U.S. Department of Transportation
Office of the Secretary of Transportation

The Inspector General

Office of Inspector General
Washington, D.C. 20590

January 5, 2006

The Honorable Christopher "Kit" Bond
Chairman
Subcommittee on Transportation,
Treasury, the Judiciary,
Housing and Urban Development,
and Related Agencies
Committee on Appropriations
United States Senate

The Honorable Joe Knollenberg
Chairman
Subcommittee on Transportation,
Treasury, Housing and Urban
Development, the Judiciary,
and District of Columbia
Committee on Appropriations
United States House of Representatives

The Honorable Patty Murray
Ranking Member
Subcommittee on Transportation,
Treasury, the Judiciary,
Housing and Urban Development,
and Related Agencies
Committee on Appropriations
United States Senate

The Honorable John W. Olver
Ranking Member
Subcommittee on Transportation,
Treasury, Housing and Urban
Development, the Judiciary,
and District of Columbia
Committee on Appropriations
United States House of Representatives

Dear Chairmen Bond and Knollenberg and Ranking Members Murray and Olver:

Pursuant to the requirements of the Fiscal Year (FY) 2006 Appropriations Act funding the Department of Transportation,[1] the purpose of this communication is to establish an operating subsidy baseline against which Amtrak's progress will be measured. The law requires this so that we, and in turn the Department of Transportation and the Congress, will be able to determine whether and to what extent Amtrak has achieved savings as a result of operational reforms. Further, under the Act, unless we certify that Amtrak has achieved operational savings by July 1, 2006, Amtrak will be restricted from using appropriated funds to subsidize the net losses from food, beverage, and sleeper car service on any Amtrak route.

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[1] Transportation, Treasury, Housing and Urban Development, the Judiciary, District of Columbia, and Independent Agencies Appropriations Act (TTHUD), 2006; Pub. L. No. 109-115.

In our next report, due on April 1, 2006, we will assess the savings to date against the operating subsidy baseline discussed below. It is not feasible to discuss savings in the current report for two major reasons. First, Amtrak is in the process of deciding upon and finalizing cost savings reform initiatives for FY 2006. Second, we continue to work with Amtrak to establish the operating subsidy sub-baselines against which we can measure savings from specific reform initiatives.

We have set Amtrak's overall operating subsidy baseline at $586 million. This baseline represents Amtrak's FY 2006 budget results before implementation of *new* strategic reforms. Amtrak will need to reduce its operating losses from this baseline of $586 million to the subsidized level of $495 million provided in the FY 2006 appropriations law. To achieve this, Amtrak will have to implement operational reforms that reflect a combination of cost savings initiatives and revenue increases. We should point out that the baseline corresponds to Amtrak's FY 2006 estimated operating losses and is derived from existing strategies and adjustments for anticipated costs and revenues. Therefore, it includes savings from initiatives begun in FY 2005 and scheduled to begin in FY 2006.

We recognize that Amtrak closed out FY 2005 with an operating loss of $475 million, which is significantly lower than the operating baseline established for FY 2006. However, it is important to point out that the FY 2005 operating loss incorporated one-time adjustments that may not be repeated, such as a casualty insurance accrual reversal of $49 million. In our view, a valid and fair assessment of Amtrak's progress requires a baseline that does not include such one-time adjustments.

To reduce its operating losses from $586 million to the appropriated subsidy of $495 million, we note that Amtrak's current FY 2006 budget relies on more than $90 million in "unidentified budget savings" or "to be determined" initiatives. Further, the FY 2006 Budget Review presented to the Amtrak Board of Directors in December 2005 identified the Efficiency Incentive Grants as one potential funding measure to be used to achieve the required operating savings.

Congress appropriated the $31.7[2] million for Efficiency Incentive Grants to be awarded at the discretion of the Secretary. These grants are intended to be used by the Secretary as discretionary incentives or contingencies, such as in the case of imminent threat of bankruptcy, loss of a route, or for capital improvements. We do not believe it would be appropriate to anticipatorily count these discretionary grants towards achieving the $90 million or more in required savings. We

[2] The Defense Appropriation Act of 2006 rescinded $8.3 million of the $40 million appropriated for Efficiency Incentive Grants under TTHUD.

understand that Amtrak will not include these funds in its forthcoming business plan.

Amtrak has indicated that they are developing *real* and *identifiable* cost savings initiatives that will be provided to us by the end of January.[3] This is a constructive effort that conveys confidence in Amtrak's ability to achieve operating reform and when developed should provide a sufficiently specific base against which we will be able to measure progress.

In monitoring Amtrak's operations we will focus our evaluation on longer term sustainable efficiency gains derived from structural changes in the way Amtrak manages its business, rather than savings not associated with operational reform. We intend to distinguish clearly between expense and revenue improvements allocable to operational reform and other types of adjustments.

Establishing Sub-Baselines to Amtrak's Operating Subsidy

In addition to an overall corporate baseline, it will be important to establish sub-baselines that reflect savings from specific initiatives. Therefore, we plan to establish sub-baselines in the following operational areas:

- food and beverage service,
- sleeper car service on long distance trains,
- maintenance and facilities operations,
- train operations,
- fare and revenue initiatives, and
- labor agreements.

The establishment of these sub-baselines will require an analysis of Amtrak's FY 2006 business plan. Although Amtrak recently provided us with baseline estimates for long distance service, sleeper service, and food and beverage service, we require further financial and operating data to develop initiative-based sub-baselines consistent with Amtrak's budget framework. We are working with Amtrak to develop appropriate reporting of these initiatives.

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[3] Amtrak is required to submit a comprehensive business plan for FY 2006 to Congress and the Secretary of Transportation by January 30, 2006.

Measuring Amtrak's Progress

Our evaluation of Amtrak's net operating savings will be conducted at several levels of detail: (1) companywide progress on operating savings; (2) operating savings attributable to the implementation of Amtrak's strategic initiatives; (3) operating savings by business line–Northeast Corridor operations, long distance service, state-supported service, infrastructure management, and unallocated system; and (4) operating savings by route.

Corporate Level Savings. We will evaluate Amtrak's companywide operating savings and financial performance relative to the $586 million baseline. Any improvement will be determined from a review and analysis of Amtrak's monthly financial performance reports and supporting documentation. This will provide a high-level view of systemwide operational savings resulting from the implementation of Amtrak's Strategic Reform Initiatives published in April 2005.

Strategic Reform Initiatives. We will identify operating savings attributable to specific initiatives implemented under Amtrak's Strategic Reform Initiatives and forthcoming FY 2006 business plan. For example, we will evaluate food and beverage service cost savings from such actions as renegotiated and new vendor contracts, simplified dining service, modified equipment, and integrated lounge and diner car food service on long distance trains.

Business Line Savings. We will evaluate the impact from Amtrak's management and operational initiatives at the business line level. With the exception of sleeper service on long distance trains, Amtrak's initiatives target operating reform across all business lines. However, the impact from these reforms may differ based on the type of service provided. Amtrak's new reporting structure by business line will facilitate a better understanding of the operating losses incurred and where efficiencies have been achieved.

Route Level Savings. We will also evaluate the impact of operating savings at the route level. Our evaluation will provide a detailed assessment of operational impacts as savings trickle down from Amtrak's Strategic Reform Initiatives. This assessment will be particularly helpful because we expect the near-term (FY 2006) results from pilot projects to be limited to specific routes. Savings from larger scale initiatives that would be spread over multiple routes and eventually, system-wide will be implemented in future years.

In our opinion, this multi-level approach will provide a comprehensive analysis of potential and realized operating savings for the longer term provision of a more efficient and financially feasible intercity passenger rail service.

We are sending an identical letter to the Secretary of Transportation and the Chairman of the Board of Amtrak.

Sincerely,

Kenneth M. Mead
Inspector General