



OFFICE *of* INSPECTOR GENERAL
NATIONAL RAILROAD PASSENGER CORPORATION

ACQUISITION AND PROCUREMENT:

Contracts Included Key Provisions to Reduce Risks, but the Company Lacks an Efficient and Effective Contract Management System

Certain information in this report has been redacted due to its sensitive nature.

OIG-A-2018-003 | February 22, 2018

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Memorandum

To: Eleanor Acheson
Executive Vice President/General Counsel & Corporate Secretary

DJ Stadtler
Executive Vice President/Chief Administration Officer

Christian Zacariassen
Vice President/Chief Information Officer

From: Stephen Lord 
Assistant Inspector General, Audits

Date: February 22, 2018

Subject: *Acquisition and Procurement: Contracts Included Key Provisions to Reduce Risks, but the Company Lacks an Efficient and Effective Contract Management System (OIG-A-2018-003)*

Amtrak (the company) relies on contractors to support various parts of its business, including manufacturing locomotives and rail cars, delivering fuel, and providing information technology (IT) support. From fiscal year (FY) 2015 through FY 2017, the company committed an average of \$2 billion per year to new contracts. Given the company's extensive reliance on contractors and the large expenditures involved, it is critical that the company writes contracts that mitigate its financial and legal risks.

However, recent high-value contracts have experienced performance issues that resulted in significant schedule delays and cost increases. For example, in February 2016, we reported that the company's \$343 million contract with CAF USA to purchase long-distance rail cars experienced delivery delays that resulted in cost overruns.¹ Ultimately, the contract's terms were critical in navigating a way forward.

¹ *Asset Management: Additional Actions Can Help Reduce Significant Risks Associated with Long-Distance Passenger Car Procurement (OIG-A-2016-003)*, February 1, 2016.

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In response to this and other high-profile contracting problems,² our objectives were to assess whether key contract provisions aimed at mitigating legal and financial risks were included in high-value, high-risk active contracts, and to assess the company's contract record-keeping practices to identify opportunities, if any, for improvement.

To identify risk-oriented contract provisions, we reviewed available literature, contracted with the American Productivity and Quality Center to conduct independent research,³ and interviewed representatives from three private-sector freight railroads—Norfolk Southern Corporation, BNSF, and Union Pacific. We compiled these data and identified 12 key contract provisions that successful organizations commonly use to mitigate their risks, such as warranties, insurance, indemnifications, and bonds.^{4,5} We then determined to what extent 20 of the company's highest-value, highest-risk active contracts included these 12 provisions.

To assess the company's record-keeping practices, we interviewed company officials and reviewed the company's processes for capturing, storing, and retaining contract documentation. For a detailed discussion of our scope and methodology, and a list of the 12 contract provisions, see Appendices A and B.

SUMMARY OF RESULTS

All 20 of the high-value, high-risk company contracts we reviewed contained key contract provisions that successful organizations commonly use to mitigate risks—such as warranties, insurance, indemnifications, and bonds. We also found that none of the key provisions in the contracts were subsequently amended in ways that would have exposed the company to unreasonable risks.

² *Amtrak: Top Management and Performance Challenges—Fiscal Years 2017 and 2018* (OIG-SP-2017-009), March 29, 2017.

³ The American Productivity and Quality Center is a member-based nonprofit organization that provides business benchmarking, best practices, process and performance improvement, and knowledge management solutions for organizations.

⁴ For a list of the 12 provisions, see Appendix B.

⁵ As a part of our ongoing audit of the company's controls over medical claim payments, we are assessing the company's use of contract provisions to prevent and detect potential fraud. We do not address those provisions in this report.

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However, we found that internal controls for managing contracts are weak because the company relies on inefficient contract record-keeping methods that are decentralized, ad hoc, manually driven, and sometimes paper-based. For example, it took us substantial time and effort to identify all of the company's contracts and obtain the relevant contract documentation to perform our review. Law department officials told us they have experienced similar difficulties in gathering basic contract information, which has hindered efforts to effectively represent the company's interests and craft a clear strategy in legal proceedings, leaving the company vulnerable to financial and legal risks.

To help mitigate these risks and align with internal control standards, other successful organizations use automated contract management systems. Executives in the Law and the Procurement departments told us they have advocated for such a system for several years, but the company does not yet have one in place.

In FY 2017, the IT department requested [REDACTED] for such a system but did not receive funds due to higher priorities. IT managers resubmitted the request in the FY 2018 budget, and the company approved [REDACTED] to undertake the first step of defining enterprise-wide user requirements for a system. IT managers said they expect to begin defining requirements for users in Procurement, Law, Finance, and other departments in April 2018. Following that effort, they will assess options to meet these requirements, including considering whether to upgrade the company's procurement system (Ariba) or to purchase a new contract management system.

The Chief Financial Officer told us the company expects to provide funding once an option has been selected. Although this is encouraging, the company's track record of not prioritizing the implementation of a contract management solution when making budgeting decisions highlights the need for a documented plan for enhancing the management and oversight of its contracts. Such a plan—consistent with generally accepted program management principles—would involve establishing clear roles and lines of accountability, committing needed staff and resources, and establishing monitoring and metrics to ensure timely and effective project completion, among other steps.

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Therefore, to address an identified internal control weakness and reduce its financial and legal risks, we recommend that the company document and initiate a plan for the timely completion of the steps necessary to fully define user requirements, determine how best to meet those requirements, establish roles and accountability for system implementation, secure the needed resources, and establish a project monitoring process to implement a cost-effective solution for enhancing the management and oversight of its contracts. In commenting on a draft of this report, the Vice President, Senior Managing Deputy General Counsel, stated that the company agreed with our recommendation. However, he clarified that the project's Executive Sponsors—the Procurement, Finance and Law departments—will lead the effort to develop a plan. Accordingly, we revised our recommendation to state that the Executive Sponsors, and not the IT department, should work together on developing and initiating the project plan.

BACKGROUND

Three departments play a key role in developing the general provisions in company contracts:

- **Procurement.** This department assigns contract administrators who are responsible for all contractual actions, including preparing, assembling, and awarding contracts. When writing the general provisions in company contracts, contract administrators are encouraged—but not required—to seek assistance from other departments.
- **Law.** This department develops templates with standard contract provisions, which contract administrators typically use when drafting company contracts. Contract administrators may amend the templates' provisions because they are subject to negotiation with contractors. The Law department also consults with contract administrators on request.
- **Finance Department's Risk Management Office.** This office reviews contracts at the request of contract administrators. The office considers the extent to which select provisions—such as insurance and indemnification provisions—address financial risks, and suggests modifications when appropriate.

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COMPANY CONTRACTS INCLUDED KEY PROVISIONS TO REDUCE RISKS

All 20 of the high-value, high-risk company contracts we reviewed contained key contract provisions that successful organizations use to mitigate risks. In addition, none of the key provisions were amended in ways that exposed the company to unreasonable risks.

Across the 240 discrete provisions we reviewed (12 provisions across 20 contracts), we found 18 instances in which the Law department determined that a particular provision was not relevant for a certain type of contract. For example, the provision for liquidated damages protects the company by establishing a predetermined amount of money that a contractor must pay for failing to perform under a contract. However, the Law department does not advise that the liquidated damages provision be included in service contracts because of the difficulty of calculating the cost of delays or nonperformance before the contract is executed.

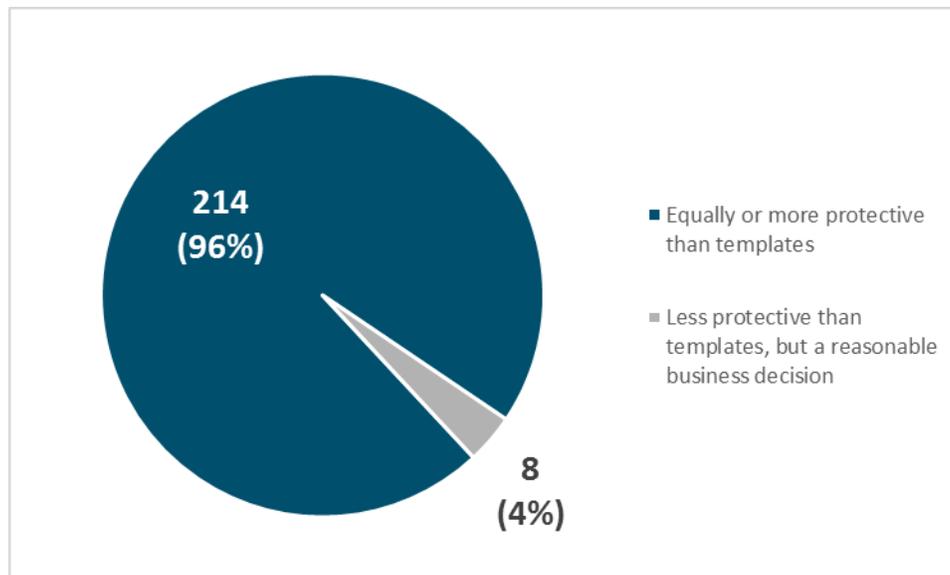
Of the remaining 222 provisions in the contracts we reviewed, 214 (96 percent) matched company templates exactly or deviated in ways that were equally or more protective for the company. The remaining 8 provisions (4 percent) deviated in ways that were less protective, but which constituted reasonable business decisions given the specific characteristics of those contracts. For example, a contract with an IT service provider included a provision requiring the company to provide 90 days' notice before terminating the contract. The Law department templates do not call for any advance notice, and adding this requirement posed the risk that the company could incur additional costs during the 90 days. However, Procurement department managers said that the contractor requested this change when negotiating the terms of the contract, and that the company made a business decision to agree to this request in exchange for other concessions. For a summary of the results of our analysis, see Figure 1.

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Figure 1. Comparison of 222 Contract Provisions to Law Department Templates



Source: OIG analysis of 20 company contracts

Our determination that there were no unreasonable risks in the contracts we reviewed align with comments from executives in the Procurement, Law, and Engineering departments who told us they are comfortable with the general terms and conditions of the company's contracts. Executives in the Law and Procurement departments also stated that some contract provisions, like indemnification, are frequently written more stringently than is typical in the private sector.

Although we did not identify any unreasonable risks posed by the key provisions of the 20 contracts we reviewed, we have previously reported problems with the company's oversight and management of some of these same contracts. For example, we reported in March 2015 that the company paid unreasonably high prices for Acela repair parts because oversight and management of that contract was ineffective.⁶ Similarly, executives in the Procurement, Law, and Engineering departments identified weak contract execution, especially contract oversight, as a greater source of problems than the content of general contract provisions. As a result, we have initiated a separate audit

⁶ *Acquisition and Procurement: Improved Management Will Lead to Acela Parts Contract Cost Savings* (OIG-A-2015-008), March 10, 2015.

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of post-award contract oversight to assess the effectiveness of the company's policies and practices, and to identify possible areas for improvement.

THE COMPANY FACES SOME FINANCIAL AND LEGAL RISKS BECAUSE IT LACKS A CONTRACT MANAGEMENT SYSTEM

The company does not have an enterprise-wide, automated contract management system. As a result, the company's contract storage efforts are decentralized, ad hoc, manually driven, and sometimes paper-based, which hinders records retention and requires departments to create their own processes to manage a contract through its lifecycle. This is contrary to standards for effective internal controls, which state that organizations should develop integrated information systems to capture and process data to enhance the efficiency, speed, and accessibility of information for users. In the absence of an automated contract management system, it took us substantial time and effort to obtain basic contract information, such as a list of company contracts and all relevant contract documentation. Law department officials told us they experience similar problems and must devote significant resources to search for related contract information, such as complete contracts and documentation of contractor correspondence. Such information is often important for addressing contract disputes and other legal claims.

Law department officials provided examples of how the absence of an automated contract management system has hindered efforts to craft a clear legal strategy and to effectively represent the company's interests in legal proceedings, leaving the company vulnerable to financial or legal risk, as shown in the following examples:

- The current decentralized record-keeping methods hinder the Law department from obtaining and synthesizing communications, contracts, and relevant provisions in a timely manner. In recurring issues or disputes, this hampers the preparation of a cohesive and effective legal defense.
- Because some company departments maintain their own contract files, it is difficult for one department to know if another department executed similar agreements with the same vendor or relating to the same Amtrak property.

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- Outside counsel is regularly used to help litigate company disputes, according to Law department officials. However, the lack of a contract management system has made sharing contract records with the company's outside counsel time-consuming and expensive.
- The Law department could not find the executed copy of several contracts, leaving the company unable to enforce contract terms. Company lawyers told us that even when they find contract documents, they cannot be certain that they obtained all relevant information, which puts the company in a weaker legal negotiating position.

Consistent with internal control standards, one way other successful organizations mitigate these risks is by using a contract management system to provide easy access to accurate contracting information. These systems provide several benefits, including the following:

- helping to manage the creation of contracts and to track contract changes and approvals
- facilitating the storage and retrieval of contracts, contract templates, and contractor correspondence
- generating and sending automatic reminders when contract milestones require action or contracts are expiring

Executives in the Law and Procurement departments told us they have advocated for such a system for several years to limit the company's financial and legal risk, but the company does not yet have such a system in place. In FY 2017, IT officials submitted a [REDACTED] budget request to procure and implement an automated contract management system, but the funds were not included in the final approved budget because the company prioritized other projects for funding. IT managers resubmitted the request for inclusion in the FY 2018 budget, and the company approved [REDACTED] to take the first step—defining enterprise-wide user requirements.

IT managers stated that in April 2018 they intend to begin defining enterprise-wide user requirements for a contract management system for users in Procurement, Law,

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Finance, and other departments and then assess the most effective options for meeting those requirements. The managers said this analysis will help them determine whether they can best meet user needs by upgrading the company's procurement system (Ariba) or by purchasing a new contract management system.

According to the Chief Financial Officer, once IT fully defines user requirements and identifies the best solution, the company will provide additional funding to implement it. Although this is encouraging, the company's track record of not prioritizing the implementation of a contract management solution when making budgeting decisions highlights the need for a documented plan. The plan should follow generally accepted program management principles for enhancing the management and oversight of contracts. These principles call for a plan that clearly lays out roles, responsibilities, and lines of accountability for ensuring the successful implementation of a contract management capability. They also provide that the project receive the necessary staff and resources, and that it is subject to monitoring and metrics to ensure timely, effective implementation.

CONCLUSIONS

The general contract provisions that the company includes in its high-risk, high-value contracts—such as warranties, insurance, indemnifications, and bonds—are consistent with those commonly used by successful organizations to mitigate risks. However, the company's contract storage and retrieval methods are inefficient, are inconsistent with internal control standards, and hinder effective contract management and oversight. The company's attempts to obtain a system have been unsuccessful, creating uncertainty about its importance to management. Until management defines all user requirements and develops a plan for implementing an enterprise-wide contract management system that is consistent with program management principles, the company is missing an opportunity to address an identified internal control weakness and reduce its financial and legal risks.

RECOMMENDATION

To reduce the financial and legal risks of not having a contract management system and to address internal control weaknesses, we recommend that the Sponsors in the

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Procurement, Law, and Finance departments, document and initiate a plan for the timely completion of the steps necessary to fully define user requirements, determine how best to meet those requirements, establish roles and accountability for system implementation, secure the needed resources, and establish a project monitoring process to implement a cost-effective solution for enhancing the management and oversight of its contracts.

MANAGEMENT COMMENTS AND OIG ANALYSIS

In commenting on a draft of this report, the Vice President, Senior Managing Deputy General Counsel, stated that the company agreed with our recommendation, but clarified that departments other than IT—Procurement, Law, and Finance—would be the project sponsors, and thus lead the overall project.

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APPENDIX A

Scope and Methodology

This report provides the results of our audit of the company's contract provisions. Our objectives were to assess whether key contract provisions aimed at mitigating legal and financial risks were included in high-value, high-risk contracts, and to assess the company's contract record-keeping practices to identify opportunities, if any, for improvement. We conducted this audit from April 2017 through January 2018 in Washington, D.C., and Philadelphia, Pennsylvania. Certain information in this report has been redacted due to its sensitive nature.

To determine the contract provisions we would use as criteria to assess the company's contracts, we contracted with the American Productivity and Quality Center to conduct independent research and provide practices on contract risk mitigation. We also interviewed Procurement officials from three private-sector freight railroads—Norfolk Southern Corporation, BNSF, and Union Pacific. In addition, we conducted our own independent research. The combined research yielded 12 key contract provisions used to mitigate organizational risk. For a list of the 12 provisions, see Appendix B.

To identify contracts for our review, we obtained a list of 2,052 active contracts and purchase orders as of June 30, 2017 from the Procurement department. Using a risk-based approach, we selected 20 of the company's top 100 highest-value, highest-risk contracts in the Engineering, Mechanical, IT, and Marketing departments. We selected these four departments based on our review of total contract value and the number of contracts per department, as well as our assessment of aggregate risk to the company from those departments' contracted operations. We then compared these 20 contracts with the Law department's contract templates to determine the extent to which the contracts contained the 12 key provisions. We omitted instances in which the relevant Law department template did not require one of these provisions for that type of contract. For example, the provision for liquidated damages protects the company by establishing a predetermined amount of money that a contractor must pay for failing to perform under a contract. However, the Law department does not advise that the liquidated damages provision be included in service contracts because of the difficulty of calculating the cost of delays and nonperformance before the contract is executed.

Certain information in this report has been redacted due to its sensitive nature.

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Eliminating these instances reduced our total dataset of discrete provisions from 240 to 222.

Based on our review, we identified certain contract provisions that deviated from the contract templates; for these provisions we requested an analysis by the Finance department's Risk Management Office and the Law department. We considered their analyses with our Office of Counsel's assistance, and we eliminated instances in which the Law department template was not applicable because of the nature of a given contract, or when the contract terms were more protective, or were modified based on a reasonable business decision.

Based on this review and our own independent assessment, we identified eight potential exceptions and sent them to Procurement for review. When the company's provisions increased company risk, we worked with our Office of Counsel to assess the reasonableness of those business decisions based on statements and documentation provided by the Law, Risk Management, and Procurement departments. We did not assess contract statements of work or other contract phases such as solicitation, vendor evaluation, award, or issuance. We also did not assess the Law department's contract templates themselves.

To assess the company's record-keeping practices, we interviewed company officials and reviewed the company's processes for capturing, storing, and retaining contract documentation. We reviewed the Project Management Body of Knowledge to identify generally accepted program management principles. We also reviewed the company's business case for procuring a contract management system, funding plans, and other assessments of user requirements. We did not assess record-keeping for the company's grant agreements because they constitute a much smaller portion of the company's record-keeping needs.

We conducted this performance audit in accordance with generally accepted governmental auditing standards. Those standards require that we plan and perform the audit to obtain sufficient, appropriate evidence to provide a reasonable basis for our findings and conclusions based on our audit objectives. We believe that the evidence obtained provides a reasonable basis for our findings and conclusions based on our audit objectives.

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Internal Controls

As detailed in our report, we reviewed the roles of the Procurement and Law departments, as well as the Finance department's Risk Management Office, in developing contract provisions. We also reviewed the management processes and controls used for tracking and storing company contracts, and we assessed the effects of the absence of a contract management system. We also reviewed the Committee of Sponsoring Organizations of the Treadway Commission's Internal Control—Integrated Framework. We found that internal controls for conducting contract management are weak because the company relies on inefficient contract record-keeping methods that are decentralized, ad hoc, manually driven, and sometimes paper-based.

Computer-Processed Data

To identify the company's largest active contracts, we relied on data provided by the company from the SAP system as of June 30, 2017. To validate the company's data, we used Audit Command Language, a data analysis software tool, to develop a query to verify the completeness of the company's SAP contract data. Based on this analysis, we concluded that the company's contract data were sufficiently reliable for our purposes of defining a contract population and selecting contracts for analysis.

Prior Audit Reports

- *Information Technology: Operations Foundation Program—Restructuring Could Help Control Costs and Limit Risks* (OIG-A-2017-011), June 19, 2017
- *Acquisition and Procurement: Improved Management and Oversight of GE Diesel Locomotive Service Contract Could Lead to Savings* (OIG-A-2017-005), February 3, 2017
- *Acquisition and Procurement: Opportunities Exist to Improve Management of Technical Support Services Contracts* (OIG-A-2016-013), September 30, 2016
- *Asset Management: Additional Actions Can Help Reduce Significant Risks Associated with Long-Distance Passenger Car Procurement* (OIG-A-2016-003), February 1, 2016
- *Information Technology: Reservation System Infrastructure Updated, but Future Sustainability Remains an Issue* (OIG-A-2015-010), May 19, 2015

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- *Acquisition and Procurement: Improved Management Will Lead to Acela Parts Contract Cost Savings* (OIG-A-2015-008), March 10, 2015
- *Train Operations and Business Management: Addressing Management Weaknesses Is Key to Enhancing the Americans with Disabilities Programs* (OIG-A-2014-010), August 4, 2014
- *Acquisition and Procurement: Closer Alignment with Best Practices Can Improve Effectiveness* (OIG-A-2014-006), May 7, 2014
- *Acquisition and Procurement: Gateway Program's Concrete Casing Project Progressing Well; Cost Increases Will Likely Exceed Project Budget* (OIG-A-2014-004), February 11, 2014

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APPENDIX B**Key Risk-Oriented Contract Provisions**

- **Contractor/Key Personnel.** A provision that makes the contractor responsible for selecting qualified personnel to perform the contracted work and prohibits the contractor from substituting personnel without prior written approval from the company.
- **Warranty.** A requirement that the contractor asserts that it (1) has the authority to enter into the contract, and (2) will perform the services promptly, diligently, and in accordance with the highest professional standards. The contractor affirms that all goods furnished under the contract are of good quality and free from defects. The contractor also agrees to repair or replace any defective goods.
- **Termination for Convenience.** A provision that allows the company to terminate a contract, in whole or in part, whenever and for whatever reason the company chooses. The contractor may submit a claim for termination costs up to the unpaid balance of the contract.
- **Termination for Default.** A provision that permits the company to terminate a contract if the contractor fails to meet its contractual obligations and does not make necessary changes after the company notifies the contractor. If the company has to buy the goods or services from another vendor, the contractor is liable for any additional costs the company has to endure.
- **Audit and Inspection.** A provision that permits the company and its Office of Inspector General to inspect, copy, or audit the contractor's data and records related to the contract.
- **Indemnification.** A provision stating that the contractor agrees to hold the company harmless against any negative effects the company, the contractor, or other indemnified parties may incur. The contractor will also be responsible for costs arising from the goods or services that the contractor provides.
- **Insurance.** A provision stating that the contractor must purchase and maintain the types of insurance that the company requires.

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- **Rights and Remedies.** A provision stating that the company's rights and remedies are not restricted to those listed in the contract.
- **Bonds.** A requirement that the contractor obtain an additional, legally binding agreement that makes a third party liable for financial losses that a contractor's actions or inactions cause to the company.
- **Contracting Officer's Technical Representative.** A requirement for a company official to be designated to act as the contracting official's technical representative to monitor the contractor's performance and provide technical advice.
- **Application to Lower-Tier Subcontractors.** A requirement that the terms and conditions of the contract between the company and the prime contractor also apply to subcontractors.
- **Liquidated Damages.** A provision that sets a predetermined amount of money that the contractor must pay to the company if the contractor does not adequately perform under a contract.

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APPENDIX C

Abbreviations

FY	fiscal year
IT	Information Technology
the company	Amtrak

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APPENDIX D

Management Comments

NATIONAL RAILROAD PASSENGER CORPORATION

Memo



Date 1/19/2018

From William Herrmann
VP, Sr. Managing Deputy General Counsel


To Stephen Lord
Assistant Inspector
General, Audits

Department Law Department

cc Eleanor Acheson
Bill Feidt
Stephen Gardner
Tim Griffin
Scot Naparstek
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Carol Hanna
Mark Benedict

Subject **ACQUISITION AND PROCUREMENT: Contracts Included Key Provisions to Reduce Risks but the Company Lacks an Efficient and Effective Contract Management System**
(Draft Audit Report for Project No. 009-2017)

Thank you for your work on this audit involving Amtrak's retention of contract workers. We appreciate the analysis you have provided and the recommendation.

Recommendation 1:

To reduce the financial and legal risks of not having a contract management system and address internal control weaknesses, we recommend that the Vice President, Information Technology, in coordination with the Law and Finance departments, document and implement a plan for timely completing steps necessary to fully define user requirements, determining how best to meet those requirements, establishing roles and accountability for system implementation, securing the needed resources, and establishing a project monitoring process to implement a cost-effective solution for enhancing the management and oversight of its contracts.

Management Response/Action Plan:

Management agrees with the recommendation. Our only point of clarification is that this project will be implemented by Information Technology with Executive Sponsors for the project in accordance with Amtrak's project management principles. While IT will lead the implementation the project sponsors will lead the overall project. Currently, Procurement, Finance and the Law departments, represented by Bud Reynolds, Carol Hanna and myself, are expected to serve as Executive Sponsors. As soon as a project plan is established we will share this with the OIG.

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APPENDIX E

OIG Team Members

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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

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800-468-5469

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