MANAGEMENT'S DISCUSSION AND ANALYSIS

ABOUT THIS REPORT

The Department of Transportation's (DOT) Performance and Accountability Report (PAR) for Fiscal Year 2007 provides performance and financial information that enables Congress, the President, and the public to assess the performance of the Department relative to its mission and stewardship of the resources entrusted to it. This Report satisfies the reporting requirements of the following major legislation.

◇ Reports Consolidation Act of 2000
◇ Government Management Reform Act of 1994
◇ Government Performance and Results Act of 1993
◇ Chief Financial Officers Act of 1990

These requirements are combined in the PAR, which consists of the Annual Performance Report—required by the Government Performance and Results Act of 1993—with annual financial statements—required under the CFO Act, as amended by the Government Management Reform Act of 1994—and other reports, such as assurances on internal controls, accountability reports by agency heads, and Inspector General assessments of an agency's management challenges.

Additional copies of the Department of Transportation's Fiscal Year 2007 Performance and Accountability Report are available by writing to:

U.S. Department of Transportation

Office of the Assistant Secretary for Budget and Programs/Chief Financial Officer

Room W95-330

1200 New Jersey Avenue, SE

Washington, D.C. 20590

You may also view this Report online at http://www.dot.gov

HOW THIS REPORT IS ORGANIZED

MANAGEMENT'S DISCUSSION AND ANALYSIS (MD&A)

The Management's Discussion and Analysis (MD&A) section provides a summary of the entire Report. It includes an organizational overview; a summary of the most important performance results and challenges for FY 2007; a brief analysis of financial performance; a brief description of systems, controls, and legal compliance; and information on the Department's progress in implementing the President's Management Agenda. The MD&A also addresses the management challenges identified by the Department's Inspector General and a summary of the Inspector General's audit report.

THE PERFORMANCE REPORT

The Performance Report section contains the annual program performance information required by the Government Performance and Results Act of 1993 (GPRA) and includes all of the required elements of an annual program performance report as specified in OMB Circular A-11, Preparation, Submission and Execution of the Budget. The results are presented by Strategic Goal.

THE FINANCIAL REPORT

The Financial Report section contains the Department's financial statements, notes, required supplementary information, supplementary information pertaining to the Department's stewardship of Federal assets, related Inspector General's Audit Report, and other accompanying information.

DOT MISSION AND VALUES

MISSION

The National objectives of general welfare, economic growth and stability, and the security of the United States require the development of transportation policies and programs that contribute to providing fast, efficient, and convenient transportation at the lowest cost consistent with those and other National objectives, including the efficient use and conservation of the resources of the United States.

VALUES

PROFESSIONALISM

As accountable public servants, we exemplify the highest standards of excellence, integrity, and respect in the work environment.

TEAMWORK

We support each other, respect differences in people and ideas, and work together in ONE DOT fashion.

CUSTOMER FOCUS

We strive to understand and meet the needs of our customers through service, innovation, and creativity. We are dedicated to delivering results that matter to the American people.
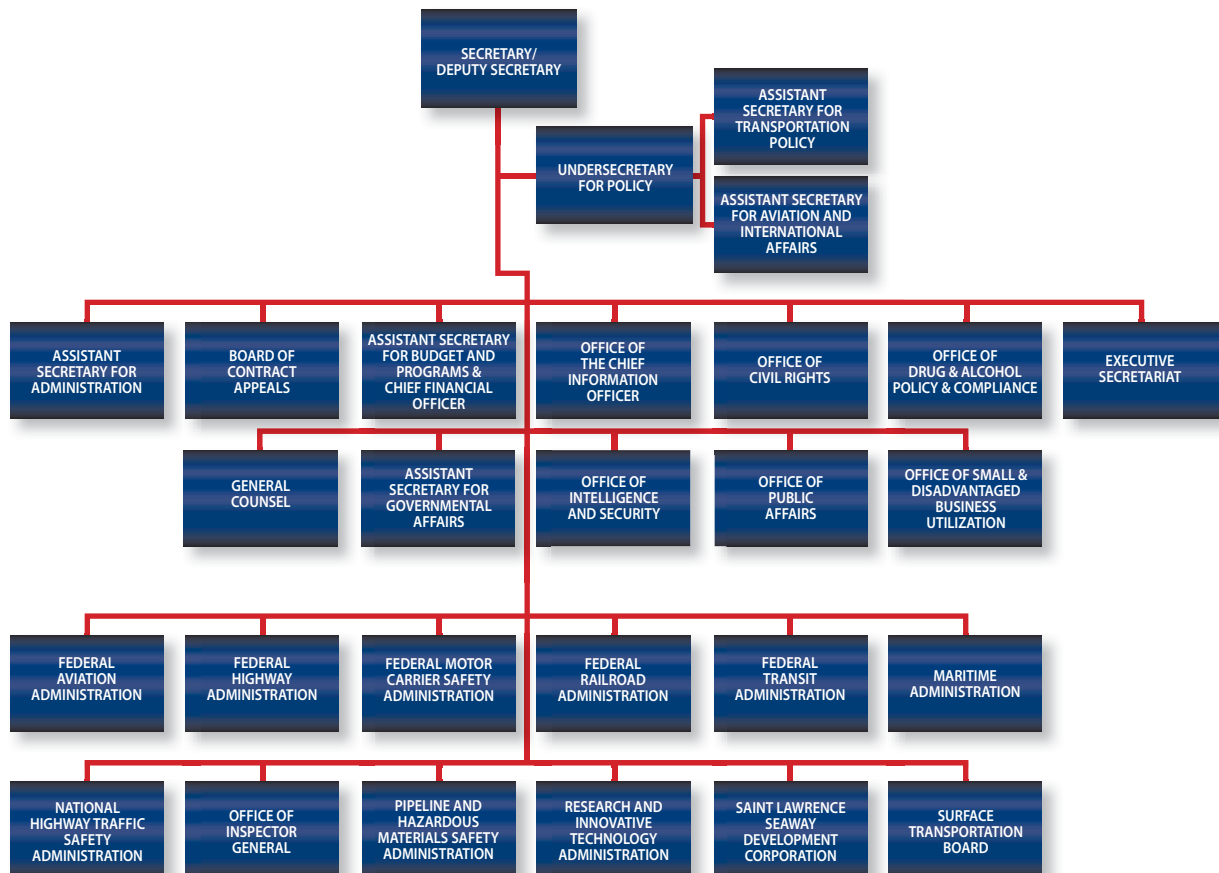
ORGANIZATION

HISTORY

Established in 1967, DOT sets Federal transportation policy and works with State, local, and private sector partners to promote a safe, secure, efficient, and interconnected National transportation system of roads, railways, pipelines, airways, and seaways. DOT's overall objective of creating a safer, simpler, and smarter transportation program is the guiding principle as we move forward to achieve specific goals.

HOW WE ARE ORGANIZED

DOT employs almost 60,000 people across the country, in the Office of the Secretary of Transportation (OST) and through twelve Operating Administrations (OAs) and bureaus, each with its own management and organizational structure.

The Office of the Secretary of Transportation provides overall leadership and management direction, administers aviation economic programs, and provides administrative support. The Office of Inspector General (OIG) and the Surface Transportation Board (STB), while formally part of DOT, are independent by law.

OVERVIEW OF LEGISLATIVE AUTHORITIES

The DOT strategic plan summarizes the legislative authorities of each Operating Administration. To provide a context for the reader, the highlights of the responsibilities of each Operating Administration are listed below.

Office of the Secretary. The Office of the Secretary (OST) oversees the formulation of national transportation policy and promotes intermodal transportation. Other responsibilities range from negotiation and implementation of international transportation agreements, assuring the fitness of U.S. airlines, enforcing airline consumer protection regulations, issuance of regulations to prevent alcohol and illegal drug misuse in transportation systems and preparing transportation legislation.

Federal Aviation Administration. The Federal Aviation Administration's (FAA) mission is to promote aviation safety and mobility by building, maintaining, and operating the Nation's air traffic control system; overseeing commercial and general aviation safety through regulation and inspection; and providing assistance to improve the capacity and safety of our airports.

Federal Highway Administration. The mission of the Federal Highway Administration (FHWA) is to improve mobility on our Nation's highways through national leadership, innovation, and program delivery.

Federal Motor Carrier Safety Administration. The Federal Motor Carrier Safety Administration's (FMCSA) primary mission is to prevent commercial motor vehicle-related fatalities and injuries by promoting safe and secure commercial motor vehicle operation through education, regulation, enforcement, and innovative research and technology.

Federal Railroad Administration. The Federal Railroad Administration's (FRA) mission is to ensure that our Nation has safe, secure, and efficient rail transportation that enhances the quality of life for all.

Federal Transit Administration. The Federal Transit Administration (FTA) provides leadership, technical assistance, and financial resources for safe, technologically advanced public transportation that enhances mobility and accessibility, improves America's communities, preserves the natural environment, advances economic growth, and ensures that transit systems are prepared to function during and after criminal or terrorist attack.

Maritime Administration. The Maritime Administration's (MARAD) mission is to promote the development and maintenance of an adequate, well-balanced U.S. merchant marine that is sufficient to carry the Nation's domestic waterborne commerce and a substantial portion of its waterborne foreign commerce, and to serve as a naval and military auxiliary in time of war or national emergency.

National Highway Traffic Safety Administration. The National Highway Traffic Safety Administration's (NHTSA) mission is to save lives, prevent injuries and reduce economic costs due to road traffic crashes through education, research, safety standards, and enforcement activity.

Office of Inspector General. The Inspector General Act of 1978, as amended, established the Office of Inspector General (OIG) as an independent and objective organization within the DOT. The OIG's mission is to promote economy, effectiveness, and efficiency and to prevent and detect fraud, waste, and abuse in DOT operations and programs by conducting and supervising independent and objective audits and investigations.

Pipeline and Hazardous Materials Safety Administration. The mission of the Pipeline and Hazardous Materials Safety Administration (PHMSA) is to protect people and the environment from the risks inherent in transportation of hazardous materials—by pipeline and other modes of transportation. In doing so, PHMSA also protects the public's interest in reliable delivery of energy resources and other critical materials.

Research and Innovative Technology Administration. The Research and Innovative Technology Administration (RITA) is dedicated to ensuring the effectiveness of the Department of Transportation's investment in research and technology. Innovations that will improve our mobility, promote economic growth, and ultimately deliver a better integrated transportation system.

Saint Lawrence Seaway Development Corporation. The U.S. Saint Lawrence Seaway Development Corporation (SLSDC), a wholly owned government corporation and an OA of DOT, is responsible for the operations and maintenance of the U.S. portion of the St. Lawrence Seaway between Montreal and Lake Erie.

Surface Transportation Board. The Surface Transportation Board (STB) is charged with promoting substantive and procedural regulatory reform in the economic regulation of surface transportation, and with providing an efficient and effective forum for the resolution of disputes and the facilitation of appropriate business transactions.

PERFORMANCE HIGHLIGHTS

Secretary Mary E. Peters is committed to ensuring that our transportation system remains safe, secure, and efficient and that it serves as the engine that drives our Nation's economy. Because economic activity and global trade are increasing, our roads, railways, pipelines, public transit systems, airways, and waterways are experiencing increasing growth in demand.

This Administration is working to ensure that our transportation system has the capacity to accommodate the needs of a growing and prosperous America. Below, we present the highlights of our fiscal year (FY) 2007 results in our five strategic areas: safety, mobility, global connectivity, environmental stewardship and security. We also present our internal organizational achievements that enhance DOT's performance as a results-driven Federal agency.

SAFETY

Transportation makes possible the movement of people and goods fueling our economy and improving our quality of life. Development of transportation systems has become a major determinant of a nation's economic success. At the same time, transportation exposes us to the risk of harm. While we have made progress in making all modes of transportation safer, the Department's top priority and central focus remains improving safety. All modes of transportation have a share in achieving our strategic safety goal: *Enhance public health and safety by working toward the elimination of transportation-related deaths and injuries.*

The number of people who died on the Nation's roads fell last year, leading to the lowest highway fatality rate ever recorded and the largest drop in total deaths in 15 years. In 2006, 42,642 people died in traffic crashes, a drop of 868 deaths compared to 2005. This two percent decline in traffic deaths contributed to the historic low fatality rate of 1.42 fatalities per 100 million vehicle miles traveled (VMT). This decline is the largest in terms of both number and percentage since 1992. Preliminary 2007 data indicates that the fatality rate will decrease to 1.40 fatalities per 100 million VMT. DOT is firmly committed to meeting the Department's longstanding overall highway fatality rate goal of 1.0 fatalities per 100 million VMT by 2011. New performance targets have been established in key areas that encompass all areas of motor vehicle crashes. This will enable the Department's efforts to focus on the critical areas responsible for the slow rate of decline in the overall highway fatality rate, stagnant impaired driving fatalities, and ever increasing motorcycle rider fatalities. These key focus areas include passenger vehicle occupants, non-occupants (pedestrians, cyclists, etc.), motorcycle riders, and large trucks and buses. They were chosen in part to cover the breadth of all road users. The Department will begin to report on these focus areas in the FY 2008 PAR.

In response to the tragic collapse of the I-35W Bridge in Minneapolis, MN, FHWA issued two technical advisories. The first strongly encouraged States to re-inspect all steel deck truss bridges and to follow-up on any critical findings, and the second advised States to ensure that the construction equipment loads and stockpiled raw materials placed on a structure do not overload its members.

The Department understands that future National Transportation Safety Board findings along with a program audit by the DOT Office of Inspector General may result in additional recommended improvements to the FHWA Bridge program.

Wisconsin Department of Transportation bridge inspectors Jim Kast, right, and Matt Murphy inspect the support structure of the Highway 51 bridge over the Rock River, just south of Edgerton, Wis., Wednesday, Aug. 8, 2007. The structure, one of about 16 deck truss bridges in the state, is generally similar to the Interstate 35W bridge that collapsed in Minnesota on August 1, 2007. This bridge was scheduled for a regular inspection next month but the special inspection is considered a precautionary measure. (AP Photo/The Gazette, Bill Olmsted)

Although FAA did not meet its commercial aviation safety measure, this remains one of the safest periods in aviation history for both commercial and general aviation. Over the last five years, nearly three billion airline passengers reached their destination safely. As the stewards of aviation safety in the U.S., FAA and its industry partners have built a system that operates nearly 32,000 scheduled commercial flights daily and has reduced the risks of flying to all-time lows. FAA's efforts during the past ten years have also resulted in reduced general aviation fatal accidents and Alaska fatal accidents. Both measures are at their lowest recorded levels in history.

Rail and transit safety continue to meet their safety targets. Based on preliminary estimates, DOT expects to better the FY 2007 target of 16.70 rail-related accidents/incidents per million train miles, limiting accidents/incidents to 15.03 per million train miles. Much of FRA's success can be attributed to its use of data and sophisticated technologies to more effectively and efficiently alert and direct FRA safety inspectors and other resources to potential track safety anomalies. This advanced notice enables FRA resources to proactively manage safety concerns. Additionally, FRA has built substantial partnerships with State and local agencies to address accidents and casualties at highway-rail grade crossings and from trespassing. Although the transit fatality rate increased slightly in FY 2007, safety performance continues to meet expectations. The transit fatality rate increased from 0.344 fatalities per 100 million passenger miles traveled in FY 2006

A Union Pacific freight train crosses an intersection in Pine Bluffs, Wyoming, Tuesday, April 10 2007. A freight train traveling at top speed often needs a mile or more to stop after applying its brakes. The train was carrying about 150 passengers who had signed up for a presentation on train safety that was given during the ride. (AP Photo/ The Wyoming Tribune Eagle, Gregory Hoenig)

to 0.378 in FY 2007. Strong growth in transit ridership and the continued expansion of transit service significantly increased the number of transit passenger miles in FY 2007 over FY 2006.

The Department continues its effort to lower the number of serious incidents—those presenting the greatest risk to people—from the transportation of hazardous materials across all modes of transportation. Overall, we have cut the risk by about one third over the past twenty years.

MOBILITY

Historically, the mobility that transportation provides has helped define us as a people and as a Nation. Our ability to travel from place to place allows us to connect with other people, work, school, and marketplaces throughout the United States and around the world. In partnerships with the States and private transportation providers, we have made continuous improvements in mobility as stated in our strategic goal: *Advance accessible, efficient, intermodal transportation for the movement of people and goods.* Highlights of our results are presented below.

Over two million people a day travel on our Nation's airlines and more than one-third of the value of all goods is moved by air. Air travel exceeded pre-9/11 levels in FY 2006, and is on track to reach more than one billion passengers by 2015. This increased passenger traffic along with adverse weather conditions resulted in the flying public experiencing increased delays in their travel plans during FY 2007. Not surprising, the FAA fell short of the FY 2007 on-time target of 87.40 percent,

achieving a rate of only 86.50 percent. To manage the increased air traffic, FAA continued to focus on easing congestion in seven metropolitan areas; improving overall capacity at the Nation's top 35 airports; building new runways; and increasing traffic coordination and communication by using new technologies. Airspace redesign is one of the key components in optimizing the U.S. airspace and allowing for increased capacity. To help reduce delays and create more efficient routings, significant changes were made to crowded en-route and terminal airspace in Atlanta, Southern California, and the Cincinnati/Northern Kentucky International Airport. In addition, a new runway at Boston-Logan International Airport and a relocated runway at Los Angeles International Airport opened during FY 2007.

An airline passenger watches for flight delays on monitors at LaGuardia Airport in New York, Friday, June 8, 2007. U.S. airline delays are at their highest level in at least 13 years, and analysts say fliers can expect continued delays. The Department of Transportation on Monday, Aug. 6, 2007 said the industry's on-time performance in the first six months of the year was its worst since 1995, the earliest period for which the agency has comparable data. In June, nearly a third of domestic flights on major U.S. airlines were late. (AP Photo/Frank Franklin II, File)

Mobility and accessible transportation go hand-in-hand. For our aging population and for persons with disabilities, we must be proactive to ensure their mobility and access to transportation, now and in the future. For FY 2007, DOT met one of its two performance targets measuring compliance with the Americans with Disabilities Act (ADA). An estimated 97 percent of bus fleets continue to be ADA compliant either being lift-equipped or having low floors to accommodate wheelchairs and people with limited mobility. However, it is estimated that only 92.3 percent of key rail stations are ADA compliant, slightly missing the FY 2007 target of 93 percent. FTA is developing an action plan and working with station operators to address this issue.

The pavement condition on the Nation's highways improved in FY 2007, but not enough to meet the Department's performance target. The estimated percentage of travel on the National Highway System exhibiting "good"-rated ride quality was 55 percent, missing the target by 1.0 percent. FHWA has found that more improvement is needed in key States that have the most influence on the nationwide results in order to meet the ride quality standard.

Congested travel was below the target level with a projection of 31.8 percent for urban-area travel occurring in congested conditions. The results from 2004 to 2006 suggest that the overall rate of growth nationwide in traffic congestion appears to be slowing. However, traffic congestion is still a significant problem, particularly in urban areas. The FHWA continued to promote operational and technological solutions to provide traveler information, improve traffic incident management, enhance mobility in the vicinity of work zones, improve traffic signal timing, and relieve traffic congestion at bottlenecks.

DOT selected five metropolitan areas across the country as the first communities to participate in a new federal initiative to fight traffic gridlock. The Department's Urban Partnership program aims to reduce traffic congestion using approaches like congestion pricing, transit, tolling, and teleworking. Funding has been provided to the cities of Miami, Minneapolis, New York City, San Francisco, and the Seattle area (King County) to implement transportation

Congested traffic fills New York's Park Avenue, Thursday June 7, 2007. New York Mayor Michael Bloomberg's plan to ease Manhattan traffic through congestion pricing got a boost from U.S. Secretary of Transportation Mary Peters, who announced that New York was one of five metropolitan areas across the country selected to participate in the Urban Partnerships Program - a new Federal initiative that provides funding to fight traffic gridlock. (AP Photo/Richard Drew)

solutions that take advantage of new technologies to keep traffic moving, and promote flexible work schedules and telecommuting to ease traditional rush hours.

GLOBAL CONNECTIVITY

Transportation systems within and among nations are lifelines to economic growth, less restricted trade, and greater cultural exchange. A domestic and international intermodal approach is central to DOT's role in promoting global connectivity. Our strategies to address transportation in the global economy have two prongs. One is directed toward opening international transportation markets and the other is directed toward the improvement of essential, intermodal transportation linkages.

Supporting economic growth is a fundamental purpose of our transportation network. Transportation facilitates distribution of goods and creates economic value for the producer. Our strategic goal: *Facilitate a more efficient domestic and global transportation system that enables economic growth and development,* concerns the efficiency of transportation, an important part of our competitive edge in global trade.

In an effort to provide greater access to international transportation markets and assure a minimum standard of safety within those markets, the Department conducts negotiations for open skies agreements, enters into open skies agreements, and enters into Bilateral Aviation Safety Agreements once the open skies agreement is in place.

On April 30, 2007, after more than four years of negotiations, the United States and the European Union (EU) achieved a historic pact on Open Skies. Beginning on March 30, 2008, the agreement will deregulate air traffic on both sides of the Atlantic, a market that represents about 60 percent of international travel. The Agreement would replace existing bilateral agreements between the United States and EU member states and establish an Open Skies Plus framework between the United States and all 27 EU member states. As a result of newly implemented open skies agreements, DOT increased the number of potential air transportation customers to 3.83 billion, a 27 percent increase over FY 2006. Open skies agreements have made it possible for the airline industry to provide the opportunity for better quality, lower priced, and more competitive air service in thousands of international city-pairs to an increasing portion of the world's population.

Bilateral Aviation Safety Agreements (BASA) promotes aviation safety and environmental quality, enhances cooperation, and increases efficiency in civil aviation safety matters. These agreements improve global understanding of U.S. safety regulations, processes, and procedures, which leads to better international regulatory oversight. In FY 2007, FAA achieved its performance target, negotiating agreements with Singapore, Japan, and Mexico.

The Saint Lawrence Seaway is the international shipping gateway to the Great Lakes, with almost 50 percent of Seaway traffic traveling to and from overseas ports, especially in Europe, the Middle East and Africa. The Great Lakes Seaway System offers access and competitive costs with other routes and modes to the interior of the country, so it is critical that the locks maintained by the Saint Lawrence Seaway Development Corporation (SLSDC) be open and navigable continuously during the navigation season. Once again SLSDC met its target, making the Seaway available for shipping 99.4 percent of the season.

ENVIRONMENT

While transportation ties us together as a Nation, it can also produce unwanted side effects such as air and water pollution, the loss of ecosystems and disruption of communities. Americans want solutions to transportation problems that are consistent with sound environmental planning. DOT is committed to avoiding or mitigating the adverse environmental effects that can accompany transportation as stated in our strategic goal: *Promote transportation solutions that enhance communities and protect the natural and built environment.* Highlights of our results follow.

For the second year in a row, the number of areas in a transportation emissions conformity lapse was well below the target. During 2002 when this measure was adopted, approximately six areas were in conformity lapse in any given month. A number of changes to the conformity provisions were implemented in 2005 to streamline and provide more flexibility to the conformity process. The

number of areas in a lapse was zero at the end of FY 2006, lowering the 12-month moving average number of areas in a conformity lapse to 1.3. In FY 2007, we sustained this effort and lowered the number of areas in a lapse to zero.

The Maritime Administration (MARAD) has more than 115 obsolete and deteriorating ships awaiting disposal that pose potentially costly environmental threats to the waterways near where they are stored. In FY 2007, MARAD removed 25 obsolete ships from the three fleet sites, twelve more than the 2007 target. All of the removals were the result of dismantling/recycling contracts with domestic ship disposal companies. Depending on the characteristics of each vessel and the capability of each contractor, it may take from several months to over a year to dismantle a ship once it has arrived at a disposal facility, In 2007, dismantling was completed on 18 ships, exceeding the target by three ships. These ships were removed from the fleet sites during the current and preceding fiscal years.

We continue to drive down the potentially harmful releases of hazardous liquids from pipelines. We are projecting that we will beat the target for FY 2007 by up to 50 percent. We believe that the improved performance over the past two years reflects the success of our integrity management program—pipeline operators are finding and fixing defects before they become failures.

SECURITY

Our transportation system must remain a vital link for maintaining the country's economy, supporting civilian emergency response and mobilizing our armed forces for military contingencies. Examples of our achievements under our strategic goal: *Balance homeland and national security transportation requirements with the mobility needs of the Nation for personal travel and commerce*, are described below.

The Department of Defense (DOD) relies on the U.S. commercial transportation industry as well as government-owned ships to deliver equipment and supplies throughout the world in order to maximize defense logistics capabilities and minimize cost. In addition to the availability of commercial U.S.-flag vessels, MARAD has 44 government-owned Ready Reserve Force vessels available to satisfy DOD's surge sealift requirements, a decrease of four vessels from FY 2006. MARAD, in conjunction with DOD, also negotiates an agreement with each DOD-designated commercial strategic port specifying which facilities will be needed to conduct a military deployment. These ports are expected to make their facilities available to the military within 48 hours of written notice. DOT met both the shipping capacity performance target of 94 percent availability within mobilization timelines, and achieved 100 percent readiness within established timelines for its target for commercial strategic port availability.

ORGANIZATIONAL EXCELLENCE

DOT's Inspector General Calvin L. Scovell III released the annual report on the Department's consolidated financial statements, for which we were issued an unqualified audit opinion. Consolidated financial statements show how the Department is accountable for budgetary resources, provided by American taxpayers for Federal transportation activities. Individual audits were also conducted for the Aviation and Highway Trust Funds, which both received unqualified opinions.

Secretary Peters' management strategy for achieving organizational improvement includes full implementation of the President's Management Agenda (PMA). The PMA contains five core, mutually reinforcing initiatives that the DOT team is integrating into its corporate culture in striving for continuous management improvement. The five core PMA initiatives are in the areas of strategic management of human capital, competitive sourcing, financial performance, performance improvement, and e-government. Our latest ratings from the Office of Management and Budget concerning the status of each core initiative resulted in the Department receiving two "green" ratings; two "yellow" ratings; and one "red" rating.

FINANCIAL HIGHLIGHTS

Preparing these statements is part of the Department's goal to improve financial management and to provide accurate and reliable information that is useful for assessing financial performance. Departmental management is responsible for the integrity and objectivity of the financial information presented in the financial statements.

The financial statements and financial data presented in this Report have been prepared from the accounting records of the DOT in conformity with generally accepted accounting principles (GAAP). For Federal entities, these GAAP standards are prescribed by the Federal Accounting Standards Advisory Board (FASAB).

OVERVIEW OF FINANCIAL POSITION

ASSETS

The Consolidated Balance Sheet shows the Department had total assets of $61.8 billion at the end of FY 2007. This represents a 3.6 percent decrease over the previous year's total assets of $64.1 billion (restated). The Department's assets reflected in the Consolidated Balance Sheet are summarized in the following table.

Assets by Type (Dollars in Thousands)	2007	%	2006 Restated	%
Fund Balance with Treasury	$ 23,392,470	37.8	$ 27,692,908	42.2
Investments	21,218,168	34.3	19,824,151	30.9
General Property, Plant & Equipment	14,683,890	23.7	14,501,762	22.6
Inventory and Related Property, Net	785,760	1.3	897,494	1.4
Direct Loans and Guarantees, Net	889,885	1.4	618,179	1.0
Accounts Receivable	623,810	1.0	315,987	0.5
Cash and Other Assets	237,855	0.4	261,091	0.4
Total Assets	$ 61,831,838	100.0	$ 64,111,572	100.0

LIABILITIES

The Department had total liabilities of $14.1 billion at the end of FY 2007. This represents a 7.4 percent increase from the previous year's total liabilities of $13.1 billion (restated), which is reported on the Consolidated Balance Sheet and summarized in the following table.

Liabilities by Type (Dollars in Thousands)	2007	%	Restated 2006	%
Grant Accrual	$ 5,526,288	39.3	$ 4,975,556	37.9
Other Liabilities	4,727,489	33.6	4,622,073	35.3
Accounts Payable	1,591,693	11.3	1,375,459	10.5
Environmental and Disposal Liabilities	852,366	6.1	953,635	7.3
Debt	1,040,761	7.4	839,357	6.4
Loan Guarantees	336,626	2.3	345,864	2.6
Total Liabilities	$ 14,075,223	100.0	$ 13,111,944	100.0

NET POSITION

The Department's Net Position at the end of FY 2007 on the Consolidated Balance Sheet and the Consolidated Statement of Changes in Net Position is $47.8 billion, a 6.4 percent decrease from the previous fiscal year. Net Position is the sum of the Unexpended Appropriations and Cumulative Results of Operations.

RESULTS OF OPERATIONS

The results of operations are reported in the Consolidated Statement of Net Cost and the Consolidated Statement of Changes in Net Position.

NET COSTS

The Department's total net cost of operations for FY 2007 was $63.1 billion.

Net Costs (Dollars in Thousands)	2007	%	2006 Restated	%
Surface Transportation	$ 47,385,306	75.05	$ 45,955,838	75.59
Air Transportation	14,814,454	23.46	14,135,417	22.97
Maritime Transportation	570,727	0.90	457,525	0.74
Costs Not Assigned to Programs	388,392	0.62	390,463	0.63
Less Earned Revenues Not Attributed to Programs	30,295	0.05	30,985	0.05
Cross-Cutting Programs	11,448	0.02	7,355	0.01
Net Cost of Operations	$ 63,140,032	100.0	$ 60,915,613	100.00

Surface and air costs represent 98.5 percent of the Department's net cost of operations. Surface transportation program costs represent the largest investment for the Department at 75.1 percent of the Department's net cost of operations. Air transportation is the next largest investment for the Department at 23.5 percent of the Department's net cost of operations.

RESOURCES

BUDGETARY RESOURCES

The Combined Statement of Budgetary Resources provides information on how budgetary resources were made available to the Department for the year and their status at fiscal year-end. For the 2007 fiscal year, the Department had total budgetary resources of $122.7 billion, compared to the FY 2006 levels of $112.5 billion.

Budget Authority of $118.7 billion – which primarily consists of $62.6 billion of appropriations received and $56.1 billion of borrowing and contract authority – comprise 96.7 percent of the total budgetary resources. The Department incurred obligations of $75.8 billion for the 2007 fiscal year, a 15.5 percent increase over the $65.6 billion of obligations incurred during 2006. Outlays reflect the actual cash disbursed against the Department's obligations.

HERITAGE ASSETS AND STEWARDSHIP LAND INFORMATION

Heritage assets are property, plant and equipment that are unique for one or more of the following reasons: historical or natural significance; cultural, educational, or artistic importance; or significant architectural characteristics.

Stewardship Land is land and land rights owned by the Federal Government but not acquired for or in connection with items of general property, plant and equipment.

The Department's Heritage assets consist of artifacts, museum and other collections, and buildings and structures. The artifacts and museum and other collections are those of the Maritime Administration. Buildings and structures include Union Station (rail station) in Washington, D.C., which is titled to the Federal Railroad Administration.

The Department holds transportation investments (Stewardship Land) through grant programs such as the Federal Aid Highways, mass transit capital investment assistance, and project grants for airport planning and development.

Financial information for Heritage assets and Stewardship Land is presented in the Financial Section of this Report under the Financial Statements and Required Supplementary Information.

LIMITATIONS OF THE FINANCIAL STATEMENTS

The principal financial statements have been prepared to report the financial position and results of operations of the Department of Transportation, pursuant to the requirements of 31 U.S.C. 3515 (b).

These statements have been prepared from the books and records of the Department of Transportation in accordance with generally accepted accounting principles (GAAP) for Federal entities and the formats prescribed by OMB. The statements are in addition to the financial reports used to monitor and control budgetary resources, which are prepared from the same books and records.

The statements should be read with the realization that they are for a component of the U.S. Government.

SYSTEMS, CONTROLS, AND LEGAL COMPLIANCE

FEDERAL MANAGERS' FINANCIAL INTEGRITY ACT (FMFIA)

The FMFIA requires agencies to conduct an annual evaluation of their management controls and financial systems and report the results to the President and Congress. The Secretary of Transportation then prepares an annual Statement of Assurance based on these internal evaluations.

As a subset of the FMFIA Statement of Assurance, DOT is required to report on the effectiveness of internal control over financial reporting, which includes safeguarding of assets and compliance with applicable laws and regulations, in accordance with the requirements of Appendix A of OMB Circular A-123. A separate discussion on Appendix A is located at the end of this section.

The Secretary of Transportation has issued a qualified Statement of Assurance for FY 2007. A copy of the Statement of Assurance is included in this section under Management Assurances. The Department evaluated its management control systems and financial management systems for the fiscal year ending September 30, 2007. This evaluation provided reasonable assurance and formed the basis of the Secretary's Statement of Assurance that the objectives of the FMFIA were achieved in FY 2007.

FMFIA ANNUAL ASSURANCE PROCESS

The FMFIA review is an agency self-assessment of the adequacy of financial controls in all areas of the Department's operations – program, administrative, and financial management.

Managers within the Department, being in the best position to know and understand the nature of the problems they face, establish appropriate control mechanisms to ensure Departmental resources are sufficiently protected from fraud, waste, and abuse, and to meet the intent and requirements of the FMFIA.

Objectives of Control Mechanisms
1. Financial and other resources are safeguarded from unauthorized use or disposition.
2. Transactions are executed in accordance with authorizations.
3. Records and reports are reliable.
4. Applicable laws, regulations, and policies are observed.
5. Resources are efficiently and effectively managed.
6. Financial systems conform to government-wide standards.

The head of each Operating Administration and Departmental office submits an annual statement of assurance representing the overall adequacy and effectiveness of management controls within the organization to the Assistant Secretary for Budget and Programs/Chief Financial Officer (CFO). FMFIA material weaknesses and material nonconformances are also reported along with remediation plans to correct the material weakness or nonconformance. Specific guidance for completing the end of fiscal year assurance statement and reporting on material deficiencies is issued annually by the Department's Office of Financial Management.

CRITERIA FOR REPORTING MATERIAL WEAKNESSES AND NONCONFORMANCES

A material weakness under FMFIA must fall into one or more of the categories below plus merit the attention of the Executive Office of the President and/or the relevant Congressional oversight committees.

Criteria for Reporting a Material Weakness
1. Significant weakness of the safeguards (controls) against waste, loss, unauthorized use or misappropriation of funds, property, or other assets.
2. Violates statutory authority, or results in a conflict of interest.
3. Deprives the public of significant services, or seriously affects safety or the environment.
4. Impairs significantly the fulfillment of the agency's mission.
5. Would result in significant adverse effects on the credibility of the agency.

A material nonconformance under FMFIA must fall into one or more of the categories below plus merit the attention of the Executive Office of the President or the relevant Congressional oversight committees.

Criteria for Reporting a Material Nonconformance
1. Prevent the primary accounting system from centrally controlling financial transactions and resource balances.
2. Prevent compliance of the primary accounting system, subsidiary system, or program system under the Office of Management and Budget Circular A-127.

SUMMARY OF FY 2007 FMFIA MATERIAL WEAKNESSES

STATUS OF INTERNAL CONTROLS (FMFIA SECTION 2)

DOT has two material weaknesses under Section 2 – Timely Processing of Transactions and Accounting for Property, Plant and Equipment (PP&E), including the Construction in Progress (CIP) Account at the Federal Aviation Administration (FAA) and Weaknesses in the Stewardship and Oversight of Federal-Aid Projects Administered by Local Program Agencies (LPA). The Timely Processing of Transactions and Accounting for PP&E, including the CIP Account material weakness is a repeat material weakness from last year and has been updated to include issues surrounding

PP&E. The Weaknesses in Stewardship and Oversight of Federal-aid Projects Administered by LPAs is a new material weakness identified by the Federal Highway Administration (FHWA). During FY 2007, the Department resolved the Financial Management, Reporting, and Oversight at the Highway Trust Fund (HTF) which was reported last year.

Timely Processing of Transactions and Accounting for PP&E, including the CIP Account. Last year we reported that the FAA did not have effective policies and procedures in place over CIP accounting, including maintaining supporting documentation for the capitalization of fixed assets. During FY 2007, the FAA executed an extensive corrective action plan, involving a complete review of the CIP balance reported by the FAA at September 30, 2006.

For FY 2007, we are updating the material weakness to include issues surrounding PP&E. FAA has not fully complied with standardized policies and procedures, including policies on unit costs, overhead burden calculations and allocation, and procedures for entry of transactions in the fixed asset subsidiary ledger, to ensure that CIP and related PP&E balances are accurate, complete, and recorded timely throughout the year. In addition, the FAA has not completed the design and full implementation of internal controls around the standardized policies and procedures that will allow management to provide reasonable assurance that internal controls over the CIP and related processes are properly designed and operating effectively.

Weaknesses in Stewardship and Oversight of Federal-Aid Projects Administered by LPAs. During FY 2006 and FY 2007, FHWA assembled an LPA Review Team to review 39 projects administered by 35 different local agencies. The findings revealed that current oversight activities, as a whole, may be inconsistent from State to State and ineffective for ensuring that Federal-aid requirements are met on LPA-administered projects. There were no indications of fraud, waste, or abuse; however, the review identified program weaknesses that allow shortcomings in the eligibility determinations in compliance with established Federal laws and regulations.

STATUS OF FINANCIAL MANAGEMENT SYSTEMS (FMFIA SECTION 4)

DOT reported again this year that the Department was not in substantial compliance with OMB Circular A-127. During FY 2006, we reported that the FAA was not in compliance with Federal accounting standards due to their inability to provide representation that the CIP balance and activity was fairly stated and in accordance with applicable accounting standards, as of and for the year ended, September 30, 2006. The non-compliance with Federal accounting standards still exists for FY 2007 due to the FAA's inability to account for transactions and present balances in its periodic financial statements in accordance with applicable accounting standards, as of and for the year ended, September 30, 2007.

Corrective Action Plans addressing material weaknesses and nonconformances are located in the Other Accompanying Information section.

APPENDIX A, INTERNAL CONTROLS OVER FINANCIAL REPORTING

Appendix A of OMB Circular A-123 emphasizes management's responsibility for establishing and maintaining effective internal control over financial reporting. Appendix A requires agencies to maintain documentation of the controls in place and of the assessment process and methodology management used to support its assertion as to the effectiveness of internal control over financial reporting. Agencies are also required to test the controls in place as part of the overall FMFIA assessment process. The assurance statement related to the assessment performed under Appendix A acts as a subset of the overall Statement of Assurance reported pursuant to Section 2 of the FMFIA legislation. Management's assurance statement as it relates to Appendix A is based on the controls in place as of June 30. The assurance statement is located in the following section of this Report.

During FY 2006, DOT began an OMB-approved two-year implementation of Appendix A and identified 12 key business processes that are material to financial reporting. Of these 12 processes, six were documented and tested in FY 2006. During FY 2007, the Department added an additional business process to document and test. The remaining seven key business processes were documented and tested during FY 2007. DOT is reporting a limitation of scope for its assurance statement on internal controls over financial reporting due to its two-year implementation of Appendix A.

Based on the results of this evaluation, DOT is reporting one material weakness in its internal control over financial reporting as of June 30, 2007. The material weakness is the Timely Processing of Transactions and Accounting for PP&E, including the CIP Account.

MANAGEMENT ASSURANCES – OMB CIRCULAR A-123

THE SECRETARY OF TRANSPORTATION
WASHINGTON, D.C. 20590

November 9, 2007

The President
The White House
Washington, DC 20500

Dear Mr. President:

I am pleased to report on the effectiveness of the internal controls and financial systems for the U.S. Department of Transportation (DOT) during Fiscal Year (FY) 2007. This report is based on our successful implementation of Office of Management and Budget (OMB) Circular A-123, *Management's Responsibility for Internal Control*, which provides guidance for meeting the requirements of the Federal Managers' Financial Integrity Act of 1982 (FMFIA).

The FMFIA holds Federal managers responsible for establishing and maintaining effective internal controls and financial systems. All DOT organizations are subject to Sections 2 and 4 of the FMFIA except the Saint Lawrence Seaway Development Corporation, which reports separately under the Government Corporations Control Act.

The DOT is able to provide a qualified statement of assurance that the internal controls and financial management systems meet the objectives of FMFIA, with the exception of two material weaknesses reported under Section 2 and one non-conformance reported under Section 4.

During FY 2007, DOT conducted its assessment of internal controls and compliance with applicable laws and regulations in accordance with OMB Circular A-123. Based on this evaluation, DOT identified two material weaknesses and one "non-compliance" with laws and regulations as of September 30, 2007. Other than the exceptions noted below, DOT's internal controls were operating effectively and no other material weaknesses were found in the design or operation of the internal controls.

The Department is pleased to report that the second Section 2 material weakness reported in FY 2006, Financial Management, Reporting, and Oversight of the Highway Trust Fund (HTF), was resolved during FY 2007.

Section 2. Material weaknesses are defined as deficiencies in the design or operation of internal controls that do not reduce to a relatively low level the risk that significant errors, fraud, or noncompliance could occur and not be detected by employees in the normal course of performing their duties. We are reporting two material weaknesses:

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1. Timely Processing of Transactions and Accounting for PP&E, including the CIP Account. Last year we reported that the Federal Aviation Administration (FAA) did not have effective policies and procedures in place over CIP accounting, including maintaining supporting documentation for the capitalization of fixed assets. During FY 2007 the FAA completed extensive corrective actions including an in-depth project by project review of the CIP balance reported at September 30, 2006.

For FY 2007 we are updating this material weakness to include not fully complying with standardized PP&E policies on unit costs, overhead burden calculations and allocations, as well as procedures for entering transactions to ensure that CIP and PP&E balances are accurate, complete and recorded promptly. We are in the process of completing the implementation of enhanced internal controls for CIP that will enable management to provide reasonable assurance that internal controls over CIP are properly designed and operating effectively.

2. Weaknesses in the Stewardship and Oversight of Federal-Aid Projects Administered by Local Program Agencies (LPAs). During FY 2006 and FY 2007, the Federal Highway Administration (FHWA) assembled a review team to review 39 projects administered by 35 different local agencies. While there were no indications of waste, fraud or abuse, the review identified inconsistent oversight activities among the States. LPA oversight needs to be enhanced to ensure that LPA-administered projects meet all Federal-aid requirements.

The FHWA has taken immediate measures to address this material weakness, including designating Local Project Oversight Coordinators to provide increased oversight and focus, to evaluate State DOT LPA processes and procedures, to analyze whether additional process reviews are necessary, and to enhance LPA project oversight with the State DOTs. During FY 2008, FHWA will be implementing additional corrective actions to improve LPA project oversight and to resolve the control weaknesses identified during the review.

Section 4. Nonconformances in internal controls represent deficiencies in the design or operation of internal controls that could adversely affect the DOT consolidated financial statements. We are reporting one material nonconformance:
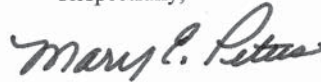
1. Compliance with the Federal Financial Management Improvement Act (FFMIA) of 1996. During FY 2006, we reported that the FAA was not in compliance with Federal accounting standards because their CIP balance was not fairly stated in accordance with applicable accounting standards. This non-compliance still existed for FY 2007 because the FAA has not yet completed implementing their Corrective Action Plan.

OMB Circular A-123, Appendix A. During FY 2007, DOT conducted an assessment of the effectiveness of internal controls over financial reporting, including safeguarding assets and complying with applicable laws and regulations.

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DOT has identified 13 key business processes that are material to financial reporting and documented and tested seven of them in FY 2007; the remaining processes were tested in FY 2006. Due to the two-year implementation of Appendix A as approved by OMB, DOT is reporting a scope limitation for its assurance statement on internal control over financial reporting. Based on the results of this evaluation, DOT is reporting one material weakness in its internal control over financial reporting as of June 20, 2007: the Timely Processing of Transactions and Accounting for PP&E, including the CIP Account.

DOT has made substantial progress in enhancing its internal controls and financial management program. Additional enhancements are planned and underway in FY 2008.

Respectfully,

Mary E. Peters

FEDERAL FINANCIAL MANAGEMENT IMPROVEMENT ACT

The Federal Financial Management Improvement Act of 1996 (FFMIA) requires that agencies' financial management systems provide reliable financial data in accordance with generally accepted accounting principles and standards. Under FFMIA, financial management systems must substantially comply with three requirements — Federal financial management system requirements, applicable Federal accounting standards, and the U.S. Government Standard General Ledger (SGL). In addition, agencies must determine annually whether their systems meet these requirements. This determination is to be made no later than 120 days after the earlier of (a) the date of receipt of the agency-wide audited financial statement, or (b) the last day of the fiscal year following the year covered by such statement.

To assess conformance with FFMIA, the Department uses OMB Circular A-127 survey results, FFMIA implementation guidance issued by OMB, results of OIG and GAO audit reports, annual financial statement audits, the Department's annual Federal Information Security Management Act (FISMA) Report, and other relevant information. The Department's assessment also relies a great deal upon evaluations and assurances under the FMFIA, with particular importance attached to any reported material weaknesses and material nonconformances.

FFMIA OF 1996 NONCOMPLIANCE ISSUES

In FY 2007, DOT reported that the Department was not in compliance with FFMIA due to the FAA not complying with Federal accounting standards because their Construction in Progress balance was not fairly stated in accordance with applicable accounting standards. FAA management was unable to provide representation that the balances in the financial statements were in accordance with applicable accounting standards.

FFMIA OF 1996 FINANCIAL MANAGEMENT SYSTEMS STRATEGY

DOT uses Oracle Federal Financials software as its agency-wide financial management and accounting system of record (called Delphi). DOT was the first – and remains the only – cabinet agency to migrate all of its Operating Administrations (OAs) to a Financial Systems Integration Office-certified, commercial-off-the-shelf based financial system running on a cost-effective single production instance of the software. Using the DOT developed Financial Statement Solution enhancement, the Department is able to produce regulatory Financial Statements overnight from the core accounting system. This improves accuracy, effectiveness, efficiency and enables DOT to meet OMB, Treasury and other Federal reporting requirements on schedule.

In FY 2007, DOT moved to a more standardized quarterly release schedule for installing Delphi patches, enhancements and upgrades. The Office of Financial Management (OFM) Financial Systems Team and the Enterprise Services Center (ESC) Delphi Team worked with customers to identify, develop, test and coordinate five separate release deliverables. This standard release schedule assured more complete testing of patches and enhancements and greatly improved communication and understanding of changes made to the system. Communication was facilitated with timely and effective "Go To" on-line web-based meetings between the OAs, ESC and OFM.

In December 2006, DOT upgraded the Delphi database to Oracle Release 9.2.0.7. In May 2007, DOT successfully upgraded its Oracle Applications software to version 11.5.10. This upgrade was quite significant: 197 patches were applied, approximately 170,000 jobs were executed and nearly 200 resources at the Enterprise Services Center were involved. Although the complexity of the Delphi 11.5.10 upgrade required extra effort on the part of the many, including the Delphi Security team, this was the most efficient and effective upgrade to Delphi in the system's seven year history. System down time and impact to customers was significantly reduced from previous upgrades.

These upgrades offer assurance that the Delphi Financial Application Software Modules are maintained at a level that ensures supportability by Oracle. The upgrade also adds some increased functionality for the Delphi support staff, reduces risks associated with technical enhancements, resolves some outstanding customer requests, provides customers with additional secure processing tools and allows Delphi to move toward future enhancements.

DOT has implemented our FFMIA corrective action plan through several initiatives. First, DOT has taken great strides in consolidating and eliminating redundant financial systems including FedWire, the Federal Reserve payment system used for FHWA grants. The Department now processes payments on daily basis through our Delphi system directly to the Treasury. Second, DOT is sunsetting the Volpe Center's labor distribution system and replacing it with web-enabled CASTLE Time & Attendance and labor distribution system. Third, DOT prepared and implemented a written policy to address monthly journal voucher processing, budgetary and proprietary reconciliation problems and inadequate analysis of abnormal account balances.

FEDERAL INFORMATION SECURITY MANAGEMENT ACT

The Federal Information Security Management Act (FISMA) requires Federal agencies to identify and provide security protection commensurate with the risk and magnitude of harm resulting from the loss of, misuse of, unauthorized access to, disclosure of, disruption to, or modification of information collected or maintained by or on behalf of an agency. The Department maintains one of the largest portfolios of information technology (IT) systems among Federal civilian agencies; it is therefore essential that the Department protect these systems, along with their sensitive data. In FY 2007, the departmental IT budget totaled approximately $2.6 billion.

During FY 2007, all Operating Administrations except the Federal Aviation Administration (FAA), the Federal Railroad Administration (FRA), and the Surface Transportation Board were relocated to a new Headquarters. As part of the Headquarters relocation, the Department consolidated individual Operating Administrations' network infrastructures (e-mail, desktop computing, and local area networks) into a common IT infrastructure—one of the IT consolidation target projects identified by the Department in FY 2003.

For FY 2007, the Department is reporting a total of 429 computer systems—3 more than last year, of which 60 percent are FAA systems. Among the systems the Department maintains and operates is the air traffic control system, which the President has designated part of the critical national infrastructure. Other systems owned by the Department include safety-sensitive surface transportation systems and financial systems that are used to manage and disburse over $50 billion in Federal funds each year.

FY 2007 was a particularly challenging year for the Department in managing its IT resources. In addition to establishing a common IT infrastructure for the new Headquarters building, we had to review, test, and certify security protection in more than half of its information systems to meet the recertification requirements. The Department completed most of the scheduled security recertification reviews. However, the overall effectiveness of its information security program declined this year because management had to divert resources and attention to resolving Headquarters move-related issues. Specifically, management did not meet Government security standards to protect information systems and did not take sufficient action to correct identified security deficiencies. In addition, commercial software products used in departmental systems were not configured in accordance with security standards and security incidents were incompletely and/ or inaccurately reported.

In the FY 2006 FISMA report, the OIG stated that the Department faced several challenges in implementing and monitoring security controls to meet Government standards. This year, we found continued deficiencies in risk categorization of sensitive systems and implementation of security upgrades required to meet Government standards. In addition, security recertification review of the expanded IT infrastructure at the new Headquarters has not been completed. As a result, management has no assurance that application systems are operating securely on this infrastructure.

The full FY 2007 FISMA report can be found at www.oig.dot.gov.

SAS-70 REPORT ON DOT'S FINANCIAL MANAGEMENT SYSTEM

The SAS-70 report summarizes the results of a review of system security controls over the DOT Enterprise Services Center's (ESC) Delphi Financial Management System. This is the third year that a SAS-70 audit has been conducted on DOT's Delphi financial system. The ESC provides accounting and financial management systems and services for DOT and other Federal agencies. Delphi is hosted, operated and maintained by Federal Aviation Administration employees at the Mike Monroney Aeronautical Center in Oklahoma City, Oklahoma, under the overall direction of the Departmental Chief Financial Officer.

ESC is one of four Federal Shared Service Providers designated by the Office of Management and Budget to provide financial management systems and services to other government agencies. ESC supports other Federal entities, including the National Endowment for the Arts, the Commodity Futures Trading Commission, the Institute of Museum and Library Services, and the Government Accountability Office. The Office of Management and Budget requires Shared Service Providers to provide client agencies with an independent audit report in accordance with the American Institute of Certified Public Accountants' (AICPA) Statement of Auditing Standards (SAS) 70.

This year's SAS-70 audit of Delphi was conducted by Clifton Gunderson, LLP, of Calverton, Maryland. The DOT Office of Inspector General performed a Quality Control Review of the SAS-70 audit work to ensure that it complied with applicable standards.

The Clifton Gunderson SAS-70 audit report dated June 28, 2007 concluded that management's description of controls for the Delphi Financial Management System presents fairly, in all material respects, the controls that had been placed in operation as of May 31, 2007. Clifton Gunderson recommended several enhancements to strengthen Delphi controls further; DOT has already implemented many of these recommendations and is implementing the remaining corrective actions. The operational environment enabled auditors to rely on Delphi system controls in conducting this year's financial statement audits.

FOLLOW UP REVIEW

Since the issuance of its June 28, 2007 report, Clifton Gunderson completed a follow-up review covering the period from June 1, 2007 through September 30, 2007 fiscal year end. The purpose of this follow-up review was to determine whether any significant changes had been made to Delphi's operating environment. The follow-up review documented the corrective actions that have been implemented to strengthen Delphi controls in accordance with the SAS-70 recommendations. The full OIG report can be found on their web site at www.oig.dot.gov.

IMPROPER PAYMENTS INFORMATION ACT OF 2002

In FY 2007, the Department continued implementing the Improper Payments Information Act of 2002 (IPIA), which requires that agencies: (1) review programs and identify those susceptible to significant improper payments; (2) report to Congress on the amount and causes of improper payments; and, (3) develop approaches for reducing such payments.

In FY 2007, the Department successfully completed its review of the Federal Highway Administration (FHWA) Federal-aid Highway Program, Federal Aviation Administration (FAA) Airport Improvement Program, and the Federal Transit Administration (FTA) Formula Grants Program. In addition, the Department developed and tested a model for determining the amount of improper payments in the FTA, Capital Investment Grant Program.

In FY 2007, the Department re-engaged AOC Solutions, Inc. to develop the nationwide sampling plan, collect the results from the application of test procedures, and provide a nationwide estimate of improper payments for Federal-aid Highway Program, Airport Improvement Program, and Formula Grants Program. With respect to the Formula Grants Program, the sampling plan, test procedures, and test results only apply to approximately one-third of Formula Grantee grantees covered by the FTA's Formula Grant Triennial Review Program. Statute 49 U.S.C. 5307 prescribes a triennial review of all Formula Grant grantees. OMB Circular A-123, Attachment C, paragraph F provides for alternative approaches, including determining the amount of improper payments for components, such as those addressed in the foregoing statute.

In addition, AOC developed and tested a model for determining the amount of improper payments in the FTA Capital Investment Grant Program. The Department will apply the model on a nationwide basis to the Capital Investment Program in FY 2008.

The samples designed to execute the model are of sufficient size to yield an estimate with a 90 percent confidence interval within +/- 2.5 percent points around the estimate of the percentage of erroneous payments, as prescribed by OMB. The results of these efforts are discussed below.

FHWA FEDERAL-AID HIGHWAY PROGRAM
The Department developed and executed a sampling plan to test project payments and estimate the amount of improper payments nationwide. The FHWA executed the nationwide testing program using personnel from the FHWA division offices and covered Federal payments to grantees over the twelve-month period March 1, 2006 through February 28, 2007.

The sampling plan involved a multi-staged statistical approach that included the selection of 53 Federal payments, 40 state payments, and then 230 testable line items from those payments for testing. The 2007 sample size is significantly less than the 2006 sample size because of a change in objectives. In 2006, the Department wanted to ensure all 50 states and two territories received sample items for testing. This required a substantially larger sample that would have been required had the Department not required that all states and territories receive sample items. In 2007, the sample was designed to support a nationwide estimate of

improper payments and was not designed to provide sample items to all States and territories. The States that did not appear in the IPIA sample received sample items for Financial Integrity Review and Evaluation (FIRE) program testing.

The test procedures applied to the line items were designed to test a range of administrative and contractual elements. Tests of administrative elements included determining whether payments were properly approved, billed at the correct Federal participation rate, and whether billings and payments were mathematically accurate. Tests of contractual elements included determining whether payments were in accordance with contract rates/prices for specified materials and whether material quality tests indicated that materials met contractual requirements.

Improper payments totaling $45,568 were found in the sample of 230 tested items. The projection of this result to the population of program payments for the twelve-month period results in an improper payment estimate of $55.2 million +/- $0.5 million. This projection does not meet OMB's definition of significant improper payments ($10 million and 2.5 percent of total program payments).

The improper payments reported resulted from factors such as unallowable charges, insufficient supporting documentation, incorrect calculations, and duplicate payments. The FHWA has implemented its FIRE Program to monitor State and territory payments and provide a mechanism for assisting these entities with effectively addressing operational issues that result or could result in improper payments.

FTA FORMULA GRANTS PROGRAM

FY 2007 was the first year of nationwide coverage of the FTA Formula Grants Program. In FY 2006, the FTA developed and tested a model used for use in IPIA testing in 2007. The FTA developed and executed a sampling plan to determine the amount and cause of improper payments in the Formula Grants Program and to assist FTA in incorporating the IPIA test procedures in its statutorily required Triennial Review Program.

FTA executed the nationwide testing program for grantees covered by the 2007 Triennial Review Program using contractor personnel. The review covered the twelve-month period March 1, 2006 through February 28, 2007.

The sampling plan involved a multi-staged statistical approach that included the selection of 60 Federal payments, 30 transportation authorities' payments, and then 169 testable line items from those payments for testing. The test procedures applied to the line items were designed to test a range of administrative and contractual elements. Tests of administrative elements included determining whether payments were properly approved, billed at the correct federal participation rate, and whether billings and payments were mathematically accurate. Tests of contractual elements included determining whether payments were in accordance with contract rates/prices for specified materials and whether material quality tests indicated that materials met contractual requirements.

Improper payments totaling $2,326.16 were found in the sample of 169 tested items. The projection of this result to the population of program payments for the twelve-month period results in an improper payment

estimate of $4.32 million +/- $0.09 million. This projection does not meet OMB's definition of significant improper payments ($10 million and 2.5 percent of total program payments).

The improper payments reported resulted from factors such as miscalculated federal participation share and lack of supporting documentation.

FTA CAPITAL INVESTMENT GRANTS PROGRAM

In FY 2007, FTA developed and tested an improper payment test model at one recipient of Capital Investment Grants Program funding. The FTA patterned the model on the model developed for the FTA Formula Grants Program in 2006.

The test model involved developing test workbooks with test criteria and procedures. The sampling plan involved a multi-staged statistical approach that included the selection of 17 Federal payments, 49 grantee payments, and then 83 testable line items from those payments for testing. The test procedures applied to the line items were designed to test a range of administrative elements and contractual elements. Tests of administrative elements included determining whether payments were properly approved, billed at the correct federal participation rate, and whether billings and payments were mathematically accurate. Tests of contractual elements included determining whether payments were in accordance with contract rates/prices for specified materials and whether material quality tests indicated that materials met contractual requirements.

Improper payments totaling $361,691.73 were found in the sample of 83 tested items. The projection of this result to the population of program payments for the twelve-month period results in an improper payment estimate of $0.55 million +/- $0.39 million. This projection applies only to the single grantee and does not apply nationwide. The improper payments reported resulted from draw-downs in excess of Federal participation share.

The FTA will apply the model on a nationwide basis in FY 2008 in order to meet the requirements of the IPIA

FAA AIRPORT IMPROVEMENT PROGRAM (AIP)

The FAA developed and executed a sampling plan to determine the amount and cause of improper payments in the Airport Improvement Program. The FAA review covered the twelve-month period March 1, 2006 through February 28, 2007.

The sampling plan involved a multi-staged statistical approach that included the selection of 50 Federal payments, 30 sponsor payments, and then 95 testable line items from those payments for testing. The test procedures applied to the line items were designed to test a range of administrative and contractual elements. Tests of administrative elements included determining whether payments were properly approved, billed at the correct federal participation rate, and whether billings and payments were mathematically accurate. Tests of contractual elements included determining whether payments were in accordance with contract rates/prices for specified materials and whether material quality tests indicated that materials met contractual requirements. The review found administrative and contractual compliance as addressed in the test model and no improper payments.

SCORECARD ON THE PRESIDENT'S MANAGEMENT AGENDA

HUMAN CAPITAL INITIATIVE

GOAL: Develop a Department-wide human capital workforce strategy to address future workforce gaps, eliminate skill gaps in critical occupations, develop performance-based incentives for the workforce, ensure citizen-centered, delayered, and mission-focused organizations; strengthen leadership skills, and ensure a robust leadership pipeline; improve the measurement and evaluation of human capital strategies; and integrate e-Government and Competitive Sourcing strategies.

FY 2007 STATUS: ● GREEN

FY 2007 PROGRESS: ● GREEN

HOW DOT IS MEETING PMA CHALLENGES: DOT's Human Capital Plan focuses on long-term management of the DOT workforce and is aligned with the Office of Personnel Management (OPM)/Office of Management and Budget (OMB) Standards for Success. DOT accomplishments in FY 2007 included the following:

◇ Issued Human Capital Strategic Plan with Operational Plan;

◇ Issued the Human Resources Accountability Report;

◇ Issued workforce plan update;

◇ Received full certification status for Senior Executive Service personnel for calendar years 2007 and 2008 by OPM and OMB;

◇ Completed backfile conversion for Electronic Official Personnel Folder (eOPF) application and established procedures for employee access;

◇ Issued additional strategies to support increased participation in telework with senior level input;

◇ Submitted hiring timeline report using new 70 percent target for hiring and notification timeliness;

◇ Closed targeted competency gaps in leadership and human resources;

◇ Submitted Competency gap targets and staffing projections for DOT-specific Mission Critical Occupations with resource tables and competency profile tables;

◇ Reported hiring process improvement strategy;

◇ Submitted strategy for accomplishing the required annual employee survey; and,

◇ Provided update on Federal Human Capital Survey Action Plans.

COMPETITIVE SOURCING INITIATIVE

GOAL: Improve the consistency for defining commercial and inherently governmental inventories across the Department. Identified compatible activities, provided strategic direction for competitive sourcing and human capital initiatives, and developed and shared high-quality intellectual capital within the Department and other agencies.

FY 2007 STATUS: ●   YELLOW

FY 2007 PROGRESS: ●   YELLOW

HOW DOT IS MEETING PMA CHALLENGES: In FY 2007, DOT was rated "yellow" for competitive sourcing. DOT accomplishments in FY 2007 included the following:

- ◇ Completed 23 competitions involving about 2,700 full time equivalents;
- ◇ Estimated savings of about $95,000 per competed full-time equivalent;
- ◇ Garnered anticipated savings of over $2.2 billion (over a ten year period);
- ◇ Completed the largest single competition to date (FAA Flight Service Stations);
- ◇ Achieved improved operational performance through innovative work processes and establishment of quality standards;
- ◇ Implemented post-competition accountability and Most Efficient Organization independent validation for five completed competitions to verify actual savings and performance improvements;
- ◇ Initiated the Workforce Analysis Pilot Project to deliberately link competitive sourcing and human capital planning (as required by the President's Management Agenda); and,
- ◇ Shared lessons learned within the Department and with other Federal agencies.

DOT's drop to yellow in status and progress was mainly due to limited competitions planned for fiscal years 2008-2009.

IMPROVED FINANCIAL MANAGEMENT INITIATIVE

GOAL: Develop financial management systems capable of producing more timely and accurate information, and maintain a record of unqualified opinions on our financial statements.

FY 2007 STATUS: ●   RED

FY 2007 PROGRESS: ●   GREEN

HOW DOT IS MEETING PMA CHALLENGES: During FY 2007, DOT accomplished the following work, which has enhanced the timeliness, quality, efficiency and effectiveness of our financial reporting and accounting and financial operations.

✧ In December 2006, DOT rolled out a new department-wide initiative designed to help the Operating Administrations (OAs) recognize and reconcile longstanding data issues in their financial systems. This initiative addresses fourteen areas of concern and defines corrective actions. The "Fab 14" raises OA awareness and accountability to correct inaccurate and incomplete data.

✧ In August 2007, the Enterprise Services Center rolled out a web-based site to enable DOT users to review and monitor our new "Fab 14" metrics on line. The site will also include all OMB Financial Performance Metrics.

✧ DOT successfully upgraded our Delphi financial management system to Oracle Financials release 11.5.10 in May 2007. Delphi's Financial Statement Solution continues to produce financial statements overnight from the core accounting system.

✧ DOT is continuing short-term planning for further Delphi upgrades to Oracle database and technology and to servers later in 2007 and 2008. We have also initiated a major long-term strategic financial management planning effort that will include future Delphi upgrades, including Oracle release 12.FSIO and the Common Government-wide Accounting Code (CGAC).

✧ We are re-engineering interfaces for additional feeder systems using the new Service Oriented Architecture (SOA). The benefits are more cost effective operation and maintenance of interfaces with better data quality and reduced reconciliation.

✧ More OAs are implementing Labor Distribution Reporting (LDR) in CASTLE, our web-based Time & Attendance and Labor Distribution Reporting system. Currently serving the FAA, FRA, FTA and FHWA, CASTLE is key to supporting DOT's managerial cost accounting program. Additional OAs will implement LDR in CASTLE by early 2008.

✧ DOT has also made significant progress in consolidating operational accounting services at the DOT's Enterprise Services Center in Oklahoma City. Accounting services have already been migrated for all but two Operating Administrations _plus_ FAA's Headquarters and nine regional accounting offices. This consolidation supports standardizing and streamlining business processes across the Department. The remaining phases will be completed in early FY 2008.

E-GOVERNMENT INITIATIVE

GOAL: To better justify and track costs and performance of information technology projects, as well as participate in government-wide initiatives that automate and simplify how the public deals with the government and reduce redundancies and increase efficiencies across the Federal government.

FY 2007 STATUS: ● YELLOW

FY 2007 PROGRESS: ● YELLOW

HOW DOT IS MEETING PMA CHALLENGES: During FY 2007, the Department's efforts in the E-Government initiative resulted in several important successes in that DOT met established requirements and milestones and made further improvements in enterprise architecture (EA), privacy, capital planning and security as follows:

 ✧ Completed all OMB E-Government Implementation Plan milestones;

 ✧ Achieved an EA Assessment Rating of Green from the Office of Management and Budget's Federal Enterprise Architecture Program Management Office;

 ✧ Established a Departmental segment architecture strategy and developed a Grants Segment Architecture;

 ✧ Completed all OMB Enterprise Architecture (EA) milestones and continues to improve the effectiveness of the DOT EA program;

 ✧ Remediated 37 of the 38 business cases that were on the OMB Management Watch List;

 ✧ Completed system of record notices for 90 percent of applicable systems with personally identifiable information;

 ✧ Made significant strides in the incorporation of encryption technology to further provide for the safeguarding of Personally Identifiable Information and other forms of sensitive information and data on removable storage and processing devices; and

 ✧ Negotiated an enterprise licensing agreement with Microsoft that reduced the average costs for their desktop products by over 25 percent.

PERFORMANCE IMPROVEMENT INITIATIVE

GOAL: To better integrate budget and performance functions by integrating respective staff work; developing plans and budget with outcome goals, output targets, and resources requested in the context of past results; charging full budgetary costs of programs; and documenting program effectiveness.

FY 2007 STATUS: ● GREEN

FY 2007 PROGRESS: ● GREEN

HOW DOT IS MEETING PMA CHALLENGES: In FY 2007, DOT achieved its goals in this area and maintained a green score by completing the following:

 ✧ Received the President's Award for Management Excellence in Budget Performance Integration;

 ✧ Submitted a budget request to OMB that clearly articulated the performance impact of implementing a budget at the target level and that was supported by sound and thorough analysis and performance data; and,

♢ Each modal administration provided marginal cost of performance information in their FY 2009 OMB budget submission in accordance with OST guidance.

ELIMINATING IMPROPER PAYMENTS INITIATIVE
GOAL: Develop financial management systems capable of producing more timely and accurate information, and eliminating improper payments to DOT vendors/customers.

FY 2007 STATUS: ● YELLOW

FY 2007 PROGRESS: ● GREEN

HOW DOT IS MEETING PMA CHALLENGES: During FY 2007, DOT took significant additional steps towards implementing the Improper Payments Information Act of 2002. DOT's efforts this year focused on four program areas in three of our largest Operating Administrations: FHWA Highway Planning and Construction Program, FTA Formula Grants, FTA Capital Investment Grants Program and FAA Airport Improvement Program. Efforts included:

FHWA Planning and Construction Program:

♢ Completed nationwide testing of grantee payments; and,

♢ Projected improper payments of $55 million out of total program payments of $33.3 billion — an improper payment rate of 0.2%.

FTA Formula Grants:

♢ Completed nationwide testing of grantee payments for grantees subject to statutorily prescribed Triennial Review program; and,

♢ Projected improper payments of $4.3 million for grantees subject to the 2007 Triennial Review out of total program payments of $1.2 billion to these grantees — an improper payment rate of 0.3%.

FTA Capital Investment Grants Program:

♢ Developed and tested an improper payment testing model at a single grantee for use in nationwide testing; and,

♢ Projected an improper payment rate and amount for this grantee.

FAA Airport Improvement Program:

♢ Completed nationwide testing of grantee payments; and,

♢ Found no improper payments out of total program payments of $3.9 billion.

REAL PROPERTY INITIATIVE

<u>GOAL</u>: Use sound real property management of real property resources for diverse transportation missions, maintaining the quality of real property assets managed, and disposing of assets that are no longer required.

FY 2007 STATUS:　　●　　YELLOW

FY 2007 PROGRESS: ●　　GREEN

<u>HOW DOT IS MEETING PMA CHALLENGES</u>: DOT continues to make strong progress under this initiative. The Real Estate Management System used by DOT is a single-point inventory, contains the required performance metrics, and is compatible with the government-wide real property database. To date, we have:

- ✧ Established Department-wide draft performance measure targets and goals;
- ✧ Established a three-year timeline for real property management to support capital improvements, acquisitions, and disposition actions;
- ✧ Disposed of 1,602 real property assets, ranking the Department 4th among all Federal agencies;
- ✧ Completed the Department's first-ever inventory of real property assets at the constructed asset level; and,
- ✧ Developed a system framework for real property management to establish operating standards and guidelines for all Operating Administrations.

OTHER MANAGEMENT INFORMATION, INITIATIVES, AND ISSUES

MANAGERIAL COST ACCOUNTING (MCA)

Managerial cost accounting (MCA) identifies, tracks, and analyzes the total costs attributable to a particular task, job, or program. The purpose of managerial cost accounting is to provide program managers with cost information required to accurately report program efficiency and to develop a program's future budget. DOT OAs are working aggressively to implement or enhance existing managerial cost accounting systems in order to provide their managers with cost information to make better-informed decisions.

DOT initiated MCA with the Federal Aviation Administration (FAA), which was directed to develop a cost system in order to establish both unit costs of services and as a means of sustaining defensible charges for reimbursable services. FAA has four lines of business and has implemented MCA across all four. Through an executive dashboard, it links costs to performance goals. Costs are tracked through three systems that interact: Delphi (DOT's financial and accounting system of record) FAA's Cost Accounting System (a People Soft System implemented largely to track projects and tasks) and DOT's Consolidated Automated System for Time and Labor Entry (CASTLE which is both a time and attendance and labor distribution reporting system).

The Federal Highway Administration (FHWA), Federal Transit Administration (FTA) and Federal Railroad Administration (FRA) have each developed an internal system for taking labor distribution files from CASTLE and costs from Delphi for rolling up cost information. FTA and FHWA have utilized a third party, activity based costing system. FRA has utilized Budget Program Activity Codes to track costs related to projects and draws reports from Delphi.

The Maritime Administration (MARAD) and Pipeline and Hazardous Materials Safety Administration (PHMSA) have begun developing systems utilizing the Delphi Projects Module. One unique issue faced by MARAD is a substantial reimbursable effort with its Reserve Fleet. Being able to track reimbursable activities and connect them with the correct interagency agreement has not been possible to date except through bookkeeping adjustments. DOT has begun developing a strategy to rewrite its payroll interface for posting salary and benefit costs to its accounting system, which will enhance both payroll posting and tracking interagency costs and payments.

As we gear up for a major system upgrade to Delphi and as we implement the OMB-mandated Common Government-wide Accounting Code structure, we expect to re-engineer many DOT business processes including standardized use of the accounting string. These efforts as well as the work we will be doing as part of the Financial Management Business Transformation Initiative will facilitate a standardized approach to MCA across DOT and enhanced integration with our performance measurement program.

DOT'S FINANCIAL MANAGEMENT BUSINESS TRANSFORMATION INITIATIVE

The DOT financial management community faces considerable challenges in the next five to seven years. External mandates from the Office of Management and Budget and the Department of Treasury, coupled with a significant upgrade planned for the Department's accounting system, are factors driving DOT to alter significantly the way we conduct financial management practices. We look at these external drivers as an opportunity to improve our way of conducting business. For example, different Operating Administrations (OAs) use different processes to conduct similar business. OAs use various reporting tools to communicate similar financial information, and use the Department's standard Accounting Code Structure (ACS) slightly differently to meet their program management needs. As a result, we are unable to take full advantage of the economies of scale available through the consolidated accounting operations at the Enterprise Services Center. Additionally, it is not always easy to roll up financial program information Department-wide.

In order to meet the external challenges of the future while further improving our internal financial management operations, the Office of Financial Management is sponsoring a Department-wide Financial Management Business Transformation (FMBT) effort. The purpose of the FMBT is to improve information sharing, standardize and streamline business processes, and implement OMB's Common Government Accounting Code structure upon receiving guidance from OMB. We are committed to managing our internal improvement efforts in an organized and structured manner, allowing adequate time for planning and resource allocation and focusing on communication with our stakeholder community. The FMBT will be managed by a governance structure comprised of representatives from all stakeholder communities, and the work required to achieve this vision will be executed using standard project management principles. Our vision is to be the government leader in Financial Management utilizing quality people, processes and technology in delivering a single integrated solution to support DOT's mission by incorporating streamlined business processes while ensuring financial integrity.

INSPECTOR GENERAL'S FY 2007
TOP MANAGEMENT CHALLENGES

DEPARTMENT OF TRANSPORTATION
OFFICE OF INSPECTOR GENERAL APPROACH

The Office of Inspector General (OIG) issues its annual report on DOT's top management challenges to provide a forward-looking assessment for the coming fiscal year. The purpose of the report is to aid DOT's agencies in focusing attention on and mapping work strategies for the most serious management and performance issues facing the Department.

In selecting the challenges for each year's list, the OIG continually focuses on the Department's key strategic goals to improve transportation safety, capacity, and efficiency. In addition to the OIG's vigilant oversight of DOT programs, budgetary issues, and progress milestones, it also draws from several dynamic factors to identify key challenges. These include new departmental initiatives, cooperative goals with other Federal departments, recent changes in the Nation's transportation environment and industry, as well as global issues that could have implications for the United States' traveling public. As such, the challenges included on the OIG's list vary each year to reflect the most relevant issues and provide the most useful and effective oversight to DOT agencies.

As required by OMB Circular A-136, the OIG's report briefly assesses DOT's progress in addressing the challenges identified. To track management challenges identified from year to year, the OIG provides an exhibit to the report that compares the current list of management challenges with the list published the previous fiscal year. In addition, the OIG may refine the scope of the management challenge from year to year based on program developments, external factors, or other information that becomes available.

The Department recognizes that Management Challenges are not issues that are easily solved. In many cases they require investments or upgrades to technology or substantial changes in long-standing procedures or program activities. To completely address a Management Challenge may take more than one fiscal year. Since the OIG may refine the scope of the management challenge based on information that may become available during the year; it can be difficult to provide a context showing how far along the Department is in resolving a particular challenge. To provide perspective on the Department's progress, we have provided a self assessment showing the achievements toward resolving the challenge as currently defined. The result is displayed via the Progress Meter icon. DOT hopes that this approach will provide perspective toward gauging the Department's progress in resolving a management challenge.

1. Management Challenge: Defining, Developing, And Implementing Strategies To Improve Congested Conditions On The Nation's Highways, Ports, Airways, And Borders.

- **Leading Stakeholders**

The current surface transportation policy and funding model has proven incapable of adequately reducing highway congestion. While highway spending at all levels of government has increased 100 percent since 1980, the hours of delay during peak travel periods has increased almost 200 percent over the same time period.

MODERATE PROGRESS

SLIGHT PROGRESS

SIGNIFICANT PROGRESS

NO PROGRESS

COMPLETE

PROGRESS METER

The Department currently has little inherent ability to counteract our nation's mushrooming urban congestion problem. The massive explosion of earmarks and special interest programs (over forty separate highway programs in SAFETEA-LU, the governing surface transportation legislation) and stovepiped highway and transit programs greatly limits the Department's discretion to invest in performance-based congestion reduction strategies.

In an effort to change the existing paradigm, the Secretary of Transportation introduced a new Congestion Initiative designed to illustrate to stakeholders that there are viable alternatives to the current model that focus less on process and more on results. As a result, under the 2007 Urban Partnership competition, 29 metropolitan areas submitted comprehensive congestion reduction plans that included transit, tolling, technology and telework elements. Five of these cities—New York, San Francisco, Seattle, Miami and Minneapolis—were awarded in excess of $800 million in highway, transit and ITS grants to expeditiously implement their plans. New York City's submission includes the nation's first substantive city-wide congestion pricing proposal.

The greatest lesson learned to date is that properly focused discretionary Federal resources can provide extremely powerful incentives for State and local leaders to confront congestion challenges in a different way. In the aftermath of the 2007 Urban Partnership announcements, other major cities such as Los Angeles and Washington have demonstrated a greater interest in implementing pricing strategies. To the extent it receives future additional discretionary resources; the Department intends to maintain its focus on a small number of large-scale congestion reducing demonstration projects.

The Department's senior leadership continues to meet regularly with opinion leaders and State and local elected officials to explain our policies. The Department has sponsored two major outreach sessions with State legislators that focused on innovative financing for new operational and technology opportunities. At the staff level, the Department has hosted a series of technical workshops around the country for State and local officials interested in congestion pricing and the

proper utilization of cost-benefit analysis in the project selection process. As a result, a national consensus is incrementally building towards innovative financing and better prioritization of spending and moving away from the status quo approach to surface transportation funding.

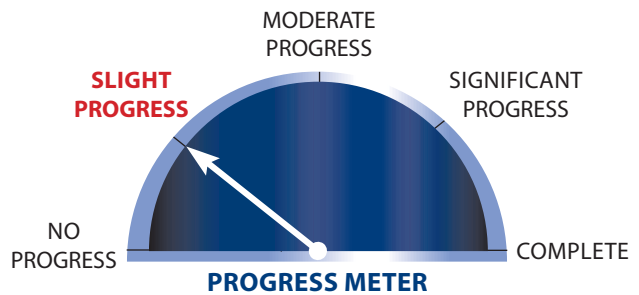### - Overcoming Organizational Structures that Inhibit Intermodal Tradeoffs

The close collaboration of the various modes under the Urban Partnership Program is a very positive early signal of how Operating Administrations can break down stovepipes in the administration of diverse discretionary programs. That collaboration also spilled over to the State and local level where highway authorities and transit authorities were forced to coordinate — at an unprecedented level in some cases — in their applications for Federal funding. The model developed to facilitate the Department's Congestion Initiative should be used to inform programmatic changes in the next reauthorization legislation.

- Funding Future Infrastructure Needs Will be a Challenge

With respect to funding future infrastructure needs, the country is at a clear crossroads. At the same time that the constraints on Federal resources have increased, opportunities to access alternative financing have never been greater. A significant volume of private capital is now available specifically to fund American infrastructure, and technology has advanced to the point that charging systems that do not rely on indirect taxes are administratively feasible and available for deployment. The Department will continue to promote the concept of private investment in infrastructure and endorse the direct pricing of roads in order to maximize available transportation funds.

The aviation system's financial structure is similarly challenged, and the Administration submitted a comprehensive reform proposal to Congress in Spring 2007. The proposal would shift dependence away from ticket taxes and move toward a true user fee system in which the charges levied on users approximate the true costs of providing various air traffic control services. This proposal would supply greater incentives to improve the efficient utilization of the existing system and provide a sustainable funding mechanism to transition to the next generation air traffic control system. It is clear that without major financial reforms, the US aviation system will not perform as well as international counterparts that have embraced such reforms.

- **Proposals for Market-Based Solutions to Better Utilize Existing Capacity Raise Important Policy Issues**

The Department's two highest policy priorities for 2007—the FAA Reauthorization proposal and the Congestion Initiative's Urban Partnership program—are both based on the concept of value pricing. Promotion of these policy priorities through public and stakeholder outreach has focused on the inherent benefits of direct user fees and the intrinsic liabilities associated with the current, indirect funding mechanisms.

MODERATE PROGRESS

SLIGHT PROGRESS

SIGNIFICANT PROGRESS

NO PROGRESS

COMPLETE

PROGRESS METER

In February 2007, the Administration submitted to Congress the *Next Generation Air Transportation System Financing Reform Act of 2007* and the Administration is currently working with Congress to ensure timely passage of legislation to reauthorize FAA programs and revenue sources. An important part of FAA's reauthorization proposal includes a new financing system. FAA's reauthorization legislation contains proposals designed to reduce congestion, accelerate the transition to the Next Generation Air Transportation System (NextGen), and otherwise improve the efficiency and oversight of the system. Under the proposal, equity and efficiency will be enhanced.

This new system will tie payments that National Air Space (NAS) users make for air traffic control services more closely to the costs they impose on the NAS. By tying costs to the benefits and services, there will be incentives for more efficient use of the air traffic control system. The Administration's proposal also includes language to permit the use of market-based mechanisms at New York's LaGuardia Airport, as well as other congested airports when certain conditions are met.

One illustration of FAA using market-based solutions to better use capacity is at LaGuardia Airport. In August 2006, FAA issued a Notice of Proposed Rulemaking (NPRM), subject to Congressional approval, that anticipates the use of market-based mechanisms at LaGuardia in the future. Additionally, under the reauthorization proposal, if the Secretary of Transportation and FAA Administrator determine that market-based mechanisms, such as auctions or congestion pricing, are appropriate to promote the efficient movement of traffic at LaGuardia, then the Port Authority of New York and New Jersey may implement market measures at the airport. If the Port Authority does not implement such actions within one year of the Secretary's determination, the Secretary may implement market measures at LaGuardia.

To address traffic congestion in cities willing to pursue comprehensive, bold, and innovative congestion pricing strategies, the FHWA assisted in formulating Urban Partnerships. The Agency embarked on implementing a comprehensive agenda to capture lessons learned from the Urban Partners and facilitate peer exchange in order to ensure the eventual widespread deployment of congestion pricing applications. For example, the FHWA initiated an effort to identify High Occupancy Vehicle (HOV) facilities that are appropriate for conversion to High Occupancy Toll (HOT) lanes, of which there are currently five in operation nationwide. HOT lanes combine HOV
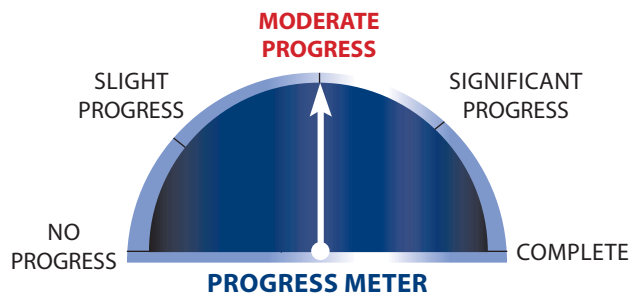
and pricing strategies by allowing single occupancy vehicles to gain access to HOV lanes by paying a toll. The lanes are "managed" through pricing to maintain free flow conditions even during the height of rush hours.

As these new pricing strategies are implemented, the Department recognizes the need to educate the public on the rationale and benefits of such strategies. FAA will continue to lead a public outreach campaign to educate stakeholders on pricing strategies, such as congestion pricing and auctions. In support of FAA's efforts, the National Center for Excellence for Aviations Operations Research organized a public workshop in June 2007 to discuss the next steps in the consideration of the use of market-based mechanisms at LaGuardia airport. FHWA developed a program for educating transportation professionals, elected officials, and the public on the broad array of issues associated with road pricing. The program includes pricing workshops that were given at locations around the country; webinars on select topics; published materials ranging from articles to a *Primer on Congestion Pricing*; assistance to jurisdictions in obtaining tolling authority; research activities that address the costs and benefits, as well as opportunities for mitigating the costs of congestion pricing; and making available a cadre of in-house experts on subjects ranging from the economics of congestion pricing to the technology required for congestion pricing.

The Department is also committed to monitoring the effects of new regulations, as well as their potential impact on market-based pricing strategies on constituents. For example, the NPRM for LaGuardia encourages the continuation of air service to small communities and proposes a fixed number of operating authorizations for service to smaller airports. FAA envisions these small community allocations would remain in place, even if FAA were granted authority to conduct a market-based mechanism at LaGuardia.

- **Keeping Short- and Long-Term Aviation Capacity Enhancing Initiatives On Schedule to Relieve Congestion and Delays**

The Next Generation Air Transportation System (NextGen) is a wide ranging, multi-agency initiative to transform the National Airspace System (NAS) to meet future demands and avoid gridlock in the sky and in the airports. The *Operational Evolution Partnership* (OEP), *OEP Version 1.0*, is FAA's plan for implementing NextGen.

MODERATE PROGRESS

SLIGHT PROGRESS

SIGNIFICANT PROGRESS

NO PROGRESS

COMPLETE

PROGRESS METER

The FAA published the new *OEP Version 1.0* in June 2007. It is an expansion of the original OEP established in 2001. The forecasted and actual benefits of the plan's activities are measured annually, and a team chaired by FAA's Deputy Administrator, ensure each program is implemented on schedule. Through the OEP, FAA along with its aviation partners, committed to increasing the capacity of the NAS by 30 percent. Analysis shows that the OEP will achieve its original goal by 2013.

As FAA's NextGen implementation plan, the OEP will also focus on producing more than 60 new operational capabilities between today and 2025. These new capabilities will transform our current air transportation system from ground-based surveillance and navigation to new and more dynamic satellite-based systems. Technologies and activities that support this transformation are currently part of the FAA's investment portfolio and represent a step beyond our legacy modernization programs. These new capabilities and the highly interdependent technologies that support them will change the way the system operates, reduce congestion, and improve the passenger experience.

The 35 airports included in the OEP account for about 75 percent of all passenger enplanements. Much of the current delay to air traffic can be traced to inadequate throughput—measured as arrival and departure rates—at these airports. The construction of new airfield infrastructure such as new runways and taxiways and major runway extensions are currently the most effective method of increasing throughput. Since FY 2000, 13 new runways have opened at the 35 OEP airports. This translates into a capacity to accommodate 1.6 million more operations every year.

Currently, eight OEP airports have ten airfield projects under construction—three new runways, two airfield reconfigurations, one runway extension, one end-around taxiways, and one center field taxiway. These 10 projects are core OEP airports projects that will be commissioned through 2010. The two new taxiways will provide a means to improve safety and decrease delays at busy airports. When commissioned, these ten projects will have the potential to accommodate about 400,000 more annual operations and will improve the safety and efficiency of eight airports.

2. Management Challenge: FAA Reauthorization – Reaching Consensus On A Financing Mechanism To Fund FAA And Establishing Funding Requirements

- **Deciding on a Financing Mechanism that Promotes a More Efficient Use of the Air Traffic Control System and is Considered Equitable by All Users**

In February 2007, the Administration submitted to Congress the *Next Generation Air Transportation System Financing Reform Act of 2007*. The Administration is working with Congress to ensure timely passage of legislation to reauthorize FAA programs and revenue sources.

SLIGHT PROGRESS

MODERATE PROGRESS

SIGNIFICANT PROGRESS

NO PROGRESS

COMPLETE

PROGRESS METER

In developing the proposal, the Administration conducted extensive reviews of FAA costs and activities, including analyses of cost drivers in order to allocate costs to user groups appropriately. This enabled the Administration to propose a set of user fees for commercial operators and fuel taxes for general aviation that more accurately reflect
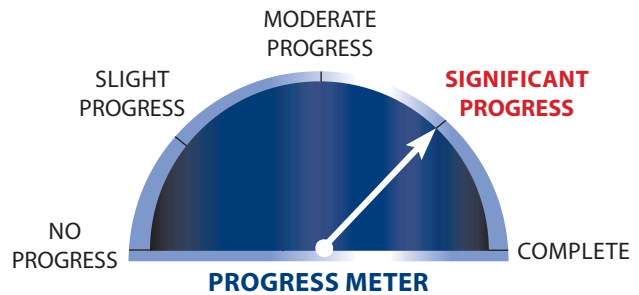
their respective use of the aviation system. The Administration's proposal reflects expected spending requirements in the outyears and ties the rates of taxes and fees to those forecasts, based on cost allocation.

The combination of funding sources in the Administration's reauthorization proposal will help improve the stability, fairness, and rationality of FAA funding without imposing a "one size fits all" solution. Both the user fees that commercial users would pay and the fuel taxes for general aviation are based on each user group's share of the air traffic control costs.

The proposal provides incentives to use resources efficiently, reduces cross-subsidization among user groups, and can adjust to account for the investment costs of the Next Generation Air Transportation System (NextGen) in the near-term and the efficiencies that NextGen will generate in the long-term. The reauthorization proposal achieves these benefits through a hybrid financing structure that is cost-based, yet allows each user group to pay through its preferred funding mechanism.

- **Determining the Next Generation Air Transportation System's (NextGen) Funding Requirements, Quantifying Expected Benefits, and Developing a Roadmap for Industry to Follow**

The current national airspace system (NAS) is reaching its limits and is increasingly unable to effectively respond to the ever-growing demand for increased capacity. NextGen is our Nation's response to the challenges faced by the aviation community. An undertaking as substantial and long-term as NextGen requires a highly deliberate and integrated planning process that, in the near-term, results in products that inform the architectural design, policy, and investment decision-making required to launch and implement NextGen.

The Joint Planning and Development Office (JPDO) made progress in 2007 to develop and mature foundational products with cooperation and collaboration across government. The JPDO delivered the NextGen *Concept of Operations (ConOps), Version 2.0* and the *NextGen Enterprise Architecture Version 1.0,* in June 2007. Together, both products detail the operational and technical performance requirements critical to the planning and implementation of NextGen. A third complementary product, the *NextGen Integrated Work Plan* (IWP) was released in July 2007. The IWP lays out the initial plan for transitioning from the current state to NextGen, considering policy, research and development, and investment needs and illustrates when NextGen operational improvements will need to be achieved to deliver critical NextGen capabilities. The IWP's comprehensive nature

contains implications for both government and industry. Accordingly, stakeholders have been involved in its review and have engaged with the JPDO from both planning and implementation perspectives.
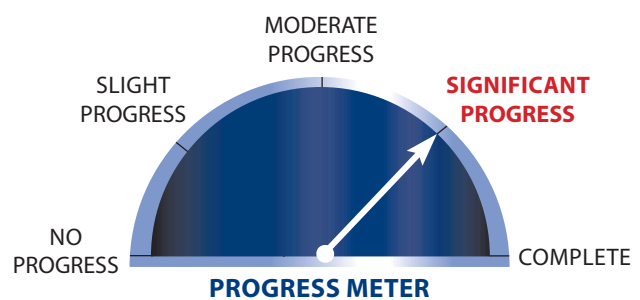
One of the JPDO's primary responsibilities is to inform policy makers on the resources necessary to realize NextGen. These resources include research and development (R&D) and capital investments, as well as the funding to support and sustain NextGen. To that effect, the *NextGen R&D Plan* (FY 2009-13) was released at the end of FY 2007. It highlights the NextGen R&D requirements and associated partner agency and stakeholder responsibilities for executing the R&D activities specified in the Plan. Research and development activities are important for mid- and long-term NextGen operational capabilities.

The JPDO also developed a NextGen Exhibit 300 that focuses on the portfolio of investments that are critical to initiating NextGen in the near-term so that cross-cutting capabilities and benefits can be realized in the mid-term. The NextGen ConOps and Enterprise Architecture set the context for the NextGen requirements and inform investment analysis and decision-making.

The JPDO has started to understand and project the costs and benefits of NextGen. An estimated $4.6 billion will be required to fund NextGen research, development, and implementation activities through 2012. Current NextGen spending estimates for the mid- and long-term range from $8 - $10 billion through 2017, and $15 – $22 billion through 2025. Cost estimates for equipping aircraft with NextGen technologies range between $14 – $20 billion through 2025. Estimates vary depending on the bundling of the technologies and the pace at which the current aircraft fleet is replaced. Next year, the JPDO plans on developing life-cycle costs for the required infrastructure beyond the initial five year period.

- **Continuing Efforts to Address the Expected Surge in Air Traffic Controller Attrition**

The FAA developed the 2006 Controller Workforce Plan to guide its activities as the agency hires an estimated 15,000 Air Traffic Controllers through the year 2016. After reviewing the 2006 plan, the OIG expressed concern that the plan did not account for staffing needs by location or the costs associated with training new controllers.
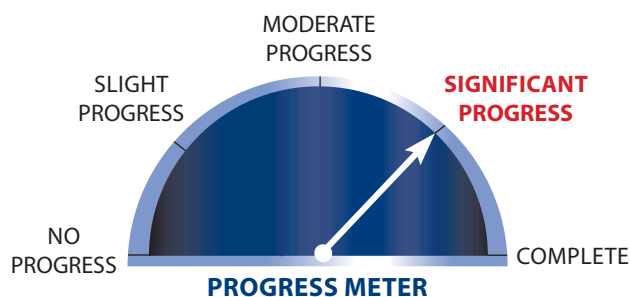

To address this challenge, FAA updated its comprehensive workforce plan in March 2007. The *2007 Controller Workforce Plan* now provides staffing ranges for each of FAA's 314 facilities. The ranges take into account not just the staffing standards generated from industrial engineering techniques, but also historical productivity, peer performance, and service and field unit input. Current staffing levels are dynamic and can be impacted by airport construction, controller training, and other

issues. Future staffing levels are a function of traffic forecasts, hours of operation, attrition forecasts, and other variables. The FAA continues to pay close attention to staffing at each facility and adjusts staffing levels accordingly.

The OIG also expressed concern that the *2006 Controller Workforce Plan* did not identify the annual developmental training costs associated with the hiring of new controllers. The *2007 Controller Workforce Plan* includes an estimate for total salary, premium pay, and benefit costs annually for all developmental controllers. Since developmental controllers in training perform actual controller work as they become certified, these salaries are included in the personnel costs of FAA's budget request.

- Using the Cost Accounting System to Control Costs and Improve Operations

The FAA's Cost Accounting System (CAS) is an accounting system designed to report the total cost of delivering FAA products and services. CAS calculates all FAA costs by projects and tasks. In 2007 FAA made a concerted effort and significant progress in improving the reliability of its cost data and in allocating those costs to NAS users.

FAA requires employees, managers, and supervisors ensure accurate, consistent and complete entry of labor distribution reporting data in accordance with the Labor Distribution Reporting (LDR) Policy, FAA Order 2700.37. Per this order, FAA managers and supervisors are primarily responsible for ensuring the compliance and integrity of LDR data entry. In addition, LDR quality assurance resources and timekeepers help by providing added focus, guidance and support for ensuring data integrity. The Order states, in part, "The FAA will collect paid hours worked by each employee, manager, and executive against identified projects and activities. No manager may excuse employees from compliance with this LDR policy."

In FY 2007, FAA targeted 92.5 percent of labor hours to be charged to valid projects and activities. Corporately, FAA achieved a final rate of 95 percent. Further, FAA's Air Traffic Organization made a significant effort to record its labor and achieved a rate of 97 percent. This labor distribution compliance rate is routinely reported on a monthly basis in an executive scorecard to the Administrator. Also, as part of the monthly executive scorecard, FAA introduced a new reporting requirement where each line of business must report back to the Chief Financial Officer within 90 days on how cost accounting data are being used to manage costs. In FY 2008, the corporate goal will be 95 percent and FAA is well-positioned to meet this goal.

To ensure cost data are current, FAA now establishes new project codes when there is a management need to track the cost of a project or activity. This is an ongoing activity to better understand the cost

of FAA operations. Customers are routinely consulted to incorporate system change requests into future CAS releases and improve its managerial cost reporting.

Improving the accuracy and timeliness of capitalization costs was a major effort in 2007. This has a direct impact on the reliability and timely recording of operating cost data because all agency expenditures are either classified as operating or capital. The FAA conducted an intensive review of its Construction in Progress (CIP) balance and introduced policy/procedural changes, along with training, to ensure the agency keeps capitalization efforts current. In addition, FAA instituted several metrics to keep management informed on the status of its capitalization workload. The agency continues to implement financial metrics to ensure improved overall financial performance.

3. Management Challenge: Responding To Natural Disasters And Emergencies – Assisting Citizens And Facilitating Transportation Infrastructure Reconstruction

- **Clarifying Roles and Responsibilities Given Expanded Mission Requirements**

Under the National Response Plan, DOT is the lead agency for coordinating transportation support (Emergency Support Function-1) following a disaster. DOT also serves as a support agency for 11 other critical functions. For example, DOT works with state and local transportation departments and industry partners after disasters to assess transportation infrastructure damage and analyze associated impacts on transportation operations, nationally and regionally, and to report changes as they occur. DOT also has statutory roles related to preparedness for, response to, and recovery from emergencies, such as through the Federal Highway Administration's Emergency Relief program.

DOT has worked very closely with Department of Homeland Security (DHS) to clarify respective roles and responsibilities. The clarifications will be included in revisions to the National Response Plan, the Federal Emergency Management Agency (FEMA) Hurricane Contingency Plan, and other operating practices and procedures.

Some of the clarification has been the result of the reassignment of responsibilities related to disasters and other emergencies. DOT has taken a more active role working with State and local transportation officials in planning for disasters. We are collaboratively assessing transportation infrastructures and systems for vulnerabilities and identifying critical elements. DOT is also working with State and local officials in identifying response options to local transportation failures. This includes developing alternatives in response to situations such as the bridge collapses in Oakland,
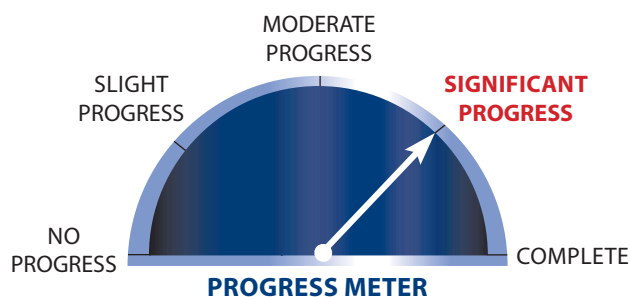
California and Minneapolis, Minnesota, and in planning for alternatives in response to other potential disruptions to the transportation system such as hurricanes, earthquakes, and terrorist attacks.

While we have taken on a more significant pre-disaster and post-disaster planning role, the role of procuring and managing transport services is being transferred from DOT to FEMA via a Memorandum of Understanding (MOU). DHS views the acquisition and management of transport services as key to FEMA's Logistics Management capability and is integrating it into its overall Logistics function. The transition between the two Departments is taking place in two phases: transportation services for evacuation of the general population transitioned June 1, 2007; transportation services for responders, equipment, and goods transfer effective January 1, 2008.

DOT is assisting FEMA in creating this new functionality through providing materials, training, and advice. The MOU contains language that requires DOT and DHS to work to actively and rapidly communicate the role transition to their own field offices and to stakeholders nationwide. DOT has already assisted DHS by briefing DOT field personnel in detail, and by briefing key leaders and staff of FEMA's field offices. While the role transition will reduce the number of locations that DOT is likely to be tasked to provide staffing, DOT has continued to develop, through training, exercises, and practical experience a cadre of response personnel sufficient to carry out the Department's requirements following any disaster. The changed role should also result in more clearly defined missions and chains of command, and lines of communication for effective intra- and inter-agency coordination.

- **Ensuring Continued Vigilance in Protecting Taxpayer Funds spent for Relief and Recovery Efforts**

Since the 2005 Gulf Coast hurricanes, the Department continues to be proactive in ensuring that funding for future recovery efforts are spent wisely and in accordance with the law. Two years after the hurricanes struck the Gulf Coast, the Department continues to have bi-monthly meetings with the Chief Financial Officers of each Operating Administration to discuss procurement and financial management procedures related to emergency response.
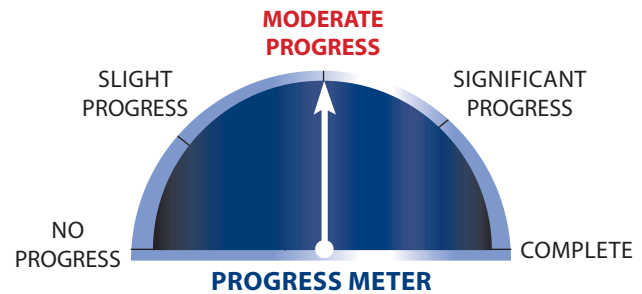

DOT has also worked to comply with every recommendation made by the OIG and by the GAO that relates to disaster response/recovery fiscal and procurement matters managed by DOT. One of the most visible of these has been acquisition of funding from FEMA for a closeout audit by the Defense Contract Audit Agency of the $800 million Landstar Express America emergency transportation services contract administered by Federal Aviation Administration.

4. Management Challenge: Strengthening Efforts To Save Lives By Improving Surface Safety Programs

- **Promoting Improved Performance Measures and Enhanced State Accountability to Maximize Efforts to Reduce Fatalities Caused by Impaired Driving**
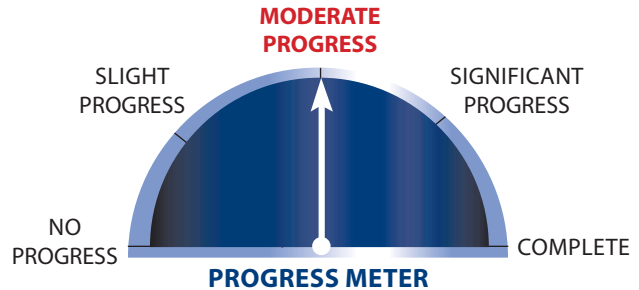
Analysis of NHTSA's efforts to counter alcohol-impaired driving found that NHTSA must ensure that States establish and report better performance measures to assess implementation of key strategies for effectively using funding to counter impaired driving. State performance plans generally contain measures on activities, such as the number of sobriety checkpoints conducted, or the overall performance goal of reducing the alcohol-impaired fatality rate. However, the plans usually do not address performance of key strategies, such as sustained enforcement of laws, effective prosecution, and full application of available sanctions. Better information is needed on the degree to which States are implementing these key strategies. For example, NHTSA communicated to the States one possible way to quantify sustained enforcement, but none of the States included this measure in their annual plans or performance reports to NHTSA.

In continuing to combat impaired driving, NHTSA made $125 million available in FY 2007 to the 50 States, the District of Columbia and Puerto Rico for alcohol-impaired driving countermeasure laws or programs, such as administrative license revocation laws and graduated licensing programs, or to meet certain performance criteria based on their alcohol-related fatality rates. Within this program, the ten States with the highest impaired driving fatality rates received extra funding. NHTSA worked closely with these ten States to facilitate implementation of effective programs, including periodic and sustained high-visibility enforcement efforts and media campaigns. NHTSA implemented the new national advertising campaign delivering the message "Drunk Driving: Over the Limit: Under Arrest." As part of this campaign, States conduct impaired driving enforcement crackdowns during the Labor Day and December holiday seasons. In FY 2007, NHTSA also further enhanced its impaired driving program, with continued emphasis on assisting high-risk populations (e.g., underage drinkers, 21 to 34 year-olds, individuals with high blood alcohol levels and repeat offenders).

- Building on Successful Efforts to Better Enforce Motor Carrier Safety Regulations

FMCSA recognizes that improvement needs to be made concerning imposing maximum fines on motor carriers that chronically violate serious safety regulations. FMCSA has worked with OIG and the Government Accountability Office concerning recommendations made during FY 2007 emphasizing the requirements of Section 222 of the Motor Carrier Safety Improvement Act of 1999. FMCSA will publish a proposed rulemaking and internal policies in FY 2008 updating these procedures for handling repeated and patterned violators.

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Fundamental ground work is being laid to correct problems associated with the data quality of FMCSA's Motor Carrier Management Information System census file and the Agency is considering a number of initiatives to encourage the motor carriers to update their registration data. Each census record contains the following information:

- ◇ <u>Census Information:</u> Entity Identifying Data - name, address, etc;
- ◇ <u>Business/ Operation Data:</u> Operation Classification and type of business;
- ◇ <u>Cargo Classification:</u> Types of cargo and hazardous materials carried;
- ◇ <u>Equipment and Driver Data</u>: Number of trucks owned, term-leased or trip-leased, number of drivers;
- ◇ <u>Carrier Review Data</u>: Latest review date, accident rate, safety rating.

Specifically, an inventory of data quality issues related to the census file has been identified. A working group of business and technical experts has been assembled to address data quality problems and will provide recommendations to improve the census file and its quality. Some preliminary findings suggest that recommendations may include: changes to the existing registration processes, the development of improved instructions and training materials to carriers, an outreach program to carriers on the importance of updating and ramifications of not updating their census data, the redesign of the technical data collection and management systems, and modification to Federal regulations and enforcement policies.

There has been a significant level of effort in the form of training and technical assistance provided to States to improve the quality of crash data reported by the State to FMCSA. Specifically, State police crash reports in 32 States have been re-evaluated and recommendations have been made to the States to improve these forms with respect to data required by FMCSA. Training for the collection of commercial motor vehicle crash data has been conducted in 10 States. This training has been tailored to accommodate State specific needs such as the inclusion of instructions on how to collect the data in the States electronic data collection system. Training materials developed for the electronic
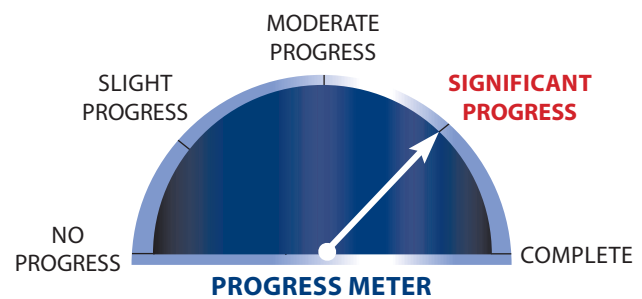
data collection disclosed weaknesses in the electronic capture systems and FMCSA has made recommendations on how to improve the electronic system to allow for more complete and accurate data collection as well. Specialized train-the-trainer materials have been developed and incorporated into State training academies. In California alone over 600 officers have been trained through the FMCSA-developed train-the-trainer program.

- **Ensuring the Integrity and Future Modernization of the Commercial Driver's License Program**

FMCSA pursued several approaches to prevent fraud in State Commercial Driver's License (CDL) programs. During FY 2007, the Agency completed comprehensive compliance reviews of 15 State CDL programs. These reviews are conducted to ensure that States have the proper statutes and administrative procedures to manage their CDL programs and that State computer systems and licensing procedures are being implemented in compliance with the Federal requirements. Findings and recommendations from the compliance reviews have been provided to the States so they can make the necessary improvements to driver licensing testing and issuance procedures in order to reduce their susceptibility to fraud.

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FMCSA has completed a demonstration test of a software application intended for detecting and deterring fraud perpetrated by third-party and State motor vehicle administration examiners. The testing of prototype software, called the Commercial Drivers CDL Skills Test Information Management System, was completed in partnership with the American Association of Motor Vehicle Administrators (AAMVA), and the States of Alaska, Arizona, New Mexico, and South Dakota.

FMCSA awarded $22.7 million in grants to States in FY 2007 to support improvements in State CDL programs and address deficiencies identified in compliance reviews and Inspector General and Government Accountability Office audits. These grants also went to improving the accuracy, speed and completeness of driver history information exchanged among the various components of the system – including law enforcement, prosecutors, the courts, employers and State driver licensing agencies – both within the States and between States.
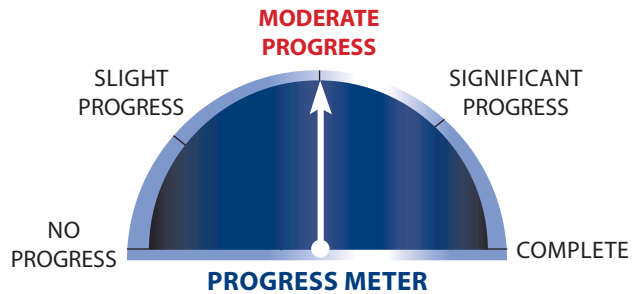
FMCSA has also awarded a Commercial Drivers License Information System (CDLIS) Modernization Grant to the AAMVA for $7 million to facilitate the modernization of CDLIS to ensure that it: 1) complies with Federal information technology security standards; 2) provides for electronic exchange of all data including posting convictions; 3) contains self-auditing features to

ensure data quality; and 4) integrates the CDL and medical certificate. The CDLIS modernization grant supports improvements to the CDLIS central facility and assists the States in upgrading their CDL computer systems to be compatible with the new central site.

FMCSA is in the process of completing efforts related to the SAFETEA-LU mandated CDL task force consisting of State motor vehicle administrators, and representatives from the motor carrier industry, labor organizations, judicial system and safety advocacy organizations. The task force met four times in FY 2007 and discussed issues and problems affecting their respective constituencies. The task force members agreed that the existing CDL program is a highly effective highway safety program that needs incremental improvements rather than major modifications or restructuring. The task force will issue a report to Congress in early FY 2008.

- **Enhancing Railroad Safety Through Improved Oversight of Grade-Crossing Reporting and Better Identification of Trends.**

As reported previously to the Office of Inspector General (OIG), FRA has routinely validated the completeness and accuracy of its grade crossing collision database against the National Response Center (NRC) data since the late 1990s. Between 2004 and 2006, our monthly NRC audit process identified a single instance where a crossing collision was reported to the NRC but not to the FRA. This audit process compares the NRC rail data against approximately 3,000 FRA crossing collision reports. The offending railroad attributed the oversight to an administrative error and submitted a late report after they were notified by FRA. The matter was also referred to the appropriate FRA region for enforcement.

FRA established a reconciliation process to ensure that fatal grade crossing collisions are promptly reported to the NRC. This "reverse" audit process was instituted in 2004, and since that time, the number of initial discrepancies (potential failures to provide telephonic notification to the NRC) has reduced drastically from 61 cases in 2004 to 16 in 2006. This is a clear indication that the reconciliation process has had a positive impact on railroads' compliance with applicable regulations.

FRA has completed the comparison of information on grade crossing collisions provided by the railroads to the information provided by local law enforcement and State regulatory agencies. The report is in the final stages of review within FRA and it is expected that the report will be released before the end of 2007.

Although FRA is still completing the report of that pilot study, the following tentative conclusions have been reached:

◇ For the great majority of police reports, matching forms 6180.57 were filed;

✧ There appears to be no pattern of discrepancies evident from the reports (e.g., no indication that railroads have misrepresented the events in question); and,

✧ In general, the 6180.57 forms provided more useful detail, although in some cases, police report narratives provide additional insight on motorist behavior.

To facilitate the targeting of resources, in October 2005, FRA began to phase in the implementation of its National Inspection Plan (NIP). The Plan is intended to make better use of data and direct safety inspectors to high-risk areas. FRA implemented the NIP for three inspection disciplines (Operating Practices, Track, and Motive Power and Equipment) at the beginning of FY 2006. Full implementation was achieved in March 2006, when two more disciplines (Hazmat and Signal and Train Control) were added to the plan.

The NIP complements the aggressive and ambitious National Rail Safety Action Plan (NRSAP), originally introduced in 2005. The NRSAP involves five strategic initiatives, including the improvement of hazmat safety and emergency response capability, and the reduction of human factor accidents—which are still the leading cause of train accidents, accounting for 36 percent of the total in 2006.

5. Management Challenge: Aviation Safety – Performing Oversight That Effectively Utilizes Inspection Resources And Maintaining Aviation System Safety

- **Advancing Risk Based Oversight Systems**

The FAA continues to improve its risk-based oversight system. A fully usable manual risk assessment/risk-based oversight system for repair stations was implemented in September 2005. This oversight system, which was automated in FY 2006, provides for continuous assessment and prioritization of each repair station and non-certificated repair facility. In October 2006, the bulletin "Air Carriers Outsource Maintenance Provider Oversight Responsibilities" was issued providing guidance to principal inspectors assigned to 14 CFR Parts 121 and 135 air carriers who outsource some or all of their maintenance to other persons including non-certificated repair facilities. These instructions were for additional oversight of each air carrier's outsourced maintenance arrangements and were issued in conjunction with a new guidance Order 8300.10, *Airworthiness Inspector's Handbook.*

The FAA is on schedule to have all of the current 120 air carriers, regulated by 14 CFR Part 121, transitioned to the Air Transportation Oversight System (ATOS) by the end of 2007. ATOS improves the Certification and Surveillance processes for air carriers and it assesses the safety of air carrier

operating systems using system safety principles, safety attributes, risk management, and structured system engineering practices.
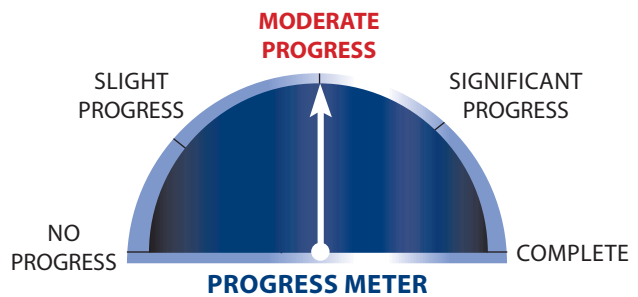
ATOS has been redesigned to provide the flexibility necessary to manage the multitude of tasks necessary to evaluate the operations of small and large air carriers and their diverse operating environments. The redesign allows inspectors to identify risks in each air carrier's operation and, on that basis, target resources to stay abreast of the rapid changes occurring in the industry. The new process and software has been tested at three key sites – United Airlines, Colgan Air, and Aerodynamics – and is now being adopted throughout the system. The FAA offices are also being staffed and reconfigured to efficiently use inspector resources in conjunction with these conversions. All ATOS users will receive training on the new process and software.

In April 2007, Notice 8000.362 became effective, requiring principal inspectors to evaluate the air carrier's outsourced maintenance programs to ensure work performed by certificated and non-certificated repair facilities is accomplished within the scope of the contract and in compliance with the air carrier's maintenance instruction for continued airworthiness. The notice also requires evaluation of the air carrier's oversight, authorization and training procedures for non-certificate repair facilities.

The FAA is currently revising Operations Specification D-91, requiring air carriers to list all certificated and non-certificated repair facilities performing outsourced maintenance and will publish the final rule by the mandated date of August 16, 2008. Redesigning ATOS, implementing a risk-based oversight system, and publishing additional guidance in 2006 and 2007 allow for effective oversight without limiting the work done at non-certificated repair facilities.

- **Maintaining a Sufficient Inspector Workforce**

The FAA is developing short and long-term strategies to address safety workforce staffing. In May 2007, FAA's Aviation Safety Organization (AVS) provided to Congress a 10-year *Aviation Safety Workforce Plan*. This plan ensures an adequate safety staff is maintained to address oversight needs and addresses inspector attrition and anticipated changes in the aviation industry. The workforce plans also address the competencies and skills required for staying abreast of new technologies and to successfully perform in a Safety Management System (SMS) work environment.

The FAA closely monitors retirements and takes steps to hire the next generation of safety inspectors. We also evaluate inspector staffing levels to ensure the Flight Standards Service and Aircraft Certification Service can sustain sufficient oversight as a result of potential attrition within the workforce.

In January 2007 FAA received a copy of the *Aviation Safety Inspector Staffing Standards Study* prepared by the National Research Council of the National Academies of Science. In response to the recommendations in this study, FAA tasked an independent contractor to conduct a phased approach to the design, development, and implementation of a new automated, demand-driven, staffing model. The contractor will conduct a baseline analysis of the aviation safety inspector workforce and identify productivity measures. Specifically, the contractor will develop a staffing model that will have the capability to perform "what if" scenarios that build on customer demands and changing employee skill sets and can support an evolving safety management system culture of the future. The project design, development and training are estimated to be completed in the next 24 months.

By the end of 2007, increased inspector resources will allow the FAA to transition all Part 121 air carriers to the Air Transportation Oversight System. This risk-based, commercial aviation safety oversight system is increasing the effectiveness of the FAA safety oversight efforts by developing safety surveillance plans for air carriers based on data analysis. The FY 2008 President's Budget would provide an additional 241 new safety positions in AVS, including 90 new inspectors for increased oversight and surveillance activities.

Currently, the most significant impact on the workforce is the evolution of the risk-based system and increased oversight of designees. While these challenges do not demand significantly more or fewer inspectors, they do demand a different skill set. The overall management strategy to meet future oversight requirements focuses on three areas – train current AVS inspectors to help manage the transition to a SMS; change the AVS culture to accept the transition to an SMS; and hire the right people with the right skills to work in the future aviation environment.

The FAA has also established recruitment plans to fill our most critical occupations. The agency is working with technical schools to fill entry-level positions. It has ongoing efforts with minority- and women-focused technical publications and associations to ensure positive publicity for FAA and AVS, as well as to enhance recruiting opportunities. By the end of 2007, increased inspector resources will allow FAA to transition all Part 121 air carriers to the ATOS. This risk-based, commercial aviation safety oversight system is increasing the effectiveness of the FAA safety oversight efforts by developing safety surveillance plans for air carriers based on data analysis. We currently have a large pool of qualified aviation safety inspectors available for recruiting. We anticipate that even with the new skill set requirements there will be enough candidates to select the needed inspectors in the future.

- **Reducing the Risk of Accidents on the Ground and in the Air**

Runway incursions occur in the airport runway environment when an aircraft, vehicle, or person on the ground creates a loss of required separation with an aircraft. Runway incursions present a serious risk to aviation and have resulted in collisions and fatalities. Reducing the risks of runway collisions and incursions is a top priority of the Federal Aviation Administration (FAA). In order to reduce the severity, number, and rate of runway incursions, the FAA continues to mitigate the errors that contribute to collision risks. The agency has been aggressively addressing the issue and has made progress reducing the most serious incidents, particularly those involving commercial aircraft. In FY 2007, the estimated rate of runway incursions was 0.302 per million operations. The number of serious runway incursions has been reduced by more than 50 percent within the last five years.

The FAA continues to conduct Runway Safety Action Team (RSAT) meetings, pilot seminars, flight instructor refresher courses, commercial flight instructor and designated pilot examiner refresher courses and airport safety meetings. The purpose of an RSAT meeting is to emphasize the importance of runway safety and communication among users. Preventative measures to reduce runway incursions include: training on airport infrastructure for new controllers, runway training on airport signage and markings, adherence to proper phraseology, read-back/ hear-back requirements for controllers and pilots to ensure understanding of directions, review of hot spots, quality assurance reviews and the review and audit of tapes.

In FY 2007, FAA installed ASDE-X at Louisville International Airport and Charlotte Douglas Airport. Ongoing activities to reduce the risk of runway incursions included improvements to air traffic controller, pilot and vehicle driver awareness, as well as to airport infrastructure and technology enhancements.

In August 2007, in response to a recent rise in runway incidents, the agency sponsored a high-level meeting with 40 aviation industry leaders to brainstorm remedies for reducing runway incursions. The meeting focused on identifying short-term steps that could be implemented within 30-60 days. The recommendations center on improved procedures, increased training for airline personnel, and more rapid deployment of technology that could reduce runway incursions.

In the longer term, the agency will be looking towards technological solutions, including the deployment of runway status lights in conjunction with ASDE-X. The agency will also be taking a close look at the performance of two lower-cost ground surveillance systems currently being tested and evaluated in Spokane. Both systems provide cost effective alternatives to ASDE-X and can be installed in less than a week. While not as sophisticated as ASDE-X, they provide incremental situational awareness for controllers.

Separation in the air, whether it is from other aircraft, terrain, obstructions, or restricted airspace, is a critical aspect of air safety. Air traffic controllers employ rules and procedures that define separation standards for this environment. An operational error (OE) occurs when there is a loss of separation between aircraft or aircraft and other objects. Reducing the risk of operational errors is one of FAA's top priorities as traffic continues to increase.

The FAA's Air Traffic Organization (ATO) is developing and implementing an automated software application that will depict Air Traffic Control (ATC) separation conformance in both the terminal and en-route environments nationwide. The Traffic Analysis and Review Program (TARP) will apply separation logic to targets; identify where applicable separation standards are not being maintained; and highlight incidents for further investigation. This will be accomplished by utilizing TARP replay features to review radar and voice data to analyze potential operational errors.

In June 2007, ATO completed its *Automated Safety Initial Performance Implementation Plan* for all applicable en-route and terminal facilities. The development of a next generation safety performance measurement tool for the en-route environment was completed in 2007. This course of action will ensure FAA has a meaningful baseline of operational errors and allow consistent reporting of operational errors.

The FAA has historically tried to understand and mitigate the incidence of OEs, focusing on the critical component of the system—the closest person to the air traffic situation and the last point of prevention—the air traffic controller. We focused attention on implementing a coordinated system of investigations to identify causal factors, fielding automation to identify and re-create events, developing metrics to categorize OE severity, and sponsoring unique performance enhancement programs.

Specifically, during FY 2007, FAA improved how the severity of operational errors is calculated. We began implementation of a new system to classify OEs and instituted a 10 percent performance tolerance on separation minima to better understand and measure our safety performance. These changes allow us to take full advantage of advances in technology that now permit for separation measurements to a hundredth of a mile (60 feet) and allow us to capture more events that approach the edges of the separation standards.

The new measurement process, referred to as the Separation Conformance (SC), measures the severity of the outcome of the OE as a result of the percent of required separation that was maintained. When the SC is measured in combination with the number of operations, it creates a reliable rate-based measure of safety.

Further, the new measurement system minimizes the number of criteria used to determine OE severity, minimizes subjectivity, and allows for better analysis of same category events—all of which enhance safety conclusions. With these changes, we now measure the proximity between two aircraft which better characterizes the actual risk of collision. The FAA is currently testing the new severity tool which will be implemented in FY 2008.

Also in 2007, FAA modified the evaluation process by which it audits and performs assessments of ATC facilities in order to reduce operational errors and focus on system risks. The FAA reviews radar and voice data tools as part of its Air Traffic Safety Quality Assurance Order, as well as disseminates initial evaluations and audit data derived from the Facility Safety Assessment System to ATO Terminal and ATO en-route facilities.
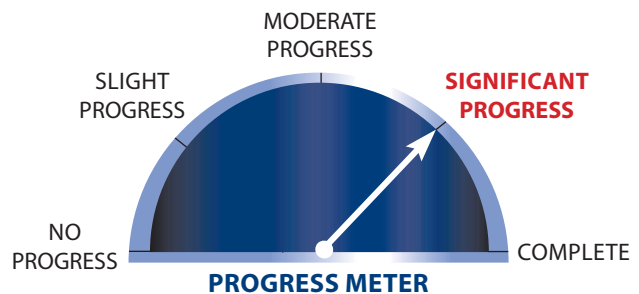
To enhance air traffic supervisor and controller discussion of serious events during team briefings, safety clips are developed using actual air traffic control incidents. These clips use video reenactments, replays of radar/voice, references, and narration of safety enhancement messages. Targeted subject matter is derived from areas such as daily reviews of operational errors and operational deviations, collisions, facility evaluations, and customer feedback. These safety awareness tools promote and support a safety culture by: 1) helping controllers visualize an event that actually happened; 2) aiding the development of strategies based on intuitive and experiential expertise for use in similar situations; 3) creating an objective examination of air traffic events and the service that FAA provides to its customers; and 4) continuously assessing individual, team, facility, and organization performance.

The ATO's Safety Services Unit continues to offer its one-day training course, Crew Resource Management (CRM), designed to help the air traffic controller detect and correct controller and pilot mistakes before they result in operational errors or pilot deviations. CRM is an operationally-relevant, one-day workshop that focuses on teamwork and individual performance such as situational awareness and safety vigilance. The course also focuses on threat and error management, vulnerabilities and countermeasures. Based on initial feedback, FAA continues to refine the current CRM training and Cadre courses.

6. Management Challenge: Making The Most Of Federal Resources That Sustain Surface Transportation Infrastructure Improvements By Continuing To Emphasize Project Oversight.

- **Initiatives to Improve the Oversight of Highway Trust Funds Need to be Implemented Effectively to Insure That Projects are Completed On Time, Within Budget, and Free From Fraud**

The FHWA continued to implement the Financial Integrity Review and Evaluation (FIRE) program to improve its compliance with the *Federal Managers' Financial Integrity Act* (FMFIA) and improve grant oversight. Also, FHWA re-implemented an improved version of Delphi's Projects Module that resolved an area of nonconformance involving Federal Lands Highway Program transaction processing

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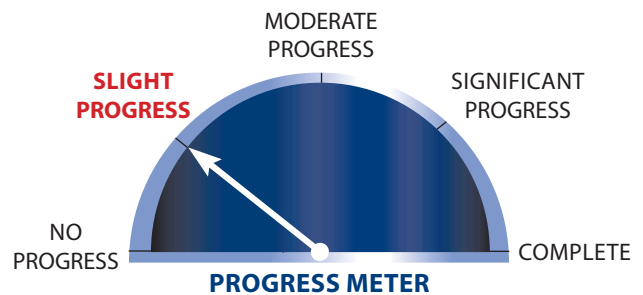
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and reconciliations. The FHWA is currently in the process of conducting agency-wide testing of its financial and cost controls for a twelve month period. The results of this testing will be provided by the end of 2007. In addition, the Agency established a grants management council to help oversee and ensure alignment of FHWA's grant-related programs and supporting financial processes.

FHWA took aggressive steps to validate State cost estimates and thoroughly address potential risks. FHWA issued Major Project Guidance in January 2007 that stresses the importance of developing reliable cost estimates. FHWA conducted risk-based cost estimate validations for seven major projects and will continue the cost estimate validations during FY 2008. A pilot test was completed for a new training course designed to address Major Project cost estimating needs and requirements. The course focuses on raising awareness of the significance of cost estimates throughout the project continuum and the need to accurately and thoroughly identify risks involved.

FHWA delivered a specific training program focused on critical risk identification. In response to this suggestion from the OIG, FHWA established a core competency framework for Major Project Oversight Managers. In addition, 34 participants including 13 current Managers completed a project management certificate training program that FHWA developed for employees who are currently responsible for supporting or managing stewardship and oversight for existing Major Projects. Members of the FHWA Major Projects Team involved in oversight activities or individuals preparing to be Major Project Oversight Managers in the near future also attended the training program.
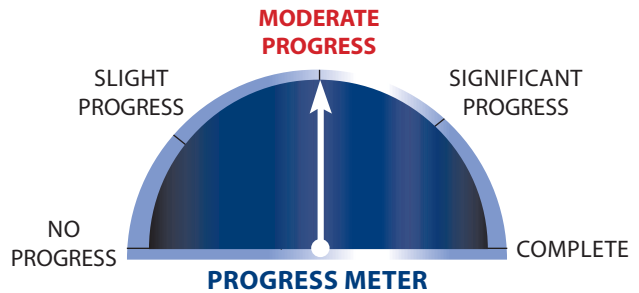
- **FHWA's Oversight Must Include Actions to Ensure That Highway Tunnels are Safe for the Driving Public.**

FHWA has begun developing an Advance Notice of Proposed Rule Making in which the Agency will outline its requirements to be included in National Tunnel Inspection Standards. If implemented, this program will require States to inventory and inspect tunnels on an established frequency. The most pressing safety challenge for tunnel facilities is dealing with fires, either accidental or intentional. FHWA's approach to bridge and tunnel security is to look for cost effective solutions that can be integrated into an infrastructure owners' planning, design, operation and maintenance, recognizing that owners and operators have many competing agendas. FHWA also completed an international scan on tunnel safety and security and issued a report outlining several measures that could be incorporated into new and existing tunnels to improve their safety and operation.

- **FTA Must Continue to Exercise Vigilant Oversight to Ensure Large and Complex Transit Infrastructure Projects are Completed On Time and Within Budget**

FTA continues to aggressively implement a program of project management oversight for its transit infrastructure projects, including the use of outside project and financial management oversight consultants. FTA uses a risk-based approach for the oversight of its Federal projects—a best practice. FTA fine-tuned its risk-informed assessments of transit projects and hired an independent management consulting firm to evaluate this approach to project management oversight. FTA's project management oversight contractors are charged with regularly monitoring each project and providing feedback to Federal officials should any problems arise. The oversight contractors hired for each project are charged with conducting risk assessments, reviewing scope, cost, schedule, project contingency, and assessing each grantee's plans for the project. FTA fully analyzes the results of the project management oversight contractors' reports; takes action, where appropriate; and exercises its own oversight role in addition to the contractors' work.
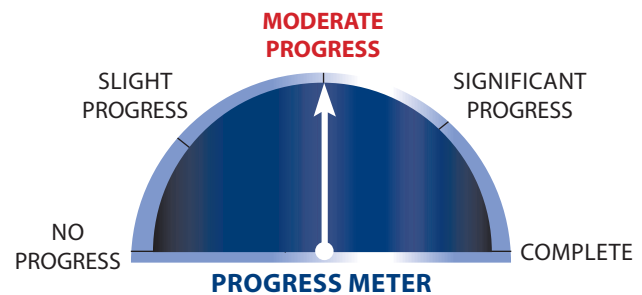
FTA's initiatives have improved oversight for its grantees' projects. On July 13, 2006, we testified to Congress that effective day-to-day oversight of these large and complex transportation projects is critical, and that FTA should use all of its oversight tools effectively. Vigilant oversight will be particularly important because FTA must continue to oversee the federally funded transit infrastructure projects throughout the Nation, while at the same time overseeing several large and complex initiatives collectively costing about $16 billion. Examples of these initiatives are the Lower Manhattan Recovery Projects (four FTA projects and one FHWA project with a Federal commitment of $4.4 billion), the New York/Second Avenue Subway Minimum Operable Segment (estimated to cost $4.7 billion), and the Long Island Rail Road East Side Access (estimated to cost $7.3 billion). The projects in New York City and the concurrent construction activity there can be expected to create significant competition for materials and labor. FTA will need the right mix of oversight resources to effectively manage costs, schedules, and quality issues during the construction of each of these large infrastructure projects.

7. Management Challenge: Achieving Reform Of Intercity Passenger Rail

- **Amtrak Must Do More to Improve Cost-Effectiveness, Operate Efficiently, and Improve Performance**

At the urging of FRA, Amtrak has taken many steps to address these areas over the past year. Amtrak's Management and Board of Directors have a roadmap of the corporation's Strategic Reform Initiatives. Amtrak tracks progress toward implementing these changes by estimating the savings and/or revenue generated. An update is presented to the Board of Directors at every regular meeting. The "bottom line" result is that revenues are up, expense growth has been limited, Amtrak's debt has been reduced, and the company is significantly more financially stable than it was five years ago.

Additionally, FRA expanded the capabilities of its Intercity Passenger Rail Analysis Division with financial, accounting, transportation planning, and engineering expertise. FRA's enhanced on-site staff capacity has facilitated FRA's review of Amtrak Management's proposals and approaches through multiple prisms. Furthermore, the Division has undertaken multiple initiatives to improve FRA management's understanding of the nuances of Amtrak's operational and corporate performance. For example, these initiatives include (1) specification and analysis of the most detailed on-time performance data ever provided by Amtrak to the FRA, and (2) new concepts for the presentation and interpretation of traffic, revenue, expense, and corporate result data.

FRA has undertaken an intensive review of Amtrak's capital-related acquisitions. Specifically, FRA conducts quarterly reviews of Amtrak's entire capital program, with civil and mechanical engineers scrutinizing infrastructure and equipment programs; as well as reviews of reprogramming proposals, with a goal of improving efficiency and cost-effectiveness.
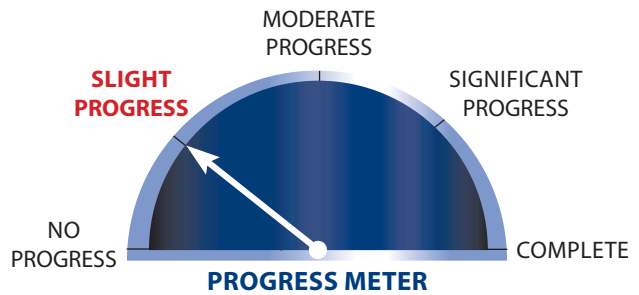
DOT is working with Amtrak on several aspects of improving financial reporting and financial management practices. DOT continues to collaborate with Amtrak on the development of a managerial cost accounting plan. Amtrak's plan, which is still being negotiated, contains the following major elements:

- ◇ Integrated financial systems project;
- ◇ Activity analysis pilot project;
- ◇ Strategic framework; and,
- ◇ Route accounting system upgrade and related FRA cost accounting methodology development project.

Additionally, through the Department's Volpe National Transportation Systems Center (Volpe Center), FRA is developing a new avoidable cost methodology. This new methodology will be reflected in a new cost allocation model Amtrak plans to implement in FY 2008. The new model will significantly improve the transparency and accuracy of Amtrak's financial reporting by route and business line.

- **Amtrak Needs a New Model for Providing Passenger Rail Transportation**

The FY 2008 budget included a request for the creation of a Federal/State Capital program to support the needs of intercity passenger rail service. This new grant program considers the fact that most publicly supported transportation in the U.S. is undertaken through a partnership between the Federal government and the States. This model, which has worked well for generations for highways, transit and airports, places the States at the forefront of planning and decision-making. States are uniquely qualified to understand their mobility needs and connectivity requirements through statewide and metropolitan area intermodal and multimodal transportation planning funded, in part, by the U.S. Department of Transportation.

DOT believes that this model will also work for intercity passenger rail. Several States have chosen to invest in intercity passenger rail service provided by Amtrak as part of strategies to meet their passenger mobility needs. Over the past 10 years, ridership on intercity passenger rail routes that benefit from State support has grown by 88 percent. Over that same time period, ridership on all Amtrak routes not supported by States has increased by only 22 percent.

State involvement in planning and decision-making for intercity passenger rail service identifies where mobility requirements justify public investment. An excellent example can be found in Washington State, which has invested in intercity passenger rail from Portland, OR, through Seattle, to Vancouver, B.C. in order to relieve highway travel on the congested I-5 corridor. Similarly, the state of Illinois has made financial commitments that have effectively doubled the number of State-supported trains operated by Amtrak on three routes.

Past experience shows active State engagement in planning and decision-making helps assure that infrastructure components, such as stations, provide connectivity to other forms of transportation, which support intermodalism within the State. For example, in North Carolina, the State has undertaken the redevelopment of its intercity passenger rail stations and transformed them into multi-modal transportation centers serving the mobility needs of the surrounding communities.
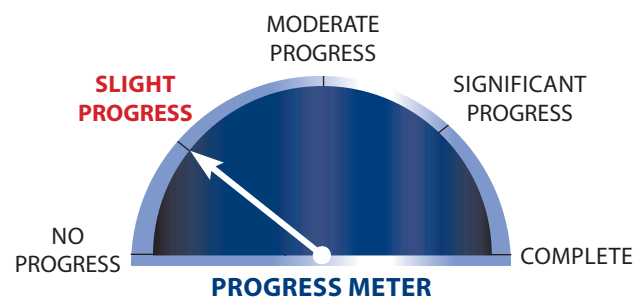
State participation in financing intercity passenger rail service provides added incentives for Amtrak to seek ways to enhance quality of service, partnership, and goodwill. In Vermont, where the State offered higher State operating subsidies for current service, Amtrak was willing to restructure services to drive down operating costs, while increasing train frequencies for Vermont citizens.

This grant proposal aligns with Amtrak's strategic reform initiative, as Amtrak seeks to build on its recent experience with the States as it is proactively seeking to create a stronger role for the States in designing and supporting State priorities. The Administration supports this aspect of Amtrak's internal reform. In discussions with interested States, the DOT has found that the greatest single impediment to implementing this initiative is the lack of a Federal/State partnership, similar to that which exists for highways and transit, for investing in the capital needs of intercity passenger rail. This partnership will play a critical role in the evolution of intercity passenger rail.

8. Management Challenge: Improving Acquisition And Contract Management To Reduce Costs And Eliminate Improper Payments.

- Institutionalizing the Use of Defense Contract Audit Agency Contract Audit Services

The Office of the Senior Procurement Executive (OSPE) has been working closely with the Office of the Inspector General (OIG) and the Chiefs of the Contracting Office (COCO) of the Operating Administrations to improve and institutionalize the use of Defense Contract Audit Agency (DCAA) services.

As noted in a recently issued OIG report on the subject, the Senior Procurement Executive has issued policy which establishes appropriate requirements for use of audits. Therefore, the focus has recently been on improving implementation of that policy.
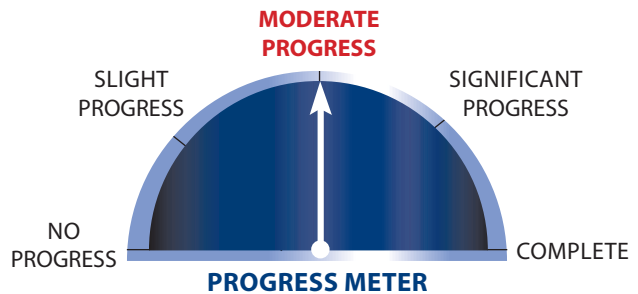
Most recently OSPE developed a methodology whereby DCAA and the Operating Administrations work together to identify cost-type contracts most suitable for audits and better estimate the necessary audit hours in an annual audit plan. This plan was first developed during this current fiscal year. Based on the lessons learned, OSPE has worked with the Operating Administrations to improve that plan for FY 2008. Discussions with the OA COCO's revealed that not all cost contracts identified by DCAA were of sufficient complexity to warrant auditor assistance. Therefore, rather than using the DCAA-provided list, in many cases, the COCO's opted to identify for themselves the contracts to be included in their FY 2008 audit plan. Once those audit plans are submitted, the OAs will begin

submitting quarterly status reports against their audit plans. The status reports will address audit hours used, resolved and unresolved questioned costs, and whether justifications have been placed in the contract file where audits were not required.

- **Strengthening Financial Management Oversight of Institutions Performing Research Under DOT Cooperative Agreements and Grants**

The Inspector General identified three examples where additional oversight of cooperative agreements was needed; one each in RITA, FTA and FHWA. Departmental actions taken to address these examples are summarized below.

RITA — In response to an Inspector General report regarding a University Transportation Center grantee using ineligible sources of grant match, RITA took a number of steps to correct this issue. The university identified an alternative eligible source of matching funding. RITA also brought this issue to the attention of the Department of Health and Human Services, which has audit responsibilities for federal grants at this university. The university has also established internal management processes to ensure that problems like this do not happen in the future.

RITA staff also periodically remind the grant recipients about the necessity of adhering to OMB guidelines on matching fund requirements. In addition, the University Transportation Research Center Program Office has developed a site visit plan that will ensure that most of the grantee universities — and all the Centers with large grants — will have periodic site visits.

FTA — FTA has undertaken a three part strategy to address improved research program oversight, most of which is awarded as cooperative agreements.

Immediate Action

Sixteen projects were evaluated to determine the level of risk; nine of the projects were recommended for more in-depth review. These reviews are still underway and should be completed by November 16, 2007. In addition, FTA is working to include appropriate questions on its oversight assessment questionnaire to capture issues related to research/cooperative agreements. For the first time, all research recipients will be evaluated during the oversight assessment in preparation for the FY 2008 reviews. Lastly, a contractor was hired to provide two training sessions on oversight of grants/cooperative agreements for FTA headquarters personnel.

FTA is also expanding the capabilities of its OTrak system (FTA's database for tracking findings and corrective actions) to include quarterly assessments of its research projects. Using OTrak will permit these reviews to be conducted for all research projects and allow more systematic follow-up on

findings from quarterly reviews. The project plan to update OTrak was approved on May 30, 2007 with an expected readiness date of July 2008. Also FTA's FY 2008 Budget to Congress included a proposed statutory takedown from the National Research Program and other programs for oversight.

Intermediate Action

In February, 2007, FTA established a team to review its Research Order and Circulars. The team is waiting on recommendations from a Booz-Allen review of FTA's research/cooperative agreement oversight procedures before taking further action. In addition, a research recipient workshop was held on April 17, 2007, with approximately 60 recipients. The workshop focused on project management and financial requirements. FTA intends to hold this event annually.

Long-term Action

FTA will form a team of oversight contractors working from recommendations made by Booz-Allen and working with its offices to develop an oversight tool appropriate for FTA's research program/cooperative agreements. Booz-Allen has met with FTA staff to examine procedures used for project management and oversight of research projects. Specific recommendations for improvement are presently in development.

FHWA — FHWA made significant progress in its stewardship of its grants and cooperative agreements. Following through on actions outlined in FHWA's *Assistance Agreement Process Review – Final Report and Recommendations,* the FHWA completed the following actions during FY 2007:
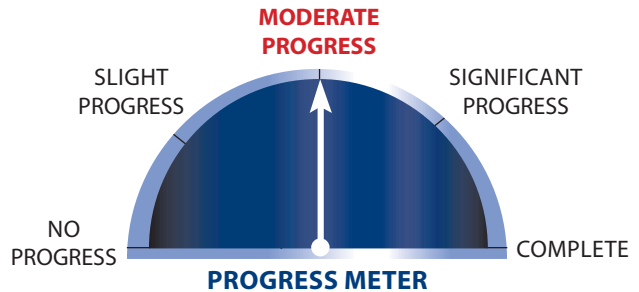
♦ Development and delivery of a series of Agreement Officer Technical Representative (AOTR) Training Modules. A total of 123 AOTRs received this training during the year and many others received copies of the materials.

♦ Publication and dissemination of a comprehensive *Assistance Agreement Procedures Manual* that provides specific guidance for all steps in the assistance agreement process from acquisition vehicle selection through award, monitoring, and close-out. A separate section devoted to concerns of AOTRs is included in the manual, which was written under contract by a recognized leader in the assistance agreement field with significant input from FHWA staff.

♦ Development of revised file organization and guidelines for acquisition staff. FHWA commissioned an internal team to review and recommend updated file tabs and guidelines for file organization to be followed by acquisition staff. Grant and cooperative agreement files were included in this review. The team has submitted its final report with a new organization recommended for implementation in FY 2008.

Other actions are also underway to further improve staff's knowledge and capabilities to provide oversight. These include an update to FHWA policy guidance for grant and cooperative awards through revision of FHWA Order 4410.1, and the development of an *AOTR Quick Reference Guide* that augments the *Assistance Agreement Procedures Manual* by providing an AOTR with concise

instructions and frequently asked questions related to agreement monitoring from a technical perspective. FHWA will continue to look for ways to improve the effectiveness and efficiency of its grant and cooperative agreement activities, as well as other acquisition areas as opportunities emerge and needs evolve.

- **Promoting More Vigilance and Enhanced Oversight of FAA's Acquisition and Contract Management Practices**

FAA's Contract Oversight function was established within the Contract Oversight Group in the Fall of 2006. The new function provides oversight and evaluation of contract operations within the FAA. In February 2007 FAA's Acquisition Executive established the National Acquisition Evaluation Program (NAEP), formerly known as the National Program Evaluation. The mission of NAEP is to improve acquisition and contract management; enhance the quality of financial documentation, reduce acquisition cost; eliminate improper payments; and curtail waste, fraud and abuse of funds.

An Acquisition Management System (AMS) policy change establishing NAEP was developed, approved by the Administrator, and incorporated into the AMS in July 2007. The AMS change states, "The National Acquisition Evaluation Program provides oversight of FAA acquisition management through the evaluation of contracts, programs, and acquisition management practices. The goal is to ensure consistent implementation of AMS policy and guidance by FAA offices and to identify innovative processes or opportunities for improvements. Recommendations based on findings are tracked to closure to promote continuous process improvement and procurement integrity."

In March 2007 the NAEP Team, composed of representatives from all contracting organizations within FAA, was formed. The NAEP team developed Standard Operating Procedures (SOPs) for evaluation teams to use in conducting contract evaluations. The SOP provides more detailed guidance on how contract and program evaluations are to be performed. Also, the SOPs specify the required contents of an evaluation report, including the development of specific recommendations for contract and acquisition management improvements, and a requirement that the recommendations are addressed, mitigation strategies are developed, and planned improvement activities are tracked to closure. The team also developed an Evaluation Work Plan which proposed contract evaluations that are to be conducted over the next three years. The list of proposed evaluations was developed using the recommendations provided by the Department's Inspector General in the audit of FAA's *RESULTS National Contracting Service Report* issued in September 2006, as well as recommendations from senior level managers.
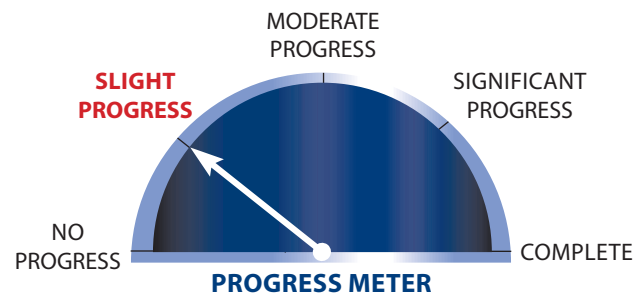
In May 2007, a comprehensive evaluation of the Alaska Region's contracting activities was conducted, in conjunction with the ARC Procurement Evaluation Program, to uncover problems in contract management and to obtain commitments from contract management to address the problems. The results of the evaluation are documented and filed for follow-up activities. The follow-up activities will be monitored and tracked to ensure completion. In June 2007 the NAEP Team began to develop its first evaluation report on the results of a yearly assessment of the consistency between the hiring of contractor personnel as compared to the labor categories and rates contained in support services contracts. The annual report will be issued in November 2007.

- **Ensuring that Department Employees Maintain High Ethical Standards**

Integrity/ethics is considered a core general business competency for acquisition personnel. In order to achieve the government-wide Federal Acquisition Certification, acquisition workforce members must complete the mandatory training courses. These training courses address all the general business competencies including integrity and ethics. Also, the Department conducts an annual ethics training program for employees, including acquisition workforce members, as required by the Office of Government Ethics.

Starting in FY 2008, DOT will provide supplemental training, in addition to required annual ethics training, for members of the acquisition workforce and other employees involved in the acquisition process. Supplemental training will cover key ethics issues of direct importance to acquisition workforce members, e.g., seeking future employment with a contractor, post employment restrictions, gifts from contractors, relationships with former private employers, other impartiality concerns relating to interaction with contractor personnel, as well as various miscellaneous matters, e.g., "moonlighting" for an agency contractor. Trainers will include both ethics and acquisition officials from departmental as well as modal organizations. DOT is in the process of identifying the acquisition workforce, including contracting officials, Contracting Officers Technical Representatives (COTR's) and program/project managers. Once this process is complete in early calendar year 2008, DOT will be able to target the supplemental training to the appropriate staff and make it mandatory for certification or recertification.
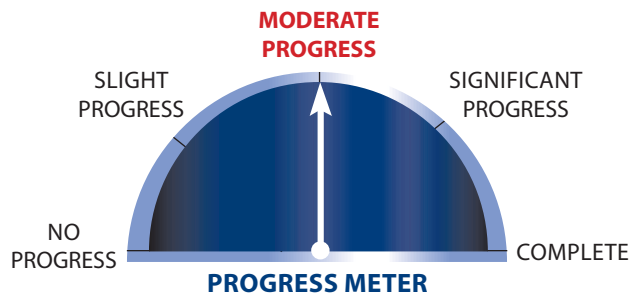
In addition to training, it is important that DOT have in place the appropriate internal controls to prevent and/or detect inappropriate conduct involving procurements and contracts. To that end, DOT is in the process of developing a risk management program which will define a set of processes across the Department to enhance internal controls for acquisition. This risk management program is based on the acquisition framework developed by the Government Accountability Office (GAO) and is consistent with internal control principles and practices. The GAO framework covers such areas as organizational leadership and alignment, policies and processes, human capital,

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and knowledge and information management. DOT's program implementing the framework will feature a series of reviews including self assessments, operational status reviews of procurement operations, and periodic on-site reviews. The risk management program also incorporates other key elements for strengthening acquisition business practices such as an enhanced competition advocate function, use of Earned Value Management, and performance based acquisition. DOT plans to begin implementation of this program during FY 2008.

Because FAA has statutory acquisition independence, the risk management program does not, as a legal matter, apply to FAA's acquisition function. FAA acquisition personnel will not be included in the supplemental training program. We plan to share both programs with the FAA, and to recommend that they undertake similar initiatives.

- Enforcing Suspensions and Debarments More Rigorously

The Department continues to strengthen its processes and procedures to exclude companies and individuals from award of Federal financial assistance and contracts when they have defrauded the government. In an effort to ensure timelier processing and reporting of suspension and debarment (S&D) actions, a centralized database for reporting S&D actions is being created. All users will be able to electronically

list and track their S&D actions as they are received from the OIG. The OIG has the capability of electronically viewing the status of actions within each OA and has the ability to create reports for the Department's S&D actions. We expect the system to be available for the annual report due in February 2008.

Additionally, an internal suspension and debarment community on DOT's intranet has been established within the agency. This community which is accessible from the agency home page, lists and shares best practices on managing suspension and debarment activities.
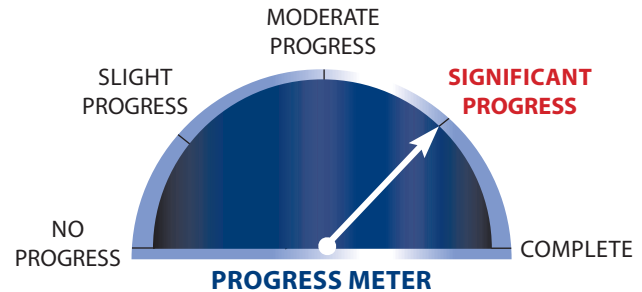
9. Management Challenge: Protecting, Monitoring, And Streamlining Information Technology Resources

- **Enhancing Air Traffic Control Systems Security Through Resource Commitment and Progress Measurement**

In FY 2007, FAA met the statutory requirement to recertify its information technology (IT) systems on their three-year anniversaries or upon major system change. Specifically, FAA recertified 100 percent of its 84 IT systems, including the air traffic control systems. FAA's remaining systems will undergo annual self-assessments as prescribed by the National Institute of Standards and Technology (NIST).

The FAA also revised the Certification and Accreditation Handbook to reflect NIST guidelines and standards, and remediated 25 of the 60 high-risk vulnerabilities to date. The FAA also continues to strengthen security protections of air traffic control (ATC) systems by conducting ATC field facility reviews. In FY 2007, ten facility reviews were completed.

In FY 2007, FAA's transitioned the *Business Continuity Plan* (BCP) from planning to implementation. The purpose of the BCP is to contemplate and address potential prolonged service disruptions at en-route centers. BCP implementation is being executed by a multi-service, multi-disciplinary engineering team.

Additionally, FAA established the Business Continuity Program Office to address long-term outages. The Business Continuity Board of Directors was established and consists of Executive Directors from every FAA stakeholder service unit. The Board meets monthly to ensure adequate resources, resolve disputes, and maintain the BCP program scope and schedule. There are nine working groups to address BCP technical capabilities, procedures, documentation, and staffing concerns.
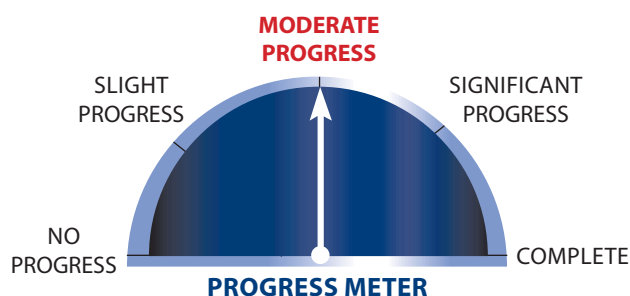
Primary infrastructure is already in place to provide BCP services. Enroute BCP operational requirements are being validated with field Air Route Traffic Control Centers. The FAA will provide all mission essential services for any affected facility with a goal to reconstitute operations at 80 percent of previous capacity within a 3 week period. To address contingency operations at all operational facilities, in the event of short-term outages, FAA has published Order 1900.47B. This order calls for tabletop exercises to involve FAA's Command Center as well as all major terminal and en-route facilities.

The operations community has direct involvement in solution implementation. Initial capability demonstrations for data communications including both radar and flight data are also underway. Voice communications infrastructure including the Voice Switching and Control System (VSCS), VSCS Training and Backup Switch, and Radio Control Equipment are being configured and installed to support both air-to-ground and ground-to-ground voice communications.

As the OIG notes, in October 2006, FAA's Chief Information Officer (CIO) and the Air Traffic Organization were planning to evaluate security differences between ATC systems in the terminal and tower environments. Specifically, FAA had planned to visit a significant number of facilities to audit security differences between systems in the field relative to laboratory conditions. After thorough study, FAA has concluded that the return-on-investment would not support the expected cost, which would have exceeded $2.5 million. This decision was also supported by results of similar efforts at en-route facilities. At en-route centers, there was less than a 10-percent variance.

   - **Meeting New Security Standards While Recertifying Systems Security**

The Department made significant progress recertifying its IT systems; to date, 210 of the 230 systems identified, approximately 91 percent, have either completed, or expect to complete recertification in FY 2007. The DOT CIO developed several policy documents to specifically address system certifications during FY 2007 and the move to the new DOT Headquarters building. In response to the Inspector General's FY 2006 FISMA audit report, the CIO required that each Operating Administration (OA) and OST office develop detailed and funded implementation plans and schedules to address the recertification workload expected during FY 2007.
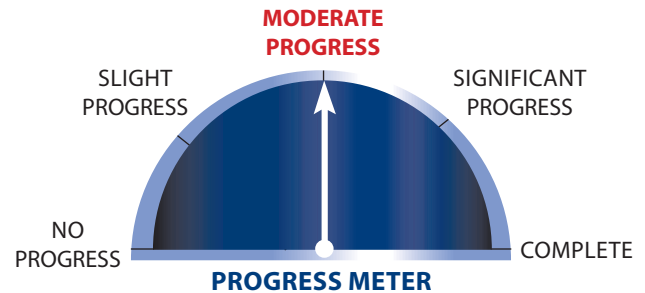
The Department also agreed with the Inspector General's concern regarding the application of new security standards at the time these recertifications are performed. By the end of FY 2007, the Department will issue policy and guidance for determining risk levels of information systems. Based on the determination of system risk level, the application of security controls is then determined. The OAs and OST offices have been instructed that they must apply the direction and guidance outlined in NIST Special Publication 800-53 Rev. 1, *Recommended Security Controls for Federal Information Systems* in selecting system security controls that apply to their systems. The OAs would then apply the new security controls when they perform their recertifications and address the risk level for their systems.

- **Securing the Consolidated IT Infrastructure and Eliminating Operating Administrations' Fragmented Systems Backup/Recovery Sites**

In the past, each Operating Administration managed its own IT infrastructure (e.g., desktop computers, local area networks, and e-mail). These duplicative IT operations were expensive to maintain and had inconsistent security protections—both physical and logical. Since they were interconnected, security weaknesses in one Operating Administration's infrastructure could endanger others: in other

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words, the agencies' IT security was only as strong as the weakest link. As part of the move to the new Headquarters, the Department seized the opportunity to consolidate these IT infrastructure operations and completed that activity in FY 2006.
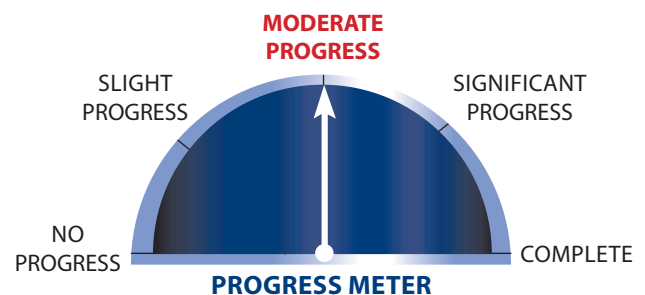
In FY 2007, DOT strengthened the security of the consolidated IT infrastructure by bringing the Campus Area Network on line. In addition, Operating Administrations' mission-specific server infrastructure was relocated to a contractor-operated hosting facility that was certified and accredited. The Common Operating Environment as well as the Campus Area Network is currently undergoing re-certifications to ensure that all necessary security controls and system interconnection agreements are in place to ensure continued strengthening of the security infrastructure.

As one of the components of the next phase of consolidation, the Department still needs to identify a consolidated backup/recovery site at a sufficient geographic distance from the new Headquarters building and conduct contingency testing for all Operating Administration systems operating on the consolidated IT infrastructure. Further, the CIO will direct that the Operating Administrations not make additional investments to equip their individual backup/recovery sites until decisions have been made for the consolidated backup/recovery site.

- **Working With Operating Administrations to Strengthen Oversight of IT Investment and to Streamline Duplicative IT Systems.**

While the Department has made the decision to delegate the oversight on specific IT investments to the operating administration review boards, each review board is required to annually review each major IT investment, looking at cost, schedule and performance goals. The Department has and will continue to monitor high risk programs monthly. In general, the variances that we have seen for cost and schedule

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are within the 10 percent tolerance level. Over the next year, the Department plans to benchmark technical performance metrics with other agencies to determine the best approach to monitor technical performance to improve overall program management.

The Department is making progress in improving its EVM oversight. DOT has become an active member of a joint Civilian Agency/Industry Working Group addressing significant open issues facing the entire federal civilian sector regarding EVM implementation. The CIO has recently completed the initial draft of EVM policy, which attempts to ensure that all Operating Administrations are performing EVM consistently across the Department. We expect to have the policy finalized by early 2008.
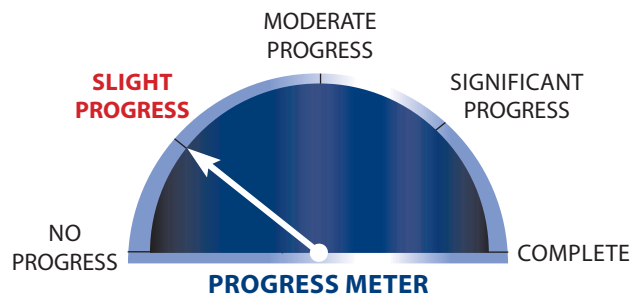
During 2007, DOT strengthened its ability to identify duplicative common systems by defining all agency programs and activities according to common business areas and services, or segments. In addition, the Department mapped all DOT IT investments (major and non major) to a DOT segment to facilitate the alignment of targeted resources based on business strategies and needs.

During 2008, the Department plans to collaborate with DOT business stakeholders to validate current business activities; identify milestones for streamlining over the next 3 – 5 years; and reflect results in the DOT Transition Strategy for certain prioritized segments. These activities will provide valuable information to agency executives and program managers as they make decisions on IT projects.

10. Management Challenge: Strengthening DOT's Coordination Of Research, Development, And Technology (RD&T) Activities And Funding

- **Ensuring Effective Coordination of DOT's Research, Development and Technology Activities**

RITA has secured an enhanced leadership role in RD&T coordination for the Department in specific cross-modal opportunities. In 2007, RITA assumed responsibility for the Position, Navigation, & Timing (PNT) program with the first priority of determining the transportation needs of PNT on behalf of the Department. A *Federal Register* notice for public comment on the future of NDGPS was issued August 1, 2007, and plans were set in motion to collect information from Operating Administrations for analysis and preparation of a decision package for the National Space-Based PNT Executive Committee in the first half of FY 2008.

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RITA also assumed leadership for the Climate Change & Environmental Forecasting Center on behalf of the Department. During 2007, RITA worked with an expert from the Environmental Protection Agency (EPA) to assist with redefining the direction of the Climate Change & Environmental Forecasting Center. Recommendations to improve overall DOT coordination and to reduce RD&T overlap of climate change and related initiatives being pursued through the Climate Change Center will be offered and an action plan established.

In 2007, RITA's oversight and coordination program completed its first Program Assessment Rating Tool (PART) evaluation. Although RITA received a Results Not Demonstrated rating, significant progress was made in refining and articulating the intent of the program. A Result Not Demonstrated rating is given when a program doesn't have established short- and long-term performance measures. As a result of this evaluation, several annual program measures were developed for consideration by RITA's Planning Council for future implementation which will lead to the first DOT-wide RD&T coordination measures.

RITA also continued to coordinate all RD&T budget information through the annual budget process. Each operating administration provides budgetary information according to RITA's guidance on all RD&T activities proposed through the Department's budget process. That information is identified in a single budget tab in order to compile and view the Department's RD&T portfolio comprehensively and according to Departmental goals.

RITA has concluded that the best way to counter the limiting effects of earmarks on management of the entire DOT RD&T portfolio is development of an objective data source that can help inform stakeholders of the state of projects in relation to others. In 2007, RITA developed a statement of work to guide development of a DOT-wide RD&T database. RITA plans to work with the Operating Administrations to collect basic information about the RD&T projects that make up the DOT portfolio of RD&T investment. The process by which information will be collected and reviewed will be completed in the first quarter of FY 2008.