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Report to the Secretary of Transportation

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FINANCIAL MANAGEMENT

Internal Control Weaknesses in FRA's Civil Penalty Program

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Resources, Community, and
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The Honorable Samuel K. Skinner
The Secretary of Transportation

Dear Mr. Secretary:

As part of our continuing effort to describe how federal agencies are improving internal controls under the Federal Managers' Financial Integrity Act of 1982 (31 U.S.C. 3512 (b)), we are issuing this report on internal control weaknesses we identified within the financial management of the Federal Railroad Administration's (FRA) civil penalty program. This program, which is managed by FRA's Office of Chief Counsel (OCC) and Office of Financial Services (OFS), assesses railroads' penalties for violations of safety regulations that pose an immediate safety hazard. We performed this work during our review of the effectiveness of FRA's safety enforcement program which we will be reporting on to the Chairman, House Energy and Commerce Committee, in the next few months.

Results in Brief

We found internal control weaknesses in the financial management of FRA's civil penalty program that undermined compliance with federal standards for settlement, collection, accounting, and recordkeeping. Additionally, FRA's actions did not comply with its own internal standard operating procedures and policies. Specific problems included the following:

- OCC did not keep adequate records of railroad correspondence in numerous cases and was therefore unable to readily determine which railroads had and had not responded to notifications of safety violations and potential civil penalty assessments.
- OFS did not establish accounts receivable for millions of dollars in civil penalty payments because OCC staff did not follow required procedures, resulting in a loss of control over government receipts.
- OCC did not process and OFS did not deposit some receipts in a timely manner, leading to a loss of revenues due to foregone interest earned on deposits.
- OCC frequently did not enforce provisions for charging interest and administrative costs for overdue civil penalty payments. As a result, the federal government lost potential revenues.
- OCC was not timely in settling railroad violation cases and collecting civil penalties, resulting in increased federal government borrowing.

Background

FRA is responsible for establishing and enforcing safety regulations for the railroad industry. FRA inspectors monitor railroads' compliance with these regulations by routinely inspecting railroads. When inspectors identify violations (defects) that pose an immediate safety hazard, they prepare violation reports that are submitted to FRA's Office of Chief Counsel. The OCC Safety Division reviews the reports for adequacy of evidence and consistency with enforcement policy and aggregates them into cases for assessment against individual railroads. OCC determines the appropriate penalties for each case and issues a notification letter to a railroad that summarizes the violations contained in the case and identifies evidence supporting FRA's position.

Once a railroad is notified of a safety violation and of associated civil penalties, the process for settling the case begins. In hazardous materials cases, railroads have 30 days to reply to FRA on the validity of the violations, according to federal regulations. If a railroad does not reply within the allowed time, it must pay the fine immediately and forfeit its rights to an administrative hearing. However, in cases involving the rail safety acts,[1] FRA gives railroads more time to investigate. After their own investigations, the railroads may negotiate a settlement with FRA. Larger railroads usually negotiate settlements annually with FRA in conferences that include technical experts and attorneys from both the railroad and FRA. When FRA and the railroad reach agreement on the settlement amount, OCC puts the agreement in writing and requests payment. The railroad then has 30 days to pay the full settlement amount to avoid paying interest and late charges.

When a civil penalty case has been settled, the responsible OCC attorney prepares a settlement sheet including the basis of settlement and a "Railroad Accounting Division (RAD) - 41" memorandum. This memorandum indicates the fines and fees to be collected from the subject railroad, as well as the due date(s). The attorney delivers these documents to OCC administrative staff, who then deliver the RAD-41 memorandum to FRA's Office of Financial Services, which operates FRA's centralized accounting system, and file the others. When OFS receives the RAD-41 memorandum, it establishes an account receivable for the settlement amount in FRA's accounting system.

[1]The Safety Appliance Acts, 45 U.S.C. 1-16; the Locomotive Inspection Act, 45 U.S.C. 22-34; the Accident Reports Act, 45 U.S.C. 38-43; the Hours of Service Act, 45 U.S.C. 61-64b; Federal Railroad Safety Act of 1970, 45 U.S.C. 421 et seq.; and the Signal Inspection Act, 49 U.S.C. app. Sec. 26.

In fiscal year 1989, FRA sent letters to railroads concerning violation reports that occurred mostly in fiscal year 1987 or before. These violations were potentially worth $5.6 million in civil penalties. Additionally, through negotiation of 800 cases, FRA settled 5,577 violation reports received in fiscal year 1989 and before totalling $4.62 million in civil penalties.

Standards for the financial management of the federal government's claims, such as FRA's civil penalties, have been established by both the Congress and GAO. The Federal Claims Collection Act of 1966 (P.L. 89-508, 80 Stat. 308 (1966)), as amended,[2] sets federal requirements for the prompt settlement of the government's claims, including the civil penalties FRA assesses against railroads for safety violations. Additionally, GAO's Policy and Procedures Manual for Guidance of Federal Agencies provides financial management guidance and establishes required procedures for accounting and internal controls. FRA's OFS has also developed standard operating procedures for managing FRA's civil penalty collection activities. (App. II contains details on internal financial control requirements.)

Internal Control Weaknesses

We found internal control weaknesses that undermined the integrity of the financial management system for FRA's civil penalty program. FRA complied with neither governmentwide requirements nor its own internal standard operating procedures and policies in four areas. First, records of significant transactions were frequently inadequate or nonexistent. Second, FRA did not establish accounts receivable for millions of dollars in civil penalties assessed against railroads. Third, FRA deposited numerous civil penalty receipts later than federal standards allow. Last, FRA enforced neither statutory nor FRA's policy for assessing interest and administrative charges on late railroad penalty payments. These problems resulted from a general inattention and lack of importance attached to internal control standards as well as from strained resources. Although OCC's Safety Division hired four additional attorneys to alleviate staff resource strains between May 1988 and March 1990, these internal control problems continued to exist.

Recordkeeping Inadequate

GAO's Policy and Procedures Manual, Title 8, "Records Management," informs federal agencies that they are required to keep records of agency transactions and functions in order to protect the government's

[2]Amended by Debt Collection Act of 1982 (P.L. 97-365, 96 Stat. 1749 (1982)).

interests. However, OCC did not comply with these federal recordkeeping requirements. For example, OCC has records that were designed to account for cases that have been settled; however, as of May 1990, these records were not current. Administrative staff responsible for updating the records were involved in other duties and had not made any entries between September 1989 and May 1990, even though FRA had settled civil penalty cases for more than 3,000 violations during that period.

GAO's Policy and Procedures Manual, Title 8, points out that federal agencies are required to make and preserve records of agency transactions so that the legal and financial rights of the government are protected. Thus, records of railroad response to FRA's letters stating that rail safety violations have occurred must be maintained in order to protect the government's legal and financial interests. Railroad response is especially important in hazardous materials cases. Federal hazardous materials regulations (49 C.F.R. 209.107) state that a failure to respond to a Notice of Probable Violation constitutes forfeiture of all rights to any administrative hearing and requires the railroad to pay the penalty immediately. For both hazardous materials and rail safety violations, FRA's letters that notify railroads that violations have occurred request a response, in accordance with these requirements. Railroads respond both in writing and by telephone. OCC attorneys are responsible for maintaining records of these responses. An OCC official told us that railroad correspondence is generally retained by the responsible attorney and not put in the official case file.

We found that FRA's records of railroad responses to civil penalty notification letters were inadequate in certain cases. For example, only 27 of 197 official files we reviewed for civil penalty cases closed during fiscal year 1988 contained records of railroad responses. Similarly, only 25 of 49 official files for "top priority" civil penalty cases initiated during fiscal year 1986 through December 1989 contained records of railroad responses to notifications of violations, even though FRA's letters clearly requested a railroad response within 30 days of receipt of the letter. Therefore, in these cases, it was impossible to determine from the official files which railroads had and had not responded. As a result, in several hazardous materials cases closed during fiscal year 1988, we found it difficult to determine whether a railroad owed an immediate payment. Furthermore, in over 50 percent of the top priority case files reviewed, we could not determine how quickly railroads responded to FRA's notification because no record of railroad response was evident.

Accounts Receivable System Ineffective

GAO's Policy and Procedures Manual, Title 2, requires federal agencies to establish accounts receivable. FRA's centralized accounting system is operated by OFS and includes standard operating procedures for the establishment and maintenance of accounts receivable which consist primarily of civil penalty payments from railroads. However, from October 1988 through January 31, 1990, civil penalty checks totalling $3.26 million were received by OFS without corresponding accounts receivable records. In these cases, the RAD-41 memorandum was not prepared by OCC attorneys and forwarded to OFS to initiate an account receivable, as required. Consequently, there was a loss of control over these government receipts because OFS staff did not know how much money was owed by specific railroads or when payments were due. Furthermore, in certain cases in which FRA followed its procedures for establishing accounts receivable, control over civil penalty receipts was compromised. For example, in October 1988, two civil penalty checks totalling $139,000 were lost in OCC offices. Although an account receivable had been established, OCC staff did not realize the checks were missing. These checks were not discovered and deposited until nearly 3 months later. Additionally, OFS did not record dates of payment receipt in many cases, thereby undermining FRA's ability to monitor the status of payments being processed.

Debt Payments Deposited Late

GAO's Policy and Procedures Manual, Title 7, describes Department of the Treasury standards that require agencies to deposit debt payments within 5 days from their receipt. Furthermore, FRA's internal provisions require OCC to forward monies mistakenly sent by railroads to OCC to FRA's OFS within 2 business days. However, FRA regularly did not comply with requirements for timely deposit and handling of debt payments. In some of the cases in which railroads mistakenly sent civil penalty checks to OCC instead of to OFS, the checks were not forwarded to OFS or deposited within the established time limits. We found that normally one administrative staff member is responsible for opening OCC's mail, accounting for civil penalty checks sent to OCC, and handcarrying these checks to OFS. This individual had numerous other administrative duties in addition to handling payments.

We found that between October 1, 1987, and December 31, 1989, railroads made 263 civil penalty payments totalling $8.94 million to FRA. Of these, at least 16 were received in OCC and not forwarded to OFS within established time limits. Furthermore, FRA deposited 24 payments totalling $1.68 million, about 19 percent of the total payments, between 3 and 92 days later than required. As a result, FRA postponed interest that should have been paid to the federal government on deposited railroad debt payments. An FRA official told us that checks mistakenly sent by railroads to OCC attorneys occasionally remained unprocessed for extended periods and were therefore not deposited within required time limits. For example, in October 1988, two civil penalty checks totalling $139,000 which a railroad sent to OCC remained in an OCC attorney's inbox until January 1989. The attorney said that he did not sort through his inbox until January 1989 because he was temporarily assigned to writing regulations.

Provisions for Charging Interest and Administrative Expenses Not Enforced

Both the Federal Claims Collection Act and FRA's own statements in settlement agreements require that late payment penalties be assessed on overdue debts owed to the government. However, FRA regularly did not enforce these requirements. For example, during the period October 1, 1987, through December 31, 1989, 10 accounts totalling over $325,000 were either overdue or paid in installments. FRA's settlement notices sent to railroads state that interest and administrative charges will be levied for failure to pay the full settlement amount by the date specified. However, no interest, penalties, or administrative charges were assessed for these late or extended payments. Instead, OCC attorneys simply amended the settlement agreements with new due dates. As a result, the federal government lost potential revenues from interest and administrative charges that FRA should have collected. However, due to data limitations, we could not determine the amount.

Settlement Goals Not Met

GAO's Policy and Procedures Manual, Title 4, requires effective agency debt-collection programs that are comprehensive, vigorous, and uniformly applied. These programs should provide for timely, forceful, and persistent action to collect payment of debts. We found that OCC's debt collection efforts do not meet these financial management objectives. Since 1986, a backlog of cases awaiting transmittal to railroads has existed because attorney staff turnover, combined with an administrative staff shortage, affected the rate at which an increasing number of violation reports and cases could be processed. Currently, FRA takes about 3 years to transmit and settle a civil penalty case.

FRA's backlog has undermined efforts to set and maintain firm goals for transmitting and settling outstanding civil penalty cases and collecting penalty payments. In May 1988, OCC issued its 1988 enforcement procedures that listed December 31, 1988, as the goal for settlement of pre-1987 civil penalty cases. However, since as early as 1986, a backlog of civil penalty cases waiting to be transmitted to railroads has existed and continues to grow. In May 1986, there were 5,334 violation reports in the backlog. In February 1988, the backlog had grown to 11,000 violation reports. By the end of 1989, the backlog was almost 18,000 violation reports. Thus, when it became apparent that the 1988 goal would not be met, OCC issued a subsequent memorandum that changed the settlement goal for pre-1987 cases to December 31, 1989. However, as of that date, 1,241 pre-fiscal year 1987 violation reports contained in cases transmitted to railroads had not been settled. Furthermore, OCC had taken no action on an additional 353 pre-fiscal year 1987 violation reports received in OCC from FRA regional offices.

These untimely actions to settle and collect civil penalties resulted in reduced federal revenues because the funds accruing from these settlements were not available to offset potential federal borrowing of the settlement amounts. For example, if FRA had collected the $3.04 million from pre-fiscal year 1987 cases that were settled in fiscal year 1989 6 to 12 months earlier, the potential interest savings to the federal government would have been between $140,000 and $240,000.

Conclusions

FRA's compliance with federal financial management standards has been undermined by internal control weaknesses in its civil penalty program. As a result, FRA (1) could not ascertain whether or not railroads responded to numerous civil penalty notification letters; (2) lost control over millions of dollars in government receipts; (3) postponed interest that would have been paid on timely deposits of receipts; (4) lost potential federal revenues from interest and administrative charges not levied on late civil penalty payments; and (5) increased federal borrowing costs as a consequence of not meeting its claims settlement goals. Although the systems and procedures we discussed above were in place to effectively manage these activities, inattention to internal financial control standards coupled with strained resources resulted in noncompliance in this important area. A rigorous program to enforce adherence to internal control principles, which could include training and more continuous oversight, would help to prevent a recurrence of these conditions. Furthermore, such a program will both strengthen the financial management of FRA's civil penalty program and increase revenues to the government.

Recommendations

We recommend that you direct the Administrator, FRA, to initiate a program to enforce adherence to internal controls by FRA personnel so that the integrity of the civil penalty program's financial management is not compromised. In particular, this program should emphasize

- updating and maintaining civil penalty case records, including documenting railroads' responses to penalty notifications and negotiations in official case files;
- establishing formal accounts receivable records when railroads are initially notified that violations have been cited and civil penalties assessed;
- forwarding receipts directly received by OCC to OFS within required time limits and ensuring that deposits are made in accordance with federal requirements; and
- enforcing statutory and agency provisions for charging interest, penalties, and administrative costs on overdue civil penalty debts.

In addition, we recommend that you direct the Administrator to set realistic goals for the settlement of claims against railroads based on analyses of attorney and administrative staff workloads.

We also recommend that OCC begin enclosing envelopes that are preaddressed to OFS when settlement agreements are sent to railroads. This would reduce the recurrence of situations in which railroads mistakenly send civil penalty checks directly to OCC.

Scope and Methodology

We obtained information for this report during our review of FRA's safety enforcement program. We contacted FRA officials and reviewed documents and records from FRA headquarters in Washington, D.C. The Chairman, House Committee on Energy and Commerce, requested that we report on our findings directly to the Secretary of Transportation. A more complete description of our objectives, scope, and methodology appears in appendix I. Our review was conducted between April and September 1990 in accordance with generally accepted government auditing standards.

Views of Agency Officials

We discussed the contents of this report with the FRA Administrator and the FRA Chief Counsel, who generally agreed with our findings.

The head of a federal agency is required by 31 U.S.C. 720 to submit a written statement on actions taken on our recommendations to the Senate Committee on Governmental Affairs and the House Committee on Government Operations not later than 60 days after the date of this letter and to the House and Senate Committees on Appropriations with the agency's first request for appropriations made more than 60 days after the date of this letter.

We are sending copies of this report to the FRA Administrator. We are also sending copies to the House and Senate Committees mentioned above; the Chairman, House Committee on Energy and Commerce; and the Director, Office of Management and Budget. Copies will also be made available to others upon request.

This work was performed under the direction of Kenneth M. Mead, Director, Transportation Issues, who may be reached at (202) 275-1000. Major contributors to this report are listed in appendix III.

Sincerely yours,

J. Dexter Peach
Assistant Comptroller General

Contents

Abbreviations

FRA	Federal Railroad Administration
GAO	General Accounting Office
OCC	Office of Chief Counsel (FRA)
OFS	Office of Financial Services (FRA)

Objectives, Scope, and Methodology

During our review of the Federal Railroad Administration's (FRA) enforcement activities, requested by the Chairman, House Committee on Energy and Commerce, we found a number of internal control weaknesses in FRA's financial management of its civil penalty program. As agreed with the Chairman's office, we are reporting on these findings directly to the Secretary of Transportation. Our objective was to determine the extent to which the financial management of FRA's civil penalty program complied with federal claims collection standards, our accounting and internal control requirements, and FRA's own standard operating procedures.

We conducted our work at FRA headquarters in Washington, D.C. We collected and reviewed documents and records from FRA's Offices of Chief Counsel (OCC), Financial Services (OFS), and Management Systems. We also interviewed officials from each of these offices.

To determine the standards with which FRA must comply, we reviewed federal laws and regulations, as well as policy and procedure guidance, pertaining to debt collection and internal financial controls. We also reviewed FRA's policy and procedural guidance documents on this subject.

To determine the extent to which FRA complied with internal control and financial management standards, we examined FRA OCC records for the civil penalty program. Specifically, we reviewed (1) log books showing penalty collections status and checks received, (2) computer records showing the aging of advances, receivables, and payables, and (3) files and documents regarding accounts receivable and deposit records.

We also obtained, through discussion with FRA officials, information on FRA internal controls procedures, OCC processing of civil penalty settlements and collections, and procedures for processing railroad payments made to FRA. Additionally, to determine what internal control weaknesses FRA had previously identified and addressed, we examined recent FRA Federal Managers' Financial Integrity Act reports.

We conducted our review between April and September 1990 in accordance with generally accepted government auditing standards.

Financial Management Requirements

GAO's Policy and Procedures Manual for Guidance of Federal Agencies sets forth the financial management requirements that all federal agencies must follow. Title 2 of the Manual states that the head of each agency is responsible for establishing and maintaining adequate systems of accounting and internal control. These systems must conform to the accounting principles, standards, and related requirements and internal control standards prescribed by the Comptroller General. In addition, the Federal Claims Collection Act of 1966, as amended, sets legal requirements for prompt settlement of the government's claims, including FRA's civil penalties against railroads. Also, FRA's Office of Financial Services has developed standard operating procedures for managing FRA's civil penalties program.

According to GAO's Policy and Procedures Manual, Title 2, "Accounting," sound agency financial management depends on strong financial management systems including sufficiently disciplined accounting systems, reliable financial information, and effective internal controls. Included in these systems are standards for recordkeeping, accounts receivable, and handling and deposit of debt collections. A principal requirement is that federal agencies make and preserve records containing adequate documentation of essential transactions so that the legal and financial rights of the government are protected. Additionally, Title 7 of GAO's Policy and Procedures Manual points out that records must be maintained of all collections in sufficient detail to readily identify the collections if called upon to do so. Agencies must also establish and maintain accounts receivable in their accounting records. According to Title 2 of GAO's Policy and Procedures Manual, amounts receivable by the agency from other entities should be recorded and accounted for as assets from the time events giving rise to such claims are completed. These amounts should be categorized into agency accounting records under the heading "Accounts Receivable."

There are also requirements intended to minimize the potential for loss of government revenues. For example, GAO's Policy and Procedures Manual, Title 7, describes the standards for the timely handling and deposit of debt payments found in the Treasury Financial Manual, Volume I, part 6, chapter 8000. Receipts of $1,000 or more should be deposited daily, while receipts of less than $1,000 may be accumulated and deposited when that total reaches $1,000. In no case should the date of deposit exceed 5 days from receipt. Additionally, the Federal Claims Collection Act, as amended, requires agencies to assess interest, penalties, and administrative costs on overdue debts owed to the United States. Specifically, 4 C.F.R. 102.13 requires that (1) interest accrue from the date on which the notice of debt is first delivered, (2) the rate of interest assessed be the rate of the current value of funds to the U.S. Treasury, and (3) administrative charges to cover the additional costs incurred in processing and handling the debt because it became delinquent be assessed. No interest or penalties may be collected on debts paid within 30 days of notice. When a debt is paid in partial or installment payments, amounts received from the debtor must be applied first to outstanding penalty and administrative cost charges, second to accrued interest, and third to outstanding principal.

In addition to the above requirements, FRA's Office of Financial Services has developed standard operating procedures for managing FRA's civil penalty collections. These procedures describe the responsibilities and steps for managing accounts receivable for civil penalty fines. Also, FRA has accounting procedures to record interest receivable which is levied for failure to pay settlement amounts on time. Furthermore, OCC's enforcement procedures set forth standards for handling civil penalty payment receipts.

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