



UNITED STATES GENERAL ACCOUNTING OFFICE
WASHINGTON, D.C. 20548

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COMMUNITY AND ECONOMIC
DEVELOPMENT DIVISION

JUL 16 1980

Mr. Donald C. Cole
President and Chief Executive
Officer
United States Railway Association

Dear Mr. Cole:

In accordance with the Government Corporation Control Act, we have completed an audit of the financial statements of the United States Railway Association (USRA) for the period October 1, 1978, through September 30, 1979, and issued our report to the Congress entitled, "Examination of the United States Railway Association's Financial Statements". We also observed several other matters during our examination which we wish to bring to your attention. These matters were discussed with the Vice President, Administration; Director, Office of Accounting; and the Director of Audits.

IMPROVEMENTS CAN BE MADE TO
CONTROLS OVER EQUIPMENT

USRA has improved its controls over equipment (e.g., calculators, tape recorders, typewriters) to prevent theft or loss since GAO's 1976 audit but further improvements can be made.

In 1979 Support Services established and filled a position for a Security Officer in charge of equipment issuance and also established a card file system and a computer inventory to keep track of equipment issued to employees. Employees who are assigned equipment sign the related equipment card which is then used to update the computer inventory. When equipment is physically inventoried or when employees resign, the computer inventory is checked to identify who is assigned equipment and these employees are held liable if they cannot account for the equipment.

We found that the equipment card file and the computer inventory were not kept up to date for all items sampled in our equipment review. In one case an equipment item had been returned to the Support Services store room but the equipment card file and the computer inventory showed the item still assigned to an employee. In two other cases the equipment items were no longer in the possession of employees listed on the equipment cards and computer inventory because the employees had transferred to other USRA departments and left the equipment behind without notifying Support Services.

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These problems are caused by employees failing to report changes in equipment possession and by the Support Services staff not immediately updating the equipment cards and the computer inventory. Support Services plans to issue a new security order to employees emphasizing their responsibility and liability for equipment signed out to them. We believe this order should be issued as soon as possible to ensure that employees inform Support Services promptly when equipment assigned to them leaves their possession. We further believe that employees who give up possession of equipment should be allowed to sign and date the equipment card to show that the equipment is no longer in their possession. This is better than relying on a phone call to Support Services which may be forgotten or ignored by whoever receives it and also protects employees better against being held liable for equipment which they no longer possess. Finally, we believe Support Services should make it a firm policy to update the computer inventory immediately after a change is made to an equipment card.

The Support Services equipment card and computer inventory assign various computer equipment items (e.g. portable terminals) to the Computer Facilities head because this equipment frequently changes hands among the Computer Facilities employees. Computer Facilities maintains its own equipment inventory showing who it is assigned to but we found this inventory was not up to date. Because this equipment frequently changes hands it is more difficult to maintain an up to date inventory showing who equipment is assigned to. We believe better control is needed and recommend that Support Services perform frequent inventories, perhaps quarterly, to verify that this expensive equipment is properly accounted for.

COMPUTER DISASTER PREPARATION CAN BE IMPROVED

USRA should improve its preparation for a disaster such as a fire or flood which might destroy its computer facilities. Although arrangements have been made to use a compatible computer in the Washington area, there may be nothing left to process because copies of computer programs and data files are stored in the same building as the computer. The same fire, therefore, could destroy the programs and files as well as the USRA computer. Reconstruction of the data files could be a time-consuming and expensive process.

We believe USRA should immediately take steps to store copies of its important computer programs and data files at a remote site to reduce the disruption a disaster at USRA headquarters would cause.

PAYROLL CAN BE SIMPLIFIED

The potential for erroneous payments to USRA employees is greater than it should be because the payroll system 1) pays employees on the last day of the pay period and 2) has variable length pay periods. USRA could simplify and better control its payroll if it paid employees biweekly and allowed sufficient time to process time and attendance forms prior to issuing the pay checks.

Paying on the last day of the pay period:

Salaried employees are paid on the last day of a pay period before their time and attendance forms are processed. Their pay for a normal pay period, therefore, is based on an unverified assumption that they have earned a full pay check. This is poor control, in our opinion, because it significantly increases the chances of employees being paid for periods when they did not work. In addition, overtime for the pay period cannot be paid because there is not enough time to determine the amounts from the time and attendance forms. Overtime is paid in the pay period after it is worked. Pay checks, therefore, include unverified pay for current pay period normal hours and verified overtime pay for the prior pay period.

This confusing and poorly controlled situation could be simplified by paying employees a week after the close of the pay period, thereby allowing time and attendance forms to be processed prior to payment. Pay checks would then be based on verified time and attendance forms for both normal and overtime hours and would include pay for only one pay period, not a mixture of periods as is currently done.

Variable length pay periods

USRA employees are paid twice each month--on the 15th and on the last day of the month. This results in pay periods which vary from 80 to 96 hours. Salaried employees, however, are paid for 87 normal hours to equalize their checks throughout the year and therefore are not paid for the actual number of hours they worked during a pay period. Their total pay at year end is correct because 24 pay periods of 87 hours each results in a normal year's hours. Nevertheless, salaried employees' cumulative pay at any time during the year will probably be incorrect.

This situation should be simplified by changing to a biweekly 80-hour pay period. Under an 80-hour biweekly payroll, salaried employees would be paid for the number of hours they actually work during a pay period.

USRA SHOULD ACCRUE YEAR-END EXPENSES

Under accrual accounting, expenses are incurred when goods or services are received even if the related bills have not been received or paid. Such expenses are referred to as accrued expenses. We found that USRA materially understated its accrued expenses as of the September 30, 1979, statement date. USRA was only recognizing accrued expenses for items on which they had received invoices by October 15, 1979. Other accrued expense items were not recognized even though the goods or services were received prior to September 30. This practice would have resulted in USRA understating its FY 1979 expenses by \$1.2 million.

We brought this matter to the attention of the Accounting Office and it was corrected. We recommend that in the future USRA adhere strictly to accrual accounting procedures and record all expenses in the year they are incurred.

211 H LOAN ACCOUNTING CAN BE MORE ACCURATE

USRA is authorized under section 211 H of the Regional Railroad Reorganization Act to loan funds to Conrail, as agent for the bankrupt railroads whose rail assets were taken over by Conrail. The loans are used to pay rail-related obligations incurred by the estates prior to conveyance of their rail assets to Conrail. The bankrupt estates are ultimately responsible for paying off the loans. As of September 30, 1979, USRA had \$344.2 million of 211H loan principal outstanding.

We found several errors in the 211H loan and interest accounts which resulted in net changes to these accounts exceeding \$2 million. Corrections were made for mistakes on interest calculations and for a year-end loss on 211H loans which the Accounting Office had decided not to record for 1979.

The incorrect interest calculations included a \$147,356 overstatement of accrued interest for January 1979 which occurred because a \$20 million repayment was not deducted from the loan principal. Accrued interest at September 30, 1979 was understated by \$251,834 because \$11,517,288 of interest earned between January 1 and June 30, 1979, was not compounded.

We believe a major cause of these undetected errors on interest calculations was insufficient communication between the Accounting Office and the Finance Department and between USRA and the 211H debtors. Because of the large amounts involved and the complexity of the 211H program we suggested the Accounting Office reconcile its records regularly with the Finance Department and with the 211H debtors. Officials from these Offices have adopted our suggestions and will reconcile Accounting and Finance 211H records quarterly and compare with the 211H debtors yearly.

A loss on the Jersey Central 211H loans resulted from that company's reorganization settlement. The settlement included 90 percent of the 211H principal and interest due from the railroad resulting in a \$2.2 million loss to USRA. The reorganization occurred on September 14, 1979, but the Accounting Office did not plan to include the interest loss on the September 30, 1979 statements because it did not receive the documentation until December. Because there was still time to include the loss on the September 30 statements and because the amount is substantial, we suggested and the Accounting Office agreed to include it on the FY'79 financial statements. We recommend that USRA make it a strict policy to record in the correct time period all significant financial events such as the Jersey Central loss.

USRA INTERNAL AUDIT PROCEDURES CAN BE IMPROVED

Lack of internal auditors independence

Internal auditors should not be subordinate to the officials whose operations they audit. If the internal auditors are not independent, management can apply pressure which may influence the auditors to the point of overlooking or not reporting management shortcomings and improprieties.

To achieve an acceptable level of independence the internal auditor should report to the highest practicable level outside the line management function of the organization.

Although the Office of Audits issues its reports to the Chairman of the Board of Directors, the internal auditors are under the administrative direction of the Vice-President for Administration. This organizational set-up does not provide the audit function with an adequate level of independence because the Vice-President for Administration is responsible for accounting and related matters. This could compromise the Office of Audits' independence whenever financial audits are conducted.

To avoid organizational impairments and to achieve maximum independence, we believe the Office of Audits should be under the exclusive direction of the Board, the Audit Committee of the Board of Directors, or the Chief Executive Officer.

Lack of timely progress reports
on audit recommendations:

USRA Order 1974-22 requires the Heads of audited organizations to submit progress reports on the implementation of internal audit report recommendations within 30 days after the audit reports are issued. These progress reports are supposed to continue quarterly until corrective action has been taken. Where feasible the estimated cost savings or resulting operational improvements are to be identified in these reports.

In our review of USRA's internal audit function, we found that progress reports on internal audit recommendations are not consistently prepared as required by USRA policy. Specifically, progress reports issued on 8 of 11 audit reports submitted since this policy was implemented were not issued within the 30 day requirement. The time lag on 6 of these reports exceeded 140 days and averaged 143 days for the 8 reports.

In addition USRA Order 1974-22 also requires summary schedules on the status of recommendations be submitted to the Vice-President for Administration. This requirement was not implemented by USRA management. The Director of Audits stated that the semi-annual report to the Board of Directors' Audit Committee was more than adequate to keep management informed.

We believe that USRA should either follow its written policy or change it if it is inappropriate.

Lack of follow-up reviews:

USRA Order 1974-22 revised on February 17, 1978, states that the Office of Audits will perform the necessary reviews to verify to the extent feasible that adopted recommendations are actually implemented.

During our audit, we found that follow-up reviews generally are not being conducted. The Director of the Office of Audits stated that limited manpower resources many times precludes follow-up reviews on audit

recommendations and the small size of the organization allows follow-up on an informal basis.

We believe follow-up reviews are important to the overall effectiveness of internal audits. If audit recommendations are not implemented the internal auditor's work is wasted. Therefore, we recommend every effort be made to provide for follow-up review work.

USRA CAN IMPROVE INTERNAL SAFEGUARDS OVER CASH ON HAND

Cash is the most difficult asset to safeguard. Sound internal controls, therefore, are important to insure that cash is properly safeguarded and accounted for. Some of the principal internal control features essential to properly safeguard cash are frequent deposit of cash receipts, limited access, and periodic independent review of cash on hand. USRA internal control procedures over cash could be improved in these areas.

We found that receipts were deposited only when they exceeded a large arbitrary amount between \$2 and \$5 thousand. The accountant responsible for cash stated that more frequent deposits of receipts are not made because they are immaterial and mostly composed of checks which are not as readily usable as cash. However, we believe frequent deposit of receipts is an essential safeguard that reduces the probability of misappropriation. USRA, in our opinion, should deposit its receipts whenever they exceed a nominal amount such as a few hundred dollars.

Another problem noted was the lack of adequate physical safeguards for cash. We found access to the safe where cash receipts are stored is not controlled, and the safe is left open during business hours. In our opinion, the safe should be kept locked.

Finally, the internal auditors should periodically verify the cash on hand because of its vulnerability to theft. This has not been done on a regular basis at USRA in the past.

USRA CAN IMPROVE CONTROLS OVER CASH DISBURSEMENTS

Payment approval procedures not consistently followed:

Good controls are essential to prevent unauthorized or erroneous payments. Although USRA's payment controls are generally adequate we found they are not always followed. Before a vendor is paid, the Accounting Office must have the vendor's invoice and a check disbursement approval form signed by an authorized official indicating that the vendor's goods or services have been received in proper order. Also the Accounting Office supervisor must review and sign these documents indicating that payment is proper. These procedures guard against fraudulent payments or payments for substandard goods and services.

We found 8 payments in our sample of 142 which were made without the necessary signatures on the check disbursement approval form, 1 payment

which was made without proper documentation, and 4 payments which were made without the Accounting Office supervisor's signature.

To prevent unauthorized or erroneous payments, we recommend the Accounting Office make every effort to ensure its established payment procedures are followed. We further recommend the Accounting Office strengthen its payment procedures by obtaining copies of receiving reports to further substantiate the receipt of goods. Accounting Office officials said they have instituted this procedure beginning in Fiscal Year 1980.

Invoices not stamped paid

To prevent duplicate payments the Accounting Office procedures require stamping all invoices paid after the checks have been drawn. We found more than 20 percent of the 142 paid invoices we sampled were not stamped paid.

We believe USRA should strive to ensure that all paid invoices are stamped paid.

Board of Directors travel claims

USRA travel policy reimburses employees for costs incurred while traveling on official business. A Report of Expenses must be filed by employees to obtain reimbursement for travel costs. These forms must be approved by a designated official within the various organizational components of the association before employees are reimbursed. This policy applies to anyone authorized to travel at USRA.

We found that USRA Directors are reimbursed for travel costs without either submitting a Report of Expenses or obtaining proper administrative approvals in compliance with the association's travel policy. In our test sample of travel claims, Board members did not file a USRA Report of Expenses but instead filed an invoice usually under their own letter-head. These claims are later processed by the travel clerk in the USRA Accounting Division without a USRA officer's approval.

In our opinion, either USRA's President or Vice-President for Administration should approve Board members' travel claims. Currently, Board members submit these claims to the President and the Vice-President for Administration tracks Board members' travel but does not approve the claim for payment. Either of these officials could approve the form for payment by attaching an approved request for check disbursement form. Afterwards, accounting could review the claim and reimburse the Board members.

Executive reimburseable claims:

Good internal controls require that employee reimburseable claims are reviewed by an appropriate official to determine if costs incurred are allowable for reimbursement under the organization's policy. We found

that USRA executives at the Vice-President level and above approve their own reimburseable claims. Thus, as in the case of Board of Directors' travel claims, these claims are reimbursed without proper internal control over the transaction.

In our opinion, good internal controls would suggest that USRA's President or an upper level official picked by the Board of Directors should approve all executive reimbursement claims.

Because of our continuing interest in USRA's financial management system we would appreciate being advised of any actions taken on our findings or suggestions. We also wish to extend our appreciation to your staff for the courtesy and cooperation given to our representatives during this audit.

Sincerely yours,



Herbert McLure
Senior Group Director