OFFICE *of* INSPECTOR GENERAL
NATIONAL RAILROAD PASSENGER CORPORATION

GOVERNANCE:

Quality Control Review of the Independent Audit of Amtrak's Consolidated Financial Statements for Fiscal Year Ended 2014

OIG-A-2016-004| February 4, 2016

Memorandum

To: Jeffrey R. Moreland
Chairman, Audit and Finance Committee, Amtrak Board of Directors

Gerald Sokol, Jr.
Executive Vice President and Chief Financial Officer

From: Tom Howard
Inspector General

Date: February 4, 2016

Subject: *Governance: Quality Control Review of the Independent Audit of Amtrak's Consolidated Financial Statements for Fiscal Year Ended 2014* (OIG-A-2016-004)

Amtrak (the company) contracted with the independent certified public accounting firm of Ernst & Young LLP to audit its consolidated financial statements as of September 30, 2014, and for the year then ended, and to provide a report on internal control over financial reporting and on compliance and other matters. Because the company receives federal assistance, it must obtain an audit performed in accordance with generally accepted government auditing standards.

As authorized by the Inspector General Act of 1978, we monitored the audit activities of Ernst & Young to help ensure audit quality and compliance with auditing standards. Our review disclosed no instances in which Ernst & Young did not comply, in all material respects, with generally accepted government auditing standards. The key aspects of the Ernst & Young reports are discussed below.

In its audit of the company's consolidated financial statements, Ernst & Young concluded, in its report dated October 1, 2015, that the consolidated financial statements fairly presented, in all material respects, the consolidated financial position of the National Railroad Passenger Corporation and subsidiaries at September 30, 2014, and the consolidated results of their operations, and cash flows for the year then ended in conformity with U.S. generally accepted accounting principles (GAAP). Ernst & Young's report also emphasized that without receipt of federal funding, the company will not be able to continue in its current form, and significant operating changes, restructurings, or bankruptcy might occur.

In its FY 2014 *Report of Independent Auditors on Internal Controls Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with Government Auditing Standards*, Ernst & Young identified four material weaknesses in internal control over financial reporting:

- **Capital Lease Accounting, Documentation, and Analysis.** The company did not properly document and review analyses of lease classifications, and its calculation of amortization schedules did not comply with GAAP. This resulted in numerous errors, some dating back to the start of the leases.

- **Income Tax Accounting.** The company had not provided deferred taxes related to the book and tax basis differentials for assets acquired with capital grant funds in accordance with GAAP, and there were numerous errors in the calculation of the income tax provision and related accounts. The company did not appropriately assess and document its consideration of key assumptions, the realizability of the deferred tax assets, and the execution costs estimate associated with the tax planning strategy.

- **Financial Reporting.** The company lacked (1) a sufficient complement of personnel with an appropriate level of accounting knowledge, (2) sufficient analysis and documentation of the application of GAAP to complex accounting issues, (3) adequate policies and procedures to ensure that accounting personnel were made aware of specific features of complex transactions, and (4) clear organization and accountability within the accounting function.

- **Information Systems.** Two significant deficiencies, when aggregated, result in a material weakness in the design and operation of general controls related to user access and change management. This impacted automated and IT-dependent manual controls across all classes of transactions significant to financial reporting processes.

Ernst & Young made several recommendations to correct these material weaknesses, and the company agreed with all of them. In responding to the recommendations, management stated that because of the timing of completion of the FY 2013 audit, it was unable to fully implement its corrective actions for capital lease accounting until FY 2015. In addition, management was unable to begin implementing corrective action for income tax accounting and financial reporting until FY 2015. Management also stated the company has taken immediate action to strengthen its processes for IT governance, user access, and change management. Ernst & Young identified other matters involving internal control over financial reporting, which it provided in a management letter on February 2, 2016.

We monitored Ernst & Young's audit activities by reviewing its reports, auditor independence and qualifications, audit plans, detailed testing results, summary work papers, and quality controls. We also attended key meetings.

Our monitoring activities, as differentiated from an audit in accordance with generally accepted government auditing standards, were not intended to enable us to express an audit opinion. We do not express an opinion on the company's consolidated financial statements or conclusions about the effectiveness of internal controls and compliance with laws and regulations. Ernst & Young is responsible for its reports dated October 1, 2015, and the conclusions expressed in those reports.

We appreciate the courtesies and cooperation that representatives of the company and Ernst & Young extended to us during our work. If you have any questions, please contact me (Tom.Howard@amtrakoig.gov) or Kevin Winters, Deputy Inspector General/ Counsel (Kevin.Winters@amtrakoig.gov) at 202-906-4600.

OIG MISSION AND CONTACT INFORMATION

Mission	The Amtrak OIG's mission is to provide independent, objective oversight of Amtrak's programs and operations through audits and investigations focused on recommending improvements to Amtrak's economy, efficiency, and effectiveness; preventing and detecting fraud, waste, and abuse; and providing Congress, Amtrak management and Amtrak's Board of Directors with timely information about problems and deficiencies relating to Amtrak's programs and operations.
Obtaining Copies of Reports and Testimony	Available at our website: www.amtrakoig.gov.
Reporting Fraud, Waste, and Abuse	Report suspicious or illegal activities to the OIG Hotline (you can remain anonymous): Web: www.amtrakoig.gov/hotline Phone: 800-468-5469
Contact Information	Kevin Winters Deputy Inspector General / Counsel Mail: Amtrak OIG 10 G Street NE, 3W-300 Washington D.C., 20002 Phone: 202-906-4600 Email: Kevin.Winters@amtrakoig.gov