

Office of the Auditor General

Follow-Up Report on Prior Audit Recommendations

Office of Rail

Michigan Department of Transportation

April 2016



The auditor general shall conduct post audits of financial transactions and accounts of the state and of all branches, departments, offices, boards, commissions, agencies, authorities and institutions of the state established by this constitution or by law, and performance post audits thereof.

Article IV, Section 53 of the Michigan Constitution



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Report Summary

Follow-Up Report

Office of Rail

Michigan Department of Transportation (MDOT)

**Report Number:
591-0195-14F**

**Released:
April 2016**

We conducted this follow-up to determine whether MDOT had taken appropriate corrective measures in response to the material condition noted in our February 2015 audit report.

Prior Audit Information
<p>Finding #1 - Material condition</p> <p>Need for effective and efficient oversight of the lease and refurbishment of commuter cab and coach cars for two rail projects.</p> <p>Agency agreed.</p>

Follow-Up Results		
Conclusion	Finding	Agency Preliminary Response
Complied	Not applicable	Not applicable

A copy of the full report can be obtained by calling 517.334.8050 or by visiting our Web site at: www.audgen.michigan.gov

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April 29, 2016

Mr. Todd Wyett, Chair
State Transportation Commission
and
Kirk T. Steudle, PE, Director
Michigan Department of Transportation
Murray Van Wagoner Transportation Building
Lansing, Michigan

Dear Mr. Wyett and Mr. Steudle:

I am pleased to provide this follow-up report on the one material condition (Finding #1) and the corresponding recommendation reported in the performance audit of the Office of Rail, Michigan Department of Transportation (MDOT). That audit report was issued and distributed in February 2015. Additional copies are available on request or at <www.audgen.michigan.gov>.

Our follow-up disclosed that MDOT complied with the recommendation.

We appreciate the courtesy and cooperation extended to us during our follow-up. If you have any questions, please call me or Laura J. Hirst, CPA, Deputy Auditor General.

Sincerely,

Doug Ringler
Auditor General

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INTRODUCTION, PURPOSE OF FOLLOW-UP, AND AGENCY DESCRIPTION

INTRODUCTION

This report contains the results of our follow-up of one material condition* (Finding #1) and one corresponding recommendation reported in our performance audit* of the Office of Rail, Michigan Department of Transportation (MDOT), issued in February 2015.

PURPOSE OF FOLLOW-UP

To determine whether MDOT had taken appropriate corrective measures to address our corresponding recommendation.

AGENCY DESCRIPTION

MDOT's Office of Rail is responsible for 665 miles of State-owned rail lines. The State Rail Plan* calls for MDOT to provide a rail system that offers enhanced mobility for travelers and the efficient movement of goods while supporting economic development and environmental sustainability. The Office of Rail works to maintain and upgrade rail lines, to promote economic development on rail corridors, and to enforce safety regulations at railroad crossings.

In fiscal year 2009, the Office of Rail worked with local units interested in alternative rail service on State-owned track for two proposed commuter rail projects. The Office of Rail planned to assist by investing in track improvements and entering into a contract in 2010 with the Great Lakes Central Railroad (GLCR) to refurbish and lease 23 used cab and coach cars for the two proposed projects. The Federal Highway Administration (FHWA) funded \$2.8 million and MDOT funded \$8.0 million of the costs of the contract.

As of March 2016, the local agencies continued to perform studies on the proposed commuter rail projects; however, MDOT informed us that local support for the services had not translated into financial commitment. As a result, the Office of Rail anticipated that the full complement of rail cars would not be needed for these two projects until at least the second quarter of 2019; therefore, MDOT pursued a divestment strategy for the rail cars. As of October 2015, MDOT had expended a total of \$11.2 million on the contract with GLCR to refurbish and lease the 23 used cab and coach cars for the two proposed projects.

* See glossary at end of report for definition.

PRIOR AUDIT FINDING AND RECOMMENDATION, AGENCY PLAN TO COMPLY, AND FOLLOW-UP CONCLUSION

FINDING #1

Audit Finding Classification: Material condition.

Summary of the February 2015 Finding:

The Office of Rail did not effectively and efficiently oversee the lease and refurbishment of cab and coach cars designated for two commuter rail projects.

As of May 2014, MDOT had expended \$9.5 million to lease and refurbish commuter rail cab and coach cars prior to the construction of two stations and completion of track work needed for the two proposed projects. The Office of Rail neither owns the commuter rail cab and coach cars nor expects to use them until at least 2017. The Office of Rail will be responsible for additional lease payments of \$2.8 million and may complete restroom updates in 14 cars that would result in \$3.7 million of additional costs.

The Office of Rail indicated that it had planned to work on the stations and track in parallel with the refurbishment of the cars and had intended to complete both by fiscal year 2015. However, after MDOT entered into the contract with GLCR for the lease and refurbishment of the cars, the federal lead agency changed from FHWA to the Federal Transit Administration (FTA). FTA required a capacity analysis of the rail line and additional environmental studies to ensure that existing intercity passenger and freight services and the new commuter rail service could reasonably coexist. The Office of Rail indicated that these additional requirements delayed the construction of the stations and completion of track work for the two commuter rail projects and that it expected to begin using the cars in 2017.

Recommendation Reported in February 2015:

We recommended that the Office of Rail effectively and efficiently oversee the lease and refurbishment of cab and coach cars designated for two commuter rail projects.

AGENCY PLAN TO COMPLY*

Michigan Compiled Laws and administrative procedures required MDOT to develop a plan to comply with the audit recommendations within 60 days after release of the February 2015 audit report.

On April 14, 2015, MDOT indicated that it expected to be in compliance with the recommendation by December 31, 2015 and had developed an action plan and taken the following steps to address the issue:

- Met with project leaders from both commuter rail initiatives to emphasize the need for local financial support and realistic service operation start dates.
- Actively solicited interest in short-term and long-term subleasing or sale of the equipment to all commuter rail agencies using these types of cars in the United States and Canada.
- Advertised rail car specifications and availability for sublease or sale in industry publications.
- Worked with a national industry expert to define a value range for refurbished commuter rail cars of this sort.
- Had discussions with Amtrak representatives regarding the use of some of the rail cars on the Pere Marquette (Grand Rapids - Chicago) route.

FOLLOW-UP CONCLUSION

Our follow-up determined that MDOT complied with the recommendation:

- MDOT worked with GLCR to seek out interim uses for the refurbished cab and coach cars when it determined that the change in federal oversight entities would result in a significant delay in the start of the commuter service. The Office of Rail:
 - Advertised the 23 refurbished cab and coach cars attempting to secure a sublessee(s).
 - Added restrooms to 2 of the coach cars to expand the possibilities for interim use.
- MDOT ended its original contract with GLCR as of December 31, 2015 for the lease of the 23 refurbished cab and coach cars and suspended lease payments of \$267,828 to GLCR for the period of October 1, 2015 through December 31, 2015.
- MDOT entered into a new contract with GLCR effective from October 1, 2015 through September 30, 2019. We reviewed this agreement and noted:
 - MDOT has no obligation to lease the 23 refurbished cab and coach cars from GLCR or

* See glossary at end of report for definition.

make any additional payments to GLCR for the period October 1, 2015 through September 30, 2019.

- MDOT has no obligation to lease any of the 23 refurbished cab and coach cars from GLCR after September 30, 2019, absent a written notice of intent to lease from MDOT to GLCR.
- MDOT secured an option to lease up to 23 of the refurbished cab and coach cars, from October 1, 2019 through September 30, 2024, at the same monthly lease rates as the original 2010 contracted rates of \$4,228 and \$3,730 per cab and coach car, respectively. As a result, if MDOT exercises its option to lease the cab and coach cars, we estimated that MDOT could potentially realize a savings of between \$61,000 and \$141,000 each month, for up to 60 months, by preserving the 2010 contracted lease rates.
- MDOT secured a share of the sales proceeds from the 23 refurbished cab and coach cars. If GLCR sells the cars during the period October 1, 2015 through September 30, 2017, MDOT will receive 50% of the sales proceeds over \$900,000, net of sales costs. If GLCR sells the cars during the period October 1, 2017 through September 30, 2022, MDOT will receive 25% of the sales proceeds over \$900,000, net of sales costs.
- MDOT estimates that it has invested approximately \$326,000 in the refurbishment of each of the 23 cab and coach cars and that each has a value of approximately \$1.1 million to \$1.3 million. Therefore, MDOT estimates that it could potentially recoup around \$120,000 for each car sold, dependent on timing of the sale and the sales price. MDOT informed us that any proceeds from the sale of the refurbished cab and coach cars would help MDOT to repay FHWA for its \$2.8 million investment in the two proposed commuter rail projects if the projects do not go forward on October 1, 2019.

FOLLOW-UP SCOPE AND PERIOD

FOLLOW-UP SCOPE

- We interviewed MDOT's Office of Rail personnel and reviewed MDOT's corrective action plans to determine the status of MDOT's compliance with the recommendation related to the material condition.
- We reviewed MDOT's contract with GLCR for the period April 6, 2010 through December 31, 2015 for the lease and refurbishment of 23 cab and coach cars to determine the status of the contract.
- We examined MDOT's new agreement with GLCR for the period October 1, 2015 through September 30, 2019 to determine the terms and status of the agreement related to the 23 refurbished cab and coach cars for the two proposed commuter rail projects.
- We analyzed MDOT's expenditure records for the period February 1, 2015 to February 1, 2016 to verify that MDOT terminated lease payments to GLCR for the 23 cab and coach cars, under the original contract, as of October 2015.
- We reviewed documentation related to MDOT's efforts to seek out alternative uses for the cab and coach cars.
- We reviewed MDOT's estimated values of the refurbished cab and coach cars for reasonableness.

PERIOD

Our follow-up was performed during February and March 2016.

GLOSSARY OF ABBREVIATIONS AND TERMS

agency plan to comply	The response required by Section 18.1462 of the <i>Michigan Compiled Laws</i> and the State of Michigan Financial Management Guide (Part VII, Chapter 4, Section 100). The audited agency is required to develop a plan to comply with Office of the Auditor General audit recommendations and submit the plan within 60 days after release of the audit report to the Office of Internal Audit Services, State Budget Office. Within 30 days of receipt, the Office of Internal Audit Services is required to review the plan and either accept the plan as final or contact the agency to take additional steps to finalize the plan.
FHWA	Federal Highway Administration.
FTA	Federal Transit Administration.
GLCR	Great Lakes Central Railroad.
material condition	A matter that, in the auditor's judgment, is more severe than a reportable condition and could impair the ability of management to operate a program in an effective and efficient manner and/or could adversely affect the judgment of an interested person concerning the effectiveness and efficiency of the program.
MDOT	Michigan Department of Transportation.
performance audit	An audit that provides findings or conclusions based on an evaluation of sufficient, appropriate evidence against criteria. Performance audits provide objective analysis to assist management and those charged with governance and oversight in using the information to improve program performance and operations, reduce costs, facilitate decision making by parties with responsibility to oversee or initiate corrective action, and contribute to public accountability.
State Rail Plan	A plan developed by MDOT to guide the future of Michigan's rail system for both passenger and freight rail over the next 20 years. The plan identifies current and future system needs and makes recommendations to encourage ongoing rail investments. The plan meets the requirements established by the federal Passenger Rail Investment and Improvement Act of 2008, which positions the State to receive additional federal funding for rail projects.

