organization and all the coordinating methods and measures adopted within the agency to safeguard its assets, check the accuracy and reliability of its accounting data, promote operational efficiency, and encourage adherence to prescribed managerial policies. The characteristics of a satisfactory system of internal control would include:

1. A plan of organization that provides segregation of duties appropriate for proper safeguarding of the entity's resources.

2. A system of authorization and record procedures adequate to provide effective accounting control over assets, liabilities, revenues, and expenses.

3. An established system of practices to be followed in performance of duties and functions of each of the organizational departments.

4. Personnel of a quality commensurate with their responsibilities.

5. An effective system of internal review.

These elements, as important as each is in its own right, are mutually reinforcing and all are so basic to adequate internal control that serious deficiencies in any one normally would preclude effective operation of the system.

ARR's internal control system lacked several of these basic characteristics.

POSSIBILITIES EXISTED FOR IMPROPER FINANCIAL TRANSACTIONS

ARR's organizational structure did not clearly separate responsibilities and duties. Functions such as authorization, recordkeeping, custody of resources, and review were not segregated to provide proper internal checks and minimize opportunities for carrying out unauthorized activities. ARR did not adequately supervise employee performance.

Separating duties and responsibilities

Duties and responsibilities were not adequately separated between individuals, so that one person was in a position to control all the accounting information and records describing the transactions taking place. For example:

--The collection, disbursing, and budget clerk told us that she received a copy of all billings. She was responsible for receipt of funds and for applying payments received to the appropriate receivable accounts. She told us that no one else reviewed or checked these transactions to insure that the entries match receipts or that the proper accounts had been reduced. The clerk authorized refunds for any overpayments and she told us that she reconciled her accounts each month to the data processing records.

--The chief of the accounting section was responsible for approving vouchers for payment. However, he also certified the existence and correctness of the facts presented in vouchers for payment. As a result, he certified vouchers which he himself approved for payment.

Properly authorizing, recording, and documenting transactions

Not only did we find instances where duties were not adequately separated, but in some cases there was an absence of a proper system to authorize, record, and document receipts and disbursements.

--A $220,916 voucher dated November 9, 1976, was approved for payment by the chief of revenue. However, we could find no documented support in the file to substantiate the voucher. Another voucher, dated November 19, 1976, amounting to $8,352 was paid; however, we found the voucher had not been signed by any official to approve or certify it. In addition, we could find no documentation in the file which supported the claim.

--We found instances where no documentation had been provided to the budget and accounting branch to support the payment of freight and legal claims. These payments were made by the accounting section based only on a statement or a signature from the chief counsel or the chief of security and claims section authorizing payment. For example, medical claims for persons involved in a July 5, 1975, train accident were paid without the accounting section being able to independently verify whether the persons had been on the train.

Since our review, FRA has taken action to correct many of the situations we found. In commenting on our draft report (see app. I), DOT told us that an internal directive had been issued preventing ARR employees from both approving and certifying vouchers for payment, and that instructions were issued stating that no vouchers can be processed without full backup documentation. In addition, DOT said that ARR now requires that refunds and adjustments be reviewed, and has taken steps to separate duties where needed.

LOSS OF REVENUES

Internal controls to assure that charges to customers are correct were not followed, and in some areas no controls existed. As a result, ARR has lost revenue.

Unverified shipments

ARR did not systematically check the contents of railcars or verify shipping weights. Such controls could deter customers from transporting goods not listed on freight bills and from loading more in cars than is listed on the bill.

We monitored northbound and southbound shipments of three ARR customers for about 1 month. We asked ARR to weigh the railcars for these shipments. Allowing for ARR's weight tolerance guidelines, 88 percent of the cars were overweight. For example:

--A northbound car weighed 13,443 pounds more than shown on a prepaid bill. The car contained many items not listed on the prepaid bill. After our inspection, the manifest was corrected, resulting in about $304 of additional revenue to ARR.

--A southbound car was supposed to contain 300 pounds of freight. We found the shipment weighed 3,200 pounds.

The amount of lost revenue for the southbound shipments was $534. The loss of revenue on the northbound shipments was harder to determine because of the different rates involved. However, we estimate that the loss in revenue could have been as much as $2,250. Considering the volume of traffic ARR carries, the losses in revenue over a year's time could be substantial.

In its comments on our draft report (see app. I), DOT told us that ARR makes random spot checks of railcar contents and weights. DOT also said that, although there may have been weight discrepancies in 88 percent of the cases we sampled, ARR said that in the majority of instances the overweight was of no consequence because the shipment was billed at a greater rate than the actual weight of the car. ARR agreed that if the extra weight of southbound freight should have been considered in the total freight charges, then $534 additional charges should have been collected, but that ARR's share would only have been $86.73, and that the material in the car may not have been subject to charges anyway.

DOT further stated that railcars can be inspected only on a spot check basis because it is not economically feasible to do otherwise. DOT estimated that ARR uses 40 minutes to 1 hour of yard and engine crew time to switch a car for inspection, which would cost between $55 and $85. In addition, DOT said that the time for a special agent and witness would cost between $25 and $40.

We agree that railcar weighing and inspections should be done no more frequently than necessary. However, because discrepancies appeared in such a large proportion of the small sample of cars we inspected, we believe that ARR needs to do more than it has in the past. Although ARR now maintains that most of the instances of overweight we found were of no consequence, our estimates of freight revenue losses included allowances for cars billed at maximum weight rates.

Reimbursable work charges not current

According to OMB Circular No. A-25, fees for special services should be established to recover costs, and the cost of providing the service should be reviewed every year and the fees adjusted accordingly. ARR did not annually review its costs for various services, and as a result some rates charged were not current. For instance, the fee for publishing tariffs had not been adjusted in over 3 years, yet costs had increased. Rates on rental equipment had not been reviewed in 3 years. We brought this to ARR's attention and equipment rates were adjusted with an overall increase of 43 percent.

All applicable costs had not been considered in establishing rates

ARR's fees for reimbursable work did not include all applicable costs. The assistant chief engineer told us that, because ARR's budget and accounting branch had not determined an overhead rate, he frequently negotiated reimbursable work rates with the customer. He said that he preferred this method because the accounting was easier.

ARR had established some rate factors that varied according to who got the service. The following criteria were used for determining charges on reimbursable work:

--Government agencies were charged the direct replacement cost of supplies and materials plus 50 percent for expenses.

--Industrial trackage users were charged the direct replacement cost of supplies and materials plus 25 percent for expenses.

--Others were charged the direct replacement cost of supplies and materials plus 75 percent for expenses.

ARR was unable to explain why the factors varied. We also noted that there were different labor rates for reimbursable work if the customer were a Government agency.

ARR's financial statements showed that ARR had losses on reimbursable work of $57,659, $126,044, and $19,863 for fiscal years 1975 and 1976 and the 1976 transition quarter, respectively.

In its comments on our draft report (see app. I), DOT told us that as a result of our findings, ARR now updates its reimbursable rates each year. However, DOT disagreed with our statement that not all applicable costs had been considered in establishing rates for reimbursable work. DOT said that ARR applied overhead rates varying from 25 percent to 75 percent and that the varying overhead rates reflected the impact of the work on ARR income; freight customers (spur track) were charged less than nonfreight customers. DOT said that the difference in percentage assured ARR full reimbursement.

ARR's annual updates of reimbursable work rates should be an improvement. We still believe, however, that the rates should accurately reflect all costs and that ARR's use of widely varying overhead rates appears to favor some customers over others.

ARR did not adequately use existing controls

Although ARR did have some measures to assure that revenue was not lost, ARR's management generally neglected internal controls. There was no audit of charges on intrastate shipments, no documented justification for reducing some bills, and inadequate control over credit. As a result ARR lost revenue, as discussed below.

Customer adjustment of freight charges

ARR's revenue section was responsible for determining that the rates ARR charged were correct. The chief of the accounting and budget branch told us, however, that ARR did not audit corrections made by customers on local freight shipments within Alaska because of the time required and the belief that customers catch mistakes. The chief of the revenue section stated that incorrect billings or tariff assessments would not be found unless the customer brought them to ARR's attention. He said that adjustments made by customers were often correct because the customers were more familiar with tariffs relating to specific commodities. Customers have reduced payment on freight charges because of disputes on rates, weights, or product descriptions. For instance, one customer adjusted its bill downward because it believed that the ARR weight bill was 5,000 pounds too heavy. ARR assumed the customer was correct even though it had the actual weight tickets which showed the higher weight. When we brought this to ARR's attention, a corrected bill was prepared, which the customer subsequently paid.

The chief of the revenue section said that all reductions were initiated by customers or other carriers and that there was no overall record of how many bills had been changed.

In its comments on our draft report (see app. I), DOT stated that this situation has been corrected, partly through new procedures requiring documentation and review of all adjustments and by resuming a local audit of bills. DOT said that ARR researches, audits, and scrutinizes all claims for overcharges, defending in writing any declinations.

Credit controls inadequate

ARR did not have a specific policy for extending credit to its customers. Interstate Commerce Commission (ICC) credit regulations which are followed by other railroads, but do not apply to ARR, allow credit to be extended for only 7 days (excluding Saturdays, Sundays, and legal holidays) and provide for extensions to 30 calendar days with assessment of a service charge equal to 1 percent of the freight bill (subject to a minimum charge). If the bill is not paid within the 30-day period, the regulations state that no further credit is to be extended

> "* * * unless and until the shipper affirmatively satisfies the carrier that all future freight bills duly presented will be paid strictly in accordance with the rates and regulations prescribed by the Commission * * *."

We found that some ARR customers had credit balances outstanding for over 30 days and that ARR had not assessed service charges or withdrawn credit on these delinquent accounts. There was no indication in the files that the shippers had satisfied ARR that the bills would be paid promptly in the future.

ARR also extended credit to customers who were not authorized to receive it. Noncredit customers were supposed to pay for their freight before receiving their goods. However, the freight agent in Anchorage told us that only 50 percent of the noncredit customers must pay their bills before receiving their freight. He said that he had given noncredit customers their freight and allowed credit to some customers beyond their credit limit because he knew these people would pay their bills.

The operations division reviewed each customer, established a credit list with the amount of approved credit, and was responsible for credit limits. Although the operations division established lines of credit, no analysis was done to determine how much a customer owed at one time because there was no list showing the customers' current outstanding credit balances. As a result, the operations division had no basi for determining whether credit limits should be modified or credit privileges canceled.

We found that about 20 percent of the credit customers at the Anchorage freight office were over their credit limits by $266,767 at December 1, 1976. Three months later, about 23 percent of the customers were over their limits by $34,526. Half of these had also been over their limits in our December analysis.

ARR's freight agent in Anchorage told us that he usually does not begin collection efforts until accounts are 60 days old. Our analysis of ARR's accounts receivable as of September 30, 1976, showed that about 24 percent were over 90 days old. At the time of our review, at least two shipping associations had gone bankrupt, owing ARR about $296,000.

ARR had not billed customers for a service charge on delinquent accounts. For those accounts receivable as of September 30, 1976, which were more than 30 days old, ARR could have realized at least $22,000 in additional revenues had a service charge been billed.

We believe that the failure to adequately control credit in effect makes ARR a no-interest lender. We believe that ARR should establish a reasonable credit policy similar to that used by other railroads in compliance with ICC regulations (49 C.F.R. 1320 _et seq._), and charge a service fee on all delinquent accounts.

DOT stated in its comments on our draft report (see app. I), that the credit program has been transferred from operations to budget and accounting and that ARR has a full-time employee working in the area of credit control. DOT also said that ARR receivables have declined since centralized billing was established and that ARR now has a uniform, systematic procedure for tracing customers. ARR does not now extend credit without the budget and accounting branch's approval and is evaluating the potential impact of instituting ICC procedures for assessing a charge when credit extensions are granted.

INADEQUATE PROTECTION OF PROPERTY AND MATERIALS

ARR did not have an adequate system to protect its property and materials. As mentioned earlier, the responsibilities and duties of several accounting processes were not adequately separated. ARR lacked adequate physical control over its property and was incurring losses.

Inventory items missing

At the time of our review, the last completed physical inventory of equipment was for fiscal year 1976. This inventory was the first one completed in over 4 years, and it took about 9 months to complete. ARR could not account for equipment valued at $36,577, out of an average total equipment valuation of $8,935,041. Many missing items could easily be converted to personal use--electric hand drills, chain saws, water pumps, wrenches, electric heaters, refrigerators, vacuum cleaners, and typewriters.

Most of the items were missing from the engineering and the motive power and equipment branches. Officials of the engineering branch said that property tags came off too easily, making it hard to locate and identify equipment and that some equipment had several property numbers.

ARR's chief mechanical officer told us that most of the losses in the motive power and equipment branch could be attributed to breakage, misplacing items, missing property tags, and other normal causes. He also said he believed that the reported losses were acceptable for a 4-year period and that thefts were not a problem, although they did occur.

We discussed the lack of inventory control with ARR officials who said that the responsibility for inventory control would be moved from the accounting branch to the supply branch and that the data processing section would assist in developing an adequate system of accountability for property.

In its comments on our draft report (see app. I), DOT told us that deficiencies in ARR's property and inventory systems have been corrected by various changes, including transfer of inventory responsibility from the budget and accounting to the supply branch.

Need to establish physical control procedures

Adequate physical control of property is essential to prevent unauthorized use of property and minimize losses. As of December 31, 1976, ARR had over $7.2 million in inventory for supplies and materials. We found very few procedures in effect to prevent unauthorized use or actual physical loss of some assets. For example, the supply branch had supplies scattered all over the Anchorage freight yard in unsecured areas. Supply branch personnel told us that the keys to the supply branch's warehouse were given to the mechanical shop personnel so the evening crews could obtain parts at night. They said that as a result (1) parts were being used for equipment repairs that do not show up as expense items and (2) material was being used and not deleted from inventory records.

In its comments on our draft report (see app. I), DOT said that ARR has tried to consolidate outside storage areas but that there are physical limitations and varying needs, depending on the season and delivery schedules. DOT also said that locks on warehouse doors have been changed and key distribution restricted.

OTHER MATTERS INVOLVING INADEQUATE CONTROLS

In addition to the weaknesses discussed previously, we noted numerous deficiencies of less significance that contributed to the pattern of inadequate controls over ARR's financial operations. For example:

--There was inadequate control over distributing payroll checks. Almost anyone could pick up another person's check without accountability, including the timekeepers who created the payment document.

--There was no system for accounting for ARR property in the custody of employees who left ARR service.

DOT told us in its comments on our draft report (see app. I) that ARR is revising its accounting manual to provide that no timekeeper shall pick up or distribute checks, and ARR has established property clearance procedures to account for property in the custody of employees who leave ARR service.

ARR LACKS AN INTERNAL AUDIT STAFF

ARR had no internal audit staff to see that appropriate internal control systems were established and monitored. The Budget and Accounting Procedures Act of 1950 (31 U.S.C. 66a) required the head of each agency to establish and maintain systems of internal control, including appropriate internal audit, to provide effective control over, and accountability for, all funds, property, and other assets for which the agency is responsible. We found audit coverage of ARR to be inadequate.

Elimination of ARR's internal audit capability

ARR's internal audit capability was eliminated when a centralized DOT audit group was established at the end of fiscal year 1971. ARR's comptroller told us that he believed that centralization by DOT did not preclude ARR from maintaining an internal audit capability, but that the internal audit function was diluted by the DOT centralization and effectively eliminated in 1973 when ARR abolished its management services branch and established the budget and accounting branch.

DOT audits of ARR activities have been limited and generally have not covered many operational areas where ARR is experiencing problems. DOT conducted three audits of ARR's real property and one audit on the controls over billing, collecting, and accounting for revenues. We believe that additional audits and more coverage should have been provided to improve control over ARR's financial operations.

CONCLUSIONS

ARR had not implemented an effective internal control system. As a result, the potential for improper transactions existed, potential revenues were being lost, and property was not being adequately safeguarded.

RECOMMENDATIONS TO THE SECRETARY OF TRANSPORTATION

We recommend that the Secretary of Transportation direct the general manager of ARR to assess its procedures and implement an effective management and control system. ARR must design a system that provides accurate, timely information on results of operations and embraces all the principles of an effective internal control system. Such a system should include:

--A plan of organization that segregates duties and responsibilities to properly control transactions.

--A system of authorization and recording procedures to provide accounting control over assets, liabilities, revenues, and expenses.

--An established system of practices to be followed in the performance of duties.

--Provisions for effective internal review.

We also recommend that the Secretary require the Administrator, FRA to closely monitor ARR's actions and provide any assistance necessary to assure that ARR's actions are effective.

AGENCY COMMENTS AND OUR EVALUATION

In commenting on our recommendations (see app. I), DOT stated that it shares our concern about internal control weaknesses and believes that ARR has made progress in eliminating many weaknesses we identified. DOT also stated that efforts to improve will continue, using all available resources.

As we noted throughout this chapter, FRA and ARR have taken many actions that should help correct the specific problems we brought to their attention. However, DOT did not address several problems in its comments on our draft report, including ARR's need for improved internal audit coverage. An effective internal control system depends on all the necessary elements being present.

CHAPTER 5

INADEQUATE FINANCIAL MANAGEMENT

One of the objectives of accounting is to provide relevant data for decisionmaking by the managers of an enterprise. We found many serious problems with ARR's financial management procedures and practices, and that improvements were needed to provide

--accurate and reliable accounting data,

--effective action to collect overdue accounts receivable,

--control over restoration of employees' annual leave,

--control to ensure that employees do not use more annual leave than they were entitled to,

--documentation of justification for travel time,

--control over use of Government transportation requests,

--reasonable pay scales,

--efficient use of personnel,

--proper temporary appointments,

--compliance with Federal Procurement Regulations, and

--compliance with FRA requirements on approvals for contracts.

Since we began our audit, FRA and ARR have worked together in trying to correct many problems discussed in this chapter. DOT's comments on a draft of this report outlining specific actions taken since our audit are included as appropriate in the chapter.

The Comptroller General approved part of ARR's accounting system in 1957, when the Secretary of the Interior was responsible for ARR. Since that time, many changes in the accounting system have taken place, but none were submitted for approval.

ARR's financial success is dependent, in large part, on management's ability to control costs while attempting to acquire and retain business in a highly competitive transportation market. Budgeting at ARR was discontinued as a formal process in 1959 or 1960. At that time, the position of budget officer was abolished because of declining business and revenues, and budgeting became the responsibility of top management. Budgets were prepared primarily to secure appropriations from the Congress for capital improvements.

In February 1977, an ARR fiscal committee and fiscal control system were established, placing cost control responsibility with the division, branch, and office managers. The comptroller said that the fiscal committee must review the accounting system to get information for budget purposes and to develop better accountability for costs by responsible managers.

CAPITAL PLANNING NEEDS IMPROVEMENT

ARR has generally lacked a formalized capital planning system, and justification for capital improvements lacked financial analysis. According to the management analyst in the policy and planning office, past planning was not based on any kind of criteria. He said that ARR was now using return on investment as criteria for capital budget items.

In 1975 FRA recommended that ARR develop a capital improvement program based on the financial analysis principles suggested in OMB Circular A-94. In March 1976 OMB made the following comments regarding ARR's capital request.

> "During our review a number of serious concerns arose on the economic justification for this project * * * in short on the quality of the Railroad's capital planning process * * *. Capital expenditures for 1977 will not be approved until we are supplied with evidence that the Railroad has a genuine capital plan in place which consists of at least these minimum ingredients:
>
> --The expected return-on-investment for each project
>
> --The degree of essentiality of the

project to continued safe and efficient operations

--The level of deferred or high-cost maintenance reduced by the capital plan and the level which will be continued

--How projects fit into long term traffic projections and the Administration's policy for disposal of the Railroad by the end of this decade

--Anticipated capital expenditures for the 1978-79 period."

In its comments on our draft report (see app. I), DOT stated that ARR has implemented formal and fully documented procedures prescribed by FRA, which conform with DOT and OMB guidance.

INACCURATE AND UNRELIABLE ACCOUNTING DATA

ARR's management could not effectively use its accounting data because it was inaccurate and unreliable. Financial statements did not adequately reflect ARR's financial position because they contained improper adjustments and misclassified items. In addition, accounting policies were not consistent from year to year. For example, ARR recently spent over $2 million for a major overhaul of 10 locomotives and 17 cabooses. This overhaul extended the useful life of the equipment by 15 years, and generally accepted accounting principles would require that such costs be capitalized and depreciated. The chief of budget and accounting stated that these costs were capitalized in fiscal year 1976, but that such costs had always been expensed in prior years.

In its comments on our draft report (see app. I), DOT said that FRA plans to work with ARR to determine its specific needs for a fully accurate and responsive accounting and financial system supported by modern data processing techniques and programs. FRA said that ARR's practice of expensing costs that should have been capitalized has been corrected.

Centralized control

A lack of central accounting control contributed to a loss of control over ARR's accounting data. The result was that data was inconsistent, inaccurate, and unreliable. These problems were most apparent in the billing and cancellation of receivables and in ARR's collection procedures.

Receivables

ARR's accounting manual stated that each office or branch was responsible for promptly preparing and submitting bills for collection. However, each department established its own time frame for billing and some billed monthly, some quarterly, and some whenever it was convenient. This distorted ARR's income and expenses because charges were not recorded until they were billed.

Accounting vouchers were sometimes prepared to cancel or reduce bills when necessary because of an error. This was usually done with no apparent approval or review of the voucher. We were told that anyone in a department that establishes a bill could cancel it. Such a system, we believe, could result in improper cancellation or reduction of bills.

Collection policies

ARR's policy for collecting bills was not adequate. Twenty-four percent of its accounts receivable, excluding Government bills of lading, were over 90 days old and 10 percent were over a year old at the time of our review. The GAO Policy and Procedures Manual for Guidance of Federal Agencies states that agency debt collection programs must be comprehensive, vigorous, and uniformly applied in principle. It further states that debt collection procedures should be consistent with good business practices. Federal regulations (4 C.F.R. 102.1, 102.2) state that each agency needs to have aggressive collection action on a timely basis. It also requires three written demands at 30-day intervals unless a response to the first or second demand indicates another course of action.

Accounts in dispute

The ARR accounting manual states that any bill over 90 days old, or which is over $100 and determined to be uncollectible, is to be turned over to the chief counsel for collection. We noted that it took an average of about 7-1/2 months after the date of ARR's last bill before overdue accounts were given to the chief counsel. The six accounts written off as uncollectible by the chief counsel's office in fiscal year 1976 had been with the chief counsel an average of 4 years. ARR's collection activities on these accounts had not been effective. For example:

--On one account, there was no documentation indicating any contact had been attempted for 2 years. When contact was attempted in 1975, the business had been bankrupt for more than a year.

--ARR could lose $112,634 because it waited 4 years before turning a case involving a shippers' association over to the U.S. attorney for legal action. Some of the individual accounts were 4-1/2 to 5-1/2 years old. Further delay could preclude collection action since the Statute of Limitations generally bars litigation after 6 years (28 U.S.C. 4515).

Need for centralized control

We believe ARR needs centralized control over its billing system. As a result of our review, ARR implemented procedures on May 1, 1977, as temporary steps toward centralizing all billings. An ARR official stated that the procedures were primarily manual because an automated system could not be used until the computer system received a major overhaul. We believe this new process is creating additional work and can be justified in the short run only if a fully automated system is developed soon.

In its comments on our draft (see app. I), DOT stated that ARR has implemented procedures to centralize all billings and that billing delays have been significantly reduced as a result. DOT also said that, as of March 1977, all adjustments to vouchers or bills require at least two levels of review. DOT said a more rigorous collection effort has been underway for some time, with a new accounts maintenance clerk devoting considerable time to bringing collections up-to-date. According to DOT, accounts in dispute have been reduced 28 percent in the past year.

INADEQUATE CONTROL OVER ANNUAL LEAVE

When annual leave is lost through administrative error, employee sickness, or public exigencies, it may be restored to the employee. The official responsible for restoring leave, however, must be designated by the head of the agency to act for him on this matter and may not be more than one organizational level below the head of a major field headquarters of the agency.

In 1975 ARR canceled scheduled leave for several employees, causing them to lose leave in excess of their ceilings. ARR failed to restore leave in accordance with Federal Personnel Manual Regulations (FPM LTR NO. 630-22, January 11, 1974). We found that (1) leave was restored by unauthorized individuals, (2) ARR did not assure that leave was rescheduled before the year ended, (3) restorations were not adequately documented, and (4) there were no adequate recordkeeping and administrative procedures to identify and monitor the restored annual leave.

In a memorandum dated August 3, 1977, concerning waiver of the repayment of the improperly restored annual leave, FRA's Associate Administrator for Administration stated that:

> "It is evident to me beyond a reasonable doubt that the forfeiture of annual leave by the affected employees was the result of the failure of The Alaska Railroads management officials to comply with the provisions of FPM Letter 630-22 because of the lack of knowledge by those officials of the existence of the FPM Letter and consequently, the regulations pertaining to the forfeiture and restoration of annual leave that the Letter addressed."

We also found that ARR had no system to assure that employees did not use leave in excess of what they had earned and were entitled to. At the end of the 1976 leave year, 13 employees had used more leave than they had earned.

Corrective action taken by ARR

Following our review, ARR took steps to correct and prevent negative leave balances and the problems arising from the restoration of annual leave.

The general manager of ARR requested a waiver from the Secretary of Transportation for employees with restored leave balances under $500 and requested that a waiver be sought from the Comptroller General for restorations in excess of $500 under 5 U.S.C. 5584. ARR has also taken steps to prevent or correct negative balances. The chief of the budget and accounting branch issued a memorandum to branch heads advising them of the regulations and the options available to employees for repayment of leave deficits.

INADEQUATE CONTROL OVER TRAVEL FUNDS

Our review of reimbursement vouchers for several ARR employees who traveled frequently disclosed a basic lack of understanding of Federal Travel Regulations (FTR) on the part of travelers, approving officials, and certifying officers. Some travel authorizations and claims resulted in overpayments. ARR corrected these problems after we brought them to its attention and initiated action to collect about $9,400 in overpayments.

Inadequate control over disbursements for travel expenses

We found cases where travelers were reimbursed for visits to cities for which inadequate official business justification was provided. These travelers were reimbursed for lodging, subsistence, and ground transportation costs during their visits and used Government Transportation Requests to pay for certain portions of air travel which could not be accounted for as official business.

The FTR and DOT travel regulations limit reimbursement of traveling expenses to those expenses incident to the transaction of official business. Further, the FTR (in section 1-2.5) provides that

> "b. Indirect-route or interrupted travel. When a person for his own convenience travels by an indirect route or interrupts travel by direct route, the extra expense shall be borne by him. Reimbursement for expenses shall be based only on such charges as would have been incurred by a usually traveled route. When transportation requests are used, they shall be issued only for that portion of the expense properly chargeable to the Government, and the employee shall pay the additional personal expense, including the Federal transportation tax."

ARR issues annual travel authorizations to managerial staff who frequently travel. Travelers under annual orders are required by DOT regulation 1500.6 to state the specific purpose of each trip on, or in an attachment to, the reimbursement voucher. ARR travelers had not stated the purposes of their trips, and so we requested that certain frequent travelers provide statements regarding the necessity of particular trips and their relationship to official business.

<u>Lack of accountability controls over Government transportation requests</u>

Government agencies using Government transportation requests must account for and safeguard these negotiable items. ARR could not account for its Government transportation requests and did not know how they were being used. We initially found that ARR could not account for 33 percent of the requests used for an 18-month period beginning in July 1975. We then searched payment schedules and travel vouchers, obtained General Services Administration verifications, and talked with travelers, and we were eventually able to account for all but two requests which were either lost, stolen, or discarded.

Many employees who used Government transportation requests did not turn in copies. The budget and accounting branch paid bills submitted by transportation companies without verifying that the requests were used properly. The budget and accounting branch did not match bills with transportation request file copies or trace billings to travel authorizations and vouchers. As a result of our review, ARR issued procedures to strengthen its control over these negotiable instruments.

In commenting on our draft report (see app. I), DOT said that ARR has emphasized to its employees the need to thoroughly understand the FTR to eliminate the problems we found.

<u>NEED TO CONTROL PAYROLL COSTS BY ATTAINING REALISTIC PAY LEVELS</u>

ARR's payroll costs were unreasonably high in comparison with other Federal agencies in Alaska. More realistic pay levels are needed to insure equity to all Federal employees. Further, we believe that ARR's payroll costs contributed directly to its poor financial performance.

ARR's payroll records showed that 1,488 employees were paid $26,121,263 during calendar year 1976. An additional $85,282 was paid to 21 employees as cost-of-living allowance under ARR's executive officer pay schedule devised in September 1976.

<u>FRA's review of pay</u>

ARR is exempted from the Classification Act of 1949, as amended, and the Coordinated Federal Wage Grade System. Historically, the pay of all positions except managerial, administrative, professional, and technical, had been based on negotiated agreements with labor organizations. The agreements provided that ARR's pay would be established on the basis of rates paid by the Burlington Northern Railroad plus a cost-of-living factor built into the base pay.

With respect to officer positions, a 1975 FRA management review found that ARR had made little, if any, effort to compare the duties of ARR and Burlington Northern positions. FRA noted that:

> "There is no evidence of a systematic or objective approach to matters of pay under former General Managers. Instead, it appears that the former General Managers set officers' pay, with or without consultation with the Personnel Officer, and that adjustments were made on subjective considerations."

In July 1975 ARR proposed, and later adopted, a plan basing officer's pay on the Coordinated Federal Wage Grade System for blue collar supervisors. The plan provided for a grading system based on Civil Service Commission (CSC) standards, with each officer slotted into a grade and step of the new system consistent with his current pay and degree of responsibility. FRA found that conversion to grade levels of the plan was based on salaries received at the time of conversion and that there was no evidence to indicate that ARR had made an effort to evaluate and rank the positions according to CSC standards.

FRA concluded that there was no assurance of equitable treatment for pay purposes and that there was reason to believe that the pay of many ARR officer grade rates was considerably more than positions of a comparable level in other DOT and Federal agencies in the area. FRA noted that ARR's positions had a built-in cost-of-living differential which was included in the base pay. FRA made the following comparisons between ARR's salaries and equivalent positions in other Federal agencies:

Position	ARR Salary	Position equivalent to GS level	Salary (note a)
Administrative assistant	$24,794	9	$16,254
Special agent trainee	24,794	5	10,759
Labor management relations specialist	29,786	11	19,596
Chief, employment services	30,888	12	23,370

a/Includes 22.5 percent cost-of-living allowance.

The FRA review team found that the problem of unjustifiably high rates also existed in clerical pay under ARR's white collar pay schedule. Rates under this schedule were tied to the Coordinated Federal Wage Grade System. FRA found that ARR's conversions to the new schedule appeared to have been based on pay received by employees at the time of conversion rather than on evaluation of the positions involved. FRA found that ARR's salaries were almost double the salaries for comparable positions in other Federal agencies.

FRA's study team recommended that positions covered by ARR's officer and white collar pay plans be reevaluated to assure proper grading, equity of pay within ARR, and some degree of comparability with employees of other Federal agencies.

Status of ARR's response to FRA's evaluation team report

During late 1975 an FRA study team performed an evaluation of the ARR pay plans. The team concluded that a new pay plan compatible with Government rules and regulations should be developed. Accordingly, they recommended adopting the Federal Pay and Classification System, with some exceptions.

In July 1976 ARR's general manager advised FRA that a study team was established to review the officer and white collar pay plans and to recommend alternative pay systems. The general manager established January 1977 as his target date for making appropriate revisions to the pay plans.

In its comments on our draft report (see app. I), DOT said it was doing everything it could to eliminate the payroll cost situation discussed above. DOT also said that all new or vacant officer positions will be classified as general schedule equivalent (GSE) and that anytime an officer changes positions, he has to become GSE. It also said that ARR is currently engaged in negotiations with the American Federation of Government Employees on the White Collar pay plan. DOT believes the "salary problem" is essentially limited to the 85 employees paid under the White Collar pay plan, 35 employees paid under the Railroad pay system, and some GSE employees compensated under saved pay provisions

We agree that DOT's actions should help the situation if conversions to GSE pay is based on the characteristics of the position rather than the pay level of the position. As we previously noted, past pay system conversions have been ineffective in controlling payroll costs because the conversions were not based on the characteristics of the positions.

INADEQUATE POSITION MANAGEMENT

We noted numerous apparent duplications of functions, heavy stratification of supervisory positions, and underutilization of personnel. We discussed our observations with ARR officials and employees and with FRA officials. FRA and ARR agreed to conduct a joint position management review. However, ARR's chief of administration delayed ARR's input to FRA and FRA decided to conduct the review without ARR participation.

FRA's June 1977 report listed numerous deficiencies in organization and staffing at ARR and recommended:

- --Abolishing the positions of assistant general manager, assistant chief mechanical officer, comptroller, policy and planning officer, and operations officer.

- --Establishing a new financial management division and the positions of market analyst, special assistant to the general manager, and an assistant general manager/operations officer.

- --Numerous other organizational, procedural, and staffing changes.

In its comments on our draft report (see app. I), DOT told us that ARR has taken the following actions in relation to the position managment problems we found.

--The assistant general manager retired, and the position is being held vacant until an upturn in business or change in circumstances justifies recruiting a replacement.

--The assistant chief mechanical officer position was abolished.

--The comptroller is expected to retire June 30, 1978, and the position will be abolished at that time.

IMPROPER TEMPORARY APPOINTMENTS

A 1973 personnel management evaluation by CSC noted that a prior evaluation had shown that ARR was using temporary employees to fill continuing positions. ARR was reported to be improving the situation by converting the temporary employees to permanent status. CSC also found, however, that 14 employees who had been with ARR more than a year were still classified as temporary.

We found that, in March 1977, the ARR engineering branch had 63 temporary employees. The majority of these were appointments in which temporary employees filled permanent positions continually. We discussed this situation with ARR personnel and operating officials, who agreed to discontinue the appointment practices. They devised a plan for orderly transition to proper appointments to be fully implemented by July 1, 1977.

The essence of the ARR plan for correction was as follows:

"When we are about to fill a laborer position and we believe it will last more than a year, we will fill it immediately with a permanent employee. And if someday we should find ourselves with a position that was in good faith filled with a temporary employee but which then appears to be a permanent position, we will take the necessary action to fill it with a permanent employee.

"An employee who, after a year of virtually continuous employment, is still on a temporary appointment will be terminated--no matter how 'legal' his current temporary appointment. In other words, we will not move an employee from one position to another for the purpose of circumventing the system.

"We will no longer give a temporary employee a break in service of a few days in order to give the new temporary appointment the appearance of legality. In no event will a person be given a new temporary appointment unless there has been a break in service of at least 30 days.

"We will not hire permanent-intermittent employees unless we have bona fide permanent-intermittent positions to be filled."

We believe that ARR's plan will resolve the problem of improper appointments, if implemented properly.

We also found an instance where a temporary appointment was apparently used to place an employee who was to fill a permanent position, but she could not qualify. ARR's former chief counsel recruited a clerk, allowed her to work 60 hours prior to being appointed to a position, arranged a temporary appointment after she failed the test for the position available, and approved a salary payment for the clerk during a period when she was not at work.

DOT's comments on our draft report (see app. I), stated that ARR is adhering to the temporary appointment policy described above and that the situation is fully corrected. In addition, DOT said that ARR had recovered the improper salary payment and that the situation was corrected because the employee in question resigned and the improper payment was rectified.

INADEQUATE CONTROL OVER PROCUREMENT ACTIVITIES

ARR negotiated procurements without proper supporting documentation and without securing competition. In addition, contracts were awarded in excess of ARR's authorized dollar limitation.

In October 1971, a DOT procurement evaluation team described the ARR procurement function as inadequate. The team considered ARR's deficiencies to be so serious that they recommended transferring procurement responsibility to the Federal Aviation Administration. In response, ARR's general manager stated that ARR was not governed by Federal Procurement and Management Regulations, citing the ARR chief counsel's view that ARR was not subject to the Federal Property and Administrative Service Act of 1949.

In January 1972 the Office of the Secretary of Transportation told ARR that the Secretary, under DOT orders, had made the entire Department, without exception, subject to the Federal Procurement Regulations and the Federal Property Management Regulations.

Use of sole-source procurement authority

The Federal Procurement Regulations require competitive procurement by formal advertising whenever feasible and practical. The Regulations permit negotiation of procurements under specific circumstances, but require that negotiated contracts be competitive to the maximum practical extent. The Regulations prescribe specific conditions that must be satisfied before contracting by negotiation. The FRA Administrator has delegated sole source procurement authority to ARR's general manager for amounts not to exceed $25,000.

We found some instances of questionable procurement practices by ARR. For example, Federal Procurement Regulations (41. C.F.R. 1-3.213) and 41 U.S.C. 252 (c)(13) permit negotiations of purchases or contracts for equipment the agency head determines to be technical equipment, where standardization and interchangeability of parts is necessary in the public interest and where procurement by negotiation is necessary to assure standardization and interchangeability. Citing this authority, in December 1975 ARR awarded a $2,209,625 contract for five new diesel electric locomotives, without obtaining competition.

We found that, nearly a year after the award, no statement of findings and determinations had been prepared. The file did contain a November 1975 memorandum to the procurement officer from ARR's chief mechanical officer, in which he stated that the request for these locomotives should be considered for replacement and standardization of older units.

We discussed with the procurement officer the failure to prepare a statement of findings and determinations as required by 41 C.F.R. 1-3.302. He said that the decision to negotiate procurements was made by the chief mechanical officer and that the procurement branch entered the transaction after the decision was made. After our inquiry, the procurement officer prepared a statement of findings and determinations for the file but declined to sign it.

In January 1977 FRA's Associate Administrator for Administration subsequently obtained approval for the contract from the Federal Railroad Administrator, stating that:

> "Attached is a Findings and Determinations prepared by the Alaska Railroad, concluding that it is in the interest of the Government to procure five Diesel Electric Locomotives on a non-competitive basis from the General Motors Corporation based upon the need to assure standardization of the equipment and interchangeability of parts.
>
> "Notwithstanding the fact that statute requires this determination be made only by the Head of the Agency (which term includes the Federal Railroad Administrator as defined in DOTPR 12-1.204), or that DOT Order 4200.10 requires a review by the FRA Sole Source Board and approval by the Federal Railroad Administrator of any proposed sole source procurement of this size, the contract was awarded on December 18, 1975, at a cost in excess of $2,200,000, without your required approval.
>
> "The determination of the Alaska Railroad is adequately supported by the findings and consequently it is appropriate that the required action be approved, albeit over a year after award. I recommend your approval of the Findings and Determinations, for its inclusion in the official contract file of the Alaska Railroad. The file will clearly reflect that this determination was made late, and is in effect a ratification of the earlier actions of the Alaska Railroad Contracting Officer."

In another case, ARR awarded a $76,000 negotiated contract in April 1976 to a Portland, Oregon, firm for gratings, drain pans, and crosswalks. ARR negotiated this contract pursuant to 41 U.S.C. 252 (c)(2), which states

> "In order for this authority to be used, the need must be compelling and of unusual urgency, as when the Government would be seriously injured, financially or otherwise, if the property or services to be purchased or contracted for were not furnished by a certain time, and when they could not be procured by that time by means of formal advertising. This applies irrespective of whether that urgency could or should have been foreseen. For example, this authority may be used when property or services are needed at once because of a fire, flood, explosion, or other disaster."

Four months prior to award of this contract, an ARR construction engineer received a quotation from the Portland office. The quotation was evidently in response to the engineer's solicitation. In January 1976 the ARR chief engineer forwarded the firm's quotation to the procurement officer, requesting that a contract be negotiated with the firm to procure the items for use in conjunction with various projects the engineering branch will be undertaking "this summer." The procurement branch prepared a statement of findings and determination endorsing the engineer's request, but the findings were not consistent with the public exigency criteria. Furthermore, ARR did not attempt to secure bids from other vendors.

Neither the statement of findings and determination nor the chief engineer's memorandum describes an emergency situation necessitating negotiated procurement. It appears that just the opposite was true, in that the need for delivery was not urgent. It is clear that a proper procurement action could have been accomplished if the using branch had planned adequately.

In December 1976 and in subsequent meetings, we discussed ARR's procurement with FRA officials and showed them examples of questionable sole-source procurements. FRA procurement officials agreed with our findings.

In its comments on our draft report (see app. I), DOT told us that ARR has taken the necessary steps to correct the inadequate procurement situation.

CONCLUSIONS

ARR's financial management procedures and practices were inadequate, and improvements were needed to provide

--accurate and reliable accounting data,

--effective action to collect overdue accounts receivable,

--control over restoration of employees' annual leave,

--control to ensure that employees did not use more annual leave than they were entitled to,

--documentation of justification for travel time,

--control over use of Government transportation requests,

--reasonable pay scales,

--efficient use of personnel,

--proper temporary appointments,

--compliance with Federal Procurement Regulations, and

--compliance with FRA's requirements on approvals for contracts.

RECOMMENDATIONS TO THE SECRETARY OF TRANSPORTATION

We recommend that the Secretary of Transportation require the general manager of ARR to establish procedures designed to give reliable accounting data, adequate control over the expenditure of funds, and compliance with Federal regulations. These procedures should include such things as

--consistent accounting policies,

--centralized accounting control,

--adequate collection action for overdue bills,

--centralized control over its billing system,

--control over leave used and restored,

--control over travel disbursements,

--accountability for Government transportation requests,

--adequate management of positions,

--control over temporary appointments, and

--control over procurement activities.

Because ARR's deficiencies were so pervasive, we recommend that the Secretary direct the Administrator, FRA to continue to work closely with ARR in developing adequate procedures and that FRA monitor ARR's progress in implementing the new procedures.

AGENCY COMMENTS AND OUR EVALUATION

In its comments on our draft report (see app. I), DOT acknowledged that many of ARR's financial management procedures and practices were inadequate, and outlined actions ARR took to correct the problems we found. We noted DOT's comments throughout this chapter and agree that the actions taken or planned should help to eliminate the problems we found. DOT indicated that it will continue to work with ARR to improve its financial management.

CHAPTER 6

FUTURE ALTERNATIVES FOR ARR

The problems discussed in this report indicate a need for systematic and effective management by ARR.

FRA has recently shown more interest in and given direction to ARR, and some important improvements are in process. The problems discussed in this report must be corrected before ARR's potential as a self-sustaining enterprise can be accurately assessed.

There is doubt about ARR's future. The executive branch has expressed a desire to sell ARR, and management actions consistent with that policy probably would be quite different than those responding to its original legislative mandate. Because of uncertainty about ARR's future, ARR may not be able to plan effectively in such areas as track and roadbed rehabilitation, rolling stock acquisition, and other capital improvements.

ARR's original purpose was to aid national defense needs, to spur settlement of public lands, and to develop Alaska's agricultural, mineral, and other resources. As mentioned in chapter 1, ARR has done much to promote Alaskan development and settlement, and today is providing an alternative means of transportation vital to the State and its people. In terms of its legislative mandate for the State's development, ARR has not expanded into areas lacking surface transportation.

CONTINUING PRESENT ARR OPERATIONS

Continuing present operations, with the possibility of eventually selling ARR, may require further Federal assistance to maintain ARR or to upgrade it for sale. The President proposed the sale of ARR in 1970, but the Secretary of Transportation has not received the necessary authority from the Congress to sell it.

Therefore, neither FRA nor prospective buyers presently know what might be offered for sale.

Future Federal funding

FRA projected that a status quo operation through fiscal year 1982 would mean requesting between $5 million and $10 million in appropriations each year.

Selling ARR would eliminate direct Federal ownership and operating responsibility, but Federal financial assistance might still be available under various Federal programs for railroads. Recent legislation, such as the Railroad Revitalization and Regulatory Reform Act of 1976, provides means for privately owned railroads to use Federal assistance to rehabilitate and maintain physical facilities, improve operation and track structures, and restore financial stability. Federal assistance could be needed to sustain ARR's passenger service, which was losing about $1.5 million a year as of fiscal year 1977.

<u>The initiative to sell ARR</u>

In February 1970 the President told the Congress that it was time for the Federal Government to get out of the operation and ownership of ARR. He stated that the need for Federal ownership had passed and that ARR had become an attractive investment. Two bills providing for ARR's sale were introduced in the House of Representatives in 1970 and 1971, but were not approved. OMB reaffirmed, as late as March 1976, the policy to sell ARR by 1980, but in November 1977, the White House Assistant Director, Domestic Policy Staff told us that the present administration had not formulated a policy on the ARR sale.

The two bills included provisions that the purchaser would operate ARR as a common carrier in intrastate, interstate, and foreign commerce and would make the necessary agreements to protect the interests of ARR employees affected by the sale. The bills also defined what was to be sold.

The terms and conditions of any sale obviously can affect the Federal Government's ability to sell ARR. In 1975 ARR's general manager advised a Member of Congress that certain items in one of the previously proposed bills were not conducive to private industries giving more than a cursory examination of the property. As an example, he cited the bare minimum of land that would have been available and the fact that railroads must have access to industrial property to entice businesses to locate along the railbelt.

<u>FRA's sale price, terms, and conditions</u>

The Federal Government's policy is to obtain fair-market value for property it sells. Even though the Congress has not approved any terms and conditions concerning any potential sale of ARR, ARR's comptroller told us that the sales price as of July 1976 was established at about $128 million based on the book value of salable assets excluding the value of more than 36,000 acres of public domain land. FRA's Deputy Administrator also told us that the sale price would be based on ARR's financial statements. We were told by FRA that there had been no attempts to determine the market value.

State ownership

The previously proposed legislation provided an opportunity for the State of Alaska to purchase ARR. In 1974, however, the Governor advised ARR's general manager that the State was not interested in buying ARR, and in 1975, a new Governor reaffirmed that position. A State commission, evaluating potential State ownership of ARR, reported in 1970 that the terms and conditions of the proposed legislation would inhibit the sale. The State commission stated that restrictions in the 1970 bill severely limited ARR's earnings base and future growth potential. Concerning the sale of ARR to private interests, the State commission said:

> "It would seem wrong now for the Federal Government in carrying out its announced plan to dispose of The Alaska Railroad to deprive the State of Alaska of this necessary means of development of its resources by selling the Railroad to private interests which, in turn, might use this valuable investment of the people of the United States in a manner not at all intended, in addition to greatly increasing transportation costs to both the State and the Federal Government."

EXTENDING ARR's OPERATION

There have been proposals by various governmental and nongovernmental organizations to extend ARR's operations into areas where surface transportation does not exist to foster mineral and general economic development. Such efforts seem to be consistent with ARR's legislative mandate. Although the State has not expressed an interest in buying ARR, it has supported extension through legislative resolutions and feasibility studies and has asked the Federal Government to consider extending ARR.

Although highway transportation can also be used for development, the Director of the Transportation Planning Division of Alaska's Department of Highways told us that the State's policy is to reconstruct the present roadway system rather than expand it, and he said that the State expected to continue such a policy for the next 10 years. In addition, he told us that highway expansion for a special type of activity, such as resource development, should be funded by those who benefited and that the State should not have to pay for transportation that helps a private company bring its product to the market.

Extending ARR to new areas would be expensive. ARR officials estimated track construction costs at $1.2 million per mile, which could drastically increase if bridge structures are needed. At a cost of $1.2 million per mile, a 297-mile extension to the Canadian border would cost about $356 million. ARR officials said that an extension to the Canadian border might not be economically justified because it would take freight from existing water routes.

ARR's role in developing resources was recognized in a recent FRA issue paper on the future of ARR; however, FRA believed that such a role was beyond the capability of ARR's present management structure and that it might also be beyond the financial capabilities of any private operator. FRA estimated that between fiscal years 1978 and 1982 about $30 million in appropriations for capital investment would be necessary if ARR were to undertake the required extensions for current resource development opportunities.

Other factors

Land ownership is another factor to be considered in Alaska. In 1974 the Department of the Interior's Bureau of Land Management concluded in its report, entitled "Multi-modal Transportation and Utility Corridor Systems in Alaska," that transportation throughout much of Alaska was not adequate for anticipated needs in the immediate future and that there was no comprehensive multimodal transportation and utility corridor plan to meet these needs. According to the report, lands available for selection by Alaskan Natives and the proposed additions to the national park, forest, wild-life refuge, and wild and scenic rivers systems comprised about one-third of the surface area of Alaska. The report further stated that adequate transportation and utility corridors could not become reality without crossing at least some Native-owned lands and some proposed additions to the four national conservation systems.

Although the Federal Government owns the majority of Alaska's land, Alaskan Natives will play an important role in developing the State. In 1971 the Congress passed the Alaska Native Claims Settlement Act (Public Law 92-203, December 18, 1971) which provided an opportunity for over 40 million acres to be made available to Alaska Natives. An Alaska Native Fund was also established, which will provide $962.5 million. Native Regional Corporations were created and have entered into Alaska's business mainstream. Besides other activities, they have been involved in initial exploration and development of Native lands. According to the Alaska Department of Commerce and Economic Development, this type of land use is a monumental step in unlocking mineral reserves within vast tracts of previously unexplored territory. Extension of ARR might also assist the regional corporations in developing the mineral resources that exist.

The Joint Federal-State Land Use Planning Commission for Alaska could also affect land and transportation development. The commission, which consists of Federal and State members, opposed a 1974 proposal reserving transportation corridors because they believed land use should determine transportation patterns and not the reverse, and because there was a failure to show sufficient need in relationship to national and State transportation objectives.

CONCLUSIONS

We believe that the material presented in previous chapters indicates that ARR had serious management weaknesses. FRA has taken a more active role recently, and FRA and ARR management have worked to correct many of the problems we found. The changes they are making should improve ARR's operations.

However, ARR needs additional guidance in determining its future role. The executive branch's expressed desire to sell ARR conflicts with ARR's legislative mandate to participate in Alaska's development. Investment and management decisions appropriate for one future contrast sharply with those appropriate for the other. Regardless of ARR's ownership, some Federal assistance to ARR seems likely.

RECOMMENDATIONS TO THE CONGRESS

We recommend that the Congress decide whether the Federal Government should continue its ownership and operation of ARR. In making this determination, the Congress should consider the appropriate role of ARR in developing the State of Alaska. As discussed on pp. 12-14, particular attention should be given to the possible economic effects on consumers and privately owned competitors.

If the Congress decides not to sell ARR and decides to continue supporting its operations, we believe the Congress needs to ensure that FRA continue to exercise proper leadership and control over ARR to avoid recurrence of the management problems we found.

If the Congress decides that ARR should be sold, it must define what assets will be sold and what conditions will be placed on the sale. Once these steps have been taken, the Federal Government will need to determine the market value of ARR's assets and propose a price that prevents a buyer from receiving a windfall gain due to undervalued assets. Without knowing ARR's market value, the Federal Government cannot determine if a prospective buyer has made a reasonable offer.

In either case, the Congress will need to consider land ownership problems in any plans calling for rail extension in Alaska, especially through Native lands or the four national conservation systems.

OFFICE OF THE SECRETARY OF TRANSPORTATION
WASHINGTON, D.C. 20590

ASSISTANT SECRETARY
FOR ADMINISTRATION

May 10, 1978

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

Dear Mr. Eschwege:

We have enclosed two copies of the Department of Transportation's reply to the General Accounting Office draft report "The Alaska Railroad--Its Management Needs to be Improved and Its Future Needs to be Decided." We believe the General Accounting Office made a contribution in performing its review of the management of the Alaska Railroad, particularly in the areas of real estate, internal control, and financial management. As a result of the General Accounting Office review and Federal Railroad Administration monitoring, the Railroad has made considerable changes. The Federal Railroad Administrator will continue to exercise the oversight role through the Alaska Railroad Management Committee.

Please let us know if we can assist you further.

Sincerely,

for Edward W. Scott, Jr.

Enclosure

DEPARTMENT OF TRANSPORTATION REPLY TO GAO DRAFT REPORT ENTITLED THE ALASKA RAILROAD - IT'S MANAGEMENT NEEDS TO BE IMPROVED AND ITS FUTURE NEEDS TO BE DECIDED

SUMMARY OF GAO FINDINGS AND RECOMMENDATIONS

GAO stated that The Alaska Railroad (ARR) has not effectively managed its affairs and there is doubt about what its future role will be.

ARR had no overall marketing plan and its rates did not consider total costs. It was losing revenue because its real estate program was not managed effectively. The system of internal controls and financial management procedures and practices were inadequate.

The Executive Branch had expressed a desire to sell ARR which would require approval by the Congress. Because of uncertainty about its future status, ARR cannot plan effectively. GAO recommends that the Congress decide whether the Federal Government should continue to own and operate ARR.

DEPARTMENT OF TRANSPORTATION POSITION STATEMENT

COVER SUMMARY

We believe the summary should be revised. While we agree that ARR has not effectively managed some of its affairs, the report addresses itself primarily to the areas of marketing, real estate, internal control, financial management, and ARR's future role, concentrating on management of support areas versus operating areas which, if examined, would speak well of ARR management. In terms of expenditures, the GAO report concentrates on only 15 percent of ARR's activities. In addition, the summary should reflect not only the inadequacies discovered in internal control, real estate and financial management, but also recognize that in the year and a half that GAO has been working on this study, ARR has taken many actions to rectify the problems.

We believe reference to ARR's tariffs not considering total costs to provide service is inaccurate as pointed out in our detailed comments. Also, although the statement is made that because of uncertainty about its future status, ARR cannot plan effectively, no details are provided in the report to show how this uncertainty has impaired ARR's performance in any tangible way and therefore, it should be deleted.

DIGEST

We believe the statement that ARR "has not effectively managed its affairs" is too sweeping a statement in light of the progress and accomplishments made by ARR over the years with the resources it has been given. Also, the statement does not recognize the many actions taken to rectify the problems noted by GAO.

Detailed comments by chapter follow on the areas listed below, but to summarize for purposes of the digest:

--There is acknowledgment within FRA of the need to strengthen ARR's marketing effort.

--ARR did consider the total costs to provide service, recognizing that improvements and refinements in its costing techniques could be made as could the industry's in general.

--ARR has embarked on a course of obtaining fair market value for its leases in direct response to the findings of GAO.

--There were many inadequacies in ARR's system of internal controls but corrective action has been taken in many of the areas to rectify the situation and such action will continue in order to institute a sound internal control system.

--Many of ARR's financial management procedures and practices were inadequate, but action has been taken to remedy the situation. We believe the digest's presentation of the payroll problem does not recognize the complexities involved. Also, the statement is made that personnel were not used efficiently, but we were unable to find documentation in the body of the report to support the statement.

--As mentioned in our comments on the cover summary, we were unable to find support in the body of the report for the allegation that because of the uncertainty about its future, ARR's performance had been tangibly impaired.

CHAPTER I INTRODUCTION

We suggest that the last sentence on page 2 be expanded to recognize the fact that much of the donated property received from the Federal Government has been World War II and other surplus military items which are still in use.

We suggest that the section entitled "PROFIT AND LOSS RECORD" on page 3 include the statement from page 52 that states that "ARR's financial success is dependent in large part on management's attempting to acquire and retain business in a highly competitive transportation market." Also, we believe the report should show that the profit and loss record for the period FY 1967-FY 1976 resulted in a net profit of $1,349,000. The $1.1 million loss for the 1976 transitional quarter was brought about by a deliberate decision of ARR to use the pipeline's profits to reduce long standing deferred maintenance. In fiscal year 1977, ARR experienced a loss of $935,925. We suggest the report recognize the fact that while railroads should seek to be profitable, ARR is charged under Executive Order No. 11107 with maintaining rates which give recognition to National Public Purposes.

We suggest that the section entitled "RESPONSIBILITY FOR ARR" include the delegation of authority from FRA to the General Manager for operation of ARR. We have attached a revised organization chart, current as of March 31, 1978.

We feel the observation of the former Deputy Administrator has been taken somewhat out of context of his total statement regarding the relationship between ARR and FRA. His comments in the first paragraph pertaining to "past interest in ARR" relate to the previous years of Washington, D.C., oversight of ARR not only when it was initially put into the Department of Transportation but also during the period under the Department of Interior. The second paragraph also referred to the aforementioned period. However, at the time he made the comment he also indicated that within the last 2 years, FRA had taken an active role in monitoring the activities of ARR and there had been a substantial improvement in the relationship between the two organizations.

Also, the statement on page 7 that ARR has not attempted to implement the recommendations in all cases is misleading. In some instances conditions changed between the time of the study was made and actually implemented. Also, the statement that FRA has not insisted that ARR resolve the problems noted in the 1975 management review and has not monitored ARR's activities closely enough to ensure that improvements were made is not supported by the facts. We consider that a review of the minutes of The Alaska Railroad Management Committee's meetings over the last several years would confirm the monitoring of ARR by FRA management. The composition of the Management Committee described on pages 7 and 8 has been changed pursuant to a FRA Order 1120.4A issued February 10, 1978. We have attached a copy for your information.

As to the physical condition of ARR described on page 8 of the draft, we also believe little support is provided that indicates a disagreement between ARR and FRA. Three statements of fact are presented, one occurring in June 1975 and the others about a year later, but the context in which the statements were made is not indicated and the last item concerning the inspection of ARR by two former General Managers actually reveals agreement between ARR and FRA.

CHAPTER 2 ARR'S MARKETING EFFORTS

There has been a concern within FRA regarding the ARR's marketing efforts. As the report points out, FRA sponsored a study on ARR's future freight market in 1976. The study involved identifying mineral resources which are likely to be commercially developed and generate a demand for rail freight service and also assessing the petroleum related development and pipeline construction impacts upon ARR.

In this regard, there is acknowledgment within FRA of the need to strengthen ARR's marketing effort. One fact overlooked is that the shipping companies that have customers shipping to Alaska in which rail cars are used are marketing on behalf of ARR. ARR is aware that a more aggressive effort must be made. In line with this, ARR recently established a new incentive rate tariff which gives lower rates to customers who utilize greater volume in freight cars and this gives ARR a distinct competitive advantage. But unless ARR controls water shipment to Alaska, it does not have the technical facilities with which to effectively compete in its market and to buy those facilities is prohibitive given ARR's financial position at this time. ARR's competitors move freight door-to-door in a faster time frame and control all aspects of the transportation chain. ARR moves only from siding to siding once the cargo arrives in Alaska. As to the report's suggestion on page 14 that ARR's marketing policy to meet competitive challenges for ARR customers seems to be based on individual cases, actually in only rare instances do ARR's marketing personnel have an opportunity to devise tariffs and policies for the benefit of specific customers. ARR is a public carrier and rate tariffs and policies must apply to all shippers.

The Traffic Officer is cognizant of total costs of providing service. It is his belief that there is not a rate or division in our tariffs that will not produce sufficient revenue to cover direct costs and contribute to overhead costs. Costing and rate making are very complex issues faced by the entire railroad industry and not solely by ARR. ARR agrees that improvements and refinements in its costing techniques are necessary.

A compendium entitled "Railroad Accounting" published in 1976, including presentations by railroad managers, accounting experts, and Government officials, pointed out numerous deficiencies and problems existing in costing and pricing. FRA is sponsoring a cost research program to develop a framework for railroad costing in light of the fact that the rail industry has collected inadequate data for pricing in accordance with basic economic principles. Other industry experts realize that, as an industry-wide accounting problem, costs of specific functions and handling specific commodities are difficult to determine. There are industry, government, and educational institution task forces trying to overcome these problems. Therefore, pricing and rate determination are not problems faced only by ARR.

A shipper protested to the Secretary of Transportation ARR's gravel rates. After extensive review of the procedures used to set the rates by FRA/OST, ARR's policy was determined to be sound and the rate developed by ARR was endorsed by FRA/OST. However, the analysis also showed that all rates more than covered variable expenses which, according to the Railroad Revitalization and Regulatory Reform Act of 1976, are to be considered just and reasonable and contributing to the going concern value of the firm.

It is fully understood by the railroad industry that it is impossible for all rates to cover fully allocated expenses (variable and fixed). A balance must be achieved among the product mix to enable the rate mix to cover fully allocated costs. Competitive rates have much impact on ARR rates. To remain competitive, ARR must at times on various products set rates that will not cover fully allocated costs but which will cover variable costs.

We suggest the various sections of the chapter be redrafted to reflect the above comments, as should the conclusions and recommendations.

CHAPTER 3 CHANGES ARE NEEDED TO IMPROVE THE MANAGEMENT OF THE ALASKA RAILROAD'S REAL ESTATE

As mentioned in the report, ARR's new real estate policy was issued May 25, 1977. In applying this policy, ARR has instituted a recurring appraisal program which should help assure receipt of fair rental values. In addition, one position was added to the real estate staff in May 1977 and another is planned. We agree with GAO that the implementation of the new policy plus additional staff assigned will correct the problems noted in the report.

As of April 1, 1978, 97 of the 295 leases were reappraised. A like number is to be reappraised in 1978 and 1979. The first reappraisal effort in 1977 resulted in new rates representing rental increases varying from as little as 20 percent to as much as 1800 percent, or as little as $200 per year to as high as $34,300 per year. Recognizing the impact of the more significant increases, a plan was implemented to phase-in the increases over a period of 3-to-5 years for those leases most affected. Where the overall increase would be at least $1,000 and 100 percent, the catch up period would be 3 years. If, in applying the 3-year catch up, the annual increases each exceed 100 percent and $3,000, the catch up period would be extended to 5 years.

The estimated annual income from 56 lease parcels in Anchorage, reappraised in 1977, will increase by $475,000 when fully implemented in 1981. The average rental rate for these parcels had been $.09 a square foot. The new fair market value would result in $.23 a square foot.

Land being leased amounts to about 1,200 acres. As to GAO's finding that the lease agreements did not specify the size of the area involved, all the leases contained a description referring to an attached plat from which the area could have been calculated. However, when we discover a lease whose area is not shown, we will insert it into the description or otherwise note the lease file.

GAO's comments concerning the lease applications not stating how much freight the applicant intended to ship by rail are academic now since fair market value is the sole criteria. As to the two land parcels used by shippers without monetary consideration, use permits should have been issued instead of leases. The area in Valdez is no longer being used and the lease on the other parcel expires on July 31, 1979. At that time, a use permit probably would be issued instead of extending the lease.

Concerning the unusual treatment of some lease holders on page 26, as mentioned previously, ARR has instituted a recurring program and all leases will be adjusted to fair market value. As to the recommendations to the Secretary of Transportation, The Alaska Railroad Management Committee was reestablished in February 1978 and will meet at least quarterly to review and provide advice on programs deemed pertinent to the efficient operation of ARR, including real estate.

CHAPTER 4 INTERNAL CONTROLS NEED TO BE IMPROVED

Where the auditors identified inadequacies in internal controls, action has been taken in many instances to correct the situation.

Possibilities Existed for Improper Financial Transactions

With regard to the Chief of the Accounting Section both approving and certifying vouchers for payment, the situation has been corrected by requiring in an internal directive that no person may both approve and certify vouchers for payment. As a result of the GAO finding relating to documentation for vouchers, instructions were issued stating that no vouchers would be processed without full back-up documentation. In addition, at GAO's suggestion, ARR now requires that refunds and adjustments be reviewed and initialled by the employees' supervisor. As to the collection, disbursing, and budget clerk, ARR states the clerk never authorized refunds for overpayment. FRA agrees that her duties should be separated and her work reviewed and will take the necessary steps to rectify the situation.

Loss of Revenues

Although GAO found no systematic check of the contents or weight of rail cars, spot checks were made on a random basis. As to verification of shipping weights, although there may have been weight discrepancies in 88 percent of the cases sampled by GAO, according to ARR in the majority of instances the overweight was of no consequence because the shipment was billed at a greater rate than the actual weight of the car.

ARR agrees that if in fact the extra 7,400 lbs. of southbound "freight" should have been considered in the total freight charges, then $534 additional freight charges should have been collected. However, ARR's division or share would have only been $86.73. Also, although not verified in these four instances, according to North Star Forwarding and ARR agents, the additional weight may have resulted from placing in the cars dunnage and cribbing materials for which there would be no freight charges per ARR Tariff 95.

Checking the content of rail cars can only be done on a spot check basis because it is not economically feasible to do otherwise. For example, ARR estimates 40 minutes to 1 hour of yard engine and crew time to switch a car for inspection which would cost between $55 and $85. In addition, the time for a special agent and witness would cost between $25 and $40.

As to the finding that reimbursable work charges are not current, as a result of the GAO work, ARR now indicates that it updates its reimbursable rates each year.

The caption "All applicable costs had not been considered in establishing rates" is not supported by the information included in the report. In the case of ARR, it has applied overhead rates varying from 25 percent to 75 percent. The varying overhead rates reflect the impact of the work on ARR income; it charges less for freight customers (spur track) and more to a non-freight customer. The difference in percentages assures ARR full reimbursement.

Customer adjustment of freight charges

This situation has been corrected, partly through centralized billing, partly through new procedures requiring documentation and review of all adjustments and by resuming local audit of bills. ARR researches, audits, and scrutinizes all claims for overcharge, defending in writing any declinations. If the overcharge claim is found correct, it is paid.

Credit controls inadequate

According to ARR, the credit program has been transferred from Operations to Budget and Accounting. ARR has a full time employee working in the area of credit control. Since centralized billing was initiated in May 1977, ARR receivables have declined. Part of this is attributable to the centralized billing process. ARR now has a uniform, systematic procedure for tracing customers and it withdraws credit if the response is not favorable. No credit is extended without prior approval of the Budget and Accounting Branch. ARR is evaluating the potential impact of instituting ICC procedures for assessing a charge when credit extensions are granted.

Inadequate Protection of Property and Materials

Deficiencies in ARR's property and inventory systems have been corrected by various changes. Changes including transfer of inventory responsibility from Budget and Accounting to the Supply Branch have been instituted. We believe it should be noted that the equipment shrinkage noted on the report over 4 years equates to an average of $9,144 per year and when compared to the average total ARR equipment valuation of $8,935,041, (not including locomotives and freight cars) is about one-tenth of 1 percent.

Need to establish physical control procedures

Efforts have been made to effect consolidation of outside storage areas. However, there are physical limitations due to arrangement of fixed facilities and overall outside storage needs vary with the season and delivery schedules. Locks at the warehouse doors have been changed and key distribution restricted. If warehouse access is required outside regular work hours, there is a procedure for contacting a Supply Branch representative who will come to the warehouse.

Inadequate Handling of Employees' Financial Interest Statements

Although the review of conflict of interest statements is presently within the purview of FRA's Office of Chief Counsel, a proposal is being considered to transfer the responsibility to ARR.

Other Matters Involving Inadequate Controls

With regard to accounting for property in the custody of employees who left ARR service, ARR established employee property clearance procedures in May 1977. Also, ARR is revising its accounting manual to provide that no timekeeper shall pick up or distribute checks.

Actions Taken or Planned, Conclusions and Recommendations

New instructions have been issued on requisitioning authority. Concerning the GAO references to security problems, action was taken to require strict compliance with existing procedures concerning Treasury security. As mentioned previously, action has also been taken to rectify the equipment and supplies situation.

We share GAO's concerns whenever internal control weaknesses are identified. In summary, we believe ARR has made progress in eliminating many of the weaknesses in internal controls identified by GAO. Such efforts will continue in the future utilizing all available resources within ARR or elsewhere in FRA or the Department.

CHAPTER 5 INADEQUATE FINANCIAL MANAGEMENT

Capital Planning Needs Improvement

Since completion of GAO's field work ARR has implemented formal and fully documented procedures as prescribed by FRA, which conforms to both Departmental and Office of Management and Budget guidance.

Inaccurate and Unreliable Accounting Data

ARR is faced with a major undertaking in order to achieve a fully accurate and responsive accounting and financial system supported by modern data processing techniques and programs. FRA plans to work with ARR to determine its specific needs in this regard. As to accounting policies not being consistent from year to year, the practice of expensing costs which should have been capitalized was followed for a short period prior to the tenure of the present General Manager and has since been corrected.

Centralized control

As noted on page 56 of the draft report, ARR has implemented procedures toward centralizing all billings. As a result, delays in billing have been significantly reduced. Also, as of March 1977, all adjustments to vouchers or bills require at least two levels of review. Also, a more rigorous collection effort has been underway for some time. The new Accounts Maintenance Clerk is devoting considerable time to bringing collections up-to-date. In the past year, accounts in dispute have been reduced 28 percent.

Inadequate Control Over Travel Funds

In response to GAO's work involving t[illegible]l, ARR has emphasized to its employees the need to thoroughly understand the Federal Travel Regulations in order to eliminate overpayments as noted by GAO.

Need to Control Payroll Costs

FRA is doing everything it can to eliminate the payroll cost situation discussed in the draft. As noted by GAO, an Executive Officer Pay Plan (EO), comparable to the General Schedule (GS) was inaugurated in September 1976. This resulted in conversion of some 14 higher level Railroad (RR) pay system employees. All new or vacant officer positions will be classified as GS Equivalent (GSE) and any time an officer changes positions, he has to become GS. Thus, ARR is gradually phasing out the RR pay plan. ARR is currently engaged in negotiations with the American Federation of Government Employees on the White Collar (WC) pay plan. Of the 658 permanent employees now on board, about 50 are covered by the EO and GSE pay plans, 85 by the WC pay plan, 35 by the RR pay plan, 150 by the United Transportation Union, 310 by an Equivalent Wage Grade pay plan (same rates of pay as other Federal agencies) and the balance by small unit plans such as dispatchers.

Thus, the "salary problem" is essentially limited to the 85 WC, 35 RR, and some of the GSE employees compensated under saved pay provisions.

Inadequate Position Management

ARR submitted extensive comments to FRA on the referenced June 1977 report in early October. While the report is being finalized, ARR has taken the following action:

--The Assistant General Manager has retired and the position is being held vacant until an upturn in business or other change in circumstances justifies recruitment of a replacement.

--The Assistant Chief Mechanical Officer position was abolished.

--The Comptroller is expected to retire June 30, 1978, and the position will be abolished at that time.

Improper Temporary Appointments

The policy described in the report is being adhered to, and the situation fully corrected. When the improper salary payment surfaced, a bill for collection to recover the salary payment was issued and paid by the employee. The situation cited in the report has been corrected because the employee in question has resigned and the improper payment rectified.

Use of Sole Source Procurement Authority

ARR has taken the necessary steps to correct the inadequate procurement situation.

Conclusions and Recommendations to the Secretary of Transportation

Since GAO completed its study, ARR has taken corrective action in many of the areas included in the draft report. Therefore, we recommend that the various presentations within the chapter be deleted.

CHAPTER 6 FUTURE ALTERNATIVES FOR ARR

We recommend that the tone of the "Conclusions" section be revised to correspond with the sentiment expressed in the opening of the chapter where it is stated that important improvements are in process. We believe progress has been made in eliminating many weaknesses in the management of ARR activities. As we previously pointed out, the payroll area is extremely difficult and ARR is doing all it can under the circumstances. In other areas, such as real estate, significant improvements have been realized and more are planned on a continuing basis.

Attachments [See GAO note.]

JOHN M. SULLIVAN
Federal Railroad Administrator

GAO note: The attachments were deleted because one is incorporated in the body of the report; the other is not used.

PRINCIPAL OFFICIALS RESPONSIBLE FOR ACTIVITIES DISCUSSED IN THIS REPORT

	Tenure of office From	To

DEPARTMENT OF TRANSPORTATION

SECRETARY OF TRANSPORTATION:

	From	To
Brock Adams	Jan. 1977	Present
William T. Coleman, Jr.	Mar. 1975	Jan. 1977
John W. Barnum (acting)	Feb. 1975	Mar. 1975
Claude S. Brinegar	Feb. 1973	Feb. 1975
John A. Volpe	Jan. 1969	Feb. 1973
Alan S. Boyd	Jan. 1967	Jan. 1969

FEDERAL RAILROAD ADMINISTRATION

ADMINISTRATOR:

	From	To
John M. Sullivan	July 1977	Present
Asaph H. Hall	Aug. 1975	July 1977
Asaph H. Hall (acting)	Nov. 1974	Aug. 1975
John W. Ingram	Oct. 1971	Nov. 1974
Carl V. Lyon (acting)	July 1970	Sept. 1971
Reginald N. Whitman	Feb. 1969	June 1970
A. Scheffer Lang	May 196[illegible]	Jan. 1969

ALASKA RAILROAD

GENERAL MANAGER:

	From	To
William L. Dorcy	Apr. 1976	Present
Walker S. Johnston	Jan. 1972	Jan. 1976
John E. Manley	Mar. 1962	Dec. 1971

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