



## **GOVERNANCE:**

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



## 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

A handwritten signature in blue ink that reads "Tom Howard".

**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](mailto:Tom.Howard@amtrakoig.gov)) or Kevin Winters, Deputy Inspector General/Counsel ([Kevin.Winters@amtrakoig.gov](mailto:Kevin.Winters@amtrakoig.gov)) at [202-906-4600](tel:202-906-4600).



## OIG MISSION AND CONTACT INFORMATION

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### 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.

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Phone: 800-468-5469

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CONSOLIDATED FINANCIAL STATEMENTS

National Railroad Passenger Corporation and Subsidiaries (Amtrak)  
Years Ended September 30, 2014 and 2013  
With Report of Independent Auditors

Ernst & Young LLP



Building a better  
working world

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Consolidated Financial Statements

Years Ended September 30, 2014 and 2013

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## Report of Independent Auditors

The Board of Directors and Stockholders  
National Railroad Passenger Corporation

### **Report on the Financial Statements**

We have audited the accompanying consolidated financial statements of National Railroad Passenger Corporation and subsidiaries (Amtrak or the Company), which comprise the consolidated balance sheets as of September 30, 2014 and 2013, and the related consolidated statements of operations, comprehensive loss, changes in capitalization, and cash flows for the years then ended, and the related notes to the consolidated financial statements.

### ***Management's Responsibility for the Financial Statements***

Management is responsible for the preparation and fair presentation of these financial statements in conformity with U.S. generally accepted accounting principles; this includes the design, implementation and maintenance of internal control relevant to the preparation and fair presentation of financial statements that are free of material misstatement, whether due to fraud or error.

### ***Auditor's Responsibility***

Our responsibility is to express opinions on these financial statements based on our audits. We conducted our audits in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the financial statements, whether due to fraud or error. In making those risk assessments, the auditor considers internal control relevant to the entity's preparation and fair presentation of the financial statements in order to design audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the entity's internal control. Accordingly, we express no such opinion. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of significant accounting estimates made by management, as well as evaluating the overall presentation of the financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

### ***Opinion***

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of National Railroad Passenger Corporation and subsidiaries at September 30, 2014 and 2013, and the consolidated results of their operations and their cash flows for the years then ended in conformity with U.S. generally accepted accounting principles.

### ***Federal Government Funding***

As explained in Notes 1 and 2 in the accompanying consolidated financial statements, the Company has a history of operating losses and is dependent upon substantial Federal Government subsidies to sustain its operations and maintain its underlying infrastructure. As further explained in Note 2 to the consolidated financial statements, the Company is receiving Federal Government funding under the Consolidated and Further Continuing Appropriations Act, 2015. The Company expects to receive interim Federal Government funding under Congressional continuing resolutions for fiscal year 2016 until the formal appropriations bill is signed into law. There are currently no Federal Government subsidies appropriated by law for any period subsequent to December 11, 2015. Without the receipt of Federal Government funding, the Company will not be able to continue in its current form and significant operating changes, restructurings, or bankruptcy might occur. Our opinion is not modified with respect to this matter.

### ***Other Reporting Required by Government Auditing Standards***

In accordance with *Government Auditing Standards*, we also have issued our report dated September 30, 2015 on our consideration of the National Railroad Passenger Corporation and subsidiaries' internal control over financial reporting and on our tests of its compliance with certain provisions of laws, regulations, contracts, and grant agreements and other matters. The purpose of that report is to describe the scope of our testing of internal control over financial reporting and compliance and the results of that testing, and not to provide an opinion on the internal control over financial reporting or on compliance. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering National Railroad Passenger Corporation's internal control over financial reporting and compliance.



October 1, 2015

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Consolidated Balance Sheets

*(In Thousands of Dollars, Except Share Data)*

	September 30,	
	2014	2013
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 424,041	\$ 282,280
Restricted cash and cash equivalents	5,149	6,813
Accounts receivable, net of allowances of \$4,429 and \$3,076 at September 30, 2014 and 2013, respectively	307,917	202,702
Materials and supplies, net of allowances of \$46,074 and \$45,423 at September 30, 2014 and 2013, respectively	268,410	258,133
Prepaid expenses	15,396	16,223
Other current assets	44,219	14,972
Total current assets	1,065,132	781,123
Property and equipment:		
Locomotives	1,709,439	1,531,045
Passenger cars and other rolling stock	2,992,737	2,922,180
Right-of-way and other properties	11,733,797	11,321,458
Construction-in-progress	1,311,304	1,126,936
Leasehold improvements	527,439	498,153
Property and equipment, gross	18,274,716	17,399,772
Less – Accumulated depreciation and amortization	(7,016,382)	(6,455,403)
Total property and equipment, net	11,258,334	10,944,369
Other assets, deposits, and deferred charges:		
Notes receivable on sale-leasebacks	54,440	53,755
Deferred charges, deposits, and other	76,020	149,906
Total other assets, deposits, and deferred charges	130,460	203,661
Total assets	\$ 12,453,926	\$ 11,929,153

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Consolidated Balance Sheets (continued)

*(In Thousands of Dollars, Except Share Data)*

	September 30,	
	2014	2013
<b>Liabilities and capitalization</b>		
Current liabilities:		
Accounts payable	\$ 337,478	\$ 304,942
Accrued expenses and other current liabilities	560,935	592,768
Deferred ticket revenue	133,733	127,653
Current maturities of long-term debt and capital lease obligations	106,291	134,393
Total current liabilities	1,138,437	1,159,756
Long-term debt and capital lease obligations:		
Capital lease obligations	483,088	510,079
Other long-term debt	681,210	645,133
Total long-term debt and capital lease obligations	1,164,298	1,155,212
Other liabilities and deferred credits:		
Deferred state capital payments	1,190,592	1,065,993
Casualty reserves	150,748	178,709
Deferred gain on sale-leasebacks	54,355	73,567
Postretirement employee benefits obligation	1,232,671	1,077,310
Environmental reserve	46,042	53,420
Deferred income taxes	226	3,879
Other liabilities	74,953	71,216
Total other liabilities and deferred credits	2,749,587	2,524,094
Total liabilities	5,052,322	4,839,062
Commitments and contingencies <i>(Note 10)</i>		
Capitalization:		
Preferred stock – \$100 par, 109,396,994 shares authorized, issued and outstanding at September 30, 2014 and 2013	10,939,699	10,939,699
Common stock – \$10 par, 10,000,000 shares authorized, 9,385,694 issued and outstanding at September 30, 2014 and 2013	93,857	93,857
Other paid-in capital	28,209,068	26,697,860
Accumulated deficit	(31,352,171)	(30,269,559)
Accumulated other comprehensive loss	(488,849)	(371,766)
Total capitalization	7,401,604	7,090,091
Total liabilities and capitalization	\$ 12,453,926	\$ 11,929,153

*See accompanying notes.*

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Consolidated Statements of Operations

*(In Thousands of Dollars)*

	<b>Year Ended September 30,</b>	
	<b>2014</b>	<b>2013</b>
Revenues:		
Passenger related	\$ 2,508,165	\$ 2,366,726
Commuter	119,032	112,230
Other	608,389	511,898
Total revenues	<b>3,235,586</b>	2,990,854
Expenses:		
Salaries, wages, and benefits	2,105,766	2,095,418
Train operations	223,880	271,974
Fuel, power, and utilities	362,971	370,131
Materials	203,232	187,255
Facility, communication, and office related	190,629	181,948
Advertising and sales	96,381	95,013
Casualty and other claims	58,653	67,378
Depreciation and amortization	759,023	687,061
Other	416,205	374,397
Indirect cost capitalized to property and equipment	(133,191)	(126,390)
Total expenses	<b>4,283,549</b>	4,204,185
Net loss before other expense	<b>1,047,963</b>	1,213,331
Other expense:		
Interest income	(2,045)	(2,371)
Interest expense	60,989	74,976
Loss on early extinguishment of debt	-	10,476
Other income, net	(24,295)	(20,858)
Other expense, net	<b>34,649</b>	62,223
Net loss	<b>\$ 1,082,612</b>	\$ 1,275,554

*See accompanying notes.*

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Consolidated Statements of Comprehensive Loss

(In Thousands of Dollars)

	Year Ended September 30,	
	2014	2013
Net loss	\$ 1,082,612	\$ 1,275,554
Other comprehensive loss:		
Pension and other postretirement benefit items:		
Net loss (gain) arising during the period	133,442	(175,016)
Prior service credit during period	–	(188,038)
Amortization of actuarial loss	(38,113)	(58,653)
Amortization of prior service cost	21,754	(3,971)
Total pension and other postretirement benefit items	117,083	(425,678)
Comprehensive loss	<u>\$ 1,199,695</u>	<u>\$ 849,876</u>

*See accompanying notes.*

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Consolidated Statements of Changes in Capitalization

*(In Thousands of Dollars)*

	Preferred Stock	Common Stock	Other Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total
Balance at September 30, 2012	\$ 10,939,699	\$ 93,857	\$ 25,208,088	\$ (28,994,005)	\$ (797,444)	\$ 6,450,195
Federal paid-in capital	–	–	1,489,772	–	–	1,489,772
Net loss	–	–	–	(1,275,554)	–	(1,275,554)
Total pension and other postretirement benefit items	–	–	–	–	425,678	425,678
Balance at September 30, 2013	10,939,699	93,857	26,697,860	(30,269,559)	(371,766)	7,090,091
Federal paid-in capital	–	–	<b>1,511,208</b>	–	–	<b>1,511,208</b>
Net loss	–	–	–	<b>(1,082,612)</b>	–	<b>(1,082,612)</b>
Total pension and other postretirement benefit items	–	–	–	–	<b>(117,083)</b>	<b>(117,083)</b>
Balance at September 30, 2014	<b>\$ 10,939,699</b>	<b>\$ 93,857</b>	<b>\$ 28,209,068</b>	<b>\$ (31,352,171)</b>	<b>\$ (488,849)</b>	<b>\$ 7,401,604</b>

*See accompanying notes.*

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Consolidated Statements of Cash Flows

(In Thousands of Dollars)

	Year Ended September 30,	
	2014	2013
<b>Cash flows from operating activities</b>		
Net loss	\$ (1,082,612)	\$ (1,275,554)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	759,023	687,061
(Gain) loss on sale of property and equipment	(10,913)	81
Gain on exercise of early buyout option	–	(19,567)
Loss on early extinguishment of debt	–	10,476
Other	8,084	10,649
Changes in assets and liabilities:		
Accounts receivable	(110,637)	6,899
Materials and supplies	(13,452)	(13,287)
Prepaid expenses	827	(2,511)
Other current assets	(29,247)	10,460
Other assets, deposits, and deferred charges	73,017	50,664
Accounts payable, deferred ticket revenue, accrued expenses and other current liabilities	4,258	76,200
Deferred state capital payments	(47,532)	(37,451)
Other liabilities and deferred credits	(10,534)	131,066
Net cash used in operating activities	<u>(459,718)</u>	<u>(364,814)</u>
<b>Cash flows from investing activities</b>		
Change in restricted cash and cash equivalents	1,664	1,317
Purchases and refurbishments of property and equipment	(1,100,167)	(1,013,136)
Proceeds from disposals of property and equipment	34,960	1,254
Net cash used in investing activities	<u>(1,063,543)</u>	<u>(1,010,565)</u>
<b>Cash flows from financing activities</b>		
Proceeds from federal paid-in capital	1,511,208	1,489,772
Proceeds from federal and state capital payments	172,129	130,778
Repayments of debt and capital lease obligations	(279,570)	(283,858)
Proceeds from issuance of debt	261,255	110,147
Net cash provided by financing activities	<u>1,665,022</u>	<u>1,446,839</u>
Net change in cash and cash equivalents	141,761	71,460
Beginning balance of cash and cash equivalents	282,280	210,820
Ending balance of cash and cash equivalents	<u>\$ 424,041</u>	<u>\$ 282,280</u>
<b>Supplemental disclosure of cash payments</b>		
Interest paid, net of amount capitalized	\$ 71,709	\$ 73,214
<b>Supplemental disclosure of noncash investing and financing activities</b>		
Debt and capital lease reduction through use of escrow deposits/notes receivable	–	400
Other non-cash changes in property, includes accruals of amounts due for purchases	1,261	4,783

See accompanying notes.



# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Notes to Consolidated Financial Statements

Years Ended September 30, 2014 and 2013

### 1. Nature of Operations

The National Railroad Passenger Corporation (Amtrak or the Company) was incorporated in 1971 pursuant to the Rail Passenger Service Act of 1970 and is authorized to operate a nationwide system of passenger rail transportation. The United States government (the Federal Government) through the Secretary of the United States Department of Transportation (the DOT) owns all issued and outstanding preferred stock (see Note 5). Amtrak's principal business is to provide rail passenger transportation service in the major intercity travel markets of the United States. The Company also operates commuter rail operations on behalf of certain states and transit agencies, provides equipment and right-of-way maintenance services, and has leasing operations.

The Company has a history of recurring operating losses and is dependent on subsidies from the Federal Government to operate the national passenger rail system and maintain the underlying infrastructure. These subsidies are usually received through annual appropriations. In recent fiscal years, appropriated funds for Amtrak have been provided to the DOT, which through its agency the Federal Railroad Administration (the FRA), provides those funds to Amtrak pursuant to operating and capital funds grant agreements (see Note 4). Amtrak's ability to continue operating in its current form is dependent upon the continued receipt of subsidies from the Federal Government (see Note 2). The DOT, through the FRA, also provides financing to Amtrak through the Railroad Rehabilitation and Infrastructure Financing Program (see Note 6 and Note 7).

### 2. Funding

The enactment on October 16, 2008 of the Passenger Rail Investment and Improvement Act of 2008 (PRIIA) as Public Law 110-432 authorized to the Secretary of the DOT (the Secretary) five annual grants for Amtrak amounting to \$9.8 billion for fiscal years (FY) 2009 through 2013. Pursuant to the Continuing Appropriations Resolutions, 2014 (the 2014 CR) and Continuing Appropriations Resolutions, 2015 (the 2015 CR), some of the requirements in PRIIA continue to apply to the 2014 CR and 2015 CR.

The enactment on October 17, 2013 of the 2014 CR as Public Law 113-46 and the enactment on January 17, 2014 of the Consolidated Appropriations Act, 2014, as Public Law 113-76 provided total funding of approximately \$1.4 billion for Amtrak's fiscal year ended September 30, 2014 (FY2014), consisting of capital and debt service assistance funds totaling \$1.0 billion, of which \$10.3 million is designated to the FRA for oversight of capital projects and expenses associated with implementation of PRIIA section 212, and operating funds totaling \$340.0 million. As of

# **National Railroad Passenger Corporation and Subsidiaries (Amtrak)**

## **Notes to Consolidated Financial Statements (continued)**

### **2. Funding (continued)**

September 30, 2014, \$1.2 billion of the funding from the enactments had been received. Amtrak received the remaining \$153.7 million in the fiscal year ending September 30, 2015 (FY2015).

The enactment on September 28, 2012 of the Continuing Appropriations Resolutions, 2013 (the 2013 CR) as Public Law 112-175 and the enactment on March 26, 2013 of the Consolidated and Further Continuing Appropriations Act, 2013 (the FY2013 Full Year CR) as Public Law 113-6 provided total funding of approximately \$1.3 billion for Amtrak's fiscal year ended September 30, 2013 (FY2013), consisting of capital and debt service assistance funds totaling \$902.2 million, of which \$9.0 million was designated to the FRA for oversight of capital projects and expenses associated with implementation of PRIIA section 212, and operating funds totaling \$441.6 million. At September 30, 2013, all of the funding from the enactments was received.

The enactment on September 19, 2014 of the 2015 CR as Public Law 113-164 along with the enactment on December 16, 2014 of the Consolidated and Further Continuing Appropriations Act, 2015, as Public Law 113-235 provided total funding of \$1.4 billion for Amtrak's FY2015, consisting of capital and debt service assistance funds totaling \$1.1 billion, of which \$10.7 million is designated to the FRA for oversight of capital projects and expenses associated with implementation of PRIIA section 212, and operating funds totaling \$250.0 million. As of September 30, 2015, \$1.1 billion of the funding from the enactments had been received.

The terms of the operating grant generally provide funding for the associated fiscal year while the capital and debt service assistance grant generally provide that such funds can be retained until expended, generally expected to be by December 31 of the subsequent year. There are currently no Federal operating or capital and debt services subsidies appropriated for any period subsequent to December 11, 2015. Without such subsidies, Amtrak will not be able to continue to operate in its current form and significant operating changes, restructuring or bankruptcy may occur. Such changes or restructuring would likely result in asset impairments. The Company ultimately expects it will receive sufficient funds in the form of Continuing Appropriations Resolutions or other appropriations legislation to support its operations for the foreseeable future.

# **National Railroad Passenger Corporation and Subsidiaries (Amtrak)**

## **Notes to Consolidated Financial Statements (continued)**

### **3. Basis of Presentation and Summary of Significant Accounting Policies**

#### **Method of Accounting**

The accompanying consolidated financial statements are presented using the accrual basis of accounting in accordance with accounting principles generally accepted in the United States of America.

#### **Principles of Consolidation**

The Consolidated Financial Statements reflect the consolidated operations of Amtrak and its three wholly owned subsidiaries, Chicago Union Station Company (CUS), Passenger Railroad Insurance, Limited (PRIL), and Penn Station Leasing, LLC (PSL); and its 99.9% interest in Washington Terminal Company (WTC). All significant intercompany balances and transactions have been eliminated.

CUS was incorporated on July 3, 1913 as the Union Station Company, for the purpose of constructing, operating and maintaining a new railroad terminal in the City of Chicago. The name was officially changed to Chicago Union Station Company on May 7, 1915. Amtrak acquired 50% stock ownership interest in CUS in 1976 as part of the conveyance of the Northeast Corridor (NEC) and off-Corridor properties. Amtrak purchased the remaining 50% stock ownership in 1984. CUS's business is comprised of the following segments: provision of right of way and station access and use to intercity and commuter services; and lease and licensing of station space for retail services, display advertising, special events and other commercial uses.

PRIL was incorporated on December 18, 1996 under the laws of Bermuda to provide excess liability and property insurance coverage to Amtrak.

PSL was formed on April 17, 2001 to acquire from Amtrak and sublet back to Amtrak the leasehold estate in a portion of the real property and improvements located in the City and State of New York, commonly known as Penn Station.

WTC was formed on December 6, 1901 and is comprised of buildings and the rail yard adjacent to Washington Union Station. WTC provides switching services for passenger trains using the station or passing through the area.

# **National Railroad Passenger Corporation and Subsidiaries (Amtrak)**

## **Notes to Consolidated Financial Statements (continued)**

### **3. Basis of Presentation and Summary of Significant Accounting Policies (continued)**

#### **Cash and Cash Equivalents**

All short-term investments with original maturities of 90 days or less are considered cash and cash equivalents. These consist of bank deposits, money market fund investments, and treasury bills. Cash and cash equivalents are maintained at various financial institutions and, at times, balances may exceed federally insured limits.

#### **Restricted Cash and Cash Equivalents**

Restricted cash and cash equivalents consist primarily of funds received that are restricted for specific purposes or cash set aside and restricted for specific payments. The balance in restricted cash and cash equivalents as of September 30, 2014 consists of restricted funds for certain operations of the Amtrak Police Department. As of September 30, 2013, the balance in restricted cash and cash equivalents consisted of (i) restricted funds for certain operations of the Amtrak Police Department (ii) restricted cash from a contractor performing work for the Illinois Department of Transportation, (iii) restricted cash held for Amtrak's Office of Inspector General and used to reimburse the cost of program management and oversight under the American Recovery and Reinvestment Act of 2009; and (iv) restricted cash set aside and used to fund union employee healthcare claims paid by a former insurance provider in connection with Amtrak's self-insured medical program.

#### **Accounts Receivable and Allowance for Doubtful Accounts**

Accounts receivable in the Consolidated Balance Sheets includes billed and unbilled accounts receivable. Billed accounts receivable represent amounts for which invoices have been sent to customers. These accounts receivable are recorded at the invoiced amount and do not bear interest. Unbilled accounts receivable represent amounts recognized as revenue for which invoices have not yet been sent to customers. The Company recorded \$102.3 million and \$46.4 million of unbilled accounts receivable as of September 30, 2014 and 2013, respectively.

The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in the Company's billed accounts receivable. To determine its allowance for doubtful accounts, the Company evaluates historical loss experience and the characteristics of current accounts, as well as general economic conditions and trends.

# **National Railroad Passenger Corporation and Subsidiaries (Amtrak)**

## **Notes to Consolidated Financial Statements (continued)**

### **3. Basis of Presentation and Summary of Significant Accounting Policies (continued)**

#### **Materials and Supplies**

Materials and supplies, which are stated at weighted-average cost, net of allowance for shrinkage and obsolescence, consist primarily of items for maintenance and improvement of property and equipment. The allowance for shrinkage and obsolescence is recorded based on specific identification and expected usage rates.

#### **Derivative and Hedging Activities**

Amtrak periodically enters into derivative contracts to manage a portion of its exposure to fluctuating energy prices. These derivative financial instruments, which inherently contain market risk, are generally effective in reducing fluctuations in cash flows. Amtrak does not enter into energy contracts for trading or speculative purposes.

Amtrak held one and three fuel derivative contracts as of September 30, 2014 and 2013, respectively. Amtrak does not designate its derivative contracts as hedging instruments. Mark-to-market gains and losses on these derivatives are recorded in current earnings in the Consolidated Statements of Operations. Changes in fair value are recorded as a component of "Fuel, power, and utilities" in the Consolidated Statements of Operations.

For FY2014 and FY2013, Amtrak recognized a net increase of \$3.9 million and \$6.5 million, respectively, in "Fuel, power, and utilities" expense in the Consolidated Statements of Operations associated with derivative fuel contracts. As of September 30, 2014 and 2013, Amtrak had derivative fuel contracts with a fair value of \$0.9 million and \$3.3 million, respectively, included in "Other current assets" in the Consolidated Balance Sheets.

Amtrak periodically enters into interest rate swap agreements to manage its interest rate exposure to floating rate debt obligations. Amtrak does not designate its interest rate swaps as hedging instruments. Changes in the fair value of its interest rate swaps are recorded as a component of "Interest expense" in the Consolidated Statements of Operations.

On June 19, 2014, in conjunction with financing for the early termination of certain capital lease obligations (see Note 6), Amtrak entered into an interest rate swap arrangement to convert floating rate debt to a fixed rate. As of September 30, 2014, the fair value of the swap contract was a liability of less than \$100,000.

# **National Railroad Passenger Corporation and Subsidiaries (Amtrak)**

## **Notes to Consolidated Financial Statements (continued)**

### **3. Basis of Presentation and Summary of Significant Accounting Policies (continued)**

On November 2, 2012, in conjunction with the Pennsylvania Economic Development Financing Authority (PEDFA) Garage Bond reissuance (see Note 6), Amtrak entered into an interest rate swap arrangement. As of September 30, 2014 and 2013, the fair value of the PEDFA Garage Bond interest rate swap derivative contract was \$0.5 million and \$1.0 million, respectively, which is included in “Deferred charges, deposits, and other” in the Consolidated Balance Sheets.

#### **Property, Equipment, and Depreciation**

Except as described below, property and equipment owned by the Company are carried at cost and depreciated using the group method of depreciation (group method) in which a single composite depreciation rate is applied to the gross investment in a particular class of property or equipment, despite differences in the service life or salvage value of individual property units within the same class. This excludes computer equipment and software, which are stated at cost and are individually depreciated on a straight-line basis over their estimated useful lives, which are generally five to ten years. Properties held under capital leases and leasehold improvements are depreciated over the shorter of their estimated useful lives or their respective lease terms. Land is carried at cost.

For assets depreciated under the group method, upon normal sale or retirement, the cost less the net salvage value is charged to “Accumulated depreciation” in the Consolidated Balance Sheets and no gain or loss is recognized. Gains or losses related to significant premature retirements of depreciable property and the disposal of land are recorded as gains and losses in the Consolidated Statements of Operations at time of occurrence. There were no significant premature retirements of depreciable property or disposals of land for which gains or losses were recorded in FY2014 and FY2013.

Amtrak periodically engages an outside civil engineering firm with expertise in railroad property usage to conduct a study to evaluate depreciation rates for assets subject to the group method. These rates are used for the group depreciation calculations. In addition to the adjustment to group depreciation rates because of periodic depreciation studies, certain other events could occur that would materially affect Amtrak’s estimates and assumptions related to depreciation. Unforeseen changes in operations or technology could substantially alter assumptions regarding Amtrak’s ability to realize the return on its investment in operating assets and, therefore, affect the amounts of current and future depreciation expense. Because group method depreciation expense is a function of analytical studies made of property and equipment, subsequent studies could result in different estimates of useful lives and net salvage values. If future group method

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 3. Basis of Presentation and Summary of Significant Accounting Policies (continued)

depreciation studies yield results indicating that assets have shorter lives because of obsolescence, physical condition, changes in technology, or changes in net salvage values, the group method calculation of depreciation expense could increase. Likewise, if future studies indicate that assets have longer lives, the group method calculation of depreciation expense could decrease.

Construction-in-progress is stated at cost and includes direct costs of construction as well as interest expense capitalized during the period of construction. Amtrak capitalizes interest costs in connection with the construction of major facilities, locomotives, and passenger cars. Construction-in-progress is transferred to fixed assets when substantially all the activities necessary to prepare the assets for their intended use are completed, at which time depreciation commences. Capitalized interest is recorded as part of the asset to which it relates and is depreciated over the asset's useful life. Interest costs capitalized on construction projects were \$11.7 million and \$8.6 million for FY2014 and FY2013, respectively.

The useful lives of locomotives, passenger cars, and other rolling stock assets for depreciation purposes range up to 42 years. Right-of-way and other properties (excluding land) are depreciated using useful lives ranging up to 105 years. Other equipment including computers, office equipment, and maintenance equipment is depreciated using useful lives ranging from five to 20 years. Expenditures that significantly increase asset values or extend useful lives are capitalized, including major overhauls. Repair and maintenance expenditures, including preventive maintenance, are charged to operating expense when the work is performed. The cost of internally developed software is capitalized and amortized over its estimated useful life, which is generally five to ten years.

The Company accounts for asset retirement obligations (AROs) in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 410, *Asset Retirement and Environmental Obligations*. The standard applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development and/or normal use of the asset. In accordance with FASB ASC Topic 410, the Company recognizes the fair value of any liability for conditional AROs, including environmental remediation liabilities, in the period in which it is incurred, which is generally upon acquisition, construction, or development and/or through the normal operation of the asset, if sufficient information exists with which Amtrak can reasonably estimate the fair value of the obligation. Amtrak capitalizes the cost by increasing the carrying amount of the related long-lived asset. The capitalized cost is depreciated over the useful life of the related asset and upon

# **National Railroad Passenger Corporation and Subsidiaries (Amtrak)**

## **Notes to Consolidated Financial Statements (continued)**

### **3. Basis of Presentation and Summary of Significant Accounting Policies (continued)**

settlement of the liability Amtrak either settles the obligation for its recorded amount or incurs a gain or loss upon settlement. The asset retirement costs capitalized were \$9.7 million as of both September 30, 2014 and 2013, and were included in “Right of way and other properties” in the Consolidated Balance Sheets.

During 2007, the Company discovered that a significant number of rail ties produced by one vendor would require replacement significantly earlier than other ties. The Company hired a third party to perform a full analysis of all related ties. Although the initial inspection is complete, Amtrak’s Engineering Department will inspect ties indefinitely and adjust useful lives to reflect the degradation of the ties and prioritize tie replacement as necessary. Amtrak replaced 99,697 and 135,515 rail ties during FY2014 and FY2013, respectively, and plans on replacing approximately 430,000 remaining ties in FY2015 through FY2018 at an estimated total cost of \$201.1 million. The Company has assigned a unique group depreciation rate to this group of ties, which was determined by an outside civil engineering firm and factors in the replacement schedule as determined by Amtrak’s Engineering Department. As a result, depreciation expense is being accelerated over the remaining life of these ties. This acceleration of depreciation expense increased the net loss during FY2014 by approximately \$1.3 million and decreased the net loss during FY2013 by approximately \$1.8 million. On March 15, 2010, Amtrak and the concrete tie manufacturer executed a settlement agreement to resolve Amtrak’s claims for defective concrete ties. Under the settlement agreement, Amtrak will receive a combination of recurring payments totaling \$10.0 million and purchase discounts up to a total of an additional \$10.0 million for new concrete tie purchases through December 31, 2018. Amtrak received \$2.0 million and \$1.4 million in FY2014 and FY2013, respectively.

### **Indirect Cost Capitalized to Property and Equipment**

Overhead expense allocations represent the indirect support expenses related to specific geographic regions and departments that are involved in particular operating and construction projects. These indirect costs, which include fringe benefits allocable to direct labor, are capitalized along with the direct costs of material, labor, and other direct costs. Amtrak’s overhead rates are updated at the end of each fiscal year based upon the actual activity and costs incurred during the fiscal year.



# **National Railroad Passenger Corporation and Subsidiaries (Amtrak)**

## **Notes to Consolidated Financial Statements (continued)**

### **3. Basis of Presentation and Summary of Significant Accounting Policies (continued)**

#### **Impairment of Long-Lived Assets**

Properties and other long-lived assets are reviewed for impairment whenever events or business conditions indicate that their carrying amounts may not be recoverable. Initial assessments of recoverability are based on estimates of undiscounted future net cash flows. If impairment indicators are present, the assets are evaluated for sale or other disposition, and their carrying amounts are reduced to fair value based on discounted cash flows or other estimates of fair value.

In performing its impairment analysis, the Company assumes future Federal Government subsidies at levels consistent with the historical funding levels discussed in Note 2. The Company believes funding at historical levels is the best estimate to be used of the future. At this approximate level of funding, the Company determined that no indicators of impairment existed as of September 30, 2014. If future Federal Government funding drops below historical levels, substantial impairment may occur as discussed in Note 2.

On October 29, 2012, Super Storm Sandy (Sandy), one of the largest Atlantic storms on record, came ashore in the Northeast and mid-Atlantic region of the United States. NEC service was suspended on October 29<sup>th</sup>, partial service was resumed on November 1<sup>st</sup> and full service was resumed on November 15<sup>th</sup>. Amtrak sustained damage to tunnels and other structures in New York and New Jersey, requiring repair work and disrupting passenger service. Costs incurred by Amtrak during FY2014 and FY2013 totaled approximately \$7.0 million and \$21.7 million, respectively, including repairs to damaged property and emergency incurred expenses to continue operating the affected tunnels. Amtrak currently estimates that total damages related to Sandy will be at least \$1.05 billion, most of which are related to cleaning the tunnels and replacing certain assets inside them over time. The tunnels are currently operating at full capacity, concurrently with the cleaning and replacement work. The Company determined that there was no impairment to the tunnels as of September 30, 2014, and expenses related to cleaning and replacement costs are being recognized as incurred. With the assistance of a third party consultant, the Company reviewed the impacted assets and determined that certain infrastructure assets associated with specific locations along the NEC route would need to be replaced sooner than previously anticipated. Accordingly, the Company assigned unique group depreciation rates to these assets. As a result, depreciation expense totaling \$193.1 million will be accelerated over the remaining life of these assets. Of this amount, \$147.1 million for ventilation facilities and bridges is being accelerated over a total of five years, \$33.5 million for the East River Tunnel is being accelerated over a total of 11 years, and \$12.5 million for the North River Tunnel is being accelerated over a total of 17 years. The acceleration of depreciation

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Notes to Consolidated Financial Statements (continued)

### 3. Basis of Presentation and Summary of Significant Accounting Policies (continued)

expense increased the Company's net loss during FY2014 and FY2013 by \$31.7 million and \$39.7 million, respectively. As of September 30, 2013 the estimated accelerated depreciation was \$231.8 million. The Company's estimate changed during FY2014 to \$193.1 million as disclosed above. The change in estimate is being recognized on a prospective basis.

#### Casualty Losses and Claims

Provision is made for Amtrak's portion of the estimated actuarial liability for unsettled casualty and other claims. Personal injury liability and ultimate loss projections are undiscounted and estimated using standard actuarial methodologies. These actuarial estimates include an estimate for unasserted claims. As of September 30, 2014 and 2013, the reserve for casualty losses and claims was \$196.7 million and \$236.0 million, respectively. Of the total amount reserved as of September 30, 2014 and 2013, the estimated current claims liability included in "Accrued expenses and other current liabilities" in the Consolidated Balance Sheets was \$46.0 million and \$57.3 million, respectively. The balance of the reserve as of both September 30, 2014 and 2013 is included in "Casualty reserves" in the Consolidated Balance Sheets.

#### Revenue Recognition

"Passenger related" revenue in the Consolidated Statements of Operations includes ticket revenue, state contribution revenue associated with requested service provided by Amtrak, and food and beverage revenue as follows (in millions):

	Year Ended September 30,	
	2014	2013
Ticket	\$ 2,147.2	\$ 2,056.2
State contribution	235.2	187.1
Food and beverage	125.8	123.4
Total passenger related revenue	<u>\$ 2,508.2</u>	<u>\$ 2,366.7</u>

These revenues are recognized as operating revenues when the related services are provided. Amounts received for tickets that have been sold but not used are reflected as "Deferred ticket revenue" in the Consolidated Balance Sheets.

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Notes to Consolidated Financial Statements (continued)

### 3. Basis of Presentation and Summary of Significant Accounting Policies (continued)

“Commuter” revenue includes the revenues earned under contractual arrangements to operate various commuter rail services for a cost-based fee. These revenues are recognized when the related services are provided.

“Other” revenue, for FY2014 and FY2013, includes (i) revenue from reimbursable engineering and capital improvement activities (these revenues are generally recognized when the associated costs are incurred); (ii) other transportation revenue from use of Amtrak-owned tracks and other services (these revenues are generally recognized when the related services are provided); (iii) commercial development revenue from retail, parking, advertising, real property leases/easements/sales, and right-of-way fees (these revenues are generally recognized as the services are provided); (iv) amortization of state funds used to acquire depreciable assets (such payments are deferred when received and amortized over the estimated composite life of the related assets purchased with the funds, and the unamortized amounts are included in “Deferred state capital payments” in the Consolidated Balance Sheets); and (v) freight access fee revenue from the use of Amtrak-owned tracks by freight railroad companies and other gains.

The components of other revenue are as follows (in millions):

	<b>Year Ended September 30,</b>	
	<b>2014</b>	<b>2013</b>
Reimbursable	\$ 277.9	\$ 188.2
Other transportation	145.0	141.6
Commercial development	77.9	84.3
Amortization of state capital payments	47.5	37.5
Freight access fees and other	60.1	60.3
Total other revenue	<u>\$ 608.4</u>	<u>\$ 511.9</u>

### Advertising Expenses

The Company records advertising expenses as incurred and reports these amounts in “Advertising and sales” in the Consolidated Statements of Operations. Advertising expenses were \$36.8 million and \$35.5 million for FY2014 and FY2013, respectively.

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Notes to Consolidated Financial Statements (continued)

### 3. Basis of Presentation and Summary of Significant Accounting Policies (continued)

#### Income Taxes

The Company accounts for its income taxes in accordance with FASB ASC Topic 740, *Income Taxes*, which requires recognition of deferred tax assets and liabilities for future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

Management evaluates its potential exposures from tax positions taken that have or could be challenged by taxing authorities. These potential exposures result because taxing authorities may take positions that differ from those taken by management in the interpretation and application of statutes, regulations, and rules. Management considers the possibility of alternative outcomes based upon historical experience, previous actions by taxing authorities (e.g., actions taken in other jurisdictions), and advice from tax experts. The Company has evaluated income tax positions taken in prior years and believes that all positions are more likely than not to be sustained in an audit.

Pursuant to the provisions of Title 49 of the United States Code, Section 24301, Amtrak is exempt from all state and local taxes, including income and franchise taxes that are directly levied against the Company. Accordingly, there is no provision for state and local income or franchise taxes recorded in the consolidated financial statements for FY2014 and FY2013 (see Note 9).

#### Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, disclose contingent assets and liabilities at the date of the financial statements, and report amounts of revenues and expenses during the reporting period.

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Notes to Consolidated Financial Statements (continued)

### 3. Basis of Presentation and Summary of Significant Accounting Policies (continued)

The Company bases these estimates on historical experience, the current economic environment, and various other assumptions that are believed to be reasonable under the circumstances. However, uncertainties associated with these estimates exist and actual results may differ from these estimates. Some of the more significant estimates include: allowance for doubtful accounts and obsolescence of material and supplies, estimated useful lives of property and equipment, calculation of accelerated depreciation related to Sandy, recoverability of long-lived assets, estimates of wrecked and damaged equipment, estimates of casualty reserves, pension and other postretirement employee benefits expense and obligations (including expected return on plan assets, discount rates, rate of future compensation increases, and health care cost trend rates), estimated costs for retroactive wages for union employees, estimated costs of asset retirement obligations, valuation allowance for deferred tax assets and environmental reserves.

#### Comprehensive Loss

Amtrak reports a comprehensive loss in the Consolidated Statements of Comprehensive Loss. Comprehensive loss is defined as changes in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. As of September 30, 2014 and 2013, "Accumulated other comprehensive loss" consists of adjustments for pension and other postretirement liabilities.

#### Recent Accounting Pronouncements

In February 2013, the FASB issued Accounting Standards Update (ASU) No. 2013-02, *Comprehensive Income (Topic 220)*. This guidance seeks to improve the reporting of reclassifications out of accumulated other comprehensive income. Companies are required to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. generally accepted accounting principles (GAAP). This update will become effective for the Company beginning with FY2015. The Company does not expect the adoption of this standard to have a material impact on its financial condition or results of operations.

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Notes to Consolidated Financial Statements (continued)

### 3. Basis of Presentation and Summary of Significant Accounting Policies (continued)

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*, which supersedes previous revenue recognition guidance. The new standard requires that a company recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration the company expects to receive in exchange for those goods and services. Companies will need to use more judgment and estimates than under the guidance currently in effect, including estimating the amount of variable revenue to recognize over each identified performance obligation. Additional disclosures will be required to help users of financial statements understand the nature, amount and timing of revenue and cash flows arising from the contracts. In August 2015, the FASB issued a deferral of the effective date of this pronouncement. The new standard will become effective for the Company beginning with the fiscal year ending September 30, 2020 and can be adopted either retrospectively to each prior reporting period presented or as a cumulative effect adjustment as of the date of adoption. The Company is currently evaluating the impact of adopting this new guidance on the consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, *Presentation of Financial Statements – Going Concern (Subtopic 205-40)*. This ASU provides guidance about management's responsibility to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern and to provide related footnote disclosures. The guidance will be effective for the Company beginning with the fiscal year ending September 30, 2017, with early adoption permitted. As the Company expects to continue to receive funding from the Federal Government, Amtrak does not expect the adoption of this ASU to have a significant impact on its consolidated statements of financial condition or results of operations.

In April 2015, the FASB issued ASU No. 2015-03, *Imputation of Interest (Subtopic 835-30)*, simplifying the presentation of debt issuance costs. Under the new guidance, the debt issuance costs related to a recognized debt liability will be presented on the balance sheet as a direct deduction from the carrying amount of that debt liability. The amortization of debt issuance costs will continue to be included in interest expense. This guidance should be applied retrospectively and is effective for the Company beginning with the fiscal year ending September 30, 2017, with early adoption permitted. This ASU is not expected to have a material impact on the Company's consolidated statements of financial position or results of operations.

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Notes to Consolidated Financial Statements (continued)

### 3. Basis of Presentation and Summary of Significant Accounting Policies (continued)

In May 2015, the FASB issued ASU No. 2015-07, *Fair Value Measurement (Topic 820)*. This ASU removes the requirement to categorize within the fair value hierarchy all investments for which fair value is measured using the net asset value per share practical expedient. This ASU is effective for the Company beginning with the fiscal year ending September 30, 2017. Reporting entities must apply the new guidance retrospectively to all periods presented. This ASU is expected to impact the Company's fair value disclosures on pension assets, but it will not have an impact on the Company's consolidated statements of financial condition or results of operations.

### 4. Accounting and Reporting for Federal Payments

Certain funds are provided to Amtrak during the year through federal payments for capital and operating expenditures. These federal payments, which are recorded when received in "Other paid-in capital" in the Consolidated Balance Sheets and Consolidated Statements of Changes in Capitalization, totaled \$1.5 billion for both FY2014 and FY2013.

In accordance with the 2014 CR, Amtrak was provided with net assistance appropriations of \$391.4 million. Of the 2014 CR appropriation, \$129.5 million was appropriated as an operating subsidy and \$261.9 million was appropriated as a capital subsidy. Both appropriations were fully received during FY2014. The FY2014 Full Year CR provided Amtrak with additional appropriations of \$988.4 million. Of the additional 2014 appropriations, \$210.5 million was appropriated and received as an operating subsidy in FY2014 and \$777.9 million was appropriated as a capital subsidy of which \$624.2 million was received during FY2014. Amtrak received the remaining FY2014 capital subsidy of \$153.7 million in FY2015.

In accordance with the Disaster Relief Appropriations Act, 2013 (Public Law No. 113-2, January 29, 2013), Amtrak was provided with a net appropriation of \$30.2 million for damages incurred following Sandy on October 29, 2012, of which \$3.5 million and \$19.8 million was received in FY2014 and FY2013, respectively, and with a net appropriation of \$185.0 million for the Hudson Yards Concrete Encasement Project, of which \$130.6 million and \$0.5 million was received in FY2014 and FY2013, respectively.

In accordance with the FY2013 Full Year CR, Amtrak was provided with a total appropriation of \$1.3 billion. Of the 2013 appropriation, \$441.7 million was appropriated and received as an operating subsidy in FY2013 and \$893.1 million was appropriated as a capital subsidy, all of which was received during FY2013.

## **National Railroad Passenger Corporation and Subsidiaries (Amtrak)**

### **Notes to Consolidated Financial Statements (continued)**

#### **4. Accounting and Reporting for Federal Payments (continued)**

The 2013 CR appropriated \$19.4 million to directly fund operations of Amtrak's Office of Inspector General (OIG) to be spent by March 31, 2013. Amtrak and the OIG entered into a services agreement on January 8, 2010 whereby Amtrak would continue to provide accounting and financial management services for the OIG. Amtrak is reimbursed for expenses incurred upon the submission of invoices to the OIG. As of September 30, 2014, Amtrak invoiced and received \$18.6 million, which was recorded in "Other paid-in capital" in the Consolidated Balance Sheets and Consolidated Statements of Changes in Capitalization.

Since 2005, the Department of Homeland Security has awarded Amtrak a total of \$149.1 million in annual grants from the Intercity Passenger Rail Grants Program, American Recovery and Reinvestment Act Rail and Transit Security Grant Program, and other security grants. Funding is provided on a reimbursable basis. Amtrak has cumulatively received \$108.3 million and \$92.0 million as of September 30, 2014 and 2013, respectively, which are included in "Other Paid-in Capital" in the Consolidated Balance Sheets and Statements of Changes in Capitalization.

In May 2011, the DOT awarded Amtrak \$449.9 million in American Recovery and Reinvestment Act of 2009 High Speed Intercity Passenger Rail funding to upgrade its rail infrastructure to support more frequent and faster high-speed rail service, and to improve reliability of current service between New York and Washington. The funding supports the project to upgrade electrical power, signal systems, and track and overhead catenary wires between Trenton and New Brunswick, New Jersey – one of the busiest segments of the NEC and where the densest concentration of Acela Express high-speed rail operations occurs. Funding is provided on a reimbursable basis. As of September 30, 2014 and 2013, Amtrak cumulatively received \$133.7 million and \$20.6 million, respectively, which were recorded in "Other paid-in capital" in the Consolidated Balance Sheets and Statements of Changes in Capitalization.

"Other paid-in capital", included in the Consolidated Balance Sheets and Statements of Changes in Capitalization, also includes the effects of certain funding received from the Federal Government to finance acquisition of and improvements to property and equipment. In exchange for this funding, Amtrak issued two promissory notes to the United States of America. The first note has a balance of \$4.0 billion as of September 30, 2014 and 2013, was issued in 1976 and matures on December 31, 2975, and is secured by the real and personal property of Amtrak, WTC, CUS, and PRIL. The second note has a balance of \$1.1 billion as of September 30, 2014 and 2013, was issued in 1983 and matures on November 1, 2082, with successive 99-year renewal terms, if the note has not been paid at maturity or accelerated in accordance with its



# **National Railroad Passenger Corporation and Subsidiaries (Amtrak)**

## **Notes to Consolidated Financial Statements (continued)**

### **4. Accounting and Reporting for Federal Payments (continued)**

terms and is secured by all rolling stock owned by Amtrak. Neither of the notes bears interest, unless prepaid, which Amtrak does not intend to do. The Federal Government is entitled to repayment and interest in the event Amtrak ceases operations, is acquired by another entity, or seeks relief under bankruptcy or insolvency laws. The amount due to the Federal Government on the first note may be accelerated by enactment of federal law or upon the occurrence of an event of default under the leases and mortgage entered into by Amtrak and PSL on June 20, 2001 (see Penn Station mortgage in Note 6), or upon the occurrence of various actions concerning an Amtrak bankruptcy, reorganization, or assignment for the benefit of creditors.

### **5. Preferred and Common Stock**

For funds received from the Federal Government prior to December 2, 1997, the Rail Passenger Service Act (49 U.S.C. 24304) required Amtrak to issue to the Secretary preferred stock equal in par value to all federal operating payments and most federal capital payments received subsequent to October 1, 1981, as well as capital and certain operating payments received prior to that date. As of September 30, 2014 and 2013, 109,396,994 shares of \$100 par value preferred stock were authorized, all of which were issued and outstanding. All issued and outstanding preferred shares are held by the Secretary for the benefit of the Federal Government. The Amtrak Reform and Accountability Act of 1997 (the Act) resulted in significant modifications to Amtrak's capital structure. Prior to the Act, dividends were to be fixed at a rate not less than 6% per annum, and were cumulative. No dividends were ever declared. The Act abolished the voting rights and the liquidation preference of the preferred stockholder and established that no additional preferred stock be issued by Amtrak in exchange for federal grants received. At the time of enactment of the Act, the minimum undeclared cumulative preferred dividend in arrears for all series issued and currently outstanding approximated \$5.8 billion and ranged between \$0.02 and \$97.08 per share. Each share of preferred stock is convertible into ten shares of common stock at the option of the preferred stockholder.

As of September 30, 2014 and 2013, 10,000,000 shares of \$10 par value common stock were authorized, of which 9,385,694 shares were issued and outstanding. The common stockholders, who acquired their stock from four railroads whose intercity rail passenger operations Amtrak assumed in 1971, have voting rights for amendments to Amtrak's Articles of Incorporation proposed by the Board of Directors. The Act also required Amtrak to redeem at fair market value the shares of common stock outstanding as of December 2, 1997, by the end of FY2002. In an effort to comply with the Act, Amtrak made an offer to the stockholders to redeem the stock for cash at a price of \$0.03 per share. By a letter, dated November 2, 2000, counsel for the four common stockholders responded to Amtrak and rejected the offer.

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 5. Preferred and Common Stock (continued)

In May 2008, American Premier Underwriters, Inc. (APU) owner of 55.8% of Amtrak's common stock through its corporate predecessor, Penn Central, filed a lawsuit in federal court in Cincinnati, Ohio, asserting that Amtrak has "eroded" the value of the common stock. APU is seeking \$52.0 million and 40 years of interest. The lawsuit has been dismissed twice in its entirety by the federal district court. APU appealed the second dismissal on June 29, 2015. Legal briefing before the Sixth Circuit Court of Appeals is scheduled to be completed by the end of October 2015 (see Note 10). Management does not believe that the ultimate outcome of this lawsuit will have a material impact on its financial condition or results of operations.

#### 6. Mortgages and Debt

Total debt in the Consolidated Balance Sheets consisted of the following (in thousands):

	September 30, 2014		September 30, 2013	
	Current	Long-Term	Current	Long-Term
Long-term debt:				
Mortgage obligations:				
Penn Station mortgage	\$ 25,040	\$ 91,695	\$ 22,870	\$ 116,735
High speed maintenance facilities	6,954	62,177	6,531	69,131
Frequency converter facility	1,675	136,855	1,610	138,535
Subtotal	<u>33,669</u>	<u>290,727</u>	31,011	324,401
Equipment loans	4,112	-	7,407	4,112
PEDFA 30 <sup>th</sup> St Garage Revenue				
Bonds	1,732	37,195	1,691	38,926
Term Loan A	17,192	108,582	-	-
Term Loan B	6,042	62,459	-	-
RRIF Loan*	4,624	190,615	-	277,694
Principal amount of long-term debt	<u>67,371</u>	<u>689,578</u>	40,109	645,133
Less unamortized discount	(470)	(8,368)	-	-
Total long-term debt	<u>\$ 66,901</u>	<u>\$ 681,210</u>	\$ 40,109	\$ 645,133

\*Debt component of Railroad Rehabilitation and Improvement Financing (RRIF) Loan obligation (see below and Note 7).

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 6. Mortgages and Debt (continued)

##### Letters of Credit

The Company has an unsecured commercial letter of credit of \$2.5 million that supports the issuance of auto fleet insurance. As of September 30, 2014 and 2013, there were no draws against this letter of credit.

##### Mortgage Obligations

###### *Penn Station Mortgage*

In June 2001, PSL mortgaged a substantial portion of improvements located at Penn Station in New York, New York for \$300.0 million at a fixed rate of interest of 9.25% per annum, which increased to 9.50% effective October 2002, receiving net cash proceeds of \$296.2 million. Of this amount, \$34.4 million as of September 30, 2014 and 2013 was deposited into escrow for the benefit of the lender and is recorded in “Deferred charges, deposits, and other” in the Consolidated Balance Sheets. Semiannual principal plus interest payments are due on the mortgage through maturity in June 2017. The outstanding balance due on the mortgage was \$116.7 million and \$139.6 million as of September 30, 2014 and 2013, respectively. The mortgage loan is guaranteed by Amtrak. The mortgage loan is not insured or guaranteed by any governmental entity, private mortgage or other insurer, trustee, or any other person.

###### *High Speed Maintenance Facilities*

On October 30, 2012, Amtrak purchased the equity ownership interests related to leveraged lease agreements under which Amtrak leases three Acela maintenance facilities. As a result of the buyout, Amtrak no longer makes lease payments relating to the equity interest, but continues to make payments servicing the leveraged lease debt. As of September 30, 2014 and 2013, the balance of such debt was \$69.1 million and \$75.6 million, respectively. Amtrak’s obligations are collateralized by a pledge of Amtrak’s interests in the maintenance facilities.

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 6. Mortgages and Debt (continued)

##### *Frequency Converter Facility*

During FY2001, PEDFA completed two issues of exempt facilities revenue bonds, the net proceeds of which were used to finance part of the costs associated with Amtrak's construction of a frequency converter facility (the Facility). The first series (Series A) for \$110.8 million was issued in February 2001, at a \$0.8 million discount, netting \$110.0 million. The second series (Series B) for \$45.0 million was issued in April 2001, at par. Amtrak procured the bond proceeds of each issue through a structured financing arrangement with PEDFA. Under this arrangement, Amtrak leased the Facility to PEDFA until November 2041, under a long-term ground lease, in exchange for the total net proceeds. Simultaneously, Amtrak leased the Facility back from PEDFA through June 2033, with an option to extend this term through November 2041. PEDFA also has the right to extend Amtrak's leaseback term through November 2041. Amtrak's obligations in connection with the Series A Bonds and the Series B Bonds (and any reissuances thereof) are collateralized by a pledge of Amtrak's interest in the Facility.

On February 15, 2012, Amtrak initiated a mandatory tender for purchase of the \$45.0 million Series B bonds. The Series B bonds were remarketed to a commercial bank that agreed to hold the reissued Series B bonds (Series B 2012) for a period of five years. In connection with the mandatory tender for purchase and the issuance of the Series B 2012 bonds, the interest rate was converted to a tax-effected fraction of the one-month London Interbank Offered Rate (LIBOR) plus 0.65% per annum, which was an effective rate of 0.55% and 0.56% at September 30, 2014 and 2013, respectively. The LIBOR-based interest rate will continue unless or until converted to another interest rate mode by Amtrak. In connection with this transaction, the Company and PEDFA executed and amended certain provisions included in the existing bond documents and lease arrangements with PEDFA.

On March 31, 2012, PEDFA issued \$95.1 million of PEDFA exempt facilities revenue refunding bonds (Series A 2012) to refund Series A of 2001 with varying maturities between November 1, 2013 and 2041. The interest rates on the Series A 2012 bonds range from 3.0% to 5.0% (yields ranging from 1.1% to 4.7%), payable semiannually. The Series A 2012 Bonds were issued at a \$4.6 million premium, which is being amortized on a straight-line basis (which approximates the effective interest method) over the term of the Series A 2012 bonds. The proceeds from the issuance and funds from the existing debt service reserve fund were used to (i) refund the 2001 Series A bonds outstanding in the amount of \$102.4 million; (ii) pay accrued and unpaid interest on Series A bonds of \$2.7 million; and (iii) pay the redemption premium of \$1.0 million and the issuance costs of \$1.3 million. The issuance costs were classified within "Deferred charges,

## **National Railroad Passenger Corporation and Subsidiaries (Amtrak)**

### **Notes to Consolidated Financial Statements (continued)**

#### **6. Mortgages and Debt (continued)**

deposits, and other” in the Consolidated Balance Sheets and are being amortized to interest expense over the term of each bond issuance. As of September 30, 2014 and 2013, \$138.5 million and \$140.1 million, respectively, of the Series A 2012 and Series B 2012 obligations remain outstanding. Amtrak guaranteed all principal and interest payments by PEDFA on the Series A and Series B bonds.

#### **Equipment Loans**

In 2010 and 2009, Amtrak exercised early buyout options to purchase 40 locomotives and eight superliner passenger cars under capital leases. Amtrak assumed the debt related to the capital leases as new loans from the lenders for \$32.0 million. The loans are payable in semiannual payments through maturity with the final loan payments due from January 2012 through January 2015. The interest rates vary from 7.37% to 9.61%. The outstanding balance due on these loans was \$4.1 million and \$11.5 million as of September 30, 2014 and 2013, respectively. Amtrak’s obligations in connection with these loans are collateralized by a pledge of the related rolling stock.

#### **PEDFA 30<sup>th</sup> St. Garage Revenue Bonds**

On January 7, 2003, PEDFA issued \$50.0 million of Revenue Bonds (the 2003 PEDFA Garage Bonds) for the purpose of financing the construction and other related costs of a parking garage located at the 30<sup>th</sup> Street Station in Philadelphia, Pennsylvania (30<sup>th</sup> Street Station Garage). The bonds had multiple maturities ending on June 1, 2033. The bonds were issued at a \$0.6 million discount and Amtrak incurred \$0.5 million in underwriter’s fees that were being amortized on a straight-line basis over the maturity of the bonds. The bonds bore interest, by individual maturities, at fixed rates ranging from 4.50% to 5.875%. Amtrak also entered into a “Pledge and Security Agreement” with PEDFA under which Amtrak guaranteed the payment of the principal and interest on the 2003 PEDFA Garage Bonds. Amtrak’s obligations with regard to the 2003 PEDFA Garage Bonds (and any reissuances thereof) are collateralized by a pledge of Amtrak’s interests in the 30<sup>th</sup> Street Station Garage.

On November 2, 2012, at Amtrak’s request, PEDFA issued \$42.0 million of Revenue Bonds (the 2012 PEDFA Garage Bonds) in order to refinance the 2003 PEDFA Garage Bonds. At the date of issuance, the 2012 PEDFA Garage Bonds were remarketed to a commercial bank that agreed to hold them for a period of seven years. The \$42.0 million proceeds together with \$4.2 million released from the then-existing restricted funds for the 2003 PEDFA Garage Bonds were used to

## **National Railroad Passenger Corporation and Subsidiaries (Amtrak)**

### **Notes to Consolidated Financial Statements (continued)**

#### **6. Mortgages and Debt (continued)**

refund the 2003 PEDFA Garage Bonds outstanding at that time plus accrued and unpaid interest and to pay other costs of the financing. In FY2013, the Company wrote off \$5.7 million of deferred financing costs related to the original issuance of the 2003 PEDFA Garage Bonds. The write-off was recognized in the FY2013 Consolidated Statement of Operations as “Loss on early extinguishment of debt”. The 2012 PEDFA Garage Bonds mature in 20 years, with mandatory purchase by Amtrak at par plus accrued interest at the end of the seventh year unless an extension agreement is executed with the commercial bank that holds them. Interest accrues at a variable one month LIBOR rate. The principal outstanding under the 2012 PEDFA Garage Bonds was \$38.9 million and \$40.6 million as of September 30, 2014 and 2013, respectively.

On November 2, 2012, Amtrak also entered into an interest rate swap agreement to manage the interest cost and risk associated with the 2012 PEDFA Garage Bonds. The notional principal amount of the swap agreement matches the outstanding bond obligation at the end of every month. The termination date is November 1, 2019, with an option to extend to November 1, 2032, if Amtrak delivers a notice of exercise prior to October 29, 2019. Under the agreement, Amtrak pays a fixed interest rate of 1.58% and receives a variable one month LIBOR rate on the outstanding notional principal amount. As a result, the effective interest rate on the 2012 PEDFA Garage Bonds is 2.39%.

Amtrak reported capital expenditures of \$35.0 million related to the construction of the parking garage in “Right-of-Way and other properties” in the Consolidated Balance Sheets as of both September 30, 2014 and 2013.

#### **Term Loan A and Term Loan B**

On November 27, 2013, the Company entered into a \$130.0 million credit facility with PNC National Bank, N.A. (the Bridge Loan) to finance the early termination of certain capital leases (see Note 7). On June 19, 2014, the Company converted the Bridge Loan into a \$200.0 million long-term loan, secured by certain of the Company’s P-42 diesel locomotives, of which \$130.0 million was financed with PNC Equipment Finance, LLC (Term Loan A) and \$70.0 million was financed with RBS Asset Finance Inc. (Term Loan B). Under the terms of the agreement for Term Loan A, the Company incurs interest at a rate of LIBOR plus 1.0%. At the time that Term Loan A was entered into, the Company entered into an interest rate swap agreement, the impact of which made the effective interest rate on Term Loan A 2.76%. Under the agreement for Term Loan B, the Company incurs interest at a rate of 3.36%. The Company is repaying the two term loans in quarterly installments beginning September 20, 2014 and

## **National Railroad Passenger Corporation and Subsidiaries (Amtrak)**

### **Notes to Consolidated Financial Statements (continued)**

#### **6. Mortgages and Debt (continued)**

continuing through June 20, 2021 in the case of Term Loan A and June 20, 2024 in the case of Term Loan B. As of September 30, 2014, the outstanding balance was \$125.8 million under Term Loan A and \$68.5 million under Term Loan B. In connection with the Bridge Loan, Term Loan A and Term Loan B, Amtrak incurred \$0.8 million of loan origination fees paid to the lenders which are being amortized using the effective interest method over the terms of the respective term loans. Amtrak also incurred \$0.6 million of legal fees and other debt issuance costs which are being amortized over the term of the loans on a straight line basis.

#### **Railroad Rehabilitation and Improvement Financing Loan (RRIF Loan)**

On June 21, 2011, the Company entered into a \$562.9 million RRIF Loan financing agreement with the FRA and a related Master Lease Agreement with Wells Fargo Bank Northwest (Owner Trustee), to finance the purchase of 70 new electric locomotives, related spare parts, and improvements to existing maintenance facilities to service the new locomotives. Amtrak's obligations are collateralized by a pledge of the locomotives, spare parts, and certain facilities expected to be constructed with loan proceeds. The Owner Trustee's role in the Master Lease Agreement is as a trustee for the benefit of the FRA. Amtrak will repay the FRA advances (plus interest thereon) via quarterly lease payments under the Master Lease Agreement. The first payment occurred on September 15, 2014. Payments will continue, on a quarterly basis, for a full 25-year period at an amount sufficient to fully pay interest and amortize principal over the term. During FY2014, Amtrak took delivery of the first 21 of the 70 locomotives. Upon acceptance of each locomotive, the associated portion of the obligation under the RRIF Loan converts to a capital lease for accounting purposes (see Note 7).

During the years ended September 30, 2014 and 2013, the Company received new advances under the RRIF Loan of \$60.6 million and \$110.1 million, respectively. As of September 30, 2014 and 2013, the total outstanding balance under the RRIF Loan (debt and capital lease obligations) was \$344.9 million and \$277.7 million, respectively. All advances under the RRIF Loan bear interest at an interest rate of 4.04% per annum. Of the total amount outstanding on September 30, 2014, \$195.2 million was classified as a debt obligation and \$149.7 million was classified as a capital lease obligation. The full balance of the RRIF Loan was classified as debt as of September 30, 2013 as the Company had not taken delivery of any of the locomotives as of that date.

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Notes to Consolidated Financial Statements (continued)

### 6. Mortgages and Debt (continued)

The Company incurred interest charges on the advances classified as debt obligations of \$11.7 million and \$8.6 million for the years ended September 30, 2014 and 2013, respectively, that were capitalized and recorded in “Construction-in-progress” in the Consolidated Balance Sheets.

Amtrak pays a 4.424% credit risk premium on all amounts advanced under the RRIF Loan program. The credit risk premium may be returned by the FRA to Amtrak after the repayment of the RRIF Loan. As of September 30, 2014 and 2013, the Company had paid cumulative credit risk premiums of \$14.4 million and \$11.7 million, respectively. The credit risk premium balance at September 30, 2014 is offset in part against the debt balance and in part against the capital lease obligation in the Consolidated Balance Sheets and is being amortized over the term of the RRIF Loan using the effective interest method. The effective interest rate of the RRIF Loan is 4.45% and will vary over time because of the additional credit risk premium with each draw. The balance of the credit risk premium is allocated proportionally between debt and capital lease obligations. The amortization of the credit risk premium allocated to debt is capitalized along with interest expense as part of “Construction-in-progress” in the Consolidated Balance Sheets.

### Interest Rates

The annual weighted-average interest rates for all interest-bearing borrowings (inclusive of the impact of any interest rate swaps) are shown below:

	<b>September 30,</b>	
	<b>2014</b>	<b>2013</b>
Mortgage obligations	<b>6.24%</b>	6.35%
PEDFA Garage Bonds	<b>2.39</b>	2.39
Equipment loans	<b>9.61</b>	9.40
RRIF Loan	<b>4.04</b>	4.04
Term loans	<b>2.97</b>	N/A

The overall weighted-average interest rate on all interest-bearing borrowings (inclusive of the impact of any interest rate swaps) is 4.7% and 5.2% per annum at September 30, 2014 and 2013, respectively.



## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 6. Mortgages and Debt (continued)

##### Scheduled Debt Maturities

On September 30, 2014, scheduled maturities of debt are (in thousands):

Year Ending September 30,	
2015	\$ 67,371
2016	67,045
2017	105,457
2018	44,698
2019	48,486
Thereafter	<u>423,892</u>
Principal amount of long-term debt	756,949
Less unamortized discount	<u>(8,838)</u>
Total long-term debt	<u>\$ 748,111</u>

Amtrak is subject to various covenants and restrictions under its borrowing arrangements. A default by Amtrak or acceleration of Amtrak's indebtedness may result in cross-default with other debt and may have a material adverse effect on the Company. As of September 30, 2014, the Company had failed to meet its covenant obligation under its borrowing arrangements to provide on a timely basis its audited financial statements, as of and for the year ended September 30, 2013. Waivers were received from certain lenders where necessary to prevent a default and upon delivery of the audited financial statements for the year ended September 30, 2013 in November 2014, the Company came into compliance with its financial reporting covenant obligation. However, in January 2015, the Company failed to meet its covenant obligation to provide on a timely basis its audited financial statements as of and for the year ended September 30, 2014. Waivers were received from certain lenders where necessary to prevent a default, and upon delivery of these audited financial statements, the Company will have satisfied all of its financial reporting covenant obligations.

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Notes to Consolidated Financial Statements (continued)

### 7. Leasing Arrangements

Amtrak leases equipment, primarily passenger cars and locomotives, and related maintenance infrastructure under capital leasing arrangements. Amtrak has entered into various lease transactions in which the lease structure contains variable interest entities (VIEs). These VIEs were created solely for the purpose of doing lease transactions and have no other activities, assets or liabilities outside of the lease transactions. In some of the arrangements, Amtrak has the option to purchase some or all of the assets at a fixed price, thereby creating variable interests for Amtrak in the VIEs.

Amtrak maintains and operates the assets based on contractual obligations within the lease arrangements, which set specific guidelines consistent with industry standards. As such, Amtrak has no control over activities that could materially impact the fair value of the leased assets. Amtrak does not hold the power to direct the activities of the VIEs and, therefore, does not control the ongoing activities that have a significant impact on the economic performance of the VIEs. Additionally, Amtrak does not have the obligation to absorb losses, or the right to receive benefits of the VIEs.

As of September 30, 2014 and 2013, the gross amount of assets recorded under capital leases was \$1.4 billion and \$1.6 billion, respectively, with accumulated amortization of \$0.7 billion and \$0.8 billion, respectively.

Amtrak is subject to various covenants and restrictions under its leasing arrangements. Amtrak has given guarantees or entered into reimbursement agreements in connection with certain of these lease transactions. A default by Amtrak or acceleration of Amtrak's indebtedness may result in cross-default to other Amtrak indebtedness, and may have a material adverse effect on the Company (see Note 6).

### RRIF Loan

In FY2014, 21 of the 70 planned new electric locomotives were delivered to the Amtrak Equipment Trust 2011 (Trust) for the RRIF Loan and leased to Amtrak. The Trust maintains title to the locomotives and administers the RRIF Loan.

The delivery of each locomotive creates a capital lease for accounting purposes between the Company and the Trust. As of September 30, 2014, \$149.7 million of the amount due under the RRIF Loan was attributable to locomotives leased under the Trust and is recorded, net of unamortized discounts applied to the capital lease obligation of \$6.3 million, as a capital lease obligation. See additional disclosure regarding the RRIF Loan in Note 6.

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 7. Leasing Arrangements (continued)

Amtrak has the right to terminate the lease and purchase any or all of the locomotives at any time during the lease term by paying the termination value specified in the lease.

#### Lease Terminations

During FY2014, Amtrak terminated certain capital leases by paying an early termination price which included the purchase of the leased equipment as part of the lease termination for all but one of the terminated leases. The lease termination amount paid by Amtrak for all of the terminated leases was \$199.9 million. As part of the lease terminations, Amtrak acquired 83 P-42 locomotives, 29 Surfliner railcars, and seven Superliner railcars. All the equipment purchased by Amtrak was for the normal operation of its train service and the Company expects to continue to use the equipment for the foreseeable future.

#### Future Minimum Lease Payments

As of September 30, 2014, future minimum lease payments under capital leases are (in thousands):

Year ending September 30,	
2015	\$ 75,348
2016	87,899
2017	89,370
2018	75,805
2019	76,484
Thereafter	<u>357,863</u>
Total minimum lease payments	762,769
Less: discounted to current period amount at interest rates ranging from 4.5% to 9.1%	<u>240,291</u>
Present value of minimum lease payments at September 30, 2014	<u><u>\$ 522,478</u></u>

The current portion of capital lease obligations as of September 30, 2014 and 2013, was \$39.3 million and \$94.3 million, respectively, and is presented in "Current maturities of long-term debt and capital lease obligations" in the Consolidated Balance Sheets.

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Notes to Consolidated Financial Statements (continued)

### 7. Leasing Arrangements (continued)

#### Operating Rights and Leases

As of September 30, 2014, Amtrak is obligated for the following minimum rental payments under operating rights and lease agreements (in thousands):

Year ending September 30,	
2015	\$ 16,610
2016	14,321
2017	13,504
2018	11,034
2019	7,711
Thereafter	<u>30,693</u>
Total	<u>\$ 93,873</u>

Rent expense for FY2014 and FY2013 was \$53.3 million and \$54.6 million, respectively and is included in "Facility, communication and office related" expenses in the Consolidated Statements of Operations.

Amtrak lease offices, operating areas, stations and other terminal space. These leases often contain renewal options to enable the Company to retain the use of facilities. Some of the leases contain escalation clauses that increase the rents based on a fixed or variable rate, such as an inflation factor index. Under certain leases, the Company is obligated to pay additional amounts based on the facility's operating expenses.

Most of the rights-of-way over which Amtrak operates are owned by other railroads. Amtrak uses such trackage under contracts with these railroads. The terms of the agreements range up to six years, although they may remain in effect longer if neither party seeks to renegotiate. Costs incurred are based on usage. The total amount incurred for use of the other railroads' rights-of-way during FY2014 and FY2013, totaled \$89.5 million and \$131.4 million, respectively, and are included in "Train operations" in the Consolidated Statements of Operations.

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 8. Fair Value Measurements

FASB ASC Topic 820, *Fair Value Measurements and Disclosures*, clarifies the definition of fair value for financial reporting, establishes a framework for measuring fair value, and requires additional disclosures about the use of fair value measurements. FASB ASC Topic 820 established a three-level valuation hierarchy for disclosure of fair value measurements. The valuation hierarchy is based upon the transparency of inputs to the valuation of an asset or liability as of the measurement date. The three levels are defined as follows:

- Level 1 – observable market inputs that are unadjusted quoted prices for identical assets or liabilities in active markets.
- Level 2 – other significant observable inputs (including quoted prices for similar securities, interest rates, credit risk, etc.).
- Level 3 – significant unobservable inputs (including the Company’s own assumptions in determining the fair value of investments).

The Company’s derivative financial instruments are valued by a third-party consultant based on prevailing market data derived from proprietary models and are carried at fair value on the consolidated balance sheet per FASB ASC Topic 820. A financial instrument’s categorization within the valuation hierarchy is based upon the lowest level of input that is significant to the fair value measurement. The following tables present the Company’s assets measured at fair value on a recurring basis as of September 30, 2014 and 2013, by the FASB ASC Topic 820 valuation hierarchy (in thousands).

	Level 1	Level 2	Level 3	Total
<b>September 30, 2014</b>				
Fuel derivative contracts	\$ –	\$ 872	\$ –	\$ 872
Interest rate swaps	–	481	–	481
Total	\$ –	\$ 1,353	\$ –	\$ 1,353
<b>September 30, 2013</b>				
Fuel derivative contracts	\$ –	\$ 3,254	\$ –	\$ 3,254
Interest rate swap	–	1,025	–	1,025
Total	\$ –	\$ 4,279	\$ –	\$ 4,279

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 8. Fair Value Measurements (continued)

The estimated fair value of Amtrak's non-derivative financial instruments is as follows (in thousands):

	September 30, 2014		September 30, 2013	
	Principal Amount	Fair Value	Principal Amount	Fair Value
Mortgage obligations	\$ 324,396	\$ 357,252	\$ 355,412	\$ 404,393
Equipment loans	4,112	4,251	11,519	12,502
PEDFA Garage Bond	38,927	29,273	40,617	41,754
Term Loan A	125,774	118,962	–	–
Term Loan B	68,501	67,899	–	–
RRIF Loan (debt component)	195,239	230,366	277,694	266,125
	<u>\$ 756,949</u>	<u>\$ 808,003</u>	<u>\$ 685,242</u>	<u>\$ 724,774</u>

The estimated fair values of the non-derivative financial instruments listed above are based upon discounted cash flow analyses using interest rates available to Amtrak at September 30, 2014 and 2013, for debt with the same remaining maturities.

For pension assets, all fair value measurement disclosures are included in Note 12. For cash and cash equivalents, restricted cash and cash equivalents, accounts receivable, accounts payable, accrued expenses and other current liabilities, the carrying amounts approximate fair value given the short-term nature of the financial instruments.

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 9. Income Taxes

There was no provision or benefit for income taxes for the fiscal years ended September 30, 2014 and 2013, which differed from the expected amount computed by applying the U.S. federal income tax rate of 35% to pretax loss. A reconciliation of the U.S. federal statutory income tax rate to Amtrak's actual income tax rate for FY2014 and FY2013 is as follows:

	<u>2014</u>	<u>2013</u>
U.S. federal statutory income tax rate	35.0%	35.0%
Federal operating grants	(11.7)	(12.3)
Valuation allowance	(24.9)	(23.8)
Other	1.6	1.1
Effective income tax rate	<u>0.0%</u>	<u>0.0%</u>

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 9. Income Taxes (continued)

Deferred income tax assets and liabilities were comprised of the following (in thousands):

	<b>September 30,</b>	
	<b>2014</b>	<b>2013</b>
Deferred tax assets:		
Net operating loss carryforward	\$ 2,442,944	\$ 2,365,336
Pension and other postretirement employee benefits	459,837	402,159
Capital leases	182,610	211,126
Claims reserves	67,877	66,949
Other accruals	32,499	43,187
Accrued vacation and other compensation accruals	36,796	35,489
Deferred gain on sale leaseback	19,024	25,749
Inventory reserve	16,126	15,898
Capital loss (rate security)	3,229	3,229
Bad debt reserve	1,550	1,077
Capitalized software	251	281
Gross deferred tax assets	3,262,743	3,170,480
Less: valuation allowance	(136,037)	(154,551)
Net deferred tax assets	3,126,706	3,015,929
 Deferred tax liabilities:		
Fixed assets	(3,113,979)	(3,013,148)
Insurance recoveries	(11,466)	-
Deferred rent	(1,367)	(6,438)
30 <sup>th</sup> Street Station	(120)	(222)
Gross deferred tax liabilities	(3,126,932)	(3,019,808)
Net deferred tax liability	\$ (226)	\$ (3,879)

Amtrak has recorded valuation allowances against net deferred tax assets as it is more likely than not that the results of future operations will not generate sufficient taxable income to realize deferred tax assets. In the current year, the valuation allowance decreased by \$18.5 million.

Net operating loss carryforwards were \$7.0 billion and \$6.8 billion as of September 30, 2014 and 2013, respectively. The carryforwards at September 30, 2014, will expire in various years from 2018 through 2034.



# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Notes to Consolidated Financial Statements (continued)

### 10. Commitments and Contingencies

#### Financial Assistance

Amtrak receives significant financial assistance from the Federal Government in the form of grants and entitlements. The right to these resources is generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal regulations, including the expenditure of the resources for eligible purposes. Substantially all grants are subject to financial and compliance audits by the grantors. Any disallowances because of these audits become a liability of the Company. The Company does not believe that the liabilities that may result from such audits for periods through September 30, 2014, would have a material effect on its financial position or the results of operations.

#### Commitments

Amtrak has various purchase commitments related to capital improvements pertaining to the ordinary conduct of business. In addition, Amtrak has entered into various agreements with states, cities, and other local transportation authorities and private companies pursuant to which Amtrak is required to fund various railroad facility and infrastructure improvements, and to fund the remanufacture and supply of railroad passenger equipment. Such commitments are not in excess of expected requirements and are not reasonably likely to result in performance penalties or payments that would have a material adverse effect on the Company's liquidity.

On August 3, 2010, the Company entered into a four-year contract with a contractor to purchase 130 new long-distance single level cars. The base price of the contract is \$298.1 million. The Company issued a Notice to Proceed on September 7, 2010. The Company makes payments to the contractor pursuant to an approved payment schedule upon the contractor's successful completion of certain tasks (milestones) during the contract. As of September 30, 2014, the Company has incurred \$95.2 million in project related costs. As of September 30, 2014, the Company had not taken delivery of any of the cars. Deliveries began in FY2015 and final delivery of all cars is expected by April 2017.

On September 28, 2010, the Company entered into a six-year contract with a contractor to purchase 70 new electric locomotives. The base price of this contract is \$466.3 million. The Company will make payments to the contractor pursuant to an approved payment schedule upon the contractor's successful completion of certain tasks (milestones) during the contract. As of September 30, 2014, the Company has incurred \$394.9 million in project costs of which \$325.4 million have been funded by the RRIF Loan (see Note 6). As of September 30, 2014, the

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Notes to Consolidated Financial Statements (continued)

### 10. Commitments and Contingencies (continued)

Company had taken delivery of 21 locomotives, and final delivery of the remaining locomotives is expected by the end of FY2016. On September 12, 2014, the Company entered into a 15 year contract with the same contractor to provide materials and engineering technical support for the new electric locomotives. The Company will pay the contractor \$7.1 million per year plus a variable amount based on total mileage of the fleet each year.

#### Insurance Claims

Amtrak maintains various insurance policies to cover its liability to employees and other parties for injury or damage resulting from accidents and to cover Amtrak's loss resulting from damage to Amtrak property. The insurance policies contain large deductibles; losses within the deductibles are self-insured by Amtrak.

The Amtrak Reform and Accountability Act of 1997 limits the amount railroad passengers may recover from a single accident to an aggregate of \$200.0 million. Since non-passenger liability is not so limited and there is a need to insure in the event of multiple occurrences, Amtrak purchases excess liability insurance limits beyond this statutory cap. See Note 13 for information regarding a derailment that occurred subsequent to September 30, 2014.

Amtrak operates a majority of its passenger rail service on tracks owned by freight railroads. Amtrak indemnifies these railroads for certain liabilities that arise as a result of its operations on freight tracks. Its indemnity generally applies to bodily injury and property damage claims made by its employees, passengers, and third parties struck by its trains, and for damage to its equipment. The freight railroads generally indemnify Amtrak for bodily injury and property damage claims made by freight railroad employees and third parties, and for damage to freight railroad equipment, lading, and property.

Amtrak holds insurance policies to insure against catastrophic events. As of September 30, 2014, Amtrak has submitted insurance claims related to losses occasioned following Sandy totaling \$1.1 billion, of which \$125.0 million has been received by the Company to date. Of this amount, \$30.0 million was received during FY2014 and \$95.0 million was received subsequent to fiscal year-end. Of the amount received to date, \$62.8 million has been recognized in the Consolidated Statement of Operations for FY2014 as a reduction of "Other" expenses, consisting of \$30.0 million allocated to business interruption and \$32.8 million related to costs incurred as of September 30, 2014. No amounts were recorded in the Consolidated Statement of Operations for FY2013. The amount received in FY2015 in excess of the amount recognized in the

## **National Railroad Passenger Corporation and Subsidiaries (Amtrak)**

### **Notes to Consolidated Financial Statements (continued)**

#### **10. Commitments and Contingencies (continued)**

Consolidated Statement of Operations for FY2014 will be recognized in the FY2015 Consolidated Statement of Operations. The remainder of the claim and all future claims will not be recognized by Amtrak until further confirmation of the assessed damages is agreed to by the insurers or additional cash is received.

On September 17, 2014, the Company filed a lawsuit in the United States District Court for the Southern District of New York regarding insurance claims for losses following Sandy. The complaint sought declaratory relief and alleged that in connection with outstanding claims for losses following Sandy the insurance carrier defendants breached more than 25 first-party all-risk property insurance policies that defendants sold to the Company in 2011. The lawsuit proceeded on an expedited schedule and the trial was scheduled to commence on July 14, 2015.

On June 24, 2015, the judge ruled in the insurers' favor on their pending summary judgment motions, finding that: (a) the inundation of property in the aftermath of Sandy falls within the definition of flood in the insurance policies; (b) no ensuing loss was suffered; and (c) Amtrak's losses arose from a single occurrence. The order then dismissed the excess liability insurers on the grounds that Amtrak's insurance claim would not allow recovery from excess liability insurers whose exposure is only to claims that exceed the \$125 million sub-limit for flood set forth in the various policies.

On July 2, 2015, the judge dismissed the lawsuit based on a settlement reached between Amtrak and those insurers providing coverage for liability amounts of \$125 million or less. Amtrak appealed the June 24, 2015 decision dismissing the excess liability insurers to the United States Court of Appeals for the Second Circuit on July 23, 2015.

#### **Labor Agreements**

Approximately 86% of Amtrak's labor force is covered by labor agreements. As of September 30, 2014, Amtrak has ratified five-year labor contracts with all of its unionized workforce, which includes the Transportation Communications International Union; Joint Council of Carmen, Coach Cleaners and Helpers; Amtrak Service Workers Council; Brotherhood of Locomotive Engineers; American Train Dispatchers Association; International Association of Machinists and Aerospace Workers; International Brotherhood of Electrical Workers; National Conference of Firemen and Oilers, International Brotherhood of Boilermakers and Blacksmiths; Sheet Metal Workers' International Association; the Fraternal Order of Police; Brotherhood of Railroad Signalmen; and Brotherhood of Maintenance of Way Employees.

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Notes to Consolidated Financial Statements (continued)

### 10. Commitments and Contingencies (continued)

With the exception of the Fraternal Order of Police, the agreements for the unions provide for specified general wage increases beginning July 1, 2010, and every six months thereafter, until and including January 1, 2015. The agreement with the Fraternal Order of Police provides for specified general wage increases beginning April 1, 2011, and every six months thereafter, until October 1, 2015.

The Company generally accrues for retroactive wages for unions with unratified contracts on the basis that the remaining contracts would ratify with similar wage increases, which is what occurred for unions with unratified contracts as of September 30, 2013. All retroactive wages as of September 30, 2013 were paid in FY2014. As all unions had ratified contracts as of September 30, 2014, no accrual was recorded as of September 30, 2014. An accrual of \$39.3 million was included in “Accrued expenses and other current liabilities” in the Consolidated Balance Sheet as of September 30, 2013.

### Legal Proceedings

In May 2008, APU, corporate successor to Penn Central, filed a lawsuit in federal court in Cincinnati, Ohio, asserting that Amtrak “eroded” the value of its common stock. APU sought \$52.0 million plus 40 years of interest. APU owns 55.8% of Amtrak’s common stock. Under the Rail Passenger Service Act of 1970, APU was permitted to have Amtrak assume APU’s responsibility to operate intercity passenger rail service in return for paying Amtrak one-half of APU’s 1969 passenger service losses. APU took advantage of that opportunity, entered into a 1971 agreement with Amtrak, paid \$52.0 million as required, and chose to receive Amtrak common stock at par value (rather than tax deductions of equal value). APU’s claims were litigated in arbitration proceedings and before the federal court. In an order dated June 21, 2011, the federal court granted Amtrak’s motion to dismiss APU’s lawsuit. In a second order dated September 13, 2011, the court also denied APU’s motion to alter the court’s judgment for Amtrak. APU filed an appeal to the U.S. Court of Appeals for the Sixth Circuit. The Sixth Circuit affirmed the District Court’s dismissal of APU’s complaint except for one procedural due process claim that was remanded to the District Court. On remand, the District Court granted Amtrak’s motion to dismiss the case, for a second time, and also dismissed APU’s subsequent motion to reconsider or alter that decision. APU appealed the second dismissal on June 29, 2015. Legal briefing before the Sixth Circuit Court of Appeals is scheduled to be completed by the end of October 2015. The Company believes it is reasonably possible, but not probable, that a loss could be incurred related to this claim. Amtrak has not recorded a liability related to this claim in the consolidated financial statements.

## **National Railroad Passenger Corporation and Subsidiaries (Amtrak)**

### **Notes to Consolidated Financial Statements (continued)**

#### **10. Commitments and Contingencies (continued)**

In July 2010, the City of New York (NY City) filed a federal court action against Amtrak in the Southern District of New York. NY City sought \$25.0 million, alleging under several theories, all based upon 1906 and 1909 agreements between NY City and other railroads, that Amtrak is responsible for a major public highway bridge reconstruction project for the Shore Road Circle Bridge in the Bronx. Amtrak disputed NY City's claims and filed a motion to dismiss on jurisdictional grounds, which was granted on June 13, 2011. The case was transferred to the U.S. District Court for the District of Columbia. The District Court granted Amtrak's motion for summary judgment and denied NY City's claims. NY City appealed to the DC Circuit Court of Appeals. On January 16, 2015, the DC Circuit ruled in Amtrak's favor, affirming the ruling of the District Court. NY City did not pursue further motions or appeals and the case is now closed.

Amtrak is involved in various other litigation and arbitration proceedings in the normal course of business, including but not limited to several distinct tort, contract and civil rights claims. The outcome of these matters cannot be predicted with certainty. When management concludes that it is probable that a liability has been incurred and the amount of the liability can be reasonably estimated, it is accrued through a charge to earnings. While the ultimate amount of liability incurred in any of these lawsuits and claims is dependent on future developments, in management's opinion, recorded liabilities, where applicable, are adequate to cover the future payment of such liabilities and claims. However, the final outcome of any of these lawsuits and claims cannot be predicted with certainty, and unfavorable or unexpected outcomes could result in additional accruals that could be significant to Amtrak's results of operations in a particular year. Any adjustments to the recorded liability will be reflected in earnings in the periods in which such adjustments are known.

#### **Americans With Disabilities Act (ADA) Compliance**

Under the ADA, stations in the intercity rail transportation system served by Amtrak were required to be readily accessible to and usable by individuals with disabilities no later than July 26, 2010, 42 U.S.C. §12162(e). This requirement applies to all components of a station used by the general public, including passenger platforms, designated waiting areas, ticketing areas, restrooms, and in some cases, concession areas. The Company has developed a plan to bring its stations into ADA compliance. This plan is regularly updated and adjusted based on new information and external factors, such as direction the Company receives from the FRA and other government agencies. On June 9, 2015, the Department of Justice (DOJ) provided Amtrak with a Letter of Findings and Conclusions regarding ADA compliance at Amtrak. DOJ has indicated, both in its Letter of Findings and in its communications with Amtrak's counsel, that DOJ intends to work cooperatively with Amtrak to negotiate a settlement or consent decree.

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Notes to Consolidated Financial Statements (continued)

### 10. Commitments and Contingencies (continued)

Amtrak is working to obtain sufficient funding to achieve full ADA compliance of all station components for which it is responsible under the ADA. The extent of these estimated costs and effects of non-compliance on operations cannot be determined at this time. Further, the nature of all expenditures that will be incurred, and the effect on operating results, have not yet been fully analyzed. Accordingly, the accompanying financial statements do not reflect the costs of Amtrak becoming fully compliant with the ADA. As of September 30, 2014, Amtrak has spent a total of \$307.7 million on ADA-related projects. Approximately \$37.5 million and \$52.8 million of the expenditures were incurred during FY2014 and FY2013, respectively.

#### Positive Train Control

In 2008, Congress enacted the Rail Safety Improvement Act. The legislation includes a mandate that all Class I railroads and each railroad hosting intercity or commuter rail passenger service have Positive Train Control (PTC) systems installed and operating by December 31, 2015. A Class I railroad is required to install PTC on any route where there are five million or more gross tons of railroad traffic per year and the presence of poison by inhalation hazardous materials. PTC is required on any rail line used for regularly scheduled intercity or commuter rail passenger service. The PTC rules provide for exceptions to PTC requirements, which are subject to FRA approval, on rail lines hosting passenger trains on which freight traffic volumes, and the number of passenger trains operated, do not exceed limits specified in the rule. Amtrak is working with federal and state authorities and commuter and freight railroads to ensure Amtrak trains are compliant with PTC systems adopted for use by host railroads. Additional funding to fully comply with PTC requirements is necessary and will be requested. Compliance with PTC requirements on the host railroads outside of the NEC could result in significant costs to Amtrak. Amtrak's contribution to PTC installation and maintenance on host railroad property has not yet been defined. Accordingly, the accompanying financial statements do not reflect the costs of Amtrak becoming fully compliant with PTC. As of September 30, 2014, Amtrak has spent \$132.1 million in general capital funds for PTC-related projects. Approximately \$32.5 million and \$20.1 million of the expenditures were incurred during FY2014 and FY2013, respectively.

Although the Company plans to have all of the NEC rail owned or controlled by the Company fully PTC compliant by the December 31, 2015 deadline, certain other Amtrak owned and/or operated rail is not expected to be compliant with the PTC requirements by December 31, 2015. In addition, certain host railroad companies over whose rail Amtrak's passenger trains operate have indicated that they will not be compliant with the PTC requirements by December 31, 2015. Those host railroads have indicated they will be forced to suspend passenger rail on their lines

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 10. Commitments and Contingencies (continued)

unless Congress extends the December 31, 2015 deadline. Absent an extension of the December 31, 2015 deadline or an alternative solution to allow continued passenger rail service over Amtrak's rail and host railroad property that is not PTC compliant, Amtrak's operations will be impacted. While the Company is hopeful that the deadline will be extended, it remains uncertain whether Congress will extend the implementation deadline or whether an alternative solution which would allow continued passenger rail service will be implemented. It is possible that Amtrak service could be disrupted in areas where PTC has not yet been fully implemented. However, the possible impact of any such disruption cannot be estimated at this time.

Kansas City Terminal Railway Co. (KCT) is a Class III railroad whose property is located in and around Kansas City, Missouri. Currently, Amtrak operates four Missouri state-supported service trains and two Amtrak long distance trains over KCT's rail lines each day. Under federal law, Class III railroads currently are not required to install PTC unless the railroad carries passenger trains. Because Amtrak operates passenger service over KCT's lines, KCT is required to install PTC by December 31, 2015. On April 4, 2014, KCT filed a claim before the National Arbitration Panel (NAP, a standing panel of railroad arbitrators established in 1971) to recover from Amtrak the full cost of installing PTC on its lines under the terms of Amtrak's operating agreement with KCT. Amtrak moved to dismiss the arbitration action, asserting that federal law, not the contract, controlled any Amtrak obligation to pay for PTC and that the Surface Transportation Board was the proper entity to decide such issues. However, the NAP ruled that the dispute fell within the scope of the Operating Agreement. Upon KCT's motion requesting "interim compensation" (i.e., a portion of KCT's ongoing costs for installing PTC), the NAP ruled that Amtrak must pay KCT a portion of its PTC installation costs, subject to a "true-up" in the final award in the arbitration proceeding. In response to that ruling, Amtrak sent a letter to KCT, notifying KCT that it would be forced to discontinue service over KCT's rail lines. Settlement discussions and a stay of the arbitration proceeding followed that notice. On August 7, 2015, Amtrak and KCT reached a settlement pursuant to which Amtrak paid KCT an agreed upon amount and KCT acknowledged their obligation to complete installation of PTC on their rail lines.

Other railroads over which Amtrak operates its passenger trains also have indicated they will assert claims against Amtrak to recover costs of PTC installation. The final outcome of any additional PTC claims cannot be predicted with certainty, but the Company expects that the outcome could result in additional accruals that could be material to Amtrak. Any accruals will be reflected in the periods in which such liability becomes probable and estimable.

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Notes to Consolidated Financial Statements (continued)

### 11. Environmental Matters

The Company is subject to extensive and complex federal and state environmental laws and regulations that can give rise to environmental issues. As a result of its operations and acquired properties, Amtrak is from time to time involved in administrative and judicial proceedings and administrative inquiries related to environmental matters. Amtrak's policy is to accrue estimated liabilities and capitalize such remediation costs relating to properties acquired with existing environmental conditions, and to expense remediation costs incurred on properties for environmental clean-up matters occurring after acquisition. The liability is periodically adjusted based on Amtrak's present estimate of the costs it will incur related to these sites and/or actual expenditures made. Some of the Company's real estate properties may have the presence of environmentally-regulated wastes or materials. If these properties undergo excavations, major renovations or are demolished, certain environmental regulations that are in place may specify the manner in which the wastes or materials must be assessed, handled, and disposed. The Company has identified a number of locations for which excavations and major renovations are planned and liabilities have been recorded. However, for remaining locations, the Company has no plans or expectations to undertake excavations, demolitions or major renovations that would require the removal of the environmentally-regulated wastes or materials.

Although a potential liability exists for the removal or remediation of environmentally-regulated materials, sufficient information is not available currently to estimate the liability, as the range of time over which the Company may settle these obligations is unknown or cannot be reasonably estimated at this time. Although the Company believes it has appropriately recorded current and long-term reserves for known and estimable future environmental costs, it could incur significant costs that exceed reserves or require unanticipated cash expenditures as a result of any of the foregoing. Based upon information currently available, the Company believes its environmental reserves are adequate to fund remedial actions to comply with present laws and regulations, and that the ultimate liability for these matters, if any, will not materially affect its overall financial condition, results of operations, or liquidity. As of September 30, 2014 and 2013, the environmental reserve was \$53.1 million and \$60.5 million, respectively. These reserves for estimated future environmental costs are undiscounted and include future costs for remediation and restoration of sites as well as any significant ongoing monitoring costs. The current portion of the reserve was \$7.1 million as of both September 30, 2014 and 2013, and is reported in "Accrued expenses and other current liabilities" in the Consolidated Balance Sheets. Of the reserve, \$33.5 million and \$40.1 million, included in "Right-of-way and other properties" in the Consolidated Balance Sheets as of September 30, 2014 and 2013, respectively, relates to estimated future capital expenditures for environmental remediation.



# **National Railroad Passenger Corporation and Subsidiaries (Amtrak)**

## **Notes to Consolidated Financial Statements (continued)**

### **11. Environmental Matters (continued)**

Amtrak has not recorded any receivables for recoveries from other parties or from insurance recoveries; the amounts included in “Environmental Reserve” in the Consolidated Balance Sheets reflect only Amtrak’s estimate of its portion of the gross liability. In those instances where Amtrak has received a buyout of third party liabilities, the amounts are recorded as credits against capital expenses, and therefore are not viewed as receivables. The ultimate liability for environmental remediation is difficult to determine with certainty due to, among other factors, the number of potentially responsible parties, site-specific cost sharing arrangements, the degree and types of contamination, potentially unidentified contamination, developing remediation technology, and evolving statutory and regulatory standards related to environmental matters.

Amtrak’s management and counsel believe that additional future remedial actions for known environmental matters will not have a material adverse effect on the Company’s results of operations or financial condition.

### **12. Postretirement Employee Benefits**

Amtrak has a qualified non-contributory defined benefit retirement plan (the Retirement Income Plan) whose assets are held in trust covering non-union employees and certain union employees who at one time held non-union positions.

Amtrak provides medical benefits to its qualifying retirees and life insurance to some retirees in limited circumstances under its postretirement benefits program. Railroad union employees’ life insurance benefits are covered by a separate policy purchased by Amtrak. Under Amtrak’s postretirement benefits program, substantially all salaried employees hired prior to April 1, 2013 (as described below) may become eligible for medical benefits if they meet the service requirement and reach age 55 while they are working for Amtrak. Company-provided medical benefits are reduced when covered individuals become eligible for Medicare benefits or reach age 65, whichever comes first. Medical benefits are subject to co-payment provisions and other limitations.

On March 27, 2013 the Retirement Income Plan and non-union postretirement benefit plan were amended to provide that no employee hired, rehired or who transfers from a collectively-bargained position on or after April 1, 2013 will be eligible to participate in these plans. However, if a non-union employee terminates employment or transfers to a collective bargaining position and returns within 90 days of the termination or transfer, he or she would be eligible to re-enter the plans.

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 12. Postretirement Employee Benefits (continued)

On March 18, 2015, Amtrak's Board of Directors approved an amendment to freeze benefits under the Retirement Income Plan, effective June 30, 2015. This change will result in no additional benefits being earned by participants based on service or pay after June 30, 2015. These plan changes resulted in a curtailment and required a remeasurement as of March 31, 2015. The curtailment and the remeasurement resulted in a net decrease in the projected benefit obligation as of the remeasurement date of \$64.6 million which was offset against existing unrecognized losses.

Also on March 18, 2015, Amtrak's Board of Directors approved an amendment to modify its postretirement medical benefits program for non-union employees. Effective June 30, 2015:

- Excluding certain Grandfathered Retirees and Retired Executives, retirees age 65 and older will have to obtain medical coverage through a third party medical exchange. Amtrak will fund a tax-advantaged health reimbursement account to assist retirees with medical expenses.
- Eligibility requirements for future retirees will be changed to age 55 with ten years of service, or age 60 with five years of service for employees who are age 50 or over as of June 30, 2015.
- Employees less than age 50 on June 30, 2015 will no longer be eligible for subsidized benefits under the Plan.

These postretirement medical benefit program changes required a remeasurement as of March 31, 2015. The remeasurement resulted in a net decrease in the projected benefit obligation as of the remeasurement date of \$402.8 million. The decrease in the projected benefit obligation will be reflected as a prior service credit and will be amortized over approximately four years beginning April 1, 2015.

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 12. Postretirement Employee Benefits (continued)

##### Obligations and Funded Status

The liability of the Company's pension benefits under its Retirement Income Plan, as well as other postretirement benefits plans, as of September 30, 2014 and 2013 was as follows (in thousands):

	Pension Benefits		Other Benefits	
	2014	2013	2014	2013
Reconciliation of projected benefit obligation:				
Obligation at October 1	\$ 422,099	\$ 457,170	\$ 1,120,535	\$ 1,356,892
Service cost	14,713	17,292	30,701	40,852
Interest cost	21,396	19,551	56,679	57,987
Change in discount rate	35,606	(47,946)	92,402	(131,041)
Actuarial loss (gain)	40,823	(8,147)	(36,609)	25,035
Change in plan provisions	-	-	-	(188,038)
Benefit payments	(17,152)	(15,821)	(49,252)	(41,152)
Obligation at September 30	\$ 517,485	\$ 422,099	\$ 1,214,456	\$ 1,120,535
Reconciliation of fair value of plan assets:				
Plan assets at October 1	\$ 393,608	\$ 345,864	\$ -	\$ -
Actual gain on plan assets	29,119	40,155	-	-
Employer contributions	14,000	25,000	49,252	41,152
Participant contributions	-	-	1,794	1,710
Medicare Part D subsidy	-	-	981	935
Benefit payments, net	(18,605)	(17,411)	(52,027)	(43,797)
Plan assets at September 30	\$ 418,122	\$ 393,608	\$ -	\$ -
Funded status:				
Net liability recognized in Consolidated Balance Sheets	\$ (99,363)	\$ (28,491)	\$ (1,214,456)	\$ (1,120,535)
Accumulated Benefit Obligation at September 30	\$ (461,126)	\$ (378,388)	\$ (1,214,456)	\$ (1,120,535)

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 12. Postretirement Employee Benefits (continued)

Pension and other postretirement benefit amounts recognized in the Consolidated Balance Sheets at September 30, 2014 and 2013 are as follows (in thousands):

	Pension Benefits		Other Benefits	
	2014	2013	2014	2013
Current liabilities	\$ 20,439	\$ 18,335	\$ 60,709	\$ 53,381
Non-current liabilities	78,924	10,156	1,153,747	1,067,154
Net amount recognized	<u>\$ 99,363</u>	<u>\$ 28,491</u>	<u>\$ 1,214,456</u>	<u>\$ 1,120,535</u>

Pension and other postretirement benefit amounts recognized in accumulated other comprehensive loss at September 30, 2014 and 2013 are as follows (in thousands):

	Pension Benefits		Other Benefits	
	2014	2013	2014	2013
Net loss	\$ 150,116	\$ 76,202	\$ 478,196	\$ 456,780
Prior service cost	–	–	(139,463)	(161,216)
Net amount recognized	<u>\$ 150,116</u>	<u>\$ 76,202</u>	<u>\$ 338,733</u>	<u>\$ 295,564</u>

#### Components of Net Periodic Benefit Cost

The following table provides the components of net periodic benefit cost for the plans for FY2014 and FY2013 (in thousands):

	Pension Benefits		Other Benefits	
	2014	2013	2014	2013
Service cost	\$ 15,163	\$ 17,692	\$ 30,701	\$ 40,852
Interest cost	21,396	19,551	56,679	57,987
Expected return on plan assets	(29,337)	(26,048)	–	–
Amortization of prior service cost	–	–	(21,754)	3,971
Amortization of net loss	3,735	11,930	34,378	46,723
Net periodic benefit cost	<u>\$ 10,957</u>	<u>\$ 23,125</u>	<u>\$ 100,004</u>	<u>\$ 149,533</u>

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 12. Postretirement Employee Benefits (continued)

Prior to consideration of the impact of the changes to the Retirement Income Plan which occurred subsequent to September 30, 2014 as described above, the estimated net loss for the Retirement Income Plan that would have been amortized from accumulated other comprehensive loss into net periodic benefit cost over the next year was \$10.9 million.

Prior to consideration of the impact of the change in other postretirement plans which occurred subsequent to September 30, 2014 as described above, the estimated net loss and prior service cost for the other defined benefit postretirement plans that would have been amortized from accumulated other comprehensive loss into net periodic benefit cost over the next year were \$34.8 million and a credit of \$21.1 million, respectively.

#### Plan Assets

The Company's pension plan asset allocation at September 30, 2014 and 2013, and target allocation for 2015, are as follows:

	Plan Assets		
	2015	2014	2013
Domestic equity securities	18–38%	<b>30.9%</b>	29.8%
Global asset allocation funds	20–40	<b>28.0</b>	28.4
Fixed income securities	13–23	<b>16.5</b>	16.1
Common/collective trust	6–34	<b>18.1</b>	18.6
Real estate investment trust	0–10	<b>5.3</b>	5.0
Money market funds	0–5	<b>1.2</b>	2.1

The investment strategy for Retirement Income Plan assets is to invest the assets in a manner whereby long-term return on the assets provide adequate funding for retiree pension payments. The investment objectives of the pension fund are to: (1) promote the growth in the plan's funded status, to the extent appropriate, minimizing reliance on employer contributions as a source of benefit security, (2) invest the assets of the plan to achieve the greatest reward consistent with a reasonable and prudent level of risk, and (3) achieve, as a minimum over time, the passively managed asset return earned by market index funds, weighted in the proportions outlined by the asset class exposures identified in the plan's strategic allocation.

# National Railroad Passenger Corporation and Subsidiaries (Amtrak)

## Notes to Consolidated Financial Statements (continued)

### 12. Postretirement Employee Benefits (continued)

Assets are strategically allocated among equity, fixed income, real estate and global asset allocation managers who have the ability to invest in stocks, bonds, and other assets in the U.S. and abroad in order to achieve diversification of investments and to reduce volatility in investment returns as well as maintain flexibility for the managers to allocate assets to areas of the market they believe have greater upside potential while avoiding areas of the market that they believe are likely to underperform. The asset allocation is evaluated and rebalanced to return each of the asset classes back to the target range percentage within six to eight weeks following the end of each quarter, unless the Retirement Investment Committee determines otherwise. As a result of the asset allocation diversification strategies, there are no significant concentrations of risk within the portfolio of investments.

The accounting guidance on fair value measurements specifies a fair value hierarchy based on the ability to observe inputs used in valuation techniques (Level 1, 2 and 3 – see Note 8). The following is a description of the valuation methodologies used for the investments measured at fair value, including the general classification of such instruments pursuant to the valuation hierarchy. Further, upon adoption of the provisions of the ASU No. 2009-12, *Investments in Certain Entities That Calculate Net Asset Value per Share (or Its Equivalent)*, the Company expanded disclosures for those assets whose fair value is estimated using the net asset value (NAV) per share or its equivalent for which fair value is not readily determinable. The Company does not intend to sell any of the funds at an amount different from NAV per share at September 30, 2014, nor does the Company have any unfunded commitments related to these funds.

#### *Domestic Equity Securities*

This investment category consists of common stock issued by U.S. corporations and American Depository Receipts (ADRs) issued by U.S. banks. Common stock and ADRs are traded actively on exchanges and price quotes for these shares are readily available. These assets are classified as Level 1 investments.

#### *Fixed Income Securities*

This investment category consists of U.S. Treasuries, U.S. Government bonds, corporate bonds, agency-backed bonds, municipal bonds, asset-back securities and mortgage-backed securities. These assets are valued based on a compilation of primary observable market information or a broker quote in a non-active market. These assets are classified as Level 2 investments.

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 12. Postretirement Employee Benefits (continued)

##### *Money Market Funds*

Money market funds generally transact subscription and redemption activity at a \$1.00 stable NAV. However, on a daily basis the fund's NAV is calculated using the amortized cost (not market value) of the securities held in the fund. It is generally accepted as industry best practice that securities valued at amortized cost are Level 2 assets; amortized cost does not meet the criteria for an "active market." This factor was the primary determinant used by management to assign a fair value hierarchy of Level 2 to money market funds. Amtrak's category of investments in money market funds is comprised of JPMorgan 100% U.S. Treasury Securities Money Market Fund. Management obtained and reviewed JP Morgan's Money Market Funds Annual Report and reviewed the investment valuation for JPMorgan 100% U.S. Treasury Securities Money Market Fund in the significant accounting policies section of the report, which states that, "Each Fund has elected to use the amortized cost method of valuation pursuant to Rule 2a-7 under the 1940 Act provided that certain conditions are met, including that the Fund's Board of Trustees continues to believe that the amortized cost valuation method fairly reflects the market based NAV per share of the Fund." Investments in money market funds are classified as Level 2 assets as of September 30, 2014 and 2013.

##### *Real Estate Investment Trust*

This category consists of an investment in the Morgan Stanley Prime Property fund. The fair value of the investments in the Prime Property Fund has been estimated using the NAV of the Plan's ownership interest (units) in the partner's capital. The investment in the Prime Property Fund can be redeemed on a quarterly basis but with no guarantee that cash will be available at any particular time to fund the redemption request. If the cash is not available, the redemption will be deferred at the discretion of the fund manager until sufficient cash is available. As of September 30, 2014 and 2013, there were no unsatisfied redemption requests. Investments in real estate investment funds are classified as Level 2 assets as of September 30, 2014 and 2013.

##### *Global Assets Allocation Funds*

This category consists of BlackRock Global Allocation Class I fund (BlackRock), PIMCO All Asset Institutional fund (PIMCO), and Stone Harbor Local Markets fund (Stone Harbor). The BlackRock investment (fair value of \$51.1 million and \$47.3 million at September 30, 2014 and 2013, respectively) seeks to provide high total investment return. It invests in domestic and foreign equities, debt securities, and money market instruments. The PIMCO investment (fair

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 12. Postretirement Employee Benefits (continued)

value of \$49.2 million and \$46.8 million at September 30, 2014 and 2013, respectively) seeks maximum real return, consistent with preservation of real capital and prudent investment management. It targets solid real (after inflation) returns from a global opportunity of traditional and alternative asset classes. The Stone Harbor investment (fair value of \$16.8 million and \$17.6 million at September 30, 2014 and 2013, respectively) seeks to maximize total return, which consists of income on its investments and capital appreciation. Stone Harbor normally invests at least 80% of its net assets in Emerging Markets Investments. "Emerging Markets Investments" include fixed income securities and derivative instruments that are economically tied to an emerging market country and are denominated in the predominant currency of the local market of an emerging country, or whose performance is linked to those countries' currencies, markets, economies or ability to repay loans. These investments are actively traded; price quotes for these shares are readily available; and these assets are classified as Level 1 investments.

#### *Common/Collective Trust*

This category consists of an investment in the Thornburg International Equity Fund (the Thornburg Fund), Eaton Vance Parametric Fund (the Eaton Vance Fund), and Loomis Sayles Multi Sector Credit (the Loomis Sayles Fund). The Thornburg Fund (fair value of \$44.0 million at each of September 30, 2014 and 2013) is a trust for the collective investment of assets of participating tax qualified pension and profit-sharing plans and related trusts and governmental plans. The Thornburg Fund seeks long-term capital appreciation by investing in equity securities of all types. As a secondary consideration, the Thornburg Fund also seeks current income. The units are not traded on a recognized stock exchange and the value of the Thornburg Fund units is determined daily by calculating the NAV. The investments in the Thornburg Fund are redeemable any day the Thornburg Fund is open for business. The Loomis Sayles Fund (fair value of \$20.0 million and \$18.2 million at September 30, 2014 and 2013, respectively) seeks to generate solid long-term risk-adjusted investment performance with significant allocations to non-U.S. dollar and emerging markets debt securities. Securities rated below BBB- are limited to 50% of the portfolio. The units are not traded on a recognized stock exchange and the value of the Loomis units is determined daily by calculating NAV. The investments in the Loomis Sayles Fund are redeemable any day the Loomis Sayles Fund is open for business. The Eaton Vance Fund (fair value of \$11.9 million and \$11.1 million at September 30, 2014 and 2013, respectively) seeks long-term capital appreciation and normally invests at least 80% of its net assets in equity securities of companies located in emerging market countries. It intends to invest primarily in securities of companies located in countries included in the MSCI Emerging Markets Index or the MSCI Frontier Markets Index. The units are not traded on a recognized



## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 12. Postretirement Employee Benefits (continued)

stock exchange and the value of the Eaton units is determined daily by calculating NAV. The investments in the Eaton Vance Fund are redeemable any day the Eaton Vance Fund is open for business.

The following table represents the fair values of the Company's pension assets by level within the fair value hierarchy at September 30, 2014 and 2013 (in thousands):

	Total	Level 1	Level 2	Level 3
<b>September 30, 2014</b>				
Agency backed bonds	\$ 581	\$ –	\$ 581	\$ –
U.S. government securities	5,418	–	5,418	–
Corporate bonds	17,599	–	17,599	–
Government bonds	277	–	277	–
Municipal bonds	4,400	–	4,400	–
Asset-backed securities	9,738	–	9,738	–
Mortgage-backed securities government	23,046	–	23,046	–
Mortgage-backed securities corporate	7,703	–	7,703	–
Total fixed income	<u>68,762</u>	–	<u>68,762</u>	–
Large cap	106,901	106,901	–	–
Mid cap	20,527	20,527	–	–
Small cap	1,397	1,397	–	–
Total equity securities	<u>128,825</u>	<u>128,825</u>	–	–
Money market funds	5,474	–	5,474	–
Real estate investment trust	22,031	–	22,031	–
Global asset allocation funds	117,122	117,122	–	–
Common/collective trust	75,792	–	75,792	–
Total fair value investments	418,006	\$ 245,947	\$ 172,059	\$ –
Other assets*	116			
Total plan assets	<u>\$ 418,122</u>			

\*Other assets include accrued interest and dividends receivable and pending broker settlements.

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 12. Postretirement Employee Benefits (continued)

	Total	Level 1	Level 2	Level 3
<b>September 30, 2013</b>				
Agency backed bonds	\$ 449	\$ —	\$ 449	\$ —
U.S. government securities	5,158	—	5,158	—
Corporate bonds	17,671	—	17,671	—
Government bonds	333	—	333	—
Municipal bonds	5,350	—	5,350	—
Asset-backed securities	4,847	—	4,847	—
Mortgage-backed securities				
government	24,730	—	24,730	—
Mortgage-backed securities corporate	4,910	—	4,910	—
Total fixed income	63,448	—	63,448	—
Large cap	93,197	93,197	—	—
Mid cap	24,051	24,051	—	—
Total equity securities	117,248	117,248	—	—
Money market funds	8,257	—	8,257	—
Real estate investment trust	19,460	—	19,460	—
Global asset allocation funds	111,699	111,699	—	—
Common/collective trust	73,191	—	73,191	—
Total fair value investments	393,303	\$ 228,947	\$ 164,356	\$ —
Other assets*	305			
Total plan assets	\$ 393,608			

\*Other assets include accrued interest and dividends receivable and pending broker settlements.

#### Rate of Return

Several factors are considered in developing the estimate for the long-term expected rate of return on plan assets. These include historical rates of return over the past three-, five- and ten-year periods as well as projected long-term rates of return obtained from pension investment consultants.

In the short term, there may be fluctuations of positive and negative yields year over year, but over the long term, the return is expected to be approximately 7.5%.

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 12. Postretirement Employee Benefits (continued)

##### Estimated Future Benefit Payments

Prior to consideration of the impact of the changes which occurred subsequent to September 30, 2014 as described above and based upon the assumptions used to measure the pension and other postretirement benefit obligations as of September 30, 2014, including pension and other postretirement benefits attributable to estimated future employee service, Amtrak expects that pension benefits and other postretirement benefits to be paid over the next ten years would have been as follows (in thousands):

	<b>Pension Benefits</b>	<b>Other Benefits</b>
Year ending September 30:		
2015	\$ 20,439	\$ 60,558
2016	22,418	64,638
2017	22,147	66,980
2018	26,022	72,785
2019	27,767	73,675
2020-2024	161,391	357,327

##### Contributions

In FY2015, Amtrak contributed \$14.0 million to the defined benefit plan and \$49.3 million towards other postretirement benefits.

##### Assumptions

Weighted-average assumptions used to determine benefit obligations at September 30, 2014 and 2013 are as follows:

	<b>Pension Benefits</b>		<b>Other Benefits</b>	
	<b>2014</b>	<b>2013</b>	<b>2014</b>	<b>2013</b>
Discount rate	<b>4.57%</b>	5.18%	<b>4.57%</b>	5.18%
Rate of compensation increase	<b>4.20%</b>	4.20%	<b>N/A</b>	N/A

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 12. Postretirement Employee Benefits (continued)

Weighted-average assumptions used to determine net periodic benefit cost for the years ended September 30, 2014 and 2013 are as follows:

	Pension Benefits		Other Benefits	
	2014	2013	2014	2013
Discount rate	<b>5.18%</b>	4.35%	<b>5.18%</b>	4.35%
Expected long-term return on assets	<b>7.50%</b>	7.50%	N/A	N/A
Rate of compensation increase	<b>4.20%</b>	4.20%	N/A	N/A

Assumed health care cost trend rates are as follows:

	September 30,	
	2014	2013
Healthcare cost trend rate assumed for next year	<b>7.50%–8.50%</b>	7.75%–8.75%
Rate to which the cost trend rate is assumed to decline (the ultimate trend rate)	<b>5.00%</b>	5.00%
Year that the rate reaches the ultimate trend rate	<b>2029</b>	2029

Assumed health care cost trend rates have a significant effect on the amounts reported for the other defined benefit post retirement plans. A one-percentage-point change in assumed healthcare cost trend rates would have the following effects on the Other Benefits plans (in thousands):

	1%	
	Increase	Decrease
Effect on total of service and interest cost component	\$ 19,881	\$ (14,530)
Effect on postretirement benefit obligation	241,895	(161,452)

## National Railroad Passenger Corporation and Subsidiaries (Amtrak)

### Notes to Consolidated Financial Statements (continued)

#### 12. Postretirement Employee Benefits (continued)

##### Prescription Drug Benefits

On December 8, 2003, the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (the Medicare Act) was signed into law. The Medicare Act introduced a prescription drug benefit under Medicare (Medicare Part D) as well as a federal subsidy to sponsors of retiree health care benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. Amtrak elected to record an estimate of the effects of the Medicare Act in accounting for its postretirement benefit plans and provide disclosures required by ASC Topic 715, *Compensation – Retirement Benefits*. Amtrak's accumulated pension benefit obligation for its other benefits is reduced by \$112.7 million and \$57.6 million for FY2014 and FY2013, respectively, for this prescription drug benefit.

##### 401(k) Savings Plan

Amtrak provides a 401(k) savings plan for non-union employees. Under the plan, Amtrak matches a portion of employee contributions up to five percent of the participant's salary, subject to applicable limitations. Amtrak's expenses under this plan were \$11.4 million and \$10.9 million for FY2014 and FY2013, respectively. Subsequent to September 30, 2014, the maximum employer contribution was increased from five percent to seven percent, effective July 1, 2015.

Additionally, Amtrak provides a 401(k) saving plan for union employees. Amtrak does not match any portion of the employee contributions under this plan.

#### 13. Subsequent Events

##### Train Derailment

On May 12, 2015, Amtrak Train 188, traveling from Washington, D.C., northbound for New York's Penn Station, derailed north of 30<sup>th</sup> Street Station while traveling through a curve. There were 250 passengers and eight Amtrak employees on board. Eight passengers were killed and over 200 were injured.

## **National Railroad Passenger Corporation and Subsidiaries (Amtrak)**

### **Notes to Consolidated Financial Statements (continued)**

#### **13. Subsequent Events (continued)**

The curve's track speed was 50 mph. The National Transportation Safety Board's (NTSB's) preliminary analysis determined that the train was traveling 106 mph when the engineer applied the train's emergency brakes moments before the derailment. The NTSB has found no evidence of mechanical, track, or signal system issues. The NTSB's investigation is ongoing, and Amtrak anticipates its final report in approximately one year from the date of the derailment.

As of October 1, 2015, there are 65 lawsuits pending: three filed by employees and 62 filed by passengers (including the estates of eight deceased passengers), with a total of 75 passengers named as plaintiffs in those 62 passenger lawsuits. Amtrak continues to move passenger cases filed in state courts to federal courts and seeks to transfer those filed outside of Pennsylvania to the United States District Court for the Eastern District of Pennsylvania sitting in Philadelphia. Several plaintiffs have joined in filing a motion for transfer to federal court in Philadelphia for coordinated or consolidated proceedings, and to transfer all subsequently filed actions arising out of the derailment to that court for inclusion in a Multi-District Litigation proceeding. The Company's current estimate of liability for passenger claims is \$163.9 million. The on-duty employee claims and lawsuits are governed by the Federal Employers Liability Act which sets the negligence threshold, allows for compensatory damages but no punitive damages and has no limit on recoveries from a single incident. The Company's current estimate of liability for on-duty employee claims is \$9.3 million. Total passenger and/or on-duty employee claim liabilities in excess of \$20.0 million are expected to be covered by insurance. Amtrak is not contesting liability for compensatory damages in these cases.

In addition, Amtrak suffered property damage in the incident. Amtrak is still assessing the extent of the damages but the financial impact of the damages will be capped at Amtrak's \$10.0 million property insurance deductible. Any amounts in excess of \$10.0 million are expected to be covered by insurance.

#### **Insurance Ruling**

On June 24, 2015, a judge for the United States District Court, Southern District of New York issued a ruling that limited the recoverable losses related to Sandy that Amtrak could seek in a suit involving its insurance providers (see Note 10).

#### **KCT PTC Settlement**

On August 7, 2015, Amtrak and KCT settled a dispute related to payment for costs incurred by KCT in connection with KCT's implementation of PTC on KCT's lines (see Note 10).

## **National Railroad Passenger Corporation and Subsidiaries (Amtrak)**

### **Notes to Consolidated Financial Statements (continued)**

#### **13. Subsequent Events (continued)**

##### **Modification to Retirement Programs**

On March 18, 2015, Amtrak's Board of Directors approved changes to certain of Amtrak's retirement programs (see Note 12).

##### **Management's Evaluation**

The Company has evaluated subsequent events through October 1, 2015, which is the date the financial statements were available to be issued. There were no other events that require adjustments to or disclosure in the Company's financial statements for FY2014.



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## Report of Independent Auditors on Internal Control Over Financial Reporting and on Compliance and Other Matters Based on an Audit of Financial Statements Performed in Accordance with *Government Auditing Standards*

The Board of Directors and Stockholders  
National Railroad Passenger Corporation

We have audited, in accordance with auditing standards generally accepted in the United States and the standards applicable to financial audits contained in *Government Auditing Standards* issued by the Comptroller General of the United States, the financial statements of National Railroad Passenger Corporation and subsidiaries (Amtrak or the Company), which comprise the consolidated balance sheet as of September 30, 2014, and the related consolidated statements of operations, comprehensive loss, changes in capitalization, and cash flows for the year then ended, and the related notes to the financial statements, and have issued our report thereon dated October 1, 2015.

### **Federal Government Funding**

As explained in Notes 1 and 2 in the accompanying consolidated financial statements, the Company has a history of operating losses and is dependent upon substantial Federal Government subsidies to sustain its operations and maintain its underlying infrastructure. As further explained in Note 2 to the consolidated financial statements, the Company is receiving Federal Government funding under the Consolidated and Further Continuing Appropriations Act, 2015. The Company expects to receive interim Federal Government funding under Congressional continuing resolutions for fiscal year 2016 until the formal appropriations bill is signed into law. There are currently no Federal Government subsidies appropriated by law for any period subsequent to December 11, 2015. Without the receipt of Federal Government funding, the Company will not be able to continue in its current form and significant operating changes, restructurings, or bankruptcy might occur. Our opinion is not modified with respect to this matter.

### **Internal Control Over Financial Reporting**

In planning and performing our audit of the financial statements, we considered Amtrak's internal control over financial reporting (internal control) to determine the audit procedures that are appropriate in the circumstances for the purpose of expressing our opinion on the financial statements, but not for the purpose of expressing an opinion on the effectiveness of Amtrak's internal control. Accordingly, we do not express an opinion on the effectiveness of Amtrak's internal control.



Our consideration of internal control was for the limited purpose described in the preceding paragraph and was not designed to identify all deficiencies in internal control that might be material weaknesses or significant deficiencies and therefore, material weaknesses or significant deficiencies may exist that were not identified. However, as described in Appendix A, we identified certain deficiencies in internal control that we consider to be material weaknesses.

A *deficiency in internal control* exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent, or detect and correct misstatements on a timely basis. A *material weakness* is a deficiency, or combination of deficiencies, in internal control such that there is a reasonable possibility that a material misstatement of the entity's financial statements will not be prevented, or detected and corrected on a timely basis. We consider the deficiencies identified below and described in greater detail in Appendix A to be material weaknesses:

1. Capital lease accounting, documentation and analysis
2. Income tax accounting
3. Financial reporting
4. Information Systems

A *significant deficiency* is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. We considered the two components of the Information Systems material weakness to individually be significant deficiencies.

## **Compliance and Other Matters**

As part of obtaining reasonable assurance about whether Amtrak's financial statements are free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grant agreements, noncompliance with which could have a direct and material effect on the determination of financial statement amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit, and accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance or other matters that are required to be reported under *Government Auditing Standards*.

## **Amtrak's Response to Findings**

Amtrak's responses to the findings identified in our audit are described in Appendix A. Amtrak's responses were not subjected to the auditing procedures applied in the audit of the financial statements and, accordingly, we express no opinion on them. The status of prior year instances of deficiencies is presented in Appendix B.

### **Purpose of This Report**

The purpose of this report is solely to describe the scope of our testing of internal control and compliance and the result of that testing, and not to provide an opinion on the entity's internal control or on compliance. This report is an integral part of an audit performed in accordance with *Government Auditing Standards* in considering the entity's internal control and compliance. Accordingly, this communication is not suitable for any other purpose.

*Ernst + Young LLP*

October 1, 2015

## Appendix A – Material Weaknesses in Internal Control Over Financial Reporting

The fiscal year 2013 audit was completed on November 25, 2014 after the Company's fiscal year 2014. The Company could not have remediated the material weaknesses identified below for the fiscal year end 2014, and therefore, the material weaknesses identified in our 2013 reports still apply. As described in the management responses below, certain steps have been taken in fiscal year 2015 to remediate the material weaknesses, however, we have not yet tested the remediation nor have the corrective action plans been subjected to audit. The first three material weaknesses below are carried forward from the prior year except for the management responses, which are updated for the status of the corrective action plans.

### **Capital Lease Accounting, Documentation and Analysis**

As part of our fiscal year 2013 audit, a material weakness was identified related to the capital lease documentation and monthly review procedures performed by the Company. We found that there was no documentation of the analyses performed to evidence proper lease classification and calculation of amortization schedules that agreed to the lease agreement in accordance with Accounting Standards Codification (ASC) 840, *Leases*. In addition, the assumptions for each capital lease were not documented or agreed to the most current contracts and lease supplements. As a result, the Company relied on amortization schedules that were not compliant with U.S. generally accepted accounting principles. Although management planned to review each lease agreement from its inception date to determine and document the appropriate capital lease classification and accounting, this material weakness was not remediated by September 30, 2014.

The majority of these lease agreements were entered into between the mid-1990s and early 2000s. Management and its third party consultants prepared extensive analyses and documentation for all of the Company's lease transactions to conclude on the proper lease classification and accounting and identify and record the required adjustments to the financial statements. As part of this review process, management identified numerous errors related to the Company's capital lease accounting. Certain errors identified dated back to the lease commencement date and involved the original lease classification and accounting conclusions. Although management's review process extended more than a year past the remediation date, management ultimately recorded the required corrections to the revised financial statements.

#### *Recommendation:*

We recommend that Amtrak implement a process to develop, document, validate and review the critical accounting conclusions for all new lease arrangements or other significant transactions, including the timeliness, accuracy, and completeness of the documentation. The Company should implement the controls that will serve to prevent, detect and resolve accounting errors timely. The Company requires a robust analysis and review process, including close coordination and meaningful collaboration with other departments, such as Treasury and Law, to understand the structure of these lease arrangements.

## Appendix A – Material Weaknesses in Internal Control Over Financial Reporting (continued)

### *Management's Response:*

#### Fiscal Year 2013 Response

We agree with the recommendation and will implement a process to develop, document, validate and review the critical accounting conclusions for all new lease arrangements and other significant transactions. In addition, we will design and implement controls that will serve to prevent, detect and resolve accounting errors timely. Finally, we will do a complete evaluation of our Accounting staff to evaluate whether we have employees with the necessary expertise to maintain complete and accurate books and records. If we do not, we will add employees as necessary.

As noted above, in addressing the significant deficiency identified as part of the 2012 audit, we reviewed all existing leases and developed documentation supporting the correct lease classification and accounting conclusions, which have been reflected in our results as of and for the year ended September 30, 2013. As part of this, we developed, with the assistance of our third party consultants, amortization schedules reflecting the proper accounting treatment for the duration of each lease. Although this process took an extended period of time, it is now complete and provides the information we need to correctly account for all existing leases. Through this process, we have developed in-house knowledge that we lacked previously of the accounting requirements. As and when we execute any significant future financing transactions for new or existing assets, we will prepare formal documentation describing our assessment of the transactions and our conclusions regarding the appropriate accounting for these transactions. For those transactions that represent new capital leases, our documentation will indicate how we will account for events that may occur during the life of the lease (e.g., exercise of early buy-out options, casualty losses, significant repairs, overhauls, sale/retirement) and we will develop amortization schedules which detail how and when we will recognize expenses over the life of the lease. During the life of our current and future capital leases, we will monitor asset activity for events/transactions affecting our leases, and verify that the accounting proposed/planned in our initial documentation is still appropriate under U.S. generally accepted accounting principles (GAAP), and appropriately accounts for the event. If there is a departure from the accounting we noted in our initial documentation, we will prepare updated documentation to explain the basis for the departure. For complex transactions, we will have our conclusions reviewed by our third party consultants, as appropriate.

#### Fiscal Year 2014 Update

Due to the timing of completion of the 2013 audit, we were unable to fully implement our corrective action plan until fiscal year 2015. We did execute a significant financing transaction during fiscal year 2014 and in fiscal year 2015 we prepared formal documentation as described above. We had our documentation and conclusion reviewed by our third party consultant and we prepared the necessary amortization schedules to support our accounting treatment.

## Appendix A – Material Weaknesses in Internal Control Over Financial Reporting (continued)

### **Income Tax Accounting**

A material weakness was identified related to the deferred tax calculation in the fiscal year 2013 audit as all assets acquired since 1998 with capital grant funds had zero tax basis and Amtrak had not provided deferred taxes related to the book and tax basis differentials for these assets in accordance with (ASC) 740, *Income Taxes*. This resulted in an understatement of deferred tax liability and an overstatement of valuation allowance. Although the Company recorded the deferred tax liability related to the book and tax basis differentials for the assets discussed above in the financial statements, the Company did not appropriately assess and document its consideration of all aspects of ASC 740. Specifically, management did not perform a timely tax planning strategy analysis to document that its strategy was prudent and feasible nor were the gross income tax balances recorded in the general ledger. This material weakness was not remediated by September 30, 2014.

We also identified numerous errors in the calculation of the income tax provision, the deferred tax liability and deferred tax asset and the related valuation allowance, including the current and long-term presentation of such amounts in the financial statements. The Company did not appropriately document the key assumptions used in its analyses, its consideration in assessing the realizability of the deferred tax assets or its estimation of the execution costs associated with the tax planning strategy. Although management recorded and disclosed the appropriate income tax amounts in the financial statements, the required analyses were not accurate, complete or reviewed in a timely manner.

#### *Recommendation:*

We recommend that Amtrak reassess its income tax process to incorporate controls that will prevent, detect and resolve accounting errors timely as well as implement processes to validate its accounting conclusions, including the accuracy and completeness of its analyses. We also recommend that the Company establish thorough review and monitoring procedures.

Management should maintain detailed book and tax balance sheet analyses and establish procedures to rigorously track these differentials to identify and calculate the respective deferred taxes. Management should continue to execute detailed quarterly reviews of the analyses.

Finally, management should appropriately assess and document its consideration of all aspects of ASC 740.

## Appendix A – Material Weaknesses in Internal Control Over Financial Reporting (continued)

### *Management's Response:*

#### Fiscal Year 2013 Response

We agree with these recommendations. During the course of correcting our deferred tax accounting as of September 30, 2013, we have developed schedules to support our calculations which will facilitate our future analysis. We are committed to doing a complete tax analysis on a quarterly basis to ensure that our tax accounting is correct. This analysis will include appropriate review by an individual who did not prepare the calculations. We will ensure that the individual preparing the calculations has the necessary expertise and ability to prepare them accurately. In addition, we will cross-train other individuals within Accounting to facilitate review of the calculations by a different person. During our fiscal year ended September 30, 2014 (FY 2014), we hired a new Controller who has implemented a quarterly balance sheet review process, which will include quarterly reviews of all tax accounts to ensure accuracy. The new Controller has a strong corporate tax background and is able to provide the oversight required to ensure that Amtrak's tax calculations are prepared accurately and timely.

#### Fiscal Year 2014 Update

Due to the timing of completion of the 2013 audit, we were unable to begin implementing our corrective action plan until fiscal year 2015. During fiscal year 2015, we hired a new Senior Tax Director with the necessary expertise and ability to prepare the complex deferred tax accounting analysis accurately.

### **Financial Reporting**

We identified the following factors that negatively impacted the quality and timeliness of the Company's financial reporting process in our 2013 audit. The significant delay in issuing that audit precluded management's ability to remediate the material weakness by September 30, 2014.

- **Complement of personnel** – lacked a sufficient complement of personnel with an appropriate level of accounting knowledge, experience, and training to support the size and complexity of the Company's organizational structure and financial reporting requirements and did not exercise appropriate oversight of certain accounting, financial reporting and internal control matters.
- **Transaction documentation and written accounting policies** – there was insufficient analysis and documentation of the application of GAAP to the capital lease transactions and accounting for income taxes. In addition, there was a lack of written procedures for identifying and appropriately applying applicable GAAP to the various categories of items that were corrected.

## Appendix A – Material Weaknesses in Internal Control Over Financial Reporting (continued)

- **Communication and information flow** – there was a lack of adequate policies and procedures to ensure that accounting personnel were made aware of the specific features in significant lease and other complex transactions.
- **Process and transaction level controls** – there was a lack of clear organization and accountability within the accounting function including insufficient review and supervision, combined with multiple financial reporting systems that were not integrated, which required manual interventions to record the required adjustments.

### *Recommendation:*

We recommend that Amtrak assess the factors identified to establish accounting policies and procedures that should be implemented to produce complete, accurate and timely financial statements. Management should challenge its current accounting and other policies, complement of personnel and communication and collaboration among departments to validate that transactions are appropriately and timely recorded in the financial statements. The Company should invest in the required financial reporting systems to ensure all restatement adjustments are recorded and system generated reports are complete and accurately produced to enable timely financial reporting. The Company uses a number of Excel-based schedules, which are heavily dependent on data input and coding of formulas, and the Company should develop, maintain and document the controls over these schedules, including the appropriate access and change controls, segregation of duties and review process.

### *Management's Response:*

#### Fiscal Year 2013 Response

We agree with these recommendations and feel we have made significant progress in this area. During FY 2014, as noted above, we hired a new Controller who was previously the Controller and Chief Accounting Officer of an SEC registrant. She brings to Amtrak the expertise necessary to manage our complex accounting requirements. As noted above, she has begun a quarterly review of all balance sheet account reconciliations. In addition, during FY 2014, we hired a Director of Financial Reporting, who reports directly to the Controller. Working together, they will review all of our policies and procedures, and update as necessary. Our plan is to complete this review by the end of 2015. As part of this review, we will ensure that we have the controls in place to ensure proper segregation of duties and review and documentation of accounting conclusions. We have also established relationships with two different third party advisors who have significant expertise in analyzing complex transactions, and who are available to us for consultation on an as-needed basis. As we are reviewing and updating our policies and procedures, for those involving particularly complex accounting rules, we may bring in one of our outside advisors to assist us.

## Appendix A – Material Weaknesses in Internal Control Over Financial Reporting (continued)

Additionally, we agree that the use of Excel-based schedules requires significant controls. We are developing these controls and will implement them during our fiscal year ending September 30, 2015. These controls will include standardized review and approvals; centralization of electronic storage; and others necessary to reduce risk of reliance on Excel-based schedules. In addition, we will review the capabilities within our accounting system, SAP, to determine if we can utilize additional functionality. We may bring in an outside advisor to assist with our systems analysis.

We are committed to maintaining high standards of management controls companywide, including controls over our operations, compliance and financial reporting. Amtrak is not subject to regulations requiring us to complete an assessment of the effectiveness of Amtrak's internal control over financial reporting as of September 30, 2013, and we did not complete such an assessment. In our fiscal year ended September 30, 2014, we completed an assessment of our management controls which confirmed the existence of opportunities to improve the controls identified in this report by our external auditors as material weaknesses. We have initiated efforts to address all such deficiencies.

### Fiscal Year 2014 Update

Due to the timing of completion of the 2013 audit, we were unable to begin implementing our corrective action plan until fiscal year 2015. During fiscal year 2015, we began reviewing and updating all policies, hired several accounting personnel, and strengthened our control environment. We placed heavy emphasis on timely documentation, enhanced communication and retention of evidence of review.

### **Information Systems**

Information management security and configuration controls are fundamental to the integrity of all information systems. Such controls, including properly authorized, designed and implemented controls, and active monitoring of security events for proper assessment and timely remediation, can help manage risks such as unauthorized access and changes to critical data. These controls include logical access restrictions to protect against unauthorized or inappropriate usage of Amtrak's information resources, including programs and data files. In addition, without maintaining an appropriate level of segregation of duties through robust information management security and configuration controls, the integrity of Amtrak's data could be compromised.

As part of our fiscal year 2014 audit, we have identified two significant deficiencies that when aggregated result in a material weakness in the design and operation of information systems controls. The significant deficiencies relate to information technology general controls,



## Appendix A – Material Weaknesses in Internal Control Over Financial Reporting (continued)

specifically user access and change management controls. These significant deficiencies contributed to the delay in issuing the 2014 financial statements.

- **User access** – lacked approval of user access, timely removal of user access, frequency, precision and documentation of user access reviews and timely resolution of discrepancies, segregation of privileged user access and conformity of and periodic and ongoing monitoring of security configurations to the Company’s standards for significant applications, operating systems and databases.
- **Change management** – lacked segregation of duties and monitoring of changes to the production environments and sufficient documentation evidencing approval and testing of program changes implemented in the production environment.

The material weakness impacted both automated controls and IT-dependent manual controls including management review controls and supporting electronic data across all classes of transactions that were significant to financial reporting process.

### *Recommendation:*

Improvements are necessary in the controls over monitoring of compliance with computer security policies, system access, and unauthorized system access and the prevention of and monitoring for inconsistencies in access rights allowing a potential lack of segregation of duties. Appropriate consideration of the design of controls over user access is essential to provide a suitable framework for subsequent implementation and operation of the controls.

An improved governance-based approach should result in strengthened control, monitoring, and oversight processes that will enhance the overall integrity of Amtrak’s information systems. Examples of such oversight processes that should be improved include the following:

- Reviewing and evaluating identified deficiencies and instances of noncompliance with stated Amtrak policies and guidance, including the documentation of conclusions and evaluating their impact on the financial reporting.
- Consistent, current and complete system security and change management documentation prepared by all IT and system owners.
- Follow relevant Amtrak guidance during the review and approval of all program changes. Documentation should be prepared and retained for all phases of the change management process.

## Appendix A – Material Weaknesses in Internal Control Over Financial Reporting (continued)

- Consider the feasibility of configuring applications and supporting infrastructure to meet the required security and authentication parameters as defined in the Company’s policy and procedure and adhering to the hardening standards or, where relevant, perform a risk analysis of non-adherence to defined policy standards and document management-approved exceptions to those standards. Monitoring controls should be implemented to timely identify and rectify areas of non-compliance.
- Follow relevant Amtrak policies related to the approval and removal of user access, assignment of privileged access rights and segregation of incompatible access rights for all significant applications and supporting infrastructure.
- Mandate periodic logical user access reviews and the retention of relevant documentation evidencing the completeness of the review, timely resolution of identified discrepancies and mitigation of risk.

### *Management’s Response:*

We agree with these recommendations and have taken immediate action to strengthen our governance, user access, and change management processes. In fiscal year 2015, the Information Technology (IT) department created a Risk & Compliance function within the IT strategy group. This function is tasked with driving internal control improvements, strategic leadership of IT governance functions, policy and procedure oversight, risk management, and technology accessibility compliance. The IT department is also implementing the Control Objectives for Information and Related Technology (COBIT) framework to improve internal controls and better align IT and business processes.

### User Access

IT has resumed the quarterly review of user access for operating systems and databases supporting financial applications and is working with business application owners to strengthen the application level user access review process. In addition, new Risk & Compliance staff resources have been added to the IT department that are specifically tasked with oversight of the user access review process, refinement of all user access provisioning/de-provisioning processes, and the training of control owners to conduct access reviews in accordance with established procedures. Furthermore, the IT department recently initiated and completed a third party assessment of its Identity and Access Management (IAM) system to assess current capabilities and develop a roadmap to automate the provisioning/de-provisioning of user access for all financial applications, enhance the access certification process, improve management of privileged account access, and enable single sign-on capabilities where feasible. Improvement opportunities identified as part of the third party IAM review will begin in the first quarter of fiscal year 2016. The IT Risk & Compliance team will be reviewing the progress of these projects to ensure enhancements are completed and operating effectively.

## Appendix A – Material Weaknesses in Internal Control Over Financial Reporting (continued)

### Change Management

IT also has been diligently working to strengthen its change management processes and address deficiencies identified during the fiscal year 2014 audit. These improvements began with the creation of the Solution Development and Delivery group within IT in June 2015. This function is now responsible for all development, application support, and change management activities. This consolidation makes IT more nimble, eliminates duplicative processes, and improves consistency.

In August 2015, we also conducted a series of change management workshops with all financial application development teams to discuss audit findings, identify process gaps, educate development teams on change management best practices, and develop action plans to remediate change management findings. Actions we are taking include:

- The acquisition and implementation of new version control and source code management tools to improve identification of all changes and provide robust change management audit trails;
- Implementation of effective segregation of duties principles to ensure development and production environments are properly segregated and secure;
- New processes to ensure testing and post implementation tasks are properly documented in Amtrak's change request management tool; and
- Enhancements to change management policies, procedures, process flows, and narratives to reflect current processes.

We are committed to controls improvement in this area and these enhancements are currently underway. The IT Risk & Compliance team will be reviewing the progress of these projects as well to ensure enhancements are completed and operating effectively.

## Appendix B – Status of Prior Year Deficiencies

<b>Process</b>	<b>Nature of Comment</b>	<b>Type of Comment in Fiscal Year 2013</b>	<b>Current Year Status</b>
Capital lease accounting, documentation and analysis	Lack of process to develop, document, validate and review the critical accounting conclusion for all lease arrangements.	Material Weakness	Not Remediated – Included in the Material Weakness for Capital lease accounting, documentation and analysis
Income tax accounting	Reassess the income tax process to incorporate controls to prevent, detect and resolve accounting errors timely and validate accounting conclusions.	Material Weakness	Not Remediated – Included in the Material Weakness for Income tax accounting
Financial reporting	Establish accounting policies and procedures that should be implemented to produce complete, accurate and timely financial statements.	Material Weakness	Not Remediated – Included in the Material Weakness for financial reporting

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